

Insurance Crisis looms

by: Jerry Robillard, Northsound Insurance

Most Americans insure their cars, homes and businesses because it is a prudent thing to do. But, most people know little about how it all works. The insurance industry was in a financial mess just three years ago. I call it a mess because many companies filed for bankruptcy, premiums increased, and companies were canceling policies at an unprecedented rate. The media has provided some information, but to simply make the insurance companies the bad guys was not helping. It was a complex issue.

The insurance industry is experiencing a "hard market." This is similar to a "bear market" in the securities industry. Like the stock market, there is a mood of cynicism when this occurs. These are normal cycles and will eventually turn around. Until it does, perhaps explaining how we got there will allow better understanding, and better planning for your peace of mind.

Cash Flow Game

During the 1990's, insurance companies made the majority of their income in the stock market. They competed with one another for market share by driving down premiums, broadening coverage, and loosening their normal underwriting standards. Making an underwriting profit (taking in more than they paid out in claims) was not a serious concern. They were more interested in cash flow. Insurance companies made so much money with their investments that losing on insurance was quite acceptable to their stockholders. Executives were rewarded not because they knew how to operate an insurance company, but because they had an aggressive investment division. Proof of this was reported recently when the industry results showed nationwide Homeowners insurance loss experience of 122%: for every dollar taken in, the insurance companies were paying out \$1.22 in claims and operating cost! Auto insurance should improve to a 103.5 % in 2002 from 108.4 % in 2001. Then, as the stock market took its turn for the worse, insurers found themselves forced to return to underwriting for profit; asking more questions, raising rates and canceling risks that were unprofitable. During a hard market, selling insurance is less important than making their existing business profitable. Companies frequently insure many things during a soft market that they would not insure during normal times or in a hard market.

Limited Capacity

Another factor that influences the market is the reduction of the insurance companies' capacity to write insurance. The decline in the value of their stock portfolio limits the insurer's reserves for paying claims. All insurance companies are legally required to maintain reserves to cover losses. When this happens, a company can not write new business. This has not happened in Washington, but when insurers get dangerously low on reserves, they voluntarily curtail new business rather than have our Insurance Commissioner order them to stop.

September 11, 2001

Compounding the problem was the terrorist attack on the World Trade Center. The stock market decline of 2002 was exacerbated by the 60 billion-dollar loss of that tragic event. Insurance companies buy insurance to cushion against catastrophic losses. This is called reinsurance. The reinsurance market absorbed most of the loss at World Trade Center. Even though Oregon Mutual, Mutual of Enumclaw, or other West Coast companies did not have losses at The World Trade Center, all of them are now paying higher premiums for their reinsurance.

Don't Have a Claim!

The effects of this on all policyholders are high costs and reduced coverages. Understanding that conditions may change within the next twelve months, temporary changes in your policies can reduce your costs without reducing your coverage. This is not a time to have losses. Submitting even a small claim can precipitate a cancellation. I recommend high deductibles. Choose the highest one you can handle. This will reduce cost, but still maintain the coverage you need to protect your property. What is important to remember is that insurance should only be used to preserve assets. Insuring for catastrophic losses makes economic sense. But, if you have a covered loss of \$600, it makes little sense to have an insurance company pay \$100 after your \$500 deductible. The reason is that the insurance company's cost on that loss could be \$600 (including the cost of administering the claim). Rather than look at the long term, most companies will see this as an unprofitable account and want to non-renew the policy. I know of no insurance company operating in Washington who will accept a new application for a Homeowners policy where there has been only one loss in the past year!

Credit Scoring

Auto insurance is equally in trouble. The newest trend in underwriting is the credit score of the insured. Our Insurance Commissioner is opposed to this, and is making some progress. Beginning on the New Year, policies can no longer be cancelled just because of a low credit score. The rates, however, will be determined by the insured's credit history. The obvious question here is how could a person's bill payment history effect how they drive a car? Statistically, people with higher credit scores have lower loss histories! Is it because they are more responsible, or is it because people with higher credit scores tend to be more affluent? People with expensive cars and homes pay high premiums. Could it be that when a person has a loss, that loss will appear greater for the person who is paying lower premiums than another person who is paying much more? If I were running an insurance company, I think that I would prefer to insure families who were paying \$5,000 in annual premiums rather than those who pay only \$2,000. I am certain they are more profitable.

Thoughtful Planning

I think that understanding the current conditions can help people plan their insurance more effectively. That is why I am recommending that you take time to review your insurance policies. Try to place all of your insurance with the same company. If you have a problem with car insurance, you are more likely to be renewed if the same company has your home insurance, and they all give multi-policy credits. Make certain that you have the coverage you would need if there were a total loss of your home. Self-insure whenever possible by not turning in small claims, and raising your deductibles. Maintain high liability limits. If you are sued, you want to be certain that there is enough money to pay a large court judgment. Insurance companies will cancel policies for fender-benders or a \$1,000,000 judgment. It makes little difference to them.