Hard Market: A Double Entendre that Means Work for You

When you hear talk about a hard market in the insurance business, it really has two meanings. There's the buyer's perspective – insurance coverage becomes scarcer (some may even disappear for your segment of the market), exclusions expand, and premiums grow. And the seller's perspective – whatever is underwritten has to make money. So it's a seller's market and time for the buyer to figure out other ways to protect his or her organization's assets. That's difficult, and harder still if you've been concentrating mostly on risk financing and haven't paid much attention to overall risk management strategies.

If you have been consistently applying safety procedures, educating your staff as your policies and procedures change, screening new hires and volunteers, maintaining equipment and buildings, and keeping your disaster plans up-to-date, you are in a better position to negotiate insurance coverage in a hard market. Because of your loss control strategies, you'll be a more attractive client, and insurance carriers will have greater confidence about writing your account.

This article will:

- give some historical perspective to the current hard market,
- help you understand the cyclical nature of the insurance market, and
- suggest steps that small companies, public entities and nonprofit organizations may employ to prepare for and weather the hard market.

A Non-Hysterical Perspective

This isn't the first time, nor is it predicted to be the last time that the insurance market "hardens." In recent memory, there were the hard markets of the 1970s and the mid- to late 1980s. What's different this round is the hard market follows the longest soft market cycle (12 years) in recent history. Thus, you may be used to having low premiums and insurance companies actively woo you for your business. Being told your premium is going to increase significantly, or worse, that the company no longer intends to write coverage for your type of organization, will come as a slap in the face, especially if you've had few or no claims. But that's exactly what happened previously.

Nowhere have the effects of the soft market been more evident than in the nonprofit sector, says Melanie Herman, executive director of the Nonprofit Risk Management Center in Washington, D.C. In the early 1980s, nonprofits were relatively modest consumers of insurance products.

"Some purchased common coverages — property, general liability, directors' and officers' liability, employment practices liability and workers' compensation," reports Herman, who formerly managed a specialized insurance program for a national association. “Many went about the process in isolation, rarely relying on organized, sponsored insurance programs. Very few took advantage of opportunities to gain control over their insurance destinies by forming self-managed insurance programs such as sponsored insurance programs, pools and captive insurers.”

The mid-1980s changed the picture for consumers of commercial insurance. There was no question it was a hard (and difficult) market. Francis J. Mastowski, CPCU, of Jimcor Agency, Inc., remembers that financial capital was insufficient to absorb the demanded renewal price increases of 100 percent to 500 percent and entire books and lines of business were “nonrenewed.” Several large insurance companies failed, re-insurance wasn’t readily available, and demand for coverage couldn’t be met. The result was dramatically increased renewal premiums and coverage that was very difficult and sometimes impossible to place.

Shocked consumers, who found themselves personae non gratae, were left between the proverbial rock and a hard place, deciding between paying a larger-than-budgeted premium, going bare, or settling for vastly reduced coverage at the renewal rate. Everyone wasn’t this lucky. Some buyers were nonrenewed and found it impossible to replace the lost coverage with any other financing.

From this morass arose a new commitment to avoid being at the mercy of the insurance marketplace. If “Never again!” wasn’t the rallying cry, it could have been. Associations and umbrella groups began seeking creative responses with which to control their insurance futures. A groundswell of interest in preventing losses, minimizing liability, and managing rates took hold.

By the time the market began softening in the early 1990s, many entities had taken steps to protect themselves from future market fluctuations. Some banded together, pooled their insurance budgets and, depending on their state laws, functioned almost as insurance companies or operated as self-insureds. Others were simply relieved to have or be able to afford coverage once again.

Examples of public entity pools are CIRSA and VSBIT. The Colorado Intergovernmental Risk Sharing Agency was formed in 1982 in response to excessive premium hikes and canceled policies to provide property and liability insurance. The Vermont School Boards Insurance Trust formed 20 years ago to serve school districts with cost-effective insurance and risk management programs. Many public entity pools have flourished and offer a range of services today. They are represented by the Association of Government Risk Pools headquartered in Prague, Okla. (For information about the association visit at www.agrip.org.)

A unique nonprofit pool, the Nonprofits’ Insurance Alliance of California, was created in 1988 when many nonprofits in the state couldn’t get insurance at any price.

According to founder Pamela Davis, “Between 1984 and 1986, general liability insurance premiums increased 200 percent or more for one out of four charitable nonprofit organizations in California. During that same period, insurance companies canceled or refused to renew the general liability policies of one out of five California charitable nonprofits. Some important human service programs, such as childcare, foster care, group homes and health services, were forced to dramatically cut services or close because they couldn’t find affordable insurance.”

NIAC is the first and only insurance entity to qualify as a “charitable risk pool” under federal law.

To Be or Not to Be?

There is disagreement within the insurance industry -- evident in the pages of such industry magazines as*Business Insurance, National Underwriter*, and *Risk and Insurance* -- whether or not this is a “real” hard market and how long the current upheaval will last. Mastowski says the factors extant in the mid-1980s hard market don’t exist today and aren’t driving the change in the marketplace. He observes that what seems to be affecting the current status quo is an attempt to correct 12 years of competitive pricing. Steps being taken to improve underwriting results (and profitability) that are also precursors to a hard market are as follows:

- class underwriting,
- line underwriting,
- restrictive policy terms,
- geographic restrictions,
- rate increases, cancellation of producers,
- cancellation or restructuring of programs,
- reduction in catastrophe exposure, and
- wholesale non-renewals.

The definition isn’t as important as the outcome, or what you as an insurance buyer are doing to weather the storm and revamp your risk management and risk financing strategies.

A Hard Market Is Unforgiving

Hard markets, says Lou Novick, president of The Novick Group, Rockville, Md., in several recent PERI_articles written to the association community, are characterized by higher rates and more restrictive policy terms.

Coverage, cost, and service, the three concerns of insurance buyers, says Robert Montgomery, CPCU, writing in *The John Liner Review*, Summer 1998, have gone missing.

A downturn in the stock market and declining interest rates are additional signs that the cycle is “hardening,” says John Scott, safety and risk manager of Melwood Horticultural Training Center in Upper Marlboro, Md.

A Soft Market Is Cushy

In a soft market, insurance company underwriters aim to get as much premium on the books as they can. To do so, they reduce premiums to win your account and may overlook loss control issues. The buyer is in control, demanding better terms for lower rates – which will be met.

Buyers Can Control a Piece of Their Destiny

In the world of commercial insurance, there's little any single buyer, or group of insurance buyers can do to change the ebb and flow of the insurance market cycle or influence the speed at which the cycle progresses. However, R. Scott Ecker, CPCU, ARM, CIPA, APA, AIAF, Are, a risk management consultant, offers a series of steps that a good risk manager can take in *The John Liner Letter*, Summer 1998. Though initially published several years ago, these tips are appropriate for the current hard market cycle:

- Check Your Policies.
- Check Your Relationships.
- Know Your Own Company.
- Get Your Submission Ready.

Check Your Policies -- Know what your policy says about cancellation and nonrenewal. Most states have laws requiring insurers to give commercial policyholders advance notice of nonrenewal or a change in coverage terms. The notice period varies based on state law and may differ based on policy type. There is a generic summary in *IRMI Insights*, October 2000, located at www.irmi.com/insights, or check your state insurance department's Web site for additional information.

Check Your Relationships -- Ask if your insurance professional has been through a hard market. Ecker says there are fewer and fewer veterans in the field, but that those buyers who've teamed up with veterans in the past have had a higher survival rate. He also suggests you ask "how much business the agency does with the insurer who writes your policies." In other words, how much clout will the agent or broker have if push comes to shove?

Know Your Own Company, Entity or Nonprofit -- Find out your entity's risk threshold. Would you rank your organization closer to the risk averse end of the spectrum or the risk-taking end? Ecker suggests retaining as much risk as possible — even when premiums are very, very low — to be prepared for market changes in the long run.

Get Your Submission Ready -- One of the after-effects of September 11 is that underwriters are demanding complete submissions from brokers, and many are asking for them more than 60 days prior to the renewal date. Ecker advises no matter what the market status it behooves you to "Get your submission ready. Keep it up-to-date — and complete."

You can help your insurance professional by determining which coverages are nice but not necessary, or could be covered by something else, should you have to make a choice. "The risk manager who has a clearly designed program, one that is well laid out for the underwriter, will get the serious consideration."

Get your five-year loss runs under control. According to Ecker, these must be prepared for all requested coverages and include an "explanation and status of all large losses, open and closed…audited premiums, limits and prior exposures…."

He indicates you'll lose points in a hard market if your application isn't complete. This means every "i" dotted and "t" crossed or your application will not be read; the competition for the underwriter's attention will be stiff.

Another area Ecker suggests including is "your servicing requirements." This would include third party administrators, law firms, or outside adjuster services in relation to retentions.

Next Steps -- Once your submission is complete, share it with your insurance professionals and ask them to review the work and provide input, suggests Ecker. Once you've completed a risk management audit, check your markets.

A market review is a time to review nontraditional insurance — options offered by pools, group plans, and captives. Jim Swanke, risk management consultant for Tillinghast-Towers Perrin, says in *BestWire Services*, Dec. 13, 2001, "More sophisticated risk managers will use their captive as a tool, taking on greater risk in a hardening market. As the market softens, they put less and less risk into their captives."

Coverage Changes

Some in the industry are predicting that one effect of the market will be coverage changes, such as a higher price for products, some types of coverage dropped, and many particular types of businesses seeing a tightening of coverage.

Other changes were recorded by a benchmark survey released by the Council of Insurance Agents and Brokers in mid-November. "The survey of 103 brokers compares the property-casualty market of Nov. 1, 2000 to Nov. 1, 2001," reports the *National Underwriter*. The Nov. 26, 2001, article by Mark E. Ruquet reiterates tightening policy terms and conditions, higher deductibles, elimination of some lines and more detailed information prior to renewals. But it adds that more and more brokers are turning to the alternative markets, and excess and surplus lines. The survey shows that 45 percent of the brokers said property and umbrella have risen 30 to 50 percent. Rate increases of more than 50 percent are being reported in "nursing home liability, construction, aviation, trucking and workers' comp in some states," according to the CIAB.

Summary

While it's impossible to know how long the current phase of the cycle and the difficult conditions will remain, history indicates that the opportunities of a soft market will return. However, no organization can afford to simply wait out the cycle. Despite the difficulty of sustaining an affordable insurance program for your small business, nonprofit organization or public entity, it's possible and advisable to take steps now that will protect your organization for the long term.