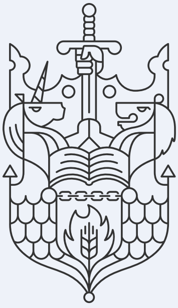

Evergreen policies:

The future of construction insurance?

by Oliver Scott

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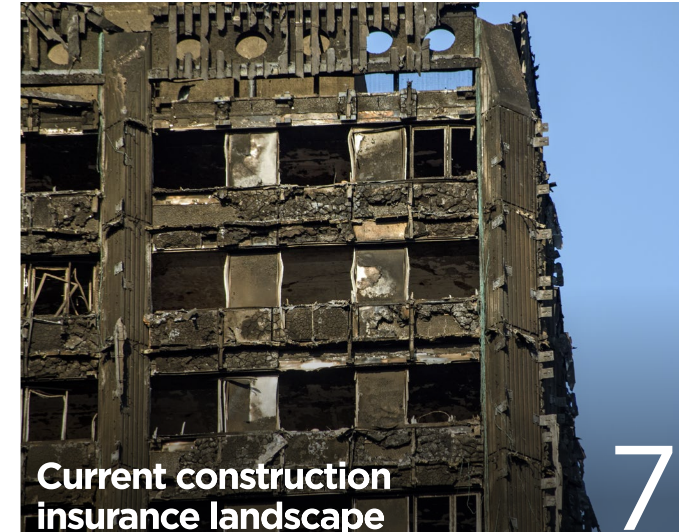
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Introduction

Insurance policies. They are the foundation of insurance, embodying the cover purchased by the client. They fulfil the criteria of consideration when creating a contract between the client and the insurer; the client pays the premium and the insurer provides the insurance policy and the promise to pay valid claims.

1 www.globalnewswire.com

Introduction - continued

For something so instrumental in the world of insurance, it is something that is almost taken for granted, just a means of detailing the extent of policy coverage. These policies however dictate the very fabric of our sector, operating on an annual or multi-year project specific basis with the repetitive cycle of information gathering, quoting and binding the policies a result of this. Policies have been bound on this basis for countless years, with it becoming the accepted norm that if you require an insurance policy, this is the process you must adhere to.

But what if it wasn't? As with everything, industry norms are only there until someone asks 'why?' and delves a little deeper to understand why things are the way they are.

Evergreen policies are the result of such a process; a process which looked beyond the standard structure of a policy and beyond into the possibilities which could enhance the service offered by an insurance broker to their clients. Currently only used on a small scale in a handful of sectors, evergreen policies present an exciting future. As stated by Nicolas Aubert (CEO of Willis GB), evergreen policies are "an evolution of the insurance policy and it represents real innovation".[1]

The purpose of this paper therefore is to analyse the concept of evergreen policies and see if it has the potential to revolutionise the insurance sector, in particular the construction sector.

1 www.globalnewswire.com

What is an evergreen policy?

An evergreen policy (also known as a continuous period policy) can be defined as a "contract provision that automatically renews an agreement after the expiry date".[2]

2 *www.investopedia.com*

It is a policy where the period runs in perpetuity until either of the notice parties (the insured or the insurer) gives 12 months' notice to renegotiate or cancel the policy. If this notice is not given then the policy will run on the same rates as dictated at inception, subject to the disclosure of material information on behalf of the client as and when appropriate. This will allow for better budgeting and greater certainty around the premium spend on behalf of the client. It is important to note that the 12-month period only runs from when both parties have agreed a change to the terms/rates. There will be a 6-month negotiating period prior to this 12 months. If no agreement can be reached within this 6 months then cancellation will be issued, 12 months after which the policy will cease.

This period will give the insured and the insurance broker enough time to negotiate or arrange for alternative cover. As insurers can negotiate for an increase in rates, the client can also negotiate for a reduction.

The best time to purchase an evergreen policy is when the rates being offered by insurers are expected to increase within the next few years, as the rates negotiated at inception will remain in place, resulting in savings on behalf of the client when compared to the rest of the market.

1 www.globalnewswire.com

Current construction insurance landscape

Now we have an understanding of what exactly evergreen policies are, it is important to understand the industry in which they are to potentially be introduced, in addition to familiarising ourselves with the policies which they could be replacing.

Hard and soft markets

The construction insurance market was experiencing an unprecedented soft market, which has been in effect for the past fifteen years. The last hard market was triggered by the 11 September 2001 bombings in America. However, with natural disasters increasing drastically in recent years (there were circa 350 in 2004, but 700 in 2016) and events like the tragic Grenfell Tower Fire (71 people died after a fire engulfed a 27-storey tower block, which was worsened by issues with the building's cladding), many insurance experts believe the construction market is beginning to harden. It is in situations like this where the market is turning and the premiums are starting to increase that an evergreen policy could be beneficial, as it would secure today's rate for multiple years.

Many insurance experts believe the construction market is beginning to harden

Types of policy structure

Typically policies are arranged in one of two ways; an annual portfolio or on a project specific basis. Annual policies aim to meet the requirement of the majority of the clients' contracts. They are arranged by the broker once a year through a lengthy renewal process of information gathering and reporting. Project specific policies aim to pick up the contracts which fall outside the scope of the annual policies, mainly due to higher limits of indemnity being required. Project specific policies will always have a place within the construction insurance sector, at least for the immediate future, because they are for standalone risks which can be easily managed. It is instead the annual portfolio of risks which we are looking at substituting for evergreen policies. We will therefore investigate this type of policy further.

Annual portfolios

The benefits of these policies are that the client is only tied in for 12 months, so can change insurer every year if desired and move to alternative, perhaps more competitive providers who are keen to obtain new business. The insurer also benefits from this structure as, if the account experiences heavy losses, then they only hold the risk for 12 months. The clear benefit here is the short-term nature of the contract for both parties. However, in the event of holding a profitable account, insurers would want to encourage a long-lasting relationship. In addition to the obvious benefit of holding a profitable account, it would also allow the insurer to invest in the risk management of the client. Whether this is through increased site surveys or training workshops, insurers will be more inclined to invest such resources into an account they know they are going to hold for a number of years. For such situations, Long Terms Agreements (LTAs) are utilised. This creates an agreement which usually lasts several years at a fixed rate subject to certain performance parameters, typically centred around claims history. For example, the loss ratio increases to 20% then the rate too will increase by a similar amount. Therefore, whilst similar in nature to the evergreen concept, it is still heavily caveated, and does not provide the ongoing certainty achieved with an evergreen policy.

Comparisons In summary, the below table shows how evergreen policies can be compared to others.

	Evergreen	Annual policy	Long-term agreement
Administratively efficient?	Yes	No	No
Encourages relationship between insurer and client?	Yes	No	Yes
Provide predictable premiums?	Yes	No	Yes
Can be cancelled when either party desires?	Yes	Yes	No

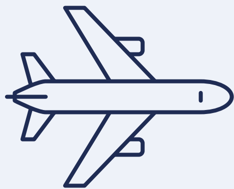
An increasing number of UK private motor insurance providers have adopted a form of evergreen policy.

Evergreen policies in use

Whilst these policies have not been seen before within the construction insurance sector, they have been in use within other sectors for a number of years.

Evergreen policies in use - continued

These examples demonstrate how effective evergreen policies have proven to be in other markets, and strengthen the argument for introducing them into the construction market. However, each market has its own intricacies, and we now therefore need to further analyse the issues and benefits of an evergreen policy when used within the construction insurance market.

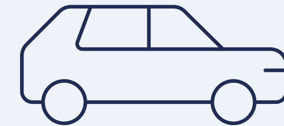


Aviation

- Implemented by JLT in 2016 as a result of a very soft market.
- JLT saw an opportunity for insurers to secure a 'stable share at higher than market terms' (continual period policy – aerospace, JLT).
- Well received by insurers, currently used in tandem with a standard policy (split 40% evergreen/60% standard). This is due to high-risk nature of aerospace, so insurers do not yet have capacity for 100% evergreen. This is not an issue for the construction sector due to the risk profile, but is a good back-up option if required.

Mid-market

- Introduced by Willis and AIG in 2015.
- Nicolas Aubert (CEO of Willis GB) stated evergreen policies "provide all the benefits of standard insurance but removes the requirement for an annual renewal. In turn, this frees up time – for the client and their risk partner – to focus exclusively on understanding the business critical risk issues".



Motor

- An increasing number of UK private motor insurance providers have adopted a form of evergreen policy whereby contracts are automatically renewed on what are often referred to as evergreen contracts.
- These are standard 12-month policies, with a clause which automatically renews the policy unless otherwise advised.
- Demand for these policies is great in private sectors where policyholders would often forget their policy expiry date.

Issues and benefits in the construction insurance market

It is my personal opinion that evergreen policies are suited for use within the construction insurance market, but in order to provide a definitive verdict we must analyse the benefits and issues for each party concerned (insurer, broker and client).

The below points are the product of discussions with the following parties, with the resolution to these issues my own work:

- Construction portfolio manager of Zurich Insurance plc
- Account executive of JLT Insurance Brokers
- Insurance officer of a JLT construction client.

1 www.globalnewswire.com

Insurer

Benefits

More control
Rate and wording changes can be discussed at a time that suits insurers, once all loss details have been established, rather than being pigeonholed into a window prior to renewal of an annual policy.

Improved client relations
More time can be spent on servicing the clients instead of only making an appearance once a year to collect their premium. As stated by Jacqueline McNamee (UK Managing Director of AIG), insurers will be able to add "a risk management proposition whilst simultaneously reducing the administrative costs associatedwith the annual renewal process". This will result in insurers earning a good reputation amongst insurance brokers and therefore increase their chances of winning new business. In addition, it will allow the insurer to make their mark on the client. They can have sufficient time to review the clients' current risk management procedures and advise of improvements. Exercises such as claims defensibility analysis can be carried out, whereby insurers review the types of claims the client receives and identifies what the business can do to specifically tackle these issues. These types of exercises are rarely carried out by insurers as they do not want to invest so much in a client only for them to then change markets at the end of the policy year, allowing a competing insurer to benefit from their input. Evergreen policies however make this option much more viable.

Hedge mechanism
By securing long-term income, insurers will gain some protection against any drops in market premium levels due to the market cycle.

Better retention rates
Shift of insurers' approach from looking to win new business to servicing large accounts on long-term evergreen policies. Insurers are currently more focused on winning new business because of the annual nature of the insurance policies. By securing large reputable clients for an indefinite number of years, whilst insurers will still obviously want new business, there will be less lost business for it to replace. This will see service levels increase and relationships flourish.

Insurer

Issues

Reinsurance

Currently insurers incorporate their reinsurance costs in their quotation to the client. If the client elects to pursue their quote and place the policy, then insurers pay for reinsurance cover out of this premium. It is integral to the way they operate and allows them to transfer a portion of the risk to another carrier. In most instances, this reinsurance is purchased on a facultative basis (one-off), so each policy has its own reinsurance cost associated with it. However, an issue with dealing with evergreen policies is that insurers do not know how much reinsurance to purchase as they do not know for how long they will hold the account. This could lead to insurers purchasing the wrong level, and either wasting capital or being left in a position where they are liable for more than they have adequately reserved. The reinsurance market is also different to the insurance market. If an insurance market is currently soft, the same is not necessarily true for the reinsurance market. However, these problems could be surmounted if a similar evergreen policy were to be introduced into the reinsurance market. Currently these policies are time defined, and the issue is trying to merge an insurer's potential evergreen policy with a reinsurer's time-defined policy. However, if both policies were to be evergreen, then these problems would be negated.

Annual policy references

As established throughout this paper, the current standard practice is to operate on an annual basis with annual policies and references created. It would therefore take a large effort on behalf of the insurer to update their internal systems to be able to accommodate these policies. However, one such solution would be to raise a separate endorsement from the master evergreen policy to raise the premium each year. A new reference could be assigned to each endorsement which could allow for easier tracking and premium allocation. This would allow insurers to keep in place their current systems whilst also satisfying the requirements of an evergreen policy. With regards to time defining the policies, this too can be overcome. The minimum period of an evergreen policy is 18 months if cancelled the day of inception (6 months' negotiation period followed by 12 months' notice period). Therefore, the end date could initially be entered 18 months from inception, and the policy could then be extended on the system on an 18-month basis. The documentation issued to the client however would reflect an evergreen policy. This would allow the principal of an evergreen policy to prevail, whilst also satisfying the insurer's internal systems.

Authority of underwriters

The majority of insurers permit each of their underwriters certain levels of authority, which dictate certain policies they can or can't write, what levels of indemnity they are allowed to write and the period of policy they are able to provide. By introducing evergreen policies, it will force insurers to review this process and could cause lack of control from a Corporate Governance perspective. However, as already established the minimum period of an evergreen policy is 18 months, after which time the policy can theoretically cease. If insurers still wanted to associate the period of a policy with certain levels of authority, then they could apply their current rules and corporate approach to evergreen polices by labelling them as 18-month policies.

Regulatory

Under Solvency II, insurers will need enough capital to have 99.5% confidence they could cope with the worst expected losses over a year. Solvency II has three pillars, the first is quantitative, laying down how much capital the insurers must hold; the second covers internal governance and formal supervision; and the third covers public disclosure and transparency. Whilst all are important, it is the first pillar 'quantitative' which we are considering here. Insurers must have enough capital and assets to outweigh their liability should a worst-case scenario occur. By writing an evergreen policy, insurers could potentially be causing themselves issues, as they are writing the same insured's business for a sustained period of time. With short-tail business (such as construction all-risks) this is not such an issue. Where the issue arises however is with longer-tail business, such as employers' liability cover, where it can take years for a claim to come through, and even longer for it to develop. In such situations it would be very difficult for insurers to ensure they have enough capital and reserves to cover the multiple years on cover for one client under an evergreen policy. By having to hold such high reserves, it would reduce the profitability of the Insurer, which could cause it to collapse. Therefore, it is perhaps worth acknowledging that evergreen policies are not suited to classes of business with a long-tail nature (such as employers' liability), and their use should therefore be restricted to lines of business with a shorter, more manageable tail.

Tacit policies

Tacit policies have been around for a number of years, mainly in Germany, and appear similar in nature to that of an evergreen policy. These policies run for 12 months and renew automatically without either Insured or insurer having an obligation to act. These policies do however have a notice of cancellation period, which is 93 days prior to expiry. Once notice is issued, then the policy will expire at the period end date, unless renegotiated. The issue here is that all insurers automatically issue a notice of cancellation 93 days from expiry, so that they can then renegotiate a new rate. This defeats the object of such a policy, as it effectively reverts to a standard 12-month policy. However, this policy is largely used within private lines (mainly motor), where the commercial relationship between insured and insurer is not present. I am therefore confident that such a situation would not arise in the construction insurance market, as insurers recognise the importance of building a relationship with their clients, and that constantly cancelling the policy is not the best way to capitalise on this.

Limit of liability

Policy limits are provided on an annual basis, with both an 'any one claim' and an 'aggregated' limit. Currently this is set up to provide the insured with one years' worth of cover. Once the aggregated (overall) limit for that year has been exhausted, then there is no further insurance cover. This therefore presents an issue for evergreen policies, which run in perpetuity. A solution to this however is linked to the new reference numbers suggested above. On an annual basis, when the new reference is provided, the terms of the policy could essentially reset, and a new limit of indemnity could be provided. This would also enable the insurer to have access to more accurate claims ratios and loss history, as each year could be compartmentalised instead of having to look at the whole evergreen period as one.

Insurance broker

Benefits

Increased admin efficiency
A large part of an insurance broker's time is occupied in the renewal process. Typically, this commences three months prior to the expiry of the clients' annual renewal date and involves the broker visiting the clients' businesses and obtaining the information required to complete a renewal questionnaire (updated turnover, business description, health and safety procedures, claims information etc.). This information then needs to be formatted into a concise report and then discussed with various insurers. Terms are then put to the client after which the policies can be drawn up, cover bound and the documentation issued. By introducing the evergreen policies, no new documentation will need to be created, any material information changes can be disclosed as and when they occur and the turnover can be declared once a year to determine the upcoming premium. This much simpler process will drastically increase the amount of time insurance brokers have to further service their clients and assist with technical queries (such as contract reviews), which arguably offers the greatest value to clients.

Increased flexibility
Under a conventional policy, insurers could advise that they are no longer in a position to honour their renewal terms due to a change in the client's business or in their underwriting approach, thus leaving the insurance broker and client a few weeks out from renewal without any firm terms. This then results in a frantic couple of weeks on behalf of the insurance broker as they try and find a solution to this problem. In all likelihood the revised terms are likely to be an increase on the expiring terms, as insurers will realise the insurance broker and client are under pressure and are more inclined to accept inflated terms. The setup of evergreen policies guarantee a negotiating period whereby the parties can discuss any changes to the cover, and if an agreement cannot be reached by the end of this time, then a 12-month period will follow, after which the policy will cease. This 12 months provides the insurance broker and client with plenty of time to carry out an extensive market wide exercise to establish which insurer would be the best partner going forward.

Issues

Convincing clients and insurers to participate
Once the brokers have invested in this new policy type and have upgraded their systems to accommodate them, it is important that there is good uptake from clients and insurers to ensure this investment pays off. Prior to making this investment the brokers should be gauging their clients' interests by carrying out workshops and discussing at regular meetings to demonstrate the benefits outlined within this paper and show how it can benefit them as a business.

Safeguarding their future
Once the broker has gone through the effort of arranging the evergreen policy and set the insurer and client on the path of a long working relationship, some may question if a broker is still needed. As referenced previously, the broker must therefore show their value to the client through other means, such as carrying out claims defensibility training, risk management analysis, assisting with insurance queries (such as contract reviews) and generally managing the relationship between insurer and client.

Client

Benefits

Increased flexibility
Instead of being restricted to a three-month operating window prior to renewal, information gathering and negotiating with insurers and brokers can take place at any time during the lifecycle of the policy. This will reduce the pressure on the business in the lead up to the previous annual renewal date, which usually coincided with the busy time of the clients' financial year-end.

Hedge mechanism
By effecting an evergreen policy, the client may be missing out on the most competitive rates available in the soft market, but they are also avoiding the increase in rates seen during a hardened market. Obtaining this rate security will enable the client to effect more accurate budgeting and have an accurate idea of their premium spend going forward.

Improved insurer relations
As well as the ongoing discussions throughout the life of the policy, the client will also benefit from the insurer wanting to invest in the client so that they are not impacted by a poor claims experience over the course of the evergreen policy. This results in the client receiving increased risk management assistance and involvement on behalf of the insurer in a bid to reduce claims received and paid.

More value from the broker
With the broker no longer needing to carry out the time-consuming renewal process, their attention can be turned to better servicing the client. This could include improved training, handling of more queries and an improvement in response times.

No sudden reactive rate reviews
Under the annual policies, insurers could state that their rate is increasing only weeks away from renewal. This could be caused by general market conditions or by more client specific causes, such as a poor claims record. With the evergreen policy, clients will have a negotiating period, followed by a 12-month buffer prior to the rate taking effect. This will allow for negotiations to take place and helps to prevent volatility.

Guarantee of cover (reduced fear of cover lapsing due to 12-month buffer)
The annual policies present a deadline (the expiry date) by which the renewal policy must be in place. This can put large amounts of pressure on all parties and often plays into the hands of the insurer, with the client desperate to have cover in place before this time. The evergreen policy negates this issue by not having an expiry date. If the policy however is cancelled, then the 12-month buffer period will provide ample time for the client and broker to arrange a new policy.

Suitable for longer term contracts
Some construction clients undertake construction programmes (contracts which run for numerous years) as their sole activities. They do not carry out any ad-hoc contracts, but instead focus on carrying out a network of work under one multiyear contract. These contracts are usually provided by the government and involve multiple parties and large sum insureds. Typical annual policies are not ideally suited to this nature of work, as the scope of work carried out in any one year is hard to identify due to budgeting limitations. The evergreen policy however provides an easy alternative; a way for the client to be clear as to the premium that will be attracted by the works and will therefore not have to worry about segmenting the works they are carrying out into an annual basis.

Client

Issues

Insurers could increase rates

Whilst the evergreen policy looks to provide stability, it is still possible for insurers to effect a rate increase, which would seemingly nullify the reason for such a policy. However, even if the insurer effects a rate change on the day of inception, the 6-month negotiation period plus the 12-month buffer period would still guarantee the client 18 months of a stable rate. This will provide ample time for the broker and client to source a replacement. However, this is a threat no insurer would willingly do, as it would ruin the relationship with the client and indeed the broker, and result in a loss of business accordingly.

What if insurers lose their acceptable credit rating?

In the event an insurer is downgraded, then a shorter policy termination period can be applied. This is to be negotiated on an individual basis, but would be much less than the 6-month negotiation period as the client would require the guarantee of their insurer being able to pay their claims.

Completing employers'/plant hirers' questionnaires

Currently within the construction industry, clients are required to complete their employers' and/or plant hirers' insurance questionnaires, which look to confirm the cover they have in place. Currently, these questionnaires require the start and end date of the policies to be disclosed. Due to the indefinite nature of the evergreen policies and the absence of an identifiable end date, this could cause issue. However, when understanding the reasoning for such an end date on these questionnaires is simply to provide confirmation that the policies are valid and in force, it becomes a problem that can be easily overcome. The client could explain the nature of their policies to the employer and provide 'To whom it may concern letters' (provided by the broker summarising the insurance cover) to confirm that the Insurance is in place. If the employer is insistent on having an end date, then a date of 12 months from the signing of the letter could be provided to satisfy their requirements.

One insurer cancels

Typically, a panel of multiple insurers underwrites one risk, rather than just one market taking 100%. In this situation it could be a risk that one insurer issues cancellation whilst the others are happy to remain at the previously agreed rates. In such a scenario it would depend on who the cancelling market is. If the lead market cancels and wishes to renegotiate, then the whole policy will be reviewed. However, if a follow market wishes to cancel then, subject to client approval, they will be removed from the programme. The free capacity will then either be allocated to a new market or shared between the remaining markets. As far as liability is concerned, the policy will run on a 'contracts attaching' basis, whereby insurers will be liable for any contracts which attached whilst they were on cover, thus ensuring cover remains in place.

Conclusion

The purpose of this paper was to identify whether or not evergreen policies have a part to play in shaping the future of the construction insurance sector.

Conclusion - continued

Throughout this paper we have established the benefits of such a policy type and compared it to the current structure employed throughout the sector. In order to consider whether or not evergreen policies have the potential to revolutionise the sector, it must positively impact all the major parties; the client, the insurer and the insurance broker. In view of the comparisons carried out, the evergreen policy definitely has the potential to achieve this positive impact. The added flexibility it affords all parties is something that the construction insurance market needs, even if it hasn't realised it yet. The whole premise of the market has been centred around annual renewals and the broking process. Evergreen policies however promise to tear up the rule book, revolutionising the way we operate and redefining the roles and responsibilities of the market. Admittedly there are a few stumbling blocks which will need to be overcome, but the solutions provided within this paper (such as implementing new tracking systems) are not unreasonable and are in line with actions taken by companies in the past (eg the shift from paper to paperless offices required much more investment and effort than merely updating the software companies already have). The biggest benefit will be felt by the clients, as they will be on the receiving end of the increased attention and servicing that insurers and insurance brokers can now afford to provide. In a world where the client comes first and service levels are paramount, this surely must be a good thing.

I therefore believe that the introduction of evergreen policies into the construction insurance market is a positive move, and is one which allow benefits to be felt by all involved. Evergreen policies are the future of construction insurance.

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