

The mood of the market

Experts at The National Alliance Academy Forum weigh in on trends and challenges

By Elisabeth Boone, CPCU

On a good day, predicting the path of the property/casualty market is a tough task. Since the dawn of the new millennium, most efforts at prognostication have been frustrated by unanticipated events like 9/11 and the ongoing threat of terrorist attacks, a wave of killer storms, and a growing energy crisis, to name just a few.

That being said, however, it's still possible to examine current market trends and essay an informed look into the future. That's what happened at the Academy Forum hosted in March by The National Alliance for Insurance Education and Research at its MEGA educational event in Denver.

At the recent Forum, five representatives of key industry segments shared their experience and insights into the current commercial lines market, which so stubbornly defies easy characterization.

Moderated by Christopher Ketcham, executive vice president of The National Alliance, the panel consisted of Wendy Baker, president of Lloyd's America, New York City; Mark DeLillo, North American risk manager for Taylor Woodrow, Inc., a home builder based in Bradenton, Florida; Richard Kerr, chairman and CEO of MarketScout, Dallas; Jim Poolman, North Dakota insurance commissioner; and Charles Wassberg, regional vice president in Dallas for Central Insurance Companies.

Reading the barometer

MarketScout has been tracking commercial property and casualty rates for five years with its Market Barometer®. According to Richard Kerr, "The data for February 2006 show an overall composite decrease of 5% across all lines and across all parts of the United States." Commenting about the devastating hurricanes of 2004 and 2005, particularly Katrina, Rita, and Wilma, Kerr said, "All we heard was that the market was going to harden. Many prognosticators, including the CEOs of large insurers, predicted that not only property but all lines of coverage would turn, and the entire market would harden because of the impact of hurricane losses."

In fact, "It didn't happen," Kerr commented. "The areas that did turn harder were what one might expect—offshore energy, habitational, and property risks—but overall, the impact was not there." Certainly, some geographical areas were hit as well. "Within the state of Florida alone, for instance, there's almost \$2 trillion of insured value," Kerr continued, "but there's \$200 trillion of value across the United States. So while Florida may be suffering from 30% to 40% rate increases, it's mitigated largely by the other placements," he said.



*Sharing their expertise are
MEGA Forum panelists:*

“Business income is on a somewhat similar trend because it’s so closely related to property,” Kerr said. “General liability was soft in August. Umbrella and excess relatively closely follows general liability,” Kerr said.

“Workers compensation was down 4% post hurricanes—they really didn’t have any impact—and it continued with further decreases. There was a little blip upward, but I think we’re going to see rates overall continuing to decrease as more of the workers comp reforms begin to take effect,” Kerr commented.

“Professional liability is headed toward a decrease in premium,” he said. “D&O is very much the same. EPLI was a very hot topic for a while, and it’s still a very important coverage, but it’s settled down much like some of the other standard coverages such as fiduciary, which is down 2%. The same with crime, which is flat, and in surety there’s been no real premium change,” Kerr remarked.

Results by account size

“With the help of The National Alliance, we’re also tracking small, medium, large, and jumbo accounts,” Kerr noted. “Small accounts are those up to \$25,000; medium, \$25,001 to \$250,000; large, \$250,001 to \$1 million; and jumbo, over \$1 million. Over the last six or seven months, the renewal premium across all accounts has been going down. The trend generally is, the larger the account, the more the discount. An exception is that the jumbo accounts are starting to move closer to the smaller accounts,” Kerr commented.

Examining the data by industry, Kerr observed, “Energy is the one sector that has gone up; it has suffered rate increases pretty much across the board, followed by habitational, and some public entity risks. Those that continue to have rate decreases are manufacturing and the service industry.”

Considering the stock performance of property/casualty stocks in 2005, Kerr noted, “As a whole, the ones that really got hurt were the reinsurers because they suffered the most from the hurricanes. Their stocks were down 5%.” Primary insurers were up 9% to 9.5% and brokers were up 13%. “Overall, the insurance industry did very well in 2005 compared to the Standard & Poor’s 500, which was up 3%,” Kerr pointed out.

More good news can be seen in the industry combined ratio for 2005, Kerr remarked. “It came in at 101, after the impact of the hurricanes. The expectation for 2006 is 97, and that means we’re not going to see a lot of premium increases.” It also means that the industry could see an underwriting profit for the year, only the second time in 27 years that has happened.

Over the past several months, Kerr observed, substantial amounts of capital—about \$75 billion—have been coming into the property/casualty market. The existing high capacity coupled with this influx of new capacity means that prices can be expected to go down, Kerr concluded.

View from Lloyd’s

Wendy Baker, president of New York City-based Lloyd’s America, a wholly owned subsidiary of Lloyd’s of London, said \$9 billion, or 40%, of Lloyd’s of London’s total premium is in the United States. “Our next biggest market

is the UK with about 30%. We also write business in Australia and Bermuda, and a lot of our business is in the old colonies. About 49% of our business is reinsurance, and about 51% is direct insurance; in the United States, most of that is surplus lines business. We are licensed in two states: Illinois and Kentucky.”

In addition to Lloyd’s original strong presence in the marine market, Baker said, “We write about 40% property and 25% casualty. We write specialty casualty and a lot of GL, and we have a big energy book.”

Commenting on Lloyd’s performance in the market, Baker said, “We’ve had a lot of ups and downs over the last 15 years. It was a little bit like a roller coaster. We’d have a couple of years of profit; then we’d bring the prices down and write as much business as we could—and then we’d have a humongous loss.”

In an effort to ‘get off the roller coaster,’ early in 2000 the Council of Lloyd’s and other leaders began to look at the market and consider how it could be managed better. At least part of the problem was the result of a system where some syndicates were profitable and well managed, while others were run in what Baker described as a “cowboy” style.

“We now have a franchise system at Lloyd’s,” she explained. “Lloyd’s is the franchisor over the 44 managing agents and 64 syndicates. It’s been a very good experiment, and we’ve had greatly improved results over the last five years, despite 9/11 and the hurricanes of 2005.”

Among the key issues that confront the property/casualty business, Baker said, is the need to control the underwriting cycle. “Why do people continually pour money into an industry that has had only one profitable year since 1980?” she asked.

Also on the front lines is tort reform. “Litigation costs amount to \$1,000 per person,” Baker said. “It’s 2% of GNP.” Particularly frightening, she pointed out, are asbestos costs. “There are a lot of people who were injured by asbestos and deserve to be paid,” she said, “and \$70 billion has been paid out so far. Of that, only \$30 billion went to the claimants, and \$40 billion went to lawyers.”

Addressing the subject of catastrophe losses, Baker said, “I don’t believe in government involvement. Natural catastrophes are finite losses; we can handle them if we’re allowed to charge the right price in the right place.”

Risk management view

Assessing the current commercial lines market from the standpoint of the insurance consumer was Mark DeLillo, North American risk manager for Taylor Woodrow, Inc., and Beneva Indemnity Company in Bradenton, Florida.

“Cataclysmic events, both natural and man-made, have rocked the U.S. commercial insurance marketplace over the past four years,” DeLillo observed. “The Insurance Services Office estimates the U.S. property and casualty insurance markets will pay catastrophe losses in excess of \$56.8 billion for insured losses in 2005, nearly double the record amount paid in 2004,” DeLillo said. “The true extent of uninsured losses may never be known. But one thing is certain: the courts will decide far too many disputes over what is covered and what is not.”

“Yet in spite of all this,” DeLillo continued, “industry-wide surplus has increased substantially, and these losses can be easily absorbed. Investment income appears once again to be a significant contributor for the U.S. property/casualty industry.”

“What effect, if any, can we expect with regard to property renewals?” DeLillo asked. “Hurricane-prone areas will face rising percentage deductibles for wind, limitations in available capacity, and subtle wording changes in policy forms that will only become evident after a loss occurs.”

“In spite of the record losses and these other complications,” DeLillo remarked, “I do not see property insurance rates rising to unacceptable levels in the near term.”

Describing his own company’s experience, De Lillo said, “With nearly half a billion dollars in insured value in Florida but no losses of any significance in the past four years, in March we were renewing our property and builders risk cover with rate increases of 35% for Florida and Texas, 15% in California, driven by quake concerns, and flat everywhere else. We have been able to secure improvements in other areas that have previously been sublimited or otherwise restricted.”

Proactive planning is key to managing exposures, DeLillo asserted. “As our business continues to experience planned rapid growth in Florida, several years ago we initiated disaster preparedness and recovery plans in addition to business continuity plans at all locations. Knowing that we faced limitations in coverage, mainly from increasing percentage deductibles for windstorm, we simply recognized that an insurance policy is not a disaster recovery plan but merely one means of financing a portion of the losses we could face,” DeLillo said.

Regulatory outlook

Addressing the commercial lines market from a regulatory perspective was Jim Poolman, who is currently serving his second term as North Dakota insurance commissioner.

“The commercial lines marketplace has been good in recent years, despite catastrophes,” Poolman declared. “The overall financial health of the industry is good. The market generally appears to be competitive, with some exceptions such as medical malpractice, which is very state specific.”

Poolman cited a number of “issues that keep us awake at night in terms of financial solvency,” the first of which is asbestos. “Claims are on the rise,” he said. “The Insurance Information Institute said asbestos losses could reach \$65 billion—that’s more than the claims after 9/11.” Because of litigation costs, “Many asbestos manufacturers have gone bankrupt. Asbestos has a long latency—sometimes more than 40 years,” Poolman noted. “Some people are filing claims despite not showing symptoms, before the money runs out.”

Addressing the subject of natural catastrophes, Poolman said, “The National Association of Insurance Commissioners plans to examine the impact of global warming and climate change on weather patterns and storm activity,” Poolman said. “We must talk about where people can build, and about building codes. Should we have an all perils catastrophe policy?” He also mentioned the wind versus water issue that is plaguing home owners and their insurers in the Gulf Coast states. “If a home is totally destroyed, how do you determine whether it was caused by wind or