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Résumé de l'article

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Whither the insurance cycle : coping with the unavoidable ! (1)

by

Roy A. Elms, F.C.I.I. (2)

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When I was in Alberta a couple of months ago, my topic title was *Up from the ashes – and back down again* ? Since then, we have seen the emergence of the collective industry results for 1987 and the wide ranging outturns of individual companies. I have seen operating ratio numbers as high as 118% and as low as less than 100%. Royal was 103,3% and we are very pleased – but not complacent – about that.

Without going into detail, I would like to give you my interpretation of those results before looking into my own crystal ball and suggesting what lies ahead in 1988 and beyond – both as regards results and the general operating environment for our industry. Then we will link that to what I see as the key issues facing our business in the next few years.

By now, we all know that overall the industry had a pretty good year – an operating ratio of 104,8% and a profit of more than $1 billion. This translates into a return on equity of a very acceptable 14%

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(1) Conference given to the Toronto Chapter of the Canadian Insurance Accountants' Association at the Ontario Club, Toronto, on April 19, 1988.

(2) Mr. Elms is President and Chief Executive Officer of the Royal Insurance Company of Canada.

or 15% for the second year in a row, but was that needed after the meagre returns of earlier years !

I would like to make it clear that I am not on the side of those members of the industry who wring their hands and point with horror to the fact that substantial underwriting losses were incurred. I am exasperated by those commentators who point to the fact that claims and expenses amounted to 105% of premiums implying that insurers had a loss of 5% of revenues. As we have seen with the interest and investment markets existing in 1986 and 1987, fairly significant underwriting losses were absorbed and yet a very satisfactory total result was obtained.

It is long overdue for the whole industry to publicize its results, whether overall or by class, on a total insurance result basis - that is after appropriate attribution of investment income from insurance operations. That is the only fair way to measure profitability of our fundamental business. After that, we can add in the investment earnings attributable to shareholders funds and develop a return on equity to compare ourselves with other businesses.

So long as underwriting losses are reasonably contained, you can still enjoy a satisfactory rate of return. What in terms of underwriting loss is reasonable, of course, depends on the class of business and the level of insurance funds in the way of unearned premiums and outstanding losses.

Now I acknowledge that the impending requirements for discounting loss reserves will affect the situation, but they do not affect the principle. And if we ever get to nil inflation and correspondingly reduced interest rates, then that will bring down the level of acceptable operating ratio also.

Now to the 1987 results per se. I think there are two basic reasons for the wide disparities in results. I suggest these differences come primarily from two sources :

1. the degree to which a portfolio is weighted with personal auto business, particularly in Ontario. An overweighting would certainly tend to drive your ratio up because of the eight-month-long rate freeze and rebates which accentuated a situation of fundamental rate inadequacy ;

2. strengthening of loss reserves. Some companies have been behind others in accurately recognizing the ultimate cost of their losses. I suspect there are still some who unwittingly (I hope) still do not have a correct and adequate fix on their ultimate liabilities. Dr. Slater estimated the industry was underreserved by 19% – I do not think it has all been made up by any means ! No one underestimates the real difficulties in getting a proper fix on loss reserves and yet it is so fundamental to the ongoing vitality and stability of our business. Last year, as a factor of earned premiums loss reserves for the industry moved from 82,2% to 86,4% ; at Royal they moved from 103,6% to 109,4%.

Mix of business obviously influences loss reserve requirements and a cynic might also suggest that Royal's higher levels is simply a reflection of how our earned premiums are more inadequate than most ; other cynics might suggest we are trying to hide profits. I am not going to try to defend our reserving levels, but surely it is cause for reflection that in all cases where companies have gone to the wall – Northumberland et al - inability either due to lack of competence or something more sinister to adequately provide for loss liabilities was a prime reason. In the case of Northumberland, its *published* figures indicated far superior performance to the industry in the two years before its demise.

Now let me turn to my outlook for 1988, which will be the initial testing phase of whether or not the industry has the collective will and ability to cope with the unavoidable insurance cycle.

With the growth in premiums decelerating quickly and being outstripped by the growth in incurred claims, I figure that 1988 will produce an operating ratio four or five points inferior to that of 1987, so we will be looking at 108% or thereabouts.

Now as in 1987, I expect there to be a wide range of individual results on both sides of that number.

In our business, results lag today's actions by a year or more so it is important to do the right things now. There is very little evidence that the industry collectively is doing the right things now – in fact, you will find a lot of sympathy for the view that it is doing the wrong things now – namely deeply cutting prices and showing a cavalier disregard for normal underwriting discipline. As we will see later, I am not as pessimistic as that observation might infer, but I think the seeds are being sown in 1988 for 1989 to be worse at least by two or three points !

If we have not learned anything from past downturns in the cycle, and results plunge even further, then heaven help us, because it will inevitably result in the dislocation of tight markets, prohibitive prices and lack of capacity to fill the insurance needs of consumers and business. I am convinced that a reoccurrence of that scenario is completely unacceptable and will result in draconian Government intervention in our business – and it will not need the presence of an NDP Government to make it happen !

You may have the feeling that further Government intervention is unlikely to improve anything – but it will not stop it happening !

The important issues that the industry will have to grapple with in the next while are many and varied and I am quite sure I have neither the foresight or wisdom to identify all of them. I am positive that we are entering a critical period in the history of our business in Canada.

To be frank, in both political and public arenas, we do not enjoy a very good image. And in large measure, this is justified because of our collective inadequate efforts to explain our business and because of our unwillingness or inability up to now to manage the cycles – or in other words to contain the wide swings in availability and pricing of our products and service, the industry just has to curb its propensity to go madly into reverse at the first sight of a decent profit.

I have already mentioned that we should be completely open about our investment earnings and not moan about modest underwriting losses. We should explain that black Mondays do not affect insurance pricing adversely because equity investing is done with shareholder funds, i.e. capital and surplus – and it is the shareholders who take the gains and losses of such activity, because policyholder funds are by and large put to work in relatively short-term, fixed income securities. We should remove any ideas that stock markets have any bearing on what we charge our customers.

This is just one aspect of communicating the realities of our business that needs attention. Overall, the public's attitude to us is one of distrust and anger primarily because they cannot understand the violent and abrupt changes in price and availability. In these days of changing social, political and economic values, we and every business have to recognize an accountability to justify ourselves not only in profit and loss terms, but also in social terms ; business exists at the whim of the consumer – it exists to serve society and if it does so effectively, it should expect to do so profitably, *but profits are a means not an end* in fulfilling our function to serve the public interest.

Our business, which has proved to be an extremely fast learner in some areas, like computerization for example, has been somewhat lead-footed in learning to anticipate important political and social changes, in adapting our methods to accommodate these new orders.

Effective communication with consumers can only be undertaken against a background of responsible performance. Competent and consistent performance in itself constitutes persuasive communication. Hence the telling image that IBM, Rolex and Spar Aerospace give out to the world.

The point I want to make here is that the best communications programme in the country simply cannot overcome poor performance by companies. We are judged not so much by what we claim we do, and say we do, as by how we actually talk to our customers, how we consider them, reason with them and treat them.

We cannot expect insurance bureau television advertising, or industry print campaigns, to paper over the inadequacies of poor performance. It is asking the impossible.

Now that we seem to be poised on the slippery slope of a softening market, we cannot fall back into our old ways and ignore reality. That reality is : we have a disturbingly low level of credibility with our customers. They like our service when they have a claim, but they remain unimpressed by us in how we explain our prices and many of our rating policies. We ignore this reality at our peril.

It is not good enough to simply say our business is too complex for the layman to understand it ; to rationalize that what happens is just a demonstration of the free-market working. As we have seen with Ontario automobile business, if control of the cycle of rapid and volatile price changes is not better controlled by ourselves, then that control will be exercised by others one way or another. Like it or not, directly or through their elected representatives, people are saying that an unfettered free market, governed strictly by the law of supply and demand will not do ! In effect, the message is regulate yourselves effectively or the Government will do it for you !

It is legitimate to say that uncontrollable extraneous factors have contributed to the volatility of our business. It was not us who sent interest rates climbing skywards and then have them drop just as precipitously. It was not us that encouraged the creation of a litigious society and new expanded concepts of liability. But we are responsible for our own image and we have been lacking in the quality of our communications, in our professionalism, in our pricing practice and our responsibility to maintain consistent and stable markets.

I agree with the premise that it is not the job of brokers or risk managers to save underwriters from themselves ; underwriters are in the final analysis responsible for the pricing and terms of the insurance product. But brokers and risk managers attracted by bargain prices should be conscious of the possible consequences of taking advantage of clearly unreasonably low premiums. I am quite sure the bruises from Northumberland et al will be around for a long time, but the impact of a repeat scenario of terrible results, market withdrawals – voluntary or by way of insolvency – will affect these other constituencies at least as much as insurers themselves. Is it not more important to have an insurance industry that is viable rather than one that provides cheap coverage ?

We have seen the move to reciprocals and other collective and self-insurance mechanisms. This movement is legitimate and need not be viewed with despair. If these other mechanisms feel they can do the insurance job better, then they are entitled to try. Their track record is not good and as the doctors in both Canada and United States have found out in the end, the losses have to be paid as do the costs of actuarial, claims, systems, investment and loss prevention expertise. I just hope that the financial strength of such mechanisms is durable enough to pay the piper if losses – especially of the long-tail variety – exceed expectations. As some of us have learned, the past is not always a reliable predictor of the future.

Although public image and management of the cycle are the dominant issues, literally in terms of survival of the industry in the form we know it, there are some further key factors that will be very much in evidence in the next few years.

First, let us dismiss a virtual non-issue from the perspective of our business, namely free trade. We have been operating for many years on a complete freedom of establishment basis and Canadian companies have operated quite satisfactorily alongside those from the United States, England and elsewhere. It would be nice if the free-trade agreement precipitated the unwinding of Government monopoly operations. The biggest impact of the free-trade negotiations on the insurance industry would be if no agreement is reached. I believe the free-trade agreement is good for the whole of Canada, including Ontario, and if the agreement is scuttled, then the general insurance sector like all others will suffer from the arresting of economic growth that will be involved.

Second, what is going to happen to the underwriting and distribution of general insurance in the face of the threat from multiple financial service organizations ? There has been a lot of hype about financial supermarketing, but there is a distinct lack of evidence that consumers want to put all their financial eggs in one basket. The current controversy over bank charges will restrain what little momentum there may have been in this direction. However, we should not let our guard down and our best defence is to do an even better job at providing insurance protection with proper attention and sensitivity to consumer interests.

Third, will there be a change in the market – like liability systems through the introduction of no fault on a full or partial basis ? The Osborne report which was promised in November has just emerged ; to me, the delay was a clear signal that resolving that issue one way or another was going to be a long and painful process. Now Justice Osborne has come out in favour of just tinkering with the status quo ; it certainly is not going to ease the path to meaningful reform – and a significant reduction in claims costs – which is the only way to contain premium costs.

Fourth, the technology area has promised more than it has yet delivered in terms of reducing the costs of delivery of our product. Somehow, the potential has to be harnessed better and C.S.I.O. is striving to make this happen, although some division in the industry sees less than universal support for its efforts. Technology is a major part of addressing the key issue of how insurers and agents jointly can drive down the overhead cost of our service to the benefit of policyholders, through the elimination of duplicative work and a general improvement in efficiency.

Fifth, the establishment of the Ontario Rate Board demonstrates that more constant and dedicated attention has to be paid to our relations with both provincial and federal Governments. For better or worse, Governments see themselves as the grand protectors of the consumer interest. I recognize the need for basic regulatory

protection against fraud and manipulation by quick-buck artists. However, there is abounding evidence that excessive Government regulation, that leads to a needless and costly bureaucracy, impedes rather than supports increased market efficiency. But again, even if we do not like the scene, we had better find ways to work effectively within it.

There has not been a time with more complexity, volatility, ambiguity and uncertainty than we are faced with now ; the consumer marketplace, the nature of competition along with technology are all changing in previously unthought-of ways and at a bewildering pace. Everyone is looking for the quick fix, but there is no quick fix, although we have to be constantly ready to change. Paramount is the need to concentrate on the quality and performance of our core business – performing the fundamentals well, by improving our internal productivity and providing exceptional value and service to our customers.

It will be clear to you that I think the industry is at a crossroads. Despite the formidable job to be done, I think we can follow the right path, but it is going to require hard and thoughtful work to truly respond effectively to legitimate consumer requirements and thus avert further stifling Government intervention. In a service business, our customers deserve the best and the fact they have not had it is reflected in the absence of goodwill toward us. We must provide products and service that are responsive to their needs, and create a working environment so everyone who works with us is impelled to provide the best of value for our customers' premium dollars.

If all concerned approach our problems with a positive attitude, and goodwill and respect for the various segments of our business, while fulfilling our functions in a disciplined fashion, then we will be able to mold it into the kind of business that will be respected for its role in Canadian society. I know we have the will to do it – let us make it happen ! I have a bright vision of the future – even if it happens to be through bifocals !

Actes de terrorisme ; indemnisation automatique

Récemment, en France, on a ajouté les dispositions suivantes dans le *Code des assurances* pour prévoir l'assurance contre les actes de terrorisme. Il a fallu procéder ainsi, tant ceux-ci se succèdent, avec des dommages corporels et matériels qui, dans certains cas, sont considérables. Voici, à ce sujet, un extrait du Chapitre VI du *Code des assurances* :

« Section I

Dommages corporels

Art. L 126-1. - Les victimes d'actes de terrorisme commis sur le territoire national et les personnes de nationalité française ayant leur résidence habituelle en France, ou résidant habituellement hors de France et régulièrement immatriculées auprès des autorités consulaires, victimes à l'étranger d'un acte de terrorisme, sont indemnisées dans les conditions définies aux articles L 422-1 à L 422-3.

Dommages matériels

Art. L 126-2. - Les contrats d'assurance de biens ne peuvent exclure la garantie de l'assureur pour les dommages résultant d'actes de terrorisme ou d'attentats commis sur le territoire national. Toute clause contraire est réputée non écrite. »

Jusqu'ici, le terrorisme au Canada n'a pas pris l'importance qu'il a dans certains pays : la France comme l'Italie, par exemple. Malgré cela, il serait bon qu'une loi canadienne précise l'indemnisation automatique que vient d'accepter le Parlement français.