Underwriting Committee Annual Report

November 30, 2010

Chair: Steven Scharien – Coast Underwriters Limited

Committee Re-cap

It has been another quiet year for the U/W Committee. A busy market and slower than expected economic recovery has kept schedules tight and many understandably keeping focus on their day-to-day. Good intentions continue of course, and hopefully we will be a little more settled for 2011 giving the opportunity to give some attention where it is needed.

Hull & Liabilities

2010 continued to be a virtual copy of 2008 and 2009. Rate decreases continue to be pushed, with adjustments only applied to the poorest of risk. Market capacity - both domestic and international is still readily available. With no real improvement in losses coupled with aging fleets, this market segment is still quite competitive.

Driven primarily by the fishing industry, the Atlantic story remains poor –

- Losses ratios still hover over 100% with a number of large losses contributing
- Continued weak fishing economy and un-employment pushed the competition further with –
    - Continued Rate decreases
    - Enhanced policy conditions and inclusions
    - Lower Deductible

Despite previously poor results, Atlantic remains a competitive market – compounded by the fact that additional markets have made capacity available putting further pressure on rates and incumbent portfolios.

With corporate margins getting thinner, hull operators are looking to reduce costs where they can. Evidence is reflected in the claims, including –

- Vessel maintenance lacking with a reluctance be pro-active, instead simply responding to major issues
- Vessel inspections being pushed to the last day possible
- Operational short-cuts to save fuel, employee wages, etc resulting in compromised navigation

As reported in 2009, as markets look to diversify their portfolios, Marine package policies are the flavor of the day. These packages blur the line between property and marine. The "Marina Package", once a rare commodity with only a few exclusive programs available has become mainstream and offered through a number of channels. This class has historically proven to be unprofitable, however a stronger yacht season has leveled marina revenues for 2010, and other than a few a major incidents the industry faired well this summer. Premium competition continues however with even deeper cuts in 2010 with some cases seeing 40% reductions from 2009.

Pleasurecraft

2010 was a strong year for pleasure craft. The slower economy did not appear to affect vessel sales and usage, and better than average weather encouraged people to get out on the water. Market landscape remained relatively unchanged, with all the key insurance providers continuing to offer products. Despite narrowing margins, competition remains strong particularly in Ontario where pricing still continues a downward trend and new products and coverage have been adopted.

This year mimicked 2009 on a number of factors, helping the strong season –

- Gas Prices.
  Lower numbers at the pump got boaters out on the water.
- Stay-cations.
  Some families, perhaps on limited budgets redirected their vacation funds to local activities instead. They actually used their boat more than once a year.
- Cheap New Boats.
  Huge incentives on new boat sales, in some cases up to 50% off retail saw many taking the opportunity to either dive into boating or go for an upgrade.
- Cheap Used Boats.
  U.S. used boats were listing for well below their fair value. As bankruptcy and other troubles pushed these boats into the market we saw eager Canadians taking advantage of "steals".
- Good Weather.
  2010 saw a lot of sunny weekends and boating activity.

The same issues continued for 2010 as well –

- Good deals = Valuation dilemmas
  With boats selling cheap, a real concern developed with respect to valuation on policies. A good deal doesn't necessarily mean the vessel is only worth that value, however raises the concern of over-insurance.
- Good deals = More less experience boaters
  New package deals, particularly from the mainstream manufacturers like Seadoo has seen more and more junior boaters hitting the water. With the ability to roll off the lot with a new boat in tow and launch it same day, training and orientation is often non-existent.
- Cheap big boats = More adventurous boaters
  Many boaters would have stuck to their local waters with their smaller craft, however goods deals and upgrading has seen, in some cases, less experienced operators being more adventurous and going to new places, particularly south.
- More boating = More claims
  Better weather and more boats on the water brought us to the obvious conclusion.
- Parts still cost the same.
  Despite overall vessel values dropping thus reducing overall policy premiums, vessel parts and repairs remained constant, pushing the loss ratios higher.
- Weak Parts availability.
  With dealers reluctant to stock-up and manufacturers keeping supplies on-demand only, finding parts was becoming an issue, particularly on certain brands.

Big boat sales continue to flourish, and unlike 2009 the smaller vessel demographic started to recover. Aggressive pricing on new boats put a strain on the used boat market, however encouraged new product launches.

Now in place a full year, the Pleasure craft OP Card has received a fair amount of attention from the media. The insurance industry has not collectively taken a stand or demonstrated support with respect to responsibility (if any) in the promotion and "enforcement" of the card. In other words, there is no united front in this regard.

Cargo

20% increase.

Roughly, that is the overall change in shipping activity that has been seen by freight forwarders and insurers for Canadian businesses in 2010. Good news, considering 2009 saw an overall decrease of *30%* on average.

The year was slow to start, as expected, however economic stimulus packages such as those for automotive or green energy industries started to kick in and a shift could be seen. Almost all corners of the market were affected, notably –

- Small business
  The smaller ventures who were cancelling policies an masse in 2009 are opening their doors again and re-starting their cargo policies.
- Auto industry
  A huge network of parts suppliers, manufacturers and many other ancillary businesses all but stopped. A "reboot" of the auto industry has seen them come back to life, albeit at a different capacity.
- Project cargo
  Economic stimulus packages and green energy initiatives have contributed towards increased project cargo volumes, with both import and export activity picking up.

With thinner margins however, cargo client trends remain static and are still –

- Pushing for lower rate.
- Expecting better rates, despite drops in volume & GFR.
- Looking for returns on previously retained deposit due to lower than expected shipping activity.
- Looking to carriers and freight forwarders to provide inexpensive insurance solutions.
- Amalgamating with parent companies, taking advantage of larger group insurance programs.

As policy holder's profit margins narrow, so are premium profit margins. Yet with results continuing to slip, the Canadian market still saw significant competition and further rate decreases through 2010.

Domestic cargo theft continues to be an issue in certain hot spots across the country although the overall frequency did not increase as much as expected. Severity did however. In many cases, entire truckloads or containers are simply disappearing, either from yards or via hijacking. More often than not, there is little police can do and their resources are focused on those thefts where victims such as drivers are involved.

Fraudulent truckers or trucking companies are a growing trend of concern. These companies mask themselves as legitimate cargo movers accepting freight and then disappearing with the shipment. They are next to impossible to track down and specifically target certain types of cargo.

Summary

It is starting to sound like a broken record, but the marine industry continued its downward trend on rates with no real sign of recovering from a relatively soft market again in 2010.

The question has been asked for a few years now, and can be asked again this year – where does that leave us? While Canada weathered the recession with arguably less battle scars than other parts of the world, it is going to be a little while yet before inflation and gross domestic figures are back where they should be. Investment income for insurance companies continues to be weak, and dwindling profit margins on the front lines simply cannot continue.

What's next? Some plans for the underwriting committee for 2011 –

- Recruit some more talent
- Continued development of CBMU standardized applications
- Promote industry awareness and education with seminars and presentations
- Work with our partners in other marine associations to share knowledge and expertise

Is there something you would like to the committee working on? We're always looking for suggestions!

I'd like to thank Marg MacKenzie, Director, Coast Underwriters Atlantic Canada for her contributions to this report.

Respectfully submitted,
Steven Scharien
CBMU Underwriting Committee Chair