MARKET BAROMETER

Picking up pace

Rates are falling faster in most classes of business. But the shock losses from last year's hurricane season have left underwriters nervous about their coastal and offshore property exposures.

Underwriters are pricing business increasingly competitively. According to Richard Kerr, chief executive of property/casualty insurance exchange MarketScout, rates have fallen further than any other month since the soft market began. "This month's 2% composite dip, to 5% in July from 3% in June, is the most dramatic monthly drop that we have seen this cycle," he says.

However, rates have not yet deteriorated as much as they did in the previous soft market. "We had a pretty prolific hard market in the three or four years preceding this cycle," notes Kerr. "Rates still have not returned to the low level they were at in the past soft market cycle – and I doubt they ever will."

-5% average P&C rate decrease
July 2005
SOFT

But prices are not falling in every line. Two areas where rates remain firm are coastal and offshore property – both of which are exposed to Atlantic hurricanes. Unsurprisingly, after sustaining losses totaling $27.3 billion last year, according to the Property Claim Services unit of the Insurance Services Office, insurers are either writing these risks highly selectively or avoiding them completely.

Coastal property rates are flat, compared with the moderate decreases being enjoyed by some inland property accounts. "Underwriters don't like habitational – period," says Kerr. "And they sure don't like it anywhere near hurricane season on the coast. It is very difficult to get a rate that is commensurate with that exposure. Unless you are a State Farm with $6 billion of insured property around the country to carry those coastal risks, there is no way you are going to have enough rate to survive a big hurricane."

Underwriters have also been hesitant to cut rates for offshore energy risks. Hurricanes Dennis and Emily have already damaged a number of offshore platforms and pipelines, although not nearly as badly as Hurricane Ivan did last year. But meteorologists are predicting that the worst is still to come.

Business interruption claims for offshore risks are of particular concern to insurers. The volatility in oil and gas prices means carriers could be liable for claims far in excess of their forecasts. To mitigate these risks, many of them have tightened up terms and conditions. "A lot of them won't even offer business interruption as part of their cover," says Kerr.

Directors' and officers' liability (D&O) is another line where rate reductions have been scant. But Kerr says D&O rates could easily soften soon along with

About MarketScout

MarketScout is an online insurance exchange for property and casualty business. More than 50,000 agents in the US use the exchange to place commercial retail risks. It sources markets where business can be placed and helps connect them with relevant industry expertise. By analyzing the business placed through the exchange, MarketScout is able to build up a picture of whether rates are increasing or decreasing across different lines of business.

most other lines. "Demand for D&O is very high and higher limits are being requested," he says. "But the market is still searching for direction. It wouldn't surprise me if D&O rates bounced all over the place for the next four to six months."

Coastal property insurance

Gary Marchitello, managing director of the North American property syndication group, and Gail Norstrom, managing director of national property resource, at broker Aon

Rates are either stable or increasing for property located anywhere within 10 miles of the coast, especially on the Gulf coast and in Florida. Last year we had four intense hurricanes in quick succession. The damage could have been a lot worse, because the storms' intensity diminished as they made landfall. But this year already appears to be an unprecedented year for hurricane activity, and underwriters are being cautious.

Once you get outside those areas, rates are down between 10% and 15% on a year-on-year basis. Even national accounts, where a portion of the property is in costal areas, are seeing price reductions. Underwriters are only skittish about accounts that are concentrated in wind-exposed areas. Once you get north of Philadelphia there is not the same degree of sensitivity, because there simply is not the same frequency of storms.

The way insurers balance their aggregate exposures is through pricing. If they want to manage exposures in a particular area, they simply price their product higher to make sure their values do not exceed their risk appetite. The storm tracks provided by the risk modelers help underwriters track their exposures on a local level, especially in built-up areas.

Not until the hurricane season is over will we see fluctuations in coastal property rates – unless an account comes up for renewal in, say, the middle of September. In those instances, if the season pans out as badly as forecasters have predicted, we could see some rate hikes. Apparently we are entering what might be a decade of increased hurricane activity, compared with the relatively benign period before. Some carriers have already exited coastal property business and many have significantly reduced their appetite for these risks.

Directors' and officers' liability insurance

Bill McGinty, president and chief executive of Nasdaq Insurance Agency

Historically, the larger the company, the more economies of scale a carrier could apply to its insurance program. Now carriers are hesitant to write the larger companies because they know they could wind up paying substantial settlements. So they are competing for smaller companies with between $5 million and $10 million directors' and officers' liability (D&O) programs. That is what has been driving prices down in 2004 and early 2005.

There are also a lot of new players in the market, many of whom are less than five years old. These carriers like to write excess layers and can be very competitive on pricing and policy terms and conditions. There is also plenty of capacity coming out of London, Bermuda and the US, so all our renewals are experiencing reductions.

But I would still say the market has stabilized. Although we are seeing small decreases in pricing, we are not seeing the large reductions we saw at the end of last year. I think that trend is going to continue into the immediate future.

There are two issues at play in D&O. The first is the segmentation of the marketplace into programs with a larger limit and programs with a smaller limit. The second is that companies that saw price reductions last year or this year are coming into the second phase of the market cycle. What is unclear is whether this time rates will renew flat, with a slight reduction, or come down again. If prices came down again it would definitely shake up the market.

D&O is by nature a catastrophic risk. Either there is no claim or there is a big claim. In 2001, there were large claims associated with 9/11, which affected the supply of capacity in all lines and pushed rates up a lot. Then in 2004 capital flooded back into the marketplace, which caused carriers to compete for business and prices to drop.

The question is: has the market normalized yet? I have not seen a large amount of fresh capital flowing into the marketplace, so I think capacity is being used and pricing should normalize. In addition, the newer players have become more experienced and they have realized that, like the traditional carriers, they will get their share of claims. So they will be showing more discipline on their underwriting. ■