

# THE RHA REVIEW

ROUTE TO:

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## WHO'S AFRAID OF THE BIG BAD WOLF?

by  
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CPCU, ARM



One of the hardest lessons life has taught me has been that "when everything is going great ... duck!" Although I admit that this is an overly cynical view of life, it does seem, as I look backward in time from my now more mature viewpoint, that the worst has a habit of appearing just when it looks like you had all the snakes killed.

Such is the case with the so-called "insurance cycle." Just when we all thought it had settled into a nicely predictable pattern of six-year swings between low rates/high capacity and high rates/low capacity, the halcyon days (at least for policyholders) of the current buyers' market has lengthened into what is now an eight-year swing going on who knows how long. Commercial buyers of insurance have reacted to this long epoch of low rates in numerous ways ... outsourcing risk management functions, closing captives, reducing retentions and generally establishing insurance as their

principal risk-financing mechanism.

The effect on the insurance industry has been curious. A number of adverse elements (inadequate rates, rampant competition, long-term liabilities, an uncertain financial market, burgeoning catastrophe exposures) are forcing significant movement toward consolidation. This phenomenon has, in the past, invariably resulted in a hardening of market conditions, particularly prices. Instead, A.M. Best Co. predicts that just the opposite will result ... prices will continue to be "soft" for at least several more years.<sup>1</sup> Why? Briefly, because regulators will continue to be consumer-oriented and because the industry made a fortune on its equities in 1995 (27 percent or \$19 billion), resulting in an increase in surplus of \$30.8 billion.

On the surface things look good. Unfortunately, there may well be "something rotten in Denmark." Companies

like Cigna and Home are being allowed by regulators to follow the lead of Hartford and Talagen and play "good bank/bad bank" by funneling their asbestos and environmental liabilities into runoff or inactive pools or companies. The industry is becoming polarized into "haves and have nots," making it almost impossible for boutique or "niche" players to stay alive, much less exert influence in the market. With the industry dominated by a few giants, they will be able to manipulate reserves to

**(WOLF**, continued inside)

### IN THIS ISSUE:

- *The Big Bad Wolf*
- *A Lesson Learned*
- *From Near and Far*
- *Step Up to the Bar*

**(WOLF**, continued from cover)

manage underwriting cycles. It could well become next to impossible to gain underwriting flexibility, and industries which might be deemed to be "problem risks" could be out in the cold, forced to deal with financially suspect companies.

The most discomforting thing about the situation is that the axiom "the

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bigger they are, the harder they fall" still applies. It is my belief that the major carriers are underreserved by hundreds of billions and are hoping to achieve substantial premium growth and maintain 1995 investment income percentages for several years, thus "writing themselves out of the hole." It could work, but what happens if the hurricanes really do get bigger (as predicted) and we have a couple of large U.S. earthquakes in the same year? And what happens if Congress cooks up another CERCLA? And what happens if interest rates skyrocket, causing another stock market crash and at the same time devaluing the companies' current bond portfolios? And what happens if Lloyd's of London really doesn't make it? Well, if all that happens, we will probably have another 1984.

We now have a generation of risk management and insurance practitioners who have not been through a single bona fide "hard market" and have no idea what to expect. I must confess that one of the sure signs of age occurs when you find your circle of friends at conventions or seminars spending all

their time sharing mutual incredulity at the current state of affairs. "Doesn't anybody remember 1984? Excess attachments went from the hundreds of thousands to the millions. Some layers of coverage disappeared entirely. Some pricing increased 1,000 percent. Wholesale cancellations and non-renewals. Layoffs by the thousands."

Actually, it's a very good question. The first reaction for all but the most cynical is, "we've all forgotten and some never knew." It occurs to me, however, that maybe, just maybe, the opposite is the case. Maybe the market refuses to harden because folks in high places in the insurance industry remember all too well and are playing both ends against the middle in a very dangerous cat-and-mouse game. Maybe there has been some very basic technical change which has yet to be completely understood. Or maybe the conditions that are conducive to "soft" markets have just hung around longer than usual.

Why is it important to even think about it? Well, to put it simply, it's

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all about whether we're going to be the little pigs who played all day and built their stick house on the beach or whether we'll build strong houses of stone on a hill so we can see the wolf coming and make appropriate plans.

Here are my very brief thoughts on the matter. The only thing we know for sure is that the insurance market is either going to "turn" or it isn't. If all, or any significant portion, of the aforementioned ills befall us, then there will

most certainly be a convulsive turn. Companies which have outsourced their risk management function to insurance brokers will find themselves dealing with advisors with no advice. Insurance will not be the "drug of choice," as there will not be enough of it to go around. Associations will scramble to put together risk-retention groups and captives and

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discover that they should have started when the sun was shining instead of in the middle of the storm. "Claims Made" will descend upon the liability market like the plague, and "buffer layers" will appear between retention layers and first-umbrella layers, at gigantic cost to the policyholders.

But if things continue like they are, insurance will be cheap, brokers will have plenty of time to be advisors, and all will seem well. It might, to some, seem like a good time to play on the beach and live in a cabana built of sticks. It is my belief, however, that now is the time to look for high ground and check out the price of bricks. That howling we hear might indeed be just the sounds of revelry, but, then again, it might very well be a pack of "big bad wolves," and if it is we'd better know what we're going to do when they come over the hill. **RHA**

<sup>1</sup>*BestWeek*, Property/Casualty Supplement, January 3, 1996.

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

# A LESSON LEARNED

By John R. Oakley

Let me offer you a piece of free advice, risk management, if you will, from a risk management novice who learned the hard way.

If your company is like most, the printing of your promotional materials is handled by an outside contractor, typically either an independent print shop or an advertising or marketing company. If you give the company your negatives or plates or have it make plates or negatives so that it can reproduce your materials, be careful. Ensure that what you supply and/or pay to have produced is returned to you along with your printed materials every time you have those materials printed. Or have a signed agreement with the company responsible for your printing stating that it will return your materials to you when and if you decide to take your patronage elsewhere. I am currently learning the hard way that you may lose valuable materials if these precautions are not taken.

My problem began when the quality of the print shop that I had used for a couple of years began to decline, both in customer service and in the quality of workmanship, and the people we had dealt with had left the company. We were never informed that "our people" were gone. Instead they were "out of the office today" — for a week and a half. Despite the problems, we decided to give them a few months to get their house in order. However, when the decline had become too much for us to put up with, we decided to

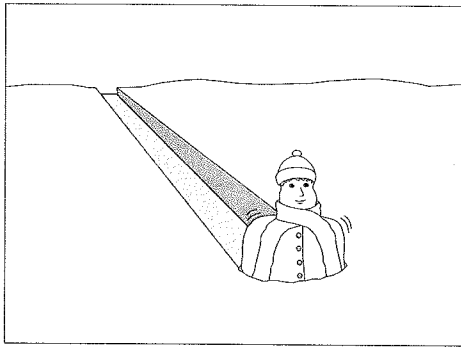
move our account to a different service provider. The management at the original print shop refused to release our materials because, according to its general manager, that's the policy. Apparently the company feels that the materials we supplied — which were created by a previous provider and are very company-specific — and those which we paid them to manufacture on our behalf, belong to the print shop and not us.

Following repeated letters and phone calls which elicited no favorable response, I contacted my company's attorneys, who are currently pursuing the matter. Although the missing materials are

probably not worth the financial cost of litigation, the lack of business ethics inherent in the situation certainly makes one consider it. After all, my company paid for all of the materials, which were kept on site for us, as most printers do. Surely if we've

paid for these materials they belong to us. If they are not returned to us, have they not been stolen?

The message from this risk management novice is this: cover all bases when seeking off-site services, especially when they involve releasing valuable, difficult-to-replace materials to an "outsider." If there is no way to store the negatives and plates in your office, then be sure to at least get a written agreement from your provider stating that it will release your materials to you within 10 days or so of receiving a written request for the return of those materials. RHA



**Don't get left out in the cold by an unscrupulous vendor.**

## FROM NEAR AND FAR



Once again the spring storm season is upon us, bringing severe storms and tornadoes to the area known as Tornado Alley. The first major storm system of the spring wreaked havoc throughout the Midwest in April, causing about \$500 million in insured losses. In Arkansas alone, at least 10 people died, and claims are expected to reach \$250 million.



It is expected that damage caused by a hailstorm that ripped through North Texas in the last week of March might reach as high as \$50 million.



A fire that swept through a night club in the Philippine capital of Manila resulted in the death of at least 150 people. Because the night club apparently did not carry any fire insurance or public liability coverage, the families of those that lost their lives will receive less than \$500 compensation from the local authorities. Business owners in the Philippines are not required by law to carry comprehensive liability insurance.



In Finland a passenger train was derailed on the outskirts of the capital city, Helsinki, resulting in the loss of four lives, including the driver. Insured losses are expected to be around \$10 million.

*John R. Oakley is editor of The RHA Review and works in RHA's marketing department. He is also a director of Oakley Marketing Associates, Inc.*

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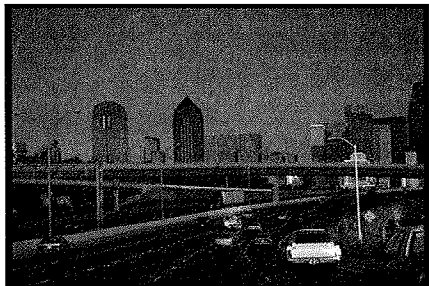
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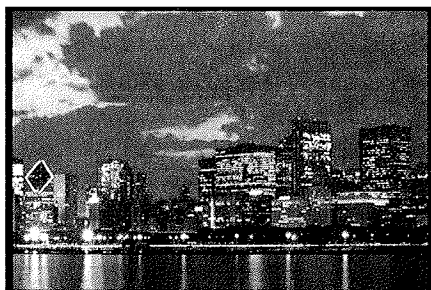
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## STEP UP TO THE BAR

If you're a Texas lawyer and are planning to attend the State Bar of Texas Annual Meeting in Dallas, please stop by and pay us a visit. The 1996 Annual Meeting is being held June 19th through the 21st at the Wyndham Anatole Hotel near downtown. We will be located in Booth #323. We will be promoting our services to the legal community and answering any



questions you might have regarding how we can help you and your practice. You are, as always, welcome to stop by for a chat or offer your insight to us. Any comment is a good comment as far as we're concerned. See you in Big D. 



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