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P-C Insurers Reach Critical Fork In The Road

By Herbert E. Goodfriend

When Yogi Berra, baseball Hall of Famer and philosopher, said, "When you come to a fork in the road, take it," he probably didn't intend to describe the state of today's property-casualty scene in the context of this economy.

But it's clear that the managements of many insurers are facing the very dilemma he was talking about. For some the fork may mean a return to Kansas from Oz. For others it leads toward a state of normality, and still others may believe nothing has really changed in the past decade.

To take the latter stance, however, is to be more like Dorothy than even Frank Baum surmised. For us, a few assumptions on macro- and microeconomics should lay a credible base on which to assess the true p-c milieu:

- The industry would do well not to rely on the securities markets to bail it out of red underwriting ink this time around, in terms of both capital gains additions to surplus and investment income yield.
- Durable goods sales, housing starts and consumer confidence in general are unlikely to maintain their recent extraordinary buoyancy, which necessarily would negatively impact auto and home sales.
- Inflation in the service sector, in

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contrast to the more traditional commodity and labor sectors, is on a track of pronounced acceleration, which portends ill for medically sensitive auto and workers' compensation costs.

While these factors surface, the Federal Reserve Board and the White House are wending their ways to conflicts on fiscal and monetary fronts, at least in rhetoric, and Congress is evaluating tax revisions that could dramatically change the longer term course of our nation's future.

Another Perspective

Meanwhile, our currency is pre-eminent, yet European financial enterprises are in a virtual frenzy to buy U.S. insurance companies.

More to the point, speaking of frenzies, the current state of the reinsurance field bespeaks a 180-degree turnaround in rates and conditions imposed on primary carriers.

Recent renewals and those upcoming reveal impressive upward moves in reinsurance property-casualty rates. Overall rates are up 5-to-15 percent, with catastrophe covers soaring by as much as 300 percent.

On the primary commercial front, with combined ratios of 112 last year as grist for the mill, and the prospect of a 7 percent premium gain in 2001, rate hikes of 10-to-20 percent are not unusual in the current negotiation environment.

The single biggest problem remains, however, workers' comp, where rate intransigence and California's regulatory impasse and non-free market conditions remain a disaster.

Some 300 individual insurers are

chasing \$117 billion in annual auto insurance premiums, increasingly dominated by three or four carriers. There is a blurring line between those dedicated to standard rate coverages and those oriented to non-standard.

Meanwhile, the combined ratio was 108.7 in 2000 and could well deteriorate further this year before meaningful rate increases, past and pending, take hold.

Nor is the homeowners picture a pleasant one, with a combined ratio of 120 in store, according to some pundits. Pricing is woefully inadequate and 15 months or more will elapse before auto and homeowners rate increases take hold in the income statement. Let the record show that for many companies, homeowners have not delivered a ratio of under 100 for 18 of the last 20 years.

But enough of setting the larger scene. Let's look at some of the significant issues facing the business of insurance:

- Markedly lower interest rates imparting unimpressive investment income to company coffers and languishing cash flow (paradoxically, of course, that's good for rationalizing rate relief).
- Continuing litigation and market conduct issues in auto insurance and from asbestosis, persisting as a Medusa from an earlier era.
- For all the red ink and restrictions on cash flow, industry capital is still awesome, even if one subtracts for under-reserving and stock market erosion.

Our neighbors across the pond, who have plenty of problems of their

own, have not been insulated from ours—Lloyd's is now facing a new phase of consolidation, already down to 106 syndicates from a peak of 437. These provide a capacity of \$16.7 billion, of which 84 percent is corporate capital and 16 percent from individuals (only 2,850 now versus 32,400 at the peak).

Volume is \$11.5 billion in premiums, of which the United States represents \$5.9 billion and has been growing at a 20 percent rate of late. In fact, Lloyd's now has captured 20 percent of our surplus lines and is the number one carrier for California risks.

The top 20 percent of the managing agents at Lloyd's hold 30 percent

of the capacity, but 50 percent of their all-too-ample losses stem from one fourth of the syndicates mentioned above. In 1999, this venerable establishment turned in as bad a year as in 1998 with a 115 combined ratio (compared with a U.S. reinsurer experience of 133).

In sum, the critical issues appear to be:

- Rising rate levels and the question of how long they'll stay high in a period of emerging recessionary pressures.
- Natural catastrophe threats worldwide (not just the new beach in Nevada or Florida's weather patterns, or even Seattle's "tremors.")
- Rising severity offsetting

frequency's more cooperative downward bias.

- Excess capital.

Loss reserve deficiencies are, of course, also omnipresent. Oh yes, let's not forget about rating agency influences and distribution channel turmoil as well.

But parenthetically, these adversities have added up to robust stock market performance for many a company's equity in stark contrast to the debacles in many other securities sectors. We deduce that such oxymoronic action looks forward to a prosperous 2002.

So perhaps the fork in the road is really not a fork at all—but merely a pit stop on the way home from Oz? **NJ**