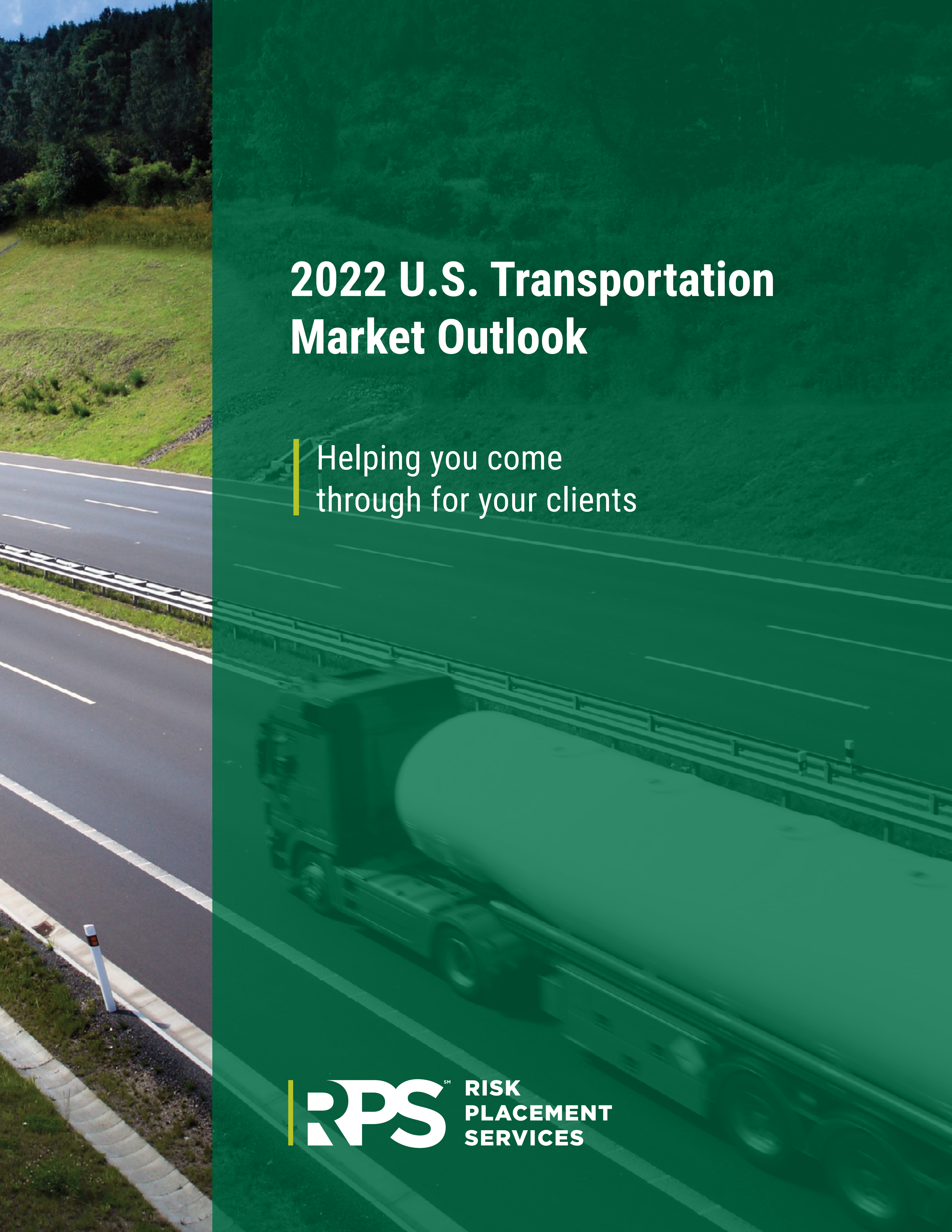

2022 U.S. Transportation Market Outlook

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RPS℠ RISK PLACEMENT SERVICES

The transportation industry has bounced back strongly from the COVID-19 pandemic, but a challenging economic climate and fears of a recession have created some testing times.

The U.S. recorded a 0.9% decline in output during the second quarter of 2022 versus first quarter 2022, which followed a 1.6% contraction over the first three months of the year versus fourth quarter 2021.

Although the National Bureau of Economic Research has yet to declare this a recession, economic fears affect the transportation industry. A corresponding drop in consumer spending is certain to have a negative impact on demand for transportation services across the country.

Despite several headwinds that persist in the industry, Mark Gallagher, Vice President, National Transportation Practice Leader for Risk Placement Services (RPS), remains very bullish on the opportunities for transportation operators moving forward and insurance providers alike. “Trucking and transportation have always been the lifeblood of America’s economy and we still foresee growth and opportunity continuing into 2023. Those insurance providers that are positioned best through market access and speed of product delivery will find growth opportunities in any market cycle in meeting the needs of a wide array of transportation clients.”

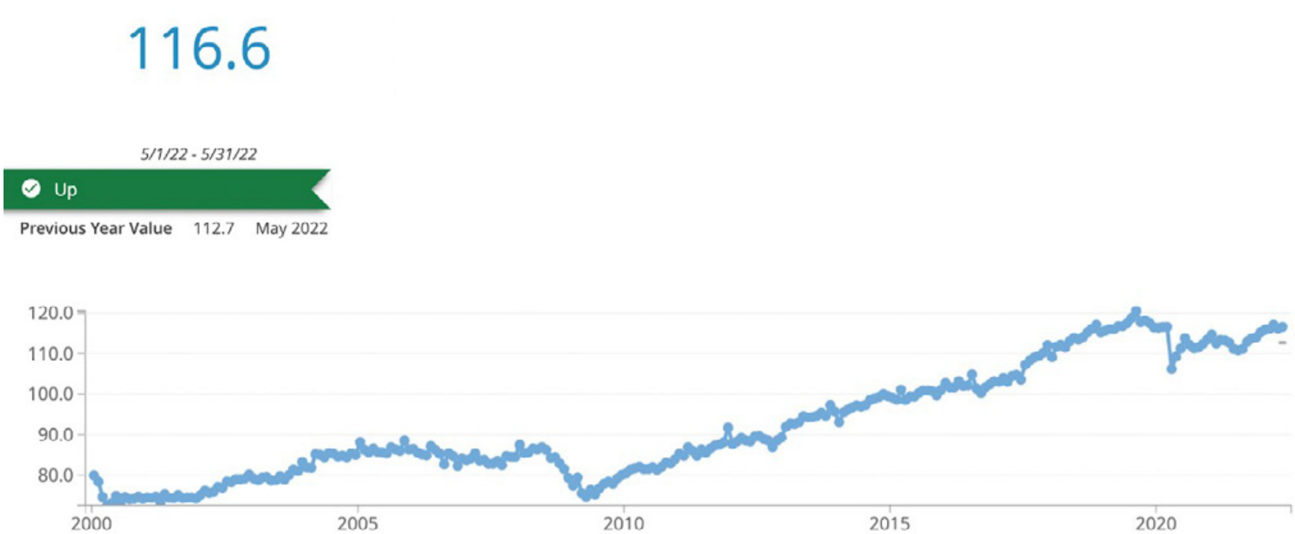
For now, demand for transportation services remains strong, aided by the U.S. government’s COVID-19 stimulus payments that boosted consumer spending in the wake of the pandemic. But if demand for goods does decrease over the coming months, lower freight rates are likely to follow.

“Trucking is often a leader of what is going on in the economy,” noted Mike Mitchell, Area President for RPS, in Charlotte. “Because if people aren’t buying things, then things aren’t going on trucks.”

“Around June 2020, trucking and freight rates really started picking up as the world began to first emerge from the pandemic and trucking was in high demand,” remarked Mitchell. “Those high rates carried into 2022, but now we are starting to see freight rates come down from those peaks.

“That doesn’t mean that freight rates are struggling – they remain healthy for now – but some of the supply chains we’ve experienced over the last couple of years are starting to level off, and some rates are dropping as a result.”

TRUCK TONNAGE INDEX – SEASONALLY ADJUSTED (MONTHLY)



Source: [U.S. Department of Transportation Bureau of Transportation Statistics]()

Outside pressures are also having an impact on rates, with rising inflation reducing the number of new homes being built and flatbed rates dipping as demand dries up.

Gallagher said that falling rates could be particularly problematic for new entrants to the market that had built a business model based on the higher freight rates that had become the norm in the immediate aftermath of the pandemic.

“Building an entire business model on some of those higher rates rather than something more realistic for the longer term could potentially put some of those transportation companies in serious trouble,” he said.

COST INCREASES HIT HARD

Outside of the general economic outlook, the transportation industry is also facing its own challenges.

Operators across the U.S. are facing rising costs as the war in Ukraine continues to exacerbate the global fuel crisis that has led to soaring diesel prices. The average price has risen by 64% over the last 12 months to $5.486 per gallon, having first broken through the $5 barrier in March 2022.

Smaller companies and new ventures are often disproportionately affected by rising fuel costs.

“Compared to larger fleets, smaller truckers don’t have as much leverage or benefit as much from the economies of scale,” Gallagher noted. “Those larger fleets can often get fuel surcharges that help to manage costs, which means that the new venture and non-fleet segments are finding things particularly tough at the moment. And if there is a long-term sustained economic downturn or inflationary period, then things are going to be very difficult for that sector of the market.”

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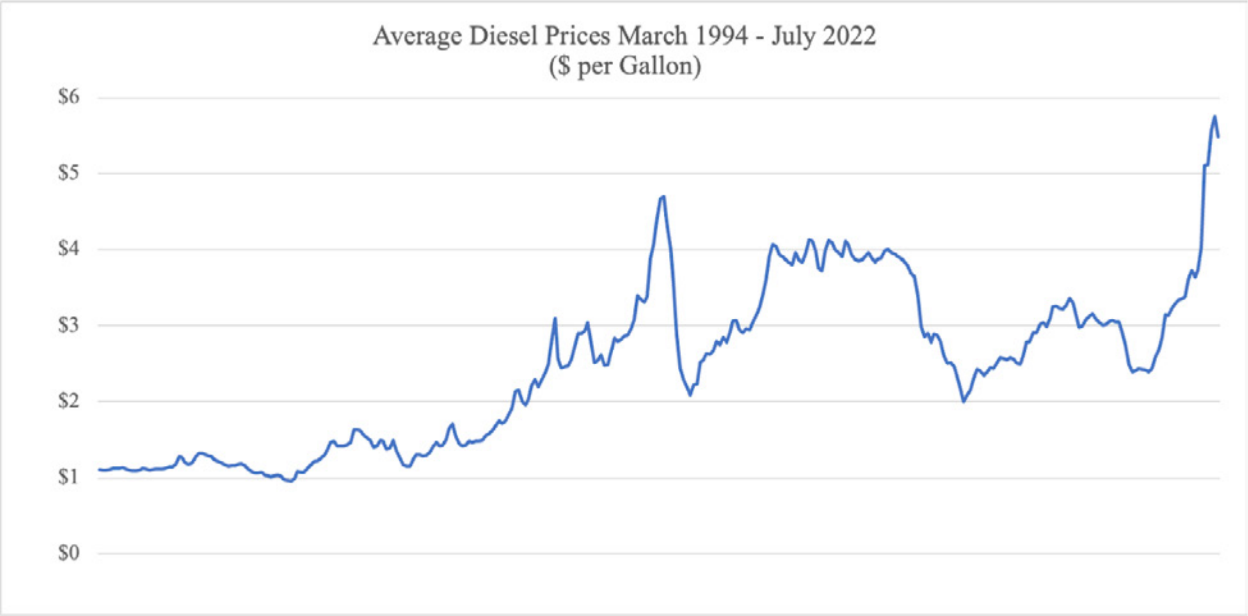

Source: U.S. Department of Transportation Bureau of Transportation Statistics

“We are definitely seeing a trend of those firms that have been operating on thin margins going out of business as a result of these increased costs,” said Eden Hancock, RPS, Area Senior Vice President, in Atlanta. “In some cases that has been as quick as two months into an inflationary period, which is much quicker than we have seen in the past.”

This rise in operational costs has already led to an increase in consolidation in certain sectors of the industry, with larger firms buying up smaller operators as they struggle with the increased cost pressures.

Rising repair costs are also hitting the transportation industry hard, with some reports saying increases to the price of parts and cost of labor are outpacing inflation.

Hancock said this means many firms have been forced to downsize in order to improve the efficiency of their operations.

“Every cent matters to these operators as they look to make themselves more profitable,” she said. “This could mean looking to make their vehicles more fuel efficient, or not having as many excess trucks or spare parts on hand.”

“Inevitably this often leads to a reduction in the overall size of the business too,” Hancock added.

Meanwhile, the cost of new vehicles is presenting an increased barrier for new entrants, as well as stifling growth, with supply chain issues reducing the availability of new vehicles.

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DRIVER SHORTAGE PERSISTS

Acquisition is also becoming a more common way for firms looking to expand their footprint to overcome the industry's driver shortage.

"We are increasingly seeing firms purchase another smaller operator because they have a strong pool of seasoned quality drivers," said Andrey Miterin, Area Vice President, Northeast/Mid-Atlantic region for RPS. "They are also using this to expand into new regions, or even different segments such as intermodal shipping.

"We've seen a lot of growth in this way in some of the southeastern states such as Georgia or South Carolina."

Miterin added that the acquired operator is then incorporated into the larger fleet, with the acquiring firm benefitting from the economies of scale that come with a larger operation.

"They also tend to offer a much more competitive compensation package than the smaller operators too," noted Miterin. "This helps to retain existing drivers as they move over to the new firm."

But the driver shortage remains a massive issue for many firms, with the industry short 80,000 drivers in 2021, according to the American Trucking Associations (ATA). Several estimates say this figure could double by 2030.

The driver shortage remains a massive issue for many firms, with the industry short 80,000 drivers in 2021.

Long-haul drivers are in particularly short supply, with approximately 300,000 truck drivers leaving the profession every year, according to the U.S. Department of Transportation. The pandemic worsened the situation by forcing training and apprenticeship programs to either close down or limit their operations.

The problem has reached national U.S. political attention. An initiative to recruit more female and younger drivers was included as part of the $1 trillion infrastructure bill President Joe Biden signed into law in November 2021.

The new Safe Driver Apprenticeship Pilot Program will allow people who are at least 18 years of age and have a state-issued commercial driver's license (CDL) with a clean record to apply to be an interstate trucker under the direct supervision of an experienced driver.

Jeffrey Marks, RPS Transportation Program Manager, noted that it could be a problem for some carriers and possibly cause rates to rise due to younger, inexperienced drivers.

"They just don't have the required experience of driving these types of vehicles that most carriers in the industry expect," he said. "Having said that, many carriers require drivers to have had their CDL for two years and it is getting increasingly hard to find drivers that meet those requirements."

In addition, many younger drivers are simply not attracted to the trucking industry. Mitchell said an increasing number of young people are going to college and then looking for careers that will make use of their education.

"They're looking to use that degree, and a lot of times that's left us with less truck drivers," he added.

But some fleets may be able to draw solace from the fact that many drivers who left the fleet market to start their sole driver businesses could return to fleet driving.

Many of the increased costs faced by transportation operators are also applying pressure to the costs facing insurers.

"Over the last couple of years we have seen a lot of owner operators either buy a truck or take a truck from a fleet that they leased to start up their own business," Gallagher noted. "A lot of these drivers may be facing the financial challenges of being on their own and may return to leasing back onto a fleet carrier, which means that some of these fleet businesses may not be as impacted by the driver shortage as they otherwise might have been."

Among the benefits of being a driver include the ability to work independently, see the country and have a steady career.

Particularly when considering the lack of drivers in some segments, it can be a rewarding lifelong career with numerous advancement opportunities.

But Marks said the long-haul trucking industry may continue to struggle with a driver shortage until it finds a way to make truck driving more appealing than other industries that recruit workers out of high school.

“To make the job more appealing you need to consider higher pay, benefits and potential work-life balance,” he said. “There are challenges in recruiting young people, particularly when it comes to long-haul trucking when you have to be away from home and family for such a long period of time.”

INSURERS ALSO FACING COST PRESSURES

Many of the increased costs faced by transportation operators are also applying inflationary pressure to the costs facing insurers.

As well as struggling with a lack of availability and an increased cost of replacement parts, insurers are also grappling with a short supply of labor that is increasing the time it takes to complete a repair following an accident.

“This means that vehicles are sitting out of action much longer, which increases rental fees for replacement vehicles as they are simply needed for much longer periods,” said Marks.

Insurer costs are also being forced up by rising claims frequency and severity, an issue exacerbated by the increase in driving miles following the drop-off in road usage at the height of the COVID-19 pandemic.

“The frequency of claims was greatly diminished during the pandemic when the roads were far less congested,” said Gallagher. “There was some evidence, however, that speeds were greater during the pandemic, increasing severity when claims occurred, which led to larger payouts and larger reserves needed by insurers.”

“Now that the roads are getting congested again, this is going to have a real impact on the insurers’ claims costs, because we still have a lot of the same ills, such as distracted drivers, that we had before the pandemic. And that is going to be an ongoing issue for insurers,” he added.

NUCLEAR VERDICTS ON THE RISE

Insurers are also struggling with social inflation, which is being fueled by rising medical costs and higher levels of litigation. This means that nuclear verdicts – cases that exceed $10 million in payments – are becoming increasingly prevalent.

“There are certain large law firms out there that have the ability to obtain nuclear verdicts as a result of finding something egregious in the claim,” noted Gallagher. “That is a concern for every transportation client out there, and they are increasingly coming under scrutiny every time a loss occurs.”

Litigation funding is also a growing problem, with many of these law firms targeting accidents involving large trucks as a way to secure large payouts for their clients.

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"You can't drive through many states now without seeing hundreds of billboards for personal injury attorneys targeting 18-wheelers," noted Marks. "These law firms are targeting trucks because they know there are large insurance policies behind these vehicles with high limits, which means they can secure a large payout if they can prove liability."

Furthermore, the backlog of claims that have resulted from the pandemic is playing a factor.

"A lot of the cases that would have been closed during the pandemic remain open because the courts were closed," said Gallagher. "We are now seeing those cases progressing through the courts, and that is having a big impact on insurers' profitability."

Insurers aren't just looking to add more premiums to their books for the sake of it, they are pushing for that business that is going to help them achieve underwriting profits.

RISING CLAIMS FORCES UP PREMIUMS

All of these inflationary pressures are leading to rising insurance premiums across the transportation sector.

"We are going to see more disciplined underwriting in the future," noted Miterin. "Insurers aren't just looking to add more premiums to their books for the sake of it, they are pushing for that business that is going to help them achieve underwriting profits."

This is leading to a growing number of non-renewals, particularly if the operator has experienced a shock loss or downturn in their safety metrics.

"We are seeing an increasing number of accounts that have traditionally performed well in the standard market, and then have a bad year that leads to a non-renewal from their carrier, and they fall into the distressed market," said Miterin. "This could lead to a double or tripling of their premiums from one year to the next, but there are still some specialist carriers that will compete for this type of business."

For some firms, these increased costs are proving too much, and that is leading to business failures.

"We are seeing a number of cancellations from clients, particularly those that have had a tougher loss history, so they are paying particularly high premiums, and this has led to the closure of a couple of our larger accounts and some smaller ones," noted Mitchell. "The issue has also affected new ventures – those that opened up during the pandemic after they saw the high freight rates that were available and are now beginning to struggle."

As well as pushing up insurance premiums, inflationary pressures are also leading to growing levels of underinsurance, with limits on policies becoming too low to cover the increased cost of replacement vehicles.

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"A lot of the insurers we work with have not received a proper valuation of the vehicles they are covering, and where they think it might be worth $50,000 it is now worth $80,000," noted Mitchell. "Then when the client looks to go and purchase a replacement vehicle for the one they lost, they do not have enough money from their insurance to cover the cost."

The issue of underinsurance and the rise of nuclear verdicts mean that excess insurance is becoming an increasingly important tool for transport operators looking to manage their exposure to large losses.

"We want our clients to understand that this is an extra offering that is out there that provides them with a much greater level of protection in the event of a claim," Gallagher added.

The rising costs of insurance– as well as the increased scrutiny surrounding claims– means that risk management and loss control services are becoming more important.

LOSS CONTROL SERVICES

The rising costs of insurance – as well as the increased scrutiny surrounding claims from carriers – means that risk management and loss control services are becoming more important.

Fleet operators need to be scrutinizing their drivers' safety scores, as well as their hiring practices, training regimens, proper equipment and even routes that may create higher exposure potential to loss.

"Having a safety director on staff that scrutinizes all of these elements is essential, because reviewing safety procedures and even embracing loss control services that are many times offered by insurance carriers are one of the most important components of a transportation business," remarked Gallagher. "Embracing a safety culture encourages owners, managers and drivers to correct any prevalent issues in order to minimize any potential losses that may occur, and will ultimately allow clients to maximize their operating profits."

TECHNOLOGY INCREASING IN POPULARITY

Telematics is becoming an increasingly important tool that allows transportation firms to be better informed about the performance of their drivers and their trucks.

In order to act as a positive force for change, however, transport operators need to make use of the information provided by their telematics devices.

"The firms need to act on the teaching moments they can find in their telematics data to improve driver behavior," said Mitchell. "Even some of our largest clients say that their most seasoned drivers didn't realize some of the things they were doing because they had picked up bad habits over the years."

"This data can be used to create an educational moment for them and can help to create better and safer drivers," he added.

Forward-facing and in-cab cameras are also becoming more prevalent within the transportation industry, helping operators to better monitor driver performance. This technology is also being used to defend claims in court.

"There's a lot of data that supports that the majority of accidents are not the truck drivers' fault," noted Mitchell. "Outward-facing cameras show what was going on outside of the truck, but it is the inward-facing camera that shows what the driver was doing."

"A lot of the cases brought against drivers argue that we don't know if the driver was paying attention, but these cameras can provide the extra proof that will help show the driver was doing the right things inside the cab."

And even if the camera does prove that the truck driver was at fault for the claim, the technology can help insurers to make faster decisions and drive down the overall cost of the claim.

"If the information from these systems shows that our insureds' driver was 100% at fault, then we can quickly make the decision to close out and settle that claim as opposed to spending a lot of money in attorneys' fees, or possibly taking it to trial and getting a nuclear verdict result," noted Hancock.

The benefits of this technology mean that some insurance carriers are now offering discounts to fleets that install telematics devices on their vehicles, whether that be on the installation of the telematics hardware or the insurance premium itself. Some insurers are even mandating telematics devices or camera technology as a requirement of cover.

"Most new entrants now require all vehicles to have forward-facing cameras at a minimum," noted Marks. "So adoption is growing, and it is something we think will become even more common across the industry over the next few years."

Inward-facing cameras are also expected to become more common in the future, although the driver shortage is having an impact on current levels of uptake of this technology.

"Several of the forward-facing camera options already have cab-facing internal cameras built in, with that option turned off if the client or their drivers prefer not to have it on," said Marks.

With numerous technology offerings available in the industry, clients have the flexibility to match up their safety program to what best meets their needs and cost structures.

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DATA IS KEY

The data available from telematics devices is becoming more useful to insurers for assessing the overall performance of a fleet of vehicles.

This could include how driving in certain locations or at different times of day affect losses, and real benefits can be gained for operators willing to share their data.

"Data is becoming an increasingly important topic in our industry," Gallagher noted, "as insurance carriers look for ways to capture more data from their clients in order to better their rates and cut down on exposures."

"Clients who share their data with their carrier partners can benefit from lower rates in the future, and possibly even increased flexibility in pricing if they are able to demonstrate reduced road usage through the data they provide."

Some vendors are even creating live dashboards that rank each driver on their driving performance in order to spot problem drivers.

Clients who share their data with their carrier partners can benefit from lower rates in the future, and possibly even increased flexibility in pricing.

This information can then be used to offer training to poorly performing drivers, as well as letting the operator know which drivers they need to focus on retaining within their pool of drivers.

"Telematics can be great for providing the information needed to run a safer operation," noted Hancock, "but if you're not using that information to improve your operation, it can actually be used against you to say: 'You knew about this problem amongst your drivers, so why didn't you do anything about it?'"

THE RPS ADVANTAGE

With the shifting Transportation insurance market, it is essential that retail agents partner with an MGA/wholesaler that truly understands the unique exposures of this dynamic industry.

RPS has a dedicated Transportation division with experienced underwriters across the country who are familiar with the industry's risks and operating model. Because of our deep industry knowledge, RPS can develop solutions customized to each Transportation client's individual needs.

Having been in business over 25 years, RPS also has longstanding relationships with many insurers and reinsurers, assuring that our placements get the attention they deserve.

As part of RPS's commitment to the Transportation industry, we are constantly investing in our people, their education and new technologies. With more than 80 offices nationwide, RPS' Transportation practice is backed by the broader RPS organization, always improving and innovating to help insurance agents secure comprehensive coverage for their Transportation clients.

CONTRIBUTORS

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ABOUT RISK PLACEMENT SERVICES

Risk Placement Services (RPS) is one of the nation's largest specialty insurance products distributors, offering solutions to independent agents and brokers in wholesale brokerage, binding authority, programs, standard lines and nonstandard auto. The RPS team, fueled by a culture of teamwork, creativity and responsiveness, works with top-rated admitted and non-admitted carriers to design robust coverage for clients through its more than 80 branch offices nationwide.

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