The Industry Insurance Crisis

Premiums Expected to Continue Their Climb in 1986

Unquestionably, the year of 1985 will be recorded in history as one in which insurers attempted to staunch the flow of red ink across their ledgers by increasing insurance prices and restricting the supply of available coverage. Some insurers border on insolvency and it will require another full year, at least, before significant stability is evident in the construction insurance market. Prices will continue to increase and insurance availability will deteriorate.

The reasons for this distressing situation in an industry that should be known for its stability have been chronicled in many publications; however, the causes can be summarized as an oversupply of insurance, underpricing of policies, underwriting losses, and a resultant decline in insurer wealth. What we are seeing now, and will continue to see for some time, are attempts to reverse these conditions for a return to some degree of stability. Irrespective of the causes or the impact of the remedies, contractors should budget for a greater insurance expense in 1986 and an insurance availability shortfall, at least in some insurance lines. We should look at the various specific construction insurance lines to determine the severity of price increases and lack of availability.

General Liability . . .

Contractors’ premises and operations liability insurance, usually purchased in the form of a Comprehensive General Liability policy (CGL), is in a state of turmoil. Insurance Services Office (ISO), the organization which provides insurance forms for most insurers, has introduced a new CGL which will change the coverage from an “occurrence” to a “claims-made” basis. It is beyond the scope of these remarks to delineate the differences between these two forms, but contractors would be well advised to discuss with their insurance representatives the implications of the new “claims-made” form, as well as several other significant changes made in the CGL. The older “occurrence” form will remain available for certain kinds of risks by some insurers. A very important issue remains unresolved in this change process. ISO had wanted to include lawsuit and other defense costs as a part of the CGL’s aggregate limits. Historically, defense costs have been paid separate from and in addition to the policy’s other limits. Moreover, such costs incurred by the insurer were not subject to any upper limit. Our social justice system, with its penchant for ever-increasing litigation, has caused insurer legal costs to skyrocket and ISO’s desire to have them brought under the CGL’s aggregate limits is an attempt to bring them under control. This change is one which has been much discussed within and without the insurance business, revealing considerable opposition to the change. ISO may try to institute it in 1986. I would predict that it will not occur, or if it does, it will be much modified from its current form. Some authors and commentators on the in-

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The construction operations using perceived hazardous materials, such as asbestos or any material deemed to be a pollutant or health hazard, will experience considerable insurance availability problems at any price. Irrespective of the extent to which the umbrella underwriters follow the basic general liability coverage restrictions, look for rate increases and a requirement that underlying general liability limits be larger. Larger contractors needing high excess liability or umbrella limits will continue to experience difficulty in obtaining the high limits they believe they need or difficulty in filling in certain layers of the excess liability or umbrella limits.

Professional Liability . . .

For those contractor operations involving design and build functions, or in-house architects and/or engineers, the professional liability insurance market has nearly evaporated. Rate increases, in some cases, have been characterized as astronomical. Unfortunately, this will continue as plaintiffs seek additional reasons why contractors are responsible for their injury or damage. In addition to the usual charges of ordinary negligence by the contractor, plaintiffs have added the burden of professional malpractice or errors or omissions. In essence, they seek redress because of a faulty design or the failure to use the standard of professional care concomitant with the expected standards of architects, engineers, and other professionals. Unless there is a significant change in our legal climate, I predict this will be the area of liability touching contractors which will continue to be impacted and, relatively, to be the most costly. Availability will continue to deteriorate.

Surety . . .

Bonding, the usual conservative cousin of the insurance business, has taken its share of hard knocks in the past few years. Surety underwriters experienced annual losses of an unexpected amount and, therefore, this market will be somewhat restricted, but not nearly to the extent of the liability market. The best advice one can give to contractors is to say that if you have a bond market, stay with it and be prepared for some, but not outrageous, rate increases. This is not the time to shop your surety business.

Property Coverages . . .

This may be the one area where the news is not all bad. Rate increases will occur, but in the less hazardous construction operations they should not be large and availability should not be as restricted as it will be in the lines discussed above. Some of the more exotic perils, such as earthquake, subsidence, water damage, and the like, may not be insurable or may be made subject to large deductibles.
Workers Compensation . . .

A few years past, insurance underwriters were competing fiercely for compensation business. Part of their enthusiasm was based on what was perceived as “known” losses (workers’ compensation benefits being established by statute). Interpretations of benefits to be allowed, increasing medical costs, insanely low pricing by insurers, and a host of similar occurrences have not only dampened the underwriters’ enthusiasm for compensation business, it has ruined their appetites, except at large rate increases. This market may be restricted severely for the coming years.

A Real Problem . . .

At the top of this article, I made a brief reference to insolvent insurers. In the past, contractors purchased insurance by relying on their insurance representative to select the insurer with which the coverage would be placed. While estimates vary and little solid information is available on specific insurers, it may be that as many as 200 to 300 property/casualty insurers are technically insolvent (liabilities exceed assets, if the insurer were to be liquidated). Recently, it was said that more than 80 such insurers are in various stages of receivership. Even though most of these are smaller, less well known insurers, it is a fact of life that years of cash flow underwriting (write the risk at any price and take the money to the investment market, which should more than make up any loss because of underpricing) has pushed some insurers to the edge of insolvency.

Contractors would be well-advised to seek more information about the insurers with whom their coverage is placed. I do not suggest that contractors become insurance finance experts, but it is in order to ask about the insurer’s Best’s Rating (an insurer financial status rating service). Ask what the rating is for the current year and whether it declined from the previous year. A considerable number of insurers had their Best’s Rating omitted in 1985, either because their financial status was unclear or had deteriorated to such an extent that it could not be estimated with any degree of accuracy.

An insurer delivers on its promises when losses occur. If it cannot deliver
because of financial impairment, the supposedly insured contractor has no coverage, may face huge losses, and is out-of-pocket the premiums paid. Contractors need to take a greater interest in the insurer’s financial status in advance of losses.

**What To Do? . . .**

We are in a seller’s market, which means we may have to “sell” the insurer on meeting our insurance requirements at reasonable prices. Try the following:

1. Start early. If your insurance program renews later this year, start now working with your insurance representative to present it for renewal, accompanied by complete supporting data.

2. Watch your bids. Anticipate that your insurance costs will be higher this year. Face it, they will be higher for your competitors, so do not undercut your costs by assuming insurance costs will increase only modestly.

3. Crank up your loss control and safety efforts. Cut your losses by preventing or reducing them. Underwriters are human (or so it is reported), and they are susceptible to risks that attempt to control losses.

4. Be prepared to accept lower limits, especially in liability coverages. You may have to accept lower limits because of less availability, or you may decide to reduce the limits somewhat in order to reduce what could be escalating insurance costs.

5. Accept greater retentions. Review your net worth to determine whether you can accept the financial impact of larger deductibles. Do not accept larger deductibles unless you obtain corresponding insurance rate reductions for doing so.

I wish this article could have been more “up beat.” I will predict that if we can get through 1986 without any great natural disasters which additionally would impact insurers’ financial health, if we do not see insolvencies of a major insurer which would drag down other weakened insurers through the operation of the state guarantee funds, and if the rate increases begin to bolster insurers’ surplus, we should see a more stabilized insurance business in 1987.