Taking the pulse

The casualty sector may have enjoyed some stability in 2006 but downward pressure on rates is continuing, explains **Craig Darling**.

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LAST YEAR’S HIGHLY ACTIVE hurricane season led many insurers and reinsurers to re-evaluate their core underwriting segments and reassess the amount of catastrophe-exposed business their portfolios can sustain. A number of companies have lowered their acceptability threshold for property catastrophe risks by diversifying into other property lines of business. Others have moved into the casualty segment.

The casualty sector can create a smoothing of results because of their extended payout patterns, allowing for more stable earnings on a calendar-year basis. Over the past 12 months, various rating agencies have started monitoring business mix and, in some cases, requiring a better spread of business.

The conventional wisdom suggests that as the primary market softens the reinsurance market will follow suit. We are not convinced this will be the case in the casualty market today, as reinsurers are increasingly focused on profitability and underwriting discipline. On the contrary, reinsurers are more likely to support those carriers that demonstrate solid year-on-year results and do not under-price their business for market-share positioning. Softening markets hold little appeal for reinsurers, and there are signs that reinsurance capacity is already beginning to tighten for the transportation business, especially for larger fleet accounts, where rates have been softening for some time.

NEW ENTRANTS

In the construction market, pricing for non-residential business remains relatively soft due to adequate capacity and favourable loss results over the recent years. Only a few traditional new entrants are currently expected in this sector over the course of the next 12 to 18 months, which should lead to a slight erosion in rates and weakening in terms and conditions.

It appears that the favourable loss experience in the construction industry may have encouraged the original insured to explore other avenues for cost management. The insureds now appear to retain more risk through increased use of deductibles, among other things. Furthermore, an increase in alternative risk transfer and the use of offshore captives continues to provide a viable alternative to traditional insurance structures. It is not uncommon to see large global construction firms assuming the first $5m of risk for cost management purposes.

In recent years, the industry saw a greater use of wrap-up project coverage on infrastructure and energy projects for cost containment. This trend is widely anticipated to continue over the next 18 months.

The market conditions are less benign for residential construction projects, where pricing remains strong due to the limited amount of available capacity. The industry continues to vacillate on the profitability of residential business. Laws continue to improve but in the US, each state presents different underwriting and pricing dynamics. Many reinsurance and direct markets absorbed large loss activity in the mid to late 1990s from multiple policy losses. Many exited the business because of the substantial loss activity and now have enormous trading hurdles to approach this market sector with any meaningful impact.

Growing interest is anticipated from reinsurers in the residential construction segment, fuelled by a combination of relatively strong pricing and limited competition. Residential terms and conditions have remained the most restrictive over the past few years as compared to other casualty business segments.

Insurers providing workers’ compensation coverage have seen underwriting profits for three consecutive years, and pricing is likely to remain flat, at best, with the exception of California. “Pure premium rates” continue to decrease as a result of reforms. The Californian Workers’ Compensation Rating Bureau has recommended a 16.4% decrease in workers’ compensation pure premium rate from July 2006. According to an industry study, Californian workers’ compensation rates for January 2006 decreased by 46%.

The main concerns for insurers are exposure to terrorism losses, medical inflation expenses, aggregate exposure management and continued development of historical losses. Furthermore, the National Council on Compensation Insurance is in the process of revising the hazard group classification methodology from four to seven groups. The impact of these changes on primary insurance and reinsurance pricing has yet to be determined.

The reinsurance market for workers’ compensation continues to remain stable and insurers are taking on larger retentions. Reinsurance capacity for catastrophe layers remains abundant with Bermuda leading the charge. Slight decreases in pricing for catastrophe layers should be expected. Insurers are looking for increases in “maximum any one life” limitations, and reinsurers are responding by increasing limitations on selected accounts to $5m-$10m.

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