



The Party's Over Or Is It?

by John H. Nelson & Chuck Eckert

After four years of softening Property and Casualty rates, business owners are likely to see premiums headed higher in 2009.

Many insurers have incurred significant investment losses from their holdings of American International Group, Fannie Mae, Freddie Mac, Lehman Bros. and other troubled financial institutions. Bond portfolios have also suffered unprecedented losses due to the world economic meltdown.

In addition, Risk Management Solutions (RMS) announced that it has updated its estimate for U.S. onshore and offshore insured losses from Hurricane Ike to \$13-21 billion, of which \$10-15 billion is estimated for wind and storm surge in Texas and Louisiana. The estimate also includes \$2-3 billion from inland wind and flood losses and \$1-3 billion in offshore losses. These estimates do not include the flood losses paid by the National Flood Insurance Program, which is in need of a less publicized tax payer "bailout" after losing an estimated \$20 billion in 2008.

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RMS had published a preliminary loss estimate of \$7-12 billion on September 17 shortly after Hurricane Ike made landfall over Galveston Island, Texas. The revised loss estimate is based on a new post-event modeling methodology, which, due to the lack of observations, that captures the uncertainty in Ike's wind and storm surge footprint using an ensemble of 300 varying simulations of this footprint.

History tells us that when policyholder surplus falls, insurance rates will rise. "You can't have these kinds of events without rates going up," said John Chaney, president of Hylant Group in Cleveland. Ideally, insurers garner a positive return on their investments and generate what's known as a "policyholder surplus," which represents the positive difference between the value of an insurer's assets and its legal obligations to pay on potential claims. When insurers take losses on their investments, they lose surplus, which usually leads to a deterioration of earnings, thereby creating pressure to increase premiums.

After a review of our January renewals, it is clear that the effect of this drain of surplus capital in the third and fourth quarters of 2008 has not yet had time to work itself through the market. We did see a material tightening in a few key areas, including transportation, environmental coverage, directors and officers for financial institutions, flood coverage and property CAT (property exposed to catastrophe).

We expect that liquidity will be an issue for many insurers next year as financial institutions have reduced lending. The diminished market value of their securities will affect surplus and thus insurer's capacity to write business. When capacity constricts and the bottom line suffers, it translates into pain at the management level, which should serve to bring about a change in pricing. We expect rates on most commercial property and casualty insurance lines to stop their downward trend in the first quarter of 2009 and begin to climb as insurers implement plans to shore up their finances.

As always, we will keep you posted on market developments.