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A Multiplicity of Market Theories



The ongoing soft market's impact on the alternative and E&S markets.



By DAN REYNOLDS, senior editor of Risk and Insurance®

When it comes to gauging insurance markets, the questions of when they'll turn, how hard they'll turn and why they will turn produce numerous theories.

Some say time is a factor. These days people in [excess-and-surplus insurance](#) and primary property/casualty are talking about the effect of capacity. Suffice to say, with this soft market in primary property/casualty that seems to be running on and on, there will be authors of theories and there will be people who will find those theories downright irritating, maybe even a little amusing.

"I think any of us who have tried to predict the market turn have learned to stop doing it," said Bill [Selman](#) , a vice president with the Philadelphia-based retail commercial broker [the Graham Co.](#)

"Our fear is that, the longer it takes to turn, the more severe the turn could possibly be,"  [Selman](#)  said.

"We're worried that, when you see renewal reductions year after year, that sooner or later we're going to find out that somebody doesn't have the right reserving practices or whatever it took to justify rates as low as they have gone," said  [Selman](#) .

One industry veteran said time alone is certainly not a factor.

"I find it almost amusing at times that as we go through market cycles people always come up with anecdotal ways of describing what's going to happen and how it's going to happen," said Bill Whitehead, a 30-year industry veteran and a Boston-based vice president with the [Lexington Insurance Co.](#)



"One theory of the cycle is time-related: i.e., the longer this cycle goes, the more severe it will be. I do not understand what the connection of timing has to do with it. I would be more interested in the underpinnings. If you are burning through capital and surplus for a longer period of time and you have limited or no access to new capital, then I suppose you could make an argument that when a turn comes, it's going to be more severe," said Whitehead.

TAKE ME TO YOUR LEADER

Another theory that's been running around these past few months is that we have lost our market leader. That with the troubles that have afflicted [AIG](#) there is no carrier dominant or strong enough to turn the market.

"It is my belief that when AIG was the dominant player in the market, they amplified trends, both to the upside and to the downside," said David Cash, chief underwriting officer of specialty lines insurer and reinsurer [Endurance Specialty Holdings Ltd.](#)

"That said, AIG was never powerful enough that they were able to unilaterally impose price increases on the market. In general, soft markets are caused by carriers responding to each other's underwriting decisions, while a hard market occurs when carriers recognize an external threat. Much like a herd of animals following each other across the plains, it is only when a lion jumps out that the herd starts to move in a different direction," said Cash.

"What the market lacks is leadership," said  [Selman](#) . "Years ago, one or two of the major carriers would move, and everybody would follow."

"AIG was a market leader in size. If you look at their writing to the overall industry, they still don't dominate any segment. So I don't follow that theory close," said Doug Bellard, a vice president of underwriting for [CNA Health](#) who

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alone," said Dave Ballard, a vice president of underwriting for [CNA reampro](#) who also oversees CNA's captive governance.

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E&S COMPETITION

One thing that is known about this turn of the cycle is that the excess-and-surplus lines are a scary place to be right now for pure E&S carriers.

Not only are E&S carriers competing fiercely with each other in the shoals and washes of their respective barrier reefs, but they are seeing bigger fish with larger appetites making their way in from the deeper parts of the ocean.

"Historically, as the market gets softer, we see large standard-lines writers encroaching further and further into the E&S marketplace, and that extra capital puts pressure on prices," said Endurance's Cash.

"And what you have now, whether it is AIG or whether it is Zurich or whether it is an established player, most of these guys will follow the market down," said Cash.

"There is a prevailing view by many in the wholesale markets or the syndicated risk markets, that if you pull back too abruptly from the market, you may incur a cost with your clients--this concern tends to cause soft markets to persist longer than one would expect or hope for," said Cash.

Meaning also that others will happily step in at a cheaper price if you decide the business is coming at too low a price for you. In late October's third-quarter earnings calls, the CEOs of the larger carriers were talking about that a lot.

"It doesn't take a genius to start the downward spiral," said Lexington's Whitehead.

He added, however, that unlike the personal lines market, there is no one carrier that has the power to move the market up.

"It takes huge amounts of market share to try to move the pricing upward. Demonstrating leadership and responsibility in pricing is not necessarily the equivalent of market share and the ability to drive all the pricing on a market-share basis. Some people are willing to lead while others follow, and that is in the eye of the beholder."

ALTERNATIVES

For their part, [captive insurance markets](#) are always growing, albeit growing slower these days due to the soft markets. That doesn't mean that risk managers and other executives aren't learning all they can for that eventuality when the market does turn.

"We have a chart that we put into every one of our captive presentations that shows the formation of captives going back 20 years, and it is interesting that the captive market always grows," said Graham's [Selman](#).

As each year passes, [Selman](#) said, risk managers and other executives get more and more educated about captives. During soft markets like we have now they're studying them and waiting to make a move when the market shifts.

"For the smart business owner, they know that there is no magic potion out there. If their claims are bad, their contracts are poor or if their risk management techniques are weak, it doesn't matter what sort of risk transfer techniques they use, they're going to have problems," [Selman](#) said.

"The people who have been in it for a while and who really get it usually gain a sense of consistency and control if they are large enough that this makes economic sense for them," said Lexington's Whitehead.

"They find it to be extremely beneficial to the financial results of the organization, and they generally stay there. The purchase of insurance then comes on in excess layers to protect the rest of the financial capacity of their enterprise," Whitehead said.

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