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magazine

# Waste Advantage

The Advantage in the Waste Industry

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## Soft or Hard Market, What Lies Ahead

Nathan Brainard

**The soft market is going to come to an end sometime in the future and you will need to be prepared. TAKE THE TIME WHILE RATES ARE DOWN TO GET AN OVERVIEW OF YOUR INSURANCE LANDSCAPE, not only from the policy side, but also from what your agent is doing to help you.**

### THE PAST THREE YEARS FOR THE U.S. ECONOMY

have been some of the worst in recent memory. Companies have struggled for survival resulting in layoffs, acquisitions, bankruptcies, restructuring and, in many unfortunate cases, the closing of shop doors. This trend has not been lost on insurance carriers, and is one of the primary reasons we are currently experiencing a "soft market."

"Soft Markets" occur when there is an excess of capital base, insurance carrier profits are up and fierce competition between the various insurance carriers exists. Factors such as these cause rates to drop and expanded coverage terms to become available. This is the current condition in the insurance marketplace.

"Hard Market" is when there is a lack of capital, insurance carrier profits are shrinking (despite higher premiums) and the competition between carriers is less aggressive. In a hard market, companies looking for a policy might have a harder time obtaining coverage as the carriers can afford to be more selective.

Soft insurance markets are very beneficial for the policyholders as it means premiums continue to go down and the competition between interested carriers becomes more aggressive. The carriers battle it out in the form of coverage terms and reduced rates. In theory, incumbent carriers should be in a prime position to retain existing clients for the renewal of a policy. Oftentimes, the incumbent carrier will ask the agent for "last look" if they are made aware of competition from another carrier. This means they have offered their terms to be presented, but if there is a chance they might lose the business, they want to have the opportunity to sharpen their pencil one more time in a last ditch effort to retain it.

If the account is being marketed and the incumbent carrier is aware of this, and the actual sustained losses were not catastrophic, the incumbent carrier might only apply a slight increase to the renewal thinking that they it will not be enough of an increase to drive their client away. This, however, can work against them if another carrier is interested in the account

and there is a reasonable explanation for why the loss occurred, such as poor winter driving conditions or other such circumstances out of the immediate control of the policyholder. This will also hold true if the policyholder has taken action to correct a similar accident from happening in the future, such as hiring a Safety Director, changing operating practices, etc.

Additionally because the competition is so fierce and because so many policy holders continue to struggle paying premiums (even though the economy has begun to very slowly show signs of life), none of the carriers want to be the first to stop the declining rates and begin to level things out or implement rate increases for fear that they will drive business from their books directly into the hands of their competitors.

### How Rates Are Formulated

Insurance carrier capital is driven by items such as the loss experience their policyholders have, investment returns, the cost of reinsurance and expenses. In both hard and soft market conditions the cost of reinsurance is heavily involved. In the same way you purchase insurance to protect your company, insurance carriers purchase insurance to protect themselves. The cheaper the cost of their insurance, the cheaper they are able to offer terms to their policyholders. Essentially it is risk transfer, and the more risk they can transfer over to reinsurance, the more they can potentially take on themselves. In the current economic conditions, it was estimated that there would have to be an "event" or series of "events" in excess of \$50 billion for the market to go from soft to hard.

As of this article, the estimates from the earthquake in Japan are coming in around \$35 billion, but it is still early in the process and these figures could change. This single event has already eroded more reinsurance capacity in 2011 than all of 2010 combined (estimated reinsurance losses for 2010 were \$31 billion). This coupled with the Earthquake in New Zealand earlier this year where loss estimates are



running between \$12 and \$15 billion put us dangerously close to the \$50 billion mark. Even though these events happened halfway around the world, all insurance policyholders will feel the impact, especially if the totals exceed the \$50 billion mark. There are a limited amount of reinsurers, so U.S. companies use the same reinsurance carriers as their counterparts overseas.

Almost all policies are based in some facet off of payrolls and/or revenues (transfer stations and material recovery facilities are sometimes rated on acreage). As there has been a downsizing in workforce, the payrolls have been reduced and the amount of revenue coming into insurance carrier coffers has been affected.

Many carriers are now also pulling D&B reports or asking for company financials to gauge the policyholder's ability to not only pay their bills, but also to maintain their equipment and facilities. This is above and beyond the review of loss history. A poor credit rating is enough to make an insurance carrier shy away from a potential client even if they have not had any losses. Companies who have leveraged themselves in large sections, or whose owners are pulling all of the capital out of the company will find it more difficult to secure multiple options at their renewal. Should the market harden, it will become even more difficult for companies in this situation. The same will hold true to companies who made several late payments to either the insurance carrier or premium finance company that they are doing business with.

To further complicate things, there have been fewer materials left at the curbside or in dumpsters as the American public is spending less and thus creating less waste. As the unemployment rate still hovers above 9 percent (according to the Bureau of Labor Statistics) in a majority of the country, this trend will most likely continue for quite some time. As these are the primary factors in rating a company for coverage, this has had an impact on the amount of competition companies have seen during their renewal process. This is true both in the number of solicitation calls companies are receiving from insurance agents and the number of carriers willing to entertain submissions and ultimately offer terms of coverage.

## The Insurance Carrier Landscape

There are many insurance carriers out there, but only a select handful have been and/or are willing to provide terms to the waste and recycling industry on a regular basis year after year. These carriers typically have a long-term stake in companies engaged in sanitation and recycling operations, and many have specific programs tailored to the industry. But just as we have seen some long-term waste and recycling companies merge or make significant changes so has the insurance provider landscape.

The most notable is the move made by Zurich over the past 12 months as it regards companies with hauling only operations. In most cases they have begun to exit this class of business as their losses paid out were above the amount of revenue being collected. This, in general, is a huge blow to the industry as they had been a major player for the better part of 20 years. While some may question their move we must remember, they are in business to make money just as you and your company are. If your operations were not profitable you would either have to adjust, or ultimately work yourself out of business. It is also important to note they were there for countless companies when no other insurance provider was interested or willing to provide coverage.

Competition for the accounts with little to no loss history is extremely aggressive and has given those in this particular situation a number of options to consider for their renewal if the items in the preceding section are in an acceptable state. There are several "programs" out there which are specifically

designed for the industry. Each has their own set of pluses and minuses ranging from deductibles and payment terms to available lines of coverage and endorsement limitations.

There are also carriers who are looking to test the waters. Here again, those companies with little to no losses and a solid financial position stand the most to gain as they are the "premier" accounts and the most likely to receive terms from these carriers who want to gauge the viability of entering the waste and recycling insurance marketplace. However, there is a gamble associated with carriers who are just entering the marketplace unless they have made a large investment in resources, training and expertise, they could jump out of the market as quickly as they got in.

In general, waste and recycling operations are considered "high hazard" as there are multiple vehicles on the road with an average Gross Vehicle Weight (GVW) in excess of 33,000 pounds. In addition to heavy vehicle weights, many haulers or operators are in and out of neighborhoods, tight alleyways and school zones. These are all areas where circumstances can lead to serious or fatal accidents. Even if your drivers and spotters are doing their best to pay attention, it is impossible to predict when a child will chase a ball into the street without looking or a driver will veer into your vehicles lane because they are texting or otherwise not paying attention. Due to sheer vehicle size and weight, when a refuse or recycling truck hits something it generally causes substantial if not catastrophic damage. While these carriers testing the industry may show initial interest, one large claim coming in could be enough to scare them out of the industry before they establish too large a book of business to sustain major losses.

Because of the complexity of the industry it is important to understand how long any carrier you and your agent are considering placing coverage with has been involved in writing this class of business. While the premiums might be very attractive this year, you could end up with a carrier who sends notice of non-renewal because of their experience with the industry as a whole, or even worse, have a carrier put out of business in the middle of a policy term due to paying out claims.

## Soft Market Expectations

Because the current market conditions are so fragile, no carrier wants to be the first to level out their rates as it gives their competition the opportunity to take their client base away. New carriers to the industry might try to "buy" the account in terms of premium dollars alone. Buying an account is when a carrier offers extremely aggressive premiums during the first policy term and then tries to make up the difference over the following renewals with increases regardless of claims history.

It is important to note that you should always look over the terms of coverage to make sure you are protecting your company. While premium dollars do matter, you are paying for protection and saving a couple thousand dollars is not worth leaving your company dangerously exposed over the course of the policy term. Improving the bottom line is certainly important, but at what cost?

The soft market scenario will not go on forever. In the past three or four months there has been talk and minimal (and extremely futile) attempts by several different insurance carriers to begin applying the brake to the descending rates in an effort to stabilize the marketplace. As described earlier, this put their competition in an advantageous position and forced these same carriers trying to level things out to once again go back to soft market tactics of aggressive rates and policy conditions.

Based on conversations with underwriters at multiple companies, there is a desire to begin making the shift. It is their anticipation that sometime in the next 12 to 18 months rates will begin to stabilize and the soft market will

begin to wind down. This timeframe could be expedited if the \$50 billion dollar event discussed earlier is reached. The unknown variable here is the ability of the policyholder to pay flat (unchanged from the prior year based on similar exposure) or slightly increased premiums.


As this process begins to be implemented, companies seeking coverage will receive renewal terms with their premiums remaining flat from the prior year, or potentially showing a slight increase. While no one knows if the 12 to 18 month timeframe is accurate, it is undeniable that the desire is there on the part of the industry insurance providers. In this respect, they are not alone. This is not only applicable to the sanitation and recycling industry, but all industries.

### Navigating the Soft Market


Insurance agents or brokers are seeing reductions in their business books as many of their clients have had a substantial reduction in premium each of the past few years. While these agents have not necessarily lost their client base, their commissions are directly tied to the overall premiums attached to each policy. As the policy premiums have reduced so has their commission income. If their client has gone out of business, they lost any revenue associated with that account. This is particularly true for agents who may have had a large book of business in the construction or other hard hit industries due to the economy. Because of this scenario, many agents are now targeting the sanitation and recycling industries because it is considered "high hazard" and the premiums (and by default the commissions) are deemed lucrative.

There is little doubt that you have received more solicitation calls in recent years than in years prior due to the economic downturn. If you are

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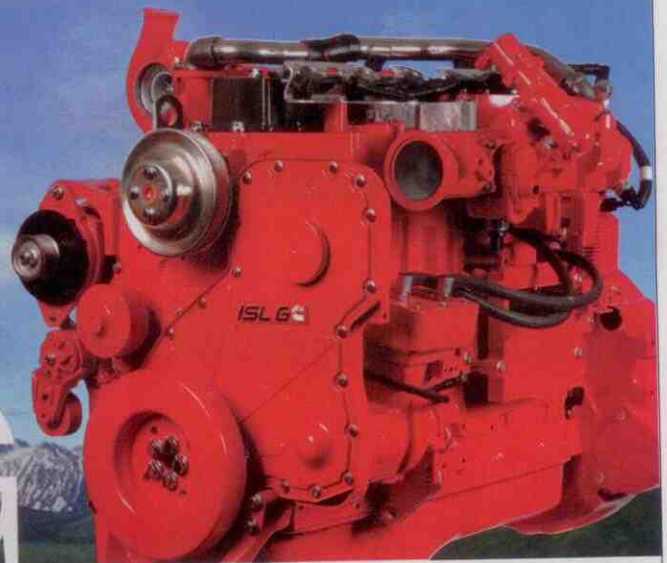


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