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IN THE KNOW

Insurance Market Outlook 2008

More of the same ... sort of

As we predicted last December, 2007, the property casualty insurance market would be marked by rate decreases and broadened acceptability of risk. And so it was. Is the stage for 2008 set to be a repeat of 2007? Yes, maybe and no.

While it is the political season and hedging your answers is all the rage, that is not my intent. While we anticipate the property casualty market to remain "soft" in 2008, there are some developments on the horizon that may interrupt last year's continuity.

First, the reasons for **Yes**: A quiet storm season, wildfires notwithstanding, did not impose significant catastrophic losses for insurance companies. Balance sheets for most insurance companies remain healthy, bolstered by good earnings providing capital to pursue aggressive underwriting. Speaking of earnings, it seems every insurance company announces quarterly earnings more favorable than last year and in-line or better than expectations. A strategy to favor the Midwest with its limited catastrophic exposures remains in place creating a favorable environment for states such as Michigan. Finally, reinsurance terms (the insurance bought by insurance companies) look to be favorable for most companies this year. Aggregate these factors and you create an environment where the core rates for an insured with favorable loss histories and non-volatile exposures remain flat to declining as much as 15 percent. A rogue insurance company looking to make a point or establish a position in the marketplace may cut a particular risk further. We will address a possible cause for concern later in this article.

The case for **Maybe**: Accepting all the reasons above in our case for Yes, the fact remains that rates over the last few years have fallen hard and fast. Rate adequacy is getting particularly thin especially for those risks with an unattractive loss history or in a difficult class of business. Simply stated, there isn't much room for error by underwriters. We have already begun to see underwriters decline risks indicating the pricing is inadequate for the exposures. They would rather "take a pass" than accept the risk at the current pricing and are happy to let an inexperienced carrier learn the hard way the difference between growth and bad growth. Another emerging trend supporting the case for "Maybe" is increased due diligence in the form of underwriting. Questions and information about a risk have increased and the answers invariably prompt even more questions, testing the patience of both the agent and the client. As stated previously, there isn't much room for error at these rate levels. An underwriter's position now is a risk needs to score above average to obtain current market pricing. Given all these reasons, we still believe the case for "Maybe" becomes more manifest as 2008 evolves.

Now is the time to begin aligning your risk management and insurance program with an insurance company and agency that will help you navigate through these changes.

The case for **No**: The soft market of the 1990's was marked by a gradual retrenchment in core rates and liberalization of terms and conditions each year. The current "soft" market descended with a vengeance and accomplished in a few short years what previously took a better part of a decade. While there is clear evidence to demonstrate that loss frequency is down, loss severity

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is up. Loss costs are creeping up as well. The 1990's was also a time of economic expansion. Increased payroll and sales by an insured helped offset the core rate reduction and there are imbedded efficiencies as a result. An increase of $1 in sales or payroll does not increase an insurance company's exposure in a linear fashion but does generate additional premium. Today the economy is flat or nominally positive at best. (Michigan would be thrilled to be flat). The other significant component missing from the 1990's formula is the investment markets. The 90's produced a bull market in equities and declining interest rates created capital gains in the fixed income portfolios of insurance companies. All these investment gains helped offset the erosion of underwriting results that invariably accompany a soft rate market. Today's investment environment is just the opposite. Interest rates remain at historical lows generating little if any capital gains and the yield from those investments barely cover inflation. The broad equity markets struggle to keep pace with inflation as well. Consequently, an insurance company looking to its investment portfolio to bail it out of bad pricing or underwriting decisions may be disappointed. In addition, we have heard rumors of some insurance companies beginning to release or harvest loss reserves to shore up their financial results which is generally a sign of the end of cycle rather than the beginning. Again, barring a significant financial event, we believe the probability of a case for "No" becomes more likely as 2008 evolves rather than a mass epiphany by insurance company executives after New Years. Finally, conventional wisdom says the soft market will continue unabated. The contrarian part of us says when everybody is on one side of the opinion boat it may be wise to begin thinking differently. While we are confident in our reasons for "No," trends can stay in place longer than fundamentals would otherwise dictate as evidenced by the recent debacles in the housing market.

Whichever scenario unfolds, all are leading to a crossroads for the property casualty business. For clients now is the time to begin aligning your risk management and insurance program with an insurance company and agency that will help you navigate through these changes. As previously mentioned, we are beginning to see seasoned underwriters and sophisticated carriers decline some risks at current pricing levels. Are the insurance companies writing those risks being declined by more experienced carriers smarter than everyone else? Doubtful. Possessing an insurance license and capital should not be confused with wisdom and experience. **Why should a client care?** After all if an insurance company is willing to offer terms and conditions significantly better than someone else isn't that all that matters? Allow us to offer just **a few other points of consideration:**

- Risk management and insurance matters with customers are becoming more involved and complicated. An inexperienced carrier will struggle with how to deal with a demanding customer's insurance language requirements in your program, or worse, they will just say no. So you saved 10% on your insurance program, but you lost a customer or prospective customer because the carrier could not or would not respond to your needs.
- At the first sign of adversity, an inexperienced carrier will cut and run leaving you at the mercy of the "experienced " carrier whose terms and conditions may be different if you had been with them before the market firmed up.
- All claims are not created equal. The claims experience is where "the rubber meets the road." A claim is the essence of the insurance contract. The inexperienced carrier will be learning as they go. Our suggestion is to let them learn on somebody else's claim.
- Loss control is not fungible. This is particularly true regarding workers compensation where mistakes are not a one year event. An employer will live with the effects of losses for four to five years.

I'll close with a comment about claims. One of the consequences of a "soft" rate cycle is insurance companies look for other ways to shore up eroding margins that inevitably accompany declining rates. We have observed a disturbing trend in the adjustment of claims where matters are being interpreted tightly and declinations issued for "technical" reasons. These technicalities include, late notice, failure to provide information, the entity in question was not a named insured on the policy or one of the hundreds of detail requirements in a policy. A thorough risk management and exposure review can help alleviate these issues or a least make for a stronger advocacy position.

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We're here for you.

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