Strategies for a Firming Insurance Marketplace

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The insurance marketplace took it on the chin in 2011. Recent estimates peg the total economic loss resulting from last year's collection of catastrophic events at over $350 billion, the most costly year on record. The insurance industry absorbed roughly $115 billion of that, which ranks second only to 2005 (approximately $123 billion - remember hurricanes Katrina, Rita & Wilma). Insurers continue to report "combined ratios" well in excess of 100%. In simple terms, the combined ratio is loss expense + operation expense divided by earned premiums. So a ratio in excess of 100% means the insurer's expenses exceeded premium intake. In more positive economic times, where investment income opportunities flourish, insurers might offset a greater than 100% combined ratio with a prudent investment portfolio. Unfortunately, the economic conditions of 2011 did not support such a strategy. Bottom line is very few insurers had a positive one in 2011.

How are insurers reacting to their 2011 results? For the majority of property insurance renewals, the so called "soft" market conditions are now a distant memory. Underwriters are applying more scrutiny in their underwriting process, asking for more detailed information and revisiting loss control recommendations with renewed fervor. Claims experience and building replacement cost valuations are under the microscope as well. Reinsurance costs are up. Insurers are restricting how much insurance (capacity) they offer in areas they believe are subject to natural catastrophic events such as windstorm, earthquake or flood. All of these are symptoms of a firming market. The most obvious and financially concerning symptom, however, is an indiscriminately applied rate increase, regardless of a risk's specific characteristics and/or claims suffered. Even worse are flat out non-renewals, which, we are happy to report, we have not seen much of yet.

So what's an insured to do? While some folks might quip that a market cycle needs to run its course and there is little we can do to control it, there are some things to consider which might mitigate the affect of a firming insurance market for your specific program. They are:

- Revisit your current risk profile vs. insurance in place - understanding the various exposures specific to your unique operations and how policies might respond is always recommended, but with insurers raising prices and restricting coverage, such knowledge is more critical than ever. While cost is certainly an important component, an uncovered loss is rarely worth the premium savings. In contrast, paying for coverage you don't necessarily need is financially detrimental as well.
- Review your loss history - as previously mentioned, underwriters will be focusing on your claims more closely (typically the last 5 years). Your current and past insurers provide loss runs which are, in turn, provided to other prospective insurers. Make certain the loss amounts are accurate, especially reserves on any open claims. Inflated loss amounts may negatively influence an underwriter's perception of the risk. Identify any unusual, out of your control, circumstances for a claim via an addendum to the insurer issued report. Similarly, if you have sold or ceased an operation that suffered a loss, that needs to be clearly articulated as well. Lastly, look for any trends, frequency or lack thereof when considering the cost savings for raising a deductible or retention.
- Embrace risk management - many insurers include risk management surveys as part of the service they provide. Suggested loss control measures can vary in scope, complexity, severity and cost. A firm market (i.e. increased premiums) often redefines the cost vs. benefit comparison and payback period, making the investment in such measures more appealing from a purely economic perspective. A good example of this is the installation of a seismic gas shut-off valve for buildings located in earthquake zones. Insurers may offer a significant premium credit for such installation. Other risk management policies and protocols may involve minimal or no "hard costs" but, if implemented, provide an underwriter more comfort allowing

them to offer more appropriate rates. Ultimately, any additional risk management applications may also prevent or minimize an actual loss which may be an equally compelling reason to contemplate their implementation.

- • Meet your underwriters - face-to-face meetings are beneficial in most business transactions. Underwriters appreciate the time and effort you invest meeting with them. The direct dialogue allows them to better understand your operations and, most importantly, get a gut feel for your risk management philosophy. Discussions can also clarify unusual circumstances of a particular claim, recently implemented loss control measures and management's overall business strategy. Think about it. An underwriter is taking a calculated chance that you will not suffer a significant, preventable claim. If an underwriter is impressed by your operations and management firsthand, more reasonable premiums will often follow.
- Start the renewal process early - the soft market we've enjoyed over the last 8+ years has spoiled most of us with regard to the potential intricacies and timing of the renewal process. The wealth of insurance capacity, rate decreases and accommodating underwriters often allowed for "last minute" renewal negotiations based on limited, available information on hand. As mentioned above, underwriters are applying more scrutiny and risk modeling which will lengthen the process. A late start may eliminate some potential insurers from responding or prevent them from providing their most competitive quote.
- Consider alternative program structures - this is a broad topic which could easily justify a lengthy article or white paper in and of itself. Your risk profile, risk appetite, amount of insurance premiums involved, and short & long term business plans will all come into play in determining potential program structures. For example, earthquake capacity for the Northwest may continue to shrink causing primary property insurers to offer less limits and/or charge higher premiums, thus warranting separate or different layered program options. Or, you currently enjoy a $10,000 base deductible on your property program and have only had two minor losses over the last 5 years. Perhaps the premium savings for a higher base deductible should be contemplated. Other possibilities might include self-insured retention programs, captives (of all shapes & sizes) and risk pools. But remember, rarely are such alternative risk transfer vehicles short term "silver bullets". Each may take significant time, effort and capital to implement/administer. Diligent analysis should be conducted to confirm such programs truly fit your risk profile, risk appetite and financial strategy.
- Partner with the right insurance advocate - you have a business to run, employees to manage and transactions to close. Perhaps you are relatively new to the insurance procurement process and have yet to experience a hardening market. Partnering with an insurance professional with appropriate experience, knowledge, market access, service culture and resources is critical. Your agent or broker should be an extension of your management team with your firm's best interests clearly in focus. The quality, accuracy and format of the underwriting information provided to prospective insurers can make a huge difference on if/how underwriters consider your risk. Positive insurer relations and market leverage also come into play. As the direct contact to the insurance marketplace on your behalf, proper preparation, representation and negotiation by your agent or broker is paramount.

One could say all of the above measures should be part of the annual renewal process regardless of market cycle. While true, the recent soft market fostered an expectation for rate decreases which were often easily achieved with or without due attention to the considerations above – because the majority of insurers were aggressively protecting market share. Unfortunately, the tide appears to be changing. Shoring up for your next insurance renewal by undertaking some or all of these suggestions will prove a worthy investment of your time and effort.