The State of Commercial Insurance

A survey of insurance carriers, brokers and policyholders

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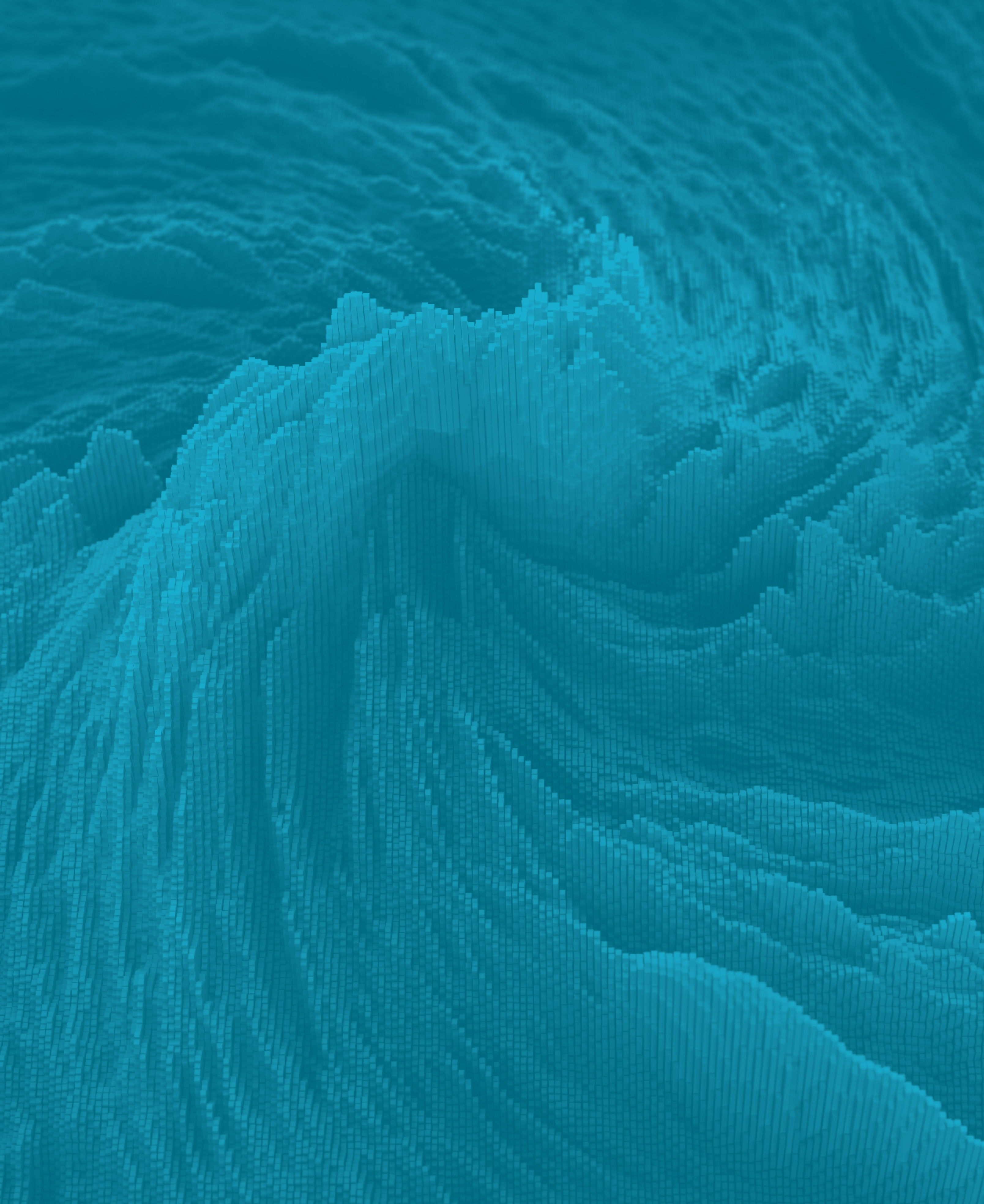


Contents

Introduction

The COVID-19 pandemic put the insurance ecosystem to the test. With the emergence and evolution of multiple variants creating additional uncertainties, carriers and intermediaries, including brokers and managing general agents/underwriters (MGAs/MGUs), faced increased pressure to innovate and adapt. While the industry weathered the storm well, the pandemic amplified vulnerabilities and gaps in technology, talent and infrastructure, and the lessons learned have better prepared the industry for current and future challenges.

Currently, key areas of pressure include evolving customer preferences and digital transformation; systemic risks, including environmental, social, and governance (ESG); premium pricing; overall macroeconomic conditions; and geopolitical risk. This high-stress environment is forcing the industry to transform to ensure that added value, transparency, efficiency, modernization, and relevance are delivered to their customer base.

The Council of Insurance Agents & Brokers (The Council) and Ernst and Young LLP (EY) initiated a state of insurance market study, inviting top insurance carriers, brokers, and policyholders to respond to questions on current industry trends and challenges that shape their relationships. The online survey polled 72 respondents, representing 47% of carriers from the top 20 insurers, with 42% from the top 50 based on asset size; 55% of the top 20 U.S. brokers, with 30% from the top 50; and 35% of the top 20 international brokers. This report is reflective of the survey findings, along with additional commentary on the accelerating macroeconomic and geopolitical events affecting the world in the time since the survey was fielded. Top findings include:

- Operational innovation and flexibility were key to insurers' success during the pandemic, resulting in policyholders reporting reluctance in changing their current brokers. However, the emergence of broader service needs and reliance on alternative risk transfer solutions and the excess and surplus (E&S) market (which clients are eager to consider) could lead to such a change in the future.

- The pandemic accelerated digital transformation, with policyholder self-service portals being viewed as the minimum standard for modernizing customer journey/customer service models. Brokers increasingly seek to integrate their systems with carriers to expedite quoting and policy issuance, positioning themselves to provide customized products and services.
- Carriers, driven by the need for profit improvement, efficiency and reduction of expenses, are increasingly leveraging digital transformation and data analysis for underwriting and product innovation. But more collaboration is needed between carriers and intermediaries to drive demand for these innovations, increase trust, and better educate and support the customer in digital transformation.
- Policyholders and brokers are experiencing hard market "fatigue" and are looking to mitigate premium increases with lower limit reductions or are seeking capital from new market entrants. As a result, carriers predict a rise in self-insurance solutions and alternative risk transfer through fronted or captive solutions.
- Insurance buying, advising, and underwriting skills are being tested by emerging risks not necessarily contemplated with the traditional risk transfer products or risk prevention services currently available. At the same time, clients are reporting a shift to a more holistic approach to insurance and risk management decisions, with increased communication among senior management and boards.
- Most policyholders cite cyber and economic risks as the areas of greatest concern to their evolving risk profiles. Remote work is adding to the increase in the frequency and severity of cyber claims, with ransomware and phishing scams being chief concerns.
- After technology, investment in talent remains one of the highest for both insurance carrier and distribution groups. At the same time, return on investment in talent is perceived to deliver more value, which reinforces the sector-specific importance of the human element and continued efforts to step up talent recruitment and development in insurance.
- There is a high variance between carriers/policyholders and brokers regarding their perspectives on ESG reporting, with policyholders and carriers exhibiting far more preparedness in their reporting than the brokers surveyed.

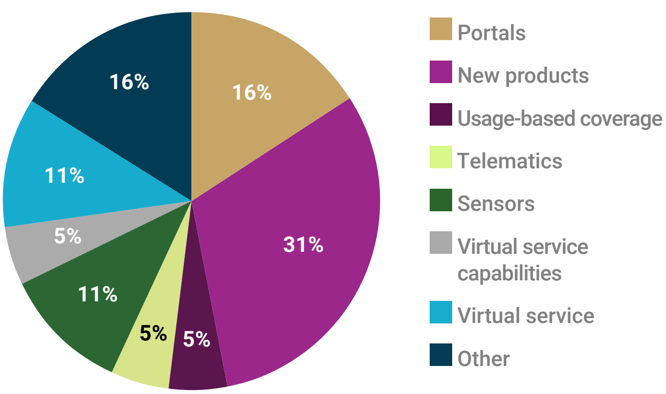
Customer centricity and digital transformation

During the height of the pandemic, insurance organizations that relied on an agile approach to business continuity and overall risk management displayed extraordinary resilience. With policyholders expecting increased levels of service, transparency, data, and innovation, operational innovation has been key to the insurance industry's strength.

Policyholders view carriers and brokers that continually evolve their product offerings as the most innovative. With brokers increasingly seeking to integrate their systems with carriers to expedite quoting and policy issuance, they're positioning themselves to provide customized products and services addressing risk. From our experience, policyholder education is key to their acceptance of new products and services, and while demand may be high, adoption is slow until the losses become routine occurrences, e.g., cyber and employment practices liability insurance (EPLI).

LEVERAGING INNOVATION TO BETTER SERVICE CLIENTS' CHANGING NEEDS

According to policyholders, investments in the following segments demonstrate innovation on the part of carriers and brokers:



The insurance industry is embracing new technology, with predictive analytics, digital self-service platforms, process automation and artificial intelligence (AI) being introduced in the claims management, underwriting, policy administration and sales functions to increase efficiency, improve communication and client interaction, and lessen operational friction. In some cases, this results in real-time straight-through processing for policy issuance and claim resolution. And while efficiency and customer service get a great boost from advanced technology, most respondents confirm the importance of the human element in certain areas.

Most brokers report that they used "soft skills" to meet evolving policyholder needs brought on by the disruption and uncertainty of the pandemic, with 37% of respondents providing advisory services, such as increased client communications, more consultative guidance, walking customers through claims, and increased relationship management. The broker's role is continuously evolving, and seeking advisory opportunities in clients' everyday operations remains a primary way brokers can differentiate themselves from the competition.

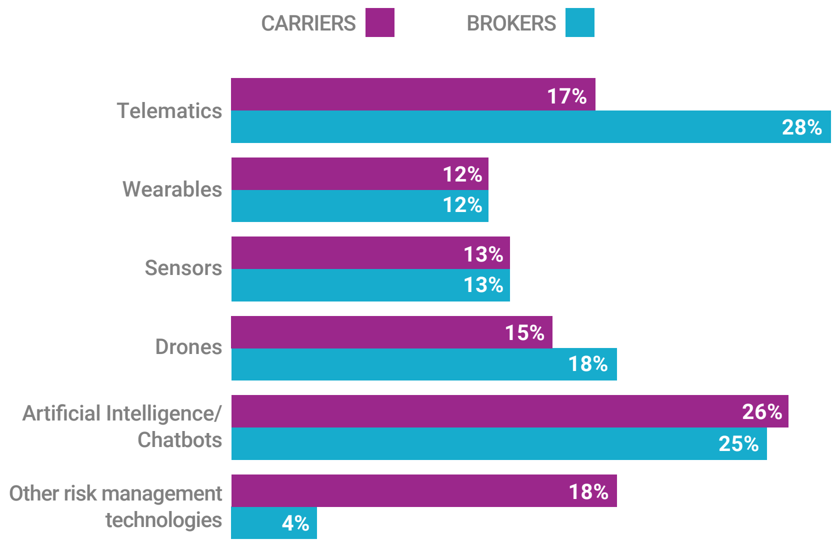
Although policyholders report reluctance in changing their current brokers, the revelation of broader service needs and guidance and reliance on alternative risk transfer solutions (which clients are eager to consider) could lead to such a change in the future.

Brokers (15%) and policyholders (16%) consider self-service portals the minimum standard to deliver on customer expectations, while sophisticated policyholders are adopting new technologies such as telematics, sensors and wearables, to assist with evaluating their risk profiles and loss and claims experience.

While interest in technology-based innovation existed prior to the pandemic, investment prioritization varied. Carriers

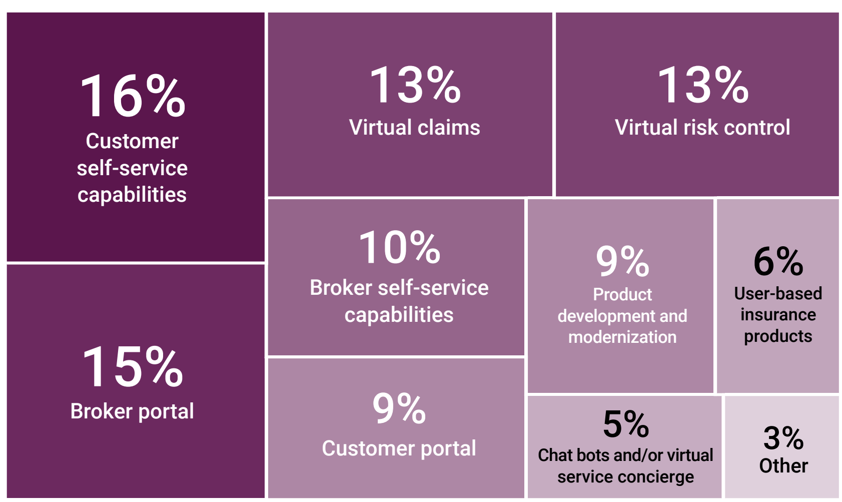
DOWN THE PATH OF TECHNOLOGY ACCEPTANCE

Carriers and brokers are seeing an increase in policyholders' acceptance of the following technologies:



CARRIERS: CUSTOMER CENTRICITY AND DIGITAL TRANSFORMATION DURING PANDEMIC

Carriers have implemented the following innovations to overcome hurdles to engage with brokers and customers:



report that during the pandemic they were more focused on modernizing and updating their systems rather than embarking on new technology products. Since we fielded the survey, interest in and prioritization of technology have grown, as carriers have realized that investing in technology is indeed a business imperative and not a “nice to have” option.

This prioritization of technology investment may be due in part to many if not most carriers having completed or in the process of completing the policy administration systems (PAS) modernization, which they considered a greater priority and foundational precursor to other digital and automation needs. Subsequently, many of those carriers are now in a position to invest in other areas.

Most brokers report that they used their “soft skills” to meet evolving policyholder needs brought on by the disruption and uncertainty of the pandemic.

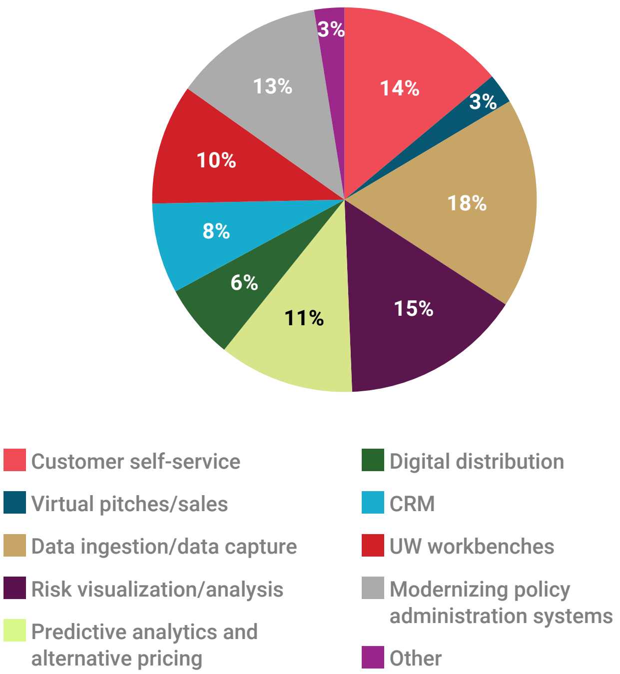
Likewise, there is more pressure to partner with insurtechs, MGAs, and external vendors for product development, value-added services and expanded distribution sources rather than to avoid or compete. Many insurtech entities are solution providers for incremental and operational needs affecting insurance and not full stack carriers or competitors. (Side note: many of the full stack insurtech carriers, not to be confused with insurtech MGAs, are seeing combined ratios that aren’t sustainable).

In addition, with customer expectations evolving, the majority of insurance carriers (61%) report partnering with big tech companies to provide the hyper-personalized, omni-channel customer experiences that big tech offers, and that customers are accustomed to. Partnerships can include embedding risk transfer, creating new distribution sources, or sharing data in exchange for risk transfer alternatives. Partnering with big tech can also eliminate or reduce non-value-added decisions, including risk assessment decisions with low-risk complexity, and free up human capital and resources to concentrate on higher value and greater risk complexity assessments and decisions. From the client perspective, the efficiencies coming from seamless underwriting and claims processing are valued, but they still don’t see innovation driving lower premium pricing.

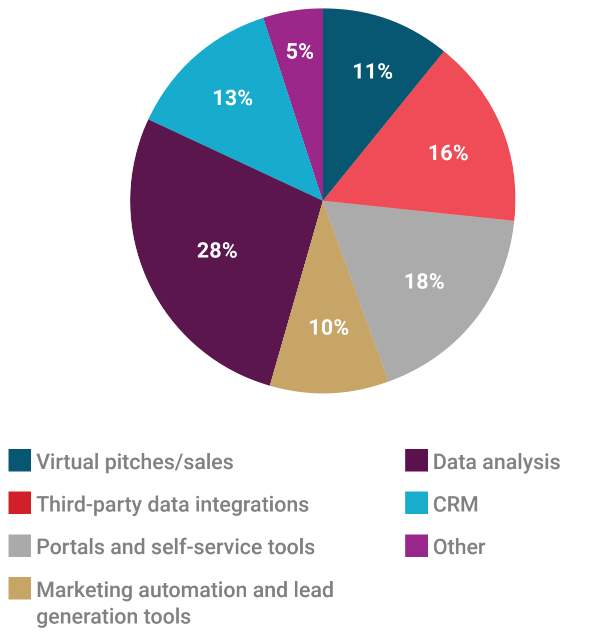
TECHNOLOGY INVESTMENT DURING THE PANDEMIC

Both carriers and brokers focused on technology investments that helped them modernize their systems, better utilize data, and develop a more seamless, customized approach to clients' risk management.

Carrier Responses



Broker Responses



Talent is an underlying concern

Innovation and talent remained the two primary areas of investment for brokers and carriers. Returns on investment in these areas were also perceived as the highest. Even though they rated their technology investment as slightly higher, both groups agreed that investment in talent delivered more value. Certainly, these areas are directly linked to companies' ability to maintain their market leadership through superior underwriting and risk management expertise. It is always preferable to have a strong mix of both, but as we saw from the insurtech experience, companies in various segments may prioritize investments unevenly, which can result in a costly catch-up later.

The industry also saw a massive migration of talent, which raised onboarding and corporate culture concerns among senior management. Respondents indicated that remote work was not conducive to preserving corporate culture, peer exchange and peer learning, and this created an additional challenge of keeping morale and productivity high. Respondents also worried that new hires, employed over the Great Resignation, may have had a harder time adjusting to a new workplace, but at the same time, respondents did not expect remote working to end even when the pandemic risks are substantially diminished.

Hiring necessary expertise remains an important factor affecting brokers' operational performance. In search of talent, brokers may be chasing the same targets, but they are also open to sourcing expertise outside of the insurance sector. In fact, we saw an almost even split between respondents' hiring only from insurance and those hiring from other sectors.

Systemic risk

The landscape of global risk is constantly changing. For example, in the time since this survey was conducted, the invasion of the Ukraine occurred in February 2022, bringing with it a new set of risks to businesses worldwide.

While those events aren't reflected here, they highlight the fact that the insurance industry is constantly facing immense, often unpredictable risks that affect their clients' coverage demands.

While most policyholders (94%) report that their risk profiles have not changed during the past year, the customers that have changed their profiles (6%) cite economic and cyber risk as the primary drivers for this change. At the same time, almost two-thirds of brokers pointed out that clients have requested new coverage, not covered by their current policies, in addition to clients inquiring on captives (27%) and other alternative risk transfers (21%).

Brokers report that they are focusing on improving their risk management consultancies (75%), utilizing new technologies and data processing (10%), and developing new products to address systemic risks (5%).

Carriers believe they have improved their terms and conditions to eliminate ambiguity and/or drive more specificity toward limits for certain causes of loss such as ransomware or social engineering, but this may not be seen as an improvement from a buyer's perspective. In addition, policyholders report that they are not buying many of the new products, i.e., pandemic coverage, and have been critical of available pandemic and other systemic risk products.

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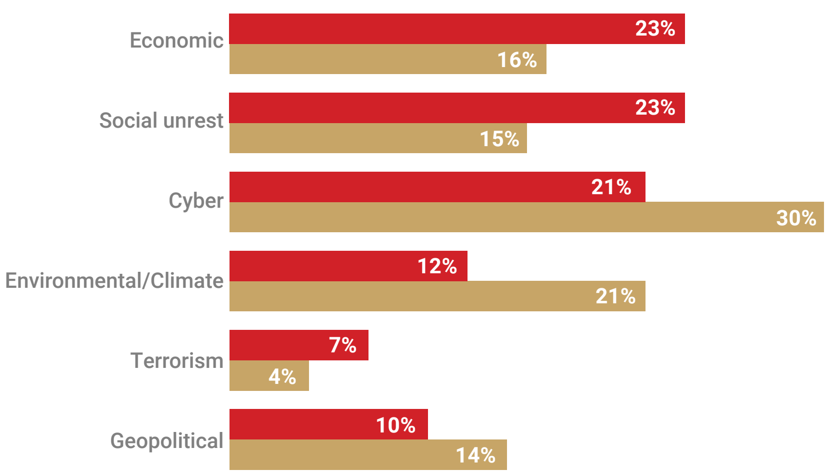
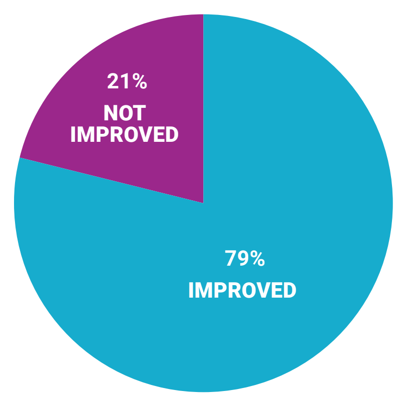
MANAGING SYSTEMIC RISKS: CARRIERS

Carriers indicated an improved ability to assess systemic risk across the following categories:

In the next 2–3 years, carriers estimate the highest potential systemic risks will come from the following:

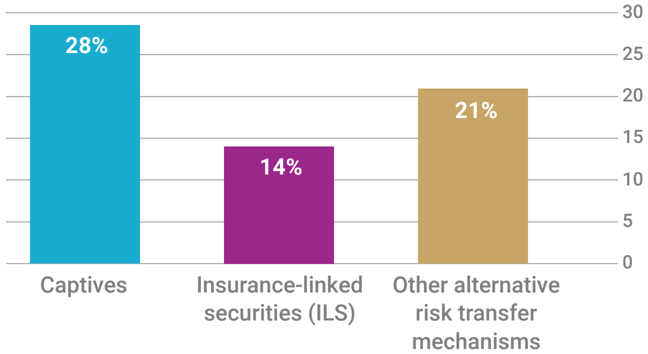


A majority of carriers have indicated improved ability to address systemic risks over the pandemic:

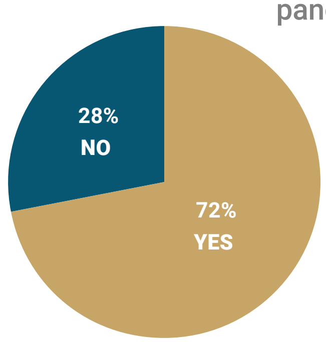


ALTERNATIVE COVERAGE OPTIONS FOR SYSTEMIC RISKS

In search of coverage solutions for systemic risks, clients consulted with brokers on alternatives to the traditional market.



The majority of brokers say clients are requesting new coverage for exposures not covered by their current policy due to the pandemic, climate, cyber, political and social unrest or reputational impacts.



Cyber risk developments

One of the most challenging systemic risks is cyber risk. Insurers and policyholders cite the remote work environment as being a contributing factor to an exponential increase in the frequency and severity of cyber claims, with ransomware and phishing scams being leading concerns. In addition, in projecting future systemic risks during the next 2-3 years, both brokers (48%) and carriers (30%) report cyber risk as their number one concern, followed by economic risk (37% of brokers) and environmental/climate risk (21% of carriers).

Our findings indicate that policyholders will continue to look to their brokers for more consultative services and coverage advice regarding new and emerging cyber risks, while brokers look to carriers and insurtechs and MGAs for analytics and the ability to quantify cyber risk information.

Carriers continue to exclude silent cyber coverage, are reducing coverage for ransomware and eliminating cyber war coverage, driving policyholders into the open market where rates are going up and carriers are less willing to extend the same amount of capacity than in previous policy periods.

As pressures on profitability mount, most cyber carriers report having stepped up their ability to detect and respond to risks quickly and address third-party risk management concerns (23%). A lower percentage of brokers' (17%) think the industry has made progress at addressing cyber risk.

Environmental, social and governance (ESG) risk, reporting and opportunities

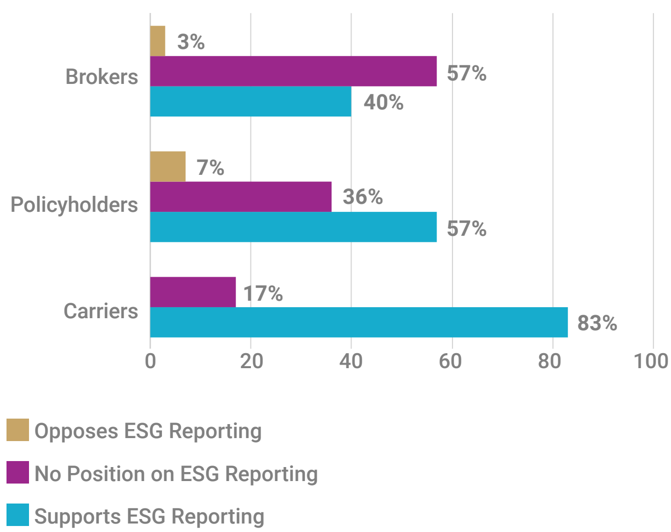
ESG risk is one of the top issues facing insurers and corporate policyholders, and remains central to legal, corporate and financial risk assessment. With large policyholders facing regulatory uncertainty and increased scrutiny from their corporate shareholders to better manage exposures to environmental and social risk, insurers are confronted with increased pressure to measure, disclose and improve these exposures.

Our findings indicate there is a high variance between carriers/policyholders and brokers regarding their perspectives on ESG reporting. Carriers and policyholders (82%/58%) exhibit far more preparedness and openness to reporting than brokers (40%). This may be due in part to investor pressure and regulatory scrutiny prompting carriers and policyholders to increase their focus on ESG reporting. In contrast, brokers' indicate a hesitancy to implement reporting frameworks due to associated implementation costs, a lack of regulatory pressure and scarcity of available data to guide their decision-making processes.

Ultimately, being enmeshed in the insurance value chain may drive this concept further into brokerages, even privately held

DIVERGING VIEWS ON ESG REPORTING

ESG requirements are not evenly implemented by the three respondent groups, reflecting the difference of attitudes in their reporting.



ones. Since the fielding of this report, the U. S. Securities and Exchange Commission (SEC) released a proposed rule that, if finalized, will require public companies to disclose certain climate-related information in their registration statements and annual reports. Publicly traded customers and insurers may demand that all vendors and members of their supply chain adhere to the requirements.

In addition, the survey reveals ideas for ESG product development and consultative services. With the increasing frequency and severity of natural disasters, brokers have an opportunity to provide services to increase resiliency. Similarly, as these increases impact carriers' pricing models and available capacity, brokers and carriers can capitalize on improving awareness of ESG risk, new indemnification options, and mitigation practices. In addition, with most ESG conversations focused on environmental risks, social and corporate governance exposures are lagging. This presents a market niche for brokers to add value as consultants by developing benchmarks for diversity, equity and inclusion (DE&I), and by helping clients embed ESG in their overall governance policies.

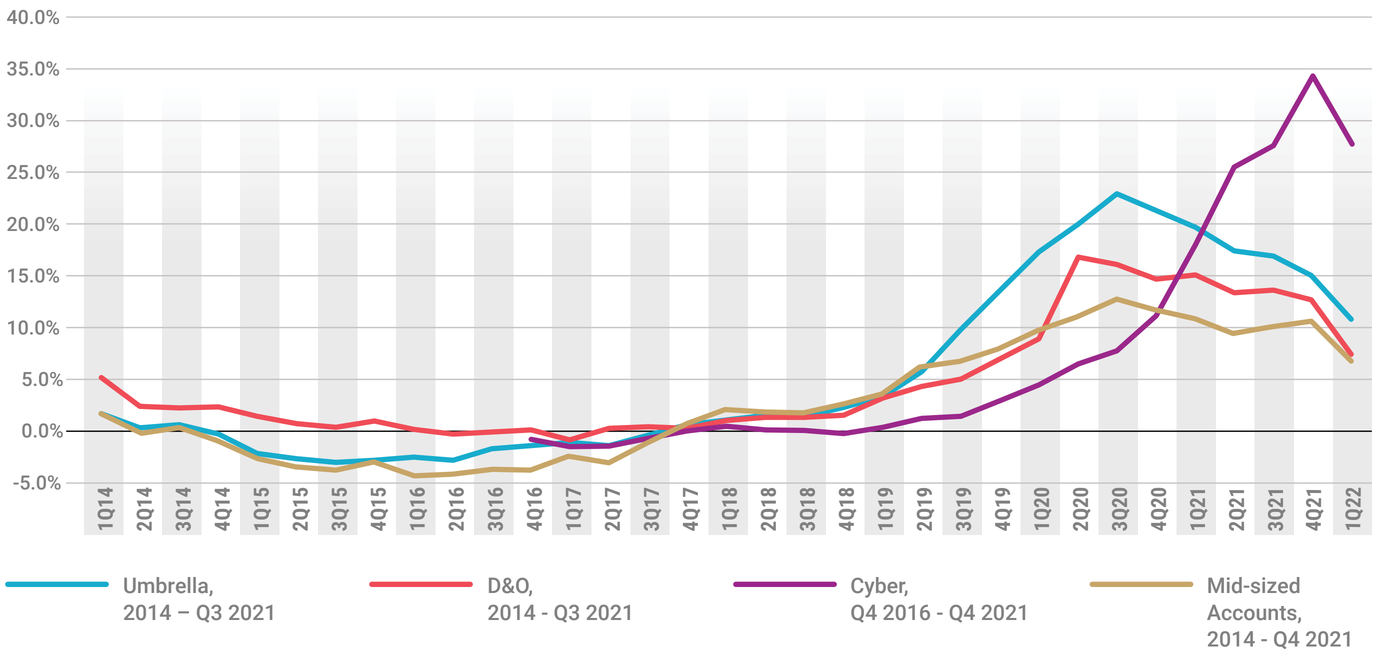
Market conditions: carriers

Primary causes for continuously rising premium rates include pre-COVID-19 profitability challenges, an increase in natural disasters' frequency and scope, cyber-attacks, economic uncertainty/inflation and geopolitical shocks. Survey findings indicate that despite higher rates, carriers still report growth and risk appetite. However, tightened standards and reduced capacity for some products or lines of business at the transaction or risk level exist. Carriers report that over the last few months they increased deductibles and lowered limits, which resulted in clients taking on greater levels of risk retention and affected their ability to shop for alternative options and reduce coverage gaps with captive solutions.

Cyber, property and general liability were the most affected retractions of limits/coverage, with some lines (construction, directors & officers (D&O)

PREMIUM CHANGES FOR FAST-GROWTH LINES

Cyber, D&O and umbrella have consistently seen fast-rising premiums.



Council of Insurance Agents & Brokers' Commercial Property/Casualty Market Report

and excess liability) also difficult to renew with expiring terms. When asked about alternative solutions for clients, most carriers pointed to self-insurance and alternative risk transfer through fronted or captive solutions.

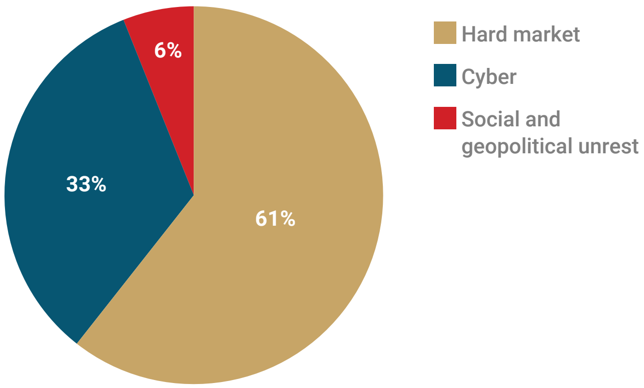
Market conditions: brokers and policyholders

With Q3 2021 marking the 16th consecutive quarter of increased premiums, with an average increase across all account sizes of 8.9%, our survey findings indicated that brokers and insureds experienced hard market "fatigue," with policyholders needing to better understand the continued increases in rates that drive up premiums when they simultaneously saw lower limits and increased deductibles and retention.

In response to the impact of the current market cycle, brokers looked to mitigate increases with lower limit reductions or sought capital from new

HARD MARKET: DIFFERING PERCEPTIONS

A majority of brokers indicated that the hard market had the largest influence on their product offerings.



market entrants, e.g., the new product-specific MGAs or new E&S providers. This occurred mostly in specialty insurance, misunderstood or underserved products or industries like large commercial healthcare, transportation or high hazard sectors. In some cases, policyholders accepted and opted for much higher retentions to balance premium expenses.

Brokers also report that unlike previous hard markets, except for cyber and D&O, capacity is readily available. Brokers indicate availability of capacity, which is likely overall capacity. And they report that although rates have increased specifically for cyber, umbrella/excess, property and executive risk, clients are not showing a desire to reduce coverage or limits. However, carriers are demonstrating less willingness to provide the same capacity per risk at the transaction level, e.g., some property carrier solvency and reluctance to provide expiring limits at renewal for natural catastrophe exposures. Likewise, aggregate limits for commercial auto and general liability are being reduced due to concerns regarding nuclear verdicts and social inflation.

Brokers have seen a retraction of limits or coverage in certain lines, including cyber (25%), property (21%), D&O (17%), excess liability (17%), and natural catastrophe (8%).

Another issue surrounding pricing is transparency. Policyholders indicate they no longer find it acceptable to be rated off a pool that isn't fundamentally reflective of their true exposure or loss experience. Carriers understand they must adjust to changes in policyholder expectations without losing sight of the premise of insurance, which is risk pooling and the law of large numbers, and are instituting alternatives such as user-based insurance. Carriers are also utilizing data for better specificity in pricing rationale and are more routinely leveraging benchmarking metrics to provide insights, transparency and justification for terms, conditions, limits and rates.

In addition, broker priorities in navigating current market conditions include "growing existing accounts" and "finding underserved accounts and niches." Some brokers are focusing on strengthening a "trusted advisor" role by taking steps to enhance the customer experience by offering new tools to help policyholders identify and understand risks and mitigation strategies to reduce loss frequency and severity. In this sense, private equity has contributed with a massive infusion of capital to develop insurtech solutions to both enhance the customer experience and strengthen carrier underwriting excellence. Last year alone, global insurtech funding reached a record US$15.4 billion, with insurance carriers and intermediaries increasingly becoming co-creators as well as investors in this fast-growing segment.

Conclusion

The evolving risk landscape—including global health, economic uncertainty and rising inflation, geopolitical risks, increasing cyber-attacks, supply chain disruptions and natural disasters—have had an enormous impact on the insurance industry. Combined with changing consumer expectations, technology innovations and market conditions, the industry has responded remarkably well. With policyholders expecting customized service, transparency, data and innovation from their insurers, operational innovation has been key to the insurance industry's strength. Carriers have realized that investing in technology is a business imperative and not a "nice to have" option and are making investments ranging from customer portals and automation, to AI and prescriptive analytics for underwriting. Brokers, as well, are investing in technology that improves the efficiency and efficacy of their work with clients.

In addition, carriers and brokers are partnering with insurtechs, MGAs, and external vendors to speed-up product development, innovate services and expand the delivery and distribution footprint.

Talent remains an underlying concern for the industry. Brokers and carriers reported that investment in talent delivered more value than technology, with both of these areas directly linked to a company's ability to maintain market leadership through superior underwriting and risk management expertise.

And as competition for talent increases and more companies position themselves as fintech players, recruitment management may need to tap increasingly into employee pools outside of insurance.

Systemic risks remain a top concern across the value chain, with carriers reporting that they have improved their ability to address systemic risk. However, in defining "improvement," this may mean that carriers have improved their terms and conditions to protect profitability, eliminate coverage leakage, and reduce limits for certain causes of loss such as ransomware or social engineering, rather than improving controls to reduce systemic risk faced by the insured using risk mitigation services or loss prevention methodologies. Increasing inflationary pressures are creating additional challenges to the sector, through an elevated focus on proper reserves to cover existing claims, and prospectively, through accurate underwriting of assets' value at the next renewal period.

As the role of the insurance professional is becoming more of a technology-enabled discipline, successful brokers are differentiating themselves through expansion of advisory services to augment their product-selling capabilities. Brokers are upgrading their skill sets by honing their "soft skills," and increasing data analytics capabilities and technical expertise. But there are questions as to how brokers and carriers are leveraging technology to add value to the client experience to offset rate increases. Some brokers reported that they feel that they are losing credibility in the eyes of clients because premiums are increasing while limits are lower as carriers are reporting record profits.

Market conditions have positively impacted carrier growth and profitability with increased rates, tightened underwriting standards, and reduced capacity in some lines of business or products. Higher inflation and increased exposures coming out of the pandemic created a tailwind to brokers' commissions and growth too. As a result, conditions may be ripe for new entrants and non-traditional insurance players to capitalize on this market dislocation. In order to offset the impact of these competitors, traditional insurance carriers and brokers must continue investing in new technology, attract new talent from diverse backgrounds and prioritize training to ensure that their teams have the new capabilities and competencies required to compete successfully in the insurance industry of tomorrow.

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