BEST'S REVIEW® ISSUES & ANSWERS:

• Specialty Coverage

• Inflation

Industry experts discuss how the private flood market is growing quickly due to better data, and how inflation is affecting claims costs and settlement patterns.

Interviewed Inside:

Neal Schmidt
Philadelphia Insurance Companies

Derek Freihaut
Pinnacle Actuarial Resources

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A Flood of Offerings

Neal Schmidt, Vice President of Underwriting, Specialty Property at Philadelphia Insurance Companies, said flood resilience is all about the ability to withstand and rapidly recover. “Resilience is proactively targeting a city’s capacity to tolerate flooding, prevent floods from entering the property, and make it easier to recover after a loss,” he said. Following are excerpts from an interview.

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Neal Schmidt
Vice President of Underwriting, Specialty Property
Philadelphia Insurance Companies

“Among the things that differentiate PHLY is that we are a Write-Your-Own provider of the NFIP and have been for the past 20 years.”

Visit the Issues & Answers section at *bestsreview.ambest.com* to watch an interview with Neal Schmidt.

What’s the current status of the National Flood Insurance Program, and what is the government focused on to make it sustainable?

The NFIP is authorized through Sept. 30, 2023. To be clear, the NFIP is managed by [the Federal Emergency Management Agency]. It’s delivered through 50-plus private Write-Your-Own insurance carriers, and they make flood coverage available to participating NFIP communities. It’s a partnership between the federal government, the insurance industry, states, cities, financial institutions, and it’s that partnership that is going to continue to be critical as we see rising sea levels, worsening storms, coastal urbanization—all of those contributing to higher flood risk going forward. The NFIP has several key policy goals. First is to provide access to primary flood insurance in high-risk areas and transfer some of that risk to the federal government. Another key policy goal for the NFIP and FEMA is to mitigate and reduce flood risk. As an example, the NFIP works with communities to adopt and enforce floodplain management regulations.

What should agents know to best support flood customers?

Step One would be: Review your in-force clients. Confirm that they understand the policy language they have regarding flood. Industry statistics say just one inch of water can cause $25,000 in damage, so it’s an important topic. Have a conversation with your client about their flood risk. Make sure they have evaluated their flood risk. Ask if they have a flood plan in the event that disaster hits. The second thing that agents can do is expand their reach and partner with local real estate agents, financial advisors, local banks.

What benefits does the private flood market offer as an alternative to the NFIP?

The private market space is growing rapidly. One of the reasons the private market space is growing so quickly is we have better data now and better analytics around flood. Private carrier markets typically are able to offer higher limits and more favorable terms than the NFIP. That could include replacement cost, it could include loss of use coverage, it could include business income coverage. The private market has the ability to offer competitive terms, price and coverage.

How does PHLY’s flood program meet the needs of agents?

PHLY can offer flood coverage as part of a package policy that includes property coverages. That’s typically available in lower-hazard zones, which allows us to offer bigger limits and more aggressive pricing as a part of a package policy. PHLY also has private market solutions for commercial accounts. That private market cover is available on a primary or an excess basis. It’s a non-admitted product with limits and coverages that are broader than a standard NFIP program. That would typically be for locations that are in maybe a little bit higher hazard zone that wouldn’t be eligible for that package policy, but because of our analytics, our modeling and our risk selection, we feel that they’re acceptable risks.

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Impact of Inflation

Derek Freihaut, Principal and Consulting Actuary for Pinnacle Actuarial Resources, said that inflation in 2022 was particularly significant to many insurers because of the replacement costs of big-ticket items. "Insurers will have to deal with rising reinsurance costs as a percentage of their overall premium at the same time they are dealing with increases in overall losses due to inflation," he said. Following are excerpts from an interview.

Derek Freihaut
Principal and Consulting Actuary
Pinnacle Actuarial Resources

"While it is easy to recognize and understand how inflation leads to higher premiums and reserves, there are other impacts for insurers that also need to be considered."

Visit the Issues & Answers section at *bestsreview.ambest.com* to watch an interview with Derek Freihaut.

What trends are the biggest concerns in the insurance space that you are hearing from clients?

The impact on claims from inflation and supply chain disruptions are the topics that we have had the most conversations with our clients about during year-end analyses. After a decade of low inflation, we saw the rate begin to increase in 2021 and jump to over 8% in 2022. The impact to some insurers was even more significant due to higher inflationary trends for replacement costs of big-ticket items such as homes and cars. In addition to higher inflationary trends, there have also been several supply chain disruptions impacting the insurance marketplace. Supply and labor shortages lead to temporary increases in cost to settle claims but also lead to claims remaining open longer until a claim can be adjusted and closed. This delay in repairs and closing claims can also lead to higher costs.

Higher inflation and supply chain disruptions obviously lead to higher claims cost. Are there other impacts to premiums and reserves?

There are certainly other notable impacts. For example, supply chain disruptions have led to slower settlement patterns for claims because it takes longer to get the necessary parts or labor to make repairs. When claims stay open longer, they tend to cost more. It also stretches out the claim development process. Actuaries often make projections based on how claims have developed historically, but now must recognize that claims in the current environment may be settling slower than historical patterns.

Another important factor is that inflation impacts losses differently based on the layer of coverage being considered. While an entire segment of business may experience an 8% inflationary trend, the trend is not the same for each insured layer of loss. The impact of the inflationary trend on claims capped at $100,000 per occurrence will be less than the trend on claims capped at $500,000 due to the lower cap. Claims in the layer excess of $500,000 will experience an even higher trend. This isn't something that is always considered when we talk about inflation. That distinction, however, has a very real impact on the insurance market. For insureds, deductibles will result in fewer savings as a percentage of premium, and there may be need for higher limits. For reinsurers covering excess of loss contracts, increases in premium may be significantly higher than the overall trend. While it is easy to recognize and understand how inflation leads to higher premiums and reserves, there are other impacts for insurers that also need to be considered.

Are inflation and supply chain disruptions impacting all carriers similarly?

We have seen significant differences by company. The entire industry is feeling the impact of these issues, but there are differences by types of coverages and a company's geographic footprint. As noted previously, there are also material differences based on the limits profile of a company's insureds as well as their reinsurance agreements.

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