Insurance Marketplace Newsletters
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As premiums double and triple, the comment most often heard is "Are they (insurers) trying to make it (the soft market years) up all in one year?"

The answer is: Not likely to happen.

The reasons are:

- Years of under-reserving have put pressure to "bolster their reserves", a euphemism for finally admitting and quantifying the sins of the past. Sources of this pressure have been internal and external. Managements themselves and their boards of directors have decided to bite the bullet plus increasing pressures from outside (independent?) auditors and rating agencies.
- The combination of investment income and realized capital gains has always more than compensated for underwriting losses. This euphoric bubble burst in 2001:
    - 9/11 happened – although only $10 billion or so was recognized by the industry in 2001.
    - Interest rates were at record lows
    - The stock market cratered.
- Underwriting results were disastrous. These are measured by the combined ratio, calculated as follows:

  $$\frac{\text{Losses + Operating Costs}}{\text{Premium Income}}$$

  This key ratio came in at 116, the third worst on record and the highest in 17 years when the cycle turned upward (a "hard" market).
- The industry's surplus (net worth) fell almost 9% to below $300 billion for the first time in six years.

Overhanging this dismal picture are the following factors:

- Reserve deficiencies yet to be recognized could be as high as 15% of statutory surplus. The ultimate cost of asbestos and environmental liabilities has not yet been determined.
- As noted above, the full impact of 9/11 is unknown and hangs like a sword of Damocles.
- Mold claims (prior to coverage exclusions) could be the next asbestosis.
- Unexpected Workers Compensation claims may require additional reserving.
- The Enron picture needs to be sorted out, especially as to whether contentions of fraud can lead to coverage denials.
- Statutory reporting requires recognizing realized capital gains or losses. The industry is sitting on $17.7 billion of unrealized capital losses.

If multiple premium increases weren't bad enough, coverages are shrinking dramatically. After all, isn't that what insurance is for?

PROPERTY INSURANCE

Blanket limits have become an anachronism, at least for now. Reasonably adequate loss limits are hard to come by. With insurers imposing separate limits for each property and in many cases separate limits for rental income or business income per property, insureds should view this imposition as an opportunity to carefully review replacement cost figures and income worksheets.

As underwriters are once again underwriting, it is incumbent to submit an all-inclusive renewal package:

- Detailed property listings including complete COPE information (**C**onstruction **O**ccupancy **P**rotection **E**xposure).
- Hard copy insurer (= credible) loss experience for the past five years.
- Detailed coverage specifications.
- Elevation certificates as flood coverage in critical zones is shrinking or disappearing.
- Evidence of corrective action in response to previously issued engineering recommendations.
- Full street addresses and zip codes (the latter being one determining factor as to whether an insurer will consider offering Terrorism insurance).

- Inadequate sub-limits are the rule rather than the exception. These run the gamut from Demolition & Increased Cost of Construction to Soft Costs in Builder's Risk policies.
- Deletion of coverage enhancements which have been virtually there for the asking since 1987.
- Broadening of the War Exclusion to include any possible definition of Terrorism, including Bioterrorism.

LIABILITY INSURANCE

Absolute exclusion for toxic mold and mildew.

Deletion of general aggregate limits on a per location basis.

Sharply reduced capacity and high premium increases for Umbrella Liability.

Unwillingness to offer Workers Compensation insurance where there is a concentration of employees at one location. At least one insurer will decline to write property insurance for an office building owner when a review of major tenants reveals they already have a major exposure. This problem of aggregation is crossing many lines of coverage, especially Terrorism.

DIRECTORS & OFFICERS LIABILITY

The "Failure to maintain insurance" exclusion has been showing up in more policies. This is especially serious as certain coverages are becoming prohibitively expensive or are not available at any price. Good risk management here would be to memorialize the company's efforts to obtain insurance for its exposures, whether or not insurable.

RISK MANAGEMENT PROTOCOLS

TRANSFER RISK: Wherever possible, transfer risk to others by contract – such as to outside contractors who may be responsible for liability claims, or to tenants, or to purchasers of your property. Indemnification and hold harmless agreements should be backed up with insurance requirements evidenced by proper certificates naming you as an additional insured.

IDENTIFY RISK: Conduct a risk management audit of every aspect of your business, thinking outside of the box.

QUANTIFY RISK: Assign a dollar range to each risk so identified.

RETAIN RISK: Since insurance companies are notoriously inefficient mechanisms through which to pump premium dollars, consider deductibles or self-insured retentions that might take a lot of frequency out of your loss experience with more than a concomitant premium saving. By doing so, you are also demonstrating to a prospective underwriter that you can't expect them to pay for all your losses but that you're willing to absorb them to some degree.

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