Competing in the (Endless) Soft Market

Strategies to Survive

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What’s Happening To Pools Now?

• In some states, tremendous pressure to reduce rates to be competitive
• Regulatory oversight becoming more restrictive where applicable
• Pools losing Members and contribution income
• WC Pools assuming new risks because of court decisions and legislation (e.g. cancer presumption risks for fire fighters)
• Pressure from Members to reduce surplus size and distribute to Members
• One Pool recently ceased operations in TX
Property/Casualty Industry Net Income

Property / Casualty Industry - Net Income after Taxes*

*per the Insurance Information Institute (III)
Property/Casualty Industry ROE

*per the Insurance Information Institute (III)
U.S. Insured Catastrophe Losses

*per the Insurance Information Institute (III)
Property/Casualty Industry Combined Ratio

P/C Industry Combined Ratio*

<table>
<thead>
<tr>
<th>Year</th>
<th>Ratio %</th>
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<tbody>
<tr>
<td>2011</td>
<td>100.3</td>
</tr>
<tr>
<td>2012</td>
<td>102.4</td>
</tr>
<tr>
<td>2013</td>
<td>96.7</td>
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<tr>
<td>2014</td>
<td>97.2</td>
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<tr>
<td>2015</td>
<td>97.8</td>
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<tr>
<td>2016</td>
<td>99.9</td>
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<tr>
<td>2017</td>
<td>TBD</td>
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*per the Insurance Information Institute (III)
How Did We Get To This Point?

- III announced the P/C insurance industry entered 2017 in very strong financial condition
- P/C industry now has $1 in surplus for every $0.75 of net premium written, close to the strongest claims paying status in its history
How Did We Get To This Point?

• According to III and the Council of Insurance Agents and Brokers:
  • 30 consecutive quarters of commercial rate declines from 2004 through the second quarter of 2011
  • 11 consecutive quarters of rate increases until the 3rd quarter of 2014
  • 10 consecutive quarters of rate declines since then
How Did We Get To This Point?

- Aggressive marketing by agents and brokers to elected officials and by competing pools
  - Example - local office of national broker claims in a letter that if you’ve been with this pool for 15-20 years then you are severely overpaying
  - Same broker says the pool charges different rates for its members - what a novel idea!
  - Same broker says there's nothing unique about the coverages or services you are receiving - really?
How Did We Get To This Point?

• Politics – Boards of Pool Members campaign on and insist on competition
• Pools viewed and treated as a commodity
• Lack of loyalty from Members and Trustees
• Inadequate communications to the Members
• Not transparent in decision making
• Poor claims adjusting services
• Reactive/limited loss control services
• Active and engaged Trustees and Member personnel retiring – loss of historical perspective
How Did We Get To This Point?

• Reliance on brokers for new business; brokers have little loyalty to Pools
• Complacency
• Not responsive enough to new exposures (e.g. Cyber Liability)
• Unwilling to take risk; reliant on reinsurance; easy to do with very competitive pricing and coverage
• Overly restrictive terms in Trust Agreement and/or coverage document as respects Member termination
• Some Pools do not share risk amongst the Members
Are Pools Still Relevant?

- Do they still serve a purpose?
- Some make it very difficult and costly to leave
- Are members staying just because of the harsh termination conditions?
- Can the current soft commercial market conditions continue for long?
- Will Hurricanes Harvey and Irma serve as the impetus for market hardening and coverage restrictions, at least for property? Yes, they will.
Underwriting Response

- Lower confidence level funding for expected losses for rate making?
- Use discounted expected loss funding in budgets?
- Use excess surplus for rate relief. How do you fairly allocate the excess surplus?
- Should your contributions to members be more loss sensitive?
Underwriting Response

• In face of severe competition, consider use of commercial marketplace to replace problem lines. For instance, if police professional liability pool rates are uncompetitive, transfer risk to specialty commercial insurer until pool rates decline or market improves.

• Approach Pool reinsurers about significantly lowering retentions so that more risk is transferred to reinsurer and away from Pool.
Underwriting Response

• Consider Loss Portfolio Transfer (LPT) to eliminate reserve problems and improve balance sheet. Limited market for LPT’s

• Simplify the Underwriting process by eliminating and consolidating CGL and Auto classifications and territories

• Review Pool’s coverage document vs. commercial marketplace and improve where possible
Underwriting Response

• If losing members, determine the members you want to retain. Devise a rating system that incentivizes good members to stay. May involve use of rating tiers. Most often used in WC.

• If competing with other Pools, should you consider merging or entering into informal agreements with the other Pools to not compete?
Underwriting Response

• Hold annual retreats or day long annual meetings to communicate Pool coverages, services and goals

• Add Cyber Liability with low reinsurer retentions to start until the Pool is comfortable with retaining more risk

• Seek multi-year commitments from renewing members along with similar rate commitments from the Pool
Underwriting Response

• Pay Dividends to renewing members only

• Design a Rate Stabilization Fund (RSF) so some funds are retained in the Pool if members leave. RSF may be better retention tool for Pools.

• Use multi-Trust discounts when there are multiple Trusts (WC, Liability and Health) under the same management

• Beware of co-mingling funds between Pools or consolidating separate Pools
Underwriting Response

- Where regulated, seek approval from regulators for use of schedule credits and debits when experience rating is not enough
- Require long notice from members of their intent to leave the Pool. Necessary for budget purposes
- Eliminate some members to reduce rates overall and be in a better competitive position; improve various financial ratios
Underwriting Example #1

• One Pool requires a departing member to be responsible for the ultimate payment of losses and associated expenses for all claims incurred while a member

• What happened to risk sharing?

• How will the Pool collect? Do they require payment for ultimate losses? Do they show the member’s liability as an asset?

• Who adjusts open claims? Impact on reinsurer?

• This Pool also allows departing members to take their underwriting surplus with them
Underwriting Example #1

- That Pool has an adverse selection risk as profitable members have an incentive to leave and poorer performing members must stay.
- That same Pool’s financial statement shows surplus but does not consider that members can take their surplus when they choose. Should those amounts be listed as a liability?
- Pool is administered by the same firm that does underwriting, marketing, claims and loss control. Firm is paid by a % of contributions. Problem?
Underwriting Example #2

• Claims Paid approach to Underwriting vs. claims made or occurrence. Pool only needs to fund expected payouts.

• Coverage document will only agree to defend and pay claims while a member. If a member leaves, Pool stops defending all existing and open claims.

• Largest single asset on this Pool’s balance sheet is premiums to be paid in the future by its members to fund the liabilities.
Underwriting Example #3

- Members with WC exp. mod. of 1.15 or higher to be expelled
- Members with maximum WC loss ratio of 75% or higher for last three loss years to be expelled
- Withdrawing members required to post security equal to 25% of the annual contribution
- Member who submits notice to withdraw then rescinds, is barred from giving notice again for two years.
Underwriting Example #4

• Any member who provides the required 90-day notice in order to solicit competitive bids shall be treated as notice of cancellation

• Any member who attempts such an inappropriate optional termination shall pay a termination fee of 10% of that member’s annual contribution

• Members of this Trust receive dividends every third year if they renew for another three years
Potential Strategies

• Require certain coverages be purchased by all members; avoid adverse selection

• Reduce expense ratio by not using brokers for new business

• Broaden and tailor coverage beyond what is typically available from commercial insurers

• Broaden and tailor risk control services beyond what is typically available from commercial insurers
Potential Strategies

• Provide robust and responsive claims services beyond what is typically available from commercial insurers
• Emphasize stable pricing and net cost
• “Mod smoothing”
• Return excess surplus in various ways
Potential Strategies

• Provide value added services unavailable elsewhere:
  • Property appraisals
  • IT services
  • Pre-claim legal consultation
  • Disability management for non-work related claims
  • Health clinics for Health pools
  • Risk control grants
  • Wellness services for Health pools
Potential Strategies

- Make website more user friendly, expand resources available through the website
- Reconsider the Pool’s reasons for being
- Expand use of social media
- Build visibility through additional outreach at sponsored Pool events
- Use member surveys for ongoing feedback
- Consider re-branding
Underwriting – What Not To Do

• One Trust reserves the right to deny any and all claims on owned autos not reported and listed on the Trust vehicle schedule

• Another Trust only covers liability assumed by the members under contract if the contract is reported to and agreed to be covered by the Pool
Underwriting – What Not To Do

• If the Pool’s casualty budget funds and reinsurance are exhausted by the payment of claims, then payment of other valid claims shall be the sole and separate obligation of the individual member against whom the claim was made.

• What happened to risk sharing and joint and several liability elsewhere in the Trust agreement?
Returns of Surplus

• Have to be a current Member to receive
• Surplus owned by the Pool, not by the individual Members with individual Member accounting/ tracking
• If a Member leaves, Member forfeits any claims to surplus
Returns of Surplus

• Dividends – go out the door when the check is sent

• Safety grants and risk control incentives

• Rate relief to “smooth” major swings in overall target contribution (e.g. large increase in property reinsurance expense due to windstorms/market)

• Rate stabilization funding – stays with Pool until drawn by current Member
Rate Stabilization Funding

- Money allocated can only be used to reduce future premium contributions
- Member uses at own discretion when needed for budget or other reasons
- Can adjust amounts available for use by Members (e.g. 40% of Year One allocation, 70% in second year, 100% in third year)
- Member portion of RSF returned to overall Pool surplus if Member leaves Pool
- Serves as retention tool for current Members
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