APPENDIX A

State of the Insurance Market 2018

The Private Sector Insurance Market

The prolonged soft market has a mixed effect on insurers of private sector risks, who have become more risk selective and more keenly focused on cost reduction. Despite difficult trading conditions, many carriers continued to generate attractive returns, although a number of major insurers were forced to take steps to reduce exposures and capacity in areas they considered ‘less attractive’. As the pressure has intensified, underwriters prioritised quality risks, with some sectors coming under greater scrutiny during the year.

The sustained soft market in that sector had also given rise to accelerated efficiency drives, with many large carriers restructuring operations, simplifying management layers, cutting staff and reducing their footprint. This trend for cost-cutting and retrenchment is of concern, as it could affect service quality, response times, and insurers’ ability to get things right at the first time of asking.

Liability Rates did attract some pressure in the early part of the year following the change in the Discount Rate, which saw Insurers reserves for major Third Party Injury claims increase in some cases by a multiple of three.

The current hurricane activity in the US is anticipated to lead to the US Property Market suffering very high losses with Houston alone already being viewed as the single largest claims event in US Insurance history – whilst it is too early to project the impact of these on the Insurance and Reinsurance market, they have the potential to have a significant if not material effect on the UK market with many US owned insurers such as Chubb, AIG, and Travelers, having significant UK operations.

The Public Sector Insurance Market

One of the reasons why these developments are of interest is because the market for private sector risks is often regarded as a barometer for public sector risks, with movements in the former being reflected at a subsequent date later in the latter. On this occasion, however, developments in the public sector insurance market make it more difficult to draw comparisons with developments on private sector risks.

For many years, the market for public sector insurance was dominated by three underwriting concerns: the insurers Zurich Municipal and Travelers, and RMP, whose underwriting capacity is currently provided by a combination of QBE, AIG, HSB and Ecclesiastical.

Capacity was, however, reduced when in 2014 Travelers took the decision to divest themselves of all public liability business for local authorities with a highways or social services responsibility. Although Travelers continued to pursue opportunities in selected areas, it was feared this loss of capacity would have a damaging effect on future premium levels for the sector as a whole. The subsequent emergence of a number of new carriers, notably Maven, Swiss Re and Protector, acted as a counterweight, more than compensating for the effects of the decision by Travelers.

Ocaso and Aspen continued to maintain their interest in local authority leasehold portfolios, with the latter also pursuing commercial leasehold risks. Protector has also started to look at the leasehold market, whilst Lloyds and other underwriters within the London market, continue to express interest in what they regard as the ‘right’ motor’ risk.

As we moved from 2016 to 2017, Protector adopted an increasingly aggressive underwriting stance and they began to make significant inroads into the public sector market, not only in respect of property but also casualty risks.

Premiums
Many public sector organisations who initiated a tender in the first six months of 2017 were to benefit to from this resurgence of competition. In June, however, a tragic and devastating fire tore through a multi-storey tower block in West London and, despite the early statements from Protector, the incident undoubtedly has the potential to impact on their terms. This is likely to have a knock-on effect as the rest of the market realises that it does not have to be as aggressive in order to compete with Protector.

Generally speaking, rates in the motor markets remain competitive for public sector risks, with liability rates having stabilised by the start of 2017. However, following the changes to the Discount Rate earlier in the year, insurers began to apply rating increases to both motor and liability premiums.

Perhaps an even more significant issue is that as a consequence of the fire at Grenfell Towers, many authorities have reviewed the level of liability cover they have in place and whereas previously, a limit of £50,000,000 for employers' and public liability insurance was often perceived an being adequate, many authorities are now looking at limits of £100,000,000 and above.

Issues Impacting on the Sector

Discount Rates
With effect from 20 March 2017, the discount rate was amended from 2.5% to -0.75% and this has had an almost inevitable effect on rating for Employers' Liability, Public Liability and Motor Risks as it means that personal injury awards will increase as a result.

The issue relates to a person who is severely injured, whether at work, by a third party or in a motor accident. This discount rate is used to calculate the amount of compensation the injured party receives to reflect the return that they will earn when that money is invested.

The reduction in rate means that those suffering from serious injuries will received significantly higher compensation payments than previously seen. Initial calculations suggested that where the claimant has a life expectancy of between 15-30 years, a reduction to minus 0.75% could increase future loss awards by approximately 30%. A life expectancy of between 30-50 years or more will potentially increase the overall future loss award by approximately 50%. As a consequence, insurers signalled their intention to increase rates almost as soon as the announcement was made.

As might be expected, the reduction to minus 0.75% provoked an outcry from insurers. The government subsequently agreed that the reduction was a step too far and suggested that a rate of between 0 and 1 per cent would be more appropriate. A review is now underway but once the final figure is determined, any change will require parliamentary approval. This is unlikely to prove possible in the immediate short-term and, in any event, even if parliamentary approval is secured, it will be a further six months before any change takes effect.

Insurance Premium Tax
Since its introduction in 1997, the rate of Insurance premium tax has changed on no less than 5 occasions and is now three times its original level;

1 April 1997 to 30 June 1999	4%
1 July 1999 to 3 January 2011	5%
4 January 2011 to 31 October 2015	6%
1 November 2015 to 30 September 2016	9.5%
1 October 2016 to 31 May 2017	10%
From 1 June 2017	12%

Many commentators have suggested that eventually, there is likely to be parity between the rates of IPT and VAT, which currently stands at 20%. However, even if IPT remains at its current level of 12% then the increases that have been applied since its introduction in 1997 endorse both the wisdom and desirability of the self-funding approach adopted by many public sector organisations.

Cyber Risks

The insurance industry is often criticised for being slow to provide insurance products for modern day business risks. One area where the market has responded is cyber risks, yet this remains a line of business that few public sector organisations arrange - despite the increasing number of highly publicised security breaches, denial of service attacks, and incidents involving ransomware. Although the number of enquiries in this area have increased, the feeling is that public sector organisations are unlikely to buy the cover until there are some significant uninsured losses amongst their peers.

The Insurance Act

The Insurance Act came into effect from August 2016 and has had a significant impact on business insurance in the following areas:

- Substituting of the duty of fair presentation of the risk by an insured to an insurer in place of the duty of utmost good-faith;
- Defining what constitutes " knowledge" for the purposes of disclosure by an insured to an insurer;
- Breach of the duty of fair presentation will give an insurer a remedy if but for the breach the insurer would not have entered into the insurance, or would have done so on different terms (together a " qualifying breach");
- Providing a range of proportionate remedies for a qualifying breach (avoidance will only be available for deliberate or reckless breach or if, but for the breach, the insurer would not have entered into the insurance contract on any terms);
- Diluting the effect of warranties so that breach of warranty will no longer permanently discharge the insurer' s liability if the breach of warranty is remedied prior to the relevant loss;
- Clarifying the effect of fraudulent claims;
- Abolishing " basis clauses" which turn the insured's pre-contractual statements into warranties; and
- Affording the right to insurers, subject to certain requirements, to contract out of the Act.