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Soft market or hard market: What will insurance rates do in 2011?

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The start of 2011 marks the 7th consecutive year of "soft market" pricing in the property and casualty insurance industry, with rates, and subsequently premiums, falling as carriers have competed with one another for clientele. The frugality of consumers during the current economic downturn has only fueled the fire, extending the soft market cycle to become the longest in 70 years. For property owners, this 7-year trend has generally meant an annual reduction in the costs of insuring their assets as carriers undercut the renewal price of their competitors to capture a greater market share. This welcome reduction of overhead for proprietors may now be short-lived, however. While some foresee a continuation of the soft market, many forecasters predict a "hard market" as soon as 2012, resulting in tightening rates and a more selective underwriting process that will inevitably drive up premiums.

Following July 2002, when average P&C rate increases peaked at 33%, carriers steadily decreased pricing until the soft market hit a low in December 2007 at -16%. Since then, rate decreases have continuously dwindled as the market moves back to a flat rate (0%). According to MarketScout.com, December 2010 showed an average rate decrease of -5% for all U.S. Property and Casualty business, with the more competitive arena of General Liability aggressively priced at -6%. MarketScout CEO Richard Kerr said, "2010 will prove to be the beginning to the end of a six year soft market cycle. While rates were still down for all of 2010, they did moderate and held steady at smaller reductions in a tight range from -3% to -5%." Other sources are less optimistic about a possible hard market in the coming years, citing the stability of renewal premiums during the 4th quarter of 2010. The Insurance Journal online states, "Average renewal premiums for commercial lines property/ casualty insurance were largely unchanged during the fourth quarter of 2010 and that may remain the case for awhile. Analysts at Advisen caution that a turn in the market is not imminent." The Journal does recognize that, while recent changes may not necessarily result in permanent rate increases, the attitude in the market is certainly leaning towards hardening rates: "We have seen more carriers exercising underwriting discipline - walking away from business that does not meet their pricing targets - but it is still a very competitive market." Those that believe the "buyer's market" is likely to continue shouldn't ignore long-term increasing rate trends that began in December 2007. Even if rate increases do not reach past hard market levels for several years, we are still likely to see rate increases to some degree, causing business and property owners' cost of insurance to rise. Current market activity appears to support the probability of such a hard market turn. Carriers have incurred heavy losses over the past few years, largely originating from the undesirable risks taken on when the companies were desperate for cash flow. As a result, many have begun non-renewing accounts with certain loss ratios and reevaluating pricing on higher risk business. The question remains: will more financially viable insurance carriers follow suit, or will economic insecurity lead them to forego improved loss ratios and continue to out-price their competitors? The real determining factor will be dictated by the surplus to premium ratio each carrier experiences.

So, what should we expect moving forward? According to Kerr, "By year end 2011, the longest soft market period in the last 70 years will finally come to a close." The weather of winter '10-'11 may prove to be an unforeseen, yet definitive factor favoring this turn. In the past few weeks, New England and the country as a whole have suffered countless claims filings that will undoubtedly exacerbate any trend towards a hard market. Expect to see rate decreases continuing to level out until the end of the year, at which point we should see a flat market state. While these changes will likely occur for the industry as a whole, it is important to remember that not every company is the same. Those that practiced conservative tactics throughout the soft market may now reap the benefits of being able to offer lower prices while their rivals can no longer afford to do so. Nevertheless, on average we may see overall premium increases for commercial business in 2012: the start of a new hard market.

Sources:

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