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## THE INSURANCE NEWSLETTER

Winter 2010-11

### Insurance Market Changes

Entities and enterprises buy goods and services all the time. The common denominator for your suppliers who sell you stock, equipment or supplies, contractors who sell materials and services, banks who sell money, and others is that all your vendors or suppliers know, to a reasonable degree of certainty, the cost of the product or service they are selling.

Not so with insurance. The primary cost of an insurance policy is the claims that must ultimately be paid. That cost will only be known many years in the future, when all claims have been presented against a policy and have been settled. Underwriters deal with the law of large numbers and rigorous actuarial principles to help them set premiums based on past loss history, but the reality is they are still setting future prices by looking squarely in the rear view mirror. Sometimes they get it right, sometimes not.

This simple fact accounts for the often mystifying, and frequently unpredictable, fluctuations in insurance pricing all buyers will see at some point. Most insurance buyers have heard the term “soft” or “hard” applied to the insurance market and insurance pricing. Most have seen premiums change fairly substantially from one year to the next, up or down. While other factors certainly apply, not least of which is your own risk profile and loss experience, at base these fluctuations are due to the inherent, and inevitable, inability of insurance underwriters to peer into a crystal ball and accurately predict their costs.

Premiums and rates tend to fluctuate over broad cycles spanning years. The insurance market was

beginning to harden and premiums were rising at the start of this current decade prior to 9/11, but that event and the uncertainty it created kicked the developing hard market into high gear; commercial insurance rate increases averaged in the 30 percent range throughout 2002. If you were buying insurance then, you’ll remember those days.

The rate of premium increases gradually moderated, by 2004 averaging only single digits, and in early 2005 rates reversed course and started to drop; according to a leading insurance industry tracking organization, January 2005 was the last month rates and premiums actually rose industry wide. Since then, insurance buyers have enjoyed a prolonged soft market. Rates have not fallen dramatically; at its softest, in 2007, rate decreases only averaged 12-14 percent and except for that year never averaged more than single digits. Rates have continued to fall by low single digits since then, and reports for this year show continuing modest reductions in the 3-4 percent range.

What’s notable about this soft market is not the size of premium reductions, which have not been particularly remarkable, it’s the length of time they have gone on. There is currently no sign that will change to any significant degree in the next twelve months. There are no factors that, alone or in combination with others, would seem to be able to move the market off its pattern of continuing modest rate reductions. Insurance companies are operating at a profit, and the absence over the last year of any major catastrophic loss events (hurricanes, terrorist attacks, etc.) or other material outside influences offers no reason to anticipate any imminent changes.

Markets get hard in other ways besides price, though. Rates may continue to drift slightly lower or even stabilize, but underwriters attitudes about terms and conditions of the policies they sell are already changing. They are more closely underwriting both new and renewal applicants for insurance these days, and we are starting to see early signs of underwriters pulling back on some of the broader terms and conditions they were formerly willing to offer in the policies they sell. This is a wild card; a pullback on a broad coverage grant in a policy renewal can have a material, but often unpredictable and unquantifiable effect on you down the road when a claim is actually filed.

Long and short, no reason for concern right now, but we are keeping a close eye on things for you.

### **Personal Insurance Limits**

Readers of this Newsletter are typically owners, principals, CEO's, CFO's or other high ranking executives of commercial or public enterprises. Such folks have typically enjoyed a certain amount of personal financial success and accumulated property and assets above the norm. This topic is directed at you.

You own homes and property; you own cars and other vehicles; you may have recreational vehicles, boats, and other toys. You may have spouses, children, friends using these things; ownership and use of all of these create a personal liability exposure. When is the last time you looked at that insurance? And when is the last time you looked at the limits of personal liability insurance you carried?

This is no idle question. Examples abound of otherwise cautious, successful, and financially secure individuals who failed to carry adequate limits of personal liability insurance, were involved in an accident or event of some kind, found their insurance limits inadequate to their needs, and suffered real and severe financial and personal consequences as a result.

Some examples:

The 22 year old son of a well to do professional was

operating dad's boat on a lake, turned to pick up a fallen water skier, and struck him. Serious injuries, only a \$500,000 limit on the watercraft policy.

A couple was burning leaves one Fall and the fire escaped their yard to an adjoining wooded area; it spread, and damaged or destroyed several neighbor's houses. The property damage liability limit in the homeowners policy was low.

A 16 year old from an affluent neighborhood driving to school on a clear day veered off the road and killed a morning jogger. Drugs, alcohol or speeding were not involved, it was just a moment of simple teenage inattention. The victim was 41, father of three small kids, a professional. The teen's parents had low insurance limits.

In a truly tragic case, a successful business owner missed a turn on an unfamiliar road and struck an oncoming car. He and his wife were killed, and their young daughter left severely and permanently disabled. The occupants of the car he hit suffered multiple severe injuries and two deaths. The defense attorney, faced with inadequate insurance limits, was left with the difficult job of trying to protect as many assets as possible in the parents' estate for the benefit of the disabled daughter.

And here's a case recently in the news: celebrity and former professional wrestler Hulk Hogan's son crashed while illegally racing his car with a friend, leaving his passenger with severe and permanent brain injuries. Hogan only had a \$250,000 per person bodily injury liability limit, grossly inadequate for a person in his financial condition; he's paying millions of dollars of damages and costs out of his own pocket.

Examples like this abound. Courts and juries do not award damages based on how much insurance you carry. The liable parties in these cases faced damage awards far in excess of their limits of insurance; when their insurance was exhausted, they were left with only personal assets to satisfy the judgments. Its not only plaintiff's attorneys who pursue personal assets to satisfy judgments; auto insurance companies who pay uninsured or underinsured motorists claims and health insurance

companies who pay medical costs for accidents for which a third party is liable all maintain large staffs of subrogation professionals, whose sole job is to recover their payments from the liable party. They will take whatever insurance limits you have, but they certainly will not stop there.

Inadequate liability limits can be a recipe for a personal financial nightmare. Personal bankruptcy may be the only option in these cases...or maybe not. In cases where the liable party is legally intoxicated (and you know how low allowable blood alcohol limits are in many jurisdictions) debts for liability awards may not be dischargeable in bankruptcy.

The moral of these stories is simple. Personal umbrella policies are relatively inexpensive. You have worked hard to get where you are. Don't risk seeing it all snatched away in a moment just because you tried to save a few premium dollars. Call us, we'll be happy to review this with you.

### **Avoiding Unnecessary WC Audit Costs**

Businesses hire contractors and service vendors all the time, but may not be as careful as they should be about obtaining evidence of insurance coverage from those contractors. This can be a costly mistake, even if no accidents or claims ensue.

Employers understand that they must carry workers compensation insurance for the benefit of their employees who might suffer a work related injury. Less well understood is the fact that in most states if you employ an independent contractor who does not carry workers compensation insurance, you are obligated to provide workers compensation benefits to that contractor or their employees in the event they suffer a work injury arising out of work done by them for you.

It may sound unfair that you should be saddled with the obligation to provide coverage for people who are not your employees, but state workers compensation authorities have good reason for structuring their workers compensation statutes this way. The purpose of state workers compensation

laws is to see that employees suffering work injuries receive certain benefits. Workers compensation regulators don't particularly care where the benefits come from, or who pays for them, as long as the injured employee gets them.

The good news is your standard workers compensation policy is written in such a way that it will provide coverage (and protect you) in such a circumstance. An injured employee of a contractor will get his benefits, if not from the contractor's policy, then from yours.

So what's the problem? Your policy provides the necessary protection, but as you would expect, there is a cost. Since insurance companies might be obligated to provide workers compensation benefits to otherwise uninsured independent contractors, they want to get paid (read: premium). Who is paying the premium for this exposure? You, of course.

When the auditor comes in to do a payroll audit for your workers compensation policy, they'll ask you if you employed any contractors. If your answer is yes, they'll want to see certificates of insurance showing that those contractors had workers compensation insurance in force. If you cannot produce certificates from your contractor(s), the auditor will include the cost of that work they did for you in your payroll; you'll pay a premium for your contractor's workers compensation exposure. And don't forget that claims from contractor's employees, paid by your policy, go against your experience rating, too.

This is an easily avoidable problem. All you need to do is get a certificate of insurance from all of your contractors. Show that to the auditor and you're in the clear. Fail to have that document and it could cost you.

### **Financial Reform Bill**

Congress recently passed, and the President signed, a massive piece of legislation rewriting financial regulations and oversight over almost every part of the financial services industry in the U.S. Not all parts, though. The insurance industry remained virtually untouched by this legislation.

Many will remember that in the recent financial meltdown that we are still trying to recover from the only major segment of the financial services industry that did not crater was property and casualty insurance. Not coincidentally, perhaps, insurance is uniquely the only segment of the financial services industry that is not federally regulated; individual states handle regulation and oversight of insurance companies domiciled within their borders.

And the states have been doing a pretty good job with it. It was no accident that AIG, while requiring a huge government bailout for its trading and financial guarantee activities, saw its state regulated insurance company subsidiaries sail relatively unscathed through the turmoil, without a blip to their financial strength ratings (the hit to their reputation just by association with the AIG name is another matter).

The new financial reform legislation left this system of state regulation of insurance untouched. The few provisions in the bill that did touch on insurance were technical, dealing primarily with establishment of some uniform standards in the excess and surplus lines segment of the business, while leaving state regulation of the industry alone.

This is good news for insurance buyers. The one issue of paramount importance to any policyholder is that your insurance company be around to pay your claim when the time comes. The current system that produces an insurance industry that is conservatively managed, and was always able to pay claims and meet its obligations to policyholders even in the darkest days of the global financial meltdown, remains intact.

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