A complex and troubled industry

Today's New Insurance Industry is a Different World

BY BOB MILLER

In a word, the insurance industry is "troubled." The issues confronting us are many and complex. Without sounding like an alarmist, it's no exaggeration to say that never before in the 150 plus year history of insurance, has this industry experienced such a crisis of profitability. Without embracing the catastrophic losses of September 11, the industry is in a profitability crisis.

To the average person, its unfathomable that those greedy insurance companies could possibly be losing money since "I have paid premiums for the past 34 years and have never made a claim."

This crisis of profitability has affected virtually every line of insurance with "availability" or an industry word "capacity." One would ask "How does capacity/availability affect us as consumers of insurance? Simply stated, capacity of insurance is the availability of various insurance products from companies willing to write certain types of coverages, otherwise known as risks. The specific examples of this capacity issue are: the "habitational" or homeowner insurance, workers compensation coverage, as well as mold and pollution coverage.

The changes in the insurance market actually began in late 2000. While there are many, one of the causes included unusually low premiums offered by the insurance companies. This was especially true when policies remained with the same carrier for many years. The dramatic rise in the cost to reconstruct was simply not monitored by those who determined the premium.

Thirty property/casualty insurers were declared insolvent in 2001, according to the special report, issued recently by A.M. Best Co.

Other Reasons for the Profitability Crisis

Significantly lower investment returns. The stock market returns have fallen drastically. Prior to the current market downturn, the industry could make a return of $4 – $5 for every premium dollar invested. Those returns added to the bottom line of insurance companies without regard to sound underwriting of the risk. The claim losses present in the 90's were made up by investment returns.

- Acquiring market share at the expense of sound premium underwriting.
- Undervaluing building coverage values based on cost per square foot of reconstruction.
- Unanticipated and unprecedented payout per claim.
- Unanticipated claims – mold, huge water claims, second wave of asbestos, etc.

Water Claims Drain Profits

In citing some specific examples, California insurers' homeowner profits are drowning in water damage claims. The cost of water claims climbed by an average of more than $56 million annually for each of the past four years. The research, which polled companies representing 63 percent of the state's homeowners insurance market, found that water claims represented 24 percent of all homeowners' claims in 1997, but grew to 32 percent by 2001. Based on trends of the insurers surveyed, overall industry water losses between 1997 and 2001 could be as high as $2.5 billion. And, these figures are merely a snapshot of the problems that uncontrolled water losses are causing the homeowner insurance industry.

As you can tell from just water claims, the property and casualty side of the business is suffering losses that resemble the gross national product of some Latin American countries.

Companies Withdraw from HOA Insurance Market

As habitational- related insurance losses skyrocket, eight companies have already withdrawn from the HOA insurance market in the past 18 months. These withdrawals take the form of non-renewing present policies, not writing any new business or re-underwriting all renewals with an eye to find any reason to non-renew.

Lower reserves and the erosion of profits have affected the ratings of such companies as State Farm General (The California operating company) downgraded in January to B+ with reserves of $250-$500 million. In a press release by AM Best, the primary causes for the downgrade and "watch" status were rising construction costs along with State Farm General's overall market share growth pricing. State Farm General has suspended writing any new homeowner business in California. State Farm Group (parent) lost $5.2 Billion in 2001 and has suspended writing any new business in 27 states.

Farmers Insurance has not escaped the pain either. Farmer's had the headline grabbing news of the $32 million judgment against them in the Texas "Ballard" mold case. Farmer's insurance had 10,150 mold- related claims in the first 10 months of 2001. The cost of mold-related claims for the three largest insurers in Texas jumped from $9.1 million in the first quarter of 2000 to $79.5 million in the first quarter of 2001, according to the Texas Department of Insurance. Further, in California, Farmers excluded mold coverage on all new business and on all renewals effective Feb 1, 2002. All agent binding authority has been revoked with a minimum of 30 days for all applications to quote. Buildings with wood roofs are ineligible. No polybutylene water piping. Inspections are no longer left to the agent. They will be re-underwriting all renewals to newly revised and stricter guidelines.

Allstate Insurance shares the problems. Last year, a federal jury in California awarded $18 million — all but $500,000 of that amount in punitive damages — to a homeowner against Allstate that declined coverage for mold damage. The trial judge reduced the award to $3 million. The case is on appeal. California, while not experiencing mold judgments quite as severe

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as Texas, is clearly in the target zone by the mold lawyers.

Many cases filed on behalf of terribly sick victims are warranted. Some other claims have "appeared opportunistic." The Personal Insurance Federation of California said that mold was never really factored into the rates that insurance companies charge.

Where might homeowner's insurance rates climb to? Calculated on the experience in Texas, a homeowner of a $213,000 house who now pays $625 per year could see that amount rise to $2,300. If the average premium reaches in excess of $2,000 per year, this rate would likely have a negative impact on the purchase price of a home.

Currently, there are over 250 mold exclusion applications pending before the California Insurance Department. Earlier this year, an effort to require insurance coverage for mold, resulted in a bill being introduced into a California assembly committee. It has been rumored that Farmers Insurance will withdraw from California if this insurance bill passes. The bill died in committee in July of 2002.

Other companies that have left the specific market of HOA's include Highlands, Constitution, Pacific National, UCA, Century National and Clarendon, Travelers and most recently, Philadelphia Insurance left the condo market. Other companies which have lost ratings or have had their ratings downgraded include Republic Western, Fireman's Fund, Travelers (A++ - A+ or B+).

The strain for insurance policies upon the remaining companies has reached a near breaking point. With limited capacity, remaining companies are under siege by agents from all directions seeking insurance of standard, substandard and surplus lines properties.

Workers Compensation Insurance

As bad as the workers' comp insurance market is all over the country at the moment, California seems to be particularly beset with trials and tribulations, all pointing towards increasing costs for employers.

At least four companies have pulled out of California's workers compensation market due exclusively to lack of profits. They are Reliance Insurance Group, Fremont Compensation, Golden Eagle, Legion Insurance Group, and Paula Insurance [recently liquidated]. As medical costs and fraud have been spiraling upwards, the cost of claims payment are $1.21 for every $1 collected. This situation mandates that just to reach breakeven, a 20.1 percent increase in premiums be implemented (rate approvals of 20.3 percent have been approved as of June 1, 2002). This unprofitable situation was present prior to Governor Davis signing into law a workers compensation reform bill AB 749. The effect of this bill is to double the compensation paid to injured workers. These benefit increases are to be phased in over the next four years. You may anticipate an 85 percent increase in premiums over the same period.

The "A" word.

Asbestos. Three years ago, the asbestos problem seemed to be under control. Due to a past federal court ruling, insurers are bracing for an explosion of personal injury claims, with a new wave of companies facing litigation. In the past month alone, insurers have agreed to pay about $3 billion in asbestos claims. That is a sizable chunk of the overall $65 billion they are expected to come up with for the entire problem, to cover this new wave of claims stretching from the late 1970s to the middle of this century.

Pollution Coverage

Storm water run-off regulations will make washing your car an endangered act. Besides you, who is affected by these new regulations? Only land owners, builders, property managers, landscapers, and homeowners associations. What will these new regulations cause? HOA's and other property owners will be required to spend thousands of dollars to capture, treat, monitor, test, and provide on-going maintenance of on-site storm water facilities. What insurance coverage is presently available for this? Only the lawyers will actually test the policy language. Fines of $10,000/day are in the law. Third party watch dogs will soon be on storm water run-off patrol.

And all of these changes without even considering 9/11.

As the insurance industry drifts into an unknown future, predictability becomes increasingly clouded. Capacity will again increase – someday, when writing these lines again becomes profitable.

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