Market Capacity
This report was prepared by the Emerging Issues & Innovation (EII) Committee of the Wholesale & Specialty Insurance Association (WSIA). This paper does not reflect the opinion of WSIA; rather, its intended use is as a “food for thought” paper, gathering open-source information and the combined insurance industry experience of committee members to serve as a starting point for insurance professionals considering issues, technologies and world events that may have an impact on the surplus lines industry. Members of the Committee are not technical experts in these issues nor does this paper provide their opinions or advice on the underlying topic, though the hope of the Committee is by gathering this information as a beginning point on new and emerging trends or issues, they can encourage readers to think independently and seek additional sources regarding the issues and topics discussed herein. All substantive information provided within this paper is the work of the cited source and WSIA and the Committee do not claim any interest or title in the work. Questions regarding cited sources should be made directly to the author or source of the cited material. Contact the WSIA offices at info@wsia.org or 816.741.3910 or visit www.wsia.org to learn more about the Committee and WSIA.

For additional research papers, please visit www.wsia.org/emerging.

Refreshed: November 2020
Executive Summary:

Market Capacity refers to the amount of insurance or reinsurance that is available; the financial strength and condition of the industry drive the maximum amount of risk an individual insurer can bear. Ultimately, the capacity or capital available has an important impact on many aspects of insurance business including products, terms and pricing.

The total Property & Casualty market (P&C) capacity available has great effect on the hard and soft market cycles that characterize the U.S. P&C market. This cycle includes periods of soft market conditions, in which premium rates are stable or falling and insurance capacity is readily available, and by periods of hard market conditions, where rates rise, coverage may be more difficult to find, capacity shrinks and insurers’ profits increase.¹

At the beginning of a soft market, premium rates drop as insurance companies compete vigorously to increase market share. As the market softens to the point that profits diminish or vanish completely, the capital needed to underwrite new business is depleted. In the up phase of the cycle (hardening market), competition is less intense, underwriting standards become more stringent, the supply of insurance is limited due to the depletion of capital, with premiums rising as a result. The prospect of higher profits draws more capital into the marketplace, leading to more competition and the inevitable down phase of the cycle (softening market).²

From 2007 to 2018, the U.S. P&C market experienced a soft market, characterized by abundant capacity, decreasing insurance rates and heavy competition among insurance carriers. There were signs in 2017 and 2018 that the soft market was starting to shift. Per a 2019 NAIC report: Although soft market conditions have existed in the U.S. property and casualty insurance industry since 2007, the market is

beginning to show signs of firming in most lines.\(^4\)

As we near the end of 2020, there are clear signs we are in the midst of a hardening market. Per a recent report from The Council of Insurance Agents & Brokers, evidence the market continued to harden was apparent in Q3 2020, with premiums increasing by an average of 11.7\% across all-sized accounts, marking the 12th consecutive quarter of increased premium pricing across all-sized accounts\(^5\). In addition, reinsurance capacity is shrinking. First-quarter 2020 global reinsurance capital decreased about 6\% from the prior year period to $590 billion, and there was a “modest but progressive” tightening of capacity at midyear renewals, according to a report from Aon. The ‘modest but progressive’ tightening of reinsurance capacity that we forecasted at the beginning of the year [2020] has been accelerated.\(^6\)

This hardening market has been evident in the E&S industry premium growth. Excess and surplus lines (E&S) premium recorded by the 15 U.S. surplus lines stamping and service offices reached $37 billion in 2019, a 19\% increase over 2018.\(^7\) Throughout 2019 and 2020, we saw many domestic E&S carriers and Lloyd’s take actions that are typical for a hardening market. These actions included increasing rates, reducing the amount of CAT aggregate deployed in the marketplace and a reduction in the number of binding authority contracts or binding authority agents. We are also seeing significant rate increases across many lines of business, along with corresponding reductions in capacity in terms of line size or limits.

This hardening market may have many implications for insurance carriers and distribution partners. It will also create opportunities for many industry players who are positioned to take advantage of the hardening market.

**Implications:**

**Soft Market (excess capacity) Implications**
- High availability of capacity and markets
- Intense competition for business amongst carriers; often seeking new distribution partners, products, and programs to support
- Marked by decreasing rates, broadening of policy coverages and expansion of underwriting appetites
- High churning of existing underwriting programs and products across carriers and proliferation of new programs and products
- Admitted carriers’ expanding appetites, often writing risks previously in the E&S market
- Carriers expanding into new products or new classes of business in search of new premium growth
- Gradual decrease in underwriting profitability over time
- Power shifts from carriers to distribution, typically resulting in higher commission rates, new incentive programs and more advantageous profit-sharing arrangements
- Carriers looking for new ways to be attract business, including improving service levels, increasing ease-of-use through technology enhancements, or increasing commissions
- Increased delegation authority (e.g., classes of business, limits, pricing authority) to MGAs,


coverholders, and program administrators
• New, “naïve” capital entering marketplace
• Carriers expanding their distribution partners
• Insureds and retail agents focused on price as decision-driver
• Increased industry consolidation as carriers and distribution seek to drive growth through acquisition in times of (soft market) low organic premium growth

**Hard Market (tight capacity) Implications**
• Decreasing availability of capacity and markets as carriers pullback capacity, discontinue writing certain products and pull out of specific lines of business
• Significant reduction in the amount of markets willing to write a particular class of business or individual risk
• Decreasing limits and “line sizes” being offered by any one carrier, often requiring more carriers to complete limit or coverage requirements for an insured
• Marked by increasing rates, tightening of policy coverages and contraction of underwriting appetite
• Carriers reducing the number of distribution partners
• Difficulty in finding new carrier or capacity to support an existing or new program
• Shift in carrier focus to underwriting profitability and return on capital
• Power shifts from distribution to carriers, typically resulting in decreasing commission rates and more focus on underwriting profitability
• Large increase in submission volume to carriers, with corresponding decrease in the number of quotes offered due to carriers’ shrinking appetites and more selective underwriting criteria
• Insureds and retail agents focused less on price, and more on availability of limits and coverage
• Initial outflow of capital and carriers, causing rates to rise and terms to tighten to the point where capital may again be interested in coming back into the market
• Attraction of new capital into market, including alternative capital such as CAT bonds, Hedge Funds, Private Equity and ILS funds
• Increased merger and acquisition activity as carriers and distribution look to acquire capabilities and talent that can assist them in capturing more of the hard market business
• Increased reinsurance costs

**COVID-19 Specific Implications**
• The economic implications are difficult to predict, but are likely to be significant to the global insurers who are now being threatened from two directions – a potential increase in claims related to COVID-19 and potential for significant investment losses
• An increase in event cancellations across the globe could result in outsized losses affecting carrier results and balance sheets which could remove capacity
• Uncertainty of legal rulings across the globe in relation to requirements to pay COVID-19 related business interruption claims leading to further reductions in market capacity
• Increased reinsurance costs for insurers, as reinsurers build uncertainty around past COVID-19 claims and potential future COVID-19 claims into their pricing which will be passed onto clients
• Advent of pandemic/COVID-19 claims-related exclusions in reinsurance contracts
• Carriers who were exposed to COVID-19-related losses, may be financially impacted or impaired
• Policy wordings related to business interruption may be clarified and strengthened as a result of COVID-19 loss adjustments and litigation
• The uncertainty created by COVID-19-related exposures may hasten the hardening of the global P&C market, even in lines of businesses not impacted by COVID-19

Opportunities

• As certain classes of business or individual risks become difficult to insure in a hard market, it may lead to new ways of assessing risk (e.g., new data models)
• Carriers with a confident view on selecting and writing profitable risks can significantly expand their premium writings during a hard market
• Carriers may have the opportunity to re-enter products or classes of business they ceased writing in the past, as a hardening market may produce rate levels and policy terms now deemed acceptable to the carrier
• Small, new or niche carriers or MGAs may find it easier to gain market share in a difficult-to-write product during a hard market
• Increased demand for insurance talent in a hard market as carriers and wholesalers react to the increased submission flow

COVID-19 Specific Opportunities

• New insurance products and coverages may emerge to help provide insurance related to global pandemics and/or government-mandated business closures
• As certain classes of business or individual risks become difficult (or impossible) to insure in a hard market (e.g., pandemic-related shutdown, wildfire exposure), this may lead to the innovation of new insurance products (e.g., parametric insurance) to cover these risks
• Global insurers impacted by COVID-19 claims and litigation may retrench from the market, offering opportunities for niche insurance players who had no exposure to COVID-19-related claims
• Creation of a government-industry solution for pandemic related events
• New capital may enter the industry which will be unencumbered from COVID-related losses and reserves

Threats:

• In a prolonged hard market, insureds may seek alternative methods of risk transfer, other than insurance, due to the significant increase in insurance premiums or inability to secure proper coverage
• As insurance market capacity gets tighter, alternative or non-traditional insurance capital may come into the insurance market, permanently displacing traditional insurance players
• As non-traditional capital seeks alternative investment returns, it may flow into the insurance industry, leading to a prolonged period of over-supply of capital
• A significant economic downturn may impede the ability for insured to pay higher rates in a hardening market, therefore slowing the market hardening

• As capacity becomes tighter and carriers pull back, MGAs, coverholders and program administrators may lose markets and capacity, putting them at a competitive disadvantage or in financial strain

• A prolonged soft market could cause less financially stable carriers to exit the industry (e.g., insolvency or sale)

**COVID-19 Specific Threats**

• The potential ultimate loss in the insurance industry as a result of COVID-19 is still unclear. Willis Towers Watson estimates between $11bn and $140bn

• COVID-19 has the potential of being the largest claim event in the insurance industry history

• As insurers address COVID-19-related claims from multiple lines of business (Workers Compensation, General Liability, Business Interruption, P&C, Directors & Officers, etc.), aggregation issues may arise causing companies to scale back on their overall capacity in the marketplace, or face significant financial strain or insolvency

• Potential for legal outcomes that would have a negative impact on the insurance industry related to whether COVID-19-related claims are covered under standard insurance policies

• Potential for increased insurance regulation as a result of COVID-19 claims and litigation

• A significant change in the regulatory or legal environment surrounding business interruption and what would be a ‘covered’ claim could impact the availability of business interruption coverage
Sources Cited:


