

# THE RHA REVIEW

ROUTE TO:

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A publication of Robert Hughes Associates, Inc., an international litigation support, actuarial, risk management and insurance consulting company.

## 1998! Where Do We Go From Here?

by Robert N. Hughes, CPCU, ARM

Prognostication always seems to be the order of business this time of year. Every publication feels bound to make predictions about the coming state of affairs in its special area of endeavor. I

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***“Up until the late '80s insurance capacity and premiums waxed and waned in rather regular cycles.”***

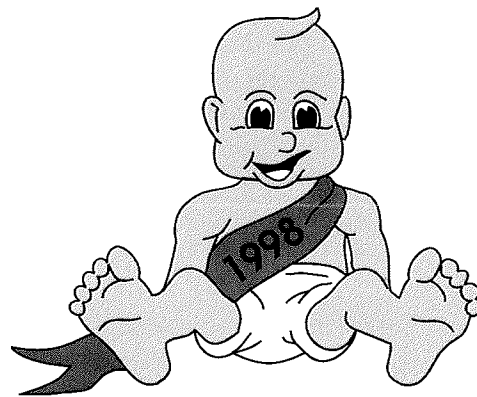
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have cautioned myself over the years to resist this temptation, but, alas, I always fail. Why should this year be an exception? So here goes.

It is, in fact, an amazing time. The consolidation at the broker level, which is creating the “mega-broker,” was predicted, believe it or not, in a Stanford Research Institute report commissioned by the National Association of Independent Insurance Agents. When? THIRTY YEARS AGO. I can't seem to find my copy, but the parts I remember were uncannily accurate. Why did it take so long? Well, I don't really know, but my suspicions are that it has something to do with the disap-

pearance of what was heretofore known as “The Insurance Cycle.”

Up until the late '80s insurance capacity and premiums waxed and waned in rather regular cycles. Admittedly, the cycles had lengthened over the decades until, at the time of the last serious “crash,” in late 1984, the span



between peaks and valleys was about six years. The next couple of years, 1985 and 1986, were marked by 1,000 percent premium hikes, the disappearance of occurrence-based policies, the unavailability of higher limits, etc. By 1987, however, the market had healed and was falling back into a glut of cash flow underwriting, coverage concessions and retroactive repudiation of some of the stern measures (such as claims made policies) that were instituted in '84 - '86. During these times, brokers played a vital role in difficult placements, and great diversity was needed in the brokerage community.

For the past ten years, however,

the market for insurance has been astoundingly policyholder friendly (at least from the standpoint of cost and availability). Insurance carriers, seemingly determined to keep it that way, began to repair their combined ratios through expense reductions and aggressive claims stances. Both postures have, in my opinion, had a deleterious effect on the brokerage community. Lower premiums mean lower gross commissions, and lower commission rates even further reduce the net incomes of brokers and agents. Too many firms were scrambling after the same pie, and the pie itself was growing smaller. The answer — consolidation. Perhaps more obscure, but just as important, the growing tendency of the industry to controvert large claims

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has caused many small and medium-sized brokerage firms to appear powerless against the might of the mega-company, and, as a result, important clients have decided that even if bigger is not better, it is at least “bigger” and they have moved to the mega-broker as a point/counterpoint.

(1998, continued inside)

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- *New Associates*

(1998, continued from cover)

I don't believe the feeding frenzy is over. I think 1998 will see continued broker consolidations worldwide.

What about the carriers? Well, on the one hand, things look rosy for the policyholder. Coverage enhancements (such as discrimination and employment practices liability) that were virtually impossible to get ten years ago are now available at little or no cost. This trend

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has even filtered down to the consumer level with expansions in homeowners' coverage such as credit card coverage, lost key replacement, expanded jewelry coverage, etc. I think this trend will continue through 1998.

On the other hand, commercial and institutional policyholders are finding it “rough sledding” when they have a large claim. Inaction, lengthy reservations of rights, non-defense and other sorts of contentious activity characterize many insurance carriers' approach to large claims. And it doesn't end there. A former employee of a major homeowners' insurer has testified that the company's employees “forged customer signatures to exclude earthquake

coverage from policies after the 1994 earthquake.” Furthermore, she testified that the company “would refuse to settle any low damage claim. These claims would be fully litigated to make it financially unfeasible for an insured to obtain benefits.”

I have long contended that the insurance industry as a whole is horrifically under-reserved — by trillions of dollars. There are only two ways to survive. The first and more honorable way is to add capital/surplus, increase reserves and pay the claims. The more popular path, however, seems to be to delay and deny, hoping that many will be discouraged and simply go away, while the balance will take so long to resolve that they will eventually settle for less than their actual value. In the meantime, vast amounts of investment income have been earned by the reluctant carriers.

I believe this practice will continue and indeed worsen. Until NAIC reporting requirements are changed, no quantitative proof of this practice will be available to the general public. And, until the economy takes a nose dive, investment income will continue to drive the ship.

Another segment of the risk/insurance industry population that is currently in a state of flux is the corporate risk management department. Many observers (myself included) believe that a very fundamental change is under way in the manner in which organizations manage risk. The new processes come under various headings — the “enterprise approach,” “integrated techniques” or “strategic risk management.” A recent article appearing in *Risk Management* describes the approach as “a dynamic process for optimizing the level of risk that a firm assumes in pursuit of business goals. Rather than concentrating solely on hazard risks, an integrated

framework seeks to establish a consistent process for addressing all events or actions that can adversely affect an organization's ability to achieve its objectives.” In other words, what might surface is a new corporate “risk guru” who concerns him/herself with all the risks faced by the corporation — hazards, currency, business environment, global change, socio/political, etc. The *Risk Management* article raises questions about the traditional role of risk

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management and speculates that “those who seek the elevated position will be challenged to learn new skills, better understand the mission and culture of their organization and function effectively in an increasingly matrix-oriented (rather than hierarchical) structure.” It will be interesting to see these changes play out. I, for one, believe it will mean that the traditional insurance flavor of the risk management department and risk managers, per se, will gradually disappear, to be replaced with a financial/legal bent. This is definitely something to watch in '98.

(1998, cont'd. on following page)

(1998, cont'd. from preceding page)

Finally, a word about London. Equitas, the company that was formed to run off the 1992 and prior liabilities of 400 Lloyd's syndicates, is up and running, paying £2.5 billion in claims during the seven months prior to March 1997. Equitas estimates it has another £17.7 billion to pay, which discounts, at 6 percent, to a present value of £11.8 billion. Equitas Chairman David Newbigging has said, "We will continue to scrutinize carefully the claims we receive by adopting a 'fair but firm' policy of paying valid claims promptly while resisting invalid claims with every means at our disposal." In fact, however, reports from the field indicate that Equitas claims adjusters and attorneys are making it very clear that they believe they

have a finite amount of money to spend and they are going to do everything in their power to limit their liability on North American pollution, asbestos, and products liability claims. While many of


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our clients found, prior to the formation of Equitas, that personal negotiation in London was the most productive method of handling these claims, we now have reports that many have decided that "sue now and negotiate later" is the better

approach to Equitas. I doubt seriously that this situation will change in 1998.

So my advice for 1998 is to continue to press for coverage enhancements and lower premiums. At the same time, those of you who have claims outstanding against Equitas should reassess the tenure of your litigation and make plans accordingly. I suppose, when you think about it, the same could be said for those of you who are in a struggle with your domestic carriers. And, in the final instance, pray for a continuation of the bull market. 

*Robert N. Hughes is founder and president of Robert Hughes Associates, Inc.*

## FROM NEAR & FAR



The ice storm that swept through parts of the northeastern United States in early January caused more than \$125 million in claims. The same storm was called "the most costly natural disaster in Canadian history in terms of insurance payouts" by the Insurance Bureau of Canada. More than 250,000 claims have been made in Canada, with an estimated cost of more than \$250 million U.S.



Severe storms also wreaked havoc in parts of western Europe. Most of the storm damage was sustained in England, Ireland, Wales and parts of western France. Claims in Britain are expected to exceed \$800 million. Most of the damage was caused by high winds and flooding, but one small seaside town, Selsey, on England's south coast, was hit by a tornado, which caused damage to more than 1,000 buildings.



In Texas, tobacco companies have agreed to pay the state of Texas \$15 billion in settlement of a suit seeking payment for Medicaid claims related to illnesses caused by smoking. The tobacco companies have already settled with two other states — Mississippi for more than \$3 billion and Florida for \$11 billion.



Also in Texas, Elton Bomer, Texas' insurance commissioner, has approved mandatory discounts for homeowners whose homes have hail-resistant roofs. The roofs must meet certain standards and be installed after February 17, 1998. Some homeowners will see their premiums drop by up to 35 percent. Roof coverings are rated on a scale from one to four. A grade four roof will give the best hail protection and lead to the highest insurance discounts. These homeowner discounts come hot on the heels of Bomer's ruling on auto insurance rollbacks at the end of last year. Most auto insurance rates will be 5 percent lower than last year's.

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# Broadening Our Horizons

In the past few months we have expanded and upgraded our already incredible family of consultants and associates. We have added three experienced and highly qualified professional insurance industry specialists:

★ **Joseph J. Launie, Ph.D., CPCU, FACFE**, who is currently professor of finance and insurance at California State University at Northridge. He has vast experience as both a teacher and a member of the insurance community. His specialties are policy interpretation, industry standards and practices, pollution exclusion, coverage issues, subrogation, fidelity bonds, bad faith and underwriting.

★ **Charles Richard (Dick) Mills, MBA**, who has more than 30 years of insurance industry experience. He was most recently the vice president for development and implementation of claims and risk management goals for Aon of Texas. He is very experienced in claims management, healthcare, workers' compensation and employee benefits.

★ **H. Thomas (Tom) Wilkins, III**, who has more than 25 years of insurance experience. He was most recently the president of Penn General Services Corp., where he was responsible for the workers' compensation TPA and employee benefits division of this national company. He is experienced in aviation, surety bonds, risk management, self-insurance, construction programs and agency/broker management.

## THE RHA REVIEW

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