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Insurance buyers—especially those with stable financials and good loss histories—have enjoyed softening prices in the primary casualty marketplace over the last six months.

Carriers, however, have continued to employ a bifurcated pricing model for existing and new business. Many carriers have attempted to raise rates for existing business after realizing that their core insurance product was priced too low, as evidenced by a combined ratio of 105 in 2008, well above the 100 break even point. At the same time, ample capacity still exists in the marketplace and carriers have been aggressively pricing new business. This approach to pricing has forced buyers to introduce competition on renewals to gain the most favorable outcome.

Insurance surplus, while declining from \$530 billion in 2007 to \$462 billion in 2008, still is nearly double 2001 levels and has been sufficient to create aggressive competition on the right deals. This surplus is chasing lower overall premium levels as the worldwide economic crisis has resulted in lower overall client exposures, including payroll and sales.

Despite the good news for many buyers, not every company has benefited from the current market. Distressed companies have more limited options in terms of carrier choice, and those carriers providing options have been pricing these risks opportunistically. In addition, those companies with poor loss histories have witnessed either rate increases or have been forced to assume higher retention levels.

Distressed companies have also experienced difficulties in meeting the collateral requirements of their insurance carriers. The credit crisis has prompted banks to reduce their credit capacity, making it more difficult for buyers to post Letters of Credit (LC). The cost for these LC's has increased substantially with a doubling or tripling of the rate common. In addition, carrier credit standards have tightened and carriers are now more conservative in their willingness to extend unsecured credit to insurance buyers.

This has had a significant impact on distressed companies because as banks have been attempting to reduce or eliminate their exposure to these distressed companies, it has become very difficult for these buyers to post the LC's required to support their insurance program. This has caused many distressed buyers to seek alternative program designs that are cash intensive and more expensive than their expiring program.

Given the overall objective of minimizing collateral, it is very difficult for buyers to move their business to a new carrier in this environment. Thus, retention rates for carriers continue to be strong and the "Power of Incumbency" continues to be a theme that will play out over the next year.

Our view in the near term is that we are at—or very near—the bottom of the pricing cycle for companies with good loss histories. The ample capacity in the marketplace is forcing insurance companies to deploy this capacity aggressively in pursuit of those companies, even at rates that generate meager profits and a low return on capital. But distressed companies will continue to be at the mercy of their incumbent carriers, subject to price increases and with only limited ability to move their business as a result of the decline in credit capacity that is available to them and the increase in carrier credit standards.