Burand's Insurance Agency Adviser

Resources and Information for the P&C Insurance Industry

Vol 29, No 1 **February 2024**

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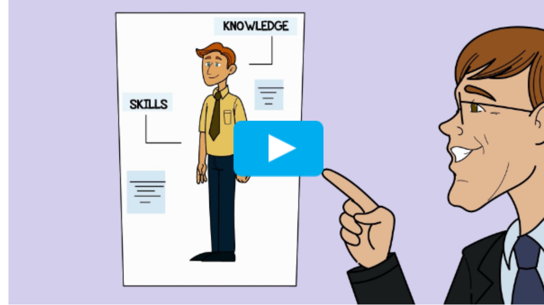

Interested in improving underwriting profitability?

Carriers can improve underwriting profitability and growth by doing two things.
This blog article, by Jason Bogart, is third in a series of three articles about the role of accuracy in underwriting judgement. View it here:
https://deepcc.com/2023/12/14/how-to-improve-underwriting-judgement-accuracy/

Bad Faith Report:

The plaintiff's bar has several newsletters where they run articles on how to sue insurance agents and carriers. In some ways it is best to be sued by one of the subscribing firms because they might know more about what they're doing rather than the ambulance chasers that sue without a clue and make life miserable relative to some issue without any basis.

I'm often asked for examples of their newsletters and not being an attorney, I don't always have access. But I came across one that I think you might occasionally find useful given the frustration I'm hearing expressed relative to carriers not paying legitimate claims. The Dykema Gosset law firm (dykema.com) publishes a quarterly Insurance Bad Faith Report of bad faith insurance case law. It's interesting. They list the carrier names and describe the cases.

Worth Noting:

1. It's time to push back against carriers that don't pay correctly for rental cars when their driver is clearly at fault. The idea is to procrastinate in providing a rental car hoping the victim does not or cannot afford to rent a car on their own and then demand reimbursement. It's a successful strategy for reducing claims, but an unethical strategy. Insurance has enough black marks and this should be an easy one to communicate to your state legislators.

2. If you're looking for employees with carrier backgrounds, now is a good time given all the carrier layoffs.

Book Recommendations:

I am reading an old book outlining a plethora of bank and insurance fraud. This is the kind of fraud perpetrated by selling fake insurance. The book, ***The Fountain Pen Conspiracy***, by Jonathan Kwitny, was written in 1973. The number of fake insurance companies covered in the book, for the period of approximately 1964 to 1972, only eight years, is impressive. Besides being a fascinating history of fraud and the confidence to create fake insurance companies, two items are applicable to our current insurance world.

1. They perpetrated social engineering fraud without computers. They did it successfully, even using snail mail and telephones. They got people to wire money to them by making them think their boss or another entity was ordering them to do so. It was impressive.

2. They used inflated or even non-existent real estate to fluff up surplus. Given the huge decreases in value of commercial real estate, I wonder if all the insurance companies with large commercial real estate investments have written down the value of those investments, and their surplus. What do you think?

A current book I recommend is ***Kleptopia***, by Tom Burgis. It is simply scary reading from multiple angles but the intersection with The Fountain Pen Conspiracy is interesting. Both rely on England to hide money. And both use complex ownership structures to hide assets. Not much has really changed in 50 years on these two points.

A third book, also current and related to the first two is ***These Are the Plunderers***, by Gretchen Morgenson. The first part of the book covers the debacle of Executive Life. Not many people in the industry remember the failure of Executive Life, but it sent shockwaves across the industry from many perspectives, including how fast it failed. This is the first comprehensive history of that failure I've read, including the insurance department's complicity (at least that is my perspective). It also details how a specific private equity firm got extremely rich, kind of like the Kleptocrats, while the insurance company failed, and its policyholders were left bereft (another lesson is don't count on a state guaranty fund. Now that private equity is getting back into owning insurance companies, a careful reading of this story is extremely worthwhile, especially relative to lobbying your legislatures.

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Finding Humor

Have you ever wondered if some material percentage of insurance executives attended a Monty Python marathon and left thinking they had a attended a management training program? If you Google, "Monty Python management training course" you will see somewhere near 2.2 million results! So maybe it's possible and based on the ridiculous statements I've been seeing, I'd say this conclusion is almost guaranteed!

For proof, consider their famous "Wink Wink, Nudge Nudge" skit. I recently read a response from the top executives of a company that said something to the effect of, "We know that language is in the contract, but don't worry, we won't actually apply it. Just pretend it is not there because that language does not follow our intent." What? Wink wink, nudge nudge. You know what I mean!

Why can't the contract simply state the actual intent? Is this not what a contract is supposed to convey?

I recently asked a carrier that had an exclusion which made the policy basically illusory why they would sell a worthless (to the insured) policy. The response was that they did not intend to actually enforce the exclusion. WHAT? Do you mean I should simply take the carrier's word for it that they won't enforce the contract?

I saw another example where the underwriter advised they would never enforce the exclusion. Awesome! Unfortunately, underwriters don't adjust claims so that was a worthless promise. Even then, what happens when that underwriter leaves? If the carrier does not intend to enforce the contract, then eliminate the contract and save everyone the hassle.

I recently saw a program that advertised it was fully funded. Reading between the lines, it was only fully funded on a reimbursement basis. Technically, maybe this is correct, but what is implied is not what is reality. This is a real wink wink, nudge nudge moment with the program sales guy saying, "This is fully funded [wink, wink]. And no worries, it's an A rated carrier [nudge, nudge].

I had a claim where the policy read, "…including but not limited to…" My claim was excluded because the adjuster read the policy, "…limited to…" When I asked how she could leave out the "but not limited to" language, her response was, "because that is the way I read it." I don't know if this meant she had a reading disability, was simply illiterate, or had orders to deny legitimate claims.

Insurance is the sale of a contract that transfers risk in return for a premium. The contract should be clearly written and clearly convey the intent. If the intent is not properly conveyed, rewrite the contract. If the contract is not to be enforced, eliminate the contract.

These kinds of actions and decisions create unnecessary expense and tarnish the industry's reputation further. And what's more, this is completely unnecessary. It's kind of like the old saying about really smart criminals, "If they'd just spend that time on legitimate pursuits, they'd be a huge success!" Quit figuring out ways around this or that and simply do the job right the first time! Or if there's a mistake, the second time.

The next time you hear someone say, "That is not really what the contract means." Ask them to describe what it actually means and if a contradiction exists, ask them to fix the contract. If they refuse, ask them to put in writing what the contract actually means. If they won't do that, ask why you should trust every single person in their company currently and forever in the future to interpret the contract the way you are saying it should be interpreted. And if they won't answer, ask if they went to the Monty Python management training school. Then in the next soft market, move the book.

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Planting Seeds

"You'll never accomplish anything if you care who gets the credit."
--Gerald Weinberg, *The Secrets of Consulting*

"It is amazing what you can accomplish if you do not care who gets the credit."
--Harry S. Truman

"A man may do an immense deal of good, if he does not care who gets the credit for it."

--Father Strickland (1863)

When I was young, I remember my grandmother planting seeds, both literally and figuratively. She liked a good garden (best snap beans ever), but she was also planting seeds in the minds of people she visited, hoping those seeds would grow and help them live more productive lives. It was my first observation of sales in action. It was also my first experience of how conviction, truly believing in something, can motivate an otherwise very traditional, old-fashioned woman (she never learned to drive). She believed so much in her product, she overcame her call reluctance.

A couple of times recently, I have had people approach me to say what a difference I made in their lives. In one case, I thought my consulting advice had been a total failure. It turned out that my advice was solid, but my timing was really bad. They applied my advice five years later to great success. Plant a seed and hope people come around when they are ready. And if they give you credit for the sale, that is awesome. But if it is their own idea by then, that is great too.

One obstacle I see in our industry is that so many people do not want to sell. They have great call reluctance. Many believe selling insurance is equivalent to selling hot air. The professionals in this industry must overcome this high wall by educating new employees about the real value of insurance, the real protection provided by solid coverage. I had a young person tell me that insurance was mostly just for rich people. I shared that insurance is actually more important for poor people. Rich people can generally recover from a claim, however painful the claim may be, they will at least partially recover.

But for a poor person who is just barely getting by, who manages to finally accumulate a little wealth, and who loses it because they did not have adequate insurance, they almost certainly will take years and years to claw back the wealth they'll lose. Insurance is not about the dollars protected, but the percentage of wealth protected relative to the person's livelihood. If I am an agent and a poor person or a retired person loses their home or their savings, or even their vehicle, their ability to continue on with life is questionable and I'd not sleep at night. If it is someone making $500,000, losing a house sucks, but they can at least afford an apartment while getting back on their feet.

Insurance sold correctly, is the greatest protection against life's unexpected catastrophes and claims. With the right insurance, people's lives are less interrupted whether their personal lives or their businesses. They can keep providing jobs, building great products, and providing important services where without insurance, they'd declare bankruptcy. When you sell insurance correctly, you are selling both financial and emotional protection. You are only selling hot air if you do not take the time to learn the product and learn each individual client's needs, and then matching the two.

For some people with call reluctance, the belief that what you are doing is not selling, but helping, is enough to overcome call reluctance. Another key for helping overcome call reluctance is to not expect immediate success. When planting seeds, it is unreasonable to expect a harvest the next week. A really good rule of thumb in sales like insurance is the sale sometimes takes three years. Often the timing is just not right to expect an immediate impact. Sometimes the situation is as simple as the insured is not ready to fire their broker. I recently witnessed a situation where the broker had screwed up coverage so seriously the insured had no coverage, and yet he still would not fire his broker. He was not emotionally ready for a divorce.

Sometimes the situation is more complicated. For example, the decision maker cannot fire the incumbent because doing so would make the decision maker look bad. This is a common situation in larger companies. Or maybe you do not have the right market at that moment. Or maybe the client has an ongoing claim to be resolved first. Or maybe any of another dozen reasonable reasons.

But if you take the perspective of serving people, helping them, and planting seeds, you will eventually have a silent sales pipeline. You might not even know how the prospects entered the pipeline. You will harvest a sale though regularly and when the time is right.

This does not mean sitting and waiting. Like any crop, care is required and in this case, a person must be constantly out meeting people and helping them understand their coverage needs all day, every day until that pipeline begins pumping out sales. To do this, you must learn your coverages at a deep level. No one needs to buy insurance from an amateur.

You must plant a lot of seeds because some will never sprout, some will take forever to develop, and some will blow away. This means making contacts by the dozens however best fits your personality, whether cold calling, seminar selling, network selling, or whatever other environment fits your personality. And regardless of which environment suits you the best, truly and honestly believing in what you are selling will be conveyed to the audience. Combine this attitude with quality and everyone wins.

Insurance sales should not be: “Hey – you need insurance, and you have to buy it from someone, and you probably want to pay the least, so give me a chance to find the cheapest insurance possible.”

A quality insurance sale is about identifying the customer’s true risk exposures and then offering them solutions, including policies that provide coverage for those exposures. And sometimes that requires simply planting the seed and not caring if you are immediately credited with a sale.

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Are Insurance Companies De Facto Charities?

Based on what’s happening in claims and the way rates are rapidly increasing, no one would ever think insurance companies are charities. They might think they are cheats, voracious capitalists, necessary plagues, and those are the nicer terms.

But the best insurance companies are run more efficiently than a great many charities. I began thinking about this when I realized that some insurance companies are running on 15-16 cents. Out of every premium dollar, after subtracting claims (their largest expense), loss adjustment expenses and agency commissions, they are running the rest of their company on 15-16 cents. That pays for all their salaries, travels, reinsurance, audits, state filings, etc., etc.

Not all carriers are this efficient, but some are. I did a quick, and anything but a thorough, review of the 100,000+ charities to learn how much they distribute. A quick review of eight large charities ranging between hospitals and generic and environmental shows that, with one exception that distributes 100% of all their donations, these charities keep between 10

and 33 cents, with most keeping around 20 cents. It's pretty amazing that some insurance companies are run on less money than charities.

This fact has huge implications for the industry's future. The first is, how much is realistically left to save? I think it is unrealistic to expect an insurance company to pay all their bills on much less than 15 cents of premiums. Yet the pressure they're under to do just this is enormous. What they must achieve, argue innocently or pointlessly otherwise, is they must greatly increase their productivity.

While most are focusing on IT, and others are laying off people in masse rather than strategically, the better answer is that a full rethink of insurance operations is required. An easy point is that either something is broken, which if true needs fixing, or the realization hasn't yet set that companies are paying three entities to do one underwriting job. They're paying underwriters, they're paying agents, and they're paying their predictive modeling vendor. Given how poorly trained some underwriters are today and how they really don't underwrite, they are low hanging fruit, but agents' contingencies are not far behind if a carrier has honed their predictive models well.

Procedural consistency in companies is lacking as much or more than in agencies. Inconsistency is extremely expensive (see the book "Noise," by Daniel Kahneman, for fantastic examples of just how expensive inconsistency is). Inconsistency is solved with better leadership, management, and training, not IT.

Next, pay for performance. Pay agents for performance rather than size and loss ratios. Size and loss ratios are outdated metrics. With procedural consistency, many more important performance metrics become available better enabling a company to differentiate the combined ratio of one agency vs another agency. Good predictive modeling minimizes the importance of loss ratios and with aggregation and consolidation, everyone of importance has a big book negating the importance of differentiating by size.

Then take some of these savings and pay for smarter employees who have the authority to make intelligent decisions. Paying people to make blanket decisions is a waste of money. Instead, just post a note on your website that you are not writing in wildfire zones regardless of how fire safe the house is. I can hear certain insurance company executives expressing frustration that they don't blanket underwrite, but the reality is they do. Go ask your most honest agents.

The bottom line is how much longer can carriers afford to pay their agents more than it costs to run all the rest of the company? And agents, how much longer do you really think such commission rates are tenable?

Carriers don't really need to pay order taker agents 15% commission, and even if they need to pay that amount, they can't afford it. The proof is in a comparison of carrier results. Certain carriers are paying far less in commission rates and yet their growth and profits exceed industry averages by large amounts. They are beating everyone else and for some reason or another, agents place even more business with the carriers paying less commission!

Agents need a strategic plan for lower commissions. A compromise that would benefit everyone including consumers is paying the professional agents more. They bring more value to consumers and carriers in my analyses. The return on investment to all involved is provable. Of course, someone has to tell the order takers they aren't worth full commission, but they've been skating a long time.

When expense ratios must be so low, the market must be consolidated. Regardless of the industry, many firms lack the management and leadership to thrive in a low expense environment and insurance is not an exception. Quite a few carriers will be eliminated. Some of the new entrants touting low expense models should be carefully evaluated by the regulators because if their low-cost model is dependent on holding less capital (i.e., surplus) or low-quality surplus, consumers may be left hanging. Financial engineering in the insurance industry often benefits specific people, including consumers, until a catastrophe hits. Insurance finance really should be kept fairly simple.

A number of carriers have worked themselves into corners relative to cutting expenses. They don't have the surplus whereby they can reasonably not buy reinsurance, but reinsurance is expensive. They have borrowed large portions of their surplus so they're paying interest instead of making interest. Some are so far behind in IT they will never catch up and they may not be able to afford to catch up. Some are simply too small. Low expense requirements favor a specific scale, and several hundred carriers lack scale.

The leverage in carrier/distributor relationships has tilted in favor of distributors over the last ten years with the aggregation and consolidation that has occurred. But with fewer material carriers and a number of carriers with limited futures, the stronger carriers are regaining some leverage. This will enable them to institute those commission cuts.

When a company is run on such a shoestring that charities can't match their expense platform, carriers' choices as to what to do next to build their business are limited. Awareness of reality helps shorten the psychological denial of reality so prevalent, focusing executives' minds more quickly. The carriers and distributors that are first movers in this space will win. It's not like technology which resembles lotteries as to which technology will win. Low expenses managed well will win.

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Picking and Choosing Markets

The last couple of years have seen the first true hard market since the 1980's. We had a few minor events in the '90's and the 2001-2002 "hard" market was simply fortuitous timing for some carriers to cover up the losses they had been hiding in their insufficient reserves. For example, if you review the subsequent reserve changes, you'll see that reserve deficiencies in specific lines were far larger than initially and, for all practicality, publicly recognized.

This long history means a vast majority of insurance people have never experienced a true hard market. It used to be, in days gone by, that a hard market would occur about once every seven years so the industry always had institutional knowledge. One of the problems with long periods of good times is that knowledge of how to deal with hard times is lost.

Here is some advice and warnings for people who have never experienced a true hard market until now.

Hard markets punish incompetent carriers. High quality carriers should thrive in a hard market eating up market share as if they hadn't been able to write a policy in the last ten years and now they need to make up for their draught. In soft markets, undisciplined

carriers can and do sell price. Disciplined carriers historically would “rest” during soft markets saving their capital for the hard market. It is quite similar to how private equity describes having “dry powder.” Disciplined insurance companies have lots of dry powder and high-quality dry powder, i.e., surplus to spend in a hard market.

The markets agents need in a hard market are the disciplined carriers who have saved their powder. While not always true (I’d argue there are a handful of very significant exceptions), a good, quick indication of high quality from this perspective is a carrier with an A+ A.M. Best rating. A huge difference exists between an A+ rating and an A- rating.

While sometimes, a high-quality carrier does not always act as if they have any more capacity than their weak competitors, they have the capacity and it’s just a matter of convincing them to use it.

The weak companies, regardless of their rating, will be limiting their writings much more severely because they do not have the surplus to support their premiums. They can either reduce their premiums or increase their surplus. They can increase their surplus by selling more stock, selling parts of the company, borrowing money, or buying more reinsurance. Sometimes strong companies in a hard market sell more stock because they see a great opportunity. But more often it is weak companies selling stock because they need more capital. If you see carriers selling parts of the company, that is quite often an indication of an issue. And while many will argue that when you see an insurance company borrowing money, they are really simply being ingenious financiers, I will argue they are so ingenious they have worked themselves into such a bind that they have no options left but to borrow against their futures. A strong company makes money on its surplus through investments. A company that borrows for its surplus pays interest.

How does surplus work? Carriers must have $X of surplus for every $Y of premium. The ratio varies by type of business, growth rate (faster growth generally requires more surplus, but not always depending on how a carrier is managing its reserves), and quality of surplus. A company that runs out of operational surplus may have no means by which to grow and in fact, may have to “shrink to their surplus.”

I mentioned borrowing. Many carrier and agency people do not know that some companies borrow their surplus. As one carrier executive said upon learning that some of his competitors have borrowed their surplus, “That should be illegal!” I won’t go that far but when the collateral for these loans is the surplus pledged to future claims, as most of these loans are designed, some caution is required. Historically, if a carrier holding these loans went sour, regulators have ruled that the lenders were losers, and the money must remain in the company with which to pay claims. One headline 20 years ago read something to the effect of, “The department of insurance ruled we cannot repay our lenders, so we’ll be defaulting, but the good news is that we now have more surplus for our policyholders.” True story.

From a policyholder basis, regulator basis, and rating company basis, these loans are not that risky. From a lender’s perspective, these loans carry extra risk. For agents though, a company that must borrow money is constrained in what it can do and how much it can grow, because it has these large interest payments, a deficit of not having as much of an investment portfolio, and eventually the repayment of these loans.

If you see high turnover of employees, that is another warning sign of instability. Something is going wrong that quality employees do not see they have a future. And obviously when you see downgrades, or even a downgrade warning, that is a sign. The

rating companies in my opinion do not downgrade a carrier without a lot of time, consideration, discussion with the carrier beforehand (any carrier "surprised" by a downgrade is lying or living in fantasy land), and likely triple checking all their numbers. Pay attention to these events. A slight downgrade may not make much difference in some cases but usually this means a carrier's ability to grow responsibly is limited.

A hard market is also a time for quality to shine because it is easier to explain to clients why cheap insurance is not always the best choice because cheap insurance is often correlated with some of the carriers reducing/restricting writings. It is a time to prove your worth in solving your clients' problems.

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Chris Burand is president and owner of Burand & Associates, LLC, a management consulting firm that has been specializing in the property/casualty insurance industry since 1992. Burand is recognized as a leading consultant for agency valuations and helping agents increase profits and reduce the cost of sales. His services include: agency valuations/due diligence, producer compensation plans, expert witness services, E&O carrier approved E&O procedure reviews, and agency operation enhancement reviews. He also provides the acclaimed Contingency Contract Analysis® Service and has the largest database and knowledge of contingency contracts in the insurance industry.

Burand has more than 35 years' experience in the insurance industry. He is a featured speaker across the continent at more than 300 conventions and educational programs. He has written for numerous industry publications including Insurance Journal, American Agent & Broker, and National Underwriter. He also publishes Burand's Insurance Agency Adviser for independent insurance agents.

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