# *Burand's Insurance Agency Adviser*

**Resources and Information for the P&C Insurance Industry**

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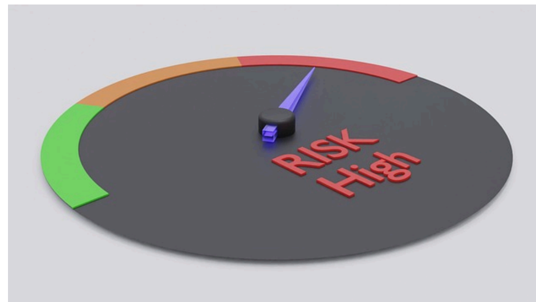


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2) Provide their clients within better coverage solutions, and
3) Reduce E&O exposures.


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## Bad Bookies

I was listening to the Michael Lewis podcast, "Against the Rules." The season involved what I consider to be the highly unethical methods designed to attract people bad at evaluating odds to gamble on sports and then gamble more. I highly recommend the podcast and his books.

Hearing the old-fashioned bookies was one of the best parts of the podcast. One of them used terms identical to insurance terms. If you have a good underwriting model for judging risk and odds, you want to attract as much money as possible (Progressive is an excellent example of this). If you have a bad underwriting model for judging and pricing odds, you shouldn't want any bets (premiums) because you'll lose!

The key difference here is that an individual might know something the bookie does not know, which a smart bookie appreciates because it helps them move the line. However, a not-so-smart bookie won't appreciate the information. That bookie will be adversely selected against. We use the same terms in insurance underwriting.

Perhaps insurance companies writing in certain states and lines are bad bookies? Maybe the public (rather than the individual) knows something the insurance companies don't know and cannot process intelligently? How else can the horrible profitability of homeowners' insurance be explained?

Someone, i.e., the carriers, has not assessed risk correctly. Whether they failed because they failed to assess the weather risk in Minnesota, the regulatory risk in California, or the litigation risk in Florida, or whatever else, they failed to assess risk accurately.

I believe the best way to analyze any problem is to break down the situation to its simplest element and build back. The simplest element is a failure to assess risk correctly, so that it can be priced correctly.

The carriers, some of whom are horrible bookies, as a whole, simply failed to assess risk for ten consecutive years, which is the number one job of an insurance company. We can get lost in the details of how one carrier never assesses risk correctly and still makes a lot of money–they might have a gargantuan investment portfolio combined with an interesting tax strategy. But they could make even more money if they assessed risk correctly.

We can get lost in the details of carriers starting off with excessive surplus, wasting it by poor assessment of risk, and how it seems to take forever for them to correct course. We can get into all kinds of details, but the fundamental job of insurance companies is to take a lot of bets, knowing they will lose many of them. Still, overall, the carriers will make 5%-10%.

There is nothing different than running a gambling book.

No excuses should be made. Either the executives, over a five-year time frame, assess and price risk correctly or new executives should replace them. Obviously, this is easier said than done, but seeing executives that never make money should also be an easy decision for the board of directors.

It should also make for an easy decision for strategic thinking distributors to assess their risk of doing business with carriers that obviously are incompetent at assessing risk. It's not going to work out without a miracle happening. Miracles are long shots, and smart gamblers will advise that methodical, well-researched, disciplined bets are the way to win.

Fundamentally, this industry has never deviated from the need to assess and price risk correctly. When we forget this, we lose, though a few individuals might get rich from people who are bad at assessing odds.

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# Are regulators regulating well?

It seems everyone in the insurance industry is aware of the California regulatory fiasco. If ever there was an insurance regulatory scenario akin to Nero fiddling while Rome burned, this is it. And it has been going on for decades. I strongly recommend everyone read "These are the Plunderers," by Gretchen Morgenson. This book has a California focus beginning in 1992 and ending in 2025. If you feel your stomach turning while reading this book, you will not be alone.

The regulatory situation there is so bad that every carrier executive wanting to remain admitted in California should likely reevaluate their goals because there is no benefit that outweighs the negative of being admitted in that state. Seriously, boards of directors should have this on their agenda.

California is one of the worst, but inadequate regulation is endemic, and I am not a fan of significant regulation in general. *Coverager* posted a notice from General Motors' new insurance launch, explaining that it began writing on August 1, 2025, and quickly realized its rates were too high in Florida. It filed, within about 60 days, a rate decrease of almost 20% because it wasn't converting enough quotes into policies. Where are the actuaries? Was the original rate even justified? Was the original rate intended to make a lot of extra profit? Or was it a mistake? Or did the sales managers override the actuaries? Or maybe the original rates were accurate and the market is underpricing by 20%? That has happened more than once.

In the big scheme of things, it is immaterial, but it helps illuminate the pricing problem we have. Are the rates actuarially validated, and who is checking? Rates have increased so fast and by so much that it is harming the public. A carrier cannot get enough claims expense in 60 days to charge rates based on claims.

Another factor is regulators are allowing carriers with minimal capital, to put it mildly, to write business under the premise that "more markets with tiny balance sheets are better for competition." Some of these carriers have less than $10 million in surplus, but even if they have $50 million, that is basically nothing. Let's use a $400,000 middle class Coverage A home. I'll be conservative and use 50% Coverage C (versus the standard 70%). Add Loss of Use, Ordinance, and so forth, and total coverage equals $750,000 easily. $50 million divided by $750,000 equals 66 homes. So this is an insurance company that can only insure 66 homes? Surplus includes reinsurance calculations, so the mantra, "We have reinsurance!" rings hollow.

And by the time the hurricane or tornado hits, the $50 million will have been diluted. The report commissioned by the Florida DOI regarding whether new markets are moving money out of carriers into related entities so that surplus is materially depleted is real. This is happening with many of the new markets. Some portion of that $50 million will likely have been distributed to related parties.

High quality capital within a handful of quality markets is far better for consumers than having a lot of little under-capitalized markets. But the problem is deeper because whether these markets are pricing correctly is another issue. Quality capital will write business if they think they can make an adequate return on their investment. If they assess that the rate must be $X and new players with limited capital are writing for $X less 20%, they will not invest. Why would these entities arrive at different rates? A lot of illegitimate reasons exist, including underpricing to get market share. This is one of the top three reasons carriers become impaired, so rates should be reviewed to prevent this from happening.

Many legitimate reasons exist, too, and the most important reason is the cost of capital.

In a reciprocal, as many of these vehicles are, the cost of capital is low and less capital is required (because, as a reciprocal, policyholders may be required to pay the difference and get nothing, no ROI, for their surplus contribution). Using a simple loan, for example, if one good market needs to deploy $100 million at 5% interest, and one of these new markets only needs to deploy $75 million at 5% interest to write the same premiums, the $75 million carrier wins. Furthermore, the $75 million market will likely have already removed a large chunk of this money to pay related third parties, and if they fail, the state will pick up the claims, not the investors.

Carriers as a whole are working hard to use balance sheet light models (Berkshire Hathaway stands out as the primary exception, although a few others exist). This is because capital, i.e., surplus, costs carriers money, and they want to reduce their costs. However, less surplus causes the market to remain hard and increases the risk of uncovered claims.

Regulators who put consumers first would eliminate inadequate rates and then require more quality capital. This is the key to a stable insurance market. I don’t know why everyone wants to make the solution so convoluted.

Given how high insurance rates are, my solution may seem impossible to institute. On property, regulators need to take an additional step and regulate credits for making homes safer, insurance-to-value, and wildfire mapping. All three factors have become cruel jokes.

Credits should be mandated for hail resistant roofs and wildfire mitigation which meets the various states’ wildfire mitigation guidelines. Credits should be mandated for wind mitigation construction. It seems carriers would figure out good property is being severely overpriced and take advantage of this great opportunity, but so far, I have not heard of a single company smart enough to offer quality credits.

I have seen multiple studies showing structural property is severely underinsured. Part of the problem is rates are so high, people are forgoing adequate coverage. But another part of the problem is the stubbornness of carriers to ignore the reality of rebuilding costs. In other words, their replacement cost estimators are trash. I’ll use my own home. The estimate came back at $158 per square foot. Someone please tell me where I can rebuild a quality home for $158 per square foot within the United States.

Why do carriers underinsure property? Incompetence and excessive reliance on third parties are clearly important reasons. But if carriers are surplus light, or even surplus inadequate, adding more TIV to the balance sheet means needing to add more surplus, and they don’t want to do this. In some cases, they are already up against a wall, and they cannot add surplus. They are not profitable and have exhausted their capital contribution options.

But this leaves insureds high and dry. Many Los Angeles fire victims are not going to rebuild because the reports I’ve read show they were underinsured by around 50%. This is an economic and social problem of scale requiring better regulation, not more regulation.

Poor wildfire mapping exacerbates the problems. Literally, not figuratively, huge swaths of the country have been labeled a wildfire risk without any consideration of the property itself. The brush maps we previously used were designed to identify the brush exposure down to the house. That makes sense and is sound underwriting. Using a house painter's brush to identify wildfire risk, when a fine-tipped brush should be used, is unnecessarily causing excessive rates, leading insureds to self-insure too often, and fostering resentment towards the industry, which will eventually result in unpalatable political solutions.

Carriers typically respond the same way, "But we don't make any money!" In Homeowners, in particular, rates are becoming unaffordable, and yet carriers' profits are poor to nonexistent. After ten years, if a market cannot make money, the market needs to look internally at what it is screwing up. More double-digit rate increases are not a plausible solution. But what happens to profits if they insure homes to value?

Outside of natural catastrophes, water damage is the most significant claim, and that is largely avoidable with technology today. In other words, risk management is an effective tool. Relative to natural catastrophes, risk management solves most of the issues.

Property hardening in wind zones has been proven to be highly effective. Wildfire mitigation is highly effective. Hail hardened roofing material is highly effective. And last, pride of ownership is actually highly correlated to mitigating property losses, though that requires actually looking at the risk being insured. Rocket scientists are not required, and since carriers are obviously ignoring these solutions, regulators should encourage them to reconsider. It is in the best interest of the public and ultimately the carriers.

Unfortunately, we need more quality regulation. More regulation for political grandstanding is just jet fuel for unnecessary debate. The industry is heading down a path that is damaging to the industry and the public. And yet, with a bit of thought, there are many options and opportunities to correct the course.

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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 the Insurance Journal, American Agent & Broker, and National Underwriter. He also publishes Burand's Insurance Agency Adviser for independent insurance agents.

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