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You can improve your chances of gaining access to capacity

By Larry Harrington

Understanding how capacity is formed and influenced in the Canadian insurance market may be interesting yet it does not really help a broker gain access to the maximum amount of capacity available at any time.

Reinsurers certainly have influence over capacity due to the fact that much of our capacity purchase is dependent on the cost and availability of international reinsurance. However, the more fundamental driver of capacity in our market is company profit, measured as shareholder return. Profit is required to support the cost of reinsurance and also to support our capital requirements for net lines.

In the past, when the Canadian market has suffered from inadequate capacity, it has mainly been driven by local conditions that virtually guarantee a poor return to shareholders. Capacity restriction is often self-imposed by the primary insurers as they simply cannot afford to write exposures at a loss.

Shareholders expect an operating ratio of 95 per cent in the current investment climate to return 12 per cent to 14 per cent of equity. With inflation on casualty claims likely in excess of 12 per cent going forward, you can envision the need for future rate increases to pay for the "compensate me" litigious society that we find ourselves in.

Future capacity will likely depend on a soft landing (gradual reduction in increases to inflation level pricing) with respect to rates, as a return to the old soft market rate reductions would soon erode capacity again.

Back to the initial point -- to help gain access to whatever capacity is available, a broker needs to know insurers' appetite. Through a better understanding of appetite, you improve your own efficiency and hit ratios as well as the insurers' efficiency. You are now far more likely to approach the market with acceptable risks that will ensure the release of capacity and influence insurers to look at your quotes first.

Hopefully, insurers that can create a report that displays their appetite for risk will also have a good understanding and knowledge of their target market, thus helping to ensure future profitability and efficiency for themselves and the broker.

New paradigm

The old tactic of companies telling brokers to just "send in the submission and we will let you know if we will write it" just won't work any more, so don't accept this approach. In our case at AVIVA, we clearly define what we are keen to quote, although occupancies

themselves are only part of the issue. It's surely no surprise that company line guides, representing capacity, favour best in class and best classes.

Brokers need to meet company decision makers by visiting their markets and including producers, marketers, and executive positions. They need to assess what works in the relationship and what doesn't as well as what should producers sell, all in an effort to match up with the company appetite when possible and/or practical.

Poor loss ratios hurt more than just contingent profit. With loss ratio problems, you can experience quotes going to the bottom of the pile, as a minimum, and this is no way to gain access to capacity. Guard your results and note that companies that do not ask underwriting questions and are basically "soft touches" generally end up with wild swings in appetite as they constantly "re-underwrite" to improve the bottom line. They look good now in a firm market but wait for the possible softer market when underwriting really counts.

With the move towards automation of small business, beware of submission applications that are "easy" as they do not ask pertinent underwriting related questions. They are heading for the same outcome. Protect your underwriting profit to make sure you are held in good standing with your markets to help ensure your access to their capacity in the long term.

If your brokerage has so-called preferred status with a market, guard against over-using the relationship by continually pushing poor or inadequately priced business as it can jeopardize your bottom line and lead to capacity problems.

Gauging appetite

As mentioned, a number of factors make up capacity and appetite and it is not just occupancies. To illustrate, I will touch on a few and knowing that if you can respond to these or, better yet, realizing that a good underwriter will release capacity based on the assessment of these factors, you can provide the right information and steer away from accounts that don't fit, or at least price the account accordingly. With profit over time you can become a preferred broker, with easier access to whatever capacity your insurer(s) have available.

- ✓ Price for exposure: Broadly speaking, there are no good risks if the price is not right for the exposure and therefore no capacity. Underwriters need to know and understand the exposure in order to price the risk and release the maximum amount of capacity available.
- ✓ Quality submission: To understand and gain comfort with exposure, the underwriter requires a competent submission. This quality factor has more to do with submissions getting to the top of the pile rather than the bottom than almost any other factor (more on this later).
- ✓ Profitable classes: If the company realizes profit over time on certain classes it will likely maintain higher capacity in these areas than they would if profit was intermittent. This should influence their appetite and they should be able to articulate this appetite to you.

- ✓ Don't subsidize a poor account: Pushing price down on an account until it loses money often backfires. At times these accounts will negatively affect a broker's result with a market to a point of influencing the hoped for preferred status. As well, pricing at a loss is counterintuitive to a good underwriter with the resultant strain in relationship.
- ✓ Low appetite for "one-of" risks: Most markets are not interested in accounts that are unfamiliar and have no experience with. Capacity is released according to known exposure, results history and so forth, so finding high capacity on risks rarely encountered can be time consuming.
- ✓ Sprinkler is superior: Properly designed sprinklers tend to afford a risk results far superior to the usually allowed rate credit with respect to fire exposure. This boosts capacity.
- ✓ Non-frequency accounts with two or more claims in three years: Data clearly indicates that such accounts will severely under-perform the average book over time. This factor should influence capacity and acceptance.
- ✓ Years in business: Business failures stabilize at seven years or more in business. This should affect capacity and acceptance.
- ✓ Depression factors and capacity: Many companies take a given dollar amount for a certain occupancy and amend the capacity based on age of risk, repair, construction, protection and so forth, all affecting the capacity.
- ✓ Broker expertise: A great broker can influence capacity in a very positive way, such as with acknowledged expertise and history in a class of business. As well, good results over time coupled with mutual respect makes placing any class of business easier.

Checking out the insurer

To access the highest amount of capacity possible, you need to become significant with a given market or markets. Who should you be significant with is a good question that deserves some research on the broker's part.

You have, no doubt, run into companies that are taking a new business holiday for a couple of months, usually due to backlog. I would wonder if this is a capital issue? At the very least this indicates a market that is not easy to do business with and you should review your relationship.

Reinsurance buying power is an issue relative to capacity and ultimately a matter of whether or not the market can pay its claims in the event of a catastrophe. An insurer needs to have international capability to ensure that reinsurers stay with them in our market if results are poor here. They must be able to assess the reinsurers' ability to pay.

If we have a large catastrophe in Canada, we need to have relationships with reinsurers who can pay and the capital to handle any net commitments. You may wish to visit your

insurer's CFO to see firsthand how this is managed (it must be stringent) and most certainly you should be welcomed as you are the customer that sells the company paper.

There are some other questions to be asked of insurers. Do they provide an efficient way of doing business -- do they tell you their appetite? At Aviva, we exclude (do not wish to consider quoting) fewer than 5 per cent of the classes of risk available in Canada on a premium basis, according to Insurance Bureau of Canada statistics. A defined appetite is one thing, but how broad is it?

If not a specialty market, is there a low expense ratio so they can compete over time? Do they provide innovative products that give you something else to sell other than price alone? Is there a clear and well-defined strategy that is articulated to you and shared? Does it make sense to you? Are they consistent? Do they have in-house capability? What is the state of their financial strength and stability?

Submissions

A quality submission is critical if you expect your quotes to receive adequate attention. From a generic point of view, the following information should be considered in the design of a submission. Note that a simple risk such as a variety store would not need all of this detail.

- ✓ Name of the insured (if multiple, a description of each is required) and what the company does. This should include the addresses of all locations and years in business; if the company has fewer than seven years in business, prior experience of the insured helps. As well, the names and work experience of the principles should be listed.
- ✓ Full description of all operations and/or products.
- ✓ Sales or receipts broken down between products, operations or subsidiaries. Sales outside Canada need to be shown separately by country and separated out the same way.
- ✓ Five years claim history, updated to the present day, showing all up-to-date payments, split between expenses and indemnity. Location of loss should be included, especially if outside Canada.
- ✓ Risk management information, such as a description of what the insured does to prevent losses, maintenance and incident logs, disaster recovery plans and quality control procedures. One of the key drivers of the loss ratio is slip and fall claims. If you have access to Aviva's slip and fall risk management package, see that clients adopt it.
- ✓ An assessment of the expected down time in the event of a loss. Is any equipment hard to replace? Note any suppliers or customers that the insured is highly dependent on.

- ✓ Full construction and occupancy details of all locations and the physical protection installed, such as sprinklers and alarms.
- ✓ Discontinued products or operations and descriptions.
- ✓ Pictures assist in the evaluation of a risk.
- ✓ If the insured is a contractor; provide sample list of jobs in the last 12 months, and any coming up in the next year, including description, contract size and any work subbed out. List equipment, with age and values.
- ✓ Avoid coverage “wish lists.” Seek coverages that you really want or need. If you’re requesting something that is not typically included in a standard package, explain why it is required and what exposure it is intended to cover.

Developing and nurturing a professional, two-way, active partnership is crucial and is ultimately a key component to being able to access all the capacity possible. Keep in mind this formula: We are seeking better ways; we are professional; we solve problems; we are self-assured; we want to work with you; we can bring something to this partnership.

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