2012 Casualty and Property Market Update

As we begin 2012, there seems to be a collective reach within the insurance industry to see what the New Year will bring with respect to the casualty and property insurance market. So far, we've seen published answers from various prognosticators ranging from "It is Decidedly So" to "My Sources Say No." To be sure, the answer likely lies somewhere in the middle, and we must be frank (but not frightful) and reassuring (but not unrealistic) about the direction that the casualty and property market could take in 2012.

In order to recap how 2011's events led to the current state of the market and what we might see occur in 2012, USI has developed 2012 Casualty and Property Market Updates. Inside, you will find:

- Insight and information about the impact of global financial problems and natural disasters on the property insurance market;
- Indications of how pricing in the Property & Casualty marketplace is firming, particularly with the property CAT exposed clients and prospects;
- Ideas on how to best approach a CAT exposed property program in a transitioning market;
- 2012 forecast and overview for commercial, habitational and industrial segments;
- Status of the market for D&O insurance.

There is more going on today than in past periods of change in the insurance marketplace. Insurance companies are now relying more frequently on in-depth analytics for both underwriting and claims handling processes. They believe the claims analytics are helping them to evaluate trends in "non-catastrophic claims".

Casualty Market Update

There are increasing indications that pricing in the Property & Casualty marketplace is firming. The unknown is just how fast and widespread the firming is as we end 2011 and enter the first quarter of 2012. We are not experiencing universal double and triple digit percentage rate increases upon renewal as in the two past hard markets of 1985-87 and 2001-03. Significant changes of this type occur when insurance companies react to a material reduction in the policyholders' surplus which is necessary for them to write business. Weak investment income and underwriting losses create conditions that cause insurance underwriters to stop writing new business, increase rates and premiums, dramatically cut back on capacity offerings, and even withdraw from certain lines of coverage. Those conditions do not exist now as there is still significant capacity in the marketplace. However, insurers continue to have poor underwriting losses coupled with inadequate investment returns. Over the past couple of years, carriers have taken down loss reserves as much as possible to provide capital as an offset to these market conditions. Many believe the carriers no longer have the ability to further take down reserves.

What concerns insurance companies now is the impact of declining profitability on their stock value. Consequently, many are now trying to affect modest increases on renewal accounts to achieve an increase on their existing business of 1%-10%. Certain desirable accounts will likely be excluded from these increases. Increases are rationalized due to the class of business or a particular account's loss experience.

The market for D&O insurance and other professional liability coverage appears to be on a slower pace toward a firming market than the rest of the P&C market. While some experts predict that the market will begin to firm in 2012, average premiums still saw slight declines in 2011. With more than fifty D&O carriers in the marketplace, experts believe that this excess capacity will prevent rapid hardening; some argue that hardening is still some time off. But, with years of both declining pricing and expanding coverage, something is going to have to give relatively soon in light of the decreasing performance of companies' financials and carriers' investment portfolios.

CASUALTY MARKETPLACE TRENDS AND PROJECTIONS FOR 2012

Directors & Officers

- Clients will need to demonstrate even more strongly why they are attractive risks to take advantage of potential premium reductions still available in the marketplace.
- The available coverages in the D&O market have increased dramatically since 2009 due to competition and insureds' demands. Some carriers are beginning to use these additional coverages to charge additional premiums or justify flat renewals. Clients should consider taking advantage of new policy forms and expanded coverage before even more carriers look for additional premium or before the market hardens.
- Clients should be willing to consider a change in carriers, if necessary, to take advantage of expanded coverages.
- Beginning in 2012, clients may have to pay more to get more, or at least, trade expanded coverage for premium.

General Liability

- Clients and prospects that have invested in safety and safety technology will fare more favorably.
- Watch for regional insurance companies to more aggressively price "main street" new business in an effort to opportunistically gain market share from national insurance companies.

Workers' Compensation

- This is the line of casualty coverage that has seen the greatest negative impact on underwriting profitability.
- Rates are increasing in most states. Increases are being seen in California right now. Renewal increases of 85% are not uncommon in California.
- Most insurance companies are moving away from writing monoline Workers' Compensation. Depending on the insurance company, they may want to see premium from the other lines of coverage. Other carriers are looking to reduce the amount of Workers' Compensation on their

book of business, so look for carriers requesting supporting lines or carriers taking rate increases on the Workers' Compensation in anticipation of losing the business if they do not get the other lines of business.

- Insurance companies are engaging in more claims analytics to determine negative and controllable trends.
- Several states, including Illinois, Kansas, Ohio, Michigan and Wisconsin, are in the process of modifying the state Workers' Compensation programs.
- The State Fund in California is filing limited rate increases. The Fund did not take as significant rate decreases over the last several years so they will become more competitive as other carriers take rate increases.
- The rates in the Southeast still appear to be stable. Look for +5 to +10% nationally, with the exception of California. Rates, depending on the class and insurance company, can easily be greater than 20% in California.
- For mid-sized insureds on guaranteed cost programs with a strong commitment to loss control and claims management, this could be the year to examine if a move should be made to a loss sensitive plan.
- More so than with General Liability, having analytics prepared will help with discussions in the marketplace.

Commercial Automobile

- Both frequency and severity are trending upward.
- Insurance companies are still looking for good risks. Risks that have a historically strong safety program are in good shape. Risks who have recently invested in such programs should tell the story to the marketplace. Some insurance company loss control engineers will work to develop real time safety programs for those with larger fleets.
- In CA, there are several markets looking to write more monoline auto for 2012 creating additional competition.

Commercial Umbrella

- With regard to Umbrella placements, a number of carriers are reconsidering their interest in writing certain types of businesses.
- There has not yet been any noticeable erosion of limit capacity. However there might be an increase in minimum premiums for excess layers as time goes by.
- In CA, there is still plenty of capacity so Umbrella business continues to remain competitive. Tougher classes may see increases.

Property Market Update

A confluence of factors, ranging from economic uncertainty to weather catastrophes, may create an ideal environment for rising rates in certain segments of the domestic property insurance market in 2012, notably Catastrophe exposed, habitational and manufacturing risks. In previous market cycles, insurers were able to stave off rate pressure because of adequate income from investment activities. Hovering near zero, insurers' yields on assets are currently at historic lows. Meanwhile, global catastrophe related losses hit an all time high in 2011—in excess of $90 billion-- which has negatively impacted loss ratios with a knock-on effect of increasing reinsurance costs.

While the United States escaped another wind season without a major hurricane (Category 3 or higher), insurance buyers may not realize that the U.S. experienced 14 weather related catastrophes, each with economic losses in excess of $1 billon. U.S. manufacturers also experienced economic losses from supply chain disruptions half a world away. As a result, combined loss ratios for the first six months of 2011 were 111.7%, compared to 101.7% for the prior year. These factors alone would typically end rate softening, but the release of RMS' latest wind modeling software has proven to be the third leg of the stool to boost rates in many CAT prone areas. Insurers, reinsurers and rating agencies are all utilizing RMS 11.0 to value their portfolios' catastrophic risk exposure. The last update to the wind portion of the RMS model was released not only prior to Hurricane Ike, but also before the destructive hurricanes of 2004 and 2005. Losses experienced during Hurricane Ike further proved that the modeling software valuations were flawed, especially in measuring non-coastal exposures. The RMS 11 update is causing insurers to: reduce capacity offerings for wind exposed property risks, consider laying off risk in the form of higher deductibles to customers, consider coverage limiting modifications to policies, and seek premium increases for coastal and inland exposures alike.

In certain segments, the pricing of domestic property coverage is trending upward as property insurers are responding to these factors. Global losses in 2011, lack of investment yield, and pressure to increase earnings could create a perfect storm for the industry, with underwriting profitability and rate increases as the only escape. While insurance and financial market conditions are ripe for hardening, it is important to remember that market spikes observed after September 11, 2001, as well as the 2005 and 2008 hurricane seasons, were quickly wiped out with new capital flooding into the market. As rates climb in 2012, this scenario could be repeated. There is considerable capital waiting in the wings to jump into a hardening market. Barring any major events over the next few months, supply and demand may cause hardening market trends to be short lived.

State of the Segments

- **Commercial CAT** - Commercial accounts with marketing competition will likely see minimal increases or flat renewals. Incumbent markets looking for rate increases will be forced by non-incumbent markets to reduce or eliminate these increases. Many incumbent markets may walk from profitable accounts if they are unable to attain their expected rate increase at renewal. **Expected rate change: Expect rate increases**
- **Commercial Non-CAT** – These risks may see a slight push from carriers who are looking nationally to increase rates, but realistically, a clean account should be able to attain flat renewal rates. **Expected rate change: Flat**
- **Habitational CAT** – This segment is seeing the largest pricing swings due not only to modeling changes, but also significant fire losses for the class across the industry. Capacity for this segment has been reduced substantially as carriers look to write risks that do not include both

exposure to CAT as well as high fire loss frequency. **Expected rate change: Expect rate increases**

- **Habitational Non-CAT** – This class should not see the same level of rate swings. There may be a push by carriers to increase deductibles in this class especially as it relates to non-named windstorm. **Expected rate change: Expect rate increases**
- **Supply Chain Exposed (Manufacturing)** – This segment may be the least impacted from a rate standpoint, but significantly impacted from a coverage and limits perspective. Insureds should be prepared to accurately quantify their exposure to losses that affects both suppliers and customers, as underwriters are closely examining these exposures in the wake of the Japanese tsunami and Thailand floods. Coverage may be unavailable or restricted to exclude flood and earthquake. **Expected change**: **Expect rate increase and firming terms and conditions**

About USI Insurance Services

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