Trucking Risks in the New Millennium

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As we begin 2005 the trucking industry continues to makes adjustments that have occurred since the turn of the century. Not only do you have to be a more sophisticated trucker in this new millennium, the chances of the owner/operator staying in business are being eliminated due to the high cost of insurance, high cost of fuel and the rate per load not catching up to offset these expenses.

Insurance pricing in the early to mid 1990's was less than half of the pricing seen in the early 1980's, yet losses did not decrease. Defense funds greatly increased due to unfavorable legal climates. Truckers now face losses in comparative/contributory states where large payouts are made, when at times the trucking risk bears no fault other than being at the wrong place at the wrong time. As an underwriter writing these risks and being involved with the claims development, we all realize that lawyers are always looking for the "deep pockets" of these trucking risks.

As 2000 began the insurance industry as a whole began to experience a hardening of the market. The stock market plunged in the mid to late I990's resulting in insurance companies no longer receiving the high returns on their equity (ROE). No trucking market makes a profit in of itself; rather they have relied on the ROE to support the writing of this line of business. The average renewal pricing for liability coverage in 2000 was only 3% over the 1995 pricing. Physical damage coverage was below those rates charged in 1995. The Consumer Price Increase rose 13% during this same time period and the commercial auto physical damage severity increased 28.4%. The average liability pricing for a tractor trailer ($1 million in coverage per power unit) in 1985 was $5,302. The average price per unit in 2003 was $4,877.

The 2000 industry combined ratio for Commercial Auto Liability and Physical Damage was 115.7%. The second quarter of 2001 results for the commercial auto line was 116% combined. *National Underwriter* reported in their year end 2002 report that the industry reported a 104.9% combined ratio for the first nine months. The property-casualty insurance industry was on track to report its best underwriting results in the four years prior to 2002. The Insurance Services Office, Inc. reported that even the lower forecast combined ratio of 103.3% in 2003 "doesn't come close to generating the 10 to 15 percent return on equity that investors expect.

Available markets writing trucking insurance in 1996 was 127. Today there are less than twenty writing this line of coverage. The Enron and WorldCom scandals resulted in the reevaluation of accounting procedures for all companies and once again sent the stock market into a downward spiral. The financial stability of many companies came under scrutiny. This resulted in the discovery that many companies had diluted their reserves and under-reserved losses to portray a more solvent financial picture. The Central Analysis Bureau reported in late 2002 that "the insurance industry, which previously relied heavily on investment returns in order to maintain profitability, has been forced to offset substantial losses in the stock market which increased premium rates and more selective underwriting, making the market for insurance even more costly for trucking companies".

While 2000 began with the hardest market in recent memory the prospects for many companies remained uncertain because of reserving issues. Major changes were on the horizon for reinsurers. Reinsurance is involved in virtually every transportation program in the marketplace today. The type and structure vary with the risk appetite. Most reinsurance treaties as based on four types of reinsurance:

- Quota Share/Pro Rata – A form of reinsurance in which premiums and losses are shared proportionately between cedant and reinsurer. One such reinsurance agreement is quota share, in which the same percentage applies to all policies reinsured. Another is surplus share, in which the percentage may vary from policy to policy and usually increases as policy limits increase.

- Excess of Loss – A form of reinsurance under which recoveries are available when a given loss exceeds the cedant's retention defined in the agreement.

- Catastrophe – A disaster involving multiple insureds and/or locations. Hurricanes, tornadoes, explosions and earthquakes are the most common catastrophe examples. Catastrophe is also sometimes used to designate a single large loss – generally $5,000,000 or more – or an event affecting a minimum number of lives, e.g. three. Catastrophe reinsurance indemnifies the cedant for such losses, subject to an agreed retention and limit.

- Surplus Relief – An increase in the cedant's surplus through financial reinsurance. Cedant's are able to use the increase in surplus to write more business while retaining reasonable operating ratios, e.g. the combined ratio and the ratio of written premium to surplus.

To fully understand the changes that have taken place in the reinsurance arena a look at the reinsurance picture for Seaboard Underwriters since 1997 is a good example. In 1997 there was an abundance of (fronting) companies available.

Reinsurance capacity was abundant and there was not enough volume projected in some lines of business to interest many of the reinsurers. No retention was necessary by the issuing carrier. There was very little oversight by the issuing carrier, no premium caps were imposed and there were minimum reinsurance audits. This trend continued well into 2000.

In early 2001 we began to see changes occur. The investment income was gone and the commercial auto industry underwriting results were poor. Now the issuing carries had to take some risks. Actuarial involvement became commonplace with all placements. While there was still plenty of capacity available, extensive reinsurance audits were now being performed.

We faced a new world order in 2002. Events of daily life and the business world would be defined going forward as pre 9/11 and post 9/11. Post 9/11 everything we knew about reinsurance placement changed. Reinsurers mandated issuing carriers to retain substantial portions of the risk. The ceding commissions were reduced by 35% and the MGA/Program Managers were now required to participate in the risk. Premium caps were imposed and the cost of reinsurance increased dramatically. Statistical information became vital and payment to reinsurers/issuing companies became immediate. The pre and post layers of reinsurance that impacted Seaboard are seen below:

- 2002 – Reinsurance was not activated until after the first $100,000 of a loss was paid out.
- 2003 – The layer increased to $250,000.
- 2004 – The layer increased to $500,000.

Shortly after 9/11 KPMG reported the “aftermath of attacks will affect insurers in ALL markets – life, health and property/casualty with virtually all P & C lines affected” and “losses will not be clear by the end of the year”.

Federal Reserve Chairman Alan Greenspan stated that “All forms of business will see sharp increases in insurance premiums. Business decision making has been made more difficult, not because costs are so high but because the events are so uncertain”. The hardening of the market was already underway prior to 9/11 and accelerated greatly immediately following the attacks. We now knew we were facing substantial rate increases and tighter terms and conditions of the treaties. Even if coverage could be placed there would be significantly more restrictions and exclusions.

These facts were reiterated by Jacques Blondeau, Chairman SCOR, stating the “new hard market will be more severe, last significantly longer and will apply to more areas of business than the last widespread hard market of the mid 1980’s”.

An article in Bestweek 10/15/01 stated “The expectation is there will be limited capacity in the reinsurance market, brought about by reinsurers looking to optimize returns and limit their exposure accumulations. Reinsurers are unbundling coverages, adding terrorist exclusions, and moving from proportional to excess of loss coverages were they can define limits. All of this will bring about increased pricing”.

The experience of Seaboard is a microcosm of what was expected in the marketplace of reinsurance for the future. What did it mean for the insurance industry as a whole?

- Pure fronting arrangements (programs) would be gone.
- Programs must be able to actuarially demonstrate an underwriting profit or they will not be placed.
- Cash flow became more important to reinsurers since investment income was gone.
- Issuing carrier retentions became higher as experienced by Seaboard.
- Capacity would be limited in general but new reinsurance capital would enter into lines where they could maximize their ROE.
- Reinsurance premium caps will be common leading to one of the following scenarios:
    1. Capacity will be used up early in the year leaving no capacity for later in the year.
    2. Reinsurers will refrain from writing business early in the year with the premise that they will be able to get more dollars for the exposure later in the year.
- A number of reinsurers exited the truck marketplace due to adverse results.
- Reinsurers will become actively involved in the underwriting process.
- Statistical information and systems are vital.
- Expense management will be a key going forward as commission are reduced and margins are cut.
- There were a lot of consolidations/acquisitions on the retail agency side.
- Retailers, wholesalers, MGA’s, program managers, insurance companies and reinsurers have all been forced to share some of the risks with profits coming only after an underwriting audit is achieved.

Even prior to 9/11 there were many changes being implemented in the transportation industry. In 2000 President Clinton signed a bill that established the Federal Motor Carrier Safety Administration (FMCSA). The new agency would have the responsibility for motor carrier safety and motor carrier registration and insurance functions which were previously performed by the FHWA. This was done to give the motor carrier industry its own agency within the USDOT umbrella with the hopes that safety would be enhanced and the backlog of rulemaking would be reduced.

January 1, 2000 was to have been the date that Mexican and US truckers would have been able to travel freely through each other's country. Until safety concerns could be alleviated the administration prohibited Mexican carriers from entering the US (with the exception of the commercial border zone). To date NAFTA is still on hold and more than likely will be on the back burner for quite some time due to the 9/11 attacks and safety concerns at all US borders.

The year 2002 was ushered in amid fears of terrorism and ever growing concern over the state of the economy. The government put into place in early November of 2001 that a terrorist form must now be signed by all risks. With the threat of war fuel prices began to skyrocket. This greatly impacted motor carriers across the nation.

While there has been some softening in the marketplace in the past four years, it still continues to be a challenge to find writing companies for transportation business, reinsurance and ways to make an underwriting profit. What we are learning is that no longer can we put competitive pricing out there and expect to sit back and have insureds knocking on our doors to place their business. As a transportation underwriter for more than 20 years I see a new breed of underwriters that basically don't know how to underwrite. From the early 1990's until the market began to harden, it was pricing that sold and not much of anything else. These relatively new underwriters have had no training field in what it takes to maintain a risk on a long term basis if the pricing is not necessarily competitive. They do not understand the need for the necessary information that is required to properly underwrite a risk, i.e. financials, safety ratings, MVRs, currently valued loss runs, etc.

As underwriters we have the availability of more information on trucking risks than we have ever had. With the SAFER website we can get information on safety numbers, prior carriers, cancellations, etc. Prior to having access to this information we basically had to go with what we were given by the retailer and what the insured said. This is no longer true and trucking risks are having to step up the bat and offer everything about their risk accurately.

At Seaboard we have worked hard to bridge the gap between the retailer, insured and ourselves. This is sometimes a delicate balancing act, but having large volume insured's with access to us directly when questions arise has been a service that we have found is paramount to building long term relationships with the insured as well as the retailer. We have several large insureds that we have invested a great amount of time and energy in developing relationships and weathering some storms with them. These risks have proven loyal in the long run, even when our pricing was not the most competitive out there.

Several accounts were presented to us in 1999 and 2000 that were not “premium” accounts to other MGA’s and insurance companies. We physically went into these large trucking companies with the retailers and developed loss control with them and looked for ways together to help them improve.

The biggest hurdles to some of these risks were driver qualifications. While each had written driver guidelines they were not following them because the demand for drivers was so high. We convinced our largest account (premium in excess of $1M annually) to strictly adhere to our driver guidelines, which meant that there would be no place for approximately 30% of their drivers. They parked units without drivers for a couple of months until qualified drivers could be found. They offered high pay incentives to qualified drivers as well as paid vacation and health insurance coverage. The result has been an underwriting profit for the past four years.

Trucking in the New Millennium means that MGA’s must now have underwriters in place that have the experience to properly underwrite risks and qualify them. They have to be inventive in making risks fit into the molds. In order to do this they must build relationships with the retailers and the trucking companies themselves.

What it means for the everyday trucking risk is that they have to be more savvy businessmen. No longer is their focus simply to acquire a load and get it delivered on time. They have new DOT guidelines to adhere to and stiffer penalties when they operate out of the guidelines.

The single owner/operator is finding it more and more difficult to operate on their own. They are now leasing onto the larger trucking risks that can guarantee them loads and provide a more stable work environment. The larger trucking risks are now realizing that they have to be more selective in their driver pool and take what steps necessary to achieve this.

One of the things I have told Safety Managers of some of our larger trucking risks is to have the mental picture when they interview these prospective drivers of “how would they perform in court”. This entails background checks as well as current MVRs. These are some of the first things that a lawyer is going to obtain in a court case against one of our trucking firms. The largest court case awards are usually on the punitive side and we have to be aware of this and be prepared should they occur.

The focus for the New Millennium is responsible underwriting on every level. We must look for the more professional trucking risks and build long-term relationships. Technology is on our side to be able to attain these goals if we remain on track.