# Insurance outlook

There is much speculation about where the market is going next. But there's no time to waste – companies should start planning now to secure the best insurance cover.
**By Lee Coppack**

Despite calls from the industry for higher premium rates, so far there is little evidence of upward movement on prices. There is still good capacity, and insurers could find themselves competing for a diminishing amount of demand as clients retrench and some businesses fail.

## Strength in adversity

"While insurers are talking about a hardening market, I'd say at the moment rates are stabilising," says Chris Tabbitt, Head of Property and Casualty, Global Risk Services at Jardine Lloyd Thompson. Despite pressure on some balance sheets and heavy losses from Hurricane Ike in September, he believes that the immediate effect will be fewer and smaller reductions on renewals, rather than rate increases.

Against this background, insurer solvency is probably a more immediate concern for corporate insurance buyers than the cost of cover. The near collapse of AIG, even though other financial activities and not the company's insurance operations were to blame, has shaken confidence. The limitations of credit ratings revealed by AIG's problems means that risk managers are looking at different ways of monitoring security issues.

"I think there is still a question mark over the stability of insurance," says Kip Berkeley-Herring, Chairman of the AIRMIC Insurance Steering Group and Group Risk Manager at BT. "It remains a fragile-looking market, and we have become wary about security ratings as we have seen their fragility, too. It means we place increased reliance on brokers to provide up-to-date market intelligence."

The UK insurance industry, especially non-life, is regarded as generally well capitalised and financially fairly secure, partly because it is regulated to protect policy holders. As a result, it is comparatively stable, although not immune from the turmoil in financial markets. Different factors affect life and non-life insurers, with the non-life market coming under pressure to meet expectations of returns. Insurers have been releasing reserves from past years' underwriting in order to support their profitability, and there is a limit to how long they can continue to do so.

### LESSONS FROM THE CURRENT CRISIS

1. High leverage is bad, no matter how the risk is perceived.
2. The risks of complexity often outweigh the benefits of diversification.
3. Business producing recent rapid growth is often a source of problems.
4. Theoretically rare events occur more often than expected; a lot of stochastic modelling is still in its infancy.
5. Financial flexibility is a myth when it is most needed.
6. Rating triggers can kill almost overnight and create credit cliffs.
7. Lack of transparency is bad.

## Credit ratings

The rating agency Fitch sees a negative outlook for all major European markets, which means that over the next 12–24 months it expects to downgrade the credit ratings of more companies than it increases. More reassuringly, though, Greg Carter, Managing Director – Insurance for Fitch, says the changes are expected to be "ticks, not whole categories".

He warns that rating agencies cannot predict every collapse in security. "We depend on what management tells us and on publicly disclosed information. If you can fool the auditors and the regulators, then you can fool the rating agencies as well, for we depend on these people," he says.

Insurance analyst Chris Hitchings of investment bank Keefe, Bruyette & Woods also believes that other than for the few well-publicised examples, the property casualty insurance industry is "not in bad shape". It probably has less contingent capital than it thought, he says, and may therefore want to buy additional reinsurance protection which could ultimately have implications for pricing for its own customers.

The last major UK insurance bankruptcy was the collapse of Independent Insurance in 2001. Although it was the result of fraud, as opposed to market losses, it heightened buyers' awareness of the need to limit the magnitude and impact of any

> "So far there is little evidence of upward movement on prices. There is still good capacity, and insurers could find themselves competing for a diminishing amount of demand."

»» such failure. One question for major companies, therefore, is how many insurers to have participating on large programmes; using several increases the risk of having one fail, but reduces the impact if it does. Tabbitt argues that insurance buyers need to make sure their brokers have a contingency plan "should the worst happen".

Less drastically, choice and continuity of insurer are likely to become issues. Sound insurers do shift the deployment of their capital, and some companies will go into run-off, especially as the capital requirements of the European Solvency II Directive take effect. Carter predicts consolidation among non-life insurers: "I think we will see a decrease in the number of active companies with bigger units and fewer small specialists."

## Managing a harder market

The cost of reinsurance has a substantial influence on the cost of insurance, and with claims from Hurricane Ike estimated at around $21 billion, the industry watched closely as Hurricane Paloma built into an extremely dangerous Category 4 storm at the unusually late date of 8 November.

In the event, Paloma decayed very rapidly after passing over Cuba, without reaching the United States, just as the renewal process got underway in London for many reinsurance treaties ahead of the 1 January contract date. As a result, it is not yet clear whether reinsurers will get the increases they want, despite third-quarter losses and their statements of need.

Even so, the effect of asset erosion and more expensive capital are likely to feed through gradually into insurers' rating models and emerge in pressure for higher premiums in the second half of next year and in 2010, according to Chris Tabbitt. He says corporate buyers should be prepared to act strategically and have good evidence to support requests for rate reductions on renewal. "Strategic planning will be the name of the game to get the best insurance coverage," he advises.

Many businesses will be under financial stress and Tabbitt suggests they look for intelligent ways to reduce spending without jeopardising protection. Some, for example, buy limits that are for the sake of comfort and higher than they need to be.

He also calls for more openness from insurers. Information about the risk is important but only gets you so far in negotiations. "We would like to see more transparency in insurers' rating models so that risk managers can focus their risk improvement plan on areas that will unlock the discounts that are available and access capacity." Buyers should challenge market practices, for example, by making long-term deals more robust. "Take out the volatility – don't just sit there at the whim of the market," he says.

> "Corporate buyers should be prepared to act strategically and provide good evidence to support requests for rate reductions on renewal."
>
> Chris Tabbitt,
> Jardine Lloyd Thompson

## Common ground

A desire for more common ground, so that they know how to make insurance best suit the company's objectives, comes through from all players. For instance, AIRMIC Technical Director Paul Hopkin says it would help risk managers to know better what changes in insurer solvency ratings mean in terms of their company's risk appetite.

Emmanuel Nivet, Chief Executive of AXA Corporate Solutions UK, would like underwriters to have discussions with CFOs and other senior managers of their clients to understand their culture, hierarchy and decision-making processes. He also says that sharing of risk information needs to start earlier in the renewal process and not at the anniversary date. This he sees as the cornerstone of a long-term relationship. RS

i Chris_Tabbitt@jltgroup.com

## TOP TIPS

1. Take time to develop existing and prospective insurer relationships.
2. Get to know the head of claims – don't wait until you have a loss.
3. Help your broker to understand your business to ensure your limits and retentions are aligned to your exposures and to avoid any unnecessary spending.
4. Ensure you have good, relevant risk information that is presented in an accurate and professional manner.
5. Focus any risk management time and money on areas that can unlock insurers' discounts and capacity.
6. Make sure your broker continually challenges convention and provides you with options.

**Lee Coppack** is editor of *Catastrophe Risk Management* and *InfoRM*, and former editor of *Global Reinsurance*. She writes widely on insurance and risk.

# Sector insight

Classes of business which incurred heavy losses in 2008 are showing clear signs of hardening. For others, it is mainly a stabilising market with no further reductions except in a few specific areas.

## Directors and officers

The reinsurance contract renewals that take place on 1 January will largely determine how expensive and how restricted D&O insurance will be for large financial institutions and firms exposed to the property market. Insurers will want to pass on to insureds the new terms and conditions that reinsurers impose. Indications so far are of increases of up to 40 per cent.

**Mike Lea**, Head of D&O Liability at Jardine Lloyd Thompson, warns companies in these sectors to expect a "much more intrusive" underwriting process with insurers asking for more information and even meetings with CEOs and CFOs. Confirming new terms and conditions will take more time than before.

In other sectors, large quoted companies should expect no further rate reductions, although coverage conditions seem to be little affected. Conversely, insurers are competing actively for D&O business from small- and medium-sized private companies.

**Topical tip for buyers:** Expect a much more intrusive underwriting process. Start renewals early, collect information and be prepared to differentiate yourself.

## Marine, oil and gas

It has been an "ugly year" for claims in the downstream energy market, says **Martin St Pierre**, Divisional Managing Director of the Marine, Oil & Gas Division at Jardine Lloyd Thompson. Windstorm losses in the Gulf of Mexico are also having a severe impact on the upstream energy market, especially for risks with natural catastrophe exposure. Uncertainties over availability and cost of reinsurance protection led to forecasts of reduced capacity, increased retentions, coverage restrictions and higher rates. For non-catastrophe business, the market is seeing rises across the board on clean renewals. Offshore construction risks are under intense scrutiny after a series of major subsea losses.

In the marine market, hull rates have been stable for fleets with good records, but the outlook is for increases of 10 per cent or more. P&I calls are increasing between 10 and 20 per cent and many of the mutual clubs have made unbudgeted supplementary calls for the first time in more than a decade. The war risks market is being dominated by discussions over piracy coverage, while shipbuilders' risk cover is bucking the trend with generally flat renewal terms as a consequence of good underwriting results and plenty of capacity for most risks.

**Topical tip for buyers:** Good communication and up-to-date information is critical to get the optimum renewal.

## Construction

Construction insurance remains competitive for most classes, according to **Paul Knowles**, Divisional Managing Director at Jardine Lloyd Thompson's Construction Division. Broad coverage is available for most risks, with limited imposition of restricted terms and conditions.

There is still a heavy focus on civil projects and natural catastrophe zones, with a strong emphasis on risk management and capacity.

Main factors driving competition are new capacity, with several new insurers coming into (or back into) the construction insurance market, and an absence of global catastrophes affecting the construction market over the last 12 months.

**Topical tip for buyers:** Leverage relationships and evaluate the potential of locking into longer-term deals.

## Property

The market is stabilising, especially on renewals and existing business. Where there has been a loss, underwriters are starting to look for increases in rates – how much depends on the loss size. Wordings for certain coverages, such as contingent business interruption, are likely to tighten, and insurers will require a lot more detail on suppliers and individual risk exposure, warns **Nick Murrell**, Head of Property at Jardine Lloyd Thompson's Global Risk Solutions.

**Topical tip for buyers:** To get reductions, innovatively restructure your programme before re-marketing. Long-term deals are worth considering at this stage in the cycle.

## Casualty

Generally liability rates are stabilising, with the reductions witnessed in the past being less prevalent, according to **David O'Ryan**, Head of Casualty at Jardine Lloyd Thompson. For certain classes where underwriting margins are traditionally small, notably Employers' Liability and Motor Liability, rates are increasing modestly (5 to 10 per cent). Buyers with larger self-insured retentions or excess limits continue to be insulated from such rate increases.

Multi-territory corporations requiring primary global liability programmes and associated regulatory fronting have a relatively limited choice of markets. There is little evidence of increasing rates but resistance to reductions is gaining momentum.

**Topical tip for buyers:** Re-evaluate and prioritise your programme limits, retentions and coverage requirements. Access markets early.