

TRANSNEWS

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Trans-News is a newsletter for our customers dedicated to bringing you useful and timely information about safety, loss control, insurance and industry issues.



Please contact us with any questions, comments and ideas!

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The Driver's Seat

Since the inception of this newsletter, we have focused "the diver's seat" column on specific insurance insights that we thought would be helpful to you in managing your business or provide some education to you to better understand how insurance functions. I'm taking a detour this month because I think it's extremely important to all of our readers that we take a retrospective look at 2001 and try to evaluate what the insurance marketplace will look like in 2002 and what impact it will have on your business.

I think it can be said with some degree of certainty that all of us have been affected by the events of September 11th. Life has become a series of uncertainties whether it is in our private or business affairs. And, while we have been encouraged by government officials to return to normalcy, it has been difficult at best and somewhat mentally disabling at worst. My office has an unobstructed view of the skyline of New York. On September 11th I had clear vision of the destruction of the World Trade Center but could not see the catastrophe that was taking place on the ground. I was out of touch with the human element; the suffering, the heroism and the fear which took place. It was only recently that I could bring myself to visit that hallowed site. I got the same reaction to "ground zero," as it has been named, that I had when I first visited the Vietnam Memorial in Washington. All human emotions flow uncontrollably. The site reeks with pathos for those

who perished and for the physical structures themselves. It is almost blasphemous to value the event in dollars and cents but that is part of the normalcy that is required. It is necessary to evaluate the event in terms of business, economics, financials, etc. and eventually bring at least the non human element to closure.

In the immediate aftermath of September 11th, insurance contributions for the human toll and property was placed somewhere in the vicinity of \$30 billion. The latest number that has been floated is \$70 billion.

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Whatever the ultimate price tag in dollars and cents, we all will be affected financially by this event. Prior to September 11th, the insurance industry had suffered through some lean years brought about, in large part, by its own devices. Certain classes of commercial business were seeing price hardening while others lagged behind. If we look back at the halcyon days of the latest stock market run up, companies and individuals were making large portfolio gains. The insurance industry was no exception. They engaged in what has become to be

known as "cash flow underwriting;" specifically, disregarding underwriting integrity and adequate claims reserving for profit. Instead of charging adequate rates to create underwriting profit, they cut rates to acquire cash that they in turn invested thereby creating huge paper profits. When the stock market began to turn in 2000, those unrealized gains started to evaporate. The industry had to take a hard look at past practices and attempt to reverse the trend. In doing so, some of the more volatile lines of business or, to be kind, those classes of business that have potential for serious loss, were evaluated first. Among those was commercial auto.

As a class, commercial auto over the years has been unprofitable for the insurance industry. Low rates, high limits of liability, highly valued equipment and liberal jury awards have all contributed to the poor experience. And yet, insurance companies were competing for the business because they wanted the cash to invest. In the July issue of the Driver's Seat, I relayed the story of a conversation I had with a coach operator at the UMA convention in North Carolina. In a nutshell, it was his contention that his low insurance costs were the only thing keeping him in the black. All other areas of his business were escalating. Towards the end of 2000, companies were mandating premium increases across the board regardless of experience. By the end of 2000 and going into 2001, the increases grew larger. No commercial auto accounts

The Driver's Seat (cont'd)

were spared as all insurance companies providing commercial auto coverage followed suit. Why?

As previously indicated, cash flow underwriting and a turn in the economy has exacerbated the inadequate rate issue. But there is another more sinister problem and that is the cost of "reinsurance." As many of you know, reinsurance by simple definition is one insurance company taking a part of the risk of another insurance company. It's a seamless transaction to the buying public but an integral piece of insurance economics. What most people don't realize is just how much of the "risk" is transferred to reinsurer's. As an example, you all know that the minimum liability limits required by the Federal Highway Administration for a charter bus operator is \$5 million. Regardless of which company insures your operation, what portion of that \$5 million limit do you think is covered by the company that has issued the policy to you? The answer is more than likely, no more than 20% and probably only 10%. Using reinsurance, they transfer a significant piece of the exposure to other insurance companies but they do so at a price. And here is where the rubber meets the road. The reinsurance market, which provides the bulk of the financial capacity to the insurance industry, has been hammered with losses in the past couple of years. The pricing on reinsurance "treaties" that each primary insurance company negotiates, has risen dramatically. The cost of this reinsurance is passed through to the customer as part of the pricing

of the insurance product. Therefore, even if you have no losses, the cost of what your insurance company has to pay for reinsurance is passed along. Many of the reinsurance price increases that were contemplated before September 11th were re-negotiated to reflect the impact this event would have on the industry as a whole. The good news is that new money is entering the reinsurance market because investors see premium price hikes as being inevitable and view this as an opportunity; although this capacity will be slow to emerge. However, while capacity may become available, the question still remains, at what price?

"We are trying to do everything we can to neutralize some of the negative impact these pricing mandates have on your business."

Are insurance premiums going up post September 11? The easy answer is yes. How high is anybody's guess. Most reinsurance treaties worldwide expire either on January 1 or July 1. Some of those January 1 treaties have not been finalized. Until the economy turns around and insurance and reinsurance companies can start making investment gains, the dollars that insurance companies need to operate profitably will come from their insureds. So what does that mean to the commercial auto sector? Because yours is one of those "high risk" businesses, you can probably count on premium increases for the

near term; perhaps the next two years and maybe more depending on other catastrophic events or economic stagnation. It will take time for the catastrophe of September 11th to filter through insurance company balance sheets and see a return to normalcy. In the interim, weaker insurance companies will fold, some of the larger companies may be downgraded by the rating organizations and some commercial auto operators will not be able to afford the increases. The landscape will change and like in nature, the strong will survive.

We at Post/ Clayton are trying to do everything we can to neutralize some of the negative impact these pricing mandates have on your business. Having an educated customer is important when it comes to explaining pricing and coverage issues. It is important that you know how rates are developed (September issue) and have at least a working knowledge of the insurance business; particularly since it's such an integral part of your business. With information such as this we hope we can help you budget for the future. It is important for you to know that it is not just your experience that dictates pricing but other factors over which you have no control. I would encourage you to drop me a note or give me a call if you have any insurance questions. We are going through some tough times and quite often getting answers isn't always easy. If you don't want your questions aired publicly, our conversation will remain confidential.

Did you know? Who cares?

Facts and Trivia of the American Civil War



1. How many medals were awarded in the Confederate Army during the war?
2. Which southern state seceded first?
3. Which southern state seceded last?
4. Where was the first Confederate currency printed?
5. What were the casualties of the bombardment of Ft. Sumter, 4/12-13/1861?
6. What was the worst one day battle of the Civil War?
7. On the first day of the Battle of Gettysburg (7/1/1863), from which directions did the opposing armies come?
8. Which notorious outlaws were part of Quantrill's raiders?
9. What position was R.E. Lee offered prior to the start of the Civil War?
10. What was the greatest killer during the war?

1. None
2. South Carolina, December 20, 1860
3. Tennessee, June 8, 1861
4. New York
5. One Confederate horse was killed
6. Antietam, 9/17/1862, About 26,000 killed, wounded or missing
7. The North (Union) came from the south and the South (Confederate) came from the north (and west)
8. The James brothers & the Younger brothers
9. Lincoln asked him to command the Union army
10. Diseases including dysentery, typhoid, scurvy, malaria, measles, smallpox, etc. Killed 2x as many soldiers as died in battle