Insurance Marketplace Newsletters
21st Century Edition – No. 1

The insurance industry is known to run in cycles – a "hard market" characterized by high rates, restricted coverages, lower sub-limits and overall limits mandated by a diminution in capacity; and a "soft market" reflecting the opposite conditions in every respect.

The last time a hard market occurred was in the 1984-1987 period and the property and casualty industry has been in a soft market mode for most coverages since then.

The benchmark for insurer profitability is known as the combined ratio:

$$\frac{\text{Incurred Losses and Expenses}}{\text{Net Premiums Earned}}$$

Whereas this ratio generally has run over 100%, the resultant underwriting loss is usually more than offset by investment income, consisting of capital gains and portfolio yield. Both these offsets have declined markedly in recent years and insurance companies, now headed by financial executives, have put the brakes on rate cuts. They have rejected as passé cash flow underwriting (practiced when interest rates were at all-time highs) as well as market share underwriting (albeit at a loss) practiced by their predecessors. Further driven by escalating reinsurance rates financially-oriented managements have mandated and enforced strict underwriting standards and whopping rate increases as well as coverage restrictions.

As insurance buyers and their brokers scurry around to find acceptable coverage terms and conditions the number of submissions has multiplied several fold. Since underwriters cannot be created overnight, insurers have imposed restrictive conditions on merely entertaining submissions for quotes:

- A risk that goes out to bid every year, barring special circumstances, will be viewed as a perennial shopper and probably not worth the effort to go through the underwriting process for.

- Insureds with unfavorable loss experience both as to frequency and severity will be harshly punished, perhaps with a doubling or tripling of premiums.

- Those insureds who do not practice good loss control will be viewed as wishing to pass along unnecessary claims to their insurers. Loss control can translate into physical safety and loss prevention measures; the practice of good corporate governance; as well as contractual transfer of risk to others backed up by appropriate documentation.

- A prospective insured that presents inaccurate or incomplete exposure data is considered a poor risk as underwriters ask themselves, "How can I assess this risk if they cannot accurately present their own vital statistics"? – insurable values, construction and protection details, square footage, occupancy, revenues by source, accurate business interruption values and credible hard copy loss runs for five years. Prompt, complete answers on an application are essential.

Those insureds that have been buying well for the past several years, while enjoying considerable savings, are now starting with an unrealistically low base. Thus, renewal quotes look startlingly high in comparison, but in many cases will still be lower than prices paid and coverages obtained just a few years ago.

For real estate operators, especially those with retail properties, they will be able to pass along these increases in their CAM charges; and their tenants (especially the chains) will have been experiencing these hefty increases from their other landlords. This is true to a lesser extent in office towers and not at all from habitational properties.

Therefore, some essential guidelines:

- Renew with your incumbent markets, if feasible. Obtain early commitments and proceed to bind coverages.

- If going to bid:
  - start early
  - restrict your effort to a limited number of brokers and markets

- Present a complete submission, along with coverage specifications.

- Select insurers with whom you can establish a reasonably long-term relationship. They, after all, would like to feel they can amortize the significant acquisition costs over a few years, not just one.

- Push for early policy delivery. Once received, study them clause by clause to ensure you've got what you paid for. Engage in an active, unstinting effort to remediate observed deficiencies.

These are serious times and the corporate strategy and effort should have full support from the highest levels of management.

4/16/01