



Early, Cassidy & Schilling, Inc.

Commercial Insurance • Risk Management • Surety
Employee Benefits • Executive Benefits

State of the Market Letter

Brought to you by: Tim Schilling, Lynne Cook, Dave Dixon

Property & Casualty

In my last state of the market letter I had indicated that the Property & Casualty insurance industry was settling into what is called a "soft market" whereby rates decline, underwriting guidelines loosen and insurance carriers begin writing almost anything they can get their hands on. Well, the market has certainly settled into the soft mode, and rates continue to fall, underwriting guidelines are loosening and carriers are certainly writing almost anything they can get their hands on.

How much more? How long will it last? Excellent questions. In the opinion of many industry analysts, the reverse of the market (hard) should not be expected any time soon, even with deteriorating insurance carrier reserves and policyholder surplus.

Also in my last report, I had indicated that soft market conditions had not yet affected the pricing and availability of the liability lines for residential builders or D&O for non-profit and private companies. While there aren't many new players in this market, there has been a softening of rates and in some cases underwriting guidelines.

In the years of 2006 and 2007, rate declines were upwards to 8% to 11% depending on the line of coverage. To date, rates have declined 6% during the third quarter of last year, and 5% in the second quarter. Rates in the fourth quarter are expected to show a drop of around 2%, with perhaps the bottom of the market coming within the first two quarters of 2010. Certainly flat renewals and small decreases can be expected to continue throughout the 2010 calendar year.

Some insurance carriers have worked their way through the woes of the financial crisis and marketplace. AIG segregated its Property & Casualty insurance operations, which became Chartis Insurance Company. The Hartford seems to have weathered its problems associated with its troubled Life insurance division.

Financial ratings of the companies still need to be monitored, and Early, Cassidy & Schilling will continue to do so for its customers.

What does this mean for the insurance buyer? It means in this tough economic time when price breaks are needed by consumers, the pricing declines that have been experienced over the last four years are going to continue, but at a lesser percentage than in the years of 2006, 2007 and 2008.

Warning: As with any cycle in the marketplace, the soft market brings with it lower rates, premium costs, looser underwriting requirements and guidelines (sometimes even suspended and ignored by irresponsible insurance carriers). These are good times for the premium payer. However, a word of caution should be taken concerning the eventual end of the "soft cycle" (and it will end eventually, but it is not expected for the next 12 months). Underwriting guidelines will dramatically tighten up. Underwriters will review past losses and profitability of accounts and

Client Communication Produced January 2010



Early, Cassidy & Schilling, Inc.

Commercial Insurance • Risk Management • Surety
Employee Benefits • Executive Benefits

then seek rate increases to cover their losses. As we said in the last hard market, insurance companies will limit their writing of various types of insurance products and/or leave the marketplace completely. These actions will affect the ability of many insureds to obtain insurance coverages at a reasonable cost or at any cost at all.

With the aforementioned in mind, it is extremely important to continue keeping an eye on the risk management procedures that you have in place with the effect of controlling your losses and making your insurance account profitable. In the long run this effort will be beneficial to the purchasing and marketing of your insurance account. Insurance clients with good loss history and strong risk management procedures always fare well when the cycle of the soft market ends and the hard market begins. Please, let's not forget the past; remember some of the horror stories of coverage cost increases and difficult placements that took place back in the post 9/11 marketplace.

We also suggest for those dealing with contractual requirements concerning their insurance coverages as they relate to additional insureds, indemnities and primary and non-contributory clauses that you continue to review your contracts to be certain the obligations of the insurance carriers follow those required in your contracts.

Early, Cassidy & Schilling, Inc. would be more than happy to review contracts from an insurance perspective and provide guidance on language to be amended and/or endorsements to your insurance policies.

State of the Market

Health Care

One of the top trends for 2010 in the health insurance market is to increase consumer awareness and involvement. Many plans have done a reasonably good job developing member portals and adopting technology that gives the consumer a better way to manage his own care. An example is Kaiser Permanente's capability for a member to access his medical records, test results, and prescription drugs online. The primary care physician supplements the results with email dialogue. This simple procedural change results in saving the cost of an office visit, the time the patient takes from work, and efficiency is increased because the test results are delivered more quickly. Other technological advances that engage members include United Health Care's system that allows employees to access and track their claims or order a replacement ID card on line. Carefirst Blue Cross's "My Account" is a similar program, but also includes an online health and wellness assessment.

The emergence of comprehensive *Wellness Programs* is beneficial but the impact on medical trends is slow. These programs focus on the individual's responsibility to get oneself in the best physical condition possible. Through smoking cessation, weight loss, and exercise programs, improved overall health of insured's should have a very positive effect in controlling the spiraling cost of health care.

Some of the factors that affect this trend can be difficult to measure but include:

Client Communication Produced January 2010



Early, Cassidy & Schilling, Inc.

Commercial Insurance • Risk Management • Surety
Employee Benefits • Executive Benefits

- The threat of possible epidemics and pandemics such as the H1N1 virus.
- The steadily increasing number of the uninsured accessing care.
- The pending retirement of **Baby Boomers** that will further burden the health care system.

This long-term development of **Health IT** and consumer involvement has the ability to transform all aspects of the U.S. health care system from one based on incidents of service to one based on quality of outcomes. The challenge for the industry is to continually improve technology to streamline the system and to involve members in their own healthcare.

Innovative Plan Designs

With Medical costs increasing between 12-14%, many carriers have developed new products to help stem the escalation. The past several years have shown a tremendous growth in the tax favored **Health Savings Account and Health Reimbursement Arrangement Plans**. One goal of these plans is for employees to understand the true costs of health care. Few knew how much an office visit or prescription cost until they paid for it out of their own account. Employees now have skin in the game and are paying attention to how their money was spent. The mistake some employers made with the HSA plan was that they funded the entire deductible for the employee and therefore did not give the employee the incentive to monitor his spending.

Other choices are the **partially self funded plan** and the **minimum premium plan** that allows the employer to assume a larger share of the out of pocket exposure in trade for lower premiums. This is not a new concept but it is now being promoted in the small group market.

Government Involvement and Cost Shifting

As the States lower the reimbursements to Medicare and Medicaid patients across the country, the government is “shifting” the costs to the private market. In order for the Doctors to make up some of the shortfall, they raise their charges to the fully insured patients and, therefore, the costs rise to both those patients and insurance companies.

ARRA09 brought about the COBRA subsidy for individuals who were laid off during a specified time during 2009. This COBRA subsidy increased administrative costs for employers who had to bear the expense up front for 65% of COBRA costs for 9 months, and subsequently for 15 months (with new legislation), while waiting for credit on their **quarterly 941**.

With the current debate in Congress, the Health Care System is being opened to a possible overhaul. Potential changes being discussed include but are not limited to the following:

- A full government take over with a Public Option
- A system of Connectors or Health Care Exchanges
- A combination of both Public and Private Choices

There is also movement in Congress to tax employee benefits as well as limit the deductibility of Health Savings Accounts.



Early, Cassidy & Schilling, Inc.

Commercial Insurance • Risk Management • Surety
Employee Benefits • Executive Benefits

Some recent elections indicate there is a public backlash to some of the Government involvement in the Health Care System. The Public Plan appears less likely and a variation of the Exchange system seems more probable.

State of the Market

Surety

For those of you that know me, when I say that I am a glass half full kind of person, I think you will nod your head in agreement. Unfortunately, as I sit at the keyboard to write my yearly epistle, it is difficult to grab onto many positives that will impact the surety industry in 2010. Typically the construction/surety industry lags the economy by twelve to eighteen months, so while we may see hints of the economy turning, the downside to the surety industry is still most likely ahead of us.

Most surety companies will end the year 2009 making a profit, but the volume will be lower than 2008, and the loss ratio will be slightly higher. Many construction companies entered 2009 with a strong backlog but as that work was prosecuted, many struggled to obtain additional work. So the backlogs dwindled, and companies are entering 2010 with lower work in progress than in prior years. There is work to bid, but the pressure of increased competition is pushing the gross profit margins downward. In addition quite a few of these jobs have not been awarded yet and some have been tabled.

Year-end financial results for companies on a calendar year will be reported shortly, and the expectation is that most companies will show lower net income levels than in the past, some break evens and others will show a loss. Two burning questions are: How long will it be until profitable work can be obtained? When will these contracts get started?

Sureties are expecting to see an increase in claim activity, initially from the payment aspect and ultimately from performance default throughout 2010 and 2011. The surety gurus tell us that the companies they expect to weather this storm are ones that are liquid (hold cash), do not depend on their bank line for normal operations and can and will reduce overhead.

So, what can we expect to see from an underwriting standpoint? Caution is the word that comes to mind. I think it will start with more questions - yes, even more than you are accustomed to. Your carriers will want to see projections for the coming year based on realistic assumptions, and they will expect timely financial reporting. Most underwriters will want quarterly information if they are currently only requiring semi-annual financial information. Obviously, they are interested in understanding your business plan and any back-up plans that may become necessary.

If financial results deteriorate, typical reactions from surety underwriters include the following:

- Reduce programs
- Require infusion of funds
- Require collateral
- Require additional indemnity

Client Communication Produced January 2010



Early, Cassidy & Schilling, Inc.

Commercial Insurance • Risk Management • Surety
Employee Benefits • Executive Benefits

- Increase price
- Retire from the account

Any one or combination of these may be used to change the terms and conditions of your surety program.

Oh, I thought of one positive characteristic of the surety community right now! For the companies that are performing well, carriers have been very responsive to the changing landscape of opportunities. We have seen the job size increasing, set aside programs becoming the main source of new work, new technologies being implemented and companies trying different work or moving into other geographical territories. Most sureties are very willing to listen to their client's rationale and are supporting solid business opportunities with bonds.

My words of wisdom to anyone who is a user of suretyship:

- Stay current with financial information.
- Collect your receivables in a timely manner.
- Actively monitor your banking relationship.
- Make sure your underwriter is updated on your business plans.

We in Early, Cassidy and Schilling, Inc.'s Bond Department are here to answer any questions and guide you through this unsettling time, so please contact us earlier rather than later!