

EMERSON, REID'S

INSURANCE OBSERVER

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Being the world's greatest DBL general agency is great, but let's face it, we'd rather play centerfield for the Mets. Fortunately, we know where our talents lie, so we've put our competitive spirit into our business. Vince Lombardi said the secret of his team's success was very simple: blocking better and tackling harder. We like that attitude a lot and have tried to follow it. But since we don't like to take chances when it comes to DBL, we've gone further: we work longer hours and have the best people, too.

Thank You Mr. Buffet

Each year we anxiously look forward to Spring, not because it means warm weather and longer days, but because it's when we receive the Berkshire Hathaway annual report. For those of you who aren't familiar with Warren Buffet's Omaha-based company, well, you should be. Not only is Buffet the greatest investor of his generation, he is a wonderful writer, and possessor of a brilliant-yet-simple perspective on the business scene. He is also in the insurance business.

Berkshire Hathaway's insurance subsidiaries boast a financial soundness unrivaled in the industry. Their 1988 premiums-to-surplus ratio was an ultra-conservative .14 to 1 versus an industry average 1.9 to 1. 1988 written premiums of \$484 million were dwarfed by

the company's \$3.12 billion in surplus.

The sheer diversity of Berkshire's holdings is also remarkable. In addition to owning The Buffalo News, World Book Encyclopedia, See's Candies, National Indemnity, and a host of other businesses, Berkshire owns 44% of GEICO, 12% of



Drawing by Wm. Hamilton
©1988 The New Yorker Magazine Inc.

"Italy just bought France."

The Washington Post, 17% of Capital Cities/ABC, 12% of Salomon Brothers, and 6% of Coca-Cola.

Since Mr. Buffet is worth several billion dollars and we're not, his thoughts on the outlook for the insurance industry are probably of greater interest to you than ours:

The property-casualty insurance industry is not only subnormally profitable, it is subnormally popular. (As Sam Goldwyn philosophized: "In life, one must learn to take the bitter with the sour.") One of the ironies of the business is that many relatively-unprofitable industries that are plagued by inadequate prices habitually find themselves beat upon by irate customers even while other, hugely-profitable industries are spared com-

plaints, no matter how high their prices.

Take the breakfast cereal industry, whose return on invested capital is more than double that of the insurance industry (which is why companies like Kellogg and General Mills sell at five times book value and most large insurers sell close to book). The cereal companies regularly impose price increases, few of them

related to a significant jump in their costs. Yet not a peep is heard from consumers. But when auto insurers raise prices by amounts that do not even match cost increases, customers are outraged. If you want to be loved, it's clearly better to sell high-priced corn flakes than low-priced auto insurance.

Buffet believes that if voters continue to insist that auto insurance be priced cheaply—below cost, in other words—then it must eventually be sold by the government. He also takes a dim view of the industry's prospects in the next few years. He feels due to rampant underpricing there will be few opportunities for underwriters to make money. Furthermore, many insurers are under reserved, but will not see the light until it is way too late. Unfortunately, that's the nature of the industry.

For those who would like to read more of Buffet's writing, a compilation of his letters to shareholders taken from Berkshire Hathaway annual reports is available upon request from the company at 1440 Kiewit Plaza, Omaha, Nebraska, 68131.

"The Gunner" Returns

We've known "the gunner" for many years, but hadn't heard from him for some time. When we recently chatted over drinks we had to admit he looked good. Very good. He was garrulous as ever, and we think we heard him say something about a corporate yacht. That's the gunner for you.

Although it's nice to see him in the ranks of the employed, we know only too well that it won't last. You see, the gunner doesn't know a damn thing about insurance, but he's a real nice guy and has got some great stories.

In the 'Seventies he was underwriting the residual values of computer leases. Then he represented a Barbados-based specialty insurer that went bust writing excess liability for the hazardous waste industry. Of course we'll never forget the time he wrote all that malpractice insurance for the First Old Colonial United Prudential Re of Panama. What a mess!

Even though every insurance company he's ever worked for has gone under, the gunner has always managed to come up with another job. Right now he's working for a fledgling insurance company near the city. We were wondering how this thinly capitalized firm has managed to write so many millions of premium in the last year. So we asked him. "Gunner, what's really going on?"

He smiled broadly. "We're specialists and we really service the business. It's all we do, you know."

"Come on gunner. You've got two employees and they're both salesmen. Fess up."

His sheepish grin was engaging, and he pretended to be embarrassed. "You got me there, Duke. But we know how to underwrite. It's all we do."

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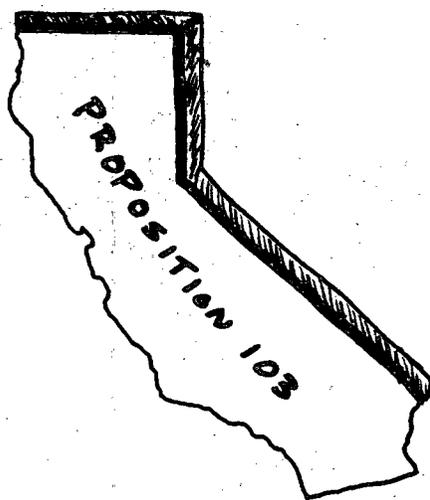
"Gunner, your company is almost out of capital. You've been incurring some of the nastiest looking loss and expense ratios we've ever seen. And by the way, stop calling us Duke."

"It'll turn," the gunner said hopefully. "We're also looking into some longer tail business that'll give us a chance to get back on our feet..."

Goodbye gunner, it's been nice knowing you.

Take Two Aspirin And Call Me In 1991

A recent research report from the esteemed investment bank Goldman, Sachs & Co., advises investors to steer clear of insurance stocks until the current cycle bottoms out in 1991—unless



Clearance sale. All insurance 20% off.

there is a recession and a large decline in interest rates before then. (Since insurance companies invest primarily in bonds, declining interest rates would give their balance sheets a real boost. Nonetheless, how ironic that the insurance industry needs a recession to make money.)

Why the gloomy outlook? A number of reasons: 1) Insurance company earnings are deteriorating gradually, hence a longer downcycle. 2) Insurance companies are unlikely to pull back from

the market or raise prices until they become alarmed by poor financial results. 3) Insurers' erratic pricing policies have encouraged many customers to seek other means of risk financing.

On the bright side: 1991 isn't so far away.

Wait Till The Year After Next Year

"Let's talk about the future. I have to say it's not a happy outlook. Prices are lousy and continue to slip. I fear our industry simply does not thoroughly understand its costs. I see a deterioration of about four points in the combines ratio this year and another four points next year. After that, who knows? Perhaps the sun will start to shine again."

—John Byrne, Chairman, Fireman's Fund, February 28, 1989

What Haven't You Done For Me Lately?

"After the season in which I hit 37 home runs, I asked Pittsburgh Pirate general manager Branch Rickey for a raise. He refused. 'I led the league in homers,' I reminded him.

'Where did we finish?' Rickey asked me.

'Last,' I replied. 'Well,' Rickey said, 'we can finish last without you.'

—Ralph Kiner, Baseball Hall of Famer

Opportunity Rocks

In 1962 the Beatles auditioned for Decca Records but were turned down cold. Why? "Groups with guitars are on the way out," said a Decca exec at the time.

Travel Accident And Long Term Disability

The word is spreading—slowly.

Emerson, Reid's marketing expertise in Travel Accident and LTD is yours for the asking. Not all of you are asking, though, and that's getting Mark Wintjen and Walter Taylor a bit concerned. They hate to see folks miss out on something good.

Enriched DBL Made Easy

Since the state no longer requires a DB-800 form to be filed, writing an enriched program is easier than ever. Give us the basic DBL information and a census showing salary and sex. We'll take it from there.

A Shameless Pitch For Your DBL

Emerson, Reid is unrivaled when it comes to handling DBL. When you do business with us you have virtually every active DBL market made available to you. Furthermore, we are the largest producer in the state and for most underwriters. Also... aw shucks. It's too embarrassing to go on like this. Just give us a call.

You Heard It Here First

In our last issue we predicted an increase in the DBL benefit. We were right. Effective May 1, 1989 the benefit was raised 17% to \$170 per week. This strikes us as rather small, so we'll go out on a limb with another forecast. Expect another benefit hike within eighteen months.

Payroll Rates For Under 50; Finally

As many of you are well aware, most insurance carriers discontinued their payroll rates for small accounts. While this is fine for most, it has posed a hardship for companies with part time, seasonal or low paid help, such as restaurants. We are pleased to report that we now have a market that can give payroll rates for less than 50 lives. Give us a call and we'll tell you more about it.

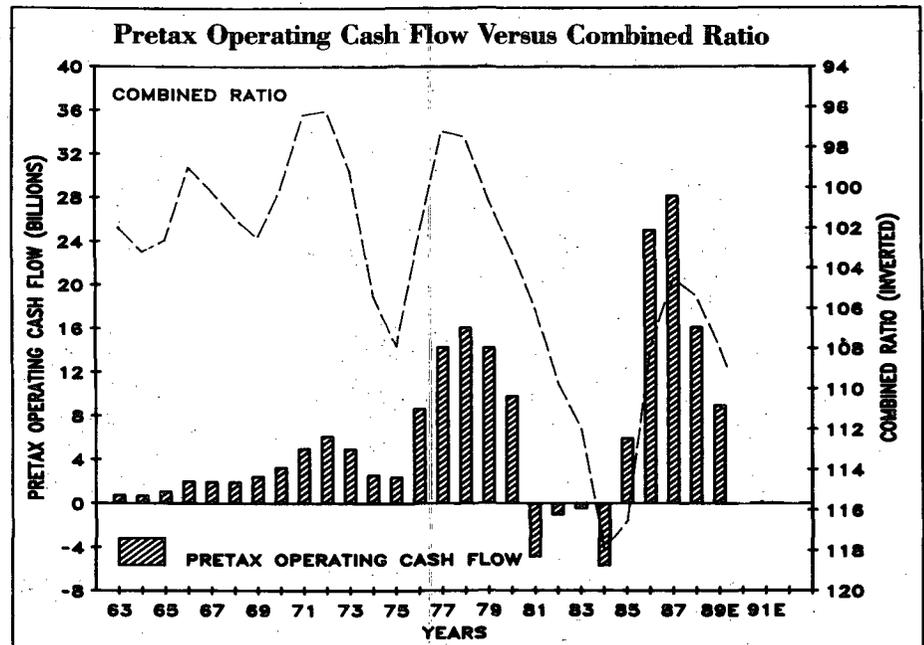
Pretax Operating Cash Flow Versus Combined Ratio

The difficult-to-read graph below tells us what we all intuitively know—that annual profits go down when the combined ratio goes up and vice versa. On a less obvious note, the chart also shows us that over the last twenty-five years profits have trended upward *even though* the combined ratio has too.

Does this mean that the glory days of the Sixties and early Seventies—when

the combined ratio hovered about 100%—will never be seen again? Certainly the financial world is much more competitive these days, and, last time we looked anyway, the insurance industry was part of the financial world.

So, will insurance companies ever show an underwriting profit again? Our answer is an unequivocal "It remains to be seen."



The Lowdown On The Benefit Increase —What's Really Going On

We think that the 17% DBL benefit increase will translate into an average premium increase of 12% give or take a little. No big deal? Guess again. As of late May only a few companies had announced their new under 50 life rates. It seems that many of them are jockeying for position, waiting to be the last to file.

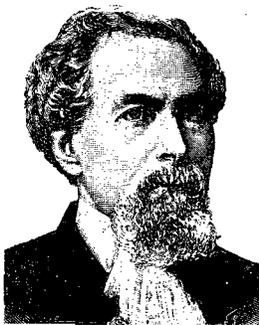
How will over 50 life cases be handled? Premiums on payroll rated cases will be adjusted to reflect the increased payroll of \$340 per week. Policies written on a per capita basis will be re-underwritten, at least that's what one carrier tells us. Others are not so sure—they're looking for ways to postpone the inevitable. But, as we all know, premiums *in general* are going up to reflect the increased benefit. In the meantime, confusion abounds.

Not at Emerson, Reid though. Due to our prominence (this is just a fancy word for huge premium volume) in the DBL market, we've had lengthy discussions with the carriers as to their intentions, so we're on top of the situation. The big questions here are simple though: Has there really been an increase in exposure? If so, does the loss experience justify an increase in premium?

We'll be glad to give you the answer.

If you would like to receive Emerson, Reid's DBL information kit, please contact Natalie Ross or Mark Wintjen. This kit includes applicable sections of the New York Worker's Compensation Laws, questions and answers, and applications.

CAN YOU SPOT THE GREAT NAMES IN DBL?



SEARS



ROEBUCK



BARNUM



BAILEY



SMITH



WESSON



EMERSON



REID

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