Transportation

Market Update

First Quarter 2021

Market Overview

Insurance companies have continued working to address profitability issues caused by insufficient pricing and increasing losses. Any hope for stabilization in these areas in 2020 was derailed by COVID-19. The economic downturn and insurance losses will most certainly mean another year of rate increases in 2021. Besides the pandemic, developing losses associated with nuclear verdicts, social unrest, natural catastrophes and business interruption will remain in the spotlight throughout the year.

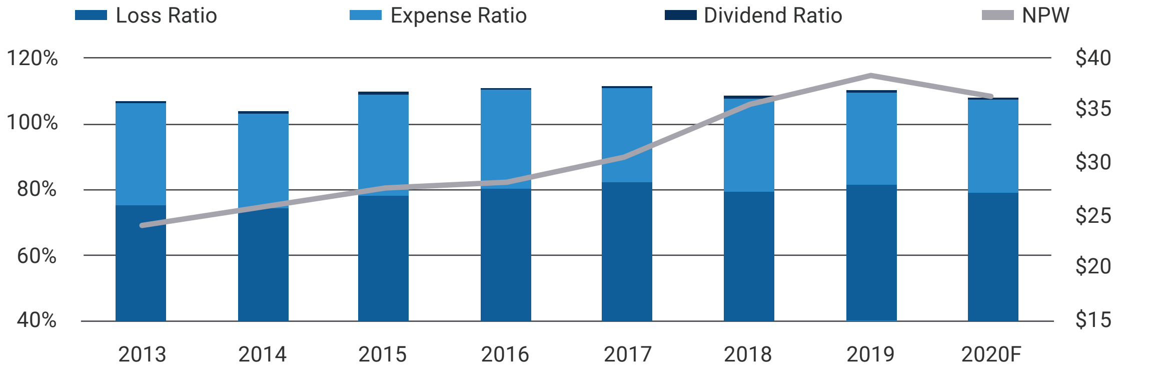
State of the Commercial Transportation Insurance Market

Even as we continue to make progress against the pandemic with vaccines, the long-term outlook for the commercial transportation market remains difficult to predict. Consumer spending will begin to shift away from products toward services, leading to a moderate growth forecast in 2021 from economic analysts. The central bank estimates U.S. economic output will grow 4.2% in 2021 and the unemployment rate will drop to 5% by year's end, down from 6.7% in December 2020. The Fed sees the jobless rate falling further to 4.2% by the end of 2022.

Recessionary conditions have significantly reduced transportation for nonessential goods and activities, leading to a reduction in claims frequency. But insurer profitability and loss ratios remain unfavorable due to large loss activity. While exposure levels vary by segment, last-mile delivery and for-hire long haul delivery are two that remain strong. As expected, public transportation, livery and rental car exposures have contracted significantly.

The industry sector has not generated a combined ratio under 100% since 2010. And despite double-digit year-over-year increases in earned premiums, losses continue to outpace premiums collected.

Recent Results: Commercial Automobile



Source: ©2020 Conning, Inc., as published in Conning's Property-Casualty Forecast & Analysis by Line of Insurance, third-quarter 2020 edition. Historical data source: ©2020 S&P Global Market Intelligence.

Primary Auto Liability

Commercial Automobile Liability rates have continued to increase at the high single-digit to low double-digit levels we've seen in recent years for favorable accounts. However, those with adverse loss experience or a lack of vehicle technology are seeing significantly higher renewals. MarketScout's third-quarter commercial rate survey reported commercial auto rates up an average of 8.5%. This remains the second highest rate increase of any commercial line in the survey (Directors & Officers was the highest).

U.S. motor vehicle accidents involving large trucks have increased nearly 30% since hitting an industry low in 2009.[1] Reserve inadequacy over this timeframe has led to claims settling at two to three times the reserve amount.

We've seen rising insurance costs across the industry, with smaller fleets feeling the most pain. These motor carriers have had trouble keeping pace with expenditures for technology and enhanced safety and loss control resources. Many insureds are increasing deductibles or reducing limits to help manage insurance premium spend.

We anticipate rate increases of 8% to 15% on average throughout 2021. Insureds with challenging loss experience will likely see significantly higher rate increases, while those with favorable loss experience will be closer to the average range.

Excess Liability

Excess Liability costs have continued to rise at a steeper pace than primary commercial auto liability. We attribute the pricing pressure to a continued reduction in capacity and appetite in the marketplace, continued large loss activity, and a challenging legal climate. Judicial areas of concern continue to include Louisiana, Florida, New Jersey, New York, Texas, Georgia and California.

We believe that 2021 will be a dynamic year in the excess liability space. Carriers in London and Bermuda plan to deploy capacity above $20 million, but we still don't know whether they will be competitive against U.S. counterparts. This leaves a small number of insurance carriers willing to look at buffer layers below $10 million. Chubb in fact remains the only domestic provider of $10 million in capacity at the $10 million attachment point. We recommend an increased focus on customized solutions, with insureds taking on more risk in various layers with a quota share or corridor deductibles.

Due to remaining capacity issues, excess liability rates will continue to see upward rate pressure. Auto buffer layer (the first excess placement attaching above primary) rate increases remain in the 20% to 30%+ range for accounts with favorable loss experience. Lead umbrella leads the way here with rate increases of 30%+. Higher excess layers continue to see rate increases that are multiples of the expiring with higher rate relativity by layer. Rate relativity, when viewed as a percentage of the underlying layer's premium per $1 million of coverage, is often reaching levels of 75% to 80%.

Nuclear Verdicts

The largest truck accident verdict in history was handed down in October 2020. Top Auto Express was found liable for an accident in Florida involving 18 vehicles and eight hospitalizations. The jury, via Zoom, awarded $411 million. In the wake of this verdict, we expect plaintiff attorneys to seek even higher awards, even though the likelihood that a case will end up in court may not be as high now due to the pandemic. Jurors are more hesitant to be in confined spaces over an extended period of time and plaintiffs in some cases have not received the same level of medical attention that can lead to higher claim values. We expect trial activity will resume as vaccines are widely distributed and the logjam of cases opens up. Also, vehicle miles traveled during the pandemic have declined, but the fatality rate has increased due to unsafe behaviors such as speeding, driving under the influence of drugs and alcohol, and driving without seatbelts. The fatality rate, at its highest since 2005, increased by 30% for the three-month period ending June 30, 2020.[2]

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Reptile Theory

Since 2009, plaintiff attorneys have used the "Reptile Theory" strategy to maximize jury verdicts, yielding settlement amounts of $5 billion and higher. In motor vehicle-related cases, plaintiff attorneys cite general safety rules (rules designed to protect the general motoring public) and then assert that the defendant's intentional violation of those rules led to the plaintiff's injury or damages. Focused questioning and arguments put emphasis on safety rules that are a higher or different standard than the standard of care established by common law. It's important for defense attorneys to identify the potential use of Reptile Theory early in the litigation process and present a counter argument that focuses on the specific facts and evidence presented in the case – and, if appropriate, the defendant's corporate mission statement, community involvement and track record of favorable operating performance.

Litigation Financing

Litigation Funding by private equity groups is an ongoing issue that gives plaintiffs an edge over motor carriers as it relates to legal expenses. The arrangement involves a third party, unrelated to the lawsuit, who provides capital to a plaintiff involved in litigation in return for a portion of any final settlement. It is presented as a way to "level the playing field," i.e., provide financial resources to undercapitalized clients, attorneys and legal firms. Opponents cite several ethical conflicts in litigation funding, including frivolous lawsuits, higher litigation costs, and undue influence for the third party over strategy and settlement discussions. Litigation funding is a multi-billion dollar industry that is reshaping the legal landscape. While no supporting information is publicly available, we believe it generates $5 billion of litigation funding in the U.S. alone.

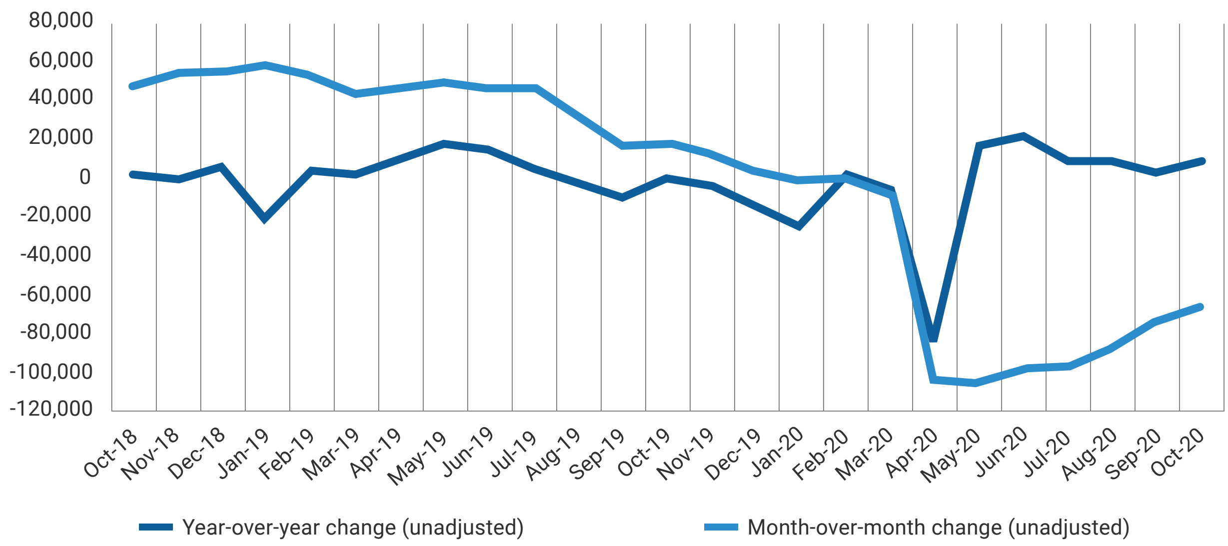
Driver Shortage

The ongoing driver shortage was the No. 1 concern in 2020, according to the ATA survey of Oct. 27, 2020. Driver turnover increased significantly throughout 2020, due to poor working conditions and lower compensation, drivers say. However, the driver shortage is also due to career changes, retirements, COVID-19, and ineligibility due to the new FMCSA Drug & Alcohol Clearinghouse.

Concerns over COVID-19 will ease and driver school enrollment will improve as vaccine distribution continues. However, with CDL issuances down by more than 100,000 in the first half of 2020 and only 10% of the 46,000 drivers with drug and alcohol violations returning to duty, the headwinds remain real and not easily addressed. There have also been bills introduced such as the DRIVE Safe Act to lower the minimum driver age for interstate travel from 21 to 18. This is appealing to motor carriers as it would allow them to pursue drivers who are not college bound before they commit to an alternative occupation or trade. The DRIVE Safe Act has been met with opposition from safety professionals citing concern related to younger drivers operating among the general motoring public.

US truck driver shortfall remains despite sequential growth

Monthly gains/losses in US trucking employment, year over year vs. month over month



Source: US Bureau of Labor Statistics

Driven by each motor carrier's operational type and geographic scope, we are confident there are many ways to address the driver shortage issue. Below are recommended areas of driver support that can be addressed by most segments:

- More Communication: Technology enhancements, including task management systems, template discussion plans and mobile apps that facilitate communications between management and drivers.
- Information Sharing: Promote transparency by allowing managers and drivers to be on the same page with respect to performance progress and clear goals.
- Educational Opportunities: Help drivers increase their skills and professional development through risk identification, learning management and training development systems.

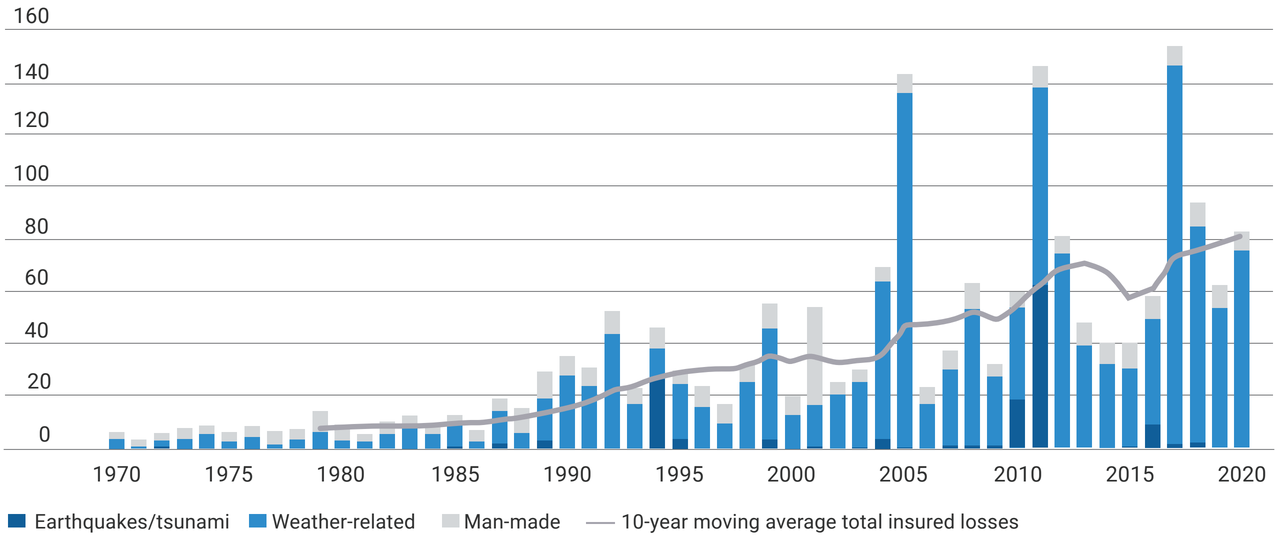
Workers' Compensation

Worker's Compensation has remained the most consistently profitable coverage segment over the last five years, with a 91% average combined loss ratio from 2015 through 2019.[3] Despite economic challenges from the pandemic, the Workers' Compensation insurance market is likely to report strong profitability in 2020 due to fewer claims. Underwriting performance in 2021 and beyond will likely deteriorate as claims activity normalizes with increased business activity. Uncertainty surrounds long-term health implications for more severe COVID-19 cases, including the potential for major organ damage and other chronic conditions that would ultimately increase Workers' Compensation costs. Future premium volume also will hinge on the pace of the economic recovery, since improvements in employment and wages will be uneven across sectors. Greater use of telemedicine, more work-from-home arrangements and reduced employee travel will affect claim trends but, due to prior profitability, Workers' Compensation is the only major commercial lines segment not experiencing significant rate increases. Throughout 2021, we expect to see renewals rates in the range of flat to +5%.

Property

The continued theme for 2021 is to attain underwriting profitability. Insurance industry losses from natural catastrophes and man-made disasters around the world were $83 billion in 2020, according to Swiss Re Institute's preliminary sigma estimates. Since many clients are in a position where insurance price increases are hard to accept, they may look to retain more risk through higher deductibles. To lower premium increases, insureds also may want to take a closer look at – and potentially remove –unnecessary coverage extensions added during the soft market.

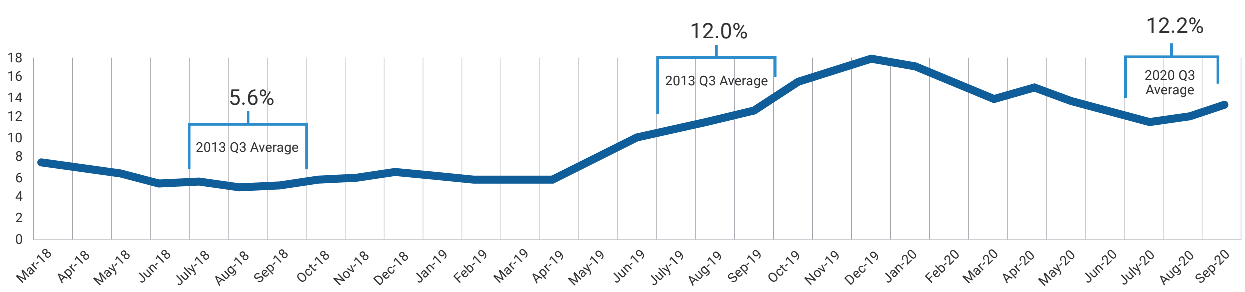
Insured losses, 1970-2020, in USD billion at 2020 prices:



Source: Swiss Re Institute

Rate increases between 10% - 20% are expected for accounts with favorable loss history, best-in-class risk management, and established carrier relationships. Insureds who are viewed as high-risk or have a poor loss history could experience a rate increase in excess of 25%, combined with increased deductibles and tighter policy terms and conditions.

Renewal Pricing Trends – Property Renewals, Rolling Quarterly



McGriff continues to invest in our suite of digital, data and analytics capabilities, and will use the data-driven market intelligence delivered by MAP®, our McGriff Analytics Platform, to assist you in securing favorable pricing and coverage terms.

Contact a member of your local McGriff team for current information and guidance on navigating this changing marketplace, specifically:

- Begin renewal conversations early to avoid the unexpected
- Document and communicate your risk control processes and communications
- Engage your McGriff team to prepare data and analytics that differentiate your company from peer organizations

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[1,2] Conning Insurance Segment Report – 2020 Fall Edition

[3] https://www.insurancejournal.com/news/national/2020/10/27/588273.htm