



## January 2010

*Editor, Larry Boyd*

*Graphics and Layout, Carolee Lance*



*"Whenever a doctor cannot do good,  
he must be kept from doing harm"*

*Hippocrates*

**Happy New 2010!**

## SLAOR News:



### Financial

We no longer pretend to know what's going on in the marketplace, but Oregon surplus lines business seems to defy gravity. November was up over last November in both premium and item count - up a whopping 24.6% in premium and 14.1% in item count. This brings the calendar year to date figures to a minus 15.1% in premium for the eleven months and item count for the same period off only 1.1%. For our "stub" year (3 months) we are up 4.0% in premium and up 6.0% in items. On the Association's financial side, things could hardly look better: income for the month, up 5.6% over budget, expenses down 4.3%. For the three months of the "stub" year, operating revenue excess of expenses is \$13.1 k. We will likely lose money in December due to cost of annual meeting and luncheon but for the full four months of the "stub" year we will have revenue excess of expenses.

Not included in these "operating" figures is \$122.6 k of investment gain accumulated in our investment account due to improved performance of our portfolio during the September - October period. At one time, our target was a balanced budget and a surplus of not less than \$500 k or more than \$1.50 million. Current surplus is in the vicinity of \$2.3 million. It is clear we have weathered the economic crisis.

The January Board meeting will be largely devoted to budget considerations. Budget being forwarded by the finance committee will not include provisions for some items that were approved at last year's retreat (participation in national meetings, for example) but not done last year due to the economic crisis. The budget committee is leaving it up to the board to reinstate activities and events where appropriate and where funding is available. If you have thoughts on what your association should be doing, share your thoughts with a member of the board or staff. Attend the board meeting as a guest if you would like.

### **Whadayaknows:**

*It is impossible to lick your elbow.*

*Rats & horses can't vomit.*

*A snail can sleep for three years.*

*It is physically impossible for pigs to look up into the sky.*

*In a study of 200,000 ostriches over a period of 80 years, no one reported a single case where an ostrich buried its head in the sand.*

## Oregon News:



Oregon made the national news with the AP report that the city of Portland had paid of Portland had paid more than \$3 million in the past five years to settle claims against the police, including more than \$850,000 for just one officer. City officials said that due to lengthy settlement periods the payments reflected police policy of a number of years ago and current practices would have avoided a number of claims.

## National News

*How the heck do you fold a fitted sheet?*



- New York's controversial Producer Compensation Transparency regulation, still hotly contested, would permit contingent commission programs provided they were appropriately disclosed. The regulations are on track in N.Y. to become effective in first quarter 2010 although producer groups have threatened lawsuit challenging the proposal. The big three, Marsh, Willis, Aon, would still be unable to accept such payments because they have separate agreements in which they have agreed to forgo such payments. Rumor is, however, once the new regulation in effect insurance regulators will agree to drop the separate

agreements if the big three agree to abide by the transparency regulation. Eventually there will be little left of the furor caused by Mr. Spitzer.

- Insurer associations are lamenting long and loud over the proposed systemic risk fund included in the House-passed financial services bill that would assess regulated entities to pre-fund the costs of dealing with shoring up or breaking up companies that threaten the country's financial system. They feel their current assessment exposure under state guarantee funds is sufficient.
- Moody's, S&P, and Fitch – the big three of rating agencies – are the subject of several lawsuits from investors alleging that they were negligent in following their procedures resulting in investors losses. The agencies seem un-concerned about these claims, perhaps because they have confidence in their immunity to suit – believing that they are not guarantors of those they rate. Nothing seen so far in proposed legislation appears to make any changes in how they operate. The ramifications of any changes could be enormous as they are specifically mentioned in numerous laws, regulations and contracts. Lawmakers are fearful that any change would be accompanied by a large number of “unintended consequences”.
- The National Association of Professional Surplus Lines Offices (NAPSLO) applauded the inclusion of surplus lines reform language in the Wall Street Reform and Consumer Protection Act of 2009 (H.R. 4173), which was passed by the House on December 11th. The language, part of an amendment offered by Rep. Dennis Moore (D-KS) and Scott Garrett (R-NJ), establishes that the tax policies, licensing and other regulatory requirements of the home state of policyholders govern surplus lines transactions.
- In a decision that may wreak havoc with conventional thinking, the Nebraska supreme court has held that an employee of a railroad injured while walking to work on a driveway owned by the City of Marysville (not his employer) was entitled to workers compensation benefits in spite of the fact he had not yet reported for duty.

In a similar “new law” situation the Missouri Supreme court has ruled that uninsured motorist protection must provide protection from an accident in which she sustained no physical injury but suffered from migraines, nausea, diarrhea, and anxiety attributed to her involvement in an auto accident including witnessing the violent death of another motorist.

- The bond market is growing as new laws and regulations are enacted requiring financial guarantees for individuals in select licensed occupations. Arkansas and Utah have recently enacted licensing requirements for appraisal management companies and included a requirement that such firms post a \$20,000 surety bond.
- Best's reports that impairments for both life/health and property/casualty writers are up by at least 30% compared with 2008. At least twenty insurers became impaired this year, up from fifteen in 2008 and fourteen in 2007.
- The Glass-Steagall Act, enacted in the 1930's in response to the Great Depression, placed some onerous controls on bank authority (among other things, prohibiting banks from owning insurance companies). In 1999, the banking lobby convinced Congress to repeal many of the Glass-Steagall provisions with enactment of the Gramm-Leach-Bliley Act. Now, some in Congress are wondering if they should not reinstate some of the Glass-Steagall controls and bills have been introduced to repeal portions of the Gramm-Leach-Bliley Act.
- State Farm and the Florida regulators have come to an agreement. Instead of leaving Florida entirely, State Farm will be permitted to cancel 15% of its policies and raise rates an average of 15%.
- We are told that the TARP program is on track to be paid off by most bank participants with a good profit to the taxpayers. What isn't properly recognized in all the hoopla is that significant rescue funds went, or are going, to purchase equity positions in companies in trouble and the return of that money is problematic and much of the loss on mortgages may be hidden in yet to be realized lack of sufficient collateral in real estate loans.

## The Marketplace:



- What's Up? (still soft)

*Why did nature create stock analysts?*

*To make weather forecasters look good.*

12/8: Price Waterhouse Coopers reports in its "Emerging from the Storm: The Day After Tomorrow for Insurance" that nine-developments are expected to reshape the insurance industry during the next five years. They are:

**Insurance Industry consolidation:** The U.S. insurance market remains highly fragmented, and the strong underlying rationale for consolidation and restructuring means that merger and acquisition activity may be set to accelerate rapidly, particularly as larger, better-capitalized firms consume smaller firms. Consolidation is expected to help to deliver the capital stability and economies of scale that will be important in attracting customers and demonstrating financial strength not only to ratings agencies but also to third-party distributors whose "ownership of the customer" makes them a key determinant of an insurer's fate.

**The end of innocence for retail investors:** The faith of investors, who had become accustomed to high yields but were unaware of the related risks, appears to have given way to shock, disillusionment and caution. The pursuit of innovation appears to have been displaced by a focus on stability, risk management and demand for simpler, more straightforward and transparent policies and investment products such as index-linked investments. An example of this is the recent resurgence in demand for whole life insurance. The apparent desire for guarantees, however, could create dilemmas for insurance companies that want to scale back such products as they seek to limit risk. Potentially higher costs of risk and guarantees, along with what may be higher commission payments to distributors, could change product economics, and insurers will need to better understand component costs, pricing and profit profiles.

**Mounting uncertainty over tax:** As debts and fiscal deficits mount, governments are looking for ways to increase their tax revenues. They will look closely at insurance companies, as the industry is a major source of potential tax receipts and has moved significant business capacity to other jurisdictions in recent years. Accordingly, insurers can expect renewed scrutiny of their tax planning techniques, as well as more stringent requirements for transparency and information exchange relating to clients.

**Organic restructuring:** As a result of the financial crisis, many insurers have been forced to raise prices, restrict the pursuit of new business or withdraw from high risk and peripheral markets. As insurers withdraw from some of their geographic markets and scale back particular lines of business, the market shares and opportunities for those that remain could sharply increase, leading to a significant reconfiguration in the list of leading players. Companies with a better understanding of their risks are likely to be in a stronger position to capitalize on potential openings that less-informed and less-assured competitors may miss.

**Rethinking insurance financial reporting:** Many insurance executives justifiably complain that their share prices fail to reflect the true level of value being created within their business. Without an industry consensus on a genuinely relevant, intelligible, and comparable basis of accounting and disclosure, insurers may find it increasingly difficult to compete for capital. With funds constrained, many portfolio investors could simply choose to put their money elsewhere, leaving the insurance industry with major challenges. According to Price Waterhouse Coopers, it seems imperative that the industry come together to develop a basis of relevant disclosures that reflect the nuances of their business and satisfy analyst and investor demands.

**Blurring the lines between the public and private sector:** The relationship between the public and private sectors could change as the government exerts a stronger influence over the insurance market as a result of bailouts, regulatory reform, and greater control over pensions, healthcare, trade credit and mortgage support.

**Greater scrutiny of executive compensation:** Two concerns raised by the financial crisis were the lack of understanding of risk at the board of directors' level and compensation for senior executives. With appointment of the Special Master for TARP Executive Compensation, in the United States, insurers are likely to base much more of their performance-related pay on risk-adjusted measures, aligned to their business strategy. They also are expected to face tougher regulation over how compensation is governed.

*cont.*

*I totally take back all those times I didn't want to nap when I was younger*

## The Marketplace (cont.):

*Was learning cursive really necessary?*



**Challenging prospects for reinsurers:** While demand for reinsurance is likely to increase within emerging markets, this is unlikely to offset the decline in reinsurance buying in developed markets and may force many reinsurers to rethink how they sustain profitability and growth. The trend toward higher retention of straightforward risks could accelerate. As companies become more risk-aware through advances in enterprise risk management, they will be better able to choose what risks to retain and which to reinsure.

- Towers Perrin study found prices in the commercial insurance marketplace showing a very slight increase after five years of steady decreases. They would not predict whether the market would harden. Everyone seems uncertain about 2010.
- ISO and PCI report that through nine months of 2009, p/c insurers' net income rose to \$16.2 billion from \$4.4 billion in the same period in 2008. The combined ratio improved to 100.7 % compared to 105.5 in 2008.
- An Insurance Journal survey revealed optimism for improvement in 2010. The "catch" is that some of the optimism appears to be of "Has to Get Better" sort – as in "2009 was so bad it just couldn't be worse in 2010".

### AIG WATCH

- 12/8: Pay Czar permits some AIG executives from the \$500,000 cap after five threaten to quit.
- 12/10: Geithner warns that not all TART investments will be returned, suggesting that there is a significant likelihood that AIG, GM and Chrysler will not pay back all government funds they received.
- 12/15: Chief executive of AIG, Robert Benmosche, says "I feel strongly that AIG is too big today – it is extremely complex to manage and we need to make sure it's more transparent, that it's smaller, and that we can make it on our own."
- 12/22: AIG halts efforts to sell Chartis and chief executive suggests the Berkshire Hathaway model of management for AIG is his goal.

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*Nothing is worse than that moment during a heated argument  
when you realize you're wrong*

## Catastrophe News:



12/7: CSU's Tropical Meteorology Project forecasts above-average activity for 2010. Forecast: eleven to sixteen named storms, six to eight hurricanes and three to five major hurricanes. The 2009 season ended with nine named storms, three hurricanes, in the Atlantic – the lowest total since 1997.

12/11: NOAA forecasts El Nino to continue into spring; CSU predicts it will die out by the 2010 hurricane season.

12/30: Munich Re reports 2009 catastrophe losses to be about \$50 billion – only 25% of what they were in 2008.

*Please share this NewsLetter with your staff – Thanks*

*Note: The opinions expressed in this newsletter are those of the Editor and do not reflect an official position of The Surplus Line Association*