2013 TRANSPORTATION TRENDS AND FORECASTS

Prepared by IMUA's
Transportation Committee

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Introduction

The transportation component of the inland marine industry has always been a difficult piece of the inland marine book, with many insurers struggling to find that one key to making this a profitable segment of their inland marine book. The transportation industry overall continues to grow and therefore will always be a significant part of an inland marine book, making that key even more critical. It will always be necessary for inland marine underwriters to stay on top of how the transportation industry is changing and to determine what factors can be used by an underwriting company in selecting and honing their appetite for this unique book of business.

Transportation and the Economy

In the United States, the U.S. economy in 2013 is still full of uncertainties despite the resolution of the fiscal cliff. The Job Report for yearend 2012 shows that the growth rate is not enough to make a significant dent in the overall unemployment rate.

Gregory Daco senior economist at IHS Global Insight, predicts the U.S. economy will grow at a modest pace around 2 percent this year and a little below 2 percent the next year.

Daco noted that other traditional drivers such as U.S. exports are slowing because of the global slowdown. He predicted that there would be a “soft landing” of China’s economic woes. He noted that the U.S. could withstand a mild European recession, but could not withstand a full-blown financial crisis there.

From a broad perspective the Transportation Industry (Rail, Road and Air) generated approximately $563 Billion in revenues in 2011. Of this, Trucking earned roughly $295 Billion, Rail $65 Billion and Air Carriers $203 Billion. In the Trucking segment, Truck Load (TL) Carriers earned 86% with Less than Truckload (LTL) Carriers the remaining 14%.

While Transportation companies saw growth in the first 6 months of 2012 of roughly 3-4%, this was mainly attributable to inventory growth for the holiday season. A survey of the Purchasing Managers Index (PMI) has shown Year over Year drops in factory orders as most manufacturers are still leery of the economic recovery. Hence, only ordering or supplying on an “as needed” basis.

The Cass Freight Index showed year over year December 2012 shipments were 1.4 percent ahead of December 2011, while unfortunately freight costs rose 4% over the prior year.

Certain financial analysts are forecasting the Transportation Sector to be a “neutral” play due to a slowing of the economy and the potential for another recession. In several industry conference calls, they have heard companies project slowing tonnage growth into 2013.
Coming off the recession of 2008-2009, trucking companies spent much of their time trimming costs and attempting to re-price contracts with shippers to more favorable terms. Fuel surcharges were one of the top concerns.  

Oil prices can have a direct impact on the entire transportation industry. Oil prices fluctuated throughout 2012 but steadied back to January 2012 levels. While forecasting oil prices is difficult since they are influenced by geopolitical events, it is believed on average that they will fall slightly in 2013. Diesel prices are four times higher today than 1999 which can force companies to look at alternatives such as the use of Intermodal (i.e. Air/Rail) and natural gas. One double-stacked train can replace 300 trucks and save 75,000 gallons of fuel. Over the last 10 years, Hybrid locomotives have been developed that use 30% less fuel and produce up to 70% less pollution in the air. 

The American Trucking Association (ATA) estimated that truckers spent about $155 Billion for diesel fuel in 2011; leading the industry to upgrade their fleets with more modern and fuel efficient tractors. It has also driven the industry to look for Route Profitability vs. Volume Growth.

**Emerging Issues**

At a recent panel discussion, The American Trucking Associations Chief Economist Bob Costello predicted that flatbed carriers would continue to do well in 2013, thanks partially to an increase in housing starts.

Another rapidly advancing industry is developing because of fracking and shale drilling in various sites in the northeast, Midwest and West. Fracking is the process used to get natural gas out of shale. This requires sand for the drilling/fracking and a need to transport oil and natural gas after it is mined. Six shortline railroads in Pennsylvania reported business was up 40% because of Marcellus Shale drilling. In addition to a boom for the Rail Industry, Bob Costello also predicts tank trucks will be the best sector in Trucking due to fracking.

Costello noted that despite the fact that volumes overall are going up, capacity “remains relatively in balance to demand.”

“However, if the overall economy were to surprise us on the upside — with, say 3 percent GDP growth for several straight quarters — we would not have enough trucks to handle the corresponding increase in freight,” he said. Concern over the lack of qualified truck drivers has been a looming transportation problem for the last few years although low shipping demand has masked the problem.” Trends suggest a real serious shortage is likely to become a reality sooner rather than later with the continued threat of the 100,000 driver shortage potentially getting worse in the future.

The total freight tonnage is expected to grow by 21 percent by 2023, and revenue for the freight transportation industry is projected to rise 59 percent in that same timeframe, according to the ATA. Trucking’s share of the tonnage market will rise over 2 percentage points to 69.6 percent by 2023, while the industry’s share of freight revenues will increase to 81.7 percent from 80.9 percent.
In terms of US trucking, it has been a continued challenge due to the persisting problems of stricter federal regulations, shortage of truck drivers and fuel prices. However, according to American Trucking Associations’ U.S. Freight Transportation Forecast to 2023, there are signs of significant growth potential in the long term out to 2023.

As carriers move to renegotiate contracts and pass on higher prices due to their heavy fixed costs, it has been opposed by shippers who have looked to mitigate their costs by moving more to Air Domestic freight and Intermodal shipments for medium to long haul loads. Air Domestic carriers (UPS, FedEx) have economies of scale to offer cheaper shipment costs.

The trends in the Trucking industry could fuel a renaissance in the Rail Industry. Rail efficiency has improved by 1.1% annually since 1990. Bulky, low density materials often travel by Rail since it too expensive to ship by truck. We have seen lightweight high capacity cars with improved aerodynamics and lighter containers replace truck trailers. In addition, higher horsepower (6000) locomotives have reduced the number of locomotives needed to pull a train.

Rail has invested $40 billion in infrastructure over past 5 years including tunnel and track work to allow double-stack container trains, improved scheduling, computerized car tracking for customers, and reduced empty car mileage. Rail has been gradually taken market share from trucks since 1999, with the shift particularly evident in distances over 500 miles.

Finally, with the passing of deregulation of the trucking industry in 1980, the Operating Ratios of most trucking companies were in the 94-96% range and were financially healthy vs. current operators with OR's around 99.1%

As a result of these factors, the Transportation Industry finds itself with a need to;

1.) Improve Speed of Delivery
2.) Improve Service
3.) Become flexible
4.) Expand area of Service

As a result of these factors, the Transportation Industry finds itself with a need to;

However, several obstacles may prevent their success. As previously noted, according to ATA, the industry could face a shortage of 111,000 qualified drivers by 2014. This is due in part to Economic factors, Hours of Service Rules, CSA and cost of fuel.

Overall, as the United States looks to be recovering from the recession, the transportation industry outlook for 2013 is full of cautious optimism with a forecast for steady growth through 2023. The industry as a whole should improve in performance because all indications are that there will be major increases in national Gross Domestic Product (GDP), Purchasing Manufacturing Index (PMI) and other leading economic indicators in 2013, showing that the economy is climbing back and recovering at a faster pace.

Underwriting Transportation Insurance
For the Inland Marine underwriter, this presents a unique set of challenges to write this class of business profitably.

- What impact does CSA and Hours of Service present to the UW?
- How is the financial health of the industry affecting your underwriting thought process?
- How does the financial health of your risk affect your decision?
Do you understand the financial ratios and their implications on your decisions?
- Revenues Year over Year and Quarter over Quarter
- Operating Profit
- Net Profit Margin
- Property & Equipment – is it older and less fuel efficient?
- What are the Deferred Tax Liabilities?
- What is the Debt to Capital ratio?

Will the move of general commodity freight to rail leave truckers with a higher percentage of target commodities for thieves?

Will the use of double-stack containers on railcars increase the loss amounts possible for both transportation and rail bill of lading exposures?

What if a train is made up of container cars and hazmat cars and a simple derailment results in total loss of the containers and contents?

Can railroads track the increasing container traffic better than trucking has?

One method to improve underwriting results may be better use of PREDICTIVE ANALYSIS:

The mono-line inland marine industry, to its credit, has always understood that there is an art to underwriting this book of business and that a true understanding of the particular risk being considered is critical to making an informed decision. The commercial automobile insurance industry has moved toward a primary focus on predictive analytics. Predictive analytics includes various components, such as statistics, modeling, and data mining, all of which analyze current and past events to predict the future. Clearly identifying patterns will generally assist an underwriter in analyzing the risk of severity and/or frequency which could impact the overall book. Creating models, similar to the property and catastrophe models used by the insurance industry has allowed many of those insurers to more deeply assess risk associated with particular factors and then create better guidelines for the actual underwriter to consider when evaluating a risk.

Commercial auto risk for the transportation industry is however, a different business then underwriting the movement of the freight.

Analytics, the science of underwriting, is beginning to change the underwriting of transportation risks by inland marine insurers.

Look at the numbers. Central Analysis Bureau records indicate that at the end of 2012 there were 1,405,879 active entities with DOT numbers. Of that, 200,898 have authority as a common or contract motor carrier for the transport of goods in interstate commerce. In addition 3,505 of those common or contract motor also have broker authority. There are 19,288 companies who operate only as transportation brokers. There are 7,241 motor carriers who transport household goods and general commodities (and therefore require a cargo filing) and 19,012 who transport only household goods, leaving the rest as carriers not requiring cargo filings. Of the many that have only DOT numbers, we can assume that a significant portion are transporting goods intra-state or providing transportation which is otherwise exempt from regulation by the FMCSA, but...
which you are still insuring. In the freight forwarder category, there are 8,427 active freight
forwarders, 1,092 of which work solely with household goods and 362 work with general
commodities and household goods. That is a large group of regulated and unregulated business
operations from which a wealth of information can be mined. Utilizing this data to determine the
proper selection of a risk is a key step in the underwriting process. Are CSA scores combined
with a commodity analysis the proper way to go? Should you focus on regional versus long haul
carriers depending upon inspection results? Is the risk greater the more vehicles are operated? Is
the risk greater with the use of owner-operators? Is there more of an exposure when an insured
operates more as a logistics provider then a straight carrier? These and many more are questions
that can be asked and answered through the use of data.

That is not to say, however, that the art of underwriting should be discarded as a means of risk
assessment. Nowhere else is the subjective analysis of an underwriter more critical than in the
underwriting of a third party logistics provider, including motor carriers, brokers and
warehouseman. This is a moving risk and an application for insurance alone or a statistic cannot
provide an underwriter with a true feel for the overall operations of a company. In a world where
every individual business, including insurance, finds it necessary to agree to provide every
service that a customer requires, it is only through the actual underwriting of a specific account
that an underwriter can understand what services are being provided by that carrier, whether the
carrier can efficiently perform the operations and whether it is a risk which you would
contemplate underwriting. Are their financials secure enough to allow for safety and efficiency?
Are they simply carrying or storing goods? Are they brokering portions of the shipment? Are they
using owner-operators? What are the true commodities being hauled? Are they providing
accessorial services – rigging, packing, processing, and storage – which are not generally covered
under the cargo or contingent book? There is an endless list of questions, and the answers to
these questions are risk specific and can only be viewed and analyzed through the underwriter’s
eyes. These answers must be factored separately after the predictive analytics help you narrow
down the search for the good risk.

The devastating impact of Hurricane Sandy has not yet been factored into the predictive analytics
or the underwriting process and in the coming year will have to be individually considered by
underwriters. Logistics operations will change, as all freight carriers/warehouseman and their
customers are beginning to see the risk of these unprecedented natural disasters on the market.
Logistics providers, including motor carriers, brokers and warehouseman, and their customers
will look to either confirm that the risk of loss is on the freight customer or accept that as an
additional exposure to the logistics provider. This could result in a greater exposure under the
inland marine policy, whether first or third party. Only through actually knowing your insured
and the industry in which it operates can you properly price and rate this type of risk.
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