December 2008

The Itinerant Auditor

- Random thoughts from the world of insurance auditing

HAPPY NEW YEAR!

Apologies if our lead story is a bit Scrooge-like. We really do try to put aside these gloomy concerns during the festive season, and we especially want to thank you for your support over the past five years. A.M. Associates is heading into its 6th year of providing audit services to the Lloyd's market, and we are very grateful for the opportunity to do such interesting work in such interesting times. Our warmest wishes of the season and for 2009,

Allison Murray and The AMA Team

Risk Selection and Coverholder Financials

In 2009 another form of risk selection may become as important as selecting the right risks to insure: We're talking about credit risk, and the impact that the selection of *Coverholders* may have on results and the security of insurance premium assets.

Over the past two years, we have noticed an increase in the level of dependency of some Coverholders on lines of credit and bank loans. Or perhaps it's just that we are more focused on these things in light of the global financial crisis.

Whatever the reason, we are seeing more and more situations where the firm is dependent upon a line of credit to meet ordinary operating expenses and even payroll. Sometimes this means that there is no cash on hand and bank indebtedness of $1,000,000 or more. And it's not always the small firms that are cause for worry: It's also the mid-sized firms that get themselves into trouble through overly ambitious acquisitions of real estate or other brokerages, or through lack of expense control, lax governance and/or poor control over receivables.

Some of these firms are among the larger employers in their towns, and as such have a degree of clout with the local bank manager, a situation that may have provided easy access to credit in the past.

But what happens when the bank's Head Office calls in the loan or line of credit? This is where the risk arises: when you have potentially millions of dollars of premiums held in trust, you need to know that those monies are in fact locked down inside the trust account and not being used as collateral for debt. Too often we see trust accounts with only two monthly transactions: once when the funds are transferred *in* from the operating account, and the day after when the funds are transferred *out* to Lloyd's. If premiums are not deposited daily to the trust account, they are at risk of being called for by the bank to shore up a credit line.

It's worth taking a closer look at those financial statements...

We Recommend … Winery Weekends

Travelling in Western Canada can be a hit and miss venture when it comes to hotel standards, and sometimes we are hard pressed to find a decent bed for the night. But there are also hidden gems where the level of comfort and service is on a par with the best accommodations anywhere.

If you find yourself in British Columbia's wine country, the Okanagan Valley, next summer, try Hester Creek Winery & Villa for something different: Comfortable suites with fireplaces, complimentary splits of the winery's own red and white wines, soothing views over the vineyards from each room, delicious breakfasts, and an estate winery and shop on site. Combined with a winery tour of local estates it's a great way to spend a weekend.

We understand they are adding a restaurant in 2009 in which case one would never have to leave, except for perhaps the occasional audit.

Hot off the Canadian Insurance Press...not unexpected news

From the December 10, 2008 issue of Canadian Insurance Bulletin www.cdins.com

Q3 Income Plummets for Canadian Insurers

Sean van Zyl | December 10

Canadian property and casualty insurers saw net earnings for the first nine months of this year plummet by 33%, according to industry financial data collected by the Office of the Superintendent of Financial Institutions (OSFI).

Earnings for the period fell to $1.5 billion, down from the $2.3 billion disclosed for the same period last year. The industry's bottom line was eroded by a significant decline in both underwriting and net investment income for the latest reporting period. Insurers' underwriting profit for the first nine months of 2008 fell by an astonishing 73% to $282.2 million, compared to the $1.05 billion reported in 2008. The ever-thinning underwriting margin is mainly attributed to escalating claims costs, particularly relating to accident benefit losses in Ontario's auto market and a rise in low-severity, but high-frequency weather-related catastrophe events. Net claims costs for the latest nine month period rose year-on-year by 11.2% to $12.1 billion, compared with the $10.9 billion reported for the corresponding period a year ago.

The rise in underwriting cost boosted the industry's loss ratio by 4.8 percentage points to 68.6% from last year's ratio of 63.8%. As a result, insurers' combined ratio for the first nine months of 2008 clocked in at 98.7%, compared to a ratio of 94.1% for the same period last year.
Insurers' net investment income for the period dropped by 19% to $1.7 billion, down from the $2.1 billion disclosed for the same period in 2007. Notably, the industry's net investment income for the third quarter shows a significantly higher year-on-year decline of 35.4% -- to $51 million, down from last year's $79 million. Insurers' dwindling net investment income for the first nine months of 2008 largely resulted from a sharp fall in realized gains, which clocked in at $55.9 million versus the $654.5 million reported a year ago.

Industry commentators expect the decline in insurers' investment income will be further pronounced in the final quarter of 2008, resulting in a weakening of the industry's capital base. Insurers' total assets stood at $79.9 billion at the end of the third quarter of this year, reflecting moderate growth on the $77.4 billion reported at the end of September 2007. The industry's top line also reflected stale growth, with direct written premiums for the latest nine months rising by a moderate 2.2% to $19.58 billion from last year's $19.15 billion. Net written premiums for the first nine months of this year came in at $18.22 billion from last year's $18.02 billion.