MAKE A SOFT LANDING IN A HARD MARKET

How high-net-worth individuals can navigate today's economic terrain

EXECUTIVE SUMMARY

The hard insurance market is in full force today and the task for high-net-worth individuals and family offices is to remain discerning, focused, and vigilant. Insurance premiums are higher, underwriting criteria is stricter, and the renewal process is likely to be more challenging as individuals try navigating this current environment.

For high-net-worth individuals, the insurance market may get worse before it gets better. The frequency and intensity of catastrophic events have been increasing. Most, if not all, households will receive less favorable terms from insurance carriers—high-net-worth individuals included. Here's why:

- The impact of these natural events has diminished the carriers' appetite for risk
- Insurers' underwriting criteria offer little to no room for flexibility
- Several insurers have left the industry

This is how hard markets work—with the increased demand for insurance coverage as carriers have constrained supply and capacity, coverage terms and conditions are constricted. For high-net-worth individuals, this hard market deeply impacts the properties in their real estate portfolios, especially since this demographic allocates half of its wealth to alternative investments, including personal and commercial properties. Of half of the wealth in their alternative investments, 11 percent is allocated to real estate. For them, the insurance price tags to cover their properties will be higher; in some cases, insurance premiums skyrocket upwards of 75%.

Still, because of the liquidity most of these households maintain, they are likely to respond better than other demographics as they aim to contain costs, so all is not lost. As high-net-worth individuals head toward renewals and assess priorities and valuations across all assets, they must ask themselves, what is most important? And the earlier the better.

Ultimately, these households need insurance advisors who can communicate simple strategies about this complex environment that align with the individual's value system. As their advisors help them explore the known and unknown cost drivers, individuals will gain comfort with a step-by-step plan for reducing their cost of risk.

Evaluating Current Market Conditions

From the wildfires that ravaged the West Coast and the windstorms that swept through the Great Plains, to the snowstorms that froze over the Midwest and Northeast, and the hurricanes that flooded coastal states, natural catastrophes in the United States continue to amount to losses in the billions of dollars, year after year. These events have been on the rise for the last 20 years. In late 2018 after Hurricanes Irma and Harvey hit and industry loss ratios rose above 100 percent, the insurance market began to turn.

For four of the last six years, carriers continued to experience net underwriting losses, retreat from the catastrophic property market, increase underwriting scrutiny and shift risk. The 2022 $45-$60 billion impact of Hurricane Ian furthered the significant capacity constraints. Energy prices, labor, and material shortages due to supply chain issues, and inflation also contributed to the current hard market.
The monetary cost of natural disasters has an immense impact on the U.S. economy, the primary insurance market, and the homeowners in affected regions. From 2010 to 2020, hurricanes killed an average of 332 people per year and did an average of $47 billion in damage, while wildfires killed an average of 23 people per year and did an average of $7 billion worth of damage per year. [1]

And the migration of individuals to regions and climates offering beautiful scenery and warm temperatures continues to increase. The quality-of-life factors outweigh the remote risk of a life-threatening event, such as fires, flooding, or hurricanes. [2]
In the case of property insurance, the pricing to policyholders depends on several variables—loss history, geographic location, age of the building, and construction type—although each carrier uses unique proprietary models to set their rates.

Carriers typically look to past events when making risk calculations, which is why they are now struggling to keep up with the impact of unpredictable, extreme weather events. They continue to adapt their underwriting strategies and develop climate modeling to keep up with the weather events, which negatively impacts their bottom line. In the current hard market, carriers are tasked with managing their financial stability while ensuring the availability and affordability of coverage for their insureds.

Because recent losses and unreliable historical data create layers of unpredictability, primary carriers have become extremely calculated in their risk selection and pricing. Ultimately, these market conditions impact the way high-net-worth individuals make decisions, especially since many of their homes exist in disaster-prone regions.

What to Expect

From inflationary pressures to underwriting losses, here is what high-net-worth individuals can expect:

Underwriting losses
The combined ratio is a measure of underwriting profitability that's calculated by taking the sum of incurred losses and expenses and then dividing them by earned premium. Hurricane Ian and cumulative natural disasters will lead to another year of net underwriting loss for insurers.

Retreat from risky markets
It is expected carriers will continue to retreat from CAT property to focus on lines of insurance where they feel they can grow safely.

Inflationary pressures
Primary insurers continue to deal with inflation issues, which have been driven by supply chain issues and shortages of skilled labor. As a response to these realities, primary insurers are looking for accurate property valuations from insureds.

Valuation of assets
Many property valuations are composed incorrectly or have not been updated in years. Undervaluation of assets can leave insureds unprotected after a natural natural disaster. For insurers, inaccurate assessments of how much risk they are truly absorbing result in inferior premiums collected. Expect carriers to increase their scrutiny of property valuations.

Increased underwriting scrutiny
Underwriters are focused on accurate valuations and proof of lessons learned on prior claims. They want to see evidence that paints a clear picture of the risk they're taking on.

Shifting more risk to insureds
Carriers will be imposing limiting coverage terms, exercising limits management, and likely leverage a host of additional strategies to shift more risk to insureds.

Private Risk Management

High-net-worth individuals and family offices tend to have more options to select from—whether the economy offers a hard or soft insurance market. They have more liquidity, so this demographic often can pay more. However, these individuals tend to make choices to lessen their insurance premiums to absorb more risk, such as higher insurance deductibles.

Sometimes this strategy may work in their favor—and other times, not. And sometimes, the hard insurance market may impact high-net-worth individuals more if their homes are in areas that experience frequent catastrophic events.

For example, homeowners in highly disaster-prone regions, such as California and Florida, may select or be subject to a cap on the total insured value of their home, or TIV. An insurer may seek to minimize risk and cap the total insured value of the property. To gain better coverage at a better price, high-net-worth individuals could obtain coverage on the dwelling only to maximize the TIV and not obtain coverage on the loss of use while a potentially damaged home is rebuilt. In other cases, to creatively cover a dwelling, a homeowner may insure the home but have a roof exclusion to avoid a substantial increase in coverage or losing coverage altogether. Everyone's valuation of assets and risk mitigation strategies needs to be reviewed with their financial team.

Here are steps you can take to best navigate the hardened property insurance market:

Develop a strategy and document it:
Preparation for your next renewal should begin at least four months ahead of time. Communicate with your broker about which information you need to gather and how to develop a strategy to get the best underwriting results. Documenting this information keeps everyone involved with your renewal accountable.

Evaluate risk tolerance:
Everyone's risk tolerance varies, which is why you need to understand how much coverage you are purchasing and how your deductibles impact your liabilities. Your broker should help you determine how to properly choose limits for your actual risk instead of solely meeting minimum insurance requirements. An experienced broker can help you evaluate creative program structures to lower the cost of coverage, which may include deductible buydowns, deductible indemnity agreements, deductible reimbursement policies (captives), and parametric insurance (loss mitigation). If you have a higher risk tolerance, you may be able to lower your premiums, but this is a decision that you should review with your financial team.

Optimize your cash flow management strategies:
Assessing your cash flow management strategy in tandem with supply chain and inflation risk management is crucial. Understanding your cash flow will empower you to forecast company profits more accurately and also improve cost tracking and resource allocation.

Reconcile all valuations:
Most carriers require higher replacement cost values for assets they insure. Work with your broker to ensure that all your assets are measured accurately. You need to evaluate the impact of increasing square footage replacement costs months before your renewal.

LEGISLATIVE UPDATE

Florida House Approves Historic Insurance Reforms, Sending Bill to Governor

One day after the Florida Senate approved a landmark revision to Florida's property insurance rules, the House followed suit, perhaps bringing to a close an era of surging claims litigation, insurer insolvencies and escalating premiums.

Florida's second special legislative session on the insurance crisis ended Wednesday, earlier than scheduled, after Senate Bill 2A sailed through both chambers with plenty of discussion but no changes. After three years of grappling with an insurance market that has been called "distressed," "imploding" and "insane," many stakeholders breathed a sigh of relief and praised the scope and breadth of the reform measures.

"The proposed legislation sends a strong message that Florida is serious about stabilizing the property insurance market and creating an environment to attract capital and create more options for Florida's insurance consumers," the Florida Association of Insurance Agents said in a statement.

The bill aims to return the state-created Citizens to the realm of insurer of last resort. Insurance agents who sell Citizens' policies may be as affected as anyone and will have to explain that some policyholders will soon be forced to buy more expensive policies in the primary market. If they remain with Citizens, all policyholders will soon have to buy flood insurance, a key section of the bill. The business community, fearing that Florida's tick-tight insurance market was scaring away development, applauded the bill's passage.

Here's a look at the bills' changes:

Mandatory Flood Insurance for Citizens' Insureds

The measures would require policyholders of the state-created Citizens Property Insurance Corp. to also purchase flood insurance. The bills provide a timetable for phasing in the requirement, with more expensive properties needing it first, by March 1, 2024. All policies would need flood insurance by March 2027, regardless of the property's elevation or location.

The 20% Rule

The bills also revive a plan that would essentially force Citizens' policyholders to switch to a primary market carrier if that carrier's premiums are no more than 20% higher than Citizens', upon renewal. Citizens' premium increases are limited by law – the main reason the insurer has become the largest carrier in Florida, with some 1.2 million policies in force. A similar provision was included in SB 1728, which was approved by the state Senate in the regular 2022 legislative session. The bill died when the House did not approve it before the 60-day session came to a close.

Expansion of Arbitration
The bills would codify what a few insurers have already adopted: binding arbitration clauses. Insurance carriers would not be allowed to require arbitration as an alternative to litigation unless it is clearly explained in a separate policy endorsement, the insured is offered a premium discount in exchange, and the policyholder signs a form accepting the clause.

One-way Attorney Fees
On the biggest cost drivers, insurers have said for years, is Florida's claimant-friendly one-way attorney fees statute, which requires insurers to pay the plaintiffs' legal fees if the carrier loses in court. The law has been in effect, in one form or another, since 1893, and is more akin to the English rule of law, according to a legislative staff analysis of the newly drafted bills. In 2016, a famous Florida Supreme Court decision underscored the legitimacy of the practice. That, along with fee multipliers, have caused fees to explode in recent years and has been the incentive behind Florida's out-of-control claims litigation industry, insurance advocates have said.

Assignments of Benefits
The bills also would prohibit AOBs for residential and commercial claims, a move that a growing number of insurance executives have called for. Assigning benefits to restoration companies is one of the biggest cost escalators because it gives contractors an unnatural incentive to inflate estimates and scope of repairs, critics have said. And when insurers balk at the claims, the assignees are often quick to sue.

Bad-faith Litigation
For years, insurance defense attorneys have argued that Florida's statutes make it too easy for plaintiffs to file bad-faith actions against insurers, long before a case has been fully adjudicated and even if claims have been paid. The special session bills would bar bad-faith claims until after a court has decided that the insurance company breached the policy contract.

Read the Full Bill

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Find the Right Partner

With underwriting scrutiny at an all-time high and carriers providing less favorable terms for coverage, you need to work with a team of experts with a proven track record that is capable of navigating a hardened property insurance market.

Be proactive and intentional when facing renewals. While it is difficult to predict how long the current hard market will last, we remain committed to delivering peace of mind to our partners. Our team of Advisors can best equip you to remain discerning stewards as you face high inflation, high-interest rates, and a hard insurance market.

Contact us to learn more about how we can help you get the coverage you need.

References

[1] NOAA National Centers for Environmental Information (2022). U.S. Billion-Dollar Weather and Climate Disasters.
[2] Clark M.B., Nkonya E., and Galford G.L. (2022): Flocking to fire: How climate and natural hazards shape human migration across the United States

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