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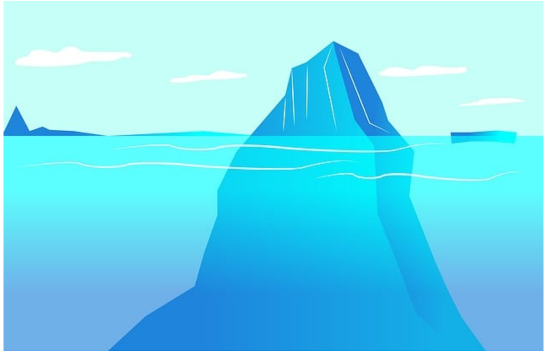

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When an Insurance Company's C-Suite Should Know it's Time to Sell the Company:

Recently, I was reading an insurance company's annual report to its agents. The carrier was effectively stating a limited number of its financial achievements. In effect, they were bragging. At least they appeared to think they were bragging.

One of three thought processes happened in deciding what data to release and how to present such data:

1) Management has no clue what they are doing and think their results are actually good.
2) Management knows their results are poor and hope their agents take all the numbers at face value without thinking anything through or looking further.
3) No thought at all because when a carrier is run so poorly for so many years, I am not sure any critical thinking happens.

All you need to know is this: Their profits relative to their assets equaled 0.4 percent.

In other words, if I have $1 million to invest, my profit at 0.4 percent is $4,000. If I put that $1 million in a 4% CD, my profit is $40,000.

An insurance company probably should sell itself if it can invest its assets in a CD that returns 900% more money. The directors and officers and board should probably use this as a litmus test.

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Are you Binding Coverage without knowing it?

Recently, I've come across many instances of agencies binding coverage without realizing they do not have the authority or they do not even realize they are binding coverage.

First things first. What is a binder? I find that only a small minority of people whom I ask, know the correct answer. As the formal issuance of binders has dwindled to almost zero, people have lost the knowledge of what a binder is.

A binder, simplistically, is a short-term insurance policy. IT IS AN INSURANCE POLICY. If you do not believe me, read the ACORD binder form.

A binder IS NOT EVIDENCE OF INSURANCE! When you issue a binder, you are issuing an insurance policy. When you issue an evidence, you are issuing evidence that insurance exists, but you are not issuing an insurance policy. The difference is huge.

When a binder is issued as an evidence, an insurance policy already exists. Therefore, issuing a binder in this situation, which is extremely common, means issuing a second insurance policy. A binder should only be issued if no other policy exists. To issue an evidence, a policy must already exist. Therefore, to substitute a binder for an evidence means issuing a second policy and no good can come from issuing a second policy. Issuing a binder to prove a policy already exists is incorrect.

The argument that a binder in this instance is not a second policy does not hold water because a binder form states it is a policy. The argument that a binder is required because the actual physical policy has not arrived does not hold water either. If a policy number has been issued, a policy exists. Whether it is lost in the mail or the carrier is a month behind with their printers (one would think carriers could afford more printers, but that does not seem to be the case), is a moot point. Issue an evidence if you have a policy number. In fact, this is a perfect scenario for an evidence because you are providing evidence coverage exists even though the policy itself has not arrived.

Additionally, read the terms and conditions on the binder. If I am a plaintiff attorney and an agent has issued a binder when a policy exists, but the binder's terms and conditions are silent, how will that attorney interpret coverages?

Furthermore, I find that almost no agent has researched the agency's binding authority in the last five years. Carriers just make changes on their websites today and no one pays attention. Binding authority has been severely curtailed. Some admitted carriers have eliminated binding authority completely, but I see agencies still issuing binders for these carriers. Some carriers have minimized binding authority to a week or even 48 hours, but I see agencies still issuing 30-day binders. If you are going to bind coverage, you can only bind coverage within your authority. Failure on this point is an E&O slam dunk for carriers.

Additionally, I am now seeing staff and producers, who do not adequately know the differences between admitted and non-admitted carriers, binding coverage in surplus lines. Retail agencies almost never have binding authority of any kind in surplus lines.

Sometimes they bind completely innocently, not thinking about their words and likely trying to sound like they have more authority than they do. A producer will tell a client, “Thank you. I’ll get your coverage bound today.” Unless the agency possesses binding authority, the agent cannot tell a client they’ll get coverage bound or that they will bind coverage. Saying this arguably means the agency has issued an even worse binder, a verbal binder. The better response is to tell the client you’ll request coverage be bound and you will let them know the result.

Sometimes the agent feels like they are under pressure because of carriers and surplus lines markets’ poor service. The policy does not arrive for a month or six months. The insured needs the policy, and the agent feels compelled to give them a policy. The market’s incompetence does not change the agency’s contractual limitations.

Another example is when the client needs a certificate before the policy is issued, prior to even receiving a policy number, and the agency issues a certificate. Arguably the agency has bound coverage here, which is not correct. Instead, this might be one of those situations where, if binding authority exists, the agency should actually issue a binder.

In today’s world when policy issuance by standard carriers is measured by the immediacy of having a policy number, binders have almost no use. The need simply does not exist.

With surplus lines carriers, never issue a binder. Instead, obtain a binder from the broker and pass it on to the insured without changing anything whatsoever. A retail agent does not have the authority to change anything whatsoever. Do not rewrite the binder either onto a new form to suggest it is your binder.

Do not verbally bind any coverage, ever, even if you have binding authority. Do not issue certificates on policies that do not exist. Do not try to make clients think you have more authority and power than you actually possess. And never, ever guess or assume you have authority or power that is not in a contract. Any authority you have should be expressly stated in your carrier contracts. Know your limits and do not exceed those limits.

Binders done incorrectly are fairly straightforward E&O claims the agency is almost certain to lose. Whether the insured sues or the carrier pays the claim and subrogates against the agency for violating their binding authority, the agency is likely to lose. Stay simple and do not issue binders unless you must absolutely do so in a situation where the insured does not have coverage, needs coverage, and you have the authority to offer coverage. An example might be someone that does not have auto coverage on Saturday morning and needs it immediately and you cannot issue a policy on a carrier’s system that morning, so you issue a binder within your authority.

And here’s the other benefit! It’s less work for your staff to not issue binders!

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It's What They Don't Tell You

“It’s what they don’t tell you that matters.”

The person, an esteemed expert, who emailed me this quote was referring to insurance company shenanigans, illusory coverage, and maybe fraud.

The easiest analogy is E&O (errors and omissions/professional liability). Most E&O classes cover errors, mistakes that agents make (do you ever wonder why the policies are professional liability policies but in E&O classes instructors advise agents to never classify themselves as professional?), but they do not cover omissions. A cyber policy is an excellent example because determining the quality of a cyber form depends heavily on your ability to know what coverage needs to be included. If you just read the policy and base a conclusion on what is specifically listed, including specific exclusions, a high probability exists you will miss the omissions. The coverages not listed are often the most important coverages.

The mental work required is hard to determine what is missing versus reading language that you do not like, such as unfair exclusions. You must know what should exist. Otherwise, no noticeable void exists. And many entities are now counting on greed and ignorance to hawk their omission filled products.

If you are a professional agent (and what good are you if you are an amateur?), you understand the importance of what coverages should be offered by the market. Markets though have absolutely no obligation to say, "Here's the blanket coverage you probably want to offer your client, but we are not going to offer it." Many agents tell me they really miss the days when their underwriters used to help them in this manner. I'm glad those agents see the difference.

I also hear many agents tell me they are depending on their underwriters to counsel them under some misguided idea they have the knowledge and a willingness to do so. Every once in a while, an agent will tell me how upset they are having incurred an E&O claim, or a lesser but important situation, because they actually depended on the underwriter and the underwriter was wrong. The best example is asking whether this or that is covered. In today's world, the underwriter's opinion is of no importance.

An acute example of having no duty to advise are Third Party Administrators (TPAs), though a limited example because most agents do not use TPAs. TPAs are the black hole omission in many contracts because it is often not clear if they are responsible for their mistakes. Possibly worse is that agents take coverage classes, but they do not take TPA contract classes. If you are engaging with TPAs, I strongly recommend getting educated on TPA contracts.

The reality is that if a person is not educated on some subject, they have no way of identifying omissions. Some TPAs in my experience are extremely willing to take advantage of such ignorance. Some of their salespeople are ignorant too, probably on purpose so they do not let anything slip. Some TPAs are fantastic, but TPAs are likely the least regulated part of the entire insurance industry. Do not do business with a TPA if you don't know what should be in the contract unless you get educated or hire an expert to assist you.

Another example is how some of the new entities' policies actually work. For example, is the policy actually a dollar one policy? Do you consider a $100,000 deductible dollar one?

What happens if the reinsurer is not rated and that attachment point is $1 million. Is this still an A+ program, especially if the non-rated carrier only has surplus equal to one large claim? You must ask the questions to learn these details and to ask the questions, you need to be educated on the subject. The market is not going to tell you voluntarily.

One of the best policy examples that commonly exists in professional liability policies and sometimes in general liability policies are absolute exclusions. As Fred Fischer has written extensively and in detail, these are extremely problematic exclusions because they limit a professional's liability coverage to their *exact* professional services. For example, if a cyber consultant is sued for failing to detect accounting fraud and their policy included an absolute clause, they probably would not even have defense coverage because their profession has absolutely nothing to do with detecting accounting fraud. The plaintiff attorneys are simply suing every consultant their client ever hired. These are not fair exclusions when applied to these kinds of situations. But these are often difficult exclusions to identify because there is no bold print announcing the exclusion.

Somewhat similarly are the policy clauses that I term as being mis-directional. For example, the common clause that states coverage applies to claims anywhere in the world *if the claim is brought to court in the U.S. or Canada*. I do not have any judicial data on how many foreign claims occur that are only adjudicated outside the U.S. and Canada but involving a U.S. based client. Where might the plaintiff have an advantage?

Or a good cyber restriction that says ransomware will be paid if paid in U.S. or Canadian dollars or Euros. Sounds good except most ransomware demands are in crypto. Oops.

I also pine for those days when agents worked collaboratively with carriers. It was more fun and safer. But those days are toast. This means agents must become far more educated than ever. If you want to buy your CE priced at $100 an hour and get four hours credit in an hour and think you're educated, keep living your delusional life. Serious education requires high quality education that may not even be approved for CE and it is going to cost a lot more than those internet classes. Professionals pay for such education in all professions. Amateurs do not. Amateurs expect someone to tell them the answers.

Professionals know the onus is on them to learn because they know it's what they do not tell you that matters.

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"To Beat the Devil"

"If you waste your time talking to the people who don't listen to the things that you are saying, who do you think's gonna hear?"

This line was written by Kris Kristofferson, one of the great songwriters of the last several generations. I am fairly confident the context in which I hear him sing this song is not the context he intended. I hear it in the context of a consultant's advice. And I hear that consultant's advice from two perspectives.

The first is from the perspective of someone who really wants to help improve the business of everyone in their audience. Kristofferson's lyrics go on to point out that people say they want to improve their lives, but they really don't, which is why they don't listen. But I believe to some extent, this is a two-way street. It is the speaker's job to sharpen their personal skills so more people listen. I believe it's a mistake to preach a message and then blame the audience entirely for not listening.

Then they commit sin number two by demanding people change too much. Maybe it's necessary to change direction severely as if someone is heading west and they absolutely should be heading south, but severe directional changes are expensive monetarily and emotionally, and especially emotionally because that requires admitting the prior direction was entirely wrong (cue the jokes about men not following directions while driving).

Instead, a nudge to be less wrong and a little more right is more practical. People tend to listen more when only a slight directional change is recommended. And the lesser magnitude is likely better advice because huge changes usually possess material unintentional consequences, or collateral damage, that may be worse than if the direction was never changed.

The other context I picture whenever I hear these lyrics is to not waste time selling to people who will not buy from you. This is more of an issue for professional level insurance sales rather than order takers. Order takers see this from a perspective of whether their timing is right, whether predictive buy analytics are working or simply a matter of dialing for dollars. But a professional is in the business of advising clients to buy the right coverages and likely to apply some form of risk management and loss control. They want clients and prospects to listen to their advice because they know their advice will lead to a better outcome for the client. But if the client is not listening to the things you're saying, what difference do your words make?

A professional's key to improved hit ratios is to improve your messaging with great care. Practice your pitches. Hone them to the sharpest point possible. And avoid interacting with people who do not want advice, they just want insurance, any insurance at the cheapest price that comes with a certificate of insurance, an evidence of insurance, or an SR-22.

A professional must find an audience that wants better solutions. Then reduce your expectations to understand that you can likely only reach one client at a time, so they had better be big enough accounts to pay your bills.

Prospects willing to listen have a sense of urgency because without urgency, nothing ever changes. Some will have a sense of urgency simply because they're driven to achieve higher, better, faster levels of whatever they do. Some will have a sense of urgency because they're scared and want to be proactive. A few will have a sense of urgency because they're facing serious losses or recently incurred large losses due to their prior life of thinking all insurance was the same. The devil sold them on that thought and they're now seeing the light.

But just because they're complaining does not indicate urgency. A line in the song states, "And I'll guess I'll die explaining how the things they complain about are the things they could be changing." Some people just like to complain. If you are a professional then, ask yourself if the prospect before you has any sense of urgency to work with a professional. If not, leave.

But this is a two-way street so ask yourself how committed you really are to offering holistic solutions. The frustration of dealing in this industry, where consumers and providers are not generally interested in holistic solutions, requires a solid commitment.

What is your holistic solution? Risk management is often a great holistic solution. In fact, risk management done well is often a better solution than buying insurance. If a business's risk management is high enough quality, the chances of a claim decrease materially. The lower the probability of a claim, the less important insurance becomes. And then, even if insurance is still required, this kind of company becomes a perfect client for alternative risk solutions such as captives and if you are preaching a holistic solution in this market, then you better be conversant on the subject of alternative markets. Are you committed enough to gain education to this level?

Most business owners have no idea risk management can make such an important difference. They think the best solution is to always get the best premium without any eye toward improving their operations. What happens when they're offered a far better solution? Some will realize an urgency they did not realize existed.

Another simpler example is to offer clients the coverages they really need. When I write, "offer", I mean discuss the coverages with them. This takes time, which requires a commitment. Order takers don't take time to do what is right and a professional must make this distinction clear. Many of the best agents I've ever known told prospective clients they did not want to see their existing coverages until much later because they were not there to compete on writing the same inadequate coverage.

Another example is that some people are simply driven to always be better. When a professional presents a superior solution, assuming your presentation is very sharp, you will find ready converts. In a sense, you will find people who have been waiting for a professional agent to find them. They instinctively knew something was missing in their insurance program, but did not know where to find an advisor with a quality strategy. This is sort of like finding a doctor who finally understands the underlying disease and offers a holistic plan versus a doctor who only treats the pain.

Rates are ridiculously high for many insureds today. Some of these rates are deservedly high and some are not, but from an insurance company's perspective, these risks are all bad risks unless rates are high, and likely need to be higher. The solution is not to always find a lower rate (though this is the solution if the incumbent carrier is raising rates simply to drive business off the books – which some are). Just moving the account to a temporarily lower priced carrier is a temporary solution. The solution is to improve risk profile and if the carrier does not recognize a better risk then, alternative markets are your solution. This article focuses on client messaging, but if underwriters are not going to listen, skip them. Go to other markets where ears are still valuable.

There are two kinds of prospective clients, those ready to hear your message of change and those who are not. Make no mistake, if you are trying to get a new client, you are preaching change to them, because at the least, they must break their existing relationship. If you are talking to someone not wanting to change, you are talking to someone that is not listening. Your best bet is to plant a seed so that when they are ready, they'll call you. But save time and move on quickly.

Another way of looking at it is if you are spending your time on prospects that will not listen, you are not spending time with prospects that will listen. Beat the devil and spend time honing your message to people largely ready to listen.

The song's title is "To Beat the Devil". For our purposes, the title could be, "To Beat the Competitor." In the song, the singer not only beats the devil, but he drinks the devil's beer and steals his song. You can beat the competitors by focusing on your competitors' clients that want professional level advice and solutions.

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The Veritas about Fronting, By Greg Lang

If you are serious about captives, fronted paper helps maximize a captive's value as a reinsurer. Fronted paper is required for regulated lines of insurance like workers' compensation and auto liability. Rated paper is often demanded by lenders with credit and liquidity concerns. This demand is increasing. Traditional insurers continue to run from difficult and emerging exposures. Fronting large property deductibles has become a cottage industry as the traditional property market reduces capacity and increase rates. There is also a growing focus on enterprise risk captives to cover policy exclusions and to provide funding for uninsurable operational, financial, and strategic risk. Fortunately, there are more fronting options now than ever. I count twenty-eight insurers offering fronting in the US right now.

Why fronting?

Fronting carriers are insurers who issue admitted or non-admitted policies on behalf of an insured or group for a fee. The term "fronting" comes from the banking industry. It is a fee payable by a borrower to a fronting bank for the credit risk the bank assumes for issuing a letter of credit (LOC), bond, or other type of contractual guarantee. The fronting fee covers the capital charge for the risk assumed. The same is true for fronting insurers.

Insurers' front fees are paid as a percent of premium subject to a minimum. Percentages range from 3% to 10% or more. The minimum fee for a single policy has grown to @$250 thousand dollars. Why so expensive? That is a fair question. What is unfair is suggesting fronts do not take any risk. When people tell me this, it gives me pause. Many captives develop their own policies and manage their own claims. These actions can create significant exposures for fronting companies.

Veritas means "truth." or "reality" in Latin. If there were no risk in fronting, why would so many transactions require it? 100% of the fronting deals I work on have risk. The biggest risk is often not underwriting risk. Regulatory, credit, and reputational risk are all exposures fronters face. As the demand for fronting increases, so do the risks.

ECO/XPL

When a bank engages in a fronted transaction, they know exactly how much risk they will assume. The loan amount does not change after the documents are signed. Insurance policies are different. Insurance is the only product I know of where the "cost of goods sold" is not known at the time a policy is issued. Even policies with well-defined terms and clear aggregate limits can be challenged and changed by a court. These exposures are real and getting worse.

Some fronting contracts specifically transfer ECO and XPL to their reinsurer or captive. In other contracts, it is implied. Commercial reinsurers have begun pushing back to mitigate their ECO/ XPL obligations. Few captives' Extra contractual obligations (ECO) are expenses imposed on an insurer by a regulatory, judicial, or governmental organization. ECO losses fall outside the insurance policy. ECO is a form of punitive damage. Its intention is to punish. Excess policy limits (XPL) losses result from the mishandling of an insurance claim. The mishandling results in liability for loss above the stated policy limit.

ECO results from negligence, bad faith, or deceptive practices. An insurer may be found to have engaged in deceptive sales practices and may be sued for misrepresenting what perils are covered by a policy. The state where the policy was issued does not care who mishandles a claim or used deceptive marketing, they hold the fronting company responsible. If a captive owner created the policy or managed the claims, it seems only fair they should cover this cost.

Credit/Liquidity Risk
Banks typically have real property or other assets such as cars or boats as collateral for their loans. Fronting carriers require liquid assets such as cash or letters of credit. Unlike banks, insurance companies are subject to Statutory Accounting Principles (SAP). Banks are subject to Generally Accepted Accounting Principles (GAAP). Statutory accounting requires a liability to be recognized on the insurer's balance sheet for unauthorized reinsurance that exceeds collateral held from that reinsurer. Captive reinsurers typically meet the definition of unauthorized reinsurance. Unauthorized reinsurance cannot be recognized on the insurer's balance sheet as an asset. An acceptable asset is required. Acceptable assets include cash or LOC. Trusts are also acceptable if the trust meets the States asset liquidity requirements. The most common form of trust is a Reg 114 trust which is modeled after NY State statute. The statute has a specific list of what assets are acceptable. Admittingly, the assets held by a bank and the insurance company does offset most of the credit risk assumed while fronting. ECO and XPL are good examples of why insurers charge more for their service. Another one is fraud.

Fraud
One of the biggest stories of 2023 was the creation of billions of dollars in fake letters of credit to support reinsurance transactions. Criminal deception is another example of the credit risk fronting carriers face. Over $3 billion dollars of fraudulent letters of credit were reportedly created by former employees of Vesttoo, an Israeli Insurtech firm and used in reinsurance transactions. Fronting carriers, Clear Blue and Trisura were exposed to the Vesttoo scandal. Cedents need to conduct appropriate due diligence on counterparties as well as conduct collateral reviews.

Compliance/Regulatory Risk
Purging clothes and cleaning out attics and garages are common new year activities. It looks like some regulators and carriers are also doing some house cleaning to begin

2024. I have had two calls to find homes for existing captives. Programs that once passed legal scrutiny no longer qualify. Both are financial guarantee captives. Nothing illegal about financial guarantee. It is just that traditional Property and Casualty (P&C) insurers are not licensed to front them. In most states, financial guarantee insurance requires its own license and capital. The only exception is if the P&C insurer uses a surety bond. Sureties has restrictions too. Structuring a financial guarantee program is often the easy part. Distinguishing financial guarantee from Insurance can be tricky. It can also result in litigation.

I sometimes see policy language that breaks insurance rules. One example is the rule of indemnity. The rule of indemnity states an insurance contract should not compensate for damages beyond the extent of the loss incurred. Insureds should not profit from a covered loss. I agree with that. I have also written about indemnity rule breakers such as parametric insurance and life insurance. I agree with them too. Some states' captive laws now specifically include language for parametics. This does not make them legal in all circumstances.

Fortunately, many of these issues can be caught and corrected before any damage is done. Alternatively, programs can be shut down before penalties are levied. I always tell my clients; we do not want to wind up on the front page of the *Wall Street Journal* or in *Captive International* for the wrong reason.

Reputational Risk

Reputational risk is a growing exposure for public and private companies trying to meet board and stockholder demand for Environmental, Social and Governance (ESG) compliance. ESG impacts traditional insurers, fronts, and service providers such as brokers, actuaries and claims administrators who support fronted business. Shifting ideologies has made placing and servicing business more challenging.

In early 2022 several major European insurers adopted restrictions on writing new oil and gas business. Later in the same year, some if these insurers reentered that market to support their countries energy crisis caused by the war in Ukraine and the sabotage of two natural gas pipelines.

I had a fronted deal rejected by several carriers because my client is in the gun industry. The insurance coverage we were looking to front is currently being written by two traditional carriers. One on an admitted basis, the other non-admitted. The premium is north of $100 million dollars between the two programs. Saying "everyone is doing it" was not enough. Mom was right... it was not good enough for the fronts either. I found other markets will entertain this exposure, but for how long?

Guns, fossil fuels, cannabis, gambling, diesel trucks and real estate in environmentally sensitive areas have all become problematic for select insurers. I support their right to choose. I am also glad we have more choices.

Conclusion

The truth or veritas is insurance is a highly regulated business. Fronting is no exception. For a person who has been doing captives and fronting for a while, it sometimes feels like we make everything more complicated than it needs to be. That is fair. Some fronting carriers have been at this business for a long time too. They make good money and make fronting look easy. It is just not fair to say they take no risk.

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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.

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.

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