

# B U S I N E S S FINANCE

## Insurance Rates Drift Downward

by Joanne Sammer

Hurricane Katrina delivered a stunning blow to the insurance industry, but a quiet hurricane season in 2006 did a lot to pull the industry back on its feet. Nevertheless, the property-insurance market continues to be a mixed bag, even as other lines of coverage show promising softness for 2007. "Overall, prices have been improving for buyers since the end of 2004," says David Bradford, executive vice president of Advisen Ltd. in New York City, adding that he expects prices to continue their gradual decline in 2007. Although a softer market is welcome news for companies, they should not expect the kind of freefall in premiums that in the past allowed them to greatly reduce risk-retention levels.

Even as the market softens in general, the lessons of Katrina have prompted insurance companies to become more diligent in their underwriting and to press business insurance buyers for more information and more detail than has been their custom over the past decade. "This is more like the old days when underwriters wanted more complete submissions before writing coverage," says Suzanne Swafford, vice president with CBIZ Insurance Services Inc. in Denver. "Buyers will need to spend more time on coverage acquisition and provide underwriters with all of the pieces of the puzzle to help them completely understand the buyers' business."

### **The Property Insurance Market**

The Risk and Insurance Management Society (RIMS) Benchmark Survey, conducted in conjunction with Advisen Ltd., found that insurance premiums fell slightly during the third quarter of 2006. Property insurance, the only line of coverage that climbed, did so by 1.7 percent. That low net increase resulted from a sharp spike in coverage for coastal property and property located in earthquake-prone regions offset by a decline in premiums for property in areas that are less vulnerable to natural disasters. The good news is that even though property in coastal areas and earthquake zones still faces very high premiums, those prices have leveled off.

In this challenging property insurance market, Clifton, N.J.-based retailer Linens 'n Things Inc. found it difficult to retain the terms and conditions of its property coverage when it negotiated its 2007 policy renewal, says Michael Mital, the company's director of risk management. "To maintain those terms and conditions, including earthquake coverage in California and windstorm coverage in Florida, we had to take on more exposure and greater retention levels," he says. "That was our choice in order to keep costs down."

Going forward, Mital is concerned about how insurers will react if there is another bad weather cycle in 2007. He recalls how much his company's property premiums jumped after hurricane Katrina even though the company did not submit Katrina-related claims. "The wild card in the market to me is the knee-jerk reaction by insurers to any weather catastrophe," says Mital.

## **The Catastrophe Market**

For catastrophe coverage, the picture is a bit murkier. On the one hand, catastrophe exposures, including windstorms, hurricanes, floods and earthquakes, are still difficult to place. The market continues to deal with the lingering impact of recent hurricane seasons even though 2006 was notably free of catastrophic storms in the United States. "Insurers have developed new catastrophe loss models that justify their need for significant premium increases and higher deductibles with certain catastrophe risks," says Martin S. Berman, a principal with Albert Risk Management Consultants in Needham Heights, Mass. "Some businesses in the most high-hazard wind areas have experienced premium increases of 400 percent or more with deductibles normally mandated at 3 to 5 percent of values."

On the other hand, some see change afoot -- even in the market for catastrophe coverage. "I expect to see lower prices and improved coverage in 2007," says Kirk N. Walsh, a vice president with Risk International in Charlotte, N.C. "With the profits earned in 2006, substantial capacity will flow back to the catastrophe market, not only from traditional reinsurance but also from established capital markets and hedge funds." The short-tail nature of property claims [the time that elapses between the point when a loss is incurred and when it is finally settled] allows investment capital to make short-term bets when rates are favorable, according to Walsh.

Therefore, Walsh recommends that risk-management executives plan their coverage needs carefully. "Any time catastrophe capacity is squeezed, you really need to evaluate your exposure and only buy what is necessary," says Walsh. For example, a company that has insured a \$500 million facility in New Orleans with a percentage deductible tied to the total replacement value could be overinsuring that facility. If the retention is five percent of the facility's total value or \$25 million and the site has taken effective loss control measures, the maximum wind/flood loss at the site is likely to be only \$50 million in total. In that case, the company's risk manager could certainly make the case not to buy more than \$25 million in insurance limits, which would cover the maximum total \$50 million loss assuming the company has the \$25 million deductible. "You would be

surprised how many companies focus on total values and overinsure as a result," says Walsh.

## **The Bright Spots**

Even though the property-insurance market is giving risk-management executives a headache, other lines of coverage tell a more encouraging story. Declining premiums in these areas are helping companies to deal with increases in property coverage.

One such line of coverage is directors and officers (D&O) liability insurance. So far, insurance experts say that D&O premiums will hold steady in 2007 despite the continuing revelations of stock-option backdating. Many observers suggest that, so far at least, the backdating scandal has turned out to be a nonevent for companies seeking D&O coverage. In fact, rates are going down for some businesses. "Companies with good risks are getting better coverage," declares Swafford. "Companies with problems are still getting coverage, but that coverage is becoming more costly."

Although D&O coverage terms and conditions are fluid and negotiable in the current market, the exact terms and conditions a company secures are likely to vary by contract. As a result, an organization should expect D&O underwriters to ask a lot of questions about its corporate governance practices, the company's method of setting executive compensation levels and the management plans for those programs. Of course, if the backdating scandals continue and worsen, D&O coverage could end up being a wild card in the market this year.

Another bright spot in the current insurance market is workers compensation. After several years of premium increases that were large enough to cause many companies to consider relocating their operations to lower-cost states, enterprises operating in most states are finally seeing major decreases in premiums as various state-level reforms start to make a difference in the marketplace.

"Workers compensation is showing the kind of declining premiums that we haven't seen in years," says Swafford. This reduction is occurring across the United States in just about every state because companies are implementing managed care and other cost-containment programs, and states are undertaking reforms. The RIMS Benchmark Survey found that workers compensation premiums declined by more than 3 percent in the third quarter of 2006. It's worth noting that some companies in California, once the poster child for escalating workers compensation costs, have seen premiums decline by as much as 40 percent or more.

## **Working With Underwriters**

The way companies work with their underwriters is changing, too, and they need to navigate the new terrain carefully. "A shotgun approach to getting coverage that is focused on price could cause companies to gloss over important things," says Andrew Gunn, vice president and leader of the specialty risk practice with Oswald Cos., a

Cleveland-based risk management consulting and insurance brokerage firm. "Many times, optimistic buyers end up with optimistic carriers and policies that look good and meet the company's price needs but come with built-in exclusions. Price is only part of the story."

Risk managers need to understand the constraints that underwriters operate under. As insurance companies automate their operations, they trim staff. As a result, underwriters must focus their efforts on the best opportunities to underwrite good risks. "Companies that consider more than just price when purchasing coverage stand a better chance of differentiating themselves in the market," says Gunn.

Swafford agrees, noting that underwriters are looking for more detailed information about risks and that buyers should be prepared to provide it. "Underwriters are looking for the who, what, where, and how on every item," she says. If a company can show the specific steps it is taking to mitigate risks and demonstrate its willingness to cooperate with the insurance company to reduce risks, it is more likely to secure advantageous pricing.

"In this climate, underwriters are still asking a lot of questions, and buyers that are prepared provide prompt information and demonstrate that they have taken proactive measures to mitigate exposure tend to fare very well," says Gunn. "Gathering and communicating this information effectively takes time, but it is time well spent."

Providing underwriters with more information may not be a matter of choice for companies any more. Mital notes that property underwriters have begun asking for more COPE (construction, occupancy, protection, exposure) data for more properties. For example, in the past, underwriters required this information only for warehouses, but they are now also requiring it for a company's retail locations. "The bottom line is that we have to provide more detailed data, which requires more legwork and research internally."

Whatever the reason behind requests for more data, businesses need to be ready to accommodate underwriters. Berman encourages them to assess their exposures and address areas that might cause concern. "Buyers need to present their exposures in the best light possible," he says.

To improve the chances that their proposal will be favorably received by prospective insurers, companies need to present a comprehensive package. They should make certain that all of their underwriting information is complete and accurate and that it includes loss experience for at least the prior five years, loss narratives that present material claims in their best light, and technical insurance specifications that incorporate the details of insurance requirements. Face-to-face meetings with underwriters are also a good idea because they help strengthen the client/underwriter relationship.

One clear benefit of the generally softer insurance market is the potential for more inclusions and freebies when risk managers ask for them. "These include everything from endorsements to additional coverage to easier administrative requirements," says

Swafford. For example, to ease its administrative burden, a company might be able to negotiate a composite rate for its automotive coverage instead of having to buy individual policies for each vehicle. "Some of those [concessions] are there for the asking, and insurance companies are being more cooperative about providing them," says Swafford.

### **Terrorism Coverage More Common**

The number of companies that are buying insurance to cover property terrorism risks has been increasing dramatically since 2003, according to a study of data from 1,623 companies and government entities conducted by insurance brokerage Marsh Inc. in New York City. The 60 percent that purchased this coverage in 2005 represents a large leap from the 27 percent that bought it in 2003 and the 50 percent that did so in 2004. Lower prices for this coverage may be fueling the trend. The survey found that the cost of property terrorism insurance was an average of 25 percent lower in 2005 than it was in 2004.

Geography, size and industry were also major factors in the decision to purchase this coverage. Companies in the northeast (67 percent) and midwest (58 percent) were far more likely to purchase this coverage than their peers in the west (53 percent) and south (50 percent). Larger companies were also more likely to buy this coverage than smaller ones: Sixty-seven percent of companies with total insured values of \$500 million to \$1 billion -- the highest take-up rate -- had this coverage, compared with 63 percent of businesses with total insured values of \$1 billion or more, 63 percent of companies with \$100 million to \$500 million, and 47 percent of companies with total insured values under \$100 million. More than 75 percent of financial institutions, real-estate companies, and health-care facilities had this coverage.