2022 Construction Market update

A hardening market – what can be done?

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Global Insurance Update

2020 saw sustained pressure on insurer earnings driven by a combination of factors, most notably a high frequency of catastrophe losses, lower investment yields and the global COVID pandemic. This trend continued in 2021 and global insured catastrophe losses were up 13% from 2020 with estimated insured losses estimated at $105 billion and COVID remaining prevalent[1]. This resulted in rate increases, albeit at a slightly slower rate than 2020, and restrictions in the availability of certain coverages as discussed later in this paper.

With the worldwide rollout of COVID vaccines and revised underwriting strategies, insurers' outlook for the future is more positive, but caution and uncertainty remains.

Looking at 2022 and beyond we expect the following:

→ Increased focus on insurer exposure to natural catastrophes. There is a concern climate change is fuelling more frequent and severe events.

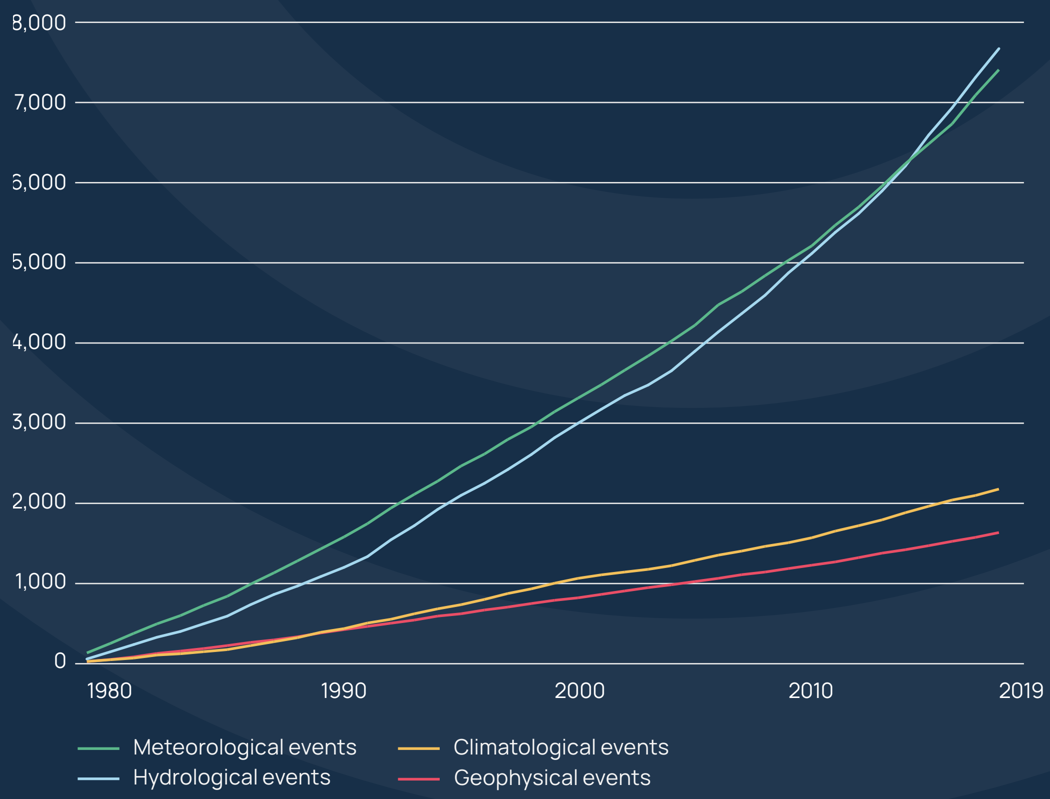
→ A refocussing and reinvestment in specific classes of insurance

→ Greater focus on environmental, social and governance initiatives

https://www.theinsurer.com/news/global-cat-losses-reach-112bn-in-2021-swiss-re-sigma/19970.article

ADVANCES IN THE FIELD OF CLIMATE ATTRIBUTION NOW PROVE THAT CLIMATE CHANGE IS IMPACTING THE FREQUENCY AND SEVERITY OF CERTAIN WEATHER PERILS

Figure 15: Cumulative number of natural catastrophes – 1980 to 2019
(Source: Munich Re, HX Analytics)



Construction Market Update

Overview

The construction insurance market has followed a similar path to the global insurance market. Rate increases and cover restrictions have continued to be imposed largely driven by poorly performing prior years, social inflation and a large number of catastrophic events. **In the first half of 2021 insured losses from natural catastrophes were estimated to be $40bn.** The second highest for the first half of a year since 2011.

The following table shows average change in premium rate since 2017.

Note - rates can be significantly by factors such as type of work being undertaken, contractor experience or geographic location of the risk.

Average rate movement since 2017

Global Insurance Update	Average rate movement (from 2017 to Q4 2021)
Construction All Risks (CAR)	+100% to 300%
Erection All Risks (Onshore)	+100% to 200%
Third Party Liability (excluding US)	+45% to 70%
US Liability	+50% to 150%
Canadian Wrap Up	+45% to 75%
Professional Indemnity	+60% to 90%
Construction Plant and Equipment	+125% to 175%
Inherent Defects / Residential Warranty Insurance	+10% to 20%

The hardening market has seen an unprecedented number of insurers withdraw from writing construction risks, with **12 major construction insurers withdrawing capacity equating to over $1b of lost capacity for any single project.** Travelers is the latest insurer to cease writing construction insurance in London.

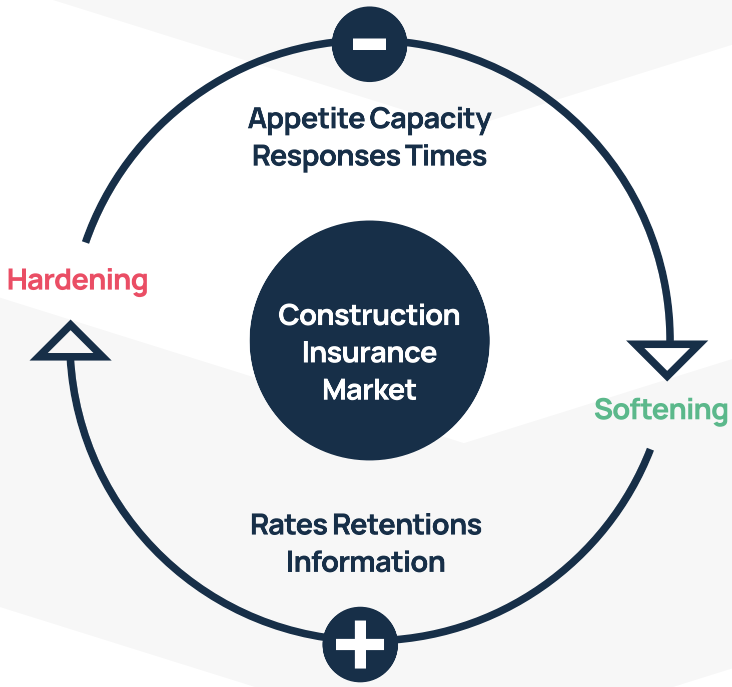
There have been few new players entering the construction market and those still writing construction insurance have tightened their underwriting discipline, resulting in a further reduction in appetite and capacity.

https://www.swissre.com/news-release/Severe-weather-events-drive-global-insured-catastrophe-losses-of-USD-42-billion-in-first-half-of-2021-Swiss-Re-Institute-estimates/c10d0aca-9cf6-4631-86e8-1e57f8dd5bc7

Unfortunately, premium rates are expected to continue to rise in the short to medium term, though at a slower rate than previous years as insurers look to recoup losses from over a decade of soft market conditions. We also anticipated further reduction in capacity. We expect the market to maintain more stringent underwriting practices for some time to come with more pressure being applied to manage limits and policy extensions. Other contributing factors to the hard market include;

- Low interest rates
- Reserve inadequacy
- Higher reinsurance costs

Plenty of capacity remains. In the London market alone there is still **$3bn of capacity** available across all risks types and territories, but critical to obtaining an optimal outcome in these challenging market conditions is having a clear and considered approach. Steps to navigate a hard market are discussed later in this paper.



Rates

Sustained periods of low interest rates and diminishing investment returns mean underwriting profits are critical to a sustainable business model. Over the last few years, following a large number of market defining losses, we have seen rate increases in both project specific and annual construction insurance policies as insurers seek to regain balance.

Whilst rate increases over the last few years have provided improved underwriting profits and market conditions are beginning to stabilise, rates are expected to continue to rise. Insurers continue to experience significant losses from legacy projects having been underwritten below technical prices at the time of placement and are now bound to automatic extension provisions at these same low rates. In addition, they now have to account for theeffects of the pandemic, which no insurer would have included in their pricing models.

For annually renewable policies, the impact of rising rates will be felt less by those that can demonstrate a good claims record and proactive approach to risk management.

Cover

As technology advances and climate change evolves, we are faced with a changing risk landscape. A report from the IPCC suggests 1.5°C of global warming compared to the average temperature in the Industrial Age (1850-1900) will bring the most severe weather events that have ever occurred.

For insurers, in conjunction with successive years of poor underwriting profits, this has created a challenging and complex environment. As a consequence, we have seen insurers impose restrictions on cover with closer scrutiny notably evident in the following areas;

Limits and deductibles

Extension provisions

Communicable disease exclusions

Cyber

Limits and deductibles

As the construction market hardened we saw policyholders having to accept larger deductibles. As well as reducing attritional losses, insurers are forcing insureds to refine and enhance their risk management procedures. A combination of high frequency, high severity claims are seeing increased deductibles being applied to:

- Water damage losses
- Defects
- Hot works conditions
- Hot testing and commissioning
- Natural catastrophe perils – earthquake, windstorm and flood. In the soft market where projects were exposed to natural catastrophes percentage of loss deductibles were often obtainable. We are now seeing percentage of value at risk at time of loss commonly imposed with increased minimum deductibles.

With regard to Delay in Start-up (DSU) insurance, longer waiting periods are being imposed and closer examination of the calculation of the basis of the sum insured is evident. In the UK, previously a 30 - 45 day time excess was the norm. This now can be as high as 90 days.

Limits remain under close scrutiny from insurers, particularly in respect of cover provided for natural catastrophe perils. In addition to offering reduced limits, in areas of high exposure insurers are commonly looking to only offer combined limits in the aggregate.

Liability markets are seeking higher attachment points on excess placements whereas primary insurers are looking to limit their exposure by offering lower limits creating a challenge for brokers and policyholders.

Extension provisions

Prior to COVID-19, due to the complex nature of construction projects and other uncontrollable factors, project delays were still prevalent. National lockdowns and global supply chain issues leading to longer lead times have compounded this issue. As a consequence, many policyholders are looking to extend their construction policies for a significant period of time.

In soft market conditions insurers found themselves bound to extending poor performing policies at nil or capped additional premiums. In the last year, there has been a shift in underwriting mentality and more consideration is being placed on the extension provisions offered. Automatic extensions and long periods capped at pro rata additional premium are commonly being stripped back and replaced with further periods provided at premium, or even terms, to be agreed.

Extensions can now take several months to secure, particularly for projects which have been extended multiple times, have a poor claims experience and/or replacement capacity is required. In the current market, it is important to ensure pre-agreed extension provisions are obtained at the placement stage to limit the ability of insurers to impose large premium loadings or more restrictive terms and conditions. Project teams should include conservative estimates in budgets for premium extensions to accommodate potential increases.

https://www.ipcc.ch/2021/08/09/ar6-wg1-20210809 pr/#:~:text=Global%20Warming%20of%20 1.5%C2%B0,development%2C%20and%20efforts%20 to%20eradicate

Communicable disease exclusions

Communicable disease exclusions are being imposed by all insurers as a result of COVID-19. Most common exclusions are the LMA5397 or LMA5393. Care needs to be taken to ensure that any exclusion purely limits the cover to the direct consequences of a disease rather than other, non-related losses which have been seen in some exclusions (e.g. excluding cover for a fire loss during a pandemic).

In respect of DSU, non-damage triggers have been stripped back and infectious disease covers are no longer typically available.

Cyber

It has been a concern for several years how far traditional insurance products address cyber related risk. Historically, construction policies offered 'silent' cyber coverage i.e. the extent of coverage is not explicit within the policy, leading to potential confusion as to the extent of coverage provided for cyber related losses. These concerns have grown as technology has advanced and plays a greater role in construction projects. As a consequence, the Prudential Regulatory Authority now requires insurers to make clear in policies the extent to which coverage is, or is not, provided.

As a result, most insurers are now insisting on cyber and data exclusions. Insurers' position on acceptable cyber exclusions continues to change. There are many different exclusions in existence, which vary in the cover they exclude. It is important to understand what cyber coverage your construction policy provides and where any gaps may exist.

Capacity

Following the United Nations 26th Climate Change conference which called for net zero to be a core principle for business, it is clear there will be an even greater focus on environmental, social and governance initiatives to tackle impact on the climate. As a result, insurers' appetite for certain types of construction projects has changed.

Only a handful of insurers are willing to provide cover for coal projects due to the environmental damage they cause and many have turned their focus to the renewables sector such as solar and wind farms.

A limited number of insurers are willing to provide cover for hydroelectric power plants following a number of market defining losses. There are industry concerns regarding the quality of construction methods used in some less economically - developed countries, particularly surrounding the adequacy or lack of linings used in tunnels. As the world focuses on a sustainable future, hydroelectric power plants are expected to be built at a faster rate and so the demand for insurance to cover these types of works will increase. Acquiring insurance for such projects is feasible but owners and contractors need to work with their broker to provide sufficient information which showcases a robust design, construction methodology and approach to risk management.

Insurers are increasingly unwilling to commit capacity to projects with a construction period greater than 5 years as they are unable to accurately determine future reinsurance costs. This is most notable in areas exposed to natural catastrophes.

DSU insurance remains closely scrutinised. Placements with DSU cover will impact the amount of capacity an insurer will commit as the DSU sum insured is considered as a 100% probable maximum loss.

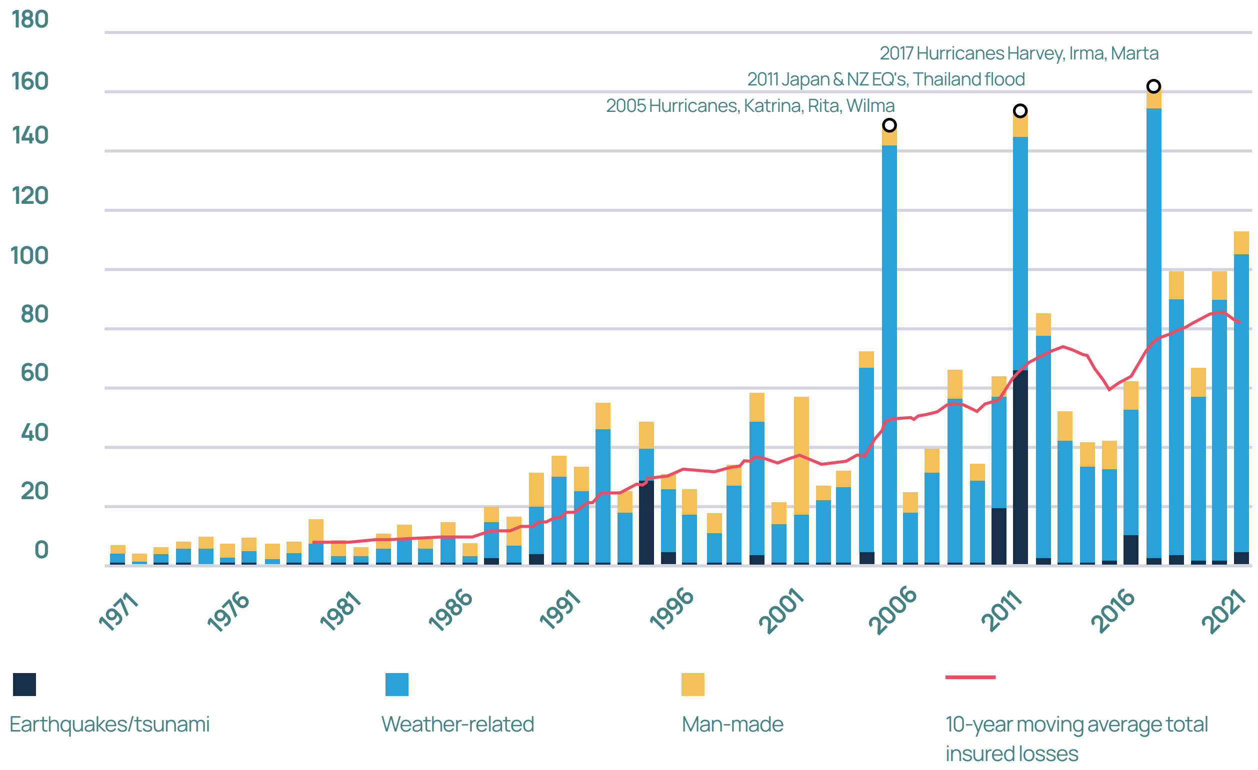
Reinsurance

In 2021 many insurers were faced with significant increases in reinsurance costs as a result of successive years of losses and continued globally uncertainty surrounding the pandemic and climate change.

There is growing concern around the impact of climate change on the frequency and severity of catastrophic events. This concern has been a contributing factor to continued rate increases. 2020 was a reasonably active year for natural catastrophes particularly in the US where the North Atlantic hurricane season had the largest number of named storms on record. Despite there being less damage than the notable years of 2005 and 2017, there was still widespread devastation consequently impacting treaty renewal discussions. The first half of 2021 seeing the second highest estimated insured losses from natural catastrophes (USD 40 billion) demonstrates the growing risk of climate events and the greater exposure to wider communities. (2)

In 2022, focus on programme structures, terms and conditions is likely to be prevalent, with particular attention regarding cyber and COVID exclusions as discussed earlier in this paper.

Global insured losses since 1970



Source: Swiss Re Institute

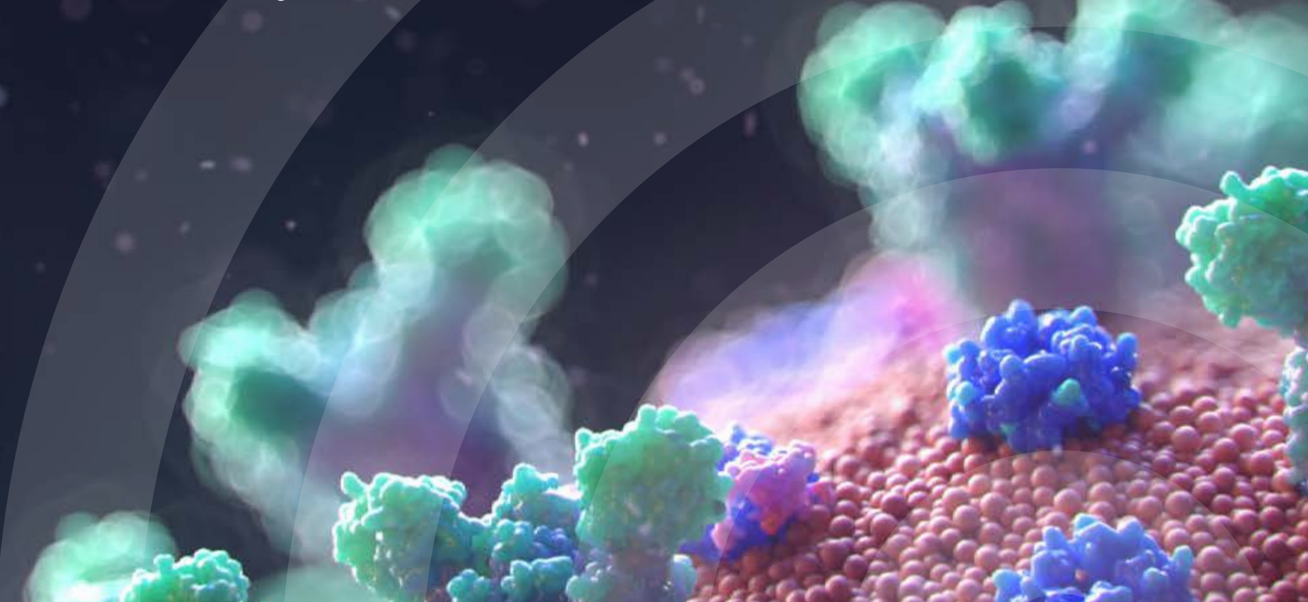
COVID-19

COVID-19 has been a catalyst for a deeper global recession. Previous trends have shown GDP and insurance premiums are directly correlated, hence the concern from insurers as gross national income has fallen so have written premiums.

COVID-19 is an unexpected and unpriced loss for the (re)insurance market. It stands out for its uncontained nature (geographical and duration) and its misunderstood consequences: the decision by governments to prioritise public health over economic activity meant the bulk of insured losses were pushed away from the life market and into the property and casualty market.

The total cost of the pandemic to the insurance sector is unknown. It will take years until we really understand the total impact on the construction market due to the long tail nature of some liability claims. At the start of COVID-19 there were some very large loss predictions from insurers. Whilst most of these have been subsequently corrected there is still uncertainty around the actual quantifiable loss and disputes regarding certain aspects of cover remain. The FCA Test Case and Supreme Court's judgment in January 2021 provided some clarity regarding how policies should respond in relation to disease 'radius' hybrid and denial of access clauses, but long litigation battles are expected for some years to come.

	COVID	Catastrophes	Capital
Impact on industry	Created market uncertainty, encouraged capital retention	Greater cat frequency exceeded budgets, triggering reinsurance attachments	Increased pricing, higher reserve releases have supported earnings and capital resiliences
What happened	Heightened risk premium and drove rate increases on in an already hardening market	Capital deployment into hardening market as insurers rebalanced and focused on selected portfolios	Higher estimated forward shareholder returns



UNDER THE SPOTLIGHT... PROFESSIONAL INDEMNITY INSURANCE

Note – this section focuses on the UK Construction Professional Indemnity market but some of the challenges faced are relevant to the international market.

The construction professional indemnity market has remained one of the most challenging classes due to significant claims activity born out of:

1. Hangovers from the 2008 global financial crisis or recession in the UK;
2. Contractors, involvement in projects that were traditionally outside of their areas of expertise (for example, energy from waste), due to 1 above and the lack of projects in their traditional sectors (such as building and civils);
3. Industry challenges associated with cladding and fire safety, becoming highly publicised, litigious and problematic, as a consequence of the Grenfell Tower tragedy in June 2017;
4. Failings in procurement methods such as public private partnerships (PPP), leading to contractors bidding and winning problematic projects with challenges and delays;
5. Failings in contractors' supply chains, including but not limited to:
    a. Poor understanding of roles and responsibilities of project stakeholders;
    b. Errors and omissions by the supply chain;
    c. An inability to recover contractually from those members of the supply chain who were responsible for the delivery of erroneous professional services and were also best placed to risk manage the delivery of such services.
    d. Financial insolvency of the supply chain.

On average, these issues led to loss ratios of circa 200% on major UK contractors' annual PI placements between circa 2010 and 2015. In other words, for every GBP 1 of premium received by insurers, GBP 2 of claims were paid out by insurers.

This has led to a compounded rate increase of between 60% to 90% in the last 4 renewal cycles since 2018, the largest increases generally being seen on excess layers. Larger proportional increases have also been seen on accounts that are tainted by adverse claims, with increases of up to 900% occurring.

Although there have not been significant changes in terms of coverage, the following has been witnessed:

1. Increases in excesses, especially in respect of fire safety and/or building fabric;
2. Increased requirements for Insureds to accept co-insurance, as a consequence of primary placements becoming prohibitively expensive or due to a lack of capacity and an inability to complete layers;
3. Cyber and data coverage restrictions;
4. Fire safety and cladding coverage restrictions;
5. 'Round the clock' reinstatements of limits becoming more challenging to obtain, especially:
    a. where smaller total towers are purchased, with primary insurers being concerned about the erosion of a tower leading to the reinstatement of the primary layer;
    b. on an unlimited basis.

As we look ahead, the market is expected to stabilise with less severe price increases. Although we have seen some new insurers enter the market, such as Convex and Mosaic, there remains little evidence of any notable capacity which would swing the pendulum back in policyholders' favour. Furthermore, we are not seeing underwriters bravely deploying more capacity to take advantage of the hard market conditions, with most underwriters still being wary of the construction professional indemnity (PI) class. Tough market conditions are expected for some time to come.

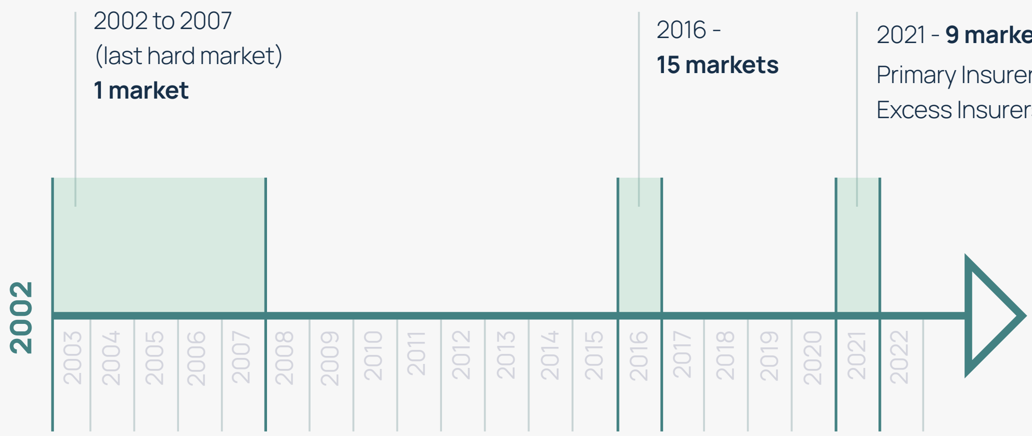
Single Project Professional Indemnity

In the UK, single project PI (SPPI) is not typically utilised on projects by contractors, as annual contractor PI policies should cover all past and future projects on a claims made basis, with no limit as to type or size of project.

SPPI is typically only purchased where:

1. **A ring-fenced SPPI solution** is contractually required by an employer;
2. **Joint ventures** are working on large projects;
3. **Foreign contractors** are working in the UK and don't historically purchase PI because it is not a required or typical insurance in their domiciled territory. This is particularly the case on joint ventures with UK contractors.

The issue for SPPI is pricing and also the limited scope of coverage when compared to annual PI arrangements. However, the bigger issue is simply one of availability of capacity, with those few insurers left in the SPPI space being highly selective, opportunistic and reluctant to deploy meaningful capacity. The position on SPPI is most definitely binary, with the default position for underwriters being a simple no, no matter what the pricing. The following metrics give further insights into the SPPI market in the UK:



Typical capacity deployed – between GBP 1m and GBP 5m per insurer (likely maximum capacity of roughly GBP 30m, but realistically an achievable limit of GBP 15m).

The trends for the supply of SPPI capacity can be broadly defined as follows:

1) Construction PI, on both an annual and SPPI basis, is a specialist class of PI, that is only written by a select number of insurers with requisite experience;
2) Construction PI is a highly volatile class of PI that has lost most underwriters large sums of money since circa 2010, with many insurers withdrawing from the class or providing very limited capacity (typically between GBP 1m and GBP 5m aggregate lines);
3) When the PI market hardens, as it has since 2018 in the construction sector, premiums on annual business become more attractive and underwriters redirect their finite capacity from SPPI to annual business;
4) The comment in (3) above should be put into context though, as SPPI, even in the soft market, would only form a very small part of an underwriter's book. Say circa 5% to 10%;
5) Contractors in many territories (including USA, Canada, UK, Australia and New Zealand) throughout the world have broad PI programmes that cover legal liability claims arising out of all previous and future projects. Such PI being purchased on an annual basis. SPPI is therefore rarely required or purchased by contractors;
6) Given point (5) above and poor SPPI loss records, many underwriters perceive SPPI as adverse selection, with a degree of moral hazard and, as a consequence, are reticent to provide such cover;
7) Multi-year SPPI can be unattractive to many underwriters due to the length of the tail exposure - 10 years typically being the maximum SPPI total policy period available in event;
8) Multi-year SPPI can be unattractive for underwriters due to certain accounting nuances;
9) In hard market cycles, SPPI capacity and providers dry up significantly, due to all of the factors outlined above. This can also be further exacerbated by difficulties associated with obtaining treaty reinsurance.

Given everything that is stated above, it can be seen that with respect to SPPI,the hard market is not necessarily analysed in terms of pricing increases, with SPPI being at the higher end of the pricing spectrum in all market cycles. The hard market for SPPI is measured more in terms of the ability to access SPPI capacity and complete placements, with most projects merely becoming uninsurable in a hard market.

A HARD MARKET - CHALLENGING CONDITIONS, LITTLE CERTAINTY OF PRICE AND COVER.

WHAT CAN BE DONE?

Navigating a hard market

The 7 Steps

1. Strategic marketing approach
2. Early engagement
3. Detailed and relevant presentation of underwriting information
4. Analytics
5. Allocation of risk
6. Clear objectives
7. Insurer relationships

1. Strategic marketing approach

A strategic approach should be adopted when marketing large complex risks. For the initial phase, key markets need to be identified and approached as potential lead insurers. Once the lead insurer has been appointed and terms finalised, support capacity can then be obtained from follow markets.

In a hard market it is not constructive to 'scattergun' and approach every insurer in the market for lead terms. This approach typically results in a poor engagement from the market and ultimately less favourable terms for the policyholder.

Accessing multiple insurance hubs can provide additional capacity, but it's important for brokers to have a coordinated approach when marketing risks. Access points should be agreed before engaging the market.

2. Early engagement

Engaging your broker at an early stage is critical to allow enough time to understand your insurance requirements, collate underwriting information and design and deliver a robust insurance programme.

The placement process is taking longer due to:

- A larger volume of enquiries for those insurers still writing construction insurance
- Longer negotiations to agree final terms
- Less capacity and appetite in the market – more challenging to obtain follow support

We recommend starting discussions 6 months before the renewal of annual insurance programmes and 3 to 6 months for project placements.

3. Detailed and relevant presentation of underwriting information

The delivery and presentation of relevant underwriting information is beneficial for all parties and critical to a successful placement process. In the hardening market, the importance of clear and comprehensive underwriting information is critical, as underwriters review projects with closer scrutiny.

Detailed information is necessary for insurers to fully understand the potential risk exposure and provide terms which are an accurate representation of the risk. For clients, this translates to greater insurer engagement and better terms due to:

- Worst case is assumed if there is missing information
- With limited time available, underwriters are more likely to make the effort to analyse those submissions that provide clear and relevant information

Within the underwriting submission, details regarding risk prevention and mitigation measures will evidence to insurers the policyholder adopts a proactive approach to risk management and ultimately lead insurers to offer better terms.

4. Analytics

Through our Hx team, we can provide data insights and analytics that can help drive informed business decisions such as:

- Collation and presentation of quantitative information for renewals
- Analytics to improve client decision-making - integrated actuarial, catastrophe modelling and advisory services. Guidance driven by the data regarding deductibles, appropriate limits and risk exposure.

Catastrophe modelling can assist by helping clients to understand the exposure at a project site. Our in-house Natural Catastrophe Analytics tool 'Cat-Kit' analyses project locations to aid decision-making behind limits to purchase, depending on a given statistical return period, deductibles to retain / pass down the chain, and whether to cap this liability or not.

Analytics can provide a differentiating factor in the presentation of information to support renewals. It can also help to assist with understanding market trends and analyse a client's risk exposure based on risk appetite.

5. Allocation of risk

Contracting parties need to clearly understand their risk exposure; what risks are insured and uninsured. Insurance provides a mechanism for transferring risk to a third party, but where certain covers may no longer be available, it is critical to understand the allocation of risk under contract. The Howden Construction team can support in this process.

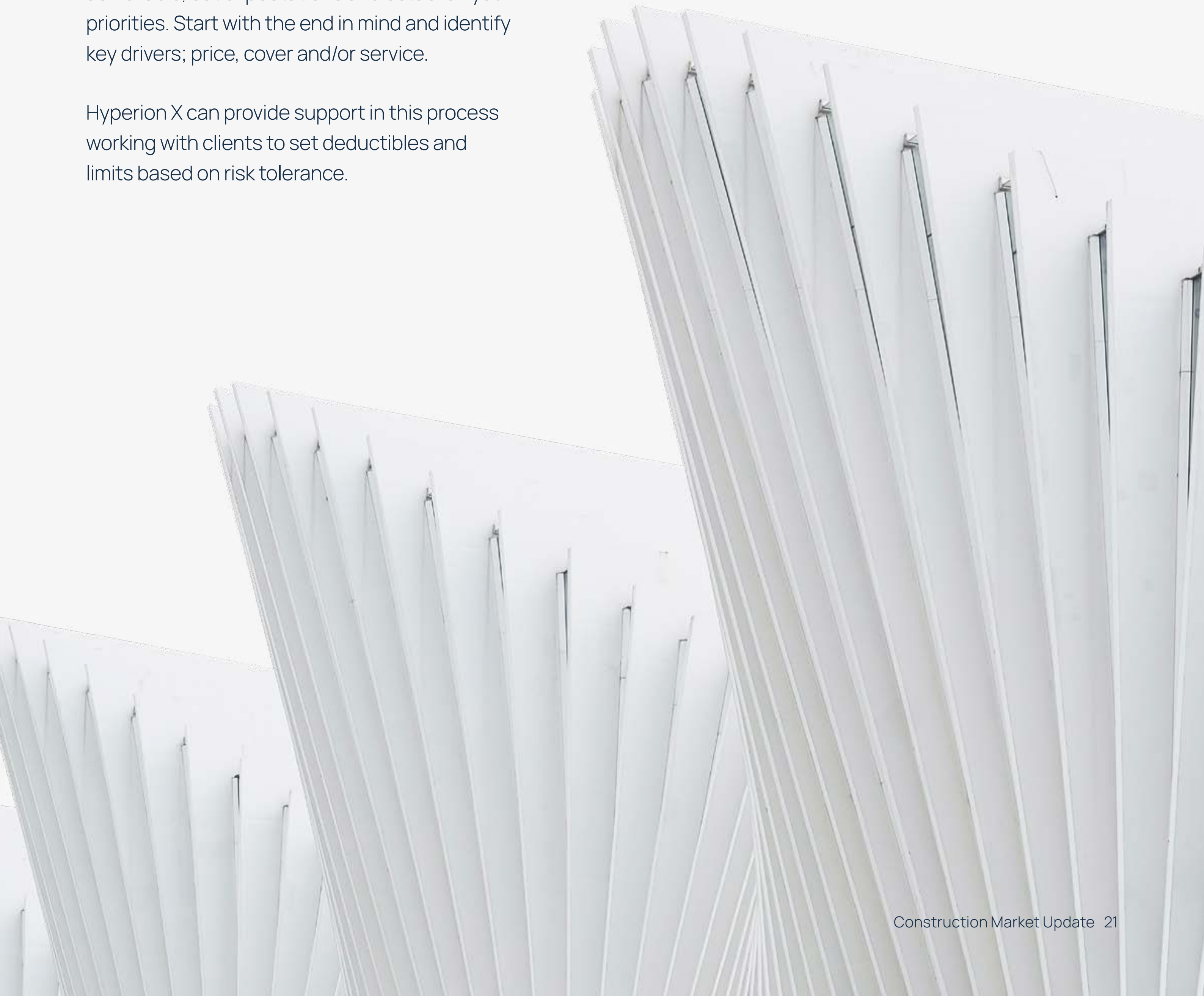
6. Clear objectivities

It is pivotal before engaging the market to work with your broker to understand what is achievable, set expectations and establish your priorities. Start with the end in mind and identify key drivers; price, cover and/or service.

Hyperion X can provide support in this process working with clients to set deductibles and limits based on risk tolerance.

7. Insurer relationships

It is frequently undervalued, but those clients who build long-standing relationships with insurers can often obtain more competitive terms than otherwise would be available. Building key relationships with trusted carriers, not based just on price but longevity, cover, claims process and service, can pay dividends. There is real value in taking the time to have market meetings with incumbents to establish and develop relationships. Howden Construction activity encourages this tripartite relationship.



The role of the London market

The London market has always had a unique insurance offering since its origins over 300 years ago. Its reputation is built on a market that individuals and companies can turn to for specialist expertise and insurance of large or complex risks.

Why is this and why is it even more important now?

- **Broad cover** – Howden's London broad wording provides much wider cover than 'off the shelf' insurer wordings and is tailored to each specific construction project(s)
- **Access to Lloyd's markets** – providing additional capacity with strong security ratings
- **Referral points** - direct negotiation with referral points
- Willingness to underwrite complex risks and offer innovative solutions

The London market's unique ecosystem allows for face to face negotiation which has resulted in the fostering of long standing relationships with many global insurers and senior underwriters. In a hardening market with less capacity and more stringent underwriting discipline, London's specialist global insurance market can assist with obtaining cover to potentially otherwise uninsurable risks.

It is important to have a strategic and considered approach when marketing specialist construction risks such as tunnelling projects. For complex coinsurance placements, appointing a reputable lead with strong technical underwriting capabilities is pivotal to obtaining sufficient support capacity.

Howden Construction

Howden Construction, which officially launched October 2021, is a newly formed Division part of Howden Specialty in the UK.

30+
Construction specialists

Holistic one stop solution

Strategic hires and expanded team
with a breadth of experience across all types of construction projects internationally

Key Insurance Hubs

To complement our London offering and provide a truly global service, Howden Construction has dedicated Construction specialists in the key insurance hubs of, Singapore, Dubai and Miami. Our Specialty teams operate under one global Profit and Loss centre, avoiding an inward-looking silo mentality and guaranteeing our service proposal is based around our client's needs and nothing else. Aligning our placement and servicing capabilities in accordance with the key placement locations ensures a regional in-depth knowledge of our clients' risks and an ability to have face-to-face negotiations with decision makers on the ground.

- **Howden One partners territories**
  Howden One increases our reach to over **90 territories** and **20,000 professionals**.
- **Howden territories**

Supported by a business with

$11bn+
Premium into international markets

45
Territories

8,500+
Employees

Conclusion

A hard market is a challenging environment for policyholders as they face rising insurance costs and greater coverage restrictions. The market is beginning to stabilise but rates are expected to continue to rise in the short to medium term. Adopting the 7 steps described in this paper will assist in navigating the market and ensure the most competitive terms are obtained.

If you have any questions please contact one of the Howden Construction & Infrastructure Assets Team and we would be more than happy to assist.

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