HOW TO MAXIMIZE INSURANCE PROTECTION WHILE MINIMIZING COSTS

Without Making Yourself Insane

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Executive Summary

This White paper is written for business leaders of companies in the lower end of the middle market, which we define as firms with $10 million to $250 million in annual revenues. We will focus here on the three major problems facing this market segment when it comes to commercial property casualty (P&C) insurance and how to resolve these issues:

1. Most corporate coverage programs suck. We'll talk about how to maximize the coverage aspects of your protection program; making sure you're purchasing the right coverages and limits, without creating dangerous gaps or shortfalls; and doing so within your budget.
2. Pricing Strategy. Most firms do not have a strategy for long term premium or cost reductions. Too many clients allow their agents to control the process which hasn't changed much in 30 years. In doing so, they eliminate their chances of achieving any pricing leverage in the marketplace. We're going to show you how to change this paradigm by deploying effective strategies which put you in the driver's seat.
3. Business risk, issues and challenges often keep decision makers "awake at night" and the traditional insurance process does little to resolve or even identify them. We'll talk about how large corporate entities strategize solutions and how we've scaled this to effectively fit the middle market.

Introduction

To begin with, let me acknowledge that for most business leaders their insurance program isn't high on the agenda of things they want to spend a lot of time on. I get it; insurance can be a real pain in the ass. It's complicated, and it never seems to "work" the way you think it should. You file a claim only to find out that you don't have the coverage you thought, the claim results in higher renewal premiums, and shopping for an alternative can be a nightmare!

And the renewal process - that probably makes you insane as well, right? Does this sound at all familiar?

The calls and emails start about three months before your current policies are going to expire. The messages are pretty consistent from several persistent insurance agents:

"I'd like an opportunity to stop by and discuss your renewal strategy with you, we've got some great programs for companies like yours and I think we can save you some significant dollars on your premium."

Or

"We're seeing ten to fifteen percent reductions on the renewals we're working on and I'd like to show you what we can do for you…"

Or

"I bet you're overpaying for your insurance and I'd like show you how we can save you money"

The scripts may be all a bit different, but the messages are clearly the same – "Let me help you save money." Right?

Now, you may just ditch these calls to your voice mail because you have some loyalty to your existing insurance agent, but every few years you may invite a few agents in to either:

a. See if they truly can save you that 15% - or –
b. Just keep your existing agent "honest" by have a little friendly bidding contest.

And, in most cases you probably give your current agent a "last look" anyway if someone comes in with a lower price. No harm, no foul - you got a lower premium and you kept your existing relationship.

This is the way the insurance business has worked for generations. Having been in the business for 35 years, I can tell you that this is the way I was selling in the 1980s, but I can also tell you that this is not the way I sell today.

Why?

Because it's terribly flawed; not just for the buyer, but also for the seller.

The Marketplace – Seller's and Buyer's Problems

Let's start with the seller. Agents that continue to practice the same "let me save you money" strategy from 30 years ago have miserably low closing ratios and they are in a constant battle for new accounts, because they close so few of the ones entering their sales cycle.

Why? Predominately because the industry has changed rather dramatically and continues to evolve; today's insurance industry is data driven and underwriters (the people who make the pricing decisions at the insurance companies) have an incredible complement of analytic and big data tools to distinguish the best accounts from the below average accounts. Average to below average accounts will often see average pricing or no offers at all from standard insurers. Whereas the best accounts - those with few losses and a strategy to prevent and minimize claims will usually see great pricing options. The problem for sellers is that if they don't have an organized methodology to distinguish between average, above average and below average types of accounts and create different selling strategies for each of them they won't achieve great results so they can't fulfill the pricing promise in their initial pitch or call, and yet another account bites the dust.

Average accounts will always see average pricing, while the best accounts will get the best/most competitive pricing tracks available.

It's a demoralizing and frustrating sales process which probably accounts for the high failure rate of new sales people in the insurance industry; and for the complacent laziness which "mature" agents seem to fall into once they "make it" and have a cushy book of business to rely on.

For buyers, who are unprepared to enter the marketplace with the right knowledge and strategy, they too will see only mediocre results as well. But what's worse for the buyer is that they will, in all likelihood end up with an insurance program that shortchanges them in terms of coverage and resources. We'll talk more about that in a minute, but for now, ask yourself - when you get three competing proposals for your insurance program, and it's just a few days until you renew, do you REALLY understand what's in those proposals and how they're different? How do you ultimately make your decision? In my experience, most buyers will take the lowest priced proposal and if it's not from their incumbent agent, they'll send it over to that agent (again, if they've got a good relationship with them) and say something like: "look XYZ agency is beating you by $20,000 - I'm giving you a last look at this so you can see what you can do." In my opinion, that's admirable. You're honoring an existing relationship and wish to continue it. But what really is happening here? Your incumbent agent may be replicating the errors that the competing agent made in order to win your deal back. Or, they may be shaving valuable coverages off your account to lower the price to match that $20,000 difference. However this deal gets done, it will likely mean that you ended up worse off on this renewal than the last one when it comes to your protection.

Ask yourself, when faced with three insurance proposals from different agents, do you REALLY understand what's in them? Do you default to price as your decision making criteria?

The marketplace as it is today just doesn't respond to this type of competitive/shopping/bidding process for several reasons. And, while most brokers play by these old-school rules, it doesn't mean that you as the buyer need to continue to do so. For now, let me say that trying to leverage the market through competition – without a strategy – just doesn't work, and it exposes the buyer to a host of problems.

A Persistent Problem - Price, Overrides Protection

Now, whether you stay with your incumbent agent (assuming they have matched the lower price) or moved to the new agent that proposed the deal, I can confidently say that you didn't end up with a protection program that actually fit your needs and this is the first and biggest problem to deal with. In fact, this new program probably is very insufficient, and could lead to catastrophe in the event of a major claim.

How do I know this?

Two reasons:

First, I've performed hundreds of coverage reviews (they're also known as coverage audits, risk diligence reports, and protection audits) and in over 95 percent of the cases I have found fatal coverage flaws that would present significant issues in any number of claim scenarios. These reviews were performed for middle market firms and for private equity firms who were purchasing companies in this same market segment. If you're in the remaining 5 percent, consider yourself lucky to have a program that's well-structured and sufficient, but here's another fact to consider - the 5 percenters that I talk about here, didn't land there by luck. They typically had a Chief Risk Officer, or hired an outsourced Risk Manager, who knew how to craft a proper protection plan and coordinate those efforts with their agents.

Second, I work with and maintain a "mastermind" relationship with about dozen other agents around North America who work in this same market segment and perform similar reviews for their clients and they report the same findings. Almost every account they review is screwed up, and we're not just talking about minor errors, we're talking about major foul ups. Statistically, I can say with confidence that your business has some real problems embedded in your protection plan, and no matter how many times you bring your account 'out to market', things will not be getting better. In fact they only get worse with each cycle because agents in a competitive bidding session aren't trying to fix the last guy's problems - their only objective is to win your deal and they can't do that if they're adding more coverages and premium to your program.

Shopping around with multiple brokers actually decreases the chances that your coverage program will be accurate. It doesn't help improve your protection plan.

You can usually tell that your protection plan isn't up to snuff in a bidding scenario when these sorts of things occur:

a. Agents come in and pick up your policies and loss runs, and that's the extent of information they secure. Sure, they may fill out supplemental applications, but do they complete an extensive risk survey with you? Is there any sort of Risk Identification process happening?

b. Agents wanting to bid your business don't ask for a tour of your facilities, or job sites (if you're a contractor).
c. Agents aren't asking for copies of your safety manual, safety processes, HR manual, OSHA logs, fleet safety logs, or financial statements.
d. There is no written report regarding the sufficiency of your protection outside of the final proposal of insurance. On occasion you will see some diagnostic suggestions in the final proposal, but they comprise only a brief portion of the selling time spent with the agents competing for your business.
e. Any loss control activities or inspections are scheduled by the insurance companies competing for your account - not by the agents, and frequently the agent is not in attendance during these inspections….worse, the agent hasn't advised you how to prepare for those inspections!

So, this constant shopping around or bidding out your insurance has a way of actually eroding the protection you thought you had, and over time this erosion becomes a cumulative problem. The incumbent agent is fighting to keep your business on their books, and the other agents are fighting like hell to get it on their books, and all along the way, valuable coverage is eliminated from your program to help reduce the costs, and what's worse is that no one is performing a comprehensive risk analysis to make sure your business is sufficiently protected.

How did it get this way?

How did it get to the point that agents focus so heavily on the price and less on the protection?

I believe that it's a combination of things that created this environment. First, look at how personal home and auto insurance is being sold today - 15 minutes can save you 15% or more on auto insurance. Sound familiar? Companies like GEICO, Progressive, esurance, Allstate, State Farm and others have been spending enormous amounts of money (literally billions of dollars collectively) for years to get you to think of insurance strictly as a commodity. It has been incredibly effective, so much so that many of those same auto insurers are now bleeding red ink because the low prices they have offered have not been sufficient to cover the cost of the claims incurred. That's a different story all together, but the point I want to make is that the commoditization of personal insurance has shifted the mindset of both buyers and sellers in all other forms of insurance - including sophisticated large account commercial insurance.

Many agents falsely believe that price is the tipping point in the minds of the buyers and prospective buyers so they willingly play into this commoditization game. As a result, what has been created is a class of lazy, under-educated agents who don't have the knowledge or ability to distinguish good protection from bad protection, nor do they have the courage to stand up and say to a prospect - "look, I'd love to write your insurance, but there's some major issues here that we have to be addressed first." Instead, most agents are willing to roll the dice, try to make the sale, and afterwards try to strengthen the coverage part of the deal, or not worry about it at all, and hope you don't have that claim which will end up being a big headache for both of you.

Another issue that has caused this problem is that the insurance industry has gone through some massive consolidations over the past 30 years. When I first started in this business there were 25 to 30 "brand name A-rated" insurance companies we were doing business with in the commercial P&C market place. Today, that number is down to about 10. That means fewer players, and fewer players means less competition, which means tremendously less pricing leverage. Unfortunately the landscape has changed dramatically, but no one has told most of the agents of this shift, so they continue to work the same way they have for decades thinking they can bring your deal out to the market and leverage one player against the next. It just doesn't work that way anymore!

For buyers, they can't help but assume this commodity mindset; after all the insurance industry was the one who taught it to them through those massive advertising budgets! On top of that, most corporate buyers are focused on reducing costs as best as they can since the recession. Even if your firm has recovered from the recession, your management still thinks in terms of scarcity and tries to get the most for the least amount of money. I totally get it. Yet, when the full picture is revealed to a buyer, they most often will select not necessarily the cheapest option, but the options which presents the most value. These are two different scenarios which need to be clearly identified and explained. Unfortunately, most insurance agents don't do a good job of explaining value and default to pricing; so the buyer just follows the agent's lead and thinks price equals value; which in most cases it does not.

How do you fix the coverage issue?

The primary objective of your corporate insurance renewal process should be making sure the protection is as broad as it can be within your budget, and understanding your coverage limitations. This way you know what risks are being properly transferred via insurance and which ones you are retaining or sharing with your insurer. This can be achieved in several ways:

1. You can hire a consultant to act as your proxy. Insurance consultants can draft a bid specification package and do all the leg work on corralling competing agents working on your bid, forcing them to submit their quotes well in advance of your renewal and helping evaluate all the proposals. There is of course a fee for this service, but at the end of the day, you'll end up with less frustration and hopefully the protection you actually need.
2. Review the coverages with your current or prospective agent and ask for a detailed explanation of how each policy and the endorsements within the policy work. This is tedious and time consuming, but what you may learn is that the agent you have or may have in the future knows less about the details than you thought. For help on this, you can download (or request) our guide on the top 100 important coverages checklist.
3. Ask the agent for a written and detailed report on the proposed coverage. This is not a proposal which often focuses on the premiums and main coverage parts, but instead a deep analysis of how well the coverage parts are assembled with special attention to the details, and recommendations for improvement.

The bottom line is that you want to know all the facts and have an expert opinion on what you're buying. As part of our process, we include a deep coverage analysis of a prospective client's program well before any pricing or competitive survey is completed.

Your Risk Profile – a key to reducing the cost of insurance

I mentioned earlier that clients with average claim experience and average to little risk controls in place will receive average to below average pricing on their insurance. Above average clients, are those with lower than expected claims experience and good risk controls in place, they will always achieve greater pricing considerations. It stands to reason, that a business which can consistently demonstrate good risk control processes as well as good claim experience will pay less for insurance than a similar business in the same industry which has no control mechanisms in place and suffers frequent losses; right?

Insurance company underwriters are tasked with only taking on better than average accounts and pricing them according to their Risk Profile. No insurer really wants to provide discounted rates to a customer that has a poor track record - in fact most insurers don't even want to consider taking on a customer at any price with a below average track record.

So, where is this leading us?

The real key to achieving pricing leverage in the marketplace has to do with your Risk Profile. This is the combination of your 3 to 5 year loss experience, plus the documented systems, processes and procedures you have for controlling risk - also known as risk control strategies. If you do not have a great loss history or don't have the right control strategies, don't give up; we're going to talk about how to get there over time. For most clients first hearing this "gospel" (which is dramatically different than what most agents talk about) they get discouraged and think "well, I don't know how to reduce my claims or even what my claim history really is &/or we don't have a real risk control strategy so I guess I'm out of luck". Wrong – every commercial account takes time to work through all these issues, but the payoff is worth the effort.

Through a Risk Profile Improvement Process, you will achieve three things:

1. A long term strategy to reduce insurance premiums
2. Open opportunities for self-insuring risk and creating long term wealth via a captive insurer
3. A business improvement process which reduces risks and costs, while enhancing productivity and enterprise value

Sure, a safety manual and good loss experience helps get better insurance pricing, but imagine if you had a comprehensive, documented, repeatable process that addressed the types of risks your company faces with a host of systems and strategies that are executed upon regularly to control those risks? And, because you had these systems in place it resulted in your company having a significantly better track record when it came to claims than your competition. Can you imagine how desirable your account would be to most insurance company underwriters, and what pricing leverage you could achieve then? And that is the point! Firms with a very good Risk Profile and claims to match, usually achieve much greater pricing leverage than their peers who do not have this systematic approach to risk.

Now you may be saying: “That’s all fine and good, but I don’t have the time, interest, or ability to create all these strategies AND execute on them. What am I supposed to do?”

Stick with me because I’ll address that shortly. For now, just know that some of your competitors have adopted this strategy and they are winning in two ways. First, they pay less for insurance; and second, they achieve even greater savings by reducing risk and having fewer claims than the average. These competitors have shifted their process because they know that there is a cost to risk within their firms in addition to premiums and they’re committed to reducing those costs.

Let me put that into a context which may be a bit easier to understand.

Understanding the Total Cost of Risk

Large corporate firms use a benchmarking tool to understand what their total costs are relative to risk and how they change year over year. In the risk management world it's known as the Total Cost of Risk or TCOR and it's comprised of the following factors:

- Insurance Premiums – to both commercial insurers and captive insurers
- Loss Costs in two forms:
  - Direct Costs – those you pay out of pocket for under-insured losses and uninsured losses, as well as for deductibles and co-payments
  - Indirect Costs – Those are the costs you also pay out of pocket but may not recognize as costs because they are buried
- Administrative Costs – These are the costs to administer your risk management and loss control projects
- Taxes & Fees (the smallest portion of TCOR) paid usually on coverages placed in the excess marketplace, or placement fees paid in lieu of or in addition to broker commissions

For Fortune 500 firms as well as those in the middle market, most of the costs are centered on premiums and loss costs. Surprisingly, loss costs will often exceed premium costs, which we'll discuss below.

The Impact of Indirect Loss Costs

All firms in the middle market experience "irksome" risk issues that dog them year in and year out. For many it's worker injury risk - employees are frequently injuring themselves and costing the firm a lot of money. There are two forms of costs that impact the typical business for every claim, but for the moment, let's focus just on worker injury risk.

The first impacts are direct costs, here's how:

a. Higher than average workers compensation claims means your experience rating modifier goes up. When the "mod" goes up, your premium goes up. The mod goes unchecked for a few years and your premiums can skyrocket.
b. If you're on a high deductible plan that means not only are premiums going up, but your out of pocket costs to cover deductibles is out of control. In my experience, clients who get hit with deductible reimbursements are at a point when cash flow is usually at its worst!
c. In other forms of insurance, the third direct cost is the dollars you pay out of pocket for insufficient or improper coverage following a claim. (This generally doesn't occur in workers compensation.)

The second impact is indirect costs. Again, sticking with workers compensation as the example, what happens when a worker is injured and what costs do you incur?

a. **Overtime**. When the worker is out due to injury there's frequently overtime for other workers to help fill the gap of that missing worker.
b. **Training**. There's also training and retraining costs for hiring new or replacement workers to fill the injured workers void if the disability is extended?
c. **Waste**. Moving from manpower, what about waste – often there more waste in materials or time to get your product or service to market because that experienced worker isn't executing properly.
d. **Damage to Reputation**. How about damage to your brand or reputation, if there's delay in getting to market what are the impacts on your customers and the impact to your bottom line?
d. **Investigations.** Then there's the cost of investigating each accident, which could involve fully or partially shutting down operations, interviewing employees/witnesses.
e. **Management Expense**. There is the time/expense of the management team involved in investigations.
f. **Fines & Penalties**. Finally are potential OSHA fines or penalties that can occur following an industrial accident.

All of these factors add up to staggering indirect costs which are not reimbursed by insurance, and are paid out of pocket.

Many industrial safety experts, including OSHA express indirect costs as a multiple of the insured costs which your insurer pays to remediate the claim. That multiple can be as high as ten times the insured costs on smaller claims and one or two times for larger claims. We conservatively estimate that on average, indirect loss costs are at least 1.5 times the insured costs. In real dollars, here's an example: a claim for a worker who is out due to injury for three years costs $80,000 which is paid by the insurer will mean that you'll pay about $120,000 out of pocket in indirect costs.

Indirect loss costs can be as high as ten times the amount of insured direct costs! In our experience, for every dollar your insurer spends on remediating a claim; you spend at least $1.50 out of pocket in the form of indirect, unreimbursed costs.

Some prospective clients that I have this direct vs. indirect conversation with will dispute the multiples - in many cases they will say indirect costs can't be 1.5 times the direct cost. Some say that 1.5 times is too little! That's okay; use whatever multiple you'd like, as long as you understand that there is a correlating cost of indirect costs to your direct or insured costs.

Why understanding indirect costs is important

As a decision maker, you need to consider ALL of the costs impacting your organization. If we're having the risk control conversation solely on how they impact your insurance premiums, we're leaving a lot of money on the table. Indirect Loss Costs in a typical firm represents a tremendous volume of wasted capital, which could be allocated elsewhere in an organization for growth and improvement. <u>Our job is to reduce or eliminate these costs and improve your bottom line</u>. In mid-market firms that do not have an active risk control program, indirect loss costs can be quite high.

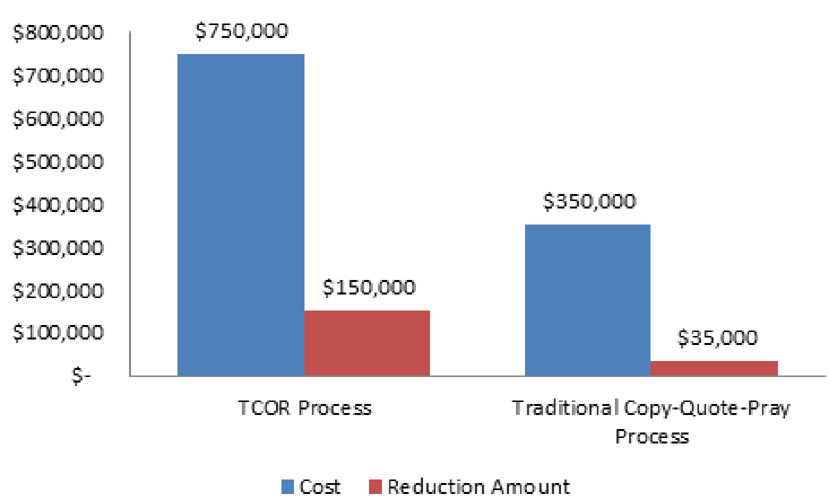
The second reason why it's critically important to understand the combination of direct and indirect costs is that motivates improvement. If your target is to improve your Risk Profile as a means of reducing premiums, you'll find that the return on investment just doesn't add up. Sure, reducing your premiums by 15% would be nice, but the effort to achieve that may not justify the investment. But, when you measure total costs and want to reduce both the direct and indirect costs, then we're talking about some very significant ROI potential.

Here's an example to help explain what we're talking about.

Take a company that is paying about $350,000 a year in premiums but has a Total Cost of Risk (TCOR) equal to $750,000 mostly due to indirect costs. If the company goes out to market and shops around, maybe they could achieve a 10% premium reduction if they're lucky, especially considering their high claims load. That's a $35,000 reduction.

But, what about reducing the TCOR? Our target for an account like this would be a 20% reduction in the first year; or about $150,000. That's more than four times the cost savings over what a shopping exercise would yield.

Illustrated graphically, this is what it looks like:



We call this illustration the symmetry of risk, and it shows the fallacy that premium reduction is the singular goal of cost reduction. The real action is in reducing indirect loss costs, which will lead to Risk Profile Improvement which in turn leads to a more managed approach to premium reduction. The best news is that indirect loss costs can be attacked year in and year out and reduced to very low levels.

Captive insurers

In the introduction we mentioned that by engaging in this holistic process there may be an opportunity to also introduce captive insurers into your risk dialogue.

Specifically, we're talking about micro captives or 831(b) captives which are a separate entity owned by you (or your beneficiaries) that act as an insurance company specifically for some of your firm's risks. We won't get too deep into the conversation regarding captives since it's a complex subject, but when you have great control over your risks and you can demonstrate to yourself that your losses are well below the average, a captive may be an excellent tool to help manage risk and create a long term wealth strategy since captives have some unique tax advantages.

How to get it done

Now, back to the issue of time and execution. If you've gotten this far, you probably have an interest in what this process can do for your company - but you're probably also saying: "this sounds interesting, but I don't have the time, skill, or interest in doing this, and my management team is already stretched thin so I can't ask them to undertake it either…."

I get it, and I understand that. That is why we have created a unique strategy to deploy this process within a mid-market firm, where we do all the heavy lifting. We have the experience and tools to identify the frictional areas of risk which need to be addressed in priority order, and then the resources to apply to those areas to resolve them. We also get involved on a granular level to communicate these strategies and if you desire to help execute on them as well. Our process is flexible and scalable to fit most companies' needs and circumstances.

Does that mean that management isn't involved or committed? No, in fact, quite the opposite; we only work with firms where management has a genuine interest in change, is committed to the process and will be engaged. We will work with management "hand in glove" to be an extension of your team to execute, but management must be committed to the process and be “team cheerleader” to make sure things happen.

While every situation is unique, we are prepared to engage on a variety of levels and have the resources to help a client transition from little risk control processes to a pragmatic and functional level of risk control.

We’ve covered a lot of ground in this white paper, because many business leaders we speak to are just so frustrated with the traditional insurance process. They’re looking for a more effective way to reduce costs (not just premium) and this Strategic Risk Process can help not only to reduce costs, but also to improve productivity and recapture wasted capital.

Want to learn more? Why not email me for more information or give me a call for a brief conversation and see if scheduling an introductory Discovery Conversation meeting makes sense. In that conversation we’ll talk about you, your company, your vision and goals; as well as the challenges you’re facing. We can also complete a Threat Assessment to see what really is going on behind the scenes. These steps are confidential and free of charge; and we welcome the opportunity to engage with you.

I look forward to hearing from you.

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