ALLIED WORLD

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SECOND OPINION

SMALL DOSES OF HEALTHCARE INSIGHT

Navigating Difficult Conversations during Shifting Cycles

Given the frequency and severity of catastrophic events in 2017 (and the impact these events had on the bottom line of insurers), the industry needs to engage in the uncomfortable and unpopular conversations regarding the shifting cycle. The insurance industry's unique market cycles last just long enough –10+ years by my estimation – that key people involved (buyers, brokers, and underwriters) have likely moved on from the day-to-day transactional debate of insurance program designs. This creates a new generation of professionals to navigate unfamiliar waters related to coverage, structure, capacity, etc. Without perspective to negotiate conversations in a balanced manner, this void of experience leaves the industry vulnerable to repeating the same awkward process and failed measures of the past.

A More Recent Historical Reference Point

While market cycles and individual transaction debates have existed since shipping days, we need only look to the late 1980s and 1990s as a cautionary example. During this time, our industry experienced 12 years of consistent rate reduction and increasing combined ratios masked by investment returns. This environment established a false expectation that rates would remain low. The marketplace experienced rate decreases throughout the 1990s despite introducing expanded coverage (e.g., built-in extended reporting periods, batch language, and more broadly within professional liability, antitrust coverage, employment practices, regulatory coverages, etc.).

In 2001 the narrative began to change slowly with increasing shareholder lawsuits related to the dotcom fall/laddering claims and then more quickly with the events of September 11th. Investment income evaporated and carriers could no longer justify the offset against underwriting profitability. This was further compounded in the Healthcare sector when St. Paul announced they were exiting the medical malpractice space a few months later.

At the time, St. Paul was the nation's fourth-largest business insurer.[1] Then CEO, Jay Fishman, was quoted, "Staying in the malpractice business would threaten the solvency of the company."[2] Even with an average increase of 24% in their malpractice book, St. Paul could not garner enough support from brokers and insureds to stay in the business. They decided it was better to vacate their positions on 750 hospitals, 42,000 physicians, and over 70,000 other health care workers — not to mention $500 million in annual premiums.

Other carriers seized on the moment to drive the corrections needed in their own portfolios without exception. Brokers and insureds reacted by speaking to their individual risk profile compared to the market, not wanting to accept their contribution to rate reduction over the prior decade-long decline. The opportunity to have an evidence-based discussion on program design was lost and the surge began. Brokers and insureds could only find ways to soften the premium blow by accepting radically different program structures. Underwriters were indifferent to the uniqueness of individual risks because their requests had been neglected for too long.

Sound familiar? I believe we are currently facing a similar environment to the one that existed before 2001 – one in which there is an established pattern of broadening coverage, unsustainable program structures combined with a reduction in insured population and increasing severity. The P&C industry experienced mounting reserves and cat events in hurricanes, earthquakes and fires in 2017. **We can wait for the next game changing event to dramatically impact our industry and clients – or we can acknowledge that we are in a cycle in the market that is no longer sustainable. If we work to fairly evaluate risk now, we may be able prevent a dramatic shift down the road.**

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What We HAVEN'T Been Talking About In The Healthcare Arena

- Healthcare consolidation since 2012 has left the industry with fewer buyers in the market
- Diminished buying population has been compounded by physician exposures incorporated into coverage without adequate structure changes
- No less than 14 new carrier entrants since 2002 (including PIAA moving into hospital business following the physicians)
- Increase in batch claims and cat losses
- Complex claims increasing defense costs
- As services transfer from the hospital setting to clinics and surgery centers, the liability has followed, essentially increasing the claim frequency in these emerging classes

Framing the conversation

Reasonable parties working through adverse loss development, rapid exposure growth or a combination of both are usually able to negotiate without issues. This merit-based discussion routinely happens. The impact to the overall insurance industry from 2017's devastating results highlight the need for dialogue about sustainability across all segments of the business. And that dialogue has to start now.

So how do we avoid fumbling through the discussion and effectively outline why divergent paths need to find a more sustainable trajectory for individual risks or portfolios? In my opinion, we need to do the following:

RESEARCH & LISTEN:

- **Underwriters** – not every account fits squarely in a box. Your broker relationships are individual by nature, so too should be your approach. Provide a full picture of the industry, product line, product line sector and individual insured experience, including historical premium to exposure, loss experience and attachment point changes. Where you can, overlay industry trends. Then, listen closely because there is a valid counter to your argument.
- **Brokers** – don't ignore what is being communicated. Denying the reality of our current environment doesn't make it go away. Know your client, sector, and product line experience. Focus should not be on what you can get done in the market... everyone knows you can get it done elsewhere. Instead, tap into the low hum of change that is being presented.
- **Insureds** – insurance relies on a pooling of risk. Although we recognize unique aspects to each account, an individual risk cannot avoid a tidal change. A well-run organization, however, can always contribute to the conversation in coordination with their brokers. Insureds can influence program results by accurately tracking their exposures, loss experience and having a meaningful discussion about their business and their risk.

DO YOUR HOMEWORK:

- **Underwriters** – if you haven't taken the time and don't come prepared to the conversation, don't plan on being taken seriously. If you only speak of the industry or your company's results you will be reminded that you were begging for new business last year and this particular risk doesn't fit that experience.
- **Brokers** – driving the point that claims happen and that is why insureds buy insurance does not change the realities of the discussion. Ask questions about how this individual risk fits into the insurer's portfolio and understand their place in the realm of things. Again, the end goal is sustainability.

CRITICAL ANALYSIS IS NEEDED:

We are inundated daily with articles discussing financial results due to recent events, how this is impacting carriers, and what future events could be on the horizon. Take the opportunity to gather as much relevant information as possible and analyze it. Look for charts, graphs, etc., that can help frame the story (this goes for both underwriters and brokers). Talk with your peers about typical claim size, frequency, etc. Utilize data and information from multiple sources to develop overall findings. Listen to carrier and broker earnings calls.

Begin the Conversation

We can't ignore this next phase of the market cycle – discussion is unavoidable. While we cannot control industry cycles, we can do a much better job of transitioning between them. No one should expect to resolve the issue after one discussion. Rather, this is a building process where trust and the mutual interests of insureds need to be cultivated and nurtured.

By listening, comparing industry experience, and sharing stories without pre-judgement or expectation, we will be able to navigate through this cycle of change.

[1] The New Times, Dec 13, 2001, "St. Paul Cos. Exits Medical Malpractice Insurance"
[2] ibid

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QUESTIONS?
Contact your local Allied World Underwriter.