

STAYING THE COURSE



E&S casualty underwriters face a challenging 2010, says Steven K Dresner, but playing to their strengths will ensure they are best placed to benefit when the market rebounds.

Endurance Reinsurance Corporation of America (Endurance Reinsurance) has been a consistent supporter of the excess & surplus casualty marketplace since we commenced operations in 2002. From the outset, we have selectively partnered with companies that have proven their ability to outperform their peers through risk selection practices, underwriting expertise, preferred distribution channels, advanced technology or a combination of these factors.

E&S business covers risks that are not easily handled by the standard lines markets, which tend to focus on risks that are homogeneous and therefore can be more readily analysed and quantified. The more unique casualty risks that are not easily underwritten—perhaps due to perceived hazards or lack of actuarial data—tend to find a home in the E&S market. However, as has been the case historically, as the P&C market softens, E&S carriers face competition not only within the E&S community, but more often from the standard lines markets, whose risk appetite broadens as they seek opportunities to grow their portfolios. Over the past several years, many E&S companies have experienced an increased competitive environment, resulting in a decrease in year-on-year premium.

Unlike past cycles, there are several new variables that successful companies now need to navigate around as well. While the stock market has rebounded from its 2009 low, most measures of economic vitality have been slower to rebound. Today, labour, employment and wages remain stagnant, and weakness continues in both residential and commercial real estate and construction. Credit markets are difficult to access, and those lenders that do offer credit, do so with painfully tight restrictions. This presents the E&S market with a strong headwind in 2010, as many of the traditional classes of business written by E&S carriers focus on exposures related to commercial and residential construction, environmental remediation, product liability and trucking, and are therefore dependent on growth in the manufacturing and construction sectors. Until there is more confidence in the US economy and these sectors regain strength, there will continue to be pressure on premium growth within the overall E&S marketplace.

Another important impact on E&S insurers is historically low levels of interest rates and inflation. This puts an even greater pressure on insurance and reinsurance companies in two areas. First, they are less likely to have significant investment income that can offset poor underwriting results. Second, inflation can significantly increase claims costs, especially for long-tail lines, and require re-evaluation and adjustment of reserves from previous underwriting years. While relatively benign today, we expect claims inflation to trend over

the next few years. This typically is not offset by inflation-driven increases in premiums for the current underwriting year and is also further complicated by pricing uncertainties related to inflation risk. E&S companies that write longer-tail classes of business, such as environmental liability, umbrella liability and product liability, will experience greater volatility in their results and therefore face a greater challenge to underwrite and price correctly.

We find that 'best in class' E&S companies are able to make reasoned decisions regarding these challenging classes of business, as they are able to appropriately identify the exposures and hazards of a given risk, and effectively manage it through the use of endorsements, exclusions and other risk-mitigating techniques. Typically, they have exceptionally strong information technology capabilities that enable them to constantly mine their data to identify the more profitable classes or attractive risk characteristics within a given class. These differentiators also provide for improved pricing decisions, in that exposures are more likely to be priced commensurate with the risk assumed.

Early indications are that 2010 will be another challenging year for the E&S community and will continue to test its willingness to remain disciplined and to navigate away from less than desirable business—despite the desire for premium growth. Underwriting expertise and experience will clearly benefit E&S insurers in managing through these challenges.

From a reinsurance perspective, the current E&S market is similar to many other lines as it remains difficult to secure the necessary increases to keep up with increased loss costs and trends. Despite this, Endurance Reinsurance continues to see the E&S market as an attractive segment over the long term by partnering with best of class companies that exhibit a disciplined and transparent underwriting approach to their business, and have historical track records that demonstrate their ability to effectively manage through cycles. We work actively with our clients to understand the evolution of their portfolios, conduct regular underwriting and claims audits, and exchange product and market knowledge. This level of communication is one of the key ingredients to effectively address the current challenges within the E&S market, and allows both Endurance Reinsurance and our clients to continue to outperform the market. ■

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