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Insurance Practice

Repositioning commercial P&C underwriting for market uncertainties

Underwriters can use granular trend-impact diagnostics on portfolios, recalibrated risk selection, and greater underwriting agility to adapt to the evolving and uncertain insurance market.

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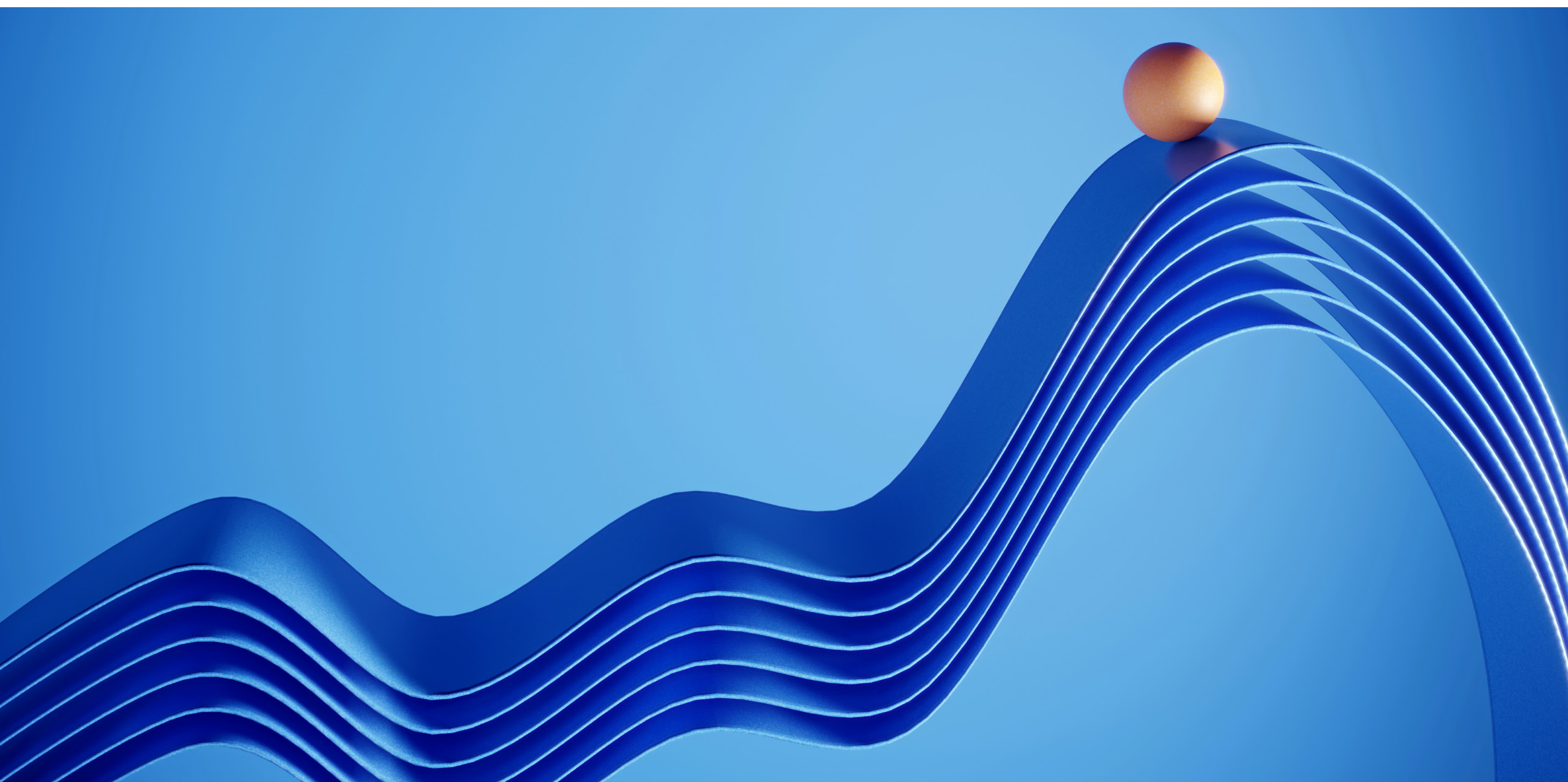

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Commercial property and casualty (P&C) insurance has been riding on the back of a hard market since 2019. However, premium increases have slowed. Global commercial insurance prices rose by only 9 percent in the second quarter of 2022, which was the sixth consecutive quarter of slowing premium increases for most P&C lines.[1] At the same time, insurance carriers have benefited from improving loss ratios, and capacity is starting to stabilize thanks to new market entrants.

Nevertheless, macroeconomic factors (such as inflation and emerging risks) and industry trends (such as new technologies and skills gaps) are creating uncertainty and opportunities.

P&C underwriters could proactively assess trends and current conditions with an eye on the future to identify market opportunities and drive profitable growth. In particular, they could rework how they use trends to make portfolio decisions, use insights to dynamically recalibrate risk-selection strategies, and execute quickly and with agility. The stakes could be high: several points of loss ratio, depending on the starting point.

Colliding macroeconomic and industry trends

P&C carriers face a combination of complex and fast-evolving macroeconomic and industry trends, which interact with each other and the industry's entrenched ways of working.

Macro developments

Insurance carriers have been striving to address the effects of climate change–related high-catastrophe losses, the impact from emerging risks, and the effects of economic inflation in tandem with social inflation (cost increases that cannot be explained entirely by inflation).

Inflation. The insurance industry faced profitability challenges even before the COVID-19 pandemic.[2] The recent unexpected spike in inflation has added to the pressure.[3]

In the United States, our estimates show that rising prices contributed to an approximately $30 billion increase in loss costs—the amount an insurer must pay to cover claims—in 2021, far more than historical loss trends.[4] Along with years of social inflation from costly litigation payouts, insurers are facing higher claims costs and pressure on expense ratios.

Depending on the situations of global markets and responses from governments, businesses, and consumers, insurers may face opportunities or threats that require them to monitor important macro measures and build operational and financial resilience.

Emerging risks. The P&C insurance industry continues to face new risks that require insurers to adapt and evolve risk assessment models, policy language, services, and capabilities. For example, the COVID-19 pandemic had a pronounced effect on the industry, with reported losses estimated between $47 billion and $48 billion, comparable to the third biggest natural-catastrophe loss ever.[5] Risks stemming from factors including cybersecurity, terrorism, and the energy transition continue to evolve.

Climate change. Extreme weather is now top of mind because of the increase in natural catastrophes and the rise in insured losses from events such as wildfires and storms. As the net-zero transition unfolds, new forms of volatility are emerging. The transition is poised to spark the greatest capital reallocation in a century, requiring an estimated annual investment of more than $9.2 trillion in energy and land-use systems.[6]

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[1] "Global Insurance Market Index," Marsh, October 26, 2022.
[2] *Creating value, finding focus: Global Insurance Report 2022*, McKinsey, February 2022.
[3] Consumer Price Index Summary, US Bureau of Labor Statistics, October 13, 2022.
[4] Kia Javanmardian, Sebastian Kohls, Gavin McPhail, and Fritz Nauck, "Countering inflation: How US P&C insurers can build resilience," McKinsey, August 25, 2022.
[5] *Reinsurance: A tipping point*, Howden Broking Group, September 2022.
[6] "Capturing the climate opportunity in insurance," McKinsey, September 14, 2022.

Insurers have a once-in-a-generation opportunity to address these new forms of volatility through product and solution innovation.

Insurers have a once-in-a-generation opportunity to address these new forms of volatility—and help catalyze an orderly transition to net-zero emissions—through product and solution innovation. Both insurance carriers and clients are racing to become front-runners in environmental, social, and governance (ESG) standards. Many insurers also have made public voluntary net-zero commitments. Although few companies are on track, momentum is rising.

Industry developments

On the industry level, technological advances, an evolving distribution landscape, and an underwriting skills gap are all major issues that insurers must address.

Technology. Sophisticated software and hardware have become significantly more cost-effective in recent years despite inflation. It is now table stakes for insurers to adopt technologies such as low-cost processing and Internet of Things (IoT) sensors, as well as to use aerial imagery and computer vision for risk assessments. This is particularly the case with short-tail and physical lines such as property, auto, workers' compensation, and cargo.

Insurance carriers are already pursuing "smart follow" algorithmic underwriting with automated decision making for high-volume risks. In addition, many insurers are experimenting with novel approaches to advanced analytics (AA) and AI. Innovations in digital-direct commercial insurance are occurring in the small and medium-size enterprises (SMEs) segment, though market leaders have yet to emerge.

These technologies are set to bring insurers large volumes of data, including external data. However, insurers do not always use external data—including proxies for leading indicators of risk—to their full extent. Instead, insurers tend to prioritize internal, insurance-specific sources of data; not even pricing is always based on the most granular data available on paid and incurred losses.

Distribution. Consolidation among brokerages has made it increasingly important for insurers to maintain strong broker relationships. With consolidation, brokers are looking to coordinate segments of their book to place with a select panel of insurers, which requires insurers to be able to analyze large volumes of data at pace.

As managing general agents (MGAs) have gained prominence, more than 40 percent of US P&C carriers have established MGA relationships in various capacities. MGAs can provide faster access to new markets without the expense of building and maintaining deep underwriting expertise and establishing agent networks. For example, growing demand for cyber insurance has led cyber-focused MGAs to target SMEs. While some MGAs still adhere to their original business

model of leveraging third-party insurance-carrier balance sheets, some have evolved to become end-to-end insurance carriers.[7]

Skills gap. With the future of work evolving through automation, digital, AA, and AI processes, core underwriting faces a growing gap in talent and skills. With private-equity-backed firms, insurtechs, MGAs (who have underwriting authority), and other nontraditional insurance companies intensifying the race for talent (particularly in specialty and large commercial lines), the need for underwriters with greater technological expertise will only increase.

Versatile team members must be able to take advantage of data-driven tools to scale across larger, more complex books with continuously evolving risks and insights. These should be based on a forward-looking steering of the portfolio through interconnected engineering and underwriting processes. However, insurers typically prioritize historical trends and past performances over future potential outcomes in assessing risk on their books.

In our experience, even the right technology and distribution would be no substitute for having a forward-looking stance. The industry often has long lead times between rate indication (a determination of the value of premiums an insurance carrier needs to collect), filing, and earning, with up to three years passing between predicting a risk or loss and adjusting the premium in response.

Premiums also tend to lag behind losses before catching up. As a result, average-performing insurers often don't see where the market is going until it is too late, so they may react with a suboptimal view of how to revise their approach as markets evolve. Insurance carriers that can stay at pace or ahead of market cycles, on the other hand, tend to emerge as winners.

Updated risk portfolios and underwriting strategies

Insurers could react to uncertainty by changing their approach to using trends to make portfolio decisions, dynamically recalibrating risk-selection strategies, and executing quickly and with agility. The key is to be forward-looking and predictive.

Overhaul approaches to diagnosing how trends could affect portfolio decisions

While the actuarial process of building a pricing indication remains at the core, there is an opportunity to transform portfolio-level diagnostics with more frequent and automated impact assessments from market trends and to take a more granular view beyond loss history, including the full range of data across the organization and from external sources. These assessments should continuously guide how the changing market and risk landscape affects the different lines within a portfolio and enable recalibration decisions, as opposed to making reactive decisions when a big dislocation such as inflation affects the market.

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[7] "2021: Managing general agents - Rising to the challenge," Conning, October 26, 2021.

More granular and precise. To make reliable impact assessments, precise models for anticipating supply-and-demand dynamics across time horizons must vary by line of business and combine multiple data sources. Actuarial indications also must be supplemented with a deep understanding of macroeconomic changes, leveraging the full spectrum of internal and external data. This includes data from across the organization, including claims, reinsurance, underwriting, and capital modeling, as well as third-party data.

More automated and continuous. This requires a real-time feedback loop on data with a built-in view on the effect of trends on the portfolio and overall exposure of the portfolio. It includes the quantification of the result of changes by segments, industries, lines of business, and markets for specific trends, as well as an assessment of the expected changes to frequency and severity of loss events. The ability to disaggregate baseline changes and multipliers, such as those caused by social inflation, is also essential.

More insightful. The effect on the portfolio should be viewed in conjunction with market supply and sentiment, such as recent premium changes and capacity development. In addition, the trend-impact diagnostic should be informed by external intelligence, such as competitive pricing (when available from brokers, aggregators, or other third-party-data providers) or changes in rate filings. Knowing that losses in a particular line are going to be adversely affected by market trends is not sufficient. But if we estimate which types of risks or segments in the line will be affected and to what extent, and where we will likely see shifts in premiums and capacity in the market, underwriters can reevaluate their strategies more effectively.

Dynamically recalibrate strategies for risk selection based on insights

Data-driven insights from real-time portfolio diagnostics should be used across the organization to recalibrate strategy. such as reinsurance planning, as well as by underwriters to optimize their risk portfolios and adjust their individual underwriting strategies.

The organization should have the ability to identify warning patterns and any potential to overlay future dislocations to keep pace and avoid shocks. An extended inflationary environment, monetary-policy responses, net-zero transition goals, trade shocks, litigation trends, or autonomous technologies could trigger pertinent dislocations not only to insurance carrier prices but also capacity availability and reinsurance terms.

Deriving faster impact from changes to premiums calls for further incorporating the assessment and expanded view of emerging loss trends and market direction into underwriting, pricing strategies, and across risk classes at both the portfolio and account levels.

At the portfolio level, this means continuously calibrating the portfolio risk appetite. This must be a well-oiled process in which the portfolio-level performance dashboards flag in real time any forward-looking indications from the trend assessments and create triggers for underwriters to make data-driven judgments on how to realign product offerings, adjust pricing strategy, manage the book, and effectively manage distribution channels based on dynamic, forward-looking market views.

This needs to be continuously looped back to individual workflows that enable account-level decisions. This can help inform decisions regarding the prioritization of prospects, the validation of exposures, capacity adjustments, renewals, policy limits, and retention structuring. Redefining policy wording based on emergent risks and adjustments of rates and technical prices also will be essential.

Build execution agility to take swift action

Insurance carriers should institute three critical enablers to help underwriting teams anticipate and seize opportunities in the current market. Because

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completing this step will take some time, now is the ideal time to start.

Build the muscle for machine learning for use across data and modeling. Use a broad set of internal and external data, in addition to actuarial analysis, to quickly construct unconstrained loss and market models, stimulate granularity in decision making, and ensure transparency in monitoring the effect of rate actions. Partnerships with third-party data and analytics providers and value-added services (such as forward-looking risk modeling for physical assets and new types of risks) can strengthen and differentiate offerings.

Enable underwriters to work with dynamic digital workflows. Automating how information and insights are extracted; filtered for what is most critical and relevant; routed; and ultimately presented to underwriters can help trim the lead time between when something changes in the market and the resulting underwriter action. Leveraging new ways of working enabled by digitization can put underwriters in a stronger position to quickly deploy the best market-predictive analytical capabilities and develop new risk-transfer solutions and services to address emerging risks. The ability for insurance carriers to provide insights to brokers and customers will remain key as market fragmentation increases.

Elevate skills and embrace technology in underwriting teams. Including frontline roles in the process helps cultivate the attributes required to systematically build greater technological capabilities and develop the ability to make judicious decisions backed by data and analytics, connecting information across diverse sources. This would enable transparent decision making, further support talent pipeline development, and reduce reliance on individual underwriter judgment.

As macroeconomic and industry developments signal a shift in the direction of the hard market, commercial P&C insurance carriers that lean into continuously recalibrating their underwriting strategies can reposition themselves to be ahead of the curve. This could be worth several points of loss-ratio improvement, depending on an insurer's starting point, and help distinguish it from the average player in the industry.

While the exact nature of macro and industry shifts remains uncertain, insurance carriers that proactively empower their underwriters with the resources needed to take full advantage of this inflection point will soon find themselves in a much better situation than those that remain complacent.

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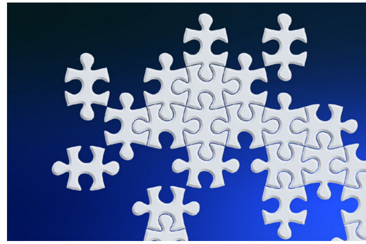

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