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INSURANCE BROKERS

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State of the Insurance Industry...And What This Means To You

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Insurance Cycles

Like many businesses, the insurance industry is cyclical in nature. It is affected by a number of factors including interest rates and investment returns, underwriting results and the general business cycle. The reason the insurance cycle is important to a business owner is because it directly impacts insurance premiums. In order to understand where we are now, you need to know something about the economics of the insurance business. If you've read newsletters from previous years, some of this may be redundant, but it's helpful to review here. I'll be referring to ***Table 1*** (below) to give you an idea of where the insurance industry is in the underwriting cycle.

Insurance companies make money in one of two ways:

- Underwriting profits
- Investment income

An underwriting profit is achieved when losses plus all expenses are less than premiums. When you divide the former by the latter, you come up with what is called the "combined ratio." A combined ratio of less than 100% means there is an underwriting profit, and a combined ratio of more than 100% means there is an underwriting loss. If you look at Table 1 you will see that in the eight years ending in 2012, the industry generated an underwriting profit twice. The last two years (2013 and 2014), however, have both generated an underwriting profit. This is primarily attributable to lower losses in general but catastrophic losses in particular have been light for both those years. While an underwriting profit is better than an underwriting loss, most insurance company executives you talk to today will tell you they would like to see their combined ratio under 95% and ideally 92.5% or lower (only achieved once in the last 10 years).

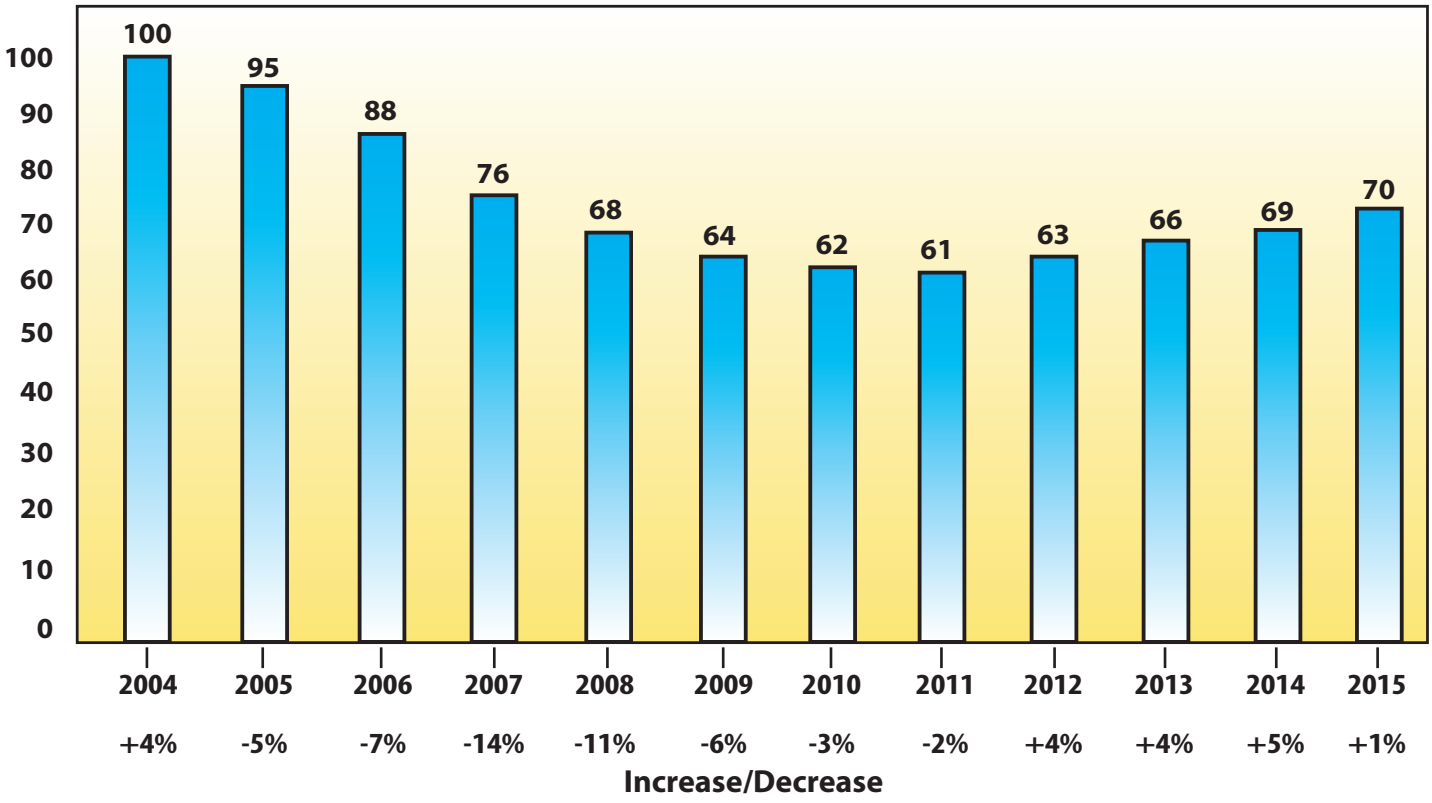
Table 1 - Insurance Cycle

$ in Billions

Description	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Net Written Premium	$425.90	$443.80	$440.60	$434.90	$418.40	$423.80	$438.0	$456.90	$477.7	$487.6
Combined Ratio	100.9	92.4	95.5	105	101	102.4	108.1	103.2	96.1	97.0
Investment Income	$49.7	$52.3	$55.1	$51.5	$47.1	$47.6	$49.1	$48.0	$47.4	$46.2
Operating Income	$45.1	$84.6	$73.4	$30.6	$45.0	$38.2	$15.4	$33.3	$64.3	$55.6
Policyholder Surplus	$425.8	$447.1	$517.90	$457.30	$511.50	$556.90	$553.70	$586.8	$653.3	$674.7
Return on Avg. Net Worth	9.6%	12.7%	10.9%	0.1%	5.0%	5.6%	3.0%	5.1%	10.3%	8.4%

Source: Insurance Information Institute (iii.org)

Table 2 - Average Property & Casualty Rate Changes



Investment Income

Insurance companies collect premiums and set aside reserves to pay future claims. These funds, known as "surplus" generate investment income. During periods of substantial investment returns, insurance companies are willing to tolerate inferior underwriting returns because they make it up on investments. If you look at 2014 on ***Table 1*** (previous page) you will see that the industry earned a 3% underwriting profit and their overall Return on Average Net Worth equaled 8.4%, the difference (5.4%) is attributable to investments. It is also important to point out that insurance companies are limited when it comes to equities. Depending on the state, this cap may be 20% of investable assets, the balance is in various types of bonds, CDs or similar investment vehicles.

The importance of Surplus

A critical component that drives the economics of the insurance industry is "surplus." As mentioned above, surplus includes money which is set aside to pay future claims as well as any additional capital held by the insurance company. Specific ratios determine how much premium can be safely written given a certain amount of surplus. If the ratio of premium to surplus gets too high, the insurance company's credit rating (as quantified by the A. M. Best Company and other rating agencies) could ultimately impair the insurance company's ability to operate. This is why the insurance industry is "supply driven." Demand for insurance stays relatively constant. Sure, it may ebb and flow depending on the economy, however these swings are relatively modest. Surplus is another issue. If surplus goes down, insurance companies must write less insurance and this causes rates to go up. Similarly, if surplus goes up, rates tend to go down. The industry's surplus has increased nearly 50% in the last 6 years and is currently at an all-time high.

Finally, it's important to realize that the insurance industry competes with every other industry for capital. In order to attract investment dollars, the insurance industry has to demonstrate an acceptable return on equity. Most investors want to earn at least 10%. Historically, the insurance industry has averaged just shy of that, however, if you look at ***Table 1*** you will note that the 5 years from 2008 through

2012 generated meager returns and it is only during the last two years that results have improved.

What is happening with insurance pricing today and what can you expect? ***Table 2*** (previous page) provides a historical picture of insurance industry rates back to 2004 as calculated by MarketScout. 2004 is the base year. The industry had been fairly profitable and surplus was strong so rates started to come down. From 2004 to 2011, rates actually dropped about 40%. When prices went down, combined ratios and profits began to deteriorate. Rates started to increase and since 2011 average rates have gone up about 15%. Still, they remain 30% below what was charged in 2004 and the rate increases have begun to taper off.

So where are we today? Underwriters want more rate but the high surplus is keeping the industry competitive. Although rates on average have increased about 1% through July of 2015, we anticipate that to change by 2016 and are anticipating a modest rate decrease. In short, the industry is flat. Note, however, that this will differ by account and policy type. Preferred risks in desirable industries with profitable loss histories may see rate decreases of 5%-10% or more while challenging accounts in high hazard classes with poor loss records can still see substantial rate increases.

Allied Lines

Allied lines refers to general lines of insurance that most companies need to purchase. This includes General Liability, Property, Inland Marine, Auto, Workers' Compensation and Umbrella coverages. We will address Workers' Compensation separately. In general, Allied Lines will track with our comments above. If you are an average risk in a decent class, your rates should be flat.

Executive Risk

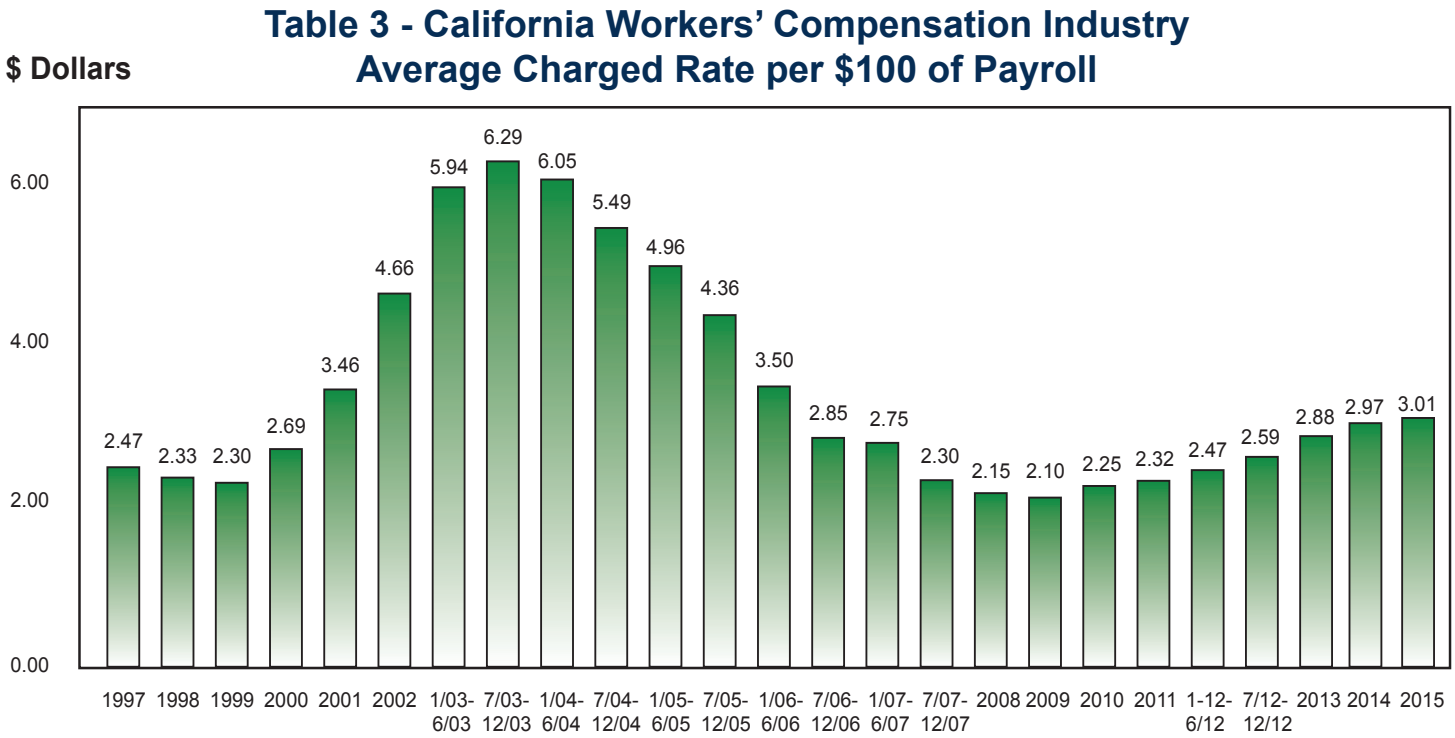
Executive Risk refers to Directors & Officers Liability, Employment Practices Liability and Fiduciary coverage. This can also include Crime, Kidnap & Ransom and Cyber. Executive Risk is more volatile than the Allied Lines. In addition, current pricing is being affected by the last economic down turn. The poor results experienced by many businesses and the layoffs and RIFs (Reduction in Force) have increased loss ratios. Insurance companies tend to be reactive in their pricing and these poor results are now manifesting themselves in higher premiums. While it is difficult to provide an average rate increase (10-25% is not uncommon), it is also misleading. Every account is different and individually underwritten. You should start early on these renewals and go in to detail on why your firm is a good risk and should be credited accordingly.

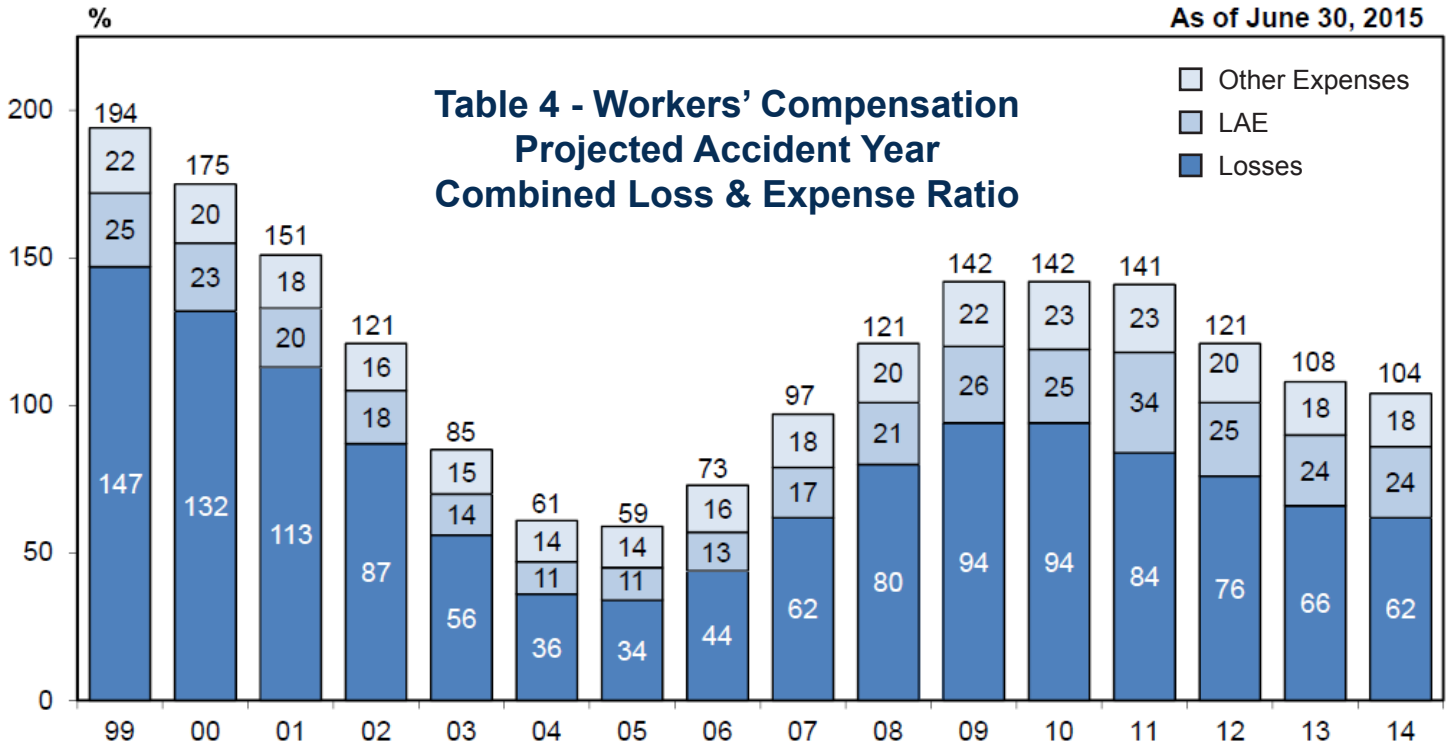
Professional Liability

In general, Professional Liability lines are flat like the industry at large, but once again this can vary by profession, specialty and account. Architects and engineers currently have more options than they have ever had. We could probably obtain 50 quotes on a preferred risk, but as they say, the devil is in the details. Every one of these policies is different and coverages can vary greatly. In addition, the claims handling and risk control services offered also vary. Some insurers simply offer a policy (often a lousy one) with a subbed out (this is called a Third Party Administrator) claims department. Others provide broad coverage, in-house specialized claims expertise and sophisticated risk management. Accountants, attorneys and other professionals also have a wide range of suitors but similar to the design profession, coverage, claims and risk control are all over the board. This underscores the importance of dealing with a broker who specializes in your industry and will know the differences in coverage and the pros and cons of each insurance company.

Workers' Compensation

Comp is trending positively after six years of rate increases. ***Table 3*** (pg. 4) shows the "Average Rate Charged per $100 of Payroll" in California. Rates peaked in 2003 at 6.29. The reason for the higher rates is attributable to the lousy underwriting results from 1999 to 2002 (see ***Table 4*** pg. 4). As rates went up, results improved and from 2003 to 2009 rates fell off 67% to an average of $2.10! While this was good news for insurance buyers, it was bad for the insurance industry and rates started back up to combat the poor combined ratios. Since then, rates have increased over 40%, but it is important to remember that they are still less than half of what they were in 2003. While rates continued to increase modestly through 2014 and 2015, it is anticipated that rates will be flat in 2016. Note that this is an average. Every classification (there are over 250) is affected by the experience of that class. Some will go down fairly substantially but others (Class Code 5606, Contractors Executive Supervisors is a good example) could go up.





Surety Outlook 2016: Do More With Less!

There has been a slow and steady improvement in the surety industry in recent years which has been mirrored in the U.S. economy and other related financial markets. In the not-so-distant aftermath of the economic melt-down of 2008 and now the poor performance of the stock market in 2015, the surety outlook for 2016 will remain positive but will be significantly challenged by factors that influence the construction and commercial business markets.

Astute contractors have not abandoned the lessons learned in the recent post-recession recovery. Construction firms today are leaner and meaner with a focus on bottom-line results. An overall acceptable profit margin for efforts expended is mandatory. However, owners' expectations are still in a buyer's market mode, interest rates are artificially

low, fuel and material prices are cheap, technology applications are ever improving and there is a painfully growing worker shortage. Going forward, successful firms will cautiously continue to grow their operations with an eye on “Doing More with Less”.

Health Insurance

Medical insurance costs in 2015 increased between 20-40%, due to the changes in the Affordable Care Act (ACA). The early renewal strategy in 2013 helped employers delay the effects of the law and *grandmothering* helped in 2014. The 2015 medical renewals for companies with 2-50 employees realized all the impacts of the law. In 2016, companies with 51-100 employees will be considered small groups in California and the ACA changes and increases will be taking effect. Although the federal government is giving states the opportunity to define small and large groups, we believe California will set the dividing number at 100 employees. Our California lawmakers are on break until January 4th, so after the recess we will know the final determination.

Rates are currently determined by the employee and their dependent’s individual ages, plan design and location of the company. A family of five will pay for each family member based on each individual’s age and the plan they select. Some younger employees or families with one child may realize lower premiums. All of the small group plans have changed to conform with the law and most have higher deductibles and copays, therefore employees will have to pay more when they use the services.

Aetna was the only insurance carrier that didn’t allow its clients to grandmother the plans and rates, and Aetna’s 2015 rate increases were in the +25-50% range. Aetna said the increase in ACA fees caused the higher than normal increases in 2015 and they hope the rates settle down in 2016.

The provider networks are changing and offering a lower number of choices for doctors and medical groups. The industry calls them “skinny networks”. Often the price looks good, but your employees will have very few choices for doctors. Be sure to run a disruption report to compare current providers to those associated with the programs you are considering. Insurance carriers continue to seek greater discounts from hospitals, medical groups and doctors and are offering patient exclusivity in return. Some insurance carriers will allow “skinny networks” to be offered side by side with “full networks”, with the price and contribution being set by the employer to favor one or the other.

2016 will be a year that the insurance carriers will be trying to figure out how to survive after implementing all of the ACA requirements. Rates will continue to increase as the plan’s taxes and fees continue to rise. Employers should budget a 10-15% increase, and depending on plan change options, rates could settle in at +5-10%.

Dental, life, vision, disability and work site products continue to remain extremely popular benefits for employees.

Bottom Line

It is a pretty good time to be an insurance buyer (with the exception of health insurance). The industry has abundant surplus and decent results. Most businesses will be able to negotiate flat rates and some businesses may even see rate reductions. Insurance premiums however need to be kept in perspective. They are only one component in the cost of risk. Time spent managing risk, training employees to be safe, dealing with claims, funding uncovered claims and a number of other costs all factor in as well. For many large companies, insurance premiums can be less than half the total cost of risk.

While you should understand the economics of the insurance industry and how this can affect your business, there is nothing you can do to positively affect it. You can, however, affect your risk profile. In the long run, the only way to reduce the cost of risk is to reduce the frequency and severity of claims that drive the cost. An effective risk control program and a partnership with the right broker who can thoughtfully present your program to the insurance marketplace is the key to lowering your costs.

Monitor Physical Activity with a Fitness Tracker

Wearable technology fitness trackers are becoming more popular as people make an effort to lead active lifestyles.

A fitness tracker is a wearable device that tracks physical activity throughout the day. Most models are worn around the wrist, and they range in appearance from a simple wristband to a stylish watch. Fitness trackers can count steps, monitor heart rate, add up calories and even track sleep. A number of options are available to accommodate a wide variety of budgets and fitness goals.

A fitness tracker can be especially useful for monitoring progress with a new exercise routine or weight loss program. Wearing a fitness tracker to monitor your physical activity can help motivate you to be more active and reach your fitness goals.

Sleep and Your Health

Many people fall short of the recommended seven to nine hours of sleep per night. With busy schedules, it may be tempting to stay up late, but sleep is an important factor in overall health. A good night's sleep allows bodies to rest, repair cells and fight off illness.

The body undergoes certain changes during sleep. Heart rate and breathing slow, body temperature drops, and yet the brain remains incredibly active. In fact, sometimes the brain is even more active during REM sleep (a state of deep sleep usually associated with dreaming) than it is during the normal waking state.

Insufficient sleep can cause many negative side effects, including drowsiness, loss of productivity and impaired judgment. In addition, losing sleep can affect mood and increase the risk of accidents and injury. Long-term side effects of not getting enough sleep include weight gain, obesity, cardiovascular disease and diabetes.

Your lifestyle, your schedule and stress can affect how much sleep you get each night. However, if you are having trouble sleeping, there are several steps you can take:

- Stick to a schedule to help regulate your body's internal clock.
- Exercise.
- Avoid caffeine, alcohol and nicotine.
- Establish a relaxing bedtime routine, such as reading.
- Keep the TV out of your room as bright light can interfere with your natural sleep cycle.
- Have comfortable bedding and pillows.
- Keep your bedroom temperature between 60 and 67 degrees.

Getting enough sleep will boost your immune system and help you stay alert and productive throughout the day. With cold and flu season just around the corner, it's now more important than ever to make sleep a priority.

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Health Benefits of Oatmeal

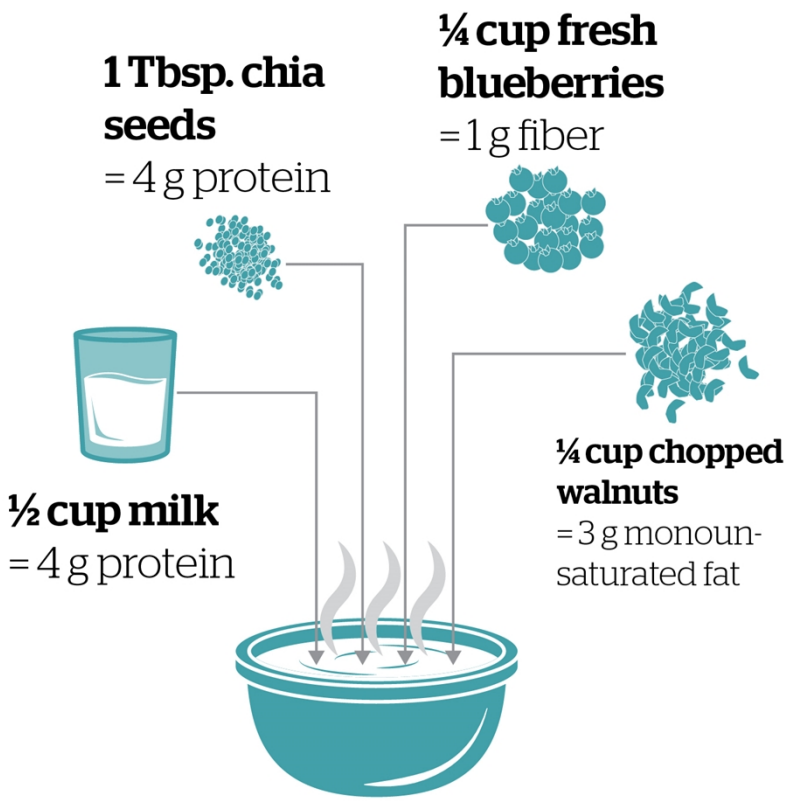
Oct. 29 is Oatmeal Day, and fall is the perfect season to enjoy this healthy grain. Oatmeal is high in soluble fiber, which regulates blood sugar and slows digestion. Not all oats are created equal, though. The level at which oatmeal is processed impacts its fiber content and health benefits. Consider the following types of oats:

- **Steel-cut oats** are minimally processed and chopped by steel cutters to retain the entire oat grain and oat bran.
- **Rolled (or old fashioned) oats** are de-hulled, then steamed to shorten cooking time.
- **Instant oats** are similar to rolled oats but are steamed for longer and often contain flavoring or sweeteners.

A half cup of oatmeal each day is all you need to reap its benefits.

Popular Oatmeal Additions

Oatmeal offers many health benefits on its own, but you can make it even healthier and more delicious by adding a few extra ingredients to your bowl. Here are some popular oatmeal additions.



Oatmeal Muffins

These healthy muffins are rich in fiber and make the perfect grab-and-go breakfast for fall.

- 1 cup low-fat bakery mix
- ½ cup crushed oat cereal
- 1½ cups oats
- ½ cup sugar
- 2 tsp. cinnamon
- 1 egg
- 2 Tbsp. vegetable oil
- 2 Tbsp. applesauce
- ½ cup fat-free milk

Preheat oven to 375 F.

In a large bowl, combine the bakery mix, cereal, oats, sugar and cinnamon.

Stir in the egg, oil, applesauce and milk (batter will be lumpy).

Spoon batter into muffin cups.

Bake for 20 to 25 minutes or until the muffins are browned.

Yield: 12 servings. Each serving provides 140 calories, 4 g of fat, 0.5 g of saturated fat, 150 mg of sodium, 3 g of protein and 2 g of fiber.

Source: USDA

Spotlight On

Cavignac & Associates is proud to support local and non-profit civic organizations, including the Challenged Athletes Foundation

Mission & Values

It is the mission of the Challenged Athletes Foundation to provide opportunities and support to people with physical challenges so they can pursue active lifestyles through physical fitness and competitive athletics. The Challenged Athletes Foundation believes that involvement in sports at any level increases self-esteem, encourages independence and enhances quality of life.

Vision

It is the vision of Challenged Athletes Foundation:

- To be a recognized leader in a movement through which physically challenged athletes are accepted and respected at the same level as able-bodied athletes;
- To have a great and significant impact on each physically challenged athlete served; and
- To reach out to the physically challenged community by providing inspiration, awareness and mentoring

For more information about Challenged Athletes Foundation, go to www.challengedathletes.org