

What Drives the Insurance Pricing Cycle?

There are several contributing factors to insurance premium fluctuations, but there are a few which really drive the insurance cycle from what economists consider, hard to soft and back again. The soft market is an insurance environment in which coverage is easily obtained, prices are lower and underwriters are actively competing for business. The hard market is exactly the opposite as companies become more risk/price conscious and only actively target low risk business. The following factors have the greatest impact on the cyclical nature of insurance:

Reinsurance

The traditional insurance companies heard about in the open market such as, Dominion of Canada, Economical, ING, etc. purchase reinsurance coverage. We are often asked when explaining price increases, how a mudslide in Mexico or a forest fire in California has any impact on our pricing here in Ontario. Any worldwide disaster affects everyone, regardless of where it has occurred. Reinsurance companies, like anyone in business, exist to earn a positive return for its shareholders. When one of these disasters occurs it depletes the earning capacity and the claims reserves for all parties involved. Reinsurance companies charge the traditional companies premiums no different than the consumer pays. When reinsurance rates are increased, it is eventually passed on to the consumer, in the form of premium increases.

Underwriting Results & Investments

Insurance companies like re-insurers, are responsible to its shareholders, and as such are committed to return profitable results. When claims costs along with administrative expenses starts to approach 100% of premiums paid by the consumer, companies rely on a strong investment portfolio to offset the underwriting losses. Insurance companies have, in strong economic times, operated at a loss without moving the cycle into hard status, because of their investment strength. Conversely, they can operate in weak investment markets when their underwriting results are positive.

Recently the industry has been void of any catastrophic worldwide event which would inevitably put pressure on the reinsurance companies capacities, however the other two factors do exist. Insurers are reporting year end 2008 losses and the investment markets are experiencing historical declines. When an insurance companies investment portfolios can not offset their underwriting losses, the industry has no alternative but to increase premiums.

In the current economic environment, where credit markets are essentially frozen, capital to create new insurance and reinsurance capacity may be in short supply. And while the global recession may delay the onset of the hard market by keeping insurance demand down, once that market sets in, it's likely to last longer than normal. As the hard market settles in, not every line of business will increase in price at the same pace.

If you wish to discuss or have any unanswered questions please feel free to give our office a call. As your insurance broker we have aligned ourselves with historically strong partners and would consider it a pleasure to assist you with understanding and surviving the next hard market.