Claims Paying Ratings versus Actual Company Stability
By Chris Burand

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This simple statement is well worth repeating because significant opportunities are available to agencies doing business with companies that truly are stable from all perspectives.

So, one more time, “*A high claims paid rating does NOT guarantee a company is stable from all perspectives!”*

Why doesn’t a claims paying rating guarantee a stable company?
Companies have only a certain amount of money with which to pay claims <u>and</u> debts. A claims paying rating only looks at a company’s ability to pay claims, but a stable company must have adequate funds to cover all its operating needs, including claims and debts.

As an example of how a company’s ability to pay claims often competes with its ability to pay debts, consider an email a carrier recently sent to its agents. The email effectively stated, “We can’t make our debt payments and this is <u>good</u> news because it means we will have more surplus with which to pay our claims.” So, this company can’t pay its debts, but it can pay its claims. To be honest, that really doesn’t sound like good news to me (but more on that subject later).

Another example of this “competition” for money occurred when a major carrier floated $400 million in debt. Their rating for claims paid was affirmed that day because as of that day, they had $400 million more with which to pay claims. That same day though, their debt rating was downgraded because $400 million more debt reduces a company’s financial flexibility, the probability of repaying its loans, and possibly its ability to invest in growth (depending on what the debt is used for).

To look only at the claims paying rating does not consider the whole picture. A stable company has good financial strength from all perspectives and again, companies have only a certain amount of money with which to pay claims and debts. Insurance commissioners will usually force companies to pay claims before paying debts and therefore, debt default usually occurs before claims insolvency occurs.

Either way, though, an agency does not escape unscathed. Whether a company with inadequate funds chooses to not pay its bills or whether it chooses to not pay its claims, the insult or injury is different, but significant nonetheless.

The impact on agents
If a company stops paying its debts, agents suddenly become unsecured creditors and when the company stops paying their bills, the company’s agents may find themselves not getting paid. The agencies’ customers may get their claims paid, but the agents who brought these customers to the insurance company will essentially be working for free.

Even if a company can pay its debts, a debt downgrade may still occur and that downgrade may negatively affect an agency. A company's need to improve its debt rating may force it to cut expenses including commissions, underwriting, and service staff. Who wishes to work with a company that is so short staffed it cannot process policies and endorsements in less than three months? How does an agency benefit from working with a company that does not have the financial wherewithal to offer competitive prices in a soft market knowing that if they do, they will suffer a rating downgrade?

Would you rather work with a company that has a good claims paying rating and is also financially stable? (Translation: they can afford to pay strong commission rates.) Would you prefer a company that can offer good prices in a soft market?

Many agencies represent too many companies (including a lot of unstable ones) because they do not have adequate knowledge of which companies are most stable. But this is a costly strategy. Working with unstable companies can drive up an agency's expenses, decrease its productivity and profitability, and increase its E&O exposures.

Representing more companies means more training, more meetings, more work. This decreases productivity which in turn decreases profitability. Profitability is further affected by having distant or more diluted relationships with companies. There are only so many relationships an agency can nurture and maintain. E&O exposures increase because there are more underwriting rules and coverages to know, making it much more likely something will be missed. The IIABA's *Best Practices Study* clearly shows that agencies that represent the fewest companies are more profitable. Every study I have seen in the past 15 years supports this finding.

Profitable Opportunities

Agents who learn which companies truly are the most stable find plenty of opportunities. Streamlining the companies you represent provides the opportunity to increase profits. As Rob Ekern, President of C.R. Ekern & Company, so wonderfully said, "we know that every risk only has three practical markets so why does anyone need to represent 25 or 50 carriers?"

The new *Growth and Performance Standards* found that 57 percent of all commissions are written with the top three carriers, yet the average agency has 14 direct appointments. The study also found that the average agency book is 25% nonstandard. Of the 43% of commissions not paid through the top three carriers, a mere 18% of the total book is placed with the remaining 11 standard carriers. This is clearly too thin. Those 11 carriers are not going to be happy with the agency and the agency is likely not making enough of these second tier relationships. Take advantage of the opportunities and consolidate some of your carriers. Out of 11 second tier carriers, at least three are probably unstable and can never be important to the agency. That ought to make the decision to downsize quite easy.

Making the decision to streamline your carriers creates another opportunity. Because many agencies do not consolidate the carriers they represent, they may eventually get burned when one of the companies suddenly pulls out of the market, becomes uncompetitive in their offers, or begins non-renewing large segments of their book. If you do business with only stable carriers, you may be able to pick up new business while the neighboring agency scrambles to find new markets.

A good example of this occurred a few years ago when a large national carriers left the US market. One agency had a significant book of business with this large carrier but they never saw the pullout coming. Other agents did and had already moved their books from this company. This allowed them to reach out to the floundering agency's clients while its staff worked overtime trying to save their book of business. As many of you may know, an agency is likely to lose 10% of their book in a hurried book roll. If you are prepared, you can be the beneficiary of that 10%.

Streamlining your carriers is a risk-free strategy when done correctly. An agent who culls through his or her carriers and selects only those that are stable may lose some sales once in awhile, but that happens no matter what. Within two or three years, the accounts lost are usually available again and these customers are more eager to do business with a smarter agent and a more stable carrier. The only price is an investment of your time to understand the stability of the companies you represent.

Get savvy, then sharpen those trimming shears.

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