THE CURRENT GENERAL INSURANCE MARKET
A SURVEY

Mr. Alan Watson*

This paper emanates from a research project entitled "A Critical Analysis and Investigation of General Business Insurers' Performance 1970-1984". The project results have been revised to include figures from 1985 to 1992.

The project results **(Appendix 1)** are based on an analysis of 10 major composite insurers' general business annual reports and accounts. Performance indicators such as premium, claims, commission, expenses, investment and income were examined. The results were expressed nominally, then deflated to 1970 figures, then expressed as an index. The performance indicators were examined in relation to external economic factors such as inflation rates and short term interest rates for the review period.

Before examining the topic in detail, let us consider a view of the insurance industry's bottom line, the underwriting result.

"The business of general insurance depends fundamentally upon underwriting operations, and it is with underwriting factors that basic general insurance statistics must be principally concerned; in a statistical context, interest earnings from general insurance investments must be regarded as having only a secondary function. This is not to belittle the importance of these earnings, or the part they have played in recent years in mitigating the effects of bad underwriting results, but the very existence of these results should be a warning against placing the wrong emphasis on premium income. We do not collect premiums so that we can invest them; we collect them to meet our eventual obligations to our insured and to pay the administrative costs involved in providing our service. Naturally, having

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collected the premiums, we put the money to efficient use until demands are made upon it, but it is the meeting these demands which must be our chief concern".

This rather lengthy quotation details factors which are highlighted as causing concern and financial depression in the world insurance market currently. The quote is from an article entitled "Realism in rating; efficiency in general insurance statistics" by J.P. Webster F.C.I.I. in 1965. Many statements could have been taken from this article and have applied to the current insurance market situation.

Unfortunately the current situation has been recently more depressing than circumstances in 1965.

If we were to conceive of the most depressing financial situation for the general business sector of the insurance market, **what would we envisage ?** Rather than relate the factors in narrative let us consider them as follows;

- Falling premium income (rising 1992)
- Increasing claims (falling 1992)
- Increasing expenditure (falling 1992)
- Profits into losses
- Falling investment levels (rising 1992)
- Falling Investment income (rising 1992)
- Unemployment and redundancy in the financial service sector (continuing)
- Falling interest rates (February 1994)
- Increasing labor and material costs
- Increasing court awards.
- Effects of inflation (falling at 2.3%)

Premium

Nominal premium income results generally indicated a gradual increase over the period 1970 to 1992. This is to be expected as insurers admit to raising premium rates to compensate for the effects of inflation, resulting in increased premium.

Inflation proved to be a significant factor within the insurers equation, and overshadowed the other influences of exchange rates and exchange fluctuations during the review period. Insurers have used nominal premium figures to create an optimistic view of premium growth and financial stability.

The significance of deflating the nominal premium figures is apparent when the peaks and troughs of the period are examined. Real premium income in 1980 at £ 1709.2m is less than the premium income for 1970 at £ 1,756.9m (**Appendix I**). This would appear to dispel the optimistic picture created by the nominal figures presented in the insurers' annual reports and accounts.

Real written premium income (**Appendix I**) has been increasing gradually from 1980 apart from reductions in 1985, 1987, 1990 and 1991.

General business premium income worldwide in 1992 amounted to £ 31,139m an increase of 14% over 1991. The ABI worldwide general business underwriting loss of £ 4,874m represents -15.7% of written premiums. Underwriting losses are often offset by investment income; however in 1992 **for the third successive year** this was not sufficient and a net trading loss was sustained.

Claims

Worldwide general business deflated claims results from the 10 insurers present a depressing picture over the 20-year review period. Claims have continually risen from £1,134.7m in 1980 to £2,418.4 m in 1991. This represents a 113.2% increase (Appendix 1); however, the 1992 figures present a more optimistic picture at £2,368m - a reduction of 2% on the 1991 results.

The major areas of concern associated with claims may be classified as natural perils, court costs and awards, catastrophe claims and recent developments such as pollution and contamination, environmental losses and terrorism.

Worldwide natural perils appear to be occurring continually with events such as storms, floods, earthquakes, and subsidence emerging as the most frequent visitors. Research, discussion and debate abound regarding the frequency and severity of such perils over past decades. Practically for the insurance market, natural peril losses are associated with the replacement of buildings, stock, machinery and plant; this material property includes labor costs and materials. Natural perils are out of the bounds of elimination by insurers and limited resources exist for risk management control.

Court costs and awards relate particularly to liability, motor, marine and aviation claims which also fall within the category of events over which the insurers cannot exert adequate control. The defence of a legal action is expensive and will include legal costs and expenses, investigation, solicitor's fees and possibly the requirement to engage Queen's Counsel and the defence entourage. Civil court defences costs for negligence are increasing dramatically, possibly fuelled by media attention, recent awards and precedents. The norms for recent court awards have been in excess of £1 million. A recent award of £ 3.4 m March 1994 established a new record for compensation to a 37-year old woman who was left paralysed after a motorway accident. The insurance markets have limited resources to cope with excessive awards and this area of claims payments will continue to increase dramatically.

Catastrophe claims include aviation and marine disasters, pollution and contamination. Certain losses would appear to be occurring more frequently; recent examples include Bhopal, Chernobyl, Kings Cross, The Challenger Space Shuttle, Hillsborough, Mexico City, Exxon Valdez, Bradford City, Manchester Airport, Zebrugge, Heysal Stadium, Clapham, Armenia, Ethiopia, Piper Alpha, Lockerbie, and San Francisco earthquakes floods and landslides, Sydney fires and flooding in the south coast of England, and increasing pollution and contamination claims. As designers create larger aircraft and seacraft the possibility of greater losses is on the horizon. Consideration must be given to the creation of new materials in the building of new craft, the design problems, the greater passenger and cargo liability and the potential for widespread pollution.

Part of the above paragraph formed a section of a paper given at Nottingham University in April 1992. British Airways have announced the introduction of a 'super jumbo' jet which will have a seating capacity of approximately 600 passengers. (Sunday Times 27th February 1994)

A collision that involved a tanker in the Bosporus on Sunday 13th March 1994 only reinforces the view that major losses to-day produce not only expensive material damage but also the possibility of pollution and contamination on an international scale.

One fortunate aspect of craft, pollution and contamination insurances is that they lie within the ambit of risk control and insurers must be vigilant in their pursuance of strict risk control and risk prevention from the initial stages of negotiation and throughout the contract.

The American dilemma regarding liability claims would appear to be that insurers are endeavoring to increase premium income in order to cope with rising claims ratios and to curtail potentially catastrophic liability business at the same time, due to forecasts of potentially expensive pollution and contamination claims. The UK market is now mirroring the American liability sector by withdrawing from certain areas. The Guardian Royal Exchange announced its withdrawal from the professional indemnity market in 1992.

The economic climate over the past few years has had a major impact on the construction industry and claims against construction insurance portfolios have risen sharply. Not only has the economic recession resulted in higher claims but recent fires have compounded the problem for insurers and reinsurers. Fire claims in the UK fell by 16.5% to £850m in 1992, following from the two previous years when claims exceeded £1 billion. Arson has been recognised to be a major factor in losses with arson claims exceeding £450m for the second successive year. A reduction in arson related losses has been assisted by the establishment of the Arson Prevention Bureau.

Reinsurers are becoming increasingly wary of potential losses from liability accounts, in particular to "new age" claims e.g. repeated strain injury, deafness, lazy lung syndrome, and stress related conditions.

The UK motor account indicated a dramatic improvement in the 1992 figures with a reduced underwriting loss of £ 579m (10.1% of written premiums) compared with the 1992 underwriting loss of £ 1,189m (23.1% of written premium)

Theft claims in particular are a major concern, with an estimated 13% increase to £1.025m in 1992 from the 1991 results. The UK Fire and Accident account revealed an underwriting loss of £1,634m (15.5% of premiums); this represented a dramatic reduction in overall claims of £1,678m in 1991 (50.6% of premiums). This is as a result of a general reduction in fire, subsidence and weather perils; unfortunately domestic theft claims rose by over 26% to £749m as a consequence of a record number of burglaries and fraudulent claims.

Commission and Expenses

Elements of expenditure for the 10 insurers such as commission and expenses follow the real premium income trends for the review period. As commission and expenses are normally related to premium income these corresponding trends are to be expected and are confirmed by the results (Appendix I).

The factors of inflation, interest rates, currency fluctuations and competition contributed to the peaks and troughs of the three distinct period ranges for the elements of expenditure.

Commission and Expenses maintain their usual consistency throughout the review period.

Commission and Expenses expressed as % of Written Premium

Year	**1970**	**1980**	**1990**	**1991**	**1992**
Commission	14.4	16.2	16.7	17.0	17.1
Expenses	15.8	16.8	15.1	14.5	13.5

Insurance brokers within the insurance sector are also facing commission difficulties, in particular individual brokers and partnerships where direct line insurance marketing is being undertaken by insurers excluding brokers from the sales equation.

Insurers intent on reducing expense ratios are involved in a series of cost cutting exercises to reduce staffing levels, this aspect of cost reduction is now part of the financial services scene. The unfortunate feature of the financial services unemployment is that often senior staff are being made redundant which does not augur well for the future of the banks and insurance companies. The removal of experienced senior staff at management level will have severe repercussions in the future.

Redundant employees make poor public relations representatives for the financial services sector, unless the industry will be able to fill up vacancies when financial circumstances improve. Each of these individuals together with family networks represent shareholders and potential shareholders who may react adversely to shareholding within the financial services sector in the future.

The aggregate of claims, commission and expenses exceeded premium income for all but three years, 1971, 1972 and 1973 of the period 1970 to 1992. As insurers declared dividends to shareholders in each of the years within the review period it is evident that another source of income enabled the insurers to achieve profitable results.

Investment and Investment Income

Investment is the mainstay of the insurance industry and is subject to the infusion of premium income and income from other sources. Investment funds tend to follow the fortunes of premium income with an overall increase in funds available for investment increasing from 1970 to 1989. The pattern is in the form of peaks and troughs, with the troughs appearing in 1974, 1985, 1987, and 1990 **(Appendix I)**. Investment funds rose by £ 530m from £ 4,397m in 1991 to £ 4,927m in 1992.

Investment income has been the means by which general business insurers have produced profits over the review period, apart from 1984, 1985 and 1990 where negative underwriting results were not compensated for by investment income. The negative £ 285.5m for 1991 represents the poorest result by far over the twenty year period.

Together with natural perils and court awards investment income is not within the financial control of insurers and is subject to external economic factors such as inflation and interest rates nationally and internationally. Insurers have relied on investment income in the past to redeem failing underwriting results; unless interest rates improve insurers must look to underwriting standards to improve premium income and possibly marketing and advertising strategies to improve image and credibility levels. Interest rates in the UK fell again in February 1994.

Underwriting losses

The underwriting aspect of the general insurance market situation has been the most depressing area to analyse with the 10 insurers' results spiralling from losses of £21m in 1970 to the trough of 1984 at £368m. After 1984 circumstances improved with a high point of an underwriting loss of £87.4m. in 1988. The market after 1988 fell to a new low of £512.2m in 1990 (Appendix I). This represents a 3,649 % increase in the underwriting loss result from 1970 to 1991. The 1992 results indicate an improvement from an underwriting loss of £596.4 to £409.9.

It may appear to the outside world that the insurance industry is not capable of controlling its own destiny and is careering out of control. Insurers are insisting on hardening the market yet are undercutting rates in order to obtain business. Most annual reports comment on insurer's intentions to increase rates which may appear counterproductive in this recessionary economic climate.

The decision to increase rates is a difficult market decision; however, these decisions must be made against a backdrop of increasing interest in industrial and commercial companies self-funding risks and the increase in captive insurance management and the influence of risk managers and corporate attitudes to risk management. Increased rates hopefully increases premium income; however, insureds tend to react to such increases by either refusing to insure or by making fraudulent claims, (estimated at £500m in 1993) or by opting for less expensive insurance often at the risk of poorer quality cover.

The major companies may now be experiencing the effects of increased rates on their domestic accounts with a seachange with previously loyal insureds defecting to direct line business and the re-activation of captive operations for commercial and industrial organisations.

Advertising

The perception of the image of the insurance industry in the USA has been identified as being;

"The industry's own image that they are responsive companies that quickly assist policyholder's to overcome temporary or major setbacks (e.g., the response of insurers to major disasters, or even the processing of day-to -day claims) seems to account for little in the eyes of the policymakers. The general perception of the insurance industry is that it is a highly profitable industry that offers a product that is relatively expensive".

Kenneth J. Meier, "The Politics of Insurance Regulation", The Journal of Risk and Insurance, December 1991.

This American perception is reflected in the United Kingdom and within Europe, with insurers creating advertisements which identify with logos, situations and events without being informative. The tendency being to treat marketing of the insurance product to the domestic, industrial and commercial buyer on par with the marketing of household products and domestic electrical equipment. The insurance product should be marketed on an informative basis with a quality projection and at a collective level.

Miscellaneous and Associated Problems .

New markets in Eastern Europe are providing new business for UK insurers; however, this new capacity may produce future problems. New risks may attract premium income; these risks may include poor capital investment, equipment, technology, training and education which may result in disastrous claims experience within five or ten years. This situation may be likened to the banks and their investment in third world countries where countries are unable to repay loans and are borrowing funds to pay interest on loans. Let us hope that common sense prevails and the industry investigates the situation closely with a view to risk improvement initially before acceptance of risk..

The insurance industry is being faced increasingly by new legislation and controls in respect of pollution and contamination, COSHH regulations and the influence of EC directives. These increasing layers of protection for consumers merely provide insurers with greater obstacles to overcome when advising insureds of legal requirements which will in, practical terms, involve increased expenditure by the insured.

The industry is operating under a conflict of interests-insurers are informing the market, including brokers, shareholders, industry and commerce and the public of the financial and economic constraints, claims, expenses, and underwriting results which are driving them to increase rates. On the other hand, competition, market share and the financial practicalities of obtaining new business are forcing insurers to accept reduced premium renewals from brokers, risks managers and direct insureds.

In the past insurers operated within identifiable hard and soft market conditions, but are now existing in a severe competitive environment where decisions have to be made in order to secure premium income and market share.

Industrial and commercial companies are diverting funds from the insurance market by self-funding and by the use of captives at a time when this "soft" market is operating. The analogy of kicking a man when he is down comes to mind. It could be said that the captive insurance market is growing at the expense of the general market and will continue to grow with the opportunities opening in Europe for new business.

Comments, Conclusions and Recommendations

The general insurance market is in a state of flux; other insurance sectors suffering similarly are the reinsurance market and the international insurance market and Lloyds where figures indicate that the overall losses in 1993, the latest figures available were approximately £2bn, far exceeding expectations. It is now beyond doubt that 1993 will have been the worst year in Lloyd's history, and the potential losses for Lloyd's as a corporation for 1994, when finally assessed, could be disastrous.

It must be stated that the industry has over the past twenty years been faced with external influences beyond its control. These influences include inflation, interest rates, exchange rates, court awards, and natural perils. These events have been compounded by recessions, wars, conflicts and severe competition.

If the present situation continues, general business will decline to a stage where insurers will no longer be financially capable of operating with premium and investment income being consumed by expenditure.

A radical program must be instigated to present the industry with a positive united profile with a willingness to dispense with traditional and conservative attitudes. The financial sector must look positively to financial service conglomerates offering all forms of financial services nationally.

The long term rationale behind most mergers in the financial services sector has been a desire to create a springboard for European expansion. The emergence of Bancassurance which involves the alliance between a bank and an insurance company provides evidence of this recent trend as a means to gain entry to emerging markets.

Although such co-operation already exists, the next few years should witness an increase in mergers between banks and insurers and eventually building societies, with insurers providing the underwriting expertise and claims service whilst the banks offer distribution outlets. Convincing insurers to cope with a new range of financial products may prove difficult. This concept has caused insurers throughout the European Community to review their traditional methods of distribution either through direct sales or through intermediaries.

Insurers must be seen by industry, commerce and the general public as financial providers, advising insureds of research undertaken, claims payments made nationally and internationally to assist society during

hardship and disaster. Information must be provided to the public of insurers and reinsurers payments of billions of pounds in compensation paid over the decades.

Insurers must create an informed public through high profile advertising of the benefits and advantages of the insurance market not only to the individual but society, the state nationally and internationally and establishment of high profile co-operation and liaison with industry, commerce, universities, college, by the funding of major national projects rather than individual insurers sponsoring elitist sporting events. Insurers must consolidate and co-operate during this difficult period and be willing to adopt and adapt to changing circumstances.

Effective education and training programs must be established to provide professional education in financial services, insurance, banking and building societies leading to common financial services degrees. These courses must be practical, interesting and informative creating a motivated and enthusiastic work force; this cannot be undertaken without the co-operation, involvement and total commitment of the financial services industry towards providing an intelligent, informed, and professional staff.

This paper is intended to be informative, provocative and is not intended to be depressive as the insurance industry is of great benefit to society. Circumstances will change; in the meantime the industry must treat the insuring public both the domestic and the industrial and commercial sectors with considerable respect for it is they who decide on their financial options including the purchase of insurance.

APPENDIX I

Figure 1

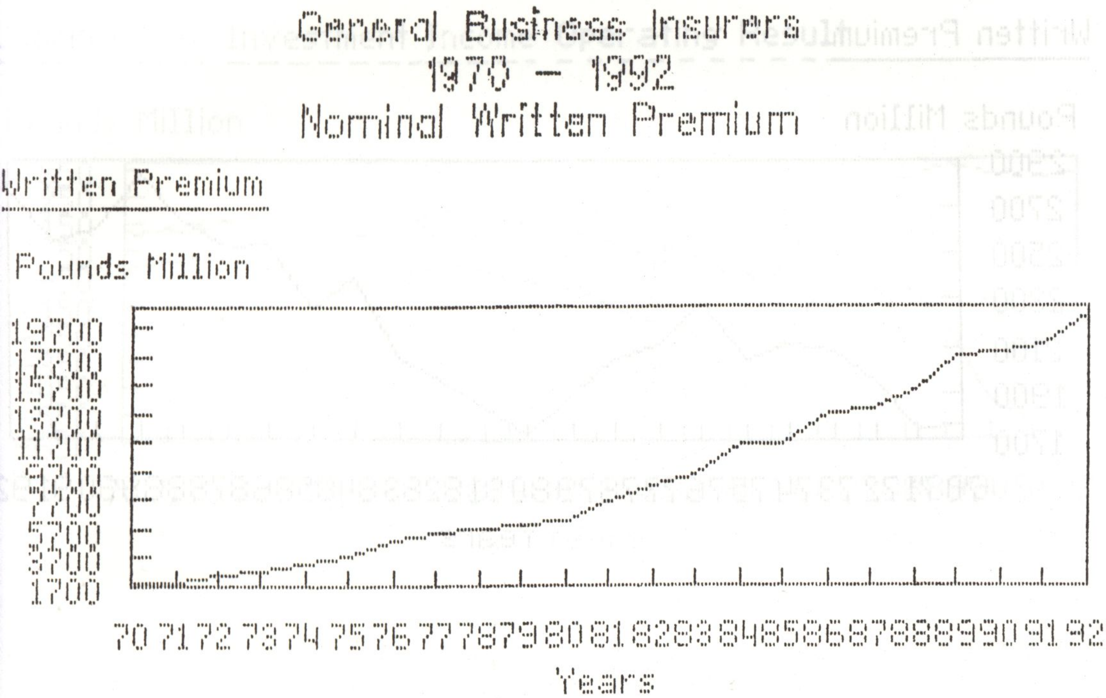


Figure 2

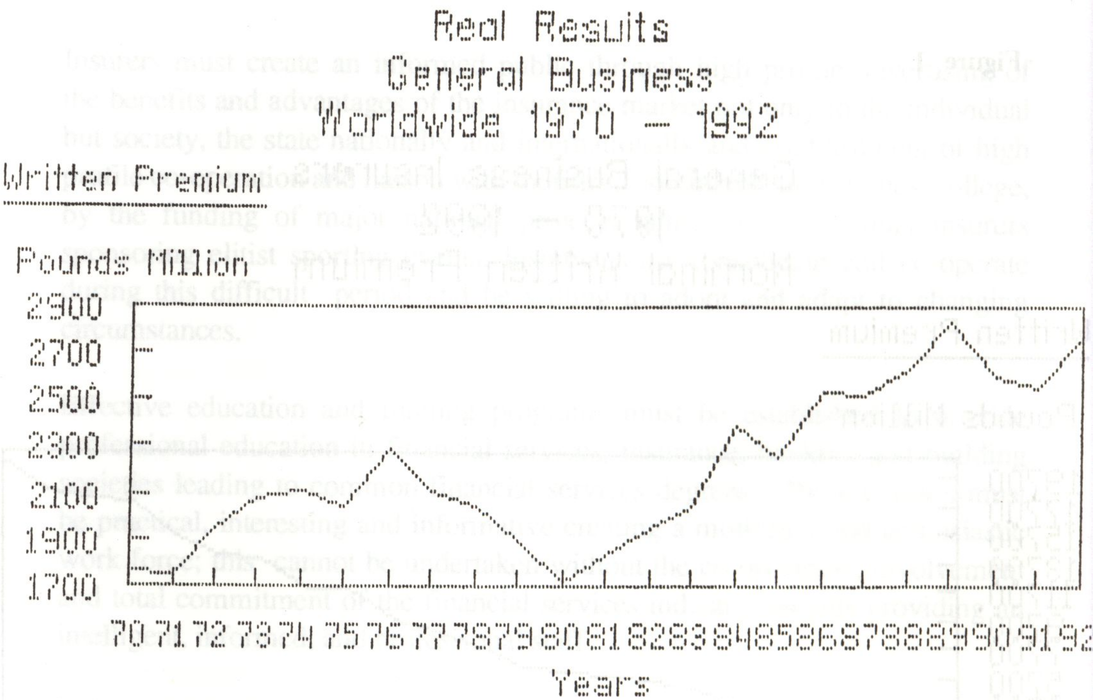

Real Results
General Business
Worldwide 1970 - 1992
Written Premium
Pounds Million
2900
2700
2500
2300
2100
1900
1700
70 71 72 73 74 75 76 77 78 79 80 81 82 83 84 85 86 87 88 89 90 91 92
Years

Figure 3

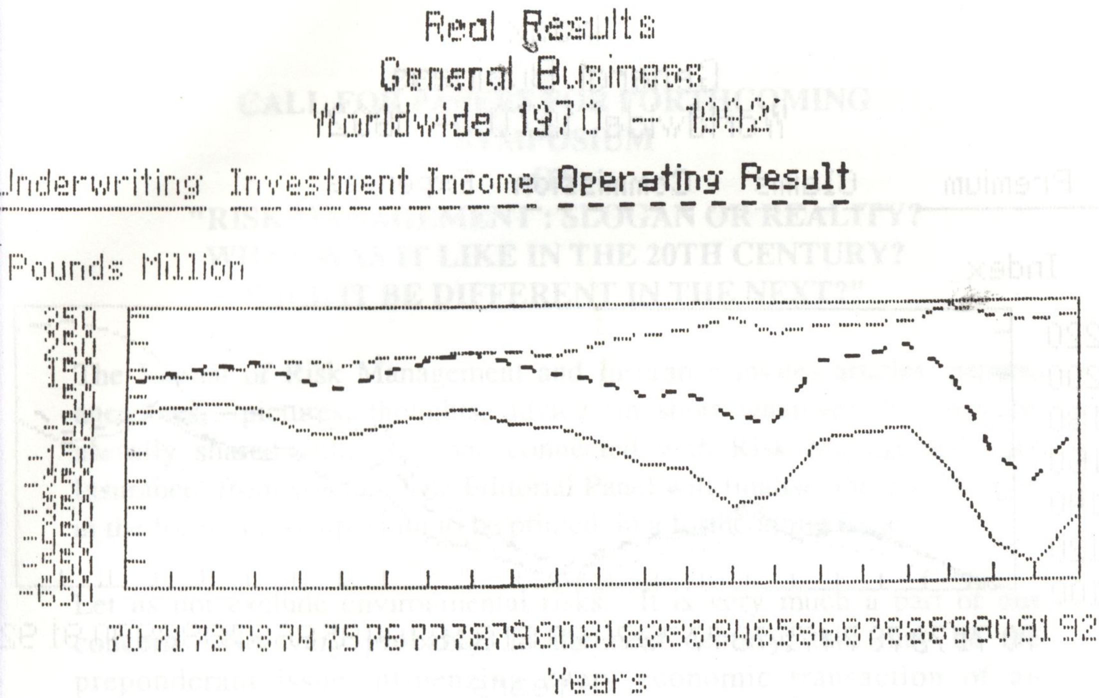
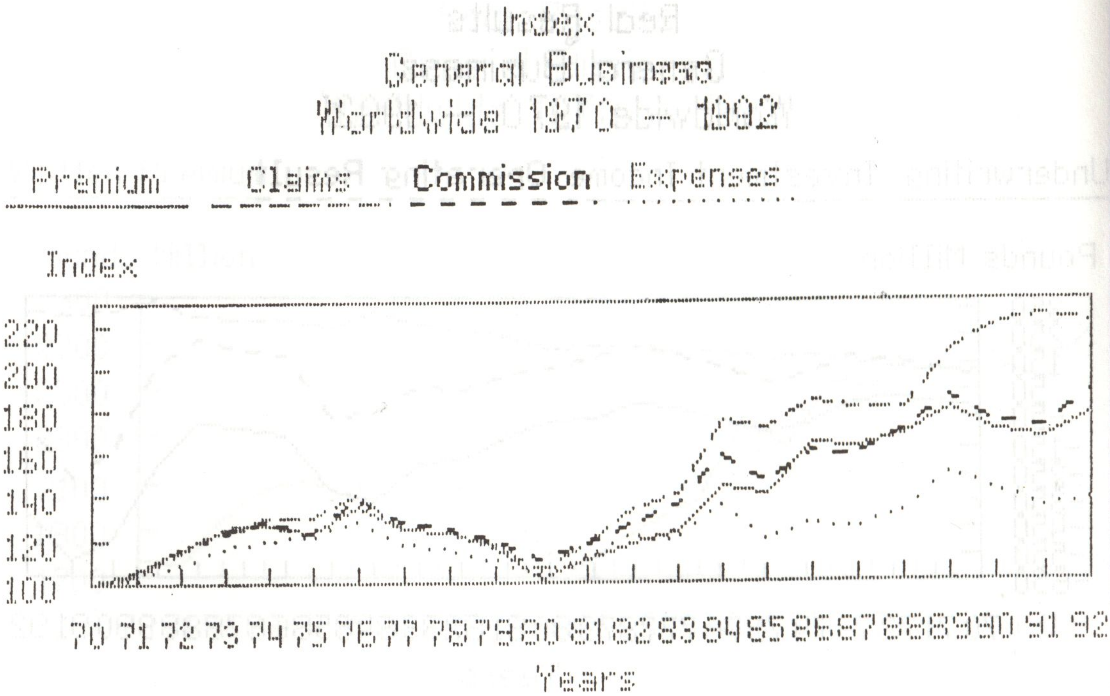

Real Results
General Business
Worldwide 1970 - 1992
Underwriting Investment Income Operating Result
Pounds Million
350
-650
70 71 72 73 74 75 76 77 78 79 80 81 82 83 84 85 86 87 88 89 90 91 92
Years

Figure 4


Index
General Business
Worldwide 1970 — 1992
Premium
Claims
Commission
Expenses
Index
220
200
180
160
140
120
100
70 71 72 73 74 75 76 77 78 79 80 81 82 83 84 85 86 87 88 89 90 91 92
Years

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