SPECIAL REPORT/CONSTRUCTION

Building a new construction insurance model

Construction business is increasingly written in the major regional hubs, like Dubai and Singapore, but Lloyd's is fighting back with a consortium of construction specialists that hope to challenge the giants of the sector

Neil Ainger
UK correspondent

Lloyd's insurers are challenging the traditional giants of the construction world. With the launch last year of the Lloyd's Construction Consortium involving Beazley, Canopius, Hardy and Talbot, the Lloyd's market is looking to win business from the regional insurance hubs.

The new $166m per-risk construction facility is looking to challenge AIG, Allianz, Zurich and the global reinsurers that have traditionally dominated the sector, Munich and Swiss Re. Large project insurance might not be the sole preserve of the major international insurance companies any more, Lloyd's hopes (see box).

Construction insurance is attractive because it is at the very beginning of a project's life. While there is huge risk, there are also huge opportunities for cross-selling and follow-on business. There are so many class subsets – running from cover for delays in start-up (DSU) to environmental, terrorist and "acts of god" cover, to professional indemnity (PI) for architects and engineering protection for power plants, through to credit risk cover for skyscrapers against fluctuating property prices – that it has always been a polymorphous product.

That is the attraction because there are so many immediate insurance options via erection all-risks (EAR) products or construction all-risks (CAR) and builders' all-risk lines, plus subsequent opportunities for lead and secondary players to gain a greater slice of the pie.

This attractiveness is what has led to overcapacity in the marketplace, however, with broker Willis registering a 15% price fall in the first half of this year.

"Pricing in the CAR and EAR sector has the potential for further softening owing to fierce competition for the limited number of major projects, plus the increase of capacity in the local regions [versus London]," James Nicholson, head of broking and industry practice groups for construction and property/casualty at Willis, says.

One caveat, though, is as construction insurance is not a "renewable" business, one cannot analyse rate reductions in the same way as one can for renewable insurances, he adds. In other words, large complex projects and decades-long infrastructure projects write their own rules.

Nevertheless, Alistair Urquhart, construction broking leader at JLT, echoes these pricing conclusions. "I've been in the construction insurance marketplace for 25 years and I can honestly say the amount of capacity in the market at the moment is the highest I've ever known. There is far too much capacity and we've consequently experienced a sustained period of softening in prices," he says.

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> **David Hayhow**
> **Lockton**

Rate softening has been exacerbated by the last recession, which left too many insurers chasing too few projects. Instead of a market consolidation and subsequent rise in rates, the low interest rate environment has caused more capital to flood in, forestalling any recovery in pricing. A generally benign claims environment – the market has not really been tested en masse since September 11, 2001 – has also contributed to the glut.

Much of the new business is, however, focused on regional hubs in Singapore, Dubai and Latin American markets out of Miami. These regional hubs have arisen in recent years and do not need London to operate – at least not to the extent they once would have done.

"London has had to retune its pricing model to compete better with the regional construction insurance hubs established in Singapore and elsewhere that have sprung up to rival Lloyd's," David Hayhow, partner, real estate and construction at international broker Lockton Companies, says.

Despite the recent run-off of Swiss infrastructure insurer Infrassure, there is still more construction insurance underwriting capacity coming on stream because the global economy is recovering in the UK, US and elsewhere is recovering from the recession. "Only mining projects have slowed as the commodities boom of the past decade recedes," Urquhart says. "But other projects, including long-delayed infrastructure ones like Crossrail or HS2 in the UK, are on the up, not to mention the expansion of office space and cranes in the City."

For pricing to go up again capacity would need to decline by 30% to 40%, Urquhart estimates, and there is no possibility of that in the immediate future.

But despite the weakening rating environment, it is not all bad news for insurers, according to actuaries. Bryan Joseph, a partner and global actuarial leader at consultancy PricewaterhouseCoopers, points out this segment of the insurance market is still profitable and has done well in comparison to other sectors. It is still attractive. "Construction insurance is a specialist field so insurers can still charge a premium, especially for complex large projects," he says.

But insurers also face competition from capital markets, he warns, pointing to the example of cat risk where profitability has been adversely affected by capital market entrants seeking somewhere to put their money in a low interest rate environment.

Product development

The construction insurance market is still in the main geared towards the traditional placement covers such as CAR and EAR, with general liability [casualty] cover for the public and employers. However, the range of products is expanding, according to Lewis Edwards, Allianz Global Corporate & Specialty's (AGCS) London construction practice leader.

"Additional products have, however, become more prevalent in recent years," he says, citing the project professional indemnity and marine cargo fields. "With the advancement of building techniques and technology changes the market has also had to adapt to meet clients evolving needs as projects become more complex or larger in scale. Regulatory or legislative changes have also been seen in emerging territories where many significant construction opportunities are coming to market."

AGCS has expanded its product offering to try to cater for the wide range of risks in the construction insurance market. Examples of this include inherent defect insurance, bonding guarantees and infrastructure debt solutions, according to Edwards. The insurer has partnered with Allianz GI and Euler Hermes on infrastructure debt and is now offering to co-invest with governments and institutional investors on large long-term infrastructure upgrades that could last decades. "This initiative aims to draw together the various complex elements required to bridge the funding gap for select large projects," Edwards says.

To try and reverse the move of business away to the regional insurance hubs, the Lloyd's Construction Consortium involving Beazley, Canopius, Hardy and Talbot was formed last year, offering an aggregated $166m per-risk facility. The intention is to challenge Allianz, Zurich and Munich and Swiss Re for the lead position on large construction projects, thereby obtaining more business for Lloyd's and more follow-on specialty business than might otherwise be the case. The aggregated capacity is obviously not large enough for super-large infrastructure projects, but it may help to win more business for Lloyd's in projects one tier down and help to keep the market in the minds of clients for follow-on business and for its technical underwriting skills.

"The consortium facility is unique," Hayhow says. "The unique selling point is really related to the collated expertise the four participants can offer, however, rather than merely the aggregated $166m capacity. For instance, Talbot could handle a power plant; Hardy a civil engineering project; Canopius a waste water treatment plant; or Beazley a large-scale office development. Extra capacity is useful and new, and may get them the lead position on construction projects as desired, but it's the combined capabilities and expertise that really matter."

The London market has always had the ability to co-operate and deploy capacity, sometimes with 15 or 16 participants, gathered together by a broker. But for clients formalising the arrangement and increasing the total capacity upfront may make it an easier sell for those unfamiliar with the Lloyd's market. "The kudos of being able to say that you're 'insured by Lloyd's of London' may also act as a further marketing spur and help London to regain ground lost to the regional hubs," Hayhow adds.

The reason the consortium came together is the critical mass it gives them. As Jon Marsh, vice-chairman of Marsh's global construction practice, says, it aggregates expertise and capacity. "It's a market penetration mechanism really and the members will still operate individually. The idea is to capture business that wouldn't otherwise have come to London. It's a global marketplace and this is a mechanism to try to capture some of it for London."

There is less need for business to find a home in London now the market has globalised and regional hubs typically serve construction insurance risk in situ in places like Singapore, Dubai and other hubs around the world. "This is why London needs to innovate and the consortium is one way to do this," Phil Lazell, chief executive of UK construction and real estate at Marsh, says, adding it is not a geographically specific offering. "These products developed in London are available anywhere else in the world now so it's not a superior or unique market anymore, excepting London's underwriting skills. It's a hard sell for London because I'm not sure most clients care about technical underwriting skills, they care about price."

According to Joseph, Lloyd's has always functioned as a consortium builder but as risks have got bigger [and regional hubs arisen] it has become more difficult for the London market to win international business. "Individual syndicates don't have the balance sheet to go it alone of course, so the aggregated facility could be seen as a sign of things to come. I'd expect to see more of these types of consortium. It is the future of Lloyd's in the construction insurance sector." ■

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Crossrail workers wait as a tunnelling machine breaks through 35 metres underground at Whitechapel, east London

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A collective response

Over the past few years, domestic markets have been growing to meet local demand, particularly in Brazil, Singapore, Miami and the United Arab Emirates. This decentralised approach has resulted in many international markets placing specialist construction underwriters in these new global "hubs" to try to maintain market share.

Despite increasing global competition, the London market is maintaining its reputation as a centre of excellence for major construction insurance business. In London, the majority of construction insurances are placed on a syndicated basis owing to the significance placed on the experience and capacity of the leading insurer/reinsurers by brokers and their clients.

Reflecting the reputation of the market, recent years have seen a new flow of highly experienced underwriting talent into Lloyd's, with a commensurate increase in the amount of capacity available from a cross section of Lloyd's syndicates. It is estimated there are now about 11 active participants in the construction/engineering market in Lloyd's offering a maximum of around $350m to $400m of probable maximum loss (PML) capacity between them.

Given none of those syndicates is able to offer capacity that is comparable with the capacities of the global carriers, however, Beazley, Canopius, Hardy and Talbot created the construction consortium at Lloyd's in May 2013 to offer a maximum line of $166m on a PML basis. Consortia are an established and unique feature of the Lloyd's market and this initiative has ensured Lloyd's remains in the top tier of global construction markets, rivalling the global carriers.

A key feature of the consortium is the ability to blend the expertise, knowledge and experience of the class underwriters within each syndicate and to respond quickly to the demands of clients and brokers with a secure alternative proposition supported by the financial security, claims service and reputation of Lloyd's.

> **$15m**
> Amount of business the consortium has written since its launch in May 2013

To date, response to the consortium has been overwhelmingly positive. Since its launch it has underwritten more than $15m of business, with a 15% win ratio, and it has achieved lead positions on a number of major construction risks in a range of global locations from the US, the Middle East and north Africa, Latin America and the UK, for high-profile, multinational and sophisticated insurance buyers. The consortium has also been successful in offering brokers access to 100% of the required limits for smaller and medium-sized complex construction projects ($50m to $250m).

Of course the construction market and the consortium face challenges like many other sectors of the industry. Over-supply of capacity is having a dampening effect on rates and with occasional significant losses failing to dent enthusiasm, experience and judicious underwriting are of paramount importance.

However, if London is to maintain its strong market position for construction risks, we must sustain service levels and demonstrate our technical expertise by continuing to create innovative solutions for increasingly complex risks. We know this approach, backed by the strength of the Lloyd's brand and its reputation for depth of expertise in construction, is an attractive and viable option for clients. ■

David Turner is the construction global practice leader at Talbot Underwriting and member of the construction consortium at Lloyd's