

Commercial Insurance Update

Topics Affecting Buyers of Commercial Insurance

MSP C 04/2002 – “The State of the Insurance Market Today — What to Expect at Your Next Renewal”

April, 2002

The State of the Insurance Market Today What to Expect at Your Next Renewal

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By now, you've heard the horror stories about the drastic price increases taking place in the insurance market. Why has this happened, how long will it last, and what can you do about it?

charged inadequate premiums for too long in an effort to compete on price. The higher premiums being paid by insureds today is attributable to more than a decade of imprudence among insurers, a period that combined a relentless price war with aggressive risk taking.

What's Going On

For years, the insurance industry has been subject to a somewhat regular insurance cycle characterized by “hard” markets (times of increasing cost, decreasing coverage and lack of availability) and “soft” markets (times of decreasing cost, increasing coverage and rising capacity). The last hard market cycle peaked in the mid- to late 1980's. For the sake of discussion, we'll use 1988.

Since 1988, rates have plummeted. The three year soft market cycle actually lasted close to 12 years, until rates started to firm in 2000. During that time, rates in general dropped as much as 75%. This was due to the substantial capacity in the insurance industry, and a “bullish” investment environment.

An analysis done by one insurance company during that time period indicated that the rate it had been charging its clients was actually down 61%. Although claims frequency during that same time frame had decreased, claims severity had increased. Basically, the total cost of claims had only decreased by 5%. This translated into a loss ratio (losses divided by premiums) of 72.2% in 1989, but 140% in 2000. This underscores the problem in the insurance market. Insurance companies have



period that combined a relentless price war with aggressive risk taking.

Insurance companies have paid the price. 2001 was the worst year ever for the property/casualty industry, and the first time in history that the industry as a whole

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Published by

Cavnac & Associates

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lost money. The industry was hit with a \$7.9 billion net loss after taxes for the year, a dramatic change from the prior year when it recorded \$20.6 billion in net income.

The combined ratio, which is a measurement of losses and underwriting expenses divided by premiums, deteriorated to 116%. In other words, for every dollar the industry took in, it paid out \$1.16. This was 5.9 percentage points worse than the industry's 110.1% combined ratio for year 2000, and the worst year, from an underwriting standpoint, since 1985.

It is estimated that the September 11th terrorist attacks will cost insurance companies in the neighborhood of \$60 to \$80 billion. Prior to this loss, the largest single catastrophe in history was Hurricane Andrew, which cost the industry \$18 billion. Perhaps hit the hardest by the terrorist attacks were the reinsurance companies, who had the upper layers of coverage on many of the properties that were totally destroyed.

The terrorist attacks certainly had an impact on the insurance industry, but that's not the only reason that you are now faced with higher prices. As previously mentioned, the industry was trending upwards prior to September 11th. September 11th only made a bad situation worse.

New Coverage Restrictions

Along with increased pricing, we are also seeing additional coverage restrictions.

1. **Terrorism** – Terrorism exclusions are starting to find their way into property policies and occasionally liability policies. Reinsurance companies have decided to exclude terrorism in their treaties, and most insurance companies don't want to expose themselves to the potential for catastrophic loss by providing this coverage.

One of our workers compensation carriers has gone so far as to add a 5% terrorist surcharge to all of its California-issued workers compensation policies. The insurance industry is currently working with the Federal government to try to find an appropriate solution.

2. **Mold** – New exclusions for loss caused by mold

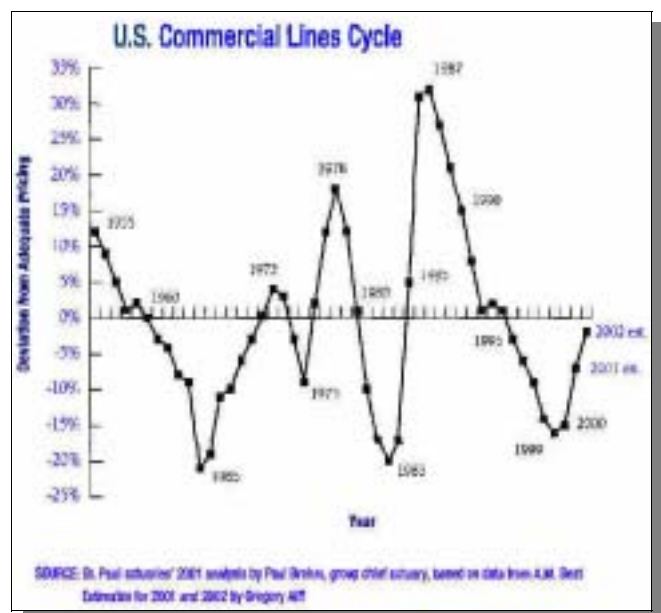
are now being found on most contractor-related liability policies. We are also seeing them on property policies, and were recently alerted by one of our standard market property and casualty carriers that there would be a mold exclusion on every policy that it issues.

3. **Other Restrictive Terms** – Insurance coverage in general is becoming more restrictive. Underwriters are less likely to provide broad additional insured endorsements (like the CG2010 11/85), and they are also adding numerous other exclusions to their policies. Before accepting coverage on your renewal, make certain that you are provided a list of these exclusions and copies of the endorsements themselves.

How Long Will This Market Last?

Depending on whom you talk to, three to four years is the estimated length of the current hard market. Since we are already about 1-1/2 years into it, it's conceivable that we're halfway through, but no one knows for sure.

Despite aggressive rate hiking in 2001, only five of the 32 publicly traded insurance companies posted combined ratios of under 100. The average of these 32 companies was 113%. At least another round of increases will be necessary to trend the industry toward profitability.



What Can You Expect at Your Next Renewal?

On average, insurance rates are increasing by approximately 31% across the country. Although this varies by line of coverage and territory, on average in San Diego we are seeing increases in the 20% to 50% range. However, it's not uncommon to see higher increases for certain industries. Lawyers professional liability and construction come to mind. We were recently told of a retaining wall contractor whose primary premium increased 300%. His excess policy went up 500%, and his limit was cut from \$5 million to \$1 million.

What Can You Do?

➤ First of all, face the fact that your premiums will increase on renewal. You should discuss this with your broker, and try to obtain an estimate of where you feel your premiums may be. You should begin building this into your budget proc-

ess, and factoring the increases in your overhead costs as it might pertain to any future work.

- You need to re-evaluate your risk tolerance. How much risk are you willing to assume? This usually comes into play with deductibles or self-insured retentions. Most underwriters today, however, are expecting their insureds to have more "skin in the game."
- Start the renewal process early. We generally recommend 90 to 120 days. Ideally, your application for coverage should arrive on the underwriter's desk no later than 60 to 75 days prior to your renewal.
- Work with your broker to create an effective submission. Provide a detailed description of your operations, and carefully explain any claims and why they won't happen again. Prepare a cover letter articulating the attributes of your firm and why you represent a better than average risk from an underwriting standpoint.
- Finally, you need to focus on loss prevention. Ultimately, the only way to control the cost of risk is to control the risk itself.*

***Disclaimer:** This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.*

Directors and Officers Liability Insurance Do You Need It?

Directors and officers liability insurance, or "D&O," as it is usually referred to, protects the directors and officers of a company from allegations of negligence in their duties as a director or officer. The coverage, which is almost always purchased by publicly held companies, and is also popular among large privately-held companies with outside boards of directors, should also be considered by smaller privately-held companies.

Serving as a director or officer of a corporation involves a number of duties, including setting corporate policy and making decisions that will guide the organization. Individual directors and officers can be held personally liable for their actions and decisions while serving in their official capacities as board members.

There are a number of potential sources of liability for directors and officers, including employees, rate payers, customers, competitors, as well as governmental agencies.

Unfortunately, most general liability policies will not cover this exposure. General liability only extends to claims arising out of bodily injury or tangible property damage from a specific occurrence or accident. In addition, most homeowners policies will not cover an individual for his or her activities on a board because of the business pursuits exclusion.

The logical alternative is to require the corporation to purchase directors and officers liability insurance.

D&O Insurance (Continued from page 3)

Several companies today are marketing a combined insurance program that couples directors and officers liability insurance with several other coverages, including employment practices liability and fiduciary liability, to name two.

Whether or not you elect to purchase D&O, there are certain steps that you can take to reduce your exposure

- Make certain you understand the organization's activities, budgets, goals and objectives.
- Never hesitate to question the decisions of key employees or officers. A director has a responsibility to exercise independent judgment in the best interests of the organization.

- Always put the interests of the organization before any personal interests.

If you are interested in learning more about directors and officers liability insurance, you should contact your insurance broker. Recognize, however, that this is a specialty line of coverage, and ideally your broker should have experience with this type of coverage.

Another excellent resource is the Chubb Executive Risk website at <http://cber.chubb.com>. Click on either "Products" or "Forms Zone" (the former if you wish to learn about the product itself, and the latter if you wish to access policy forms and/or applications). *

Charitable Opportunities

Senior Community Centers Breaks Ground for Market Square Manor

Friday, February 8, 2002 was officially declared a day of "Exuberance and Celebration" according to Senior Community Centers President and CEO, Paul Downey.

Representatives from Senior Community Centers were joined by elected officials and community and business leaders as they celebrated this important housing milestone.

Market Square Manor, which will be located at the intersection of 14th and Market Streets, will provide 200 handicap-accessible units for low-income seniors. Construction will begin in March and the doors are expected to open in Summer 2003. The project is estimated to cost up to \$23 million.

"We have waited a long time for this and now, 200 low-income seniors can look forward to living with dignity in a safe environment," said Downey.

"Market Square Manor comes when housing options for low seniors are inadequate," said Council member Toni Atkins. *"Senior Community Centers deserves our applause for its efforts to help low-income seniors survive in San Diego. This is a project that we can all be proud of."*

Rent for qualifying seniors at Market Square Manor will be \$350 per month and the facility will include a central kitchen, dining room, recreation

rooms, outdoor courtyards, a park and administration space. Currently there are 500 seniors on the waiting list.

The project would not have been possible if not for the more than \$13 million in California State tax credits awarded to Senior Community Centers late last year. The Center is looking to the community to help secure the rest of the funding. For more information on how you can help, please call 619-235-6572, Ext. 301 (for Paul Downey), or e-mail servingseniors@servingseniors.org.

Senior Community Centers is one of the charitable organizations that Cavnac & Associates actively supports.*

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