Kibble & Prentice USI

Property & Casualty

Current State of the Insurance Marketplace: Touched by Supply & Demand

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As business professionals and investors, we are informed repeatedly that past performance is no guarantee of future results. The same is true in the insurance marketplace. The financial markets and the insurance markets are both characterized by numerous – and unpredictable patterns that make it impossible for anyone to use past price moves to accurately forecast future moves in the market. However, experience can teach us useful lessons and historical results are important, though not infallible indicators of future outcomes. This is the backdrop against which we present the following overview of recent conditions in the U.S. property & casualty (P&C) insurance industry.

The P&C insurance industry is a cyclical business, and insurers' profits are cyclical and highly volatile. This is due in large part to the frequency and severity of catastrophes and competitive pressure on prices. In 2004, the industry entered a "soft" market cycle, characterized by declining rates and pressure on carriers' margins. "Soft" market conditions occur when insurance losses are low and prices are very competitive.

Despite carriers' continued price cutting in 2009, industry profits increased sharply, from $3B in 2008 to $28.3B in 2009. (Note industry profits were $62.5B in 2007.) These results were fueled by higher investment income, a quiet year for natural catastrophes and downward adjustments of reserves held to cover losses incurred in prior years. The industry combined ratio – the ratio of losses and other underwriting expenses per dollar of premium – improved from 105% in 2008 to 101% in 2009.

Some or all of these factors may turn negative in 2010 and put pressure on carriers' profits. We have already seen what looks like the end of a benign catastrophe

environment. Natural catastrophe losses in Q1 2010 were likely the worst ever for a first quarter. However, it is important to be aware that one bad quarter will not turn the market. An oversupply of industry capacity and insurers' challenges in achieving top-line growth mean most insureds, in particular those with good loss records, should anticipate stable pricing, or even moderate reductions in their insurance rates in 2010. Evidence from Q1 2010 renewals supports this view. On average, rates dropped 5.3% in the first quarter, after declining 5.6% in Q4 of 2009.

According to data reported by The Council of Insurance Agents & Brokers, large enterprises saw the biggest rate declines, at more than 7%. Declines for small and midsize companies were 3% and 5.7%, respectively. ("Small" firms are those that pay less than $25,000 in commissions and fees. "Midsize" firms pay $25,000 to $100,000. "Large" firms pay more than $100,000.)

Despite carrier efforts to achieve top-line growth, competition has taken its toll. Pricing for renewals – particularly when there is competition for the business – is generally flat. And carriers have been hyper-aggressive in pricing new business.

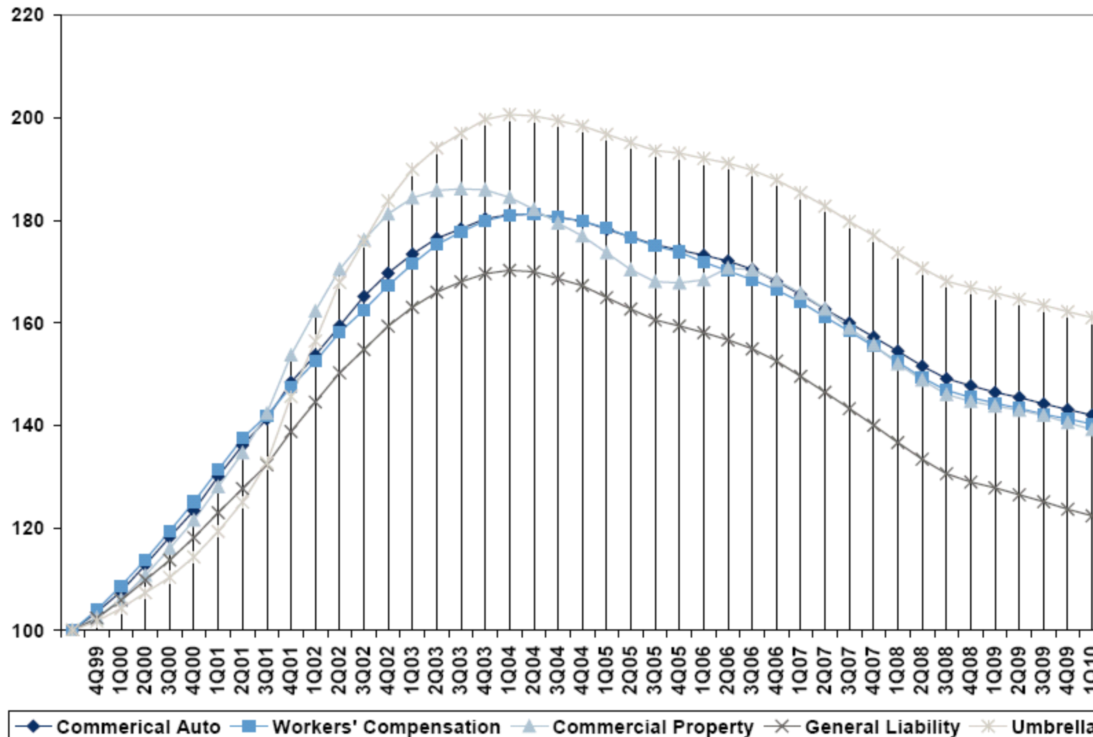
Only 7% of small firms, 6% of midsize firms and 5% of large firms report rate increases in the first quarter. On the other hand, 53% of small firms, 74% of midsize firms, and 71% of large firms report rate declines.

Lines of business in which rate declines are most prevalent are commercial auto (57% of respondents reporting declines), commercial property (64%), general liability (66%), umbrella (55%) and workers' compensation (57%). Some respondents report rate cuts of as much as 30% in Q1.

Rate increases are most prevalent in Directors & Officers Liability, but there are no reports of increases greater than 10%.

As the chart below outlines, rates in most lines have been declining since mid-2004.

Cumulative Quarterly Rate Increases by Line



Source: The Council of Insurance Agents and Brokers. Chart prepared by Barclays Capital Equity Research.

Earlier, we called attention to the danger of relying on past performance to forecast future results. It may be tempting to assume P&C insurance rates will continue their downward course inexorably. This is human nature. As Professor Gregory Berns of Emory University Medical School points out, when your mind formulates images, your brain commonly fills in the blanks "in ways that we expect them to be, how we expect the world to behave." P&C insurance rates have been on a strong downward trajectory for six years. Therefore, as humans, we naturally expect them to continue this trajectory.

However, as also mentioned above, insurers' profits are cyclical and volatile. Rate decreases could turn into rate increases next month, next quarter, next year, or not for several years. The old adage, "you can't time the market," is just as true in insurance markets as it is in financial markets.

What you can do is use the data provided above to benchmark your own experience in the insurance market. Did your rates drop at the most recent renewal? If not, do you know why? Did you introduce competition to help you reduce your rates?

If you can not respond affirmatively to these questions, now may be an ideal time to review your pricing history in the context of the market environment. If your rates are increasing or stable while those of your competitors are dropping, you are at a competitive disadvantage.

Market intelligence is not a crystal ball, but it is a highly effective measuring stick for evaluating trends in your rates relative to those in the market at large.

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