

**WHAT'S HOT IN
CONSTRUCTION RISK MANAGEMENT SEMINAR**

INSURANCE MARKET CHALLENGES

Presented by

**Michael J. O'Neill, CPCU, ARM
President
ACIG Insurance Agency, Inc.**

Monday, November 11, 2002



INSURANCE IN TOUCH WITH BUSINESS

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Michael J. O’Neill, CPCU, ARM
President
ACIG Insurance Agency, Inc.

Mr. O’Neill is one of four panelists for Monday’s “What’s Hot in Construction Risk Management?” seminar and is a copresenter for Miniseminar K, “Hard Market Risk Finance Alternatives.” He has been involved in the construction insurance industry for more than 25 years. He is president of ACIG Insurance Agency, Inc., a construction-industry-owned insurance organization in Dallas. Mr. O’Neill is a frequent speaker for construction industry trade associations; he has spoken 10 times at the Construction Risk Conference and was a previous Words of Wisdom Award winner. His expertise lies in the areas of captive management, risk management, retention analysis, contractual risk transfer, development of specialized coverage, and risk funding programs. Mr. O’Neill has written many articles for construction industry publications, including AGC, CFMA, and *Engineering News Record*.

Notes

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INSURANCE MARKET CHALLENGES

**Michael J. O'Neill, CPCU, ARM
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- C. Net Income After Taxes
- D. Return or Average Net Worth

II. Underwriting Results

III. Investment Income and Capital Gains

IV. Surplus and Leverage

- A. Premium to Surplus
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V. Comparison With Other Industries

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INSURANCE MARKET CHALLENGES

2001 Year End Results

- Property/Casualty Industry reported its first net loss after taxes.
- Produced by sharply higher losses, and
- Weaker investment results.

Summary of Financial Results (\$ Billions)

	<u>2000</u>	<u>2001</u>
Combined Ratio	110.1%	116%
Operating Income (Loss)	\$9.9	\$(15.2)
Net Income After Taxes	\$20.6	\$(7.9)
Return of Average Net Worth (GAAP)	5.9%	-1.4%

Source: Insurance Services Office

Underwriting Results

- Net loss on underwriting ballooned by 69% to a record \$53 Billion.
 - Impacts of Catastrophe Losses
 - 09/11/01 \$ 10 Billion
 - Other Catastrophe Losses \$ 6.5 Billion
- \$16.5 Billion
- Non Catastrophic Losses
 - Reserve strengthening for environmental & asbestos
 - Reserve strengthening for non-environmental & asbestos

Investment Income and Capital Gains

- 2001 investment results deteriorated.
- 8.9% decrease in net investment income attributed to two developments.
 - The yield on cash and invested assets fell to 4.7%
 - Insurers decrease holdings of cash and invested assets declined by .09%.

Surplus and Leverage

- P&C industry surplus declined by 8.7% to \$289.6 Billion
- Leverage Ratios
 - Premium to Surplus 1.12 from .94
 - LLAE Reserves to Surplus 1.29 from 1.12

Comparison With Other Industries

2001	Estimated GAAP Return on Net Worth (Fortune 500 Companies)	11.0%
2001	Estimate GAAP Return on Net Worth (U.S. Property/Casualty Industry)	-1.4%

2001 – A Year the Industry Would Like to Forget

Key Forces

- **Economic Recession**
- **Years of Underpricing**
- **Catastrophe Losses**
- **Medical Cost Inflation**
- **Enron Financial Collapse**
- **Abuse of the Legal System**
- **September 11 Terrorist Attacks**

Recession

- **Weak economy of 2001 affected insurance investment returns and commercial lines exposure growth.**
- **S&P down by 13% for the year following year 2000 drop of 10%.**
- **Business cut back dramatically on capital expenditures and payrolls.**
- **Unemployment rate of 4.8%.**

Years of Underpricing

- The 1990's were a buyers or soft market with double digit rate decreases.

Remember:

- Discounted guaranteed cost W/C programs.
- \$400 per unit for commercial vehicles, umbrella coverage throw ins, e.g. professional liability.
- \$.03 Builders Risk Rates.

Catastrophes (Excluding 9/11 Terrorist Attacks)

- Natural Disasters – Tropical Storm Allison
- Natural Disasters – “Hail Belt” and “Ice Belt”
- Totaled \$6.5 Billion

Medical Cost Inflation

- **Medical cost is a key driver in many lines of insurance.**
 - **Auto Liability**
 - **Workers Compensation**
 - **Medical Malpractice**
- **2001 health care rose by 4.6% - U.S. Bureau of Labor Statistics.**
- **Pharmaceutical Companies – Sophisticated and aggressive marketing – “Purple Pill” “Blue Pill”.**

Enron and the Issue of Corporate Governance

- **Enron once the 7th largest corporation.**
- **WorldCom - leading telecommunications company.**
- **Global Crossing - leading telecommunications company.**
 - **Tyco - leading industrial conglomerate.**
 - **Imclone - pharmaceutical company.**
 - **Adelphia - cable television company.**
- **Industry lost millions in share price on these companies.**
- **Trial lawyers smell blood – shareholder federal class action lawsuits up 125%.**
- **Directors and officers liability has taken some huge hits.**

Abuse of our Legal System

- Average jury award has risen to 1.2 million in 2000 from \$419,000 in 1994.
- Asbestos cases continue to grow.
- Collapse of the medical malpractice market.
- Surge in "Toxic Mold" cases.

Terrorist Attacks of September 11, 2001

- Terrorism in the United States became a reality.
- Forced a top to bottom analysis of risk.
- Terrorism shifted from a theoretical risk to a real risk.
- Workers Compensation is now underwritten as a catastrophe risk.
- Federal Back Stop Legislation has been slow to materialize.

First Quarter 2002 Results

Recession	Unemployment grew to 5.6% from 4.8%
Corporate Profits	Weak investment environment
Underpricing	This is being corrected as policies renew
Catastrophes	So far a relatively quiet year

First Quarter 2002 Results (cont.)

Medical Cost Inflation	Continuing to rise
Crisis in corporate government	Crisis in confidence for investors
Abuse of the Legal System	Continued pressure for the P&C Industry
Terrorism	No domestic terrorism events in 2002, but the threat is real. Terrorism exclusions are common

Projections for 2002 and Beyond

- Insurers are still coming to grips with the underpricing sins of the 1990's and the cost drivers of the 2000's.
- Restoring rate adequacy will take years.
- Current hard market will continue in 2002 and beyond.

Pricing Projections

Property	40% to 60%*
*Much higher if Cal. quake or coastal wind storm exposure	
Workers Compensation	10% to 40%
General Liability	20% to 50%
Auto Liability	20% to 50%
*Higher for large construction fleets	
Professional Liability	20% to 65%
Umbrella Liability	50% to 300%

Coverage Restrictions and Limitations

- Residential/Condo Exclusions
- Lead Exclusion
- Silicosis Exclusion
- Fungus (Mold) Exclusion
- Subsidence Exclusion
- Terrorism Exclusion
- Additional Insured Endorsement that leaves a gap for completed operations or “sole negligence” of the additional insured

Surviving the Hard Insurance Market

- Cover your core activities – a return to basics.
- Deal from your strengths.
 - Reputation
 - Corporate Governance
 - Risk Management Program
 - Safety Track Record

Retain More Risk Balance the Ingredients

- Capital Position
- Risk Appetite
- Funding Levels for Retained Risk
- Cash Flow Requirements
- Restrictions – Loan or Surety Covenants

Avoid Risk of Marginal Activities

- New operations or services – low impact on probability/high impact or risk severity.
- Examples
 - Blasting Operations
 - Equipment Rental
 - Environmental Clean-up

Communicate and Educate

- **Top to Bottom** – from the Board of Directors to the individual employees.
- **Budgets may need to be increased for higher retained risk and insurance premiums.**
- **Re-pricing of products and services to reflect the increased cost of risk.**

Communicate and Educate (cont.)

- **Everyone is responsible for managing risk.**
 - **Corporate Culture**
 - **Take ownership of risk from your activities.**
- **Protect Your Assets**
 - **Physical**
 - **Human**
 - **Non-tangible “Reputation”**

Strategy for Dealing With the Hard Insurance Market

- **Start early – 90-120 days before renewal.**
- **Prepare an accurate underwriting submission.**
- **Provide details on your operations (current and past).**
- **Timely, accurate loss information is a necessity.**
- **Detail large losses and steps implemented to prevent them from recurring.**
- **Meet with your current underwriter and prospective underwriters.**