Riding Out the Hard Insurance Market

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What Your Nonprofit Can Do to Survive and Thrive in Deteriorating Market Conditions

Across the country nonprofit managers are expressing dismay and frustration about deteriorating insurance market conditions. Having enjoyed a long period of “soft” market conditions, where insurers were competing to underwrite nonprofit accounts, a “seller’s” market can be a rude awakening. The “hard” market brings organizations face-to-face with nonrenewals, escalating premiums and increasingly restrictive coverage. Those of you who’ve never experienced this part of the market cycle need to know that you can keep on pedaling, but you need to shift gears.

The purpose of this article is threefold: 1) to offer the perspective of the Nonprofit Risk Management Center on the hard insurance market, 2) to suggest steps that every nonprofit should consider in order to weather the current hard market cycle, and 3) to help readers feel a little more comfortable and less ill at ease when they hear news of the changes occurring in the insurance industry.

Wheel of Misfortune

Like the wheel of chance on a popular television game show, the insurance market is always in a state of flux. We have just emerged from the longest soft market cycle in recent history, a period in which premiums were low and insurance companies actively competed for your business. Arguably, nowhere have the effects of the soft market been more evident than in the nonprofit sector. In the early 1980s, nonprofits were relatively modest consumers of insurance products. Some purchased common coverages — property, general liability (GL), directors’ and officers’ liability (D&O) and employment practices liability. Many went about the process in isolation, rarely relying on organized programs developed specifically by and for groups of nonprofits. Very few took advantage of opportunities to gain control over their insurance destinies by forming self-managed alternatives such as sponsored insurance programs, pools and captive insurers.

The late 1980s were a wake-up call for consumers of commercial insurance, including nonprofits. True to the characteristics of a hard market, some companies decided to exit certain lines of business or geographical areas, or offer drastically reduced limits of liability, unprecedented restrictions, or sublimits for certain coverages. Others simply raised premiums by large sums, from 50 percent to several hundred percent.

Stunned nonprofit consumers were left deciding between paying a larger-than-budgeted premium, going without coverage (“going bare”), or settling for vastly reduced coverage at the renewal rate. And these were the lucky ones. Some organizations were “non-renewed” and found it impossible to obtain coverage elsewhere.

From this difficult environment arose a new commitment to avoid being at the mercy of the insurance marketplace. Associations and umbrella groups began developing creative responses to control their insurance destinies. Interest in preventing losses, minimizing liability and controlling premiums began to take hold.

By the time the black cloud cover dissipated and the situation began improving in the early 1990s, many nonprofits had taken steps to protect themselves from future market fluctuations. Others were simply relieved to have or be able to afford coverage once again.

What’s a Hard Market?

“Hard market” refers to the overall state of the insurance marketplace, or the condition of a particular segment of it. It is a “seller’s” market. For example, there might be a hard market or hard market conditions with respect to commercial insurance in general, or with regard to a specific line of coverage, such as workers’ compensation or directors’ and officers’ liability. Signs that a consumer is facing a hard market include:

- *Premium increases may be unrelated to loss experience*. During a hard market cycle an insured with an enviable loss ratio (total incurred losses divided by total premium paid) may face steep increases in annual premiums, reflecting the insurer’s need to generate revenue to compensate for losses and poor investment outcomes. In recent weeks we have heard about carriers imposing minimum increases of 30 percent on all accounts, as well as increases of greater than 100 percent for nonprofit accounts with favorable loss experience.
- *Carrier movement may be unpredictable.* During a hard market, it’s not unusual to see carriers pack up and leave certain geographical areas, or decide not to offer certain lines of coverage (e.g., medical malpractice) or not to insure certain classes of insureds (e.g., day care centers). In some cases companies will disappear altogether after suffering devastating losses. Medical malpractice coverage is a segment of the industry facing turmoil at this time. One major force in that field for at least 25 years pulled out of the market in mid-December. Two other carriers have gone bankrupt, another is in receivership and two more have lost their reinsurance. Only a handful of companies remain to meet the needs of nonprofits with a medical malpractice exposure.
- New coverage restrictions, exclusions or requirements may apply. Customers facing hard market conditions may find that coverages that were readily accessible in prior years are only available under highly restrictive terms, or not at all. Or certain conditions may be imposed on buyers before a carrier will agree to write a policy.

The events of September 11, 2001, greatly exacerbated the hard market, which was only in its formative stage at the time. The current hard market is particularly driven by the demands of reinsurers — all of whom faced enormous losses stemming from the terrorist attacks and are charging the insurance companies they insure higher rates. Because more than 50 percent of reinsurance contracts expired on January 1, 2002, these rates and terms were negotiated during the tumultuous time following September 11th and during the early stages of the U.S. military campaign in Afghanistan.

What’s a Soft Market?

Perhaps the easiest way to define a soft market is to describe some of the common characteristics that suggest it’s a “buyer’s” or “soft” market. For example:

- *Insurance is relatively affordable*. But, you say, insurance costs too much. Always has, always will. But if you’re facing single digit annual premium increases or relatively stable premiums despite some losses, you’re probably benefiting from soft market conditions.
- *You can buy coverage for just about anything*. During a soft market insurers work hard to compete for your business. In doing so, they spend time trying to offer coverage they can tout as “better” or improved from that available from a competitor. An insurer might add some additional coverages to a policy as a way to distinguish its product from the crowd. For example, during the late 1990s a number of D&O carriers began adding coverage for spouses of current, former and future board members to their D&O policies. In many cases these add-ons have little or no effect on the annual premium. They are offered as a way for an insurer to add checkmarks to the column touting policy benefits — allowing easy contrast

with the competitor's policy, whose summary contains fewer checkmarks. Not surprisingly, some of these additional coverages reflect remote areas of risk.
- *There's competition in the air.* During a soft market a nonprofit consumer may be in the enviable position of having two or more insurance companies interested in writing the organization's account. So the consumer (through its broker or agent) is able to say to Company A, "We're thinking about going with Company B because their policy doesn't include a sublimit for employment practices." Company A might agree to match Company B's terms in order to retain the account.
- *Innovation grows on trees.* During a soft market insurers may be inspired to identify coverage needs and design new lines of coverage or insurance products to meet those needs. Innovative insurance solutions may result, including some that address key areas of exposure. Or carriers may be willing to extend the breadth of coverage by deleting exclusions that are common during hard market conditions, such as the sexual abuse exclusion, communicable disease exclusion, or athletic participation exclusion. Finally, a variety of "add-ons" may be offered, such as automatically covering funding sources as additional insureds, adding employees and volunteers as insureds on the nonowned auto policy, including mental anguish in the definition of bodily injury, or automatically including additional property coverages such as money & securities, electronic data processing (EDP), business income, property of others, property in transit, and backup of sewers. These property coverages can come in handy depending upon the claim. Also, during a soft market carriers may be willing to write liability coverage on occurrence rather than claims-made forms for certain difficult classes of business.

Up the Odds in Your Favor

In the world of commercial insurance, there is little that any single consumer, or group of nonprofit insurance buyers can do to change the ebb and flow of the insurance market cycle or increase or slow down the speed at which the cycle progresses. But there are a number of practical steps you can take that will improve the odds your nonprofit will survive the current cycle relatively unscathed and ready to take advantage of soft market conditions. These measures don't need to consume vast resources in your organization. And like other risk management strategies, they can fortify your organization for an uncertain future.

We describe some of these steps in the paragraphs below.

- *Understand your coverage.* There is no time like the present to understand the scope of your insurance program. Are the risks you're most concerned about insured under your current coverages? Are you aware of the areas where you have an exposure but no coverage? Understanding your program requires taking time to read your policies. We guarantee that reviewing your policy wording won't be anything like reading the latest *Harry Potter* novel from J.K. Rowling, but you may discover some vitally important information, such as key policy conditions that you have overlooked, exclusions or endorsements that conflict with what you thought you were buying, or an error on your declarations page that needs to be corrected.
- *Identify a competent insurance professional and team up for best results*. It's never been more important to have a competent insurance professional advising your organization. Throughout the year we hear complaints from workshop attendees or technical assistance callers who bemoan the lack of responsiveness or professionalism in their insurance agent or broker. And we often hear that "my agent doesn't understand what we do." Make it a top priority to find an agent or broker who is willing to learn about your organization and who demonstrates that he or she is an effective advocate for your insurance interests. There are two times when the mettle of an agent or broker is tested: during the purchasing process and following the filing of a claim. If your agent's performance during the buying or renewal process has been less than stellar, then you may be in trouble if you wind up in a fight with your insurer about whether your claim is covered. Regard your insurance professional as a partner with whom you work for the benefit of your nonprofit. Like the consultant you hire to improve any aspect of your operations, an insurance professional should be a trusted source for information and eager to understand your nonprofit's unique circumstances and needs.
- *Find out if you're protected.* Most states have laws that require insurers to give commercial policyholders advance notice of nonrenewal or a change in coverage terms. Companies may also issue what is called an "alternative notice," which indicates the company's intent to either nonrenew or renew the coverage conditioned on a change in terms, conditions or rates. A second notice must be sent indicating the company's final decision. The notice period varies based on state law and may differ based on policy type. For example, New York policyholders are entitled to 60 days' notice, while in New Jersey 30 days' notice of nonrenewal or change in contract terms is required. In Connecticut 60 days' notice is required for nonrenewal of most commercial coverages, although 90 days' notice is required for professional

liability policies. One agent based in New Jersey reports that he was recently able to obtain a policy renewal for a nonprofit client due to an insurer's failure to give timely notice.

- *Keep up with the Jones's*. One of the best sources for information about insurance is your existing network of nonprofit professionals. Where do similar nonprofits in your community or in your national federation or umbrella organization go for coverage? What are they hearing about the movement of carriers in and out of your particular area? While speaking to members of your professional network about these issues, you may glean some valuable insurance insights. For example, you may learn about an effort to band together to create a new insurance program for nonprofits with common exposures, or about the decision of an insurance pool to expand to new states or new client categories.
- *Know your insurance company*. Obtain an agreement in writing with your insurance agent or broker that he or she will, not *may*, inform you, again in writing, within 48 hours of any change in the ratings for your insurance companies, such as the ratings issued by A.M. Best & Co., Standard & Poor's, or Moody's. Your insurance companies are like banks: they hold your funds in anticipation of future payment under specific contingencies. You should be as careful about their financial security as you are with a bank or mutual fund.
- *Take risk management to heart*. Many of the risk management strategies suitable for your nonprofit cost little to nothing to implement. There's no time like the present to address nagging concerns, the fears that keep you up at night, or losses that have occurred on more than one occasion or for which the total loss was substantial. Don't wait to thoroughly examine what happened and why in your effort to prevent a loss from recurring. And engage a group of creative people in both your risk identification and strategy development processes. Never limit the discussion to senior managers — it's critically important to involve those who understand your nonprofit's operations. For example, if you own a building, the individual responsible for maintenance could be a critical member of your risk management committee. If you rely principally on volunteer resources, your director of volunteers, as well as a longtime volunteer, should be tapped to help with the process. If parental participation in your nonprofit is key, invite a parent to participate on the risk management task force.
- *Budget wisely*. Insurance advisors are responding to clients who demand, "How much more should we expect to pay at renewal?" by offering specific percentage increases. In a week's time, we've read one article advising consumers to expect "20-40%" increases and another predicting "10% to 30%" pricing bumps for the same line of coverage. We have also heard directly from nonprofits that are facing 100% or greater increases in annual premium and, in some cases, nonrenewal of long-standing policies. At the other extreme, we know nonprofits that have policies that renewed in October 2001 and later at the prior year's premium.

In all likelihood, even though you may be planning to stay with your current carrier and not add new coverages, your insurance costs will be higher in 2002 than 2001. That assumes you don't face cancellation or nonrenewal. Unless you're planning to eliminate certain lines of coverage from your insurance program, you should figure that the amount you pay for insurance in 2002 will increase and budget accordingly.

The best way to predict the amount of the increase is to ask your insurance professional what he or she is seeing with respect to similar nonprofit accounts for the same carrier. A second strategy is to discuss this issue with colleagues in your nonprofit's line of business (e.g. day care, drug rehabilitation, recreation, etc.). Finally, make certain that you budget for losses that fall under your deductibles or outside the scope of coverage you buy. Consider setting higher deductibles if you can to reduce premium increases. Then, to cover the increased deductibles you might have to pay, set up or adjust reserves, making certain that your board approves these reserve funds.

While it's impossible to know how long the current phase of the cycle and the difficult conditions facing nearly all nonprofits will remain, we know that the wheel will turn and the opportunities of a soft market will return. No organization can afford to simply "wait out" the cycle. Despite the difficulty of sustaining an affordable insurance program for your nonprofit, it's possible and advisable to take steps now that will protect your organization for the long-term.

Questions about any of the topics covered in this article or about insurance topics generally may be addressed to the author, Melanie Herman, at (202) 785-3891 or via e-mail.

The Nonprofit Risk Management Center offers an easy way to pose your risk management questions to our staff experts. See the "Advice" section of www.https://nonprofitrisk.org/ for details.

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