

# Beyond The Text Podcast



July 2024

TRANSCRIPT

## **Small Commercial Insurance Market: Opportunities to Compete**

Beyond the Text is a Conning podcast that features insights from its Insurance Research Department. Hosted by Alyssa Gittleman, a Director and Head of Consulting and Customer Operations for Conning Insurance Research. Alyssa will invite analysts and guests to provide insights on recent publications and emerging industry trends.

Beyond the Text is intended to provide just that: going beyond Conning's typical research. Conning's analysts have deep industry knowledge and come from various backgrounds providing a greater level of context on industry trends for insurance professionals.

[OPENING MUSIC]

## **SEGMENT 1 – OPENING**

### **[Alyssa Gittleman (AG)]**

Hello, and welcome to Beyond the Text, a Conning podcast featuring insights from our Insurance Research department.

I'm your host, Alyssa Gittleman, a director and head of Consulting and Customer Operations here at Conning.

Join me as I welcome analysts and guests to provide insights on recent publications and emerging industry trends. I'm excited to launch this today with two of our analysts who are lead authors for our "2024 Small Commercial Insurance Market Opportunities to Compete" report. First, we have Alan Dobbins, a director at Conning and the head analyst for Insurance Research.

We are also joined by Bradley Felix, a vice president in the Insurance Research department. Thank you both for joining us today.

Conning has been reporting on the small commercial market for over two decades.

I was hoping we could start this off with you Alan, telling us why this is such a compelling market?

### **[Alan Dobbins (AD)] (Time stamp - 1:03)**

Sure.

There are a couple of reasons why we continue to focus on this segment. One is the sheer volume of small businesses that are out there with unique risk management needs. Small businesses account for more than 90% of total firms and the opportunity to address the needs of this segment are drawing increasing interest from both traditional insurers and from some innovative startups that are out there. Small businesses are a key driver of job creation in the economy but are also the most volatile segment in terms of survivability, and it still appears that a large portion of this segment is under and uninsured and/or uninsured.

And the needs of the businesses in this segment are different from those in the mid-market or larger segment, and insurers are continually trying to come up with products and processes to meet those needs. But no insurer yet has captured the market or dominated the market. No one has developed a dominant market share as in some of the other lines.

So, the innovation in the market coupled with the importance of the market to the economy make it a very interesting segment to follow.

### **[AG] (2:04)**

And we discussed this earlier. The term small business can mean a couple of different things to different people. So, Bradley, I was hoping you could let us know what that definition of small business is as defined by Conning.

### **[Bradley Felix (BF)] (2:16)**

Sure, Alyssa. Let me start by saying that the definition of small business is all over the place. So, for example, the SBA, that's the Small Business Administration, they're generally going to define small business as an independent business that has fewer than

500 employees. Now that's much broader than most insurers would think. The insurance industry tends to vary on definitions as well. Some insurers use industry or sector.

Others tend to look at the underwriting processes that are involved with more automated underwriting going to their small business portfolios.

But at Conning, after talking to a lot of our market participants, we decided on a \$50,000 cap and annual premium or thirty employees.

**[AG] (3:01)**

So, given that definition, could you share with us what the size of the small commercial market is?

**[AD] (3:06)**

Yeah, so our estimate, which is based on 2022 data, for the total small commercial market is \$140 billion in direct premium, that's 31% of total commercial direct premium.

Our previous study - we do this every two years, so the last study, which is based on 2020 data, found a market of \$113 billion. That's growth of 23% in the small business market from 2020 to 2022. Exposure growth and a hardening market for a lot of the major lines of business, like commercial auto and CMP, were key drivers of this increase in written premium. The overall market during that same period grew by 21%, so a little stronger than overall market growth.

**[BF] (3:52)**

Yeah. And I'll just add to that, Alan. It's important to note that we break that \$140 billion estimate down to a standard and a specialty business. So, for example, the standard small business accounts are what we often refer to as "Main Street" business.

So, this is the market that most insurance executives are talking about when they talk about small business, this is going to be a target for them. And another way to think about it is: what is the principal market for small commercial?

Conning projects the standard or principal small commercial market wrote about \$93 billion or about 2/3 of the small commercial premium in 2022.

That's an increase over the prior estimate of \$74 billion in 2020, similar to the substantial growth for commercial lines overall. We attribute this to aggressive rate increases, inflation-driven exposure growth and technological improvements to automate the underwriting process, and each of these factors contributed to the overall growth in this market.

The remaining \$47 billion is what we estimate to be specialty small commercial.

So, these accounts typically require special handling. They're not what we think of when we're referring to Main Street business. So, for example, we have insurers that specialize in physicians, for example, and they have a substantial amount of this medical professional liability in their small practices, so we can see how there's a little bit more of a specialty nature to this, not what we referred to as Main Street.

**[AG] (5:24)**

Now earlier, one of the attractions you noted about this market is that no one company has developed a dominant market share. What is the competitive environment for this segment?

**[AD] (5:35)**

Yeah, there is no one dominant insurer like you see in some other lines, but the big insurers still tend to control the market. Those insurers with more than \$2.5 million in premiums, so very large insurers, account for 2/3 of the market.

So, the market share, the breakdown for the principal small commercial market is 2/3 for very large insurers, 18% for mid-sized insurers and 15% for small insurers.

**[BF] (6:01)**

Yeah, this market is so fragmented. So based on our estimates in 2022, the top insurer wrote just under 5.5% of total principal small commercial business. So that's the Main Street business.

And then looking again at that Main Street, the top five companies are separated by less than a percentage point.

The top 15 companies collectively wrote about 54% of the principal small commercial market. So to put that in context and compare it

with personal lines for the auto insurance industry, the top 15 personal auto insurers wrote 83% of the premium for that business. And for homeowners, the top 15 companies wrote 71% of that market.

So small commercial remains intensely competitive for the insurance market.

## SEGMENT 2 – Audio Break

### [AG] (06:53)

Now shifting gears a little bit, what are the different types of industry sectors we're talking about when we talk about the small commercial market?

### [AD] (7:00)

Well, there are about six million, a little less than six million small commercial firms with fewer than 30 employees in the US when we did our count, which is based again on 2022 data, and that group employs a little more than 24 million workers. For this study, when we analyze these firms, we're looking at the Bureau of Labor Statistics, super sector category. So, we're looking at construction, retail, hospitality, breaking things down at that level and looking at the universe of small businesses in terms of number of firms, most are in the professional and service sectors, followed by construction. Those three account for a little under 50% of total firms.

In terms of the number of employees, this shows a basically similar pattern, but hospitality and healthcare become more important when viewing the sector employment statistics.

The highest number of small commercial employees are in the professional sector, followed by hospitality and healthcare, and collectively that group those three categories account for about 45% of total small commercial employees.

### [AG] (8:08)

So earlier we were talking and you mentioned the traditional attractions of the small commercial insurance market have remained consistent over the past years of writing this report. Those are the size of the market, the lack of a dominant player and the diversity of the potential client base. So here we are in 2024 and the title of this year's study is "Opportunities to Compete."

Could you walk us through what the current opportunities are in the small commercial market that these insurers are talking about?

### [BF] (8:36)

We interviewed several small commercial insurers for this study. Four common themes tended to emerge in terms of opportunities for this market. So, we have the integration of third-party data, smart tech and the Internet of Things, embedded distribution and increased E&S (excess and surplus) offerings.

So, in terms of integrating third-party data, business owners and agents want a frictionless purchase experience that increases the decision speed and minimizes agent involvement. Having more robust third-party data delivers on both points and gives insurers a bit more confidence about underwriting risks when they're unable to get the information from the owner or an agent directly.

Moving on to the smart tech or the Internet of Things, IoT, you know this has gathered a lot of momentum in the personal line space. But we're now seeing it develop in commercial lines, which presents a much broader set of potential applications. So already we see insurers partnering with smart device manufacturers and providing incentives to policyholders to use IoT devices.

Insurers are using this technology in smart detectors - that's water alarms, leak detectors, pressure sensors - so sort of limits the amount of damage caused by a frozen or otherwise leaky pipe.

Smart smoke detectors and security systems have been on the market for many years, and other IoT solutions being considered by the industry are temperature sensitive, monitoring for cold storage and refrigeration and vehicle telematics for commercial fleets.

### [AD] (10:11)

Yeah, another item that Bradley mentioned is the issue of embedded insurance. A lot of the insurers we spoke with note that embedded

has the potential at least to be a material portion of the small commercial market. The concept of embedded insurance isn't unique to small commercial, it's actually probably more well known in sectors like personal auto; maybe the clearest example of the concept is Tesla's insurance option.

Insurers that have partnered with retailers like Best Buy to offer warranty coverage at the time of sale.

Anyone who's booked a flight is reminded of travel insurance options available to them – that's another example.

The market for integrated insurance solutions into customer experiences is still pretty untapped, but small commercial has the potential at least to be a pretty fertile market, just like small businesses are becoming used to dealing with non-banking organizations, platforms like Intuit or Shopify to obtain services traditionally provided by banks. They may well grow increasingly comfortable obtaining insurance from platforms they interact with every day like payroll firms, rather than a traditional insurance company or an agent.

And then sort of the last thing that Bradley mentioned was the emergence of the E&S market within small commercial. There's a growing interest in the excess and surplus lines market to expand offerings available for the small commercial market. This was a particular interest in the hardening market in the last two years. The catalyst for this is broadening the ways for an insurer to meet the needs of a client. If there's a small business whose needs can be addressed by the non-admitted market, some insurers may write a portion in the small business unit and the specialty portion will go through a specialty unit.

### SEGMENT 3 – Audio Break

#### [AG] (11:57)

Could we hear about the concerns for the small commercial market?

#### [BF] (11:59)

Sure, Alyssa. So I'm going to start with the most frequent concern we heard, which was the increasing level of competition. We actually had one participant refer to it as a quote "race to zero." So, this is the other side of the "no dominant competitor" issue that we talked about earlier. With a number of insurers offering similar products with a similar market share competing for the space, the competition can get pretty intense.

Now you have to remember that insurance services are fungible, more or less. Big concern, of course, is the potential for commoditization of the small commercial market. So the emphasis on comparative raters is actually making this worse, exacerbating the issue. Those comparative raters can further commoditize the market and pressure insurers to compete on price and price alone.

#### [AD] (12:47)

Yeah, another item that certainly popped up in the interviews was inflation. Inflation remains a key concern of small businesses and small business insurers.

In an environment of high inflation, it's difficult to keep up because inflation is a lagging indicator: you have to see the inflation before responding, and a company can only respond - an insurance company can only respond - at renewal. The CPI numbers are improving, maybe stagnating a little bit, but the headline number can mask some important underlying trends and for certain lines of business, drivers of lost costs are dramatically higher. The same claim that happened post-inflation conditions might be 20% more than the same claim that happened pre-inflation.

Getting on top of the inflation-induced valuation problem is a key issue and the issue has been hard for the customer base. Insurers are increasing insured values to account for exceptional inflation levels over the last three years. Typically, property insurers would have a 2% to 3% inflation guard to kick in on the policies, but that's not sufficient in this environment. Insurers have been careful to include increases to make sure policies are protected, but those can begin to push up in the mid- to high-teen range in some cases.

And then a final concern voiced by insurers with whom we spoke was the issue of weather events, which appeared to become more volatile than in the past. The weather appears more severe, and particular perils are popping up in places where they were not historically a threat. Hail is a particular example, as is the sort of expansion of the tornado corridor. And a bit of a shift, in the Midwest, the brunt of the 2023 catastrophes, the US experienced 28 separate weather and climate disasters costing at least a billion dollars last year. That number puts 2023 into first place for the highest number of billion-dollar disasters in a calendar year. So weather is a top-of-mind issue for insurers as well.

**[AG] (14:36)**

Now to close this off, could you leave us with Conning's outlook for the small commercial market?

**[BF] (14:41)**

We called the study "Opportunities to Compete." We did that because the important takeaway that we want readers of the study to take away and think about for their own company, are our concerns about the increased competition.

We might see small commercial go the way of personal lines. As we expect the market to soften at some point, comparative raters are going to further fuel and increase competition on price.

Increasing use of comparative raters and a general trend towards agency consolidation will inherently favor the large insurers. However, there's still an opportunity for small insurers to write this market. What they have to do is avoid offering this fungible product.

We spoke with one insurer that offers, for example, contract review as part of its Business Owners Policy (BOP). This is a risk control, sure, but it's also a huge value add for the customer.

The smaller players in the market are going to have to ask themselves if they have the scale to compete or the technological capabilities to establish a horizontal presence on these comparative raters.

Some won't, and they're going to have to leverage their agency relationships, which may be a little bit more difficult as more independent agents are getting gobbled up by the aggregators.

Or they're going to have to get creative with their offering of risk controls, coverages, market niches and things like that to remain relevant going forward and have that opportunity to compete.

**[AG] (16:15)**

Great. Thank you both for joining me today as we went beyond the small commercial report. And thank you all for joining us for today's episode of Beyond the Text. If you are interested in learning more about the small commercial report it is available to purchase at Conning.com or contact us at [insuranceresearch@conning.com](mailto:insuranceresearch@conning.com). We hope you will subscribe to this podcast and join us for our next episode as we stay up to date on industry trends.

Thank you.

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