Markets in Focus

Q1 2024

PRIVATE CLIENT

Insurance Pricing & Market Update

IMA Select

EXECUTIVE SUMMARY

The insurance marketplace for successful families and individuals will remain challenging most likely through at least 2026, driven primarily by increasing property insurance rates in the face of more and more costly natural disasters, specifically in California, Texas and Florida.

As such, the relationship between clients and carriers is today more closely mirroring that of commercial insurance, via increased cost-sharing (i.e., deductibles) and proactive risk management (i.e., property safety improvements). This trend is unlikely to reverse itself in future years, fundamentally altering the high-net-worth insurance environment.

INSURANCE HEADWINDS

Historically the personal and commercial insurance sectors were not highly correlated outside of exceptional situations (the terrorist attacks of 9/11/2001) or natural disasters that affected a specific geography. In the last four years they have become more closely correlated across the board, both experiencing a hard market of increasing costs and decreasing coverages.

There are a multitude of factors which have driven this convergence, though a few have had an outsized impact:

INFLATION

+ While goods inflation has dominated headlines beginning in 2022, the more protracted issue of services inflation has flown under the radar. Services inflation is highly correlated to the cost of labor, and thus is a good barometer for industries in which the cost of labor is a primary determinant of pricing. Where this is most visible today, as well as impactful, is via the increase in construction costs which has a direct impact on the replacement cost of homes.

+ While service inflation has flown under the radar, goods inflation has not, and with good reason. The US, and world, economy is still working through the ripple effect of the COVID-19 shutdown (now nearly 4 years in the rear view) and now is grappling with the decoupling between the US and China as geopolitical tensions rise between the two countries. While Federal Reserve Chairman, Jerome Powell, may be proven correct that “inflation is transitory,” the price increases absorbed in 2022 and 2023 will not be given up.

AUTO

+ Commercial insurers have not profitably priced auto insurance in nearly a decade, driven by losses which consistently outpace premium. While the impact on personal auto insurance pricing was blunted in the past, it is beginning to more closely match that of commercial auto. There are two primary driving factors behind this, which are ‘bar-belled’ on the severity spectrum.

  – The most severe is the increase in ‘nuclear verdicts,’ the end outcome of a long-term trend of social inflation in jury decisions. While these are typically reserved for business entities the same social phenomenon which has driven juries to award massive verdicts to plaintiffs against corporations is now bleeding into cases against wealthy defendants.

  – On the other end of the spectrum, what were formerly insignificant ‘fender benders’ are now five, ten, or fifteen thousand dollar losses; as electronics have permeated the periphery of our cars, from cameras to sensors. Further, improvements in the safety of automobiles over the last 20 years has been heavily impacted by ‘crumple zones’ which are designed to fail; with so many electronics installed in these crumple zones, the labor cost of repairs to reinstall bumpers, fenders and more has skyrocketed.

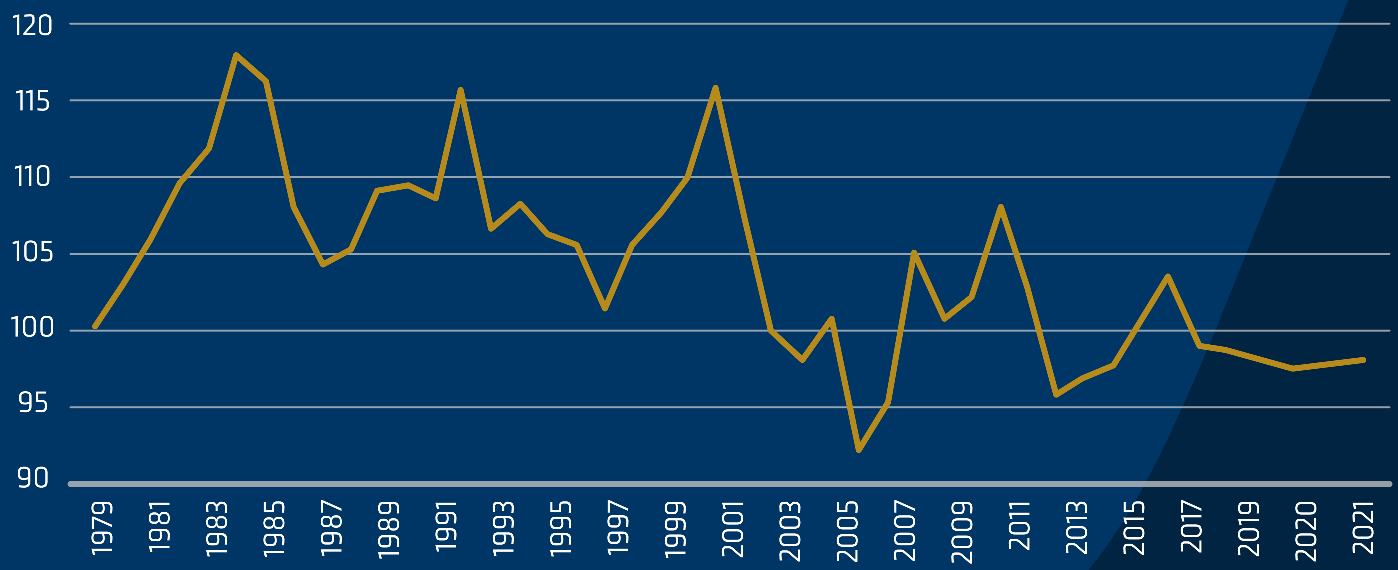
NATURAL DISASTERS

+ There are two factors driving the impact of natural disasters on insurance pricing. One is the increase in frequency of natural disasters, particularly in California, Texas and Florida; but potentially more important is the massive increase in the insured costs of these disasters.

+ As a case-in-point, 95% of all property located in hurricane-prone areas are insured for wind damage, a significant increase compared to a decade ago. This is of course good for those homeowners, and a great example of appropriate risk management, but it also means when a hurricane strikes insurers have larger losses to cover, meaning more significant rate hikes, both nationally and in the affected areas.

COMBINED RATIO FOR PROPERTY AND CASUALTY INSURANCE

1979-2021



*Excludes state funds and other residual insurers.
Source: ISC

While combined ratios, the primary measure of insurer profitability, have trended downwards since the early 1980's, there has been an uptick since the recent low reached in 2012. As the ratio climbs, and especially when it climbs above 100, rate increases become more likely as insurers look to return to profitability.

ZIRP (ZERO INTEREST RATE ENVIRONMENT)

+ Insurance carriers are heavily regulated entities, a by-product of which is they have a strong tendency to invest in US Treasuries. As such, the ZIRP environment which has continued off-and-on since the 2008 financial crisis has affected a significant portion of carriers investment portfolio, a portfolio which the carriers rely on to remain profitable during high-loss years. The decrease in this income has increased pressure on carriers to increase rates over the last decade, an issue made more acute by the natural disasters referenced above.

PROPERTY

Homeowners have experienced substantial increases in the cost of renewing policies over the past year.

The property insurance industry has faced challenging results over the last decade, with natural catastrophes and claims severity driving skyrocketing increases in personal lines premiums for automobiles, collections, and homeowners. Supply chain issues and shortages of skilled labor have prolonged claims settlement, leading to higher costs for loss of use or temporary housing and vehicle replacement, which, in turn, drive premium increases.

Reinsurance costs have also risen significantly, passing on additional expenses to consumers in premiums, especially in catastrophe-prone areas.

As stated above, the HNW personal lines market, led by property, has begun to more closely mirror that of commercial, as in the case of two important distinctions recently introduced into the high net worth property market. The first is a percentage deductible rather than a fixed flat cost, the second is more nuanced but equally important when it comes to determining insurance costs for homeowners, the introduction of multi-carrier ‘towers’ to fill limits. This has long been the case for commercial accounts where the first $5M of risk is taken by one carrier, $5-$25M is taken by another, and so on; capacity is so tight in the homeowners' space that brokers are pursuing the same strategy to ensure their clients are fully insured.

Due both to aggregate population and business hubs, California, Florida, New York and Texas combined host a large plurality of high-value homes in the United States. Unfortunately for insureds, these states each drive a significant number of natural catastrophe claims such as wildfires (California), hurricanes (Florida and New York) and winter and convective storms (Texas). While carriers do take into account location when pricing policies the increased cost of risk for homeowners in these states reduces overall capacity, increasing insurance costs nationwide.

“Bad weather and natural disasters have disproportionately found themselves to be in areas where wealthy people live.”

- HNW carrier executive via Insurance Insider

ART/COLLECTIBLES

According to the FBI, an estimated $4 billion to $6 billion of art has been stolen each year in the 21st century. In an Atlantic article detailing the career and expertise of Robert Wittman, retired FBI agent, in the field of art recovery, it is cited that only 1.5% of stolen art is ever recovered.[1]

The reasons for the surge in high-profile cases may be both blatantly obvious—the astronomical amounts of money floating around the art world, the proliferation of websites selling art online, the lack of transparency or regulations on art transactions—and a bit more mysterious, or at least unique to the art world, with its idiosyncratic, unspoken code of conduct. Few among us would for a second consider buying a seven-figure house without a thorough inspection and a meticulously worded contract drawn up by our lawyer, yet multimillion-dollar artworks are routinely exchanged based on nothing more than a handshake, or even a phone call. In the clubby art world, no one wants to risk offending a gatekeeper to prime works.[2]

Weather-related disasters associated with climate change, including droughts, floods, hurricanes, wildfires and windstorms, have increased in number, intensity and geographical spread in recent years. While those affected consider not only how to rebuild but also how to recover from the loss of precious artworks, insurance companies simply do the math.[3]

Interestingly, private collectors will come to us very concerned about theft, when in reality, they are at much greater risk of water damage. A bath can overflow, a pipe can burst, an appliance can fail, ice dams can cause a leak in your roof, or flooding from a hurricane can cause your sewer to back up. The next most common type of damage is caused during transit, which accounts for about one in four art insurance claims. Every time you buy, move, or sell a work of art, the risk of damage significantly increases. For example, did you know that the surface of a de Kooning can remain somewhat tacky during its entire lifetime due to the salad oils the artist favored in his paint mix? While in transit, this work needs to float within its crate without any surface contact for it to remain pristine and protected.

AUTO

AM Best noted that personal auto loss severity led to a significant 13-percentage-point jump in the net loss and loss adjustment expense (LAE) ratio for the private passenger auto line in 2022. The average cost per private passenger auto claim increased 16% in 2022 and eclipsed the $10,000 per claim threshold.[4]

The shift in workplace patterns post-pandemic, with increased work-from-home arrangements, reduced the number of vehicles on the road. However, the report highlights that driver inattentiveness and riskier driving habits in recent years have offset these changes, contributing to worsening auto severity.[5]

Vehicle repairs are also costing more. CCC shows that the average total loss claim cost climbed from slightly less than $8,000 in 2010 to slightly less than $10,000 in 2020, then jumped to more than $12,000 in 2021.

CCC attributed the steady increase in vehicle replacement cost to the growing complexity of automobiles during that period.

"The rate of increase in both repair costs and total loss costs over the four quarters ending Q2 2021 however are some, if not the most significant increases we've seen, and are predominantly being driven by global supply chain disruptions and shortage of workers in many fields," the report says.

The report said the average cost for parts increased 6% in 2021 from 2020, the largest increase since 1997.

"At the same time growing complexity has led to an increase in the average number of replacement parts per appraisal/repair, a trend heightened by an increase in non-driveable claims," the report says.

Vehicles are also taking longer to repair. The report says the average backlog for repair shops was 2.6 weeks during the third quarter of 2021, a full week longer than the prior quarter. The average backlog was 1.7 weeks during the third quarter of 2019.

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UMBRELLA/EXCESS

U.S. tort costs rose on average 6% a year from 2016 to 2020, with personal liability at 4.4% and commercial liability at 6.9%.[6] These rates far exceed the growth rates in inflation (1.9%) and GDP (2.8%) during that time. It is interesting to note that only $0.53 of every dollar paid in the tort system in 2020 made its way to claimants; the remainder went to litigation costs and other expenses.[7]

But there are liability claims that go far beyond knowable risks. Laila Brabander, Head of North American Personal Lines Claims for Chubb, describes a case in which a client at a yoga studio fell onto the person next to her while doing a downward dog and was sued by the injured yogi for pain and suffering. “If someone gets into an automobile accident, they can figure out fairly quickly if anyone involved is worth suing,” explains Cowart.[8] “Because information is so readily available, people know who you are just with the push of a button. We all need to be aware that there’s little anonymity anymore.”

Damage awards are rising dramatically for a number of reasons, explains Brabander. “Economic damages historically were based on factors such as the extent of an injury and resultant medical expenses or past and future loss of income, but we are seeing a rise in non-economic damages, such as pain and suffering and PTSD, that overshadow actual economic losses,” she says. Social inflation, which describes how the cost of claims exceeds economic inflation, comes out of shifting attitudes about who is responsible for absorbing risk.

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