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EXCLUSIVE INSIGHT AND ANALYSIS FROM INSURANCETIMES, STRATEGICRISK & GLOBALREINSURANCE

Michael Faulkner ■ Editor

The insurance industry is waiting for the return of the hard market. While some lines of business, notably catastrophe exposed reinsurance business, are seeing hardening rates, other lines are still pretty soft.

One issue for the market that could hamper the sector's return to hard market condition is a dislocation between renewal premiums and new business premiums. Some insurers have been willing to cut rates for new customers to win the business, while simultaneously trying to increase rates for existing customers. As we argue on page 2, this practice of dual pricing is potentially damaging to the industry and should be abandoned.

Insurers are also taking a close look at the value provided by their distribution channels as they seek to reduce their costs. The consolidators were the first to come under the spotlight, and now networks are in the insurers' glare. On page 3, we examines how networks must respond.

The recession means insurance buyers are looking for swift claims settlement by their insurers in order to assist with cashflows. Nathan Skinner argues that insurers must seize the opportunity to distinguish themselves by show better claims handling and empathy with their clients (page 4).

Finally, now that European politicians have reached agreement on Solvency II, the forthcoming risk-based solvency regime, insurers face years of hard work to comply with the rules – and the fine detail has yet to be published (page 5).

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Michael Faulkner • Editor • Insurance Agenda

Dual pricing must end

The dislocation of renewal and new business premiums can only do the industry harm

For months senior insurance executives have been talking of the need for increased premium rates to counter rising claims costs and declining investment returns. They have been happily talking of the increases that have been – and will be – achieved. It seemed a swift and easy transition to a hard market was on the way. But it hasn't been that simple.

Brokers have been questioning the extent to which any rate increases have filtered through to the coal face. Senior broking figures have pointed the finger at the disparity between some insurers' renewal rates and the rates they are offering new business customers.

This two-tier, or dual pricing means that existing customers could facing double-digit rate increases, while new business customers with the same insurer are enjoying rates that could be as much as 10% less. Brokers say this practice is resulting in as much as a 20% difference between the renewal rate and the rate for new business.

Dual pricing is frustrating and potentially harmful. Slashing rates at a time when insurers must increase rates to stem underwriting losses and counter the damage inflicted on investment portfolios by the financial crisis, is counter-productive and damaging.

Moreover, two-tier pricing increases customer churn, as clients move insurers to get the better rate, which increases the administrative costs for insurers and brokers.

Dual pricing is also bad for the industry's reputation. It does not make the sector look professional when brokers and insurers are explaining to customers that rates are rising, yet some are being cut to win business.

It also demonstrates how frightened insurers are of losing market share as rates rise – despite what is said about being willing to sacrifice volume for profit.

An analysis of commercial lines trading data by Acturis, the software house, shows the impact of the dislocation of renewal and new business premiums on the market's recovery.

The data shows that dual pricing is particularly marked in the case of property owners' business, where average premiums fell 9% in the first quarter of 2009, compared with the full year 2008. This was wholly due to a massive fall in new business premiums which offset an increase in renewal rates.

But the same research does show a mixed and evolving picture of dual pricing; indeed it appears that the disparity between renewal and new business rates is narrowing. In the case of package and motor fleet business, average new business rates rose during the first quarter (4% and 5% respectively) compared with the full year 2008, while renewal premiums fell (6% in the case of packages).

For commercial combined, new business rates were up 3% on average in the first quarter of 2009 compared with the previous quarter. Renewal rates fell 1%.

The data suggests that the market is, in fact, bottoming out in commercial combined and motor fleet; although rates for property owners' business continue to fall.

Of course the data shows only average premium rates and brokers will undoubtedly point to individual insurers that are more aggressive followers of two-tier pricing.

Until insurers abandon dual pricing and properly price risks, both at renewal and for new business, then the road to profitable underwriting and a hard market will be a long one.

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Key points

- Some insurers are slashing rates for new business while increasing renewal premiums, so-called dual pricing.
- Dual pricing is potentially harmful to the insurance industry, threatening the early onset of a hard market and insurers' profitability.
- It also risks making the industry look unprofessional, by contradicting the message that rates must rise.
- Customer churn increases, adding to insurers' and brokers' administrative costs.
- Dual pricing must be abandoned.

Archive

➔ Rates still softening, claims Marsh
28 May 2009

➔ Market: Commercial lines
14 May 2009

➔ Rates: it's not what you think
5 February 2009

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Networks must sharpen up

Partnerships with insurers will fold unless networks prove they can offer good value

The pressure on broker networks is mounting as more insurers run the slide rule over the value they bring. AXA is currently reviewing its network partnerships, while insurers such as RSA and Norwich Union are also thought to be doing so. They won't be the only ones.

When one senior insurance executive described networks as "having their noses in the trough" in terms of the additional remuneration they charge insurers, it was clear that some would face tough action if they did not live up to insurers' expectations.

Already Zurich has pulled the plug on its partnership with Westinsure, which is unlikely to be the only network to face action from an insurer partner. The message is loud and clear: networks must provide good value to insurers or face the threat of commission reductions or the termination of partnership agreements,

A network's value to an insurer is the high volume of business it can provide at lower than average transaction costs. This has enabled networks to negotiate additional commission, typically between 1 and 3%.

To be successful, networks need to provide large volumes of the right type of business to their insurer partners. They must have a clear vision of what they can offer them and a clear understanding of what they need. They must also have a clear strategy of how this can be delivered.

The make-up of their membership base is crucial. Insurers want large volumes of homogenous business and the networks need to ensure they can provide this. Existing networks will need to fine-tune their membership; the new networks that have sprung up in recent months must choose their members carefully.

The volume of business is also critical, which makes maintaining a high membership crucial. The new networks are pushing hard to win members – some undoubtedly will be poached from rivals. Additionally, the impact from the consolidators which may acquire members (and potential members) cannot be ignored.

But there is no point having a lot of members if they do not use your facilities. Therefore each network must ensure that it successfully encourages members to place business with its partners. Networks have been criticised for failing to live up to their promises of moving books of members' business to insurer partners.

Making sure that the transaction with insurer partners is as efficient as possible is also key. Insurers are looking for a low-cost, streamlined process. Networks must take a close look at their current systems and processes to see if they can be improved – the effective use of technology is vital.

Networks have an important role to play in the distribution chain, but only if they can meet the needs of their insurer partners. Networks that fail to do this will find their future becoming increasingly bleak.

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Key points

- Networks' value to insurers is the volume of business they can provide at a low transaction cost.
- Insurers are taking a close look at the value each network provides.
- Networks must assess what they offer their insurer partners to ensure it meets their requirements.
- The membership base, type and volume of business provided and transaction efficiency must be examined and changed where necessary.

Archive

➔ AXA plans to kick out weak network partnerships
21 May 2009

➔ Leader: Networks must work harder to survive
9 April 2009

➔ Networks under pressure as Zurich leaves Westinsure
9 April 2009

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Nathan Skinner • Associate Editor • Strategic Risk

Risk managers chase swift settlements

Insurers must show that they are willing to pay claims when they are needed most

A shrinking economy is forcing companies to examine the value of their insurance programmes. In a tough environment, delays in the payment of a claim could force a company into administration. Risk managers are therefore looking for swift settlement.

There are several reasons why claims may not be resolved as quickly as buyers would like, particularly during the recession. First, the rising number of suspicious claims means insurers are taking a closer look at major losses to check for signs of fraud. This takes time.

Second, understaffing in claims departments as some insurers cut their payrolls can cause delays. Finally, risk managers worried about the solvency of their insurance partners are increasing the number of carriers on their programmes, which makes claims settlement more complicated and time consuming.

For these reasons resolving claims quickly and efficiently has become a priority for risk managers. The Association of Insurance and Risk Managers (Airmic) has spearheaded a strategy to improve handling and the speed of payment with a detailed analysis of the strengths and weaknesses of insurers' claims handling.

The strategy is three-pronged. An agreement was reached last year with several insurers on a 90-day cooling-off period during which they would refrain from issuing a reservation of rights letter, a device that puts the policyholder on notice that the insurer may not accept liability for a particular claim. It has become a knee-jerk response whenever insurers are notified of a large loss.

With the agreement in place, risk managers hope to be able to iron out problems without involving lawyers, something that often follows a reservation of rights.

In January, Airmic also published a guide highlighting the hallmarks of good claims service. This is set to be reviewed and updated annually.

Finally, the association wants to agree a strategy with insurers to speed claims payments. This last stage will be the hardest to achieve as the varying complexity of claims makes it difficult to agree a standard time frame for payment.

Brokers have also ridden to the defence of buyers and have begun to demand that insurers give a reason why they are issuing a reservation of rights. Aon also devised a "willingness to pay" model which ranks insurers into three groups: best performer, middle-rankers and below average.

So far Airmic has reached agreement over the reservation of rights issue with its seven partner insurers – Ace, Allianz, AXA, AIG, RSA, XL and Zurich. Other insurers should become involved and demonstrate that their claims service also meets best practice.

As the recession deepens, insurers have the opportunity to distinguish themselves by showing better claims handling and empathy with their clients. In fact, since the onset of the credit crunch, some have shown more willingness to make interim payments to clients during the early stages of a claim.

If insurers want to continue to present risk transfer as a viable risk management option they must show that they are willing to pay claims when they are needed most.

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Key points

- Risk managers want their claims to be resolved quickly, particularly as cash is hard to come by.
- During a recession claims can take longer to settle.
- Nevertheless, seven of the biggest insurers have agreed with Airmic to resolve large claims within 90 days.
- More insurers should join the initiative if they want to present risk transfer as a viable risk management option.

Archive

➔ Airmic and insurers agree reservation of rights principles
4 December 2008

➔ Claims handling index
11 September 2008

➔ Insurers agree to resolve large claims in 90 days
17 June 2008

➔ Insurers limit use of reservation of rights
16 June 2008

➔ UK risk managers speak out
6 May 2009

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Solvency II fudge offers little support

Agreement has been reached on the Solvency II directive, but now begins three years of hard work for European insurers who must struggle to comply with it

Agreement on Solvency II, the most important piece of legislation affecting European insurers and reinsurers, has finally been reached but at the cost of a political fudge that leaves out one of the most important parts of the new regime: group support. This crucial component of the original directive was opposed by some nations, including Spain and Poland, who were worried that it could undermine the power of their national regulators. The deadline for compliance has also been pushed back to 2012 and when deadlock threatened to delay Solvency II further, group support was dropped as a matter of expedience.

Group support was an imaginative idea that reflects economic realities and would have allowed subsidiaries in European groups to meet local solvency capital requirements by a financial commitment from their parent. This would have enabled European groups to manage capital centrally. Without group support, subsidiaries will be forced to maintain financial commitments in each country of operation. This costs groups more.

So why did the fudge happen? The sad answer is that politicians, desperate to be seen to be acting in response to the financial crisis, allowed themselves to be pressured into a deal. They wanted the deal done quickly just to be seen to be doing something. Solvency II is being billed as an "answer" to the financial crisis. Whether in reality it would ever stop a financial crisis originating in the insurance industry is anyone's guess. Basel II did not stop the financial crisis in the banking industry.

Brussels, the home of the waffle, fine chocolate and an excellent range of fruity beers, is also no stranger to fudge – including the political variety. But it would have been better to have the courage to delay the Solvency II directive and iron out the real differences that exist over group support, rather than go off half-cocked. European insurers are now engaged on the burdensome task of preparing for compliance with a version of Solvency II that is far removed from what was originally planned.

One solution that some insurance groups are considering is replacing their foreign subsidiaries by branches. But this is a costly solution. Also, many consumers will be put off if they are asked to buy from the branch of a foreign company.

Insurers are now studying the directive in detail. To say they are finding it difficult would be an understatement. Also, the directive only contains high-level principles, not the implementation measures and guidelines. Much of the detail that will flesh out the directive will not be agreed upon until 2011, only a few months before the implementation deadline.

Unfortunately, many insurers, large and small, will struggle to comply with this complex example of European regulation.

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Key points

- Agreement on Solvency II was reached by means of a political fudge
- Group support, a key part of the original plan, has been left out
- Compliance will be complex and expensive for insurers

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➔ Heightened scrutiny
27 May 2009

➔ E&Y comments on Solvency II
12 May 2009

➔ FSA stressing 'urgency' of Solvency II compliance
7 May 2009

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