CONSTRUCTION
Insurance Market Update Q1:2018

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Australian construction insurance market update at a glance

Overview

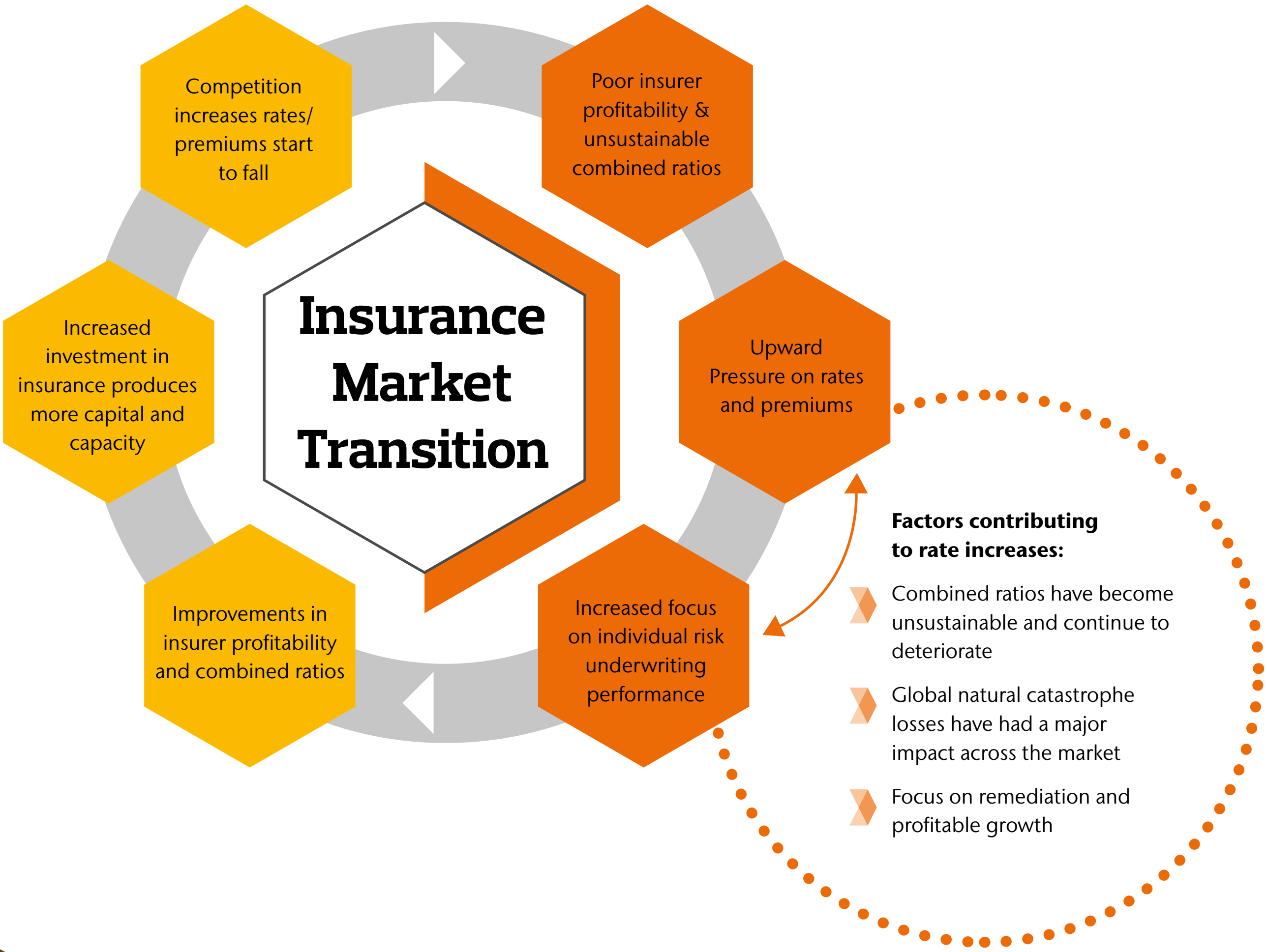
- 2017 saw the end of the competitive insurance environment with the majority of insurers beginning to remediate their annual construction portfolio.
- Increasing claim costs and a low interest rate environment are impacting insurer returns.
- Insured global natural catastrophe (property including construction) losses for 2017 currently estimated at USD 134 billion making it the second costliest year on record.
- Local authority of many insurers has been reduced, with head office in Europe/USA/London ultimately responsible for many decisions.
- Risk selection will continue to be a focus, with particular attention to:
  - Claim performance
  - Natural catastrophe exposure
  - Risk quality and detailed engineering data
  - Coverage extensions and deductibles.
- Project construction opportunities still in high demand with market appetite at an all-time high.

State of the market

The first quarter of 2018 has seen market conditions start to transition for construction risks. A number of insurers have reviewed their pricing and coverage models and are looking for wholesale increases; whilst new entrants continue to enter the market providing aggressive alternative options on well managed risks. Clients, who are experiencing pricing increases from their existing insurers, can obtain rollover or minor reductions if they are willing to take their business to market.

The release of a number of multi-billion dollar infrastructure projects to the market over the last 12 months has helped to balance insurer books, for the time being. But, this could just be the calm before the storm, once losses from these projects eventuate.

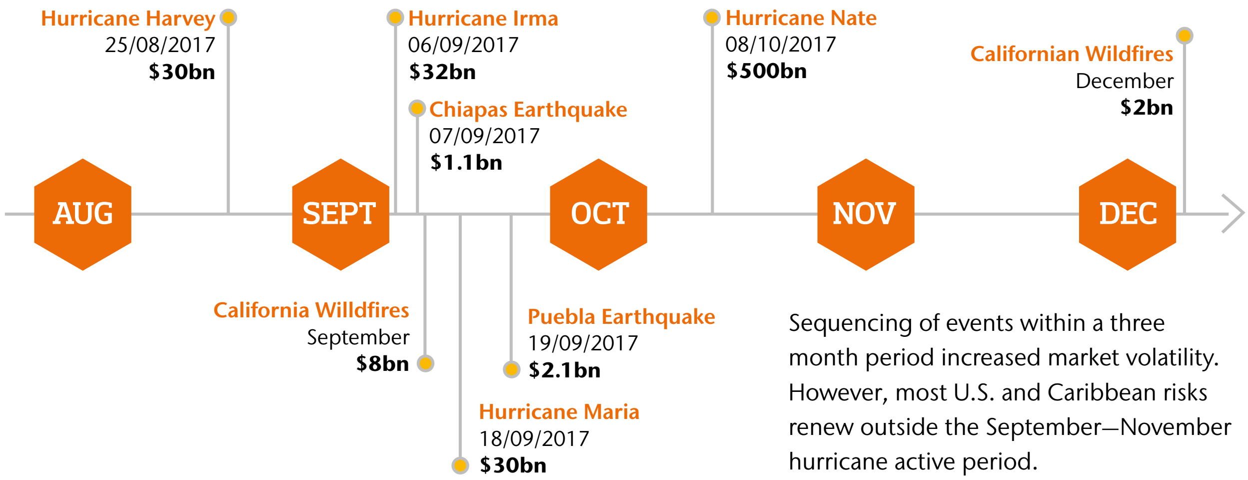
Insurance market cycle – where are we now?



The diagram above shows changing factors that influence the market pricing and capacity. There is no doubt that we have seen a prolonged period of falling rates and coverage enhancements. The classes of insurance that relate to construction are all at different points in the cycle; Professional Indemnity is the standout, rates are no longer sustainable on the back of diminished insurer profitability.

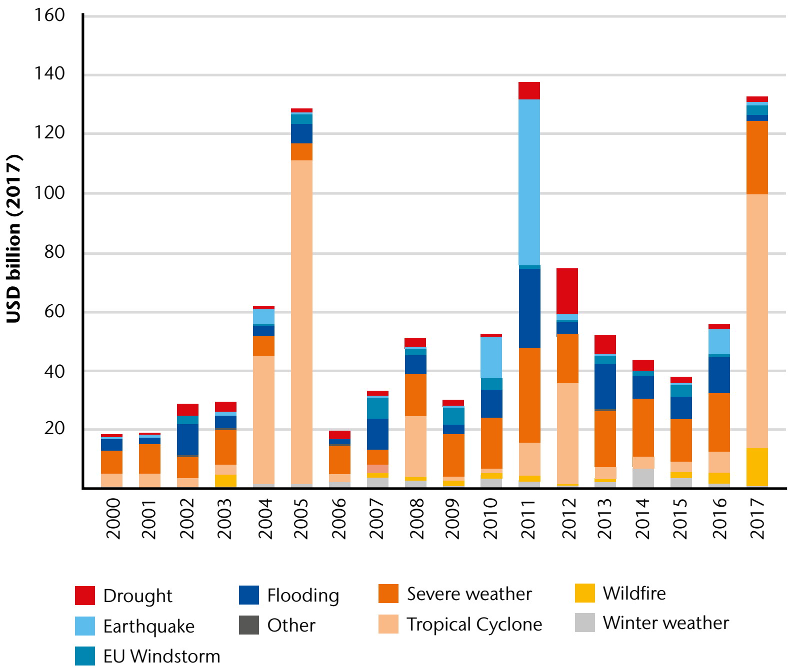
2017 – a big year for catastrophes and claims

After a benign 5 year run of global natural catastrophe losses, the back end of 2017 has proven to be costly for insurers and reinsurers with a string of earthquakes, typhoons and hurricanes.



Sequencing of events within a three month period increased market volatility. However, most U.S. and Caribbean risks renew outside the September—November hurricane active period.

Additionally, there have been a number of major construction losses both in Australia and overseas, weather perils have been a major contributor. We are also experiencing significant claim costs in relation to workmanship and design reaching new levels in regard to quantum.



Based on current estimates, 2017 is the second most costly natural catastrophe loss year in history, although it wouldn't take much of a shift in current estimates to see the year setting a new benchmark. As reinsurance market costs are shared across property and construction, we will see the impact of these losses filtering through to the underwriting of construction placements.

This pricing expectation has now started to fuel further M&A activity and the recent announcements by AIG and AXA of their intentions to acquire Validus and XL Catlin are just two examples of a companies looking to take advantage of a changing market environment.

Reinsurer	2017 Catastrophe Losses
Lloyd's	$4.8 billion
Swiss Re	$3.6 billion
Munich Re	$3.2 billion
AIG	$3 billion
Chubb	$1.95 billion
XL Catlin	$1.48 billion
SCOR	$516 million
PartnerRe	$475 million
MAPFRE	$240 million

The Lloyd's market experienced an exceptionally difficult year in 2017 driven by challenging market conditions and a significant impact from natural catastrophes. These factors mean that for the first time in six years Lloyd's is reporting a loss. A total of GBP 18.3 billion in claims gross of reinsurance was paid out by the Lloyd's market during 2017.

Lloyd's Annual Report 2017

The bigger picture – global and reinsurance landscape

The good news

- Reinsurance capacity remains at an all-time high.
- Global reinsurance treaties renewed at lesser rate increases than expected.
- Alternative capital investment has stayed, bringing stability to the reinsurance landscape.
- Underlying position remains strong, but depleted.
- New overseas markets looking to grow (for the right price).
- Project business is in high demand.

The not–so–good news

- Australian 1/1 property treaty renewals experienced up to 30% increases on loss affected and catastrophe exposed layers.
- Construction treaty renewals remain flat but lag 6-12 months behind property treaties where these are not shared.
- Overseas markets (USA/EU/UK) looking to up rates in the wake of global losses suffered.
- Facultative reinsurance market remains challenging and is driving increases for local insurers.
- Markets are looking to portfolio increases on their construction books regardless of individual underwriting performance.

What does this mean for 2018 construction industry renewals?

The first quarter of 2018 has seen a subtle shift in the property market for construction risks. A number of insurers have reviewed their pricing and coverage model, albeit there are a number of alternative options that continue to be aggressive on well managed risks. The release of a number of multi-billion dollar infrastructure projects to the market has helped delay - or soften - the impact of deteriorating results and provide a much need injection of premium.

Below is the updated position from an individual construction class perspective.

Annual Construction Material Damage

The change in the market continues with insurers seeking increases on unprofitable business

- Market continues in its competitive cycle albeit a number of domestic insurers are remediating specific risks.
- Certain insurers looking to change their risk exposure from civil contractors to building contractors ensuring this segment remains competitive.
- Push from new capacity to be involved in annual portfolios.
- Coverage remains broad with insurer preferring to push for increased deductibles over reducing cover.

Annual Construction Liability

No material changes expected with new capacity available

- Market remains flat with minor reductions available.
- Insurers continue to push for deductible remediation on claim frequency business.
- Minimum worker to worker deductibles increasing to $100,000 in some cases.
- Capacity remaining steady with increased capacity available on excess business.

Professional Indemnity

Becoming restrictive and decreasing capacity available in certain circumstances

- Continued development in claims activity particularly on annual design and construct business. This is driving a major contraction in the market for these risks.
- Insurers are forewarning clients that 2018 renewals will see pricing increases.
- A number or insurers are also reducing capacity from $20m to $10m on certain placements. This has resulted in the need to introduce new capacity.
- Insurers are placing a higher scrutiny on cladding exposures with some insurers placing full exclusions around these risks.

Construction Plant and Equipment

No material changes expected with specialist markets losing their dominance

- Market contracting in light of mergers, acquisitions and unsustainable premium ratings.
- New capacity being sought from Asia and Europe.
- Coverage still attractive as carrier preference is for increased deductibles over retracting cover.

Construction Industry Claims Activity

2017 the 2nd costliest year for insured global catastrophe claims. Attritional losses affecting local insurers

- Global losses currently estimated at USD 134 billion with construction now a major contributor.
- Notable events in Australia include Cyclone Debbie; storms and bushfires through QLD, NSW, VIC.
- Industry specific losses have significantly impacted affected sectors – pipelines, waste treatment plants and major road construction.

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