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The New Risks in the Insurance Industry

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For many years prior, the insurance industry cycle was three years. It was three years of soft market followed by three years of hard market. Although markets had different degrees of softness and hardness the cycle was quite constant. In the 80's this cycle went haywire and a new constant was initiated – it seemed for some time a never ending soft cycle appeared. Purchasers of insurance were continually obtaining insurance at prices below their previous years cost.

Insurers were using the investment income to offset losses and operating expenses while at the same time they were able to purchase reinsurance at very low cost. The investment income all but disappeared and insurance companies lost heavily. Recently the availability and pricing of insurance has changed. In addition to the stated causes there is a shrinking of the insurance company base caused by the consolidation of carriers. The problems of September 11th just exacerbated the deteriorating situation and more recently ENRON and the Arthur Andersen debacle have taken their toll on the industry.

With this as a background lets look at the insurance marketplace of today and how to get the most “bang for your buck”.

Fewer and fewer insurance companies are willing to enter an arena where they have little or no experience. Municipalities are not easy risks to underwrite. They have complex exposures that require knowledge to underwrite. They are subject to large losses. Consider the risks in municipalities – Police, Jails, Nursing Homes, Fire Departments, Parks & Recreation areas, Water & Sewer, Power Generation Plants & Transmission Lines, Dumps site open & closed, Municipal Transportation – each one a difficult exposure to underwrite in their own rite and when many are combined in one risk the difficulty is magnified.

Today your insurance cost will generally increase from 20% to 35% over your immediate past years premiums. In some cases, rates can jump 100% and higher. Is it possible to mitigate these increases? The answer is “Yes”. While some increases are almost a given you can modify them by using good judgement. Your past loss experience is a major factor in the rating and acceptability of an insurance account. You may be able to explain losses and what you did to reduce or eliminate them from occurring in the future. You can adjust your insurance by adding or increasing deductibles. Using large deductibles with “basket” aggregate deductibles is becoming more acceptable with higher costs.

It is always wise to have deductibles for property insurance. Sometimes it is reasonable to accept large deductibles without cost savings to make your exposure more acceptable to the insurer. For instance, if you have a building that is in poor condition or in an area that concerns the insurer accept a higher deductible or consider actual cash value in lieu of replacement cost for buildings that are no longer very functional.

We have dealt with clients who have totally self-insured and we feel that generally this is neither effective nor reasonable. You have a responsibility to taxpayers to protect their assets and bonding to pay large uninsured losses in not a prudent approach.

Another method of containing costs is risk management. This is a very common term and often misused. Simply put it is simply reviewing exposures to loss and taking appropriate steps to reduce or eliminate potential losses.

Among the best ways to obtain quality insurance at a fair price is competitive bidding. Like anything else, if it is done well it is very effective, if not, it is like comparing “apples to oranges”. Someone who understands insurance must draw up the specifications. Each bidder must present a basic bid based upon uniform standards. The specifications should also allow for some variations in the way you will accept proposals in ways that can be quantifiable (e.g. different deductibles, combining coverages, partial self-insurance). You should also allow for single lines of coverage to be awarded to the selected successful agent regardless of who submitted the proposal. You should have one responsible agent for all the municipalities' coverages. We also feel it is important to pre-qualify those who are authorized to submit proposals, limit the number of potential proposers and to assign the

markets available to them. This eliminates problems in the marketplace and gives no one the opportunity to block markets. We find the results of our RFP process to be very satisfactory.

What can you expect in the future? This is a great imponderable. No one can foresee the current marketplace. I would suggest that the current restrictive marketplace will continue for 2002 and probably for several additional years. The fear of another September 11th will justifiably be with us for several years. Insurers will have to build their surplus in order to continue to pay losses. In New York we have a very strong Insurance Department who is not allowing terrorism restrictions but how long will this continue and at what cost? Who knows? Will large limits be a thing of the past? Again who knows.