

The Property Insurance Market

Willis

2004 Mid-Year Review

It is said that there is nothing as constant as change. Certainly, change remains the most constant aspect of the property insurance market as we catch our collective breaths at mid-year and examine the market's status.

From the continuously softening industry standards of the closing years of the 20th century, morphing into the stricter standards at the opening of the 21st, followed by 9/11, which created one of the hardest markets in history, change was the thread which ran through the successive phases: the property market rapidly healing itself post-9/11, recapitalizing, creating startup capacity and working to produce underwriting profits and improve its combined ratio.

By the close of 2002, property carriers were beginning to discuss rather than to dictate. They began, once again, to listen and move their focus from a strict survival mode to one of partnership, characterized by a willingness to listen to the particular needs of a client or prospect, and to organize their capabilities towards fulfilling those needs. Pricing began to stabilize, particularly for clean risks without significant natural catastrophe exposures, although policy conditions remained relatively severe.

Moving into 2003, carriers were united in stressing that while their 2002 figures showed improvement, all was still not well. There remained an urgent need to hold the line and maintain underwriting standards. While the property underwriting results were strong – in fact for most carriers, property was the star performer – legacy carriers with historic casualty tails still faced poor overall results. Major reserve strengthening was required to support a rising tide of significant liabilities in directors and officers coverage, asbestos and other environmental risks. Many carriers watched their ratings being downgraded, along with those of their reinsurers.

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Thus, change rolled on. Although carrier spokespeople continued to talk of strict standards, the need to meet premium goals started the inevitable competition, which, as always, weakened the pricing standard. By years' end, reductions of up to 20 percent were not uncommon.

Still, 2003 turned out to be another good year for property insurance. An absence of large catastrophes and still restrictive, although softening, underwriting produced a further growth in premiums, which together with a modest improvement in the investment income sector produced a positive result for the property and casualty industry of some \$32 billion in pre-tax operating income (A.M. Best). This was approximately four times the aggregate result of the previous four years.

So we arrive at 2004, which kicked off in good shape. The market was sorted, old and new capital was showing good results and property continued to be a superb performer. Reinsurance was more readily available and reinsurance premiums were beginning to soften. Once again the word went out to the underwriters, “Go forth, protect your book and grow your account.” Premium budgets and capacity were increased and more competition was introduced into the market. All ingredients for continuing change.

For clients, the market finally brought changes they could anticipate eagerly. Many buyers expressed lingering resentment over their treatment at the hands of insurers in the dark



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days of 2001 and 2002. Now opening before them were options that had been missing for a few years. Most clients had been charged a lot more for a lot less and they wanted to redress the imbalance. They wanted more – and for less premium.

It became apparent that risks with thoughtful, transparent and complete submissions would still receive by far the best underwriting consideration. The need for a detailed underwriting file remained. Technical underwriting and risk modeling (especially for catastrophe risks) remained the standard. Underwriting themes developed, as many carriers, particularly domestic, defined strategic plans, identifying classes and areas of risk where they would be most aggressive in providing pricing, coverage and capacity. A client who “partnered” with a carrier in its most comfortable zone, without a doubt would receive the winning deals. With synergy established with a particular client, carriers began to push their brokers in attempts to ensure they had provided everything necessary to win the deal.

The pace of change continues to accelerate. Rates continue to fall, with reductions averaging 20 percent – on top of what might have been as much as 20 percent in 2003. First-class risks without significant catastrophic exposures may have achieved more; those with more problematic characteristics found it harder to achieve as much.

As the year progresses, other improvements are also developing:

- Limits and sublimits that were severely restricted during the hard market can often be improved, especially where information has been developed to support the limits requested.
- Deductibles can be negotiated to more reasonable levels, again with the support of solid information.
- Wordings can be reviewed. Restrictive conditions can be negotiated away. Value margin clauses can be improved and occasionally removed entirely.
- Broker manuscript forms, while not uniformly welcome, are at least becoming a subject for discussion, especially with the Excess and Surplus markets.

Carriers – particularly the US domestic licensed carriers – are placing a lot of value on continuity; they realize that it is far more cost efficient to renew an existing account than to bear the additional frictional costs of acquiring, underwriting and setting up new business. This means that often they will fight tenaciously to retain existing business. That is not to say that they are not after new business; they are. In a softening market that is how they achieve their growth.

The early view of the 2004 results remains very positive. The Property Claims Services unit of Insurance Services Office, Inc.



reports catastrophe losses in the first six months of \$2.69 billion, representing the second best result in the past decade. Despite what carrier spokespeople may protest, in the absence of a major catastrophe loss we see no reason to forecast any change in the market’s softening trend.

Market Sectors

We tend to divide the market for US global and domestic risks into four main sectors:

- Licensed US domestic carriers
- US Excess and Surplus carriers
- The London market/Lloyd’s, London and European carriers
- The Bermuda market

As the market tightened and constricted in 2001 and 2002, the need to consider all these markets became critical. The licensed domestic carriers were providing much smaller limits, and in any event were often non-competitive. Business flowed elsewhere: to the unlicensed, foreign or offshore markets. Premiums into these markets rose rapidly and they became key factors in providing alternative solutions and/or building adequate program limits. Now, as the licensed market softens, becoming more competitive and offering adequate limits, we expect to see the premium flow begin to reverse, thus creating further competition in the overall market.

- **The US Domestic Licensed Market**

With the possible exception of the FM Insurance Company (FM Global), which appears to be “holding the rating line” as it applies its membership credits to this year’s renewals and St. Paul Travelers in the midst of its merger, the large domestic

carriers are all presenting themselves in a positive, competitive light. As the premium base starts to erode they are often fighting furiously to maintain their renewals, especially those in their strategic market sectors. Rates, limits, coverage and services such as property loss control are all open to negotiation; deductibles selectively so. These markets are anxious for new business and may be expected to vigorously chase those risks they favor as they strive to win.

- **The US Excess and Surplus Lines Carriers**

This sector remains strong. Carriers will write All Risks competitively with the licensed market, especially for those risks with more severe and/or catastrophic exposures. In competitive situations we have seen this sector regularly produce rate reductions of 15 percent to 20 percent and in one extreme case a cumulative rate reduction over the past two years of nearly 75 percent. Capacities are increasing and the need to achieve premium budgets in support of capacity and capital is crucial.

- **The London Market/Lloyd's, London and European Carriers**

We see a continued hunger in London, with substantial amounts of capacity, especially excess, swiftly available. Like-for-like renewals are regularly achieving 15 percent to 20 percent rate reductions and by changing program layer structure, often much more is achievable. The market is responsive to new opportunities, working to offer competitive rates and to improve limits, deductibles and to broaden coverage terms. This market will defend renewals and attack new business.

- **The Bermuda Market**

This capacity is stable, security is strong and results are positive. As much of the Bermuda capacity is "start up," the long-term burdens of the legacy carriers are not an issue. The market is following the downward pricing trend, perhaps a little more reluctantly than some, and the attitude of rigidly adhering to fixed minimum premiums is more relaxed. The market appears to be suffering some retraction in business as the domestic market increases its retained limits. Bermuda has a lot of infrastructure, not only in terms of capital but carriers and brokers, as well, and it needs to be fed – conditions seem right for competitive performance.

A final comment on the market for monoline Boiler and Machinery or Equipment Breakdown insurance: While this cover continues to be provided in multiline programs, particularly by licensed domestic carriers as part of their All Risk programs, there is still a strong need for monoline B&M coverage. Five carriers are writing this coverage: HSB, Travelers, CNA, Chubb and Zurich. Together, they provide a vigorous and healthy market and, as in the rest of the property market, buyers can expect aggressive underwriting and a fight to hold renewals. On a recent placement, one client reduced its premium by 60 percent by working with its broker and moving markets.

Change? Certain and continuous. In the absence of a major catastrophe loss, expect the market to grow increasingly competitive. Rates should drop, and limits, terms and conditions should improve. If a major catastrophe occurs, all bets are off.

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