Top 10 HOT Markets to Watch – Part 1

April 15, 2014 by **Amy O'Connor & Andrea Wells**

Insurance Journal and MyNewMarkets.com examined industries experiencing changes and expansions in the past year. Here are the top 10 market sectors that just might deliver hot opportunities for agents and brokers in the property/casualty insurance industry in 2014.

1. Private Flood Insurance

Private (re)insurers today have the capacity to provide coverage for flood risk along with new technologies and a better understanding of flood risk — all of which could increase private insurers' interest in providing flood insurance, according to Fitch. More sophisticated risk mapping and modeling tools mean the private industry is more able to provide coverage and more accurately price the risk.

Several states, including Florida and West Virginia, have advanced legislation to give private insurers more leeway in policy forms, underwriting and pricing in hopes of increasing the availability of private flood insurance.

However, there are obstacles to a private flood market. The obstacles include political and consumer resistance to full cost-based pricing of flood risks, a resistance demonstrated by the legislation to roll back rate increases called for under the Biggert-Waters Flood Insurance Reform Act of 2012.

While private (re)insurers have the capacity to cover flood risk according to Fitch, they need to be able to charge actuarially sound rates to be willing to write significant amounts of risk.

Despite the unwinding of the Biggert-Waters reforms, there are some who think there is opportunity in private flood sector.

The Flood Insurance Agency, located in Gainesville, Florida, is now selling private flood insurance underwritten by Lloyd's of London in 15 states and making it available to commercial risks and apartment buildings.

Also in Florida, Homeowners Choice Property and Casualty Insurance Co. is offering a flood insurance endorsement for its existing 140,000 homeowners policies that the company says will cost the same as what homeowners have been paying for their NFIP policies.

Insurance software firm Vertafore formed a partnership with flood insurance policy processing firm StoneRiver National Flood Services (NFS) to provide independent agents an easier way to quote flood insurance when selling homeowners.

Also, federal regulatory agencies will soon require lenders to accept private flood policies to satisfy the mandate that certain homebuyers in flood hazard areas purchase flood insurance.

If federal subsidies for flood insurance are reduced and the cost of government-provided insurance goes up, the demand for private flood coverage could also rise. The reduction or elimination of federal assistance could create a potential opportunity for traditional private (re)insurers or alternative capital markets to serve this sizable market, according to Fitch. But it remains to be seen if the private reinsurance or insurance markets would be able to provide sufficient capacity for flood risk at an economically viable price.

2. Accountable Care Organizations

Accountable Care Organization's (ACO) — networks of healthcare providers working together to offer a full range of healthcare services — have so far emerged as the most popular healthcare delivery model of the Affordable Care Act. But insurers have struggled with how to best insure these, says Mike Grady, president of independent agency Grady Professional Services, a medical professional liability insurance agency operating in 15 states.

Grady says all of the different coverages ACO's require and the different exposures from insuring large physician groups, have left many med mal companies scratching their heads.

"It's going to be interesting to see the Doctors Companies, the Medical Protectives, the ProAssurances of the world figure out, 'Hey, with this large ACO, do we need to handle their property and their workers' comp, as well as their managed care liability, their directors and officers coverage, and their malpractice piece?,'" says Grady.

Perhaps that's why many of the products created for ACO's have been from traditional property and casualty insurers.

CNA launched a product that addresses the full range of exposures ACO's face, including: healthcare professional liability; directors and officers liability; business errors and omissions — with managed care E&O; cyber liability; and privacy and social media.

ACE USA's Medical Risk Group introduced a range of physician professional liability products and coverage options targeting hospitals, healthcare facilities and ACOs providing insurance or alternative risk financing to their employed physicians or owned or affiliated medical groups.

NAS Insurance introduced a professional liability insurance program for ACO's that combines E&O and D&O coverage that address regulatory exposures, as well as cyber liability. The policy also offers MEDEFENSE Plus for billing errors and regulatory claims.

3. Construction

Despite a sluggish start in 2014, construction insurance experts expect slow, but steady growth in the construction sector as the industry recovers from the recession's fallout.

The Dodge Momentum Index — a monthly measure of nonresidential building projects in planning — slipped 2.6 percent in February compared to the previous month. However the drop in "builder momentum" is expected to be just a brief pause in a broader upward trend, according to McGraw Hill Construction, which publishes the index.

The year 2014 began slowly, due to behavior specific to each of the three main construction sectors, said Robert A. Murray, chief economist for McGraw Hill Construction.

Nonresidential building in 2013 advanced 7 percent, but the progress was occasionally hesitant, including sluggish activity at the end of last year that carried over into January, Murray said. The prospects for continued growth for nonresidential building during 2014 are generally positive.

Residential building in 2013 climbed 24 percent, but towards the end of last year growth began to decelerate as mortgage lending to first-time homebuyers remained stringent, Murray said. The January slowdown for housing was due in part to tough winter weather conditions.

Meanwhile, competition among insurance markets remains strong for the construction segment and has kept rates from rising dramatically across most construction lines in 2013, a trend that should continue in 2014, according to Marsh's "Insurance Market Report 2014" released in February.

There is still a lot of capacity in the industry and some of it is new capacity that has come into the industry over the last two to three years, Michael Anderson, managing director and CEO of the U.S. Construction Practice for Marsh, told *Insurance Journal*.

"There has not been any significant uptick in the overall rate levels, but underwriters have been a little more selective in individual account underwriting based on a given contractor's loss experience," he said. That means 10-year loss histories instead of five-year histories.

A few notable expansions in the construction market include:

- Berkshire Hathaway Specialty Insurance (BHSI) introduced a consolidated insurance endorsement which combines numerous primary general liability coverage enhancements in a single product designed for construction wrap ups and project-specific programs.
- Pioneer Programs Insurance Solutions expanded its specialty program, Contractor's Choice, to now include excess liability.
- XL Group partnered with the American Contractor's Insurance Group (ACIG), a construction industry owned insurance organization, to provide data and analytics for construction clients.

4. Directors & Officers Liability

It is no secret that the D&O market has seen a flurry of claims activity since the financial crisis in 2008. Financial institutions saw the brunt of the claims against directors and officers, with an estimated one-third of the directors and officers of failed financial institutions between 2009 and 2010 being sued by the Federal Deposit Insurance Corp., according to a report by Cornerstone Research.

While many insurers have opted to stay away from this segment, new entrant Berkshire Hathaway Specialty Insurance says it is committing to the class for the long term with a new product for directors and officers of financial institutions.

Dan Fortin, senior vice president of Executive and Professional Lines for BHSI, says their approach to being successful involves being selective in pricing and with whom they insure, as well as partnering with brokers who share their perspective.

"In a seven to 10 year period, there will be a time when underwriting results will not be pretty. But that can be offset by some very good years," says Fortin.

That being said, there are plenty of other issues that are keeping underwriters and their D&O insureds awake at night.

According to Rachel Turk, Beazley, the frequency of merger and acquisition claims against directors and officers are going up and so are the defense costs for these claims, which is eroding the retention of limits faster.

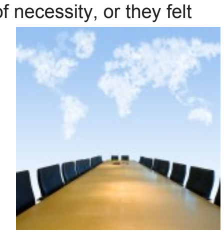
“It is a very active claims environment but also very different because we are now seeing an increased frequency of claims that affect the primary and low level limits,” she says.

Beazley formed a consortium with Hiscox so the two insurers could offer combined limits of $50 million to the commercial D&O segment, excluding financial institutions.

Turk says the goal of the consortium is to give the two London-based markets a “seat at the table” when it comes to providing directors and officers coverage to U.S.-based companies and the insurer hopes to now to see more risks.

Another segment of the D&O market that is ripe with opportunity is the non-profit sector. Travelers, which updated its D&O coverage for public, private and non-profit organizations earlier this year, conducted research in the fourth quarter of 2013 on nonprofit buying habits and found that 69 percent of the more than 2 million U.S. nonprofits don’t have D&O coverage.

The top four reasons the carrier found for nonprofits not to purchase coverage were: lack of perceived risk, lack of budget, lack of necessity, or they felt the coverage was not affordable.



“The lack of perceived risk is most concerning,” says John Trefry, D&O product manager for Travelers’ Bond and Financial Products Trefry. “Clearly there is a knowledge gap and that is valuable information. We are trying to encourage our trading partners to educate their nonprofit clients.”

5. Cloud Liability

One hot market that continues to evolve is the cloud computing segment. Insurers are still grappling with exposures and how to insure cloud computing risks.

“The insurance industry has taken awhile to embrace the aspect of cloud computing. But as more companies move to clouds, the insurance industry has to recognize that data won’t be in an internal server but in the cloud,” says Fred Bartkiewicz, co-founder and partner of CyberRiskPartners, which develops and manages risk mitigation platforms for cloud companies through its subsidiary, CloudInsure. “Insurers have not fully embraced this technology and how it works.”

Businesses are reallocating IT operational costs away from hardware and software and human capital to a service platform — the cloud. However, many do not have contracts that require third parties to cover all the costs associated with a data breach. This is a concern as most cyber liability products either exclude data loss by a third-party provider or have an endorsement that provides minimal coverage. As more companies turn to cloud providers better coverage options are needed.

Cloud computing is gaining in popularity. Gartner, a business technology research and consulting firm, predicts that the bulk of new information technology (IT) spending by 2016 will be for cloud computing platforms and applications with nearly half of large enterprises having cloud deployments by the end of 2017. The worldwide cloud-based security services market totaled about $2.1 billion in 2013, and Gartner expects that to rise to $3.1 billion in 2015.

The cloud computing industry’s growth will continue to drive insurer interest in product development.

Liberty International Underwriters partnered with CloudInsure last summer to provide insurance backing for cloud providers and the businesses that utilize them.

CloudInsure also formed an agreement with Lockton at the beginning of 2013, which allows it to establish relationships with primary insurers to offer liability coverage.

And most recently, Oceanwide Inc. launched its Cloud Provider Assessment Model (CPAM) designed for the insurance industry to give IT and information security groups a method of comparing cloud technology providers. CPAM allows the IT professional to compare multiple cloud providers side-by-side in order to assess risk.

Check back Thursday 4/17 for the five remaining HOT Markets to Watch.