Excess Capacity Could Push Down U.S. Property Rates

By Jim Rubel, Executive Vice President, Lockton Companies

Many U.S. insurance buyers found that property rates remained flat for accounts renewing in January and February 2007, despite industry predictions that post-Katrina rate increases would continue into the first quarter of this year.

Of course there may have been exceptions to the rule: some accounts experienced price increases if they had losses in fiscal year 2006 or they were located in catastrophe-prone areas. But even those accounts that had rate increases found they were not as high as been expected for business renewing during the first two months of 2007.

Available capacity levels also reflect a changing marketplace. Early last year, it was very difficult to obtain as much as $100 million of capacity for a catastrophic risk. On the other hand, $150 million-$250 million now can be obtained relatively easily—even for accounts with Tier 1 wind exposures and catastrophic earthquake exposures.

Capacity continues to enter marketplace

The coming months may see some additional downward pressure placed on rates as a result of the influx of insurance and reinsurance capital into Bermuda as well as Lloyd's of London.

In addition, the recent decision by Florida lawmakers to bolster the size of the state catastrophe fund may put further pressure on rates, as traditional reinsurers are forced to deploy their capacity elsewhere. Other states are considering similar moves in order to mitigate the premium increases passed onto policyholders. As a result, even more capacity could be looking for a home.

However, there are additional dynamics at work in the insurance marketplace, which could slow the downward pressure on U.S. property rates:

- Modeling recalibrations. Modeling companies, such as RMS, have recalibrated their wind and earthquake assessments. This has dramatically altered many clients' PML (probable maximum loss) expectancies for both wind and earthquake-exposed areas. The updated models in many cases have increased the projected losses by as much as two to three fold. (It is possible to reduce the negative impact of the new modeling system on PML results if clients are able to provide information on certain secondary factors, such as building construction, which would help a property withstand the impact of wind and earthquake damage.)
- Rating agency recalibrations. Rating agencies, such as A.M. Best, have tightened up their financial requirements for the surplus supporting U.S. catastrophe exposures.

These modeling and rating agency changes have caused insurers and reinsurers to re-think their aggregate exposures in catastrophe-exposed areas and are forcing a more conservative calculation of the capital supporting those exposures. These business realities could dampen the desire to make dramatic premium reductions during the coming year.

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Lockton's client strategy during a volatile year

Without question, 2007 will be another volatile year for the U.S. insurance marketplace. That volatility could manifest itself in rate increases, or, potentially, rate decreases.

But, whether the market is hard or soft, Lockton always aims to reassess each client's appetite for risk and risk transfer in order to obtain the best renewal results. At Lockton, one size does not fit all; each account is evaluated on its own merits. This is why we place such high value on pre-renewal meetings and strategies, which are critical approaches to any client—regardless of the volatility of the marketplace.

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