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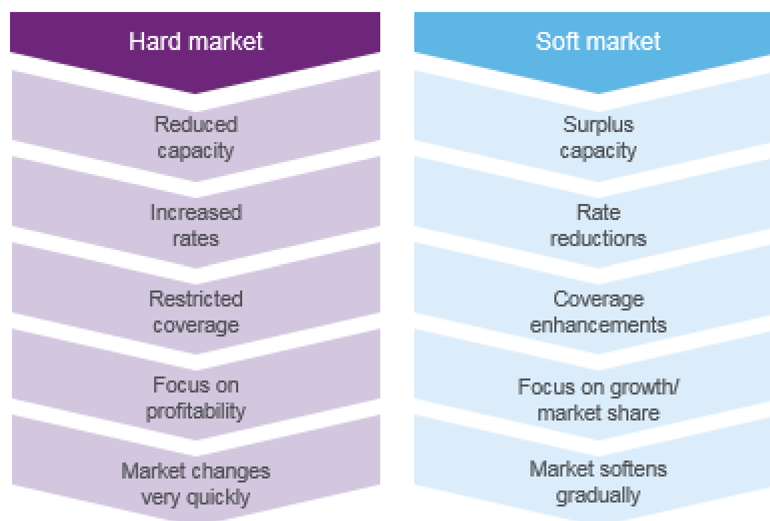
Most of you by now have likely been shocked at the sudden change in the insurance market. The intent of this article is not to justify this drastic change, but rather, to explain the insurance market cycle, and more importantly, provide some simple strategies to ensure you achieve the most competitive terms available.

In the insurance world, we speak in terms of "hard markets" and "soft markets", which can be characterized by the following differences:



We are currently in the midst of a hard market, which is why you're seeing large premium increases, a lack of alternative options, and reduced coverage. In a soft market, you likely experienced the opposite; premium reductions, lots of options to chose from, broad policy wordings, and so on.

Simply speaking, the insurance market is driven by profitability. The market changed quickly around July/August 2019, and continued to harden throughout 2020. Until then, the market was considered to be "soft" and had been so since around 2008. Through the soft market cycle, insurers would reduce rates year after year. Policy wordings became broader each year, meaning that as premiums are reducing, more and more claims are being covered. Eventually, it hits a tipping point and insurers can no longer sustain a continued lack of profitability.

There is a common misconception that insurers make millions/billions in profits. In reality, it is often not the case. Insurance profitability is measured by a formula called a "combined ratio". This is a simple calculation where all of the insurers annual expenses (claims, salaries, operating costs, etc) are divided in to their annual revenue, to generate a percentage number. A number less than 100% means the insurer made a profit, and more than 100% means they made a loss.

For the last 5 years, the Canadian insurance market has operated at an average combined ratio of 98% (slightly better than the UK and US at 99% and 100% respectively). Historically, insurers could sustain

such small profit margins, or even operate at an underwriting loss, as interest rates were much higher and the financial/stock markets offered a more predictable return. Those days are over; interest rates are at all time low levels, and insurers need to refocus their efforts on underwriting profit.

Right now, the entire industry is going through a significant correction, whereby we see insurers execute various strategies to return to profitability. Some of these strategies include;

- Rate and deductible increases
- Insurance coverage restrictions
- Restrictions in capacity (i.e. the size of insurance limits they are prepared to offer)
- Much tighter underwriting controls
- Exit certain industry classes completely
- Restrict/remove an underwriters authority

As mentioned already, this is an inherent feature of the insurance market cycle, but hard market conditions place considerable stress on clients who haven't experienced it before and/or cannot budget for the sudden change.

Whilst almost all clients will be impacted by the change, there is a broad spectrum of different experiences. For clients with a good claims history, in desirable industry classes, premiums might be impacted by as little as 20%. At the other end of the spectrum however, it is likely that clients are seeing their premiums double/triple/quadruple… or even more. This is especially true for clients with a poor claims experience, and even more so for clients with poor claims in certain undesirable industry classes (for example, residential real estate is an extremely difficult class of business right now).

Fortunately, there are some basic strategies that can be implemented to make sure that you're able to secure the most competitive terms and conditions from the insurance market, and these can be broken down in to:

Time

In a hard market, almost all clients ask their broker to obtain alternative quotations. The knock on effect is that underwriters get overwhelmed with quotation requests; in some cases, they might have 4 or 5 times more submissions on their desk than at the same time twelve months ago. We need to plan for this to make sure that underwriters have time to consider the submission.

Further to this, underwriters lose much of their underwriting authority, which means they are required to seek approvals from head office (this could be Canada, US, London, Europe, Asia, etc). Significantly more information is required before underwriters secure approval to issue a quotation, which adds even more time in to the process.

On top of that, limits are generally reduced, which means brokers need more time to secure additional limits.

Overall, it is a much more time consuming process. The more time your broker has, the better the underwriter can understand your business. But also, the more time your broker has to negotiate and find alternative options. Underwriters are routinely rejecting quotation requests if they do not feel there is sufficient time to work through the approval process.

At a minimum, my suggestion would be to start speaking to your insurance broker 120 days before renewal date. Be sure to understand your claims experience, your loss ratios (a measure of how profitable your account is to an insurer), and get a realistic expectation of the upcoming renewal negotiation.

Information

The importance of "information" cannot be overstated enough. The better an underwriter understands your business, the more likely it is that you'll have better terms. You have built a viable business; be proud of it, and don't be afraid to "show off" the positive features that demonstrate to insurers that yours is an attractive opportunity.

Your insurance broker can provide more specific guidance based on your business, but some important items would include;

- What are your budgets? Can you afford to take an increased deductible to offset a premium increase?
- Claims experience. Underwriters really need to understand why you've had claims, but as importantly, what you have done to avoid future recurrences? Underwriters need confidence that they can make a profit, so demonstrating that lessons have been learned is a vital piece of information
- Risk management. What process and procedures do you have in force to help avoid accidents, injuries, etc? Again, your insurance broker can provide more specific guidance, but things to consider include;
  - Hot works permits
  - Employee training
  - Physical security protections
  - Risk assessments
  - Quality control / inspections
- Operations. What do you do? How is your revenue generated, and how is that divided between different industry sub-classes? E.g. a contractor may have 30% of their revenue from plumbing, 40% electrical, 30% mechanical.
- Do you have sub-trades, and if so, what liability limits do you require them to carry

Hard markets generally don't last very long; 2-3 years is normal, before it plateaus, and then begins to soften again. For many businesses, this may be their first experience with a hard market, but rest assured, it will pass. By following the simple advice above, it is possible to avoid the worst of it, but if you have any doubts or questions, please contact your insurance broker in the first instance.