# UNDERWRITING THE INDUSTRIAL RISK

As we look at our Insurance Industry today and try to evaluate its nature and purpose, it is impossible not to ask ourselves what part can Underwriting play or, frequently, does it in fact exist at all when we see attitudes and practices which have invaded the Market and which have had such an impact not alone on its direction but also on its very well-being. We are seeing Underwriting as we knew it, being cast aside so frequently and supplanted entirely in many instances by so-called commercial expediency. Such terms as "portfolio underwriting" or "package underwriting" are being used to cover what is nothing more than an effort to get business on the books at any cost. We frequently see a contest of bid and counter-bid to produce simply the lowest possible premium which will persuade the prospective Client or Insured to place his business with one or other of perhaps several vendors of the Insurance package being offered. In the majority of such instances, it is impossible to see any attempt whatsoever to relate price to the degree of risk being assumed. It is inevitable that the larger risks are particularly vulnerable to these procedures and the practice has developed to such an extent that practically no Industrial Risk is now immune.

This negative approach to Underwriting without doubt is having an adverse effect on the Market as a whole and must be hitting even more severely, those Insurers who have become immersed in such practices. How can such Insurers complain if their Underwriting subsequently produces painful financial results. It can be suggested that these Underwriting attitudes may be justified as long as they are merely absorbing what are considered to be surplus solvency margins but this is a rather short-sighted approach, ignoring the added ultimate adverse effect on Market stability.

High interest rates both in this country and in other financial markets have undoubtedly been a major factor in the development of these attitudes which have resulted in sensible Underwriting being submerged by financial considerations and turned into what is frequently described as"Cash Flow Underwriting". However, the short-comings of using interest rates as a support or crutch for Underwriting are now being exposed by the erosion of the high rates which existed up to a few months ago and it is quite likely, if not inevitable as trade picks up internationally and particularly in the U.S.A., that interest rates may come down even further. Already this changing situation may well be creating substantial problems for some Insurers in their efforts to balance bad Underwriting Results with Investment Income. Whilst high interest rates are an undoubted attraction to Insurers, particularly Investment Managers, they are a positive impediment to the growth of the economy in general and as such they are certainly not in the longer term interests of Insurers.

There is frequently some degree of argument as to whether Reinsurers have contributed to this adverse Underwriting position and there is ample support for the view that soft Reinsurance rates have played a significant part in setting the base for inadequate rates offered by direct Insurers. The essence of Insurance is, of course, the spreading of risk and Reinsurance plays a very necessary and prudent part in general insurance operations. It is very much a world-wide aspect of our business and when used on a proper and sensible basis, it can and, indeed, should be beneficial to direct Insurers.

However, there has been a strong temptation for direct Insurers to take advantage of the particularly soft rates available in many secondary Reinsurance Markets. Well spread arrangements have been made with the Insurer passing on the major share if not the entire risk written at basic inadequate prms ~~rates~~, retaining for himself the commission offered by the Reinsurers on such transactions. These Reinsurers, in their turn, pass on, at times their entire acceptance, in retrocession to other Reinsurers, again for commission and this process can be repeated several times so that at the end of the day, the ultimate risk carrier is left with a risk premium of negligible proportions and quite inadequate to cover the degree of risk with which he is involved.

In the course of the past year, the Reinsurance Market, as we know, has been going through a traumatic phase and many undesirable aspects of certain sections of the Market have been exposed. Indeed, it has been difficult in some instances, to distinguish genuine Reinsurance transactions from financial manipulations designed solely for the benefit of non-risk carrying interests. It is not surprising that several, admittedly rather down-market Reinsurers, have been unable to meet their commitments and current Market indications suggest that further such Reinsurers are heading for similar difficulties. Direct Insurers falling into the temptation to use these cheap sections of the Market to further their own competitiveness must carry the extra risk involved with its potential impact on their own net Underwriting position. We should be particularly aware of Reinsurers based in countries which have existing or potential political instability with its associated financial or exchange control hazards.

Any Insurer who does not attach the utmost importance to the strength of the security provided by all his Reinsurers does so at his own peril. On-going vetting of such security is essential. As we know, many claims particularly under Liability Covers, may not be settled for perhaps seven or ten years or even more and we need to be sure that today's Reinsurer will still be in existence and will be able to pay claims if required at the end of that period.

Inevitable reaction has already been shown in some sections of the Reinsurance Market and led by some of the major long-established leading Reinsurers, a degree of hardening of rates and terms has begun to emerge. Continued bad experience has forced Reinsurers into situations where we have been told, considerable numbers of Treaty arrangements have not been renewed at all for the current year - an action which reflects what is seen as the inferior quality of the Ceding Company's Underwriting. We cannot forget that Reinsurance in reality is merely a vehicle for spreading out losses over an extended period. The Reinsurer also has to live and what he charges a particular direct Insurer must ultimately reflect the experience which has developed under any such arrangements. At the end of the day, reluctance to adopt a sound and sensible approach to Underwriting catches up with the direct Insurer who operates in this way and will dictate what he has to pay for stable Reinsurance arrangements.

The experience shown in Irish Market Statistics for the past few years is sufficient to indicate that there are major problems here. In 1980, the Non-Life Market produced Revenue of £246m. with Underwriting Losses of £32m. In 1981 the Revenue was £308m. with
(Net figs)

losses increased to £39m. When 1982 figures are published, they will show even further deterioration and if this progression continues into the current year, the inherent problems will magnify very considerably. The overall picture clearly indicates that a serious re-appraisal of Underwriting attitudes is necessary.

If, in face of such Market Results, we see a continuation of the current practice where the premiums for so many risks, particularly commercial and industrial risks of any size, are reduced/substantially each year at renewal in these times of on-going inflation, for no justifiable reason other than market competition, and frequently in spite of seriously adverse claims experience, Market stability cannot but be affected. This must be a matter of concern for all of us in the Market, both Insurers and intermediaries. As premiums to the Insurers reduce to totally inadequate levels for the risks being carried, the intermediary market must also suffer a comparable loss with all that this entails.

We all appreciate that we operate in a competitive commercial world and have to be realistic in our expectations. To do otherwise would simply be foolish. We are dealing with Insureds who are fighting in the front line of a severe economic recession in which many have already failed to survive. Others have had to look very closely at all aspects of their operations and in slimming down in efforts to remain competitive, have been forced to cut back in many areas with redundancies increased at an alarming rate as indicated in National Statistics. Overall, so many Policyholders have to subject themselves to considerable financial restraint and save money where they can. Trading, employment and stocking level projections are being substantially reduced in so many areas. Insurance premiums represent a major item of outlay for most commercial and industrial organisations and it is inevitable that the present economic climate will compel Financial Managers to seek as much saving as possible on such premiums. Fortunately, experience has shown that not all Policyholders will go for the cheapest market - they will realise that cheapest is not necessarily the best value and they will still look for the best value for the premiums which they have to pay.

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An Insurer cannot ignore these realistics. He must be ready to assess what he can do to meet the challenges involved and make sure that his premiums are as competitive as possible but, at the same time, adequate to meet the risks which he has to carry. Leaving aside the question of profit, there are really two elements which have to be covered by premiums. They are simply,

Claims

and

Expenses.

If either of these can be reduced or at least contained, then the Insurer will be in a position to become more competitive in the minimum premiums which he requires. Expenses, of course, are a very important element but for the purposes of the subject under discussion, we shall consider Underwriting and the vital part which it must play in the well-being of our business.

The science of Underwriting, as we understand it in relation to Insurance, is basically the transfer and acceptance of risk and in so doing to evaluate that risk. This demands the ability to assess the likelihood of loss or accident and the probable cost involved. The reluctance or inability to apply this science is, I am satisfied, a key factor in the creation of many of the market problems which exist today. Insurance is a technical business even though many people in the business seem too easily to ignore this fact.

The development and application of technical skills in a professional manner must be a very important priority for any Insurer who wishes to underwrite successfully and failure to do so is simply setting off down an inevitable road to disaster in present conditions. I refute entirely suggestions that correct Underwriting procedures are an unnecessary encumbrance and a technicality which can have no place in to-day's competitive world.

If such aspects of our business are to be ignored, then we are really wasting our time here this evening. We are all here because we are Members of this Institute and we subscribe to the aims and objectives of the Institute. One of these primary aims is the furtherance of

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technical skills and knowledge amongst our Members and in support of this, we actively encourage Members to study and sit for Chartered Institute Examinations set in Courses which deal specifically with technical and professional aspects of Insurance - in particular the science of Underwriting. We set out to develop professional people for a professional job.

Many will see some problems in reconciling Underwriting Principles with sales achievement to get a proper balance between the two. There may always be some degree of difficulty in relation to this but to sell merely for the sake of Revenue Growth is nothing more than creating serious problems for the future. It is significant to observe that a number of Insurers, including some large International Groups,have taken steps to remedy adverse Underwriting situations created in the main by past indiscreet excessive selling. As corrective action in dealing with the serious Underwriting Losses, they are cutting back on exposures as necessary, even though it means loss of some business and reduction in overall revenue. This is happening in several major International Markets and it is encouraging to note that similar action is being taken by several Insurers in this Market in spite of the serious contrary worrying trends to which I have already referred.

In practice, successful Underwriting is by no means easy under to-day's conditions and it can tax the skill and endurance of even the most experienced. When we consider the average commercial and industrial risk which is presented to an Underwriter, it may constitute several individual categories of risk and, in practice, is frequently put forward as a collective package. The concept of packaging has many advantages both for Insurer and for Policyholder but we must never fail to satisfy ourselves that the individual risks making up such a package are underwritten on a proper basis ensuring that the collective premium is adequate to provide for the collective risks which are being covered.

If we acknowledge, as we must, that Underwriting entails an assessment and acceptance of risk, then it is essential that we know the exact nature and extent of such risk. The Underwriter must have the fullest information about the prospective Insured and his business. This may seem to be an elementary requirement but it is something which, in practice, is often ignored as shown by the limited information frequently accompanying submissions for quotations, where premium quotations have already been given by another Insurer without full details which should be essential to an adequate assessment of the risk. When Proposal Forms are used, they can supply a reasonable amount of basic information but the Underwriter must not fail to seek any additional information which ~~that~~ he regards as material. There are, of course, specific duties imposed by law on a Proposer to disclose all material facts but circumstances may place limitations on this and an Underwriter can never sit back and assume that the law will do his work for him. The law may even attribute to an Insurer knowledge and professional skill which he has not utilised and,as a result, preclude him from relying on alleged non-disclosure.

With many Standard Risks, an Underwriter may know from his own experience the various types of operations involved in the particular industry but where he does not possess such information, he must acquire it if he is to fully appreciate the risks which he is taking on.

In general, Industrial Risks will usually involve Covers for Property, Liabilities and Financial Loss under the various types of individual risks. Whilst each category will require separate consideration by Underwriters, there are certain broad issues which can have a bearing on the overall risk. In particular, previous claims experience should always be verified not merely in financial terms, but the circumstances which gave rise to the claim should be known and the likelihood of a recurrence considered. Costings on settled claims will normally be factual but those for outstanding claims, particularly cases involving Liability issues, can call for special consideration. With Personal Injury Claims, full details should be obtained not only of the circumstances of the accident but also of the injury, with an indication of age, occupation and earnings, to assist in consideration of the financial costings being presented. Such demands may seem superfluous to some but experience in these areas has shown that variations can occur in claims figures put forward for the same risk in submissions from different sources - a situation which at best can perhaps be described as one of"varying interpretations". As an Underwriter is looking to the provision of cover for the future, it is important that costings for past claims are suitably trended to allow for inflationary factors since the date of accident or loss. Indeed, recent levels of come Court Awards for Personal Injury can only reinforce this requirement.

Favourable claims experience can only be regarded as a factor to the Insured's credit and should never influence rating to the extent that it reduces premiums to a level which does not make reasonable provision for the degree of inherent risk which is always present even though it has not revealed itself over the past few years. To achieve this, the experienced Underwriter will undoubtedly supplement his own judgment with own Company and Market Statistics and, for specialised types of industry, may well look to other Markets such as U.K. for guidelines.

As I have already indicated, an Underwriter must have a reasonable basic understanding of the Proposer's operations such as the nature of his premises, plant and machinery, the sources and supply of power, heat and water, whether the risk is sprinklered, the actual manufacturing process, the type of goods produced and where they are sold, quite apart from fundamental financial matters relating to various sums insured and projections of turnover and

+ Indemnity Limits

wages. A full appreciation of an Industrial Risk can only really be obtained by inspection of the premises where the experienced Underwriter or his Surveyor can see for himself and can discuss, as necessary, practical issues with those directly in control of the various aspects of the operation. Experience suggests that there is ample scope for extended use of Surveyors to assist Underwriters in their task. These Surveyors should be equipped to deal not only with Fire and Sprinkler issues but also with Accident and Liability Risks which are involved.

Trained Surveyors will observe many incidental factors apart from basic aspects of construction and materials and many such factors which may appear unimportant at the time to the unenlightened, have been shown from experience to be material in the frequent causation of claims. Perhaps one of the most important areas of concern and which is universal to all Industrial Risks is simple housekeeping, covering supervision and tidiness. How often have we heard, for example, of a fire starting in a pile of rubbish which had been allowed to accumulate perhaps in an unused corner or worse still the accumulation of waste around machinery which has caused a serious accident to an employee.

Apart from reporting on the nature and extent of risk as found on inspection, Specialist Surveyors can also play an essential role in recommending and supervising the implementation of positive risk control

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measures. Such a service has been proven to be a very useful method of controlling the incidence of loss and accident and is an extremely advantageous aid to Underwriters in helping to minimise claims cost. As a result, it can assist in giving some extra degree of competitiveness to which I have previously referred.

Effective risk control can relate to practically all aspects of a risk. The necessary measures which should normally be listed by the Surveyors would include the remedying of positive defects which had been found whether these are physical, relating to the premises or machinery or if they concern the systems of work or management and supervision.

For example, it may be found that basic aspects such as fire-fighting equipment and water supply are deficient or that there is no system for testing these. There may be dangers inherent in the method of heating the premises and perhaps elements of defective electrical wiring or apparatus. If these are of major dimensions, a total declinature would be more justified until complete renewal has been effected and sensible Underwriters would adopt such a course.

An extremely important aspect of risk control relates to safety measures designed to protect employees and others from accidents and the Insured from the resulting claims which can have a major impact on costings. The Surveyor in liaison with the Underwriter must take himself through the various aspects of the duties imposed by law on the Insured and set out any necessary procedures for ensuring that all such duties are adhered to. In dealing with human beings, it is impossible to eliminate incidental acts of casual negligence and, as a result, all accidents cannot be avoided but positive steps can be taken to effectively reduce the incidence of many other accidents and consequent claims. It may be necessary to set down specific rules for the training of new or young employees or for their supervision and employment, for example, on machines, where these matters have only been given scant or casual attention, if at all. First Aid or other accident services may be deficient. Equipment such as ladders, trolleys, storing racks and lifting facilities may either be defective, placed in hazardous situations or used in a dangerous manner. Machines may be inadequately guarded or existing guards may be defective or simply do not match up to statutory requirements. Machinery may be sited in such a way as to impede access or lighting may be inadequate to ensure safe operation of such machinery. Protective clothing and eye-shielding may be necessary. Noise may be found to be excessive with the result that its reduction or the supervised use of ear-protectors is called for. These and many more beneficial measures can be introduced on the operational side.

Other aspects of risk control will cover protection of the premises and its contents against burglary or vandalism. Indeed, this has become such a serious risk in some areas that it may well be impossible to make some premises suitable for Insurance Cover no matter what measures are taken. Malicious fires are an ever-present and, indeed, growing hazard and whilst malicious damage legislation is available through which recompense can be sought, it can often be difficult to satisfy the strict legal requirements of proof of malice when issues come to Court.

However, co-operation with Security Firms in many cases resulting in the installation of satisfactory Alarm Systems or Security Personnel Protection can transform some risks and make them acceptable to the Underwriter. This type of protection may also be demanded for the Cash Carrying element of risks.

If Fidelity Guarantee Cover is included in an Industrial Package, effective Underwriting must ensure that proper systems of audit are in operation with cash and stock control and that financial and credit supervision are maintained at all times. Particular attention may be called for in relation to access to and the supervision of computer facilities.

Many Industrial Risks include Motor Fleets which can produce considerable numbers of claims. As an effective underwriting tool in this area, specialised risk control procedures can be introduced to ensure that vehicles are subject to regular checks and are properly maintained and serviced and that sensible control is operated over their driving and use. As Gardai Statistics and our own Claims Departments' experiences show, defective vehicles, particular commercial vehicles, are the cause

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of many serious accidents on our roads.

The overriding service which is sold to Policyholders and which the Underwriter sets out to provide is for the payment of claims. We should not be too concerned because claims arise. Let us not forget that if there were no claims, we would simply have no Insurance to sell, but whilst claims are inevitable, we must ensure that they are settled at the most advantageous terms possible and this is invariably associated with avoiding delays at all stages. This is why an efficient Claims Service is such a necessary adjunct to successful Underwriting. There has been a tendency in the past to pay inadequate attention to Claims Departments which in many instances were inadequately staffed, making it impossible for them to operate with the necessary degree of efficiency which could result in keeping claims costs to a minimum.

An efficient Claims Service will always save money for an Underwriter and the greatest benefits will be obtained where an effective on-going liaison is maintained between Claims and Underwriting Departments. In this way, Underwriters will develop greater risk appreciation which must have beneficial effect on Underwriting Results. Furthermore, an expeditious and efficient Claims Service will undoubtedly produce a more appreciative and responsive Policyholder.

Over the years, we as Insurers have responded to Market needs. The demands of the Industrial Sector in particular have presented many problems, but we have adapted to these and we must continue to do so. However, facing and accepting change does not mean that we should lose sight of the basic principles of underwriting. We simply cannot afford to do so. This is a formidable challenge in to-day's conditions and whilst I cannot claim to have all the answers, I hope that the few aspects which I have been able to cover in the short time available this evening will at least generate some useful thought.

B.K.Fitzsimon. 7th March 1983.