Climbing to the top on the insurance rate roller coaster

Not a ride for the faint-hearted

by Jim Matthews

"Many people laughed at me when I told them to expect a 100 percent increase in our property and casualty insurance premiums," recalls NRCA contractor member Bob Bellitt.

Bellitt had just returned home after chairing the January NRCA Insurance Committee meeting in Chicago when he broke the grim news to his colleagues at Arapahoe Roofing & Sheet Metal, Inc., Broomfield, Colo. At the Committee meeting, Bellitt had been told to expect premium increases in the 30 percent to 50 percent range when he renewed his firm's property/casualty (P/C) insurance. Bellitt's intuition caused him to inflate those estimates even more.

"But I was sure wrong," he added ruefully. "We didn't have a 100 percent increase. We got quotes that were 200 percent to 300 percent above what we'd been paying, and some carriers wouldn't even quote on it." Bellitt eventually found a carrier whose P/C rates seemed a bit more reasonable—they were only 150 percent higher than what Bellitt paid the previous year.

If Bellitt's were an isolated case, we could simply dismiss it as bad luck, unusually high losses, or just being in the wrong place at the wrong time. But the fact is, Bellitt's experience is not all that unusual. As many roofing contractors have discovered over the years, insurance rates have more ups and downs than a roller coaster, and unfortunately, this current upswing is steeper and faster than anyone expected.

Everyone's in the same predicament

It may be some small comfort to know that almost every segment of American industry has been hard hit by enormous, unanticipated increases in the cost of P/C insurance. For example, the American Institute of Architects reported that some of its members have been socked with increases as high as 1,000 percent when renewing their P/C insurance. In mid-August 1985, *The Chicago Tribune* reported that "many Illinois municipalities, school districts and other government bodies face cancellation of their liability insurancer, or as much as tenfold increases in premiums."

Even professions such as law and medicine are not immune. "Lawyers and doctors are being much harder hit than roofers," says Walter Derk, executive vice president of Fred S. James & Co., NRCA's insurance advisor and broker.

While industry professionals had anticipated some increases in P/C cost, few had any inkling that the price hike would be so high. "I've never seen anything like it in the 39 years I've been in the business," Derk marvels. "We didn't think it would jump like it has." The situation has left many wondering what happened, and why it happened so quickly.

Huge losses create tight market

Two major factors account for the higher prices and reduced availability of P/C coverage. First is the P/C companies' need to pull themselves up by their bootstraps after six straight years of heavy losses. Second is the limits the sudden contraction in the reinsurance market has placed on the insurers' ability to write new business.

The P/C industry is on the bottom of a down-cycle that lasted six years—from 1978 to 1984. While insurance underwriting has always been a boom-and-bust business (see Chart 1), the bust has never been so bad or lasted so long. In 1984, the industry turned in the worst financial results in its history with a composite pretax net loss of $3.8 billion, 106 percent higher than a year earlier. Its 1984 underwriting losses totaled $21.3 billion, 61 percent higher than in 1983. Worst of all, the underwriting losses for 1983 and 1984 combined ($34.6 billion) exceeded the total underwriting losses for the 25-year period from 1958 to 1982.

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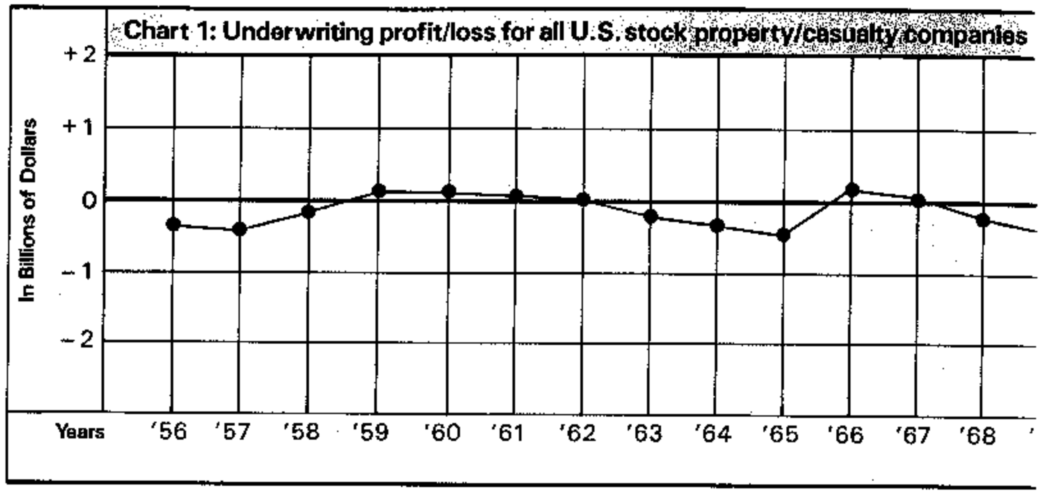

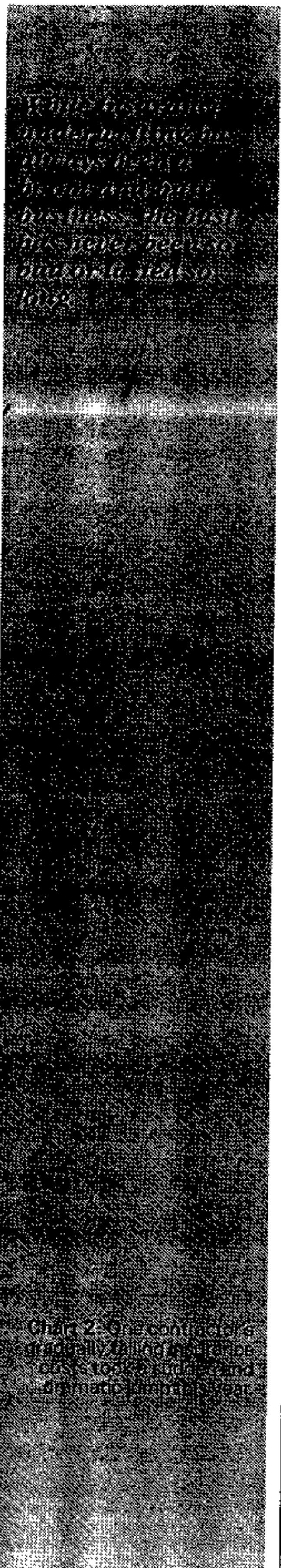

The industry's plunge into its present predicament began in 1977 and 1978 when underwriting profits were relatively high, following major rate increases. At about the same time, several large American conglomerates realized that an insurance company's tremendous liquid assets and megabuck securities portfolios could be combined with prevailing tax law and accounting practices to offer an advantageous way to shelter conglomerate earnings. The tax-exempt income of Sears, Roebuck & Co.'s Allstate Insurance Group, for example, allowed the company to pay income tax rates ranging from 1.6 percent to 30.2 percent between 1981 and 1983.

In addition, current insurance accounting methods enabled P/C company owners—through tax-exempt income, loss carryforwards and carrybacks, and deferred tax liabilities—to significantly cut pretax losses with tax credits.

Conglomerate financial managers were also quick to realize that the huge amounts of cash their insurance companies were reaping from premium payments could, if invested shrewdly, yield even greater profits. This made the sale of insurance important only as a way of collecting investment capital and allowed the pursuit of investment income to become the tail that wagged the dog.

To maximize their cash flows, conglomerates deliberately set premium rates below the amount the company would pay out in claims and administrative expenses. The rest of the industry was forced to follow suit, touching off a rate war.

As the competition for cash flow dollars intensified, premium levels came tumbling down. It was, as Derk describes it, "ya-ha time" for an industry long known for its conservative, intelligent approach to pricing. Traditional underwriting, whose guiding principle was that premiums from the business underwritten should be high enough to provide a profit even after paying anticipated losses and expenses, became a thing of the past. As long as investment income remained high enough to more than offset underwriting losses, insurance company owners weren't concerned by the companies' inability to support themselves.

The party came to an abrupt end in 1983, however, when major catastrophic losses sent insurers' loss ratios to previously unheard-of levels—as high as 130 percent for some companies. The deteriorating situation continued unabated into 1984, as the industry recorded the highest underwriting losses in its history and saw reserves dip to dangerously low levels, nearly driving some companies to bankruptcy. Obviously, the industry had to take some corrective actions or face extinction. It chose to jack up premiums to survive.

Chart 2: One contractor's P/C costs

Year	Coverage Limit	Premium	% of 1978–79 Premium	% Change For Prior Year
1978–79	$5 Million	$27,000	----	----
1979–80	" "	20,400	75%	− 25
1980–81	" "	25,500	94%	+ 25
1981–82	$10 Million	10,500	39%	− 59
1982–83	" "	6,000	22%	− 43
1983–84	" "	5,000	19%	− 17
1984–85	" "	4,700	17%	− 6
1985–86	" "	40,000	148%	+751

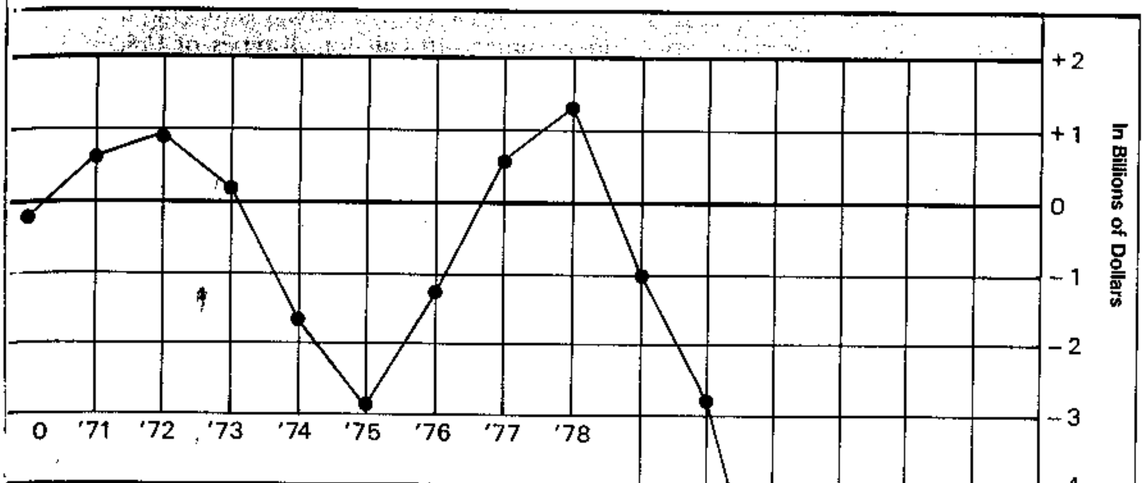
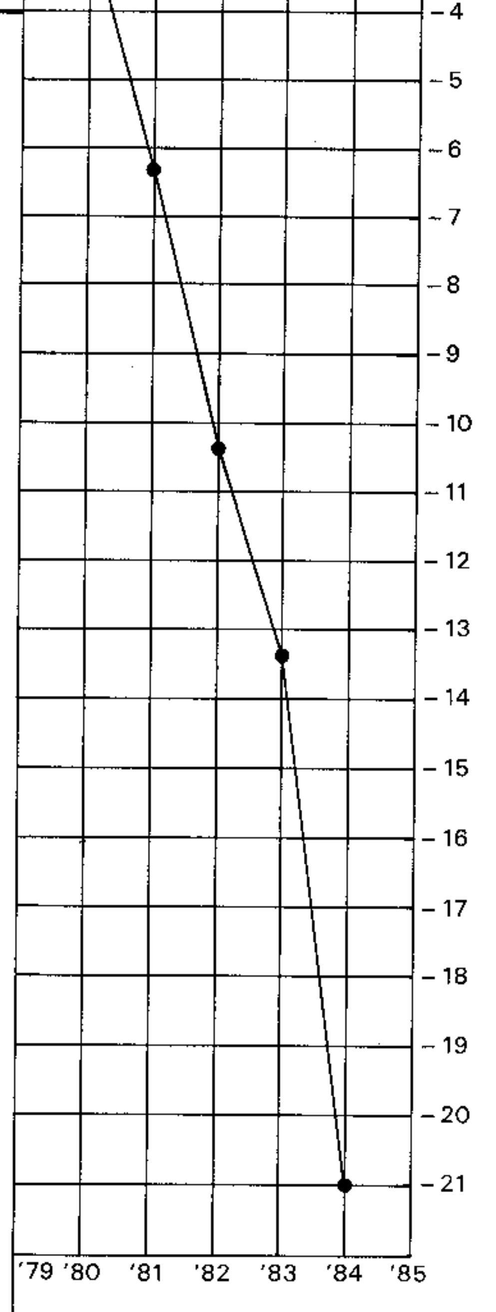

Chart 2 graphically illustrates the roller coaster ride premium rates have been on since 1978. The chart shows the actual yearly cost of one general contractor's umbrella coverage during the last seven years.

During the period charted, the contractor had no losses to affect his premium costs. Discussing this contractor's experience, Derk said, "We can see how ridiculously low premiums had become." For example, by 1984-85, the contractor's premium was only 17 percent of the rate he had paid in 1978-79. And this was for twice as much coverage.

In comparison to the steady fall of premium rates since 1978, the 751 percent increase between 1984-85 and 1985-86 looks enormous. However, the rate is only 67.5 percent higher than 1978-79's rate. Had rates steadily increased rather than decreased during the intervening years, they would have had to rise only about 6 percent per year to reach current levels.

A good insurer is hard to find

As roofing contractors who have tried to renew their P/C insurance have discovered, the price isn't the only problem. Many insurers are choosing to discontinue roofing contractors' coverage, and the sources of P/C insurance are drying up. Even contractors with wheelbarrows full of cash are being turned away.

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Chart 1. Dramatic losses over the last five years are causing serious problems for the insurance industry.

Many insurers are choosing to discontinue roofing contractors' coverage and the sources of P/C insurance are drying up.

The scarcity of P/C insurers is due, to a large extent, to the tight reinsurance market. Primary P/C companies insure their large risks by purchasing insurance from other insurers, called reinsurers. As a result, large corporate risks are spread among many different reinsurance companies. Today's reinsurers either can't or won't share the insurers' risks, inevitably causing the market to tighten and shrinking the availability of P/C coverage.

The reinsurance market has been beset by many of the same difficulties as the primary insurance market. During the last ten years, U.S. conglomerate cash and Mideast oil money poured into the reinsurance marketplace, creating fierce competition, falling rates and reduced profits. By 1984, the situation was as bad for the reinsurers as it was for the primaries, with investment income no longer able to cover the reinsurers' losses.

The reinsurance market has suffered even worse losses, however. Because of a series of massive health, product liability and environmental claims and judgments against major corporations in U.S. courts, many reinsurers, particularly members of Lloyd's of London, have incurred heavy court-imposed losses already and stand to lose more in the future. U.S. courts have repeatedly handed down unprecedented product liability decisions that were unexpected by the insurance industry. As Robert Kuntz of Fred S. James & Co. says, "they are losses that the underwriters never intended to cover, but which the courts say they will."

The courts' actions have caused major financial problems for the P/C reinsurance industry because damages are being awarded in many cases that exceed the limits of the policies in force when the damage occurred. "The policy years that were considered closed, that had been dormant for many years, were reopened, and insurance companies are having to pay a great many times more than their premium prices contemplated. It's driving the industry crazy," Derk points out.

The last straw for many Lloyd's underwriters came when U.S. courts began granting huge awards to asbestos victims. Insurers have already paid an estimated $2 billion, and the total claims worldwide could cost them $10 billion to $30 billion by the year 2000. These awards, along with claims involving Agent Orange and potential claims resulting from the Bhopal chemical leak, have driven many Lloyd's underwriters out of the reinsurance market altogether.

The reinsurers' withdrawal is making it increasingly difficult for all types of U.S. organizations to obtain liability insurance, especially umbrella coverage. Most insurance companies are scrutinizing existing business more critically and are reluctant to write large volumes of new business, particularly high risk business. "Now that they have the luxury of being limited to how much insurance they can write, they're looking for cream puffs," maintains Derk.

Roofing hard hit by increases

Many contractors who have attempted to renew their P/C insurance in the past year have horror stories to tell. A random, unscientific sampling of NRCA members around the country reveals many hair-raising tales.

Steven Reidhaar of Cedars West Roofing, Inc., in Boise, Idaho, said that the cost of his coverage increased by nearly 300 percent, with general liability accounting for most of the increase. Reidhaar, whose P/C coverage is now with CNA, changed carriers at his last renewal even though he was not dissatisfied with his previous carrier. He chose CNA because he believes the company's coverage is "tailor-made for the roofing contractor."

The cost increases caught Reidhaar by surprise, though. He says, "the trade magazines implied that we should be careful, but the size of our increases really startled me."

Clarence Dailing of Dailing Roofing in Midwest City, Okla., says, "My $2 million umbrella coverage cost me $1,400 last year. This year for just $1 million they wanted $5,000. When they told me that, I told them to 'Kiss my ——.'" Rather than pay the increased rate, Dailing chose not to renew his umbrella coverage.

Dailing's insurance problems may be further aggravated by liability claims against his company resulting from a fire at Tinker Air Force Base that caused damages estimated at $138 million. As the prime contractor on a large roofing project at the base, Dailing stands to bear the brunt of the claims.

Sam Piper of J.A. Piper Roofing in Greenville, S.C., says that his overall increase amounted to about 40 percent. His case is special, however, because he carries his workman's compensation insurance with a captive insurance company that serves contractors in North and South Carolina. His general liability coverage has been with the same company for the last eight years although there were years when he could have reduced his general liability insurance costs by switching carriers. He chose to stay with his present company because "they have experience with us, and we feel like it could get us a better deal in the long run than by going with another company," he says.

Bruce Martin, AN-CO Roofing, Inc., in Woodinville, Wash., says that his previous carrier got out of the general liability market so quickly that it canceled his coverage a month before the policy's renewal date. Luckily, he found a carrier to cover him that month as well as for the coming year. The coverage will cost him dearly, however. His general liability insurance costs went from $20,000 per year to almost $110,000 per year.

Vernon Newell, Southwestern Roofing in Oklahoma City, Okla., says that by changing carriers he was able to avoid a drastic rate increase. His workman's compensation coverage was only 30 percent higher this year, while his general liability costs remained the same. He says, "We were with CNA and they jumped up so high we started looking around. Shoot, they were wanting 300 to 400 percent more this year than the year before. They were ridiculous."

Dave Knutson, Fisher Roofing in Scottsbluff, Neb., thinks his small loss ratio was responsible for the moderate increase he experienced in P/C insurance costs this year. He's been with USF&G for 25 years, and during that time has built a strong working relationship with their local agent. He doesn't shop around for insurance and thinks he's better off that way.

Bellitt says that when CNA told him his rates would be going up by as much as 300 percent, he switched carriers, but he made the change with some reluctance. As NRCA's Insurance Committee chairman, he's aware of CNA's efforts to sustain the NRCA insurance program and support the industry. But the increase in CNA's rates this year "wasn't competitive enough" for him to stay with the company, he says.

Who's in and who's out

With changes happening so rapidly in the insurance industry, most contractors will want to shop around before renewing their coverage. It would be most helpful if they could start out their search with a list of P/C insurance companies that have dropped out of the market altogether or have significantly reduced the extent of their participation. Unfortunately, no such list exists.

The best information available is the informed guesswork of the industry experts. Michael O'Grady, a CNA underwriting manager, says that he has no specific knowledge of who's in and who's out, but he does know that "some companies have shut off new business and other companies have made a conscious effort to get out of certain classes of business."

O'Grady has heard some news through the grapevine, however. "In the South, we've noted that Reliance has withdrawn rather sharply. In other territories—Ohio specifically—USF&G quit making a market for certain types of contractors," he said.

James & Co.'s Derk is hesitant to mention names. He's afraid there are individual agents or offices that are continuing to write business even though their companies have formally announced their withdrawal from a market. He notes that because insurance is a "people business," an insurance agent may well continue to write business to protect a long-standing relationship rather than adhere to the company's stated plan. "It's very hard to say that a company is definitely out. If I made that claim, I'm sure someone else would be able to say, 'I know where they're still in,'" he said.

Keeping costs down

With global economic forces affecting P/C insurance rates and availability, it may seem as if there's little contractors can do to improve their situation. And it is true that the cyclical swings of the P/C industry are beyond any contractor's ability to control.

However, contractors can introduce programs and procedures into their operations that will help control their losses. While these measures may not eliminate losses entirely, they will demonstrate to potential insurers a contractor's commitment to safety. This commitment can give a contractor a leg up when the going gets tough, according to the experts. They claim that contractors who emphasize loss prevention and control are in a better position to:

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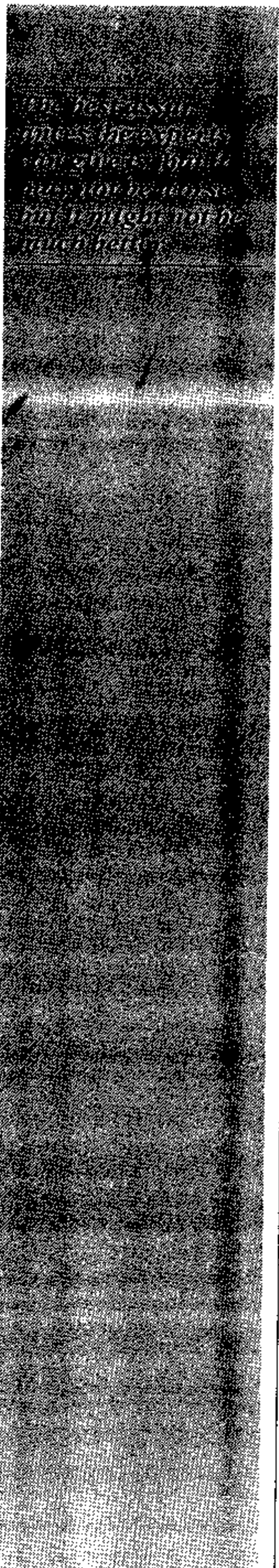

- keep P/C insurance costs down;
- retain coverage with their present carrier; or
- obtain coverage from a new carrier, if necessary.

Loss control is important because the inherently dangerous nature of the roofing business has prompted insurers to rate contractors individually rather than collectively. Each contractor's insurance rate is based on the company's actual loss experience and an evaluation of the contractor's emphasis on safety and loss prevention.

"Management commitment is vital in planning, implementing and maintaining an effective loss control program," CNA's O'Grady stresses. He claims that CNA statistics show a significant correlation between a roofing contractor's interest in safety and loss prevention and the premiums he or she pays.

Piper agrees. He says, "I think your insurance company, or a potential insurer, looks for a commitment from management. I'm not talking about the eyewash stuff—meetings no one goes to and posters no one looks at -- I'm talking about real commitment. If you can show that you're making a conscious effort to work at it, I think you can benefit, even if you've had some bad experiences in the past."

Bellitt says, "Safety isn't something you can just pass over. First you have to have good safety procedures. Then you have to stand behind them, enforce them and follow up on them. Insurance carriers look closely at the safety programs you've installed, and that can mean the difference between getting high-priced coverage or reasonably priced coverage."

Bellitt also believes that keeping in touch with the agent and the carrier's loss control experts is a good way to build a solid working relationship that can result in favorable rates. As he says, "I think they may rate you better if you ask for assistance and information. They may figure your losses will be lower."

Newell is adamant about safety. "It's money in our pocket," he maintains. "We stress it and always have. That's probably why we have the lowest insurance rates of any roofing contractor in the state of Oklahoma."

All these contractors cited the safety guidelines NRCA has developed as a logical place to begin a safety program. In addition, they mentioned the extensive materials CNA will make available to NRCA members to help them improve their loss prevention and control programs. (A more detailed description of the safety-related information and materials available from NRCA and CNA can be found in the December 1984 *Roofing Spec.*)

Future not so rosy

Contractors who are still reeling from the recent round of insurance price increases may be wondering if the future can be any worse. The best assurances the experts can give is that it may not be worse, but it might not be much better. Derk shies away from making predictions, saying only that, "the consensus, based on what we read, is that we're in for more increases. It's still a tough market."

Derk notes that part of the uncertainty about next year's rates results from the reinsurance treaties that must be renewed on Jan. 1, 1986. At the moment, no one knows for sure how eager reinsurers will be to buy into a market that has already burned them badly.

O'Grady's best guess is that if industry operating results continue to improve through the remainder of 1985 and well into 1986, the capacity of insurance companies to write new business will increase and the market should loosen up. Based on that assumption, he says, "The market will become more competitive, probably by the third quarter of 1986."

In other words, for roofing contractors who must renew their insurance in the coming year, there's good news and bad news. The bad news is that more increases are probably are on their way. The good news is that the increases won't be as large as they were this year.

If the P/C insurance industry continues to follow the cyclical pattern of the past 25 years, then another buyer's market isn't too many years off. Nor is another tight period like the present one. That should be reason enough for roofing contractors to get their safety programs firmly in place, making their loss experience as good as possible. That way, if conditions get tough again, they'll have a good track record to prove to insurers that they warrant coverage and favorable consideration on premium rates. It may sound trite, but an ounce of prevention could well be worth a pound of cure.