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Burand's Insurance Agency Adviser

Resources and Information for the P&C Insurance Industry

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"You have to get up every morning with determination if you're going to go to bed with satisfaction."

--Emmylou Harris

Are you fighting to improve underwriting profitability?

If you are, this article will be of interest: "How Underwriting Accuracy Improves Profit & Growth," by Jason Bogart of Deep Customer Connections. It is the first of a series of three articles about improving accuracy in underwriting judgement.
deepcc.com/2023/10/17/how-underwriting-accuracy-improves-profit-growth/

Agency Values: More than just good conversation

Have you had your agency valued recently? If not, an up-to-date valuation can be a valuable planning tool for your agency. An agency valuation is the crucial first step for many agency events, including:

- Perpetuation
- Mergers and acquisitions
- Estate planning
- Buy/sell agreements
- Divorce settlements

As the foundation for these important transactions, an accurate valuation is crucial. Furthermore, a valuation that does not cut corners and meets tax and court guidelines may prevent expensive future litigation.

At Burand & Associates, we combine our financial and industry expertise with our proprietary evaluation software to provide an accurate, comprehensive and detailed appraisal. We also identify opportunities and offer suggestions for increasing your agency's value.

Most importantly, we SPECIALZE in INSURANCE! Generalist often do not know a premium from a commission from a contingency. Why is this distinction critical? Without an accurate, detailed valuation performed by an industry specialist, agency owners can find themselves facing a number of potential hazards, including running afoul of the IRS, incurring negative tax implications, and increasing the potential for litigation.

Additionally, Chris Burand is a Certified Business Appraiser (CBA), a designation earned from NACVA. The CBA designation is only earned by those who demonstrate extensive knowledge of valuation case law and the ability to write high quality valuation reports that meet stringent requirements. Most valuation designations do not require proof the appraiser can put their knowledge to constructive use in valuation reports, which is obviously important and a tremendous benefit to the client.

If you are an agency owner or potential owner, an agency valuation will, at some point, be required. Contact Chris at chris@burand-associates.com to start with the strongest foundation possible.

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ERISA Exposures

Agents are facing ERISA exposures they don't even know exist. And their E&O policies likely do not provide coverage.

Most people think of ERISA relative to retirement accounts. However, ERISA was expanded to health insurance around 2020. Much of the ensuing litigation involves excessive fees as related to self-funded health plans.

I am not an expert on this issue by any means. However, I have solid knowledge of most insurance agents' lack of knowledge in this space and their exposures. Keep in mind, ERISA suits typically pierce the corporate veil so if you have an ERISA liability, all your assets are on the line. Everything you've ever worked for can likely be attached. Therefore, a prudent agent would learn about their exposures and make a decision to become educated and institute better protocols, or eliminate their exposure entirely.

Possibly the biggest risk, especially for agents that only have one or two self-funded health clients, involves TPAs and certain health insurance companies. (And, if you are only dabbling to this extent in self-funding, my advice is that you sell those accounts or otherwise eliminate this exposure because it's probable that you are creating significant other exposures simply due to not living and breathing daily in this complex insurance niche.)

While I wouldn't hold myself out as an expert on this subject, I've done enough work to know that many TPAs are sloppy. TPAs seem to be held as fiduciaries now and the suits are advising the fees they, and maybe some insurance companies, are charging are excessive and illegal under ERISA rules. What have you, the agent, done to:

1. Ensure your fees are reasonable? Are the fees consistently applied through a formula (almost certainly not in my experience).
2. Ensure the TPA you've helped your client choose is charging appropriate fees and doing so in a provably consistent manner?
3. Ensure claims are reviewed to verify the claims are priced correctly?
4. Verified who is addressing claim recovery?
5. Verified you are receiving correct information? Are you trusting your carrier reps to deliver correct information and data? If so, you probably should not do so without verification and education.

How much of a stretch is it for an insured, or worse, the Department of Labor who oversees ERISA, to claim that you, the agent, are charging too much? How much of a stretch is it for someone to claim that you, the agent, failed to complete adequate due diligence on the TPA? If you are getting a fee, odds are your standard of care relative to completing due diligence on the TPA is much higher than you are applying.

If you want to learn more, I encourage you to read the DOL guidelines and articles like this: https://www.dwt.com/blogs/employment-labor-and-benefits/2023/08/health-plan-sponsors-excessive-fees-litigation#page=1

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Breaking News! The sky is not falling!

The world is not ending!

Heresy: "Belief or opinion contrary to orthodox religious doctrine." Oxford Dictionary

My self-confessed heresy is that reality trumps the alarmist headlines propagated in the insurance industry that weather related events associated with climate change are serious risks to the viability of this industry. The only reason such events might be a serious challenge is if the key decision makers believe the religion without checking the facts and/or are unwilling to do the research and analysis.

Example: A recent headline that spoke to the $2.6 trillion bill for weather and climate "disasters" topping $1 billion since 1980. That means there's an average of $65 million per year. This industry has approximately $1 trillion of surplus in the U.S. alone (as of 12-31-22 per A.M. Best, *Aggregates & Averages*, 2023). That is 6.5% of surplus and those losses are baked into, or should be baked into, the rates.

Last year, 2022, NPW was $780 million. $65 million is 8% of premium. Losses last year including LAE were $859 million. Therefore, the average climate and weather disasters that we should be so fearful of equal only 7.6% of all losses. Should we be more fearful of the 92% of losses or the 8% of losses? And after 40 years, if we haven't figured out how to deal with these losses, we're in a world of hurt due to incompetency, not weather changes.

In fact, SwissRe analyzed these "catastrophic" weather changes and identified that the pattern change began in 1992. Seriously, this is not new news and if we just now are dealing with it, then all the executives should be fired and more intelligent people hired. To solve the problem, one must analyze the situation and appreciate the context.

To truly understand the weather impact, you must isolate the cause of loss. Take all the flooding in New Orleans. The people who originally built and settled in New Orleans built on the higher ground. They were smarter. Other people moved there and high ground was no longer available. Rather than building intelligently or moving somewhere else, they built homes on slabs on low ground. Now we have weather events? No, we have floods where floods are to be expected.

Or take hail in Colorado and Texas. I personally did a hail study specific to Colorado in 1989. What did I find? That 99% of all areas on the eastern slope of Colorado had incurred hail events over the last 75 years. There was one small town with a unique weather pattern which protected it from hail, but that was the only exception. Now move forward 30 years and the population of the front range of Colorado has more than doubled. The claims should therefore at least double regardless of whether climate change is causing more hailstorms.

All these articles and people crying wolf, as heretical as it is to write, seem to be failing to analyze how much of these claims are due to increases in exposures versus changes in weather patterns. And if insurance industry decision makers and actuaries fail to analyze the situation correctly, the industry is in serious crisis due to incompetency, not climate change.

Another example relative to the insurance fiasco on the Gulf Coast. Years ago after Hurricane Andrew hit and literally wiped buildings from the face of this earth, a study was done. I don't remember the author or I would cite the source. The bottom-line of the study was how so many places in Florida that looked appealing for development, looked appealing because of hurricanes. No one had built there historically because those were places hurricanes hit. Like New Orleans, developers ran out of other places to build. Is this a weather issue or a development issue?

Another example involves building codes. To accommodate developers and increase property taxes, municipalities across the U.S. have allowed homes with extremely flammable exteriors to be built closely together. Large wildfires have moved from house to house to house (look it up if you don't believe me) because the houses were built too closely together. We have a housing crisis and the solution to preventing the spread of wildfires means more expensive housing whether with less flammable exteriors or more distance, but this is not a climate issue.

Another example specific to wildfires is that many have been sparked by power lines. Did the winds get worse or did the power poles get old?

Then how many people used to live in wildfire zones? Extremely few back in 1980. Now everyone wants to live in a forest and no one wants to cut the trees next to their houses (I've spent considerable time with foresters and researching fire prevention because I live in a forest). This is not a climate issue. It's an issue of wanting to be safe without giving up niceties that make you less safe, and then blaming climate for the loss.

And for all those who cite weather records, accurate weather records are often maybe 150 years old (this excludes the weather recorded in tree rings and ice cores, but those don't record the "record high for the day"). 150 years out of 10,000 years since the last Ice Age equals 1.5% of all years. It's nothing, not really even a rounding error.

My heresy is not in climate change denial (though climate by definition is always changing and acceleration is the actual issue). It's that writers and decision makers are not analyzing the situation and providing context so that better decisions are made. Go back and read history books for some excellent examples of weather. The Texas Big Freeze that is "obviously" proof of climate change really isn't. Read histories of early settlers and Native Americans. And then feel sorry for them trying to keep warm when a Northerner came down and all they had were buffalo chips for heat.

Property insurance is a mess partially because the industry's analytics are poor and actuarial models are poor, i.e. someone thinks flood histories are relevant without considering all the homes built in low lying areas. Or the models are built on the assumption the population stays in New York where catastrophes are rare versus the fact so many millions of people have moved to Texas where catastrophes happen every year. In New York you have frequency and not so much severity. In Texas you have severity (everything is bigger in Texas!). Actuaries are not that good at modeling severity.

The industry must address these realities instead of running from them. Forms need to be updated and rates adjusted to encourage risk management. In central New York these issues are not that important. But in Florida, Louisiana, Texas, California, Colorado, Idaho, and Utah, the assumption that the standard forms and rating models will work in high catastrophe prone areas is a really bad assumption. Insurance alone cannot be the solution in high severity areas. Insurance must be paired with risk management and then the rates adjusted downward for property owners completing the right risk mitigation actions.

Then we need underwriters to stop doing blanket underwriting so they recognize those properties with quality risk mitigation. When I was an underwriter writing high dollar property in fire zones, we built risk mitigation strategies that made risky property safe property. I never lost one of those properties to fire and simultaneously still could charge an elevated rate. No wonder the loss ratios were continually in the '40's, but it takes effort to see beyond the "Sky is Falling" headlines.

If this industry cannot handle an average of $65 million in catastrophe claims per year, this industry has way bigger problems. If it can't handle multiple billion dollar "nuclear" claims, it has way bigger problems. And never forget, for additional context, this industry was designed specifically to handle catastrophic claims, i.e., entire ships and their payloads sinking. It was not designed for small claims so catastrophes should be expected--or get out of the industry.

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What is the definition of a Truly Professional Agent?

In some states, nail technologists (people who do manicures) must complete 600 hours of training and education prior to earning a license. P&C agents only need 40 hours give or take, depending on the state. For perspective, each fingernail gets the equivalent of more education than is required for agents in total!

I have lost fingernails in accidents, but so far, the value of a fingernail has never come close to the value of my home. However, agents with only 40 hours of education are selling legal contracts that buyers hope will protect their largest (most likely) personal asset. With context, this mismatch is ridiculous. I am not saying that nail technologists need less education either.

I read an E&O case today where the agency won. The agency won because the court ruled the agency was an order taker. Considerable E&O defense rests on this foundation. What is an order taker agent?

Depending on how E&O claims data is compiled, the failure to procure appropriate coverage is often the leading cause of E&O claims. The allegation is that the agent failed to procure the appropriate coverage relative to the insured's known (or should have known) exposures. Duty to advise is another form of this allegation.

According to my favorite insurance law book, *Understanding Insurance Law*, Sixth Edition by Robert H. Jerry, II and Douglas Richmond, there are at least 24 precedent setting cases that, "...absent special circumstances that might give rise to a broader duty, the default rule is that agents and brokers have no duty to advise insureds about the adequacy or appropriateness of the insurance coverage they purchase or about optional coverage that might be available."[1] In other words, an insurance agent is not an insurance advisor (unless of course they make that their title, advertise as an advisor or call themselves a risk manager, etc.). The book goes on to cite another case, "In short, in most situations, an intermediary satisfies his duty to the insured by procuring the coverage requested by the insured."[2]

A lot of agents depend on these legal precedents to sleep at night thinking they do not really have much of a duty to clients and being required to complete only 40 hours of education correlates well with having less duty to protect huge assets.

Agents are paid pretty well for having no obligation to advise. Mike Edwards, one of the best insurance educators I have ever known, used to joke about how those agents who advocated cross-selling insurance policies seemed to think cross-selling insurance was like offering drive-up window customers fries with their hamburgers.

Times have somewhat changed. Cross-selling insurance remains far more complex and if you are only cross-selling on an order-taker status, you have already lost. What has changed is that technology now allows insureds to order their insurance off a technological platform. Click here and click there for this limit and that coverage. Technological platforms are the epitome of order taking, just like a drive-up window. There is no future in being an agent taking orders without accepting minimum wage compensation, and minimum wage is fair because order takers are not worth much. Technology can take orders for about half the going commission rate.

Being an order taker means selling a product. This product is a complex legal contract. The legal contract, at the order taker level, is a generic product. It is a one-size fits all. Rather than being bespoke and fitting well, it will have more coverage than some people need. However, in my experience, it will have much less coverage than the majority of people need.

I have many friends who believe deeply in coverage knowledge, and they are consummate educators. But really, what difference does education make if all you are going to do is take orders? As one judge stated, "...[individuals] take an intellectual gamble when purchasing insurance as they weigh the expense of insurance versus the amount of coverage they purchase."[3] It is a much bigger gamble than that when an agent does not know what they are selling, has not really done much work to truly ascertain the coverages needed, and the insured has no idea of their real options or needs and never reads the policy. What a ludicrous situation. This makes the Keystone Cops look intelligent.

A real professional sells a service, not a product. That service entails putting the customer first. That service requires full engagement with the client, meaning deep conversations. I get the response all the time, "Customers won't give me the time for a deep conversation!" Certainly, that happens, but I have also tested this, and the results suggest the vast majority of time, the problem lies with the agent and not the client. In many cases, the client simply does not think enough of the agent to give them the required time. They see the agent as an order taker. Why spend time with an order taker? Do you really want to spend time with the teenager at the pick-up window?

Lots and lots of people are totally comfortable wearing ill-fitting clothes. Some really funny websites are dedicated to this fact. Lots and lots of people are completely comfortable buying the wrong insurance, until they need it. A true professional, no matter how good they are, will rarely get those people to see the light. This is why technological platform order taking agents can scale. This is why some of them have outrageously high valuations because it is easy to scale one size fits all insurance policies. Truly professional services are not scalable enough. The offset is a better profit margin.

A truly professional agent puts the client first and accepts the responsibility of providing professional advice. They are paid for professional advice too, not just for placing an insurance policy. To provide truly professional advice, one must complete far more than 40 hours of education classes. A truly professional agent will spend time learning exposures/coverages, and not just so they can explain a form either. One of the great advantages of education is you can identify exposures you would not have otherwise recognized. Another great advantage is you can identify creative solutions for your clients.

If you truly want to be a professional agent, assuming the risk but gaining the reward of better compensation, while knowing you are providing real value to people, contact me at chris@burand-associates.com. I have a program for you.

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[1] Robert H. Jerry, II and Douglas Richmond, *Understanding Insurance Law* (6th Ed.) (Durham, Carolina Academic Pr. 2018), 208.
[2] Ibid.
[3] Jerry and Richmond, 209.

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Making Lemonade

A *Carrier Management* article, from July 17, 2023, covered a report by McKinsey Global Institute that $800 billion of value has been lost specific to office building values attributable to work from home, post-pandemic employment trends. For context, $800 billion is about 80% of surplus as all U.S. insurance companies have, combined, as of 12-31-22 ($1 trillion).

This has multiple implications for insurance. The first is, if you insure office buildings, you may need to find some new clients. Also, depending on the nature of your clients, expect some fires. Maybe fire those clients prior to them burning down your loss ratios and contingencies.

Second, loss trends will materially change. It's speculative to think we can predict how losses will change but workers' comp will for sure, maybe for the better and maybe for the worst. Auto loss trends likely will show less frequency and more severity (and always, always remember to not drink the Kool-Aid about severity being the end of the world because if frequency decreases, severity will always increase so severity should be increasing). Many homeowners need additional coverage working from home, but without the coverage, loss trends won’t affect homeowners loss ratios.

Another loss trend likely to increase is associated with professional liability. Virtual training is inadequately effective, and some trends already indicate a material increase in frequency specific to professional liability.

Cyber is another line likely to see an increase in frequency, and maybe severity. Work at home is simply not as secure for many firms.

Getting in front of these trends is a great opportunity. Proactive is better than reactive.

My third point might be a stretch, but I like to find the silver lining. Given how hard the property market is, fewer offices should free up some surplus, provided the offices are not insured at the time they burn.

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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 Advise*r for independent insurance agents.

Burand is a member of the Institute of Business Appraisers and NACVA, a department head for the Independent Insurance Agents and Brokers of America's Virtual University, an instructor for Insurance Journal's Academy of Insurance, and a volunteer counselor for the Small Business Administration's SCORE program. Chris Burand is also a Certified Business Appraiser and certified E&O Auditor.

Burand & Associates, LLC is an advocate of agencies which constructively manage and improve their contingency contracts by learning how to negotiate and use their contingency contracts more effectively. We maintain that agents can achieve considerably better results without *ever* taking actions that are detrimental or disadvantageous to the insureds. We have ***never*** and would not ever recommend an agent or agency implement a policy or otherwise advocate increasing its contingency income ahead of the insureds' interests.
