Burand's Insurance Agency Adviser

Resources and Information for the P&C Insurance Industry

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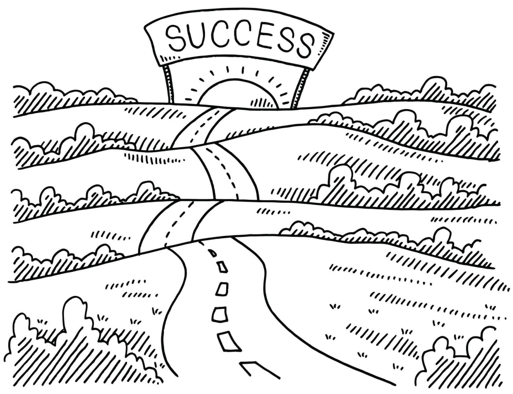

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Wait! There's more...

It's time to put yourself in the Driver's Seat!

Wouldn't you prefer to be in the driver's seat, rather than being taken for a ride by your carriers?

Burand & Associates' Carrier Analysis Service provides the **predictive insights** agents and brokers need to proactively steer their carrier relationships. In the current, unsettled state of the insurance industry, top agents and brokers rely on our Carrier Analysis to put them in the driver's seat.

Contact Chris today to learn more at: chris@burand-associates.com.

"There is a major difference between intelligence and stupidity: intelligence has its limits." --Albert Einstein

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An Extremely Clear Path to Success

I was talking to my good friend Don Phin who has worked with, spoken to, and consulted with over 10,000 CEOs. He made a succinct statement that I've found to be true for people running insurance companies and especially people running insurance agencies/brokerages: CEOs are extremely motivated by revenue growth, sometimes to their peril. They tend to ignore other critical factors because their emotional brain simply does not connect.

A singularly or even heavily focused, sales driven insurance industry CEO is not good for the health of their organization. Many have gotten away with this, as have so many CEOs in many industries, for the last 20 years because of the Federal Reserve's easy money policy. There's simply too much money chasing too few real assets.

However, in the insurance industry, like banking (which has had a similarly easy life only broken by unbelievable stupidity and greed, but bailed out nonetheless), revenue growth can ONLY happen if surplus increases commensurately. In other words, if an insurance company wants to grow 10% and assuming it does not have legitimate excess surplus, it must simultaneously grow surplus. Period. This is not a negotiable or arguable point.

Of course, many insurance companies ignore this by actually arguing they are special, by arguing they have excess surplus “to grow into,” by arguing their growth model does not require as much surplus as everyone else’s models, etc., etc. Rarely in my 35 years of experience are these arguments backed up by facts. Instead, these are examples of what the famous German writer Hans Fallada wrote of his fatalist key characters, “In other words, the Quangels were like most people: they believe what they hoped.” These CEOs simply believe 100% in what they hope the outcome to be rather than figuring out how to actually make the desired outcome come true. It’s a silly way to run a company, and I believe that point is less an opinion than an obvious conclusion.

But this explains why so many carriers are growing quickly in 2024 even though their companies lost record amounts of surplus in 2022, with only a slight to no recovery in 2023. They seem to think they never lost the surplus. The industry as a whole lost a record amount of surplus in 2022, not due to claims but due to bad investments. And that record does not include the full reduction of mark-to-market securities (which would have been another 7%-10% of those investments for a large number of carriers) or the mark down on their commercial real estate. The losses were even more significant than reported in the real world, not the accounting world.

When a carrier grows by 10%, they must grow their surplus by 10%, all else being equal and not adjusting for the quality of surplus. When a carrier loses 15% of their surplus (some have lost more than 30%), but grows by 15%, their leverage skyrockets and it’s the leverage that gets out of whack when carriers increase revenues without increasing surplus commensurately. For example, a carrier begins with $100 million in surplus and $200 million in premium. They lose $15 million in surplus but grow their revenues $30 million. Their leverage increased from 1:2 to 1:2.7. That is a significant increase. If the carrier was already short of surplus, the situation gets serious which is why some leverage ratios now are in the 5 to 6 range.

This is also one of two leading causes of insolvency and impairment over the last 30 years according to A.M. Best. And thank goodness for A.M. Best keeping some of these CEO’s on the right side of the line!

The right CEO is a person who understands the need to balance revenue growth and balance sheet strength. Balance sheets are critical to the health of carriers (and agencies), and surplus is a balance sheet item.

If a carrier finds themselves short of surplus, they have three basic options if they want to grow. They can raise capital by selling equity (or borrowing money, which is a poor substitute for an insurance company), they can sell parts of the company, or they can increase profits and then LEAVE the money in the company. I get a kick, and frustrated, by people who develop complex models covered with MBA language, when in reality, the solutions are this simple. You only have these three options if the carrier wants to grow. A fourth option for a carrier just wanting to survive is to eliminate as many accounts as possible, aka, shrink premiums to the amount of surplus available.

In my most recent groundbreaking research, I have identified the six key elements required for carriers to grow profitably while growing surplus commensurately. This research has been thoroughly tested, while nearly 100% of all the existing metrics and benchmarks I’ve reviewed for carriers and agencies have never been tested as to whether they correlate to success, stock prices, values, growth, profits, or anything whatsoever!

My research identifies the correlations. But to use my research, a CEO needs to see past revenue growth, or they need a team member to balance their thought process. My research shows a near perfect correlation that focusing on revenue growth without that balance is a recipe for failure. On the other side, the carriers that are achieving the balance are putting other carriers out of business. The losers do not see the results yet because the winners are taking little bites from 250 carriers. They're leaving the losers with an ever-growing percentage of adverse selection, but it is happening so slowly the losers are not seeing it. My in-depth research shows that over the last five years, the trend is undeniable.

The first step then is learning if you are on the winning side or losing side – and not believing blindly in what you hope to be the case. I have that data.

The second step is building a strategy based on the six fundamental elements that I've identified the winners possess in greater abundance than the losers. These are tangible measures, nothing wishy-washy.

The third step is building a real-world strategy with tactics to which executives will be held accountable. This is what winners do.

On which side of history do you want to be? The winners are a small but elite group. Contact me today if you'd like to join them.

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Agency Valuations

I recently returned from a phenomenal convention dedicated to business valuations. The presenters and attendees were high quality, extremely well-educated people focused on all the complexities of doing business valuations correctly.

I hate to tell the readers who believe a business valuation is simply X times EBITDA that it is not that simple. Business valuations vary **significantly** by purpose, jurisdiction, and a myriad of other factors. For example, the value of a business legitimately varies depending on if the value is for selling to private equity versus a divorce versus partnership litigation versus ERISA compliance versus damage litigation versus tax compliance (and the many different types of tax compliance), and many other situations.

Additionally, the value is only half the equation! If the valuation might be litigated, and **ALL valuations might be litigated**, the way the report is written must comply with the applicable standards appropriate to the purpose. This means the valuation report format and material will vary depending on the purpose such as estate tax versus divorce litigation versus a sale.

As one speaker, a premier valuation tax expert stated, certain regulators look at valuation reports and note whether the value seems reasonable, whether the appraiser has a nationally recognized business valuation credential(s), and whether the format is correct. If so, then in about 5 minutes they decide whether to further scrutinize the report.

While reviewing my email during the conference, I saw two emails sent from an email list that made me a little queasy because I know many agency owners understand little about business valuations, so they are easy targets for these well-crafted marketing emails.

The first offered "free" valuations. At least they disclosed the valuation was not actually free but that potential buyers would pay for it. Never, ever should anyone have their agency valued for free. That won't withstand scrutiny if ever contested. Moreover, never, ever have your agency valued if someone else is paying for it. As that internet saying goes, "If you do not know who is paying for something, know that someone is paying to take advantage of you."

And they will. Your data will also become available to a pool of buyers or maybe a specific buyer, and then your agency is compromised. Additionally, why in the world would their valuation ever favor you? No one in their right mind should ever accept this offer.

In fact, a tax case in 2023 (Connelly v United States) was lost by the taxpayer, in part because the valuation report did not meet the standards of a "Qualified Appraisal" and the taxpayer used a nonqualified appraiser. A question that was asked as to why the business owner did not hire a qualified appraiser to write a qualified report was answered with, because it [the appraisal we received] was "free"! That free appraisal cost the taxpayer an additional $650,000 in taxes per the report in *Business Valuation Update*, January 2024. You get what you pay for and free appraisals are worth less than zero.

The second email was a do-it-yourself offer, "Here's instructions on how to value your agency!" If you want to value your own agency and not pay anyone, buy Jon Persky's book from the National Alliance. But don't go onto a mailing list because then they know you are looking to sell and additionally, they know they have a seller who is too cheap to hire expertise – which means they know they have a potential seller who is ignorant and ready to be taken advantage of. I hate to be so blunt, but there's no sugar coating the truth.

Additionally, understand that valuations for anything other than selling your agency to a third-party (not related parties) is the only situation in which you are effectively allowed to do your own valuation. Otherwise, tax law, labor law, corporate law, and common-sense dictate business owners cannot do their own valuations. The reason? Might the business owner be biased? Does the business owner know how to properly value a business? These types of marketing offers are 100% designed to take advantage of business owners who don't understand the importance and intricacies of a proper valuation.

Another situation of which to be aware is someone offering a Calculation of Value, Indication of Value, Letter of Value, or some other cut rate valuation. Most business owners do not know and really have no reason to know that such valuations are not even allowed under some ethics rules by important business valuation associations. Some that do allow these kinds of valuations only allow them if the appraiser is extremely specific with the client about how limited these appraisals are. To me, this means educating the client rather than simply inserting a disclaimer into the report.

These kinds of valuations have no use except for specific situations in which the client understands and agrees that they do not need a valuation that can withstand any kind of scrutiny or is to be contested. For example, maybe the client agrees that the valuation is for generic guidance only and that it is the responsibility of the shareholders to actually set the value. Even then, a smart appraiser may not agree to completing a limited appraisal because they might know that a law or regulation does not permit it or they simply don't believe their client will use the valuation correctly.

I recently had a call from an agency owner who was burned by this. They had spent thousands of dollars and not only was the valuation worthless given their situation, but now they had a number from a worthless report that could still be held against them in litigation. Their extra legal fees specific to defending against this one point, if it goes to court, is likely to equal the valuation fee.

Business valuations are complex. Most small- and medium-sized business owners do not know much about these complexities and until a situation arises, they have no reason to know about all these requirements and specificities. This makes them quite vulnerable to being targets for people looking to make easy money.

An appraiser should possess one of the recognized business valuation credentials, and you'll pay probably at least $7,500 for a simple valuation for a small agency as a starting point. Anything less might be questioned. Valuations are complex and they vary by purpose. The appraiser should be quite specific from the beginning in understanding the exact nature of your purpose and then you should ask whether their reports and methods are applicable and compliant with that purpose. Be direct with them.

Simple valuations are rarely any good. Your agency is likely your most valuable asset. This is not the situation to cut corners or be cheap. Take care and protect your asset.

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Property Rates are Arguably Not Affordable

A friend in a major city with no material extraordinary fire or flood catastrophe risk, PC 3, low crime, and upper middle-class neighborhood, advised his homeowners premium had tripled in the last five years. The carrier wants another 20% this year. He's never had a homeowners claim.

That kind of rate increase makes zero sense, unless the carrier itself has financial issues. Needing to increase rates 300+% in five years means the actuarial models used five years ago were failures. The models were complete failures to such a degree the board of directors should be reviewing governance bylaws.

And if they are blaming the increase on weather, which they partially are, then again their actuaries are wrong because this is a recency bias. If the pattern is over 100 years showing an increase, then the actuaries should have identified the change five years ago. In fact, SwissRe identified weather changes in 1994, not 2020. The weather hasn't actually "changed" that fast, though this carrier is claiming that is a cause of their rate needs.

If the carrier blew the old model so horribly, waiting 25 years to figure out the weather changed per their reasoning, then how much confidence should anyone have in their new model with triple the rate? After all, when rates increase that much, do the best accounts stick around if other options are available? Or might this carrier need a 300% rate increase because they're already stuck with adverse selection because they are so incompetent? If so, no amount of extra rate is going to save their bacon.

It's funny looking back over a long career. I haven't trusted most carriers' "clear future vision" for many decades, especially if their x-ray vision requires major rate increases or radical underwriting changes. Their vision is usually camouflage for serious mismanagement. Thinking back, I remember how specific carriers wailed that the end of personal auto insurance was at hand because California passed Proposition 103 back in 1988. Instead, the market has changed completely with the best companies making high profit margins. I recall another time when a leading carrier decided there was no future in workers' compensation, so they dialed it back right as the workers' compensation market became so incredibly profitable that it generates almost all the profit in the entire industry per A.M. Best. Those executives had clear visions in the wrong direction, and it was pretty easy to see they were wrong at the time. But they get paid the big bucks so they assured everyone they were right. Significant layoffs and disruptions happened, but they got their retirement packages.

I am not knocking carriers just to knock carriers. I am trying to push back enough so that people will start thinking things through. My friend's state has a reasonable five-year homeowners loss ratio of 65%, but the median is 56%. Both are better than the national average on an unweighted basis by state per A.M. Best data. Average might not be great, but 20% more rate on a median of 56% puts the loss ratio at 36%. Why in the world is a 36% loss ratio required? That makes no sense. Something is broken in the model and when carriers spout off the need for rate, work backwards and then ask whether they truly need that much rate. If they think that without 20% more rate, their loss ratio is going to explode to 76%, then they have an underwriting problem, one for which rate is not the solution. Their vision is blurred one way or the other.

But sometimes demanding such significant rate increases is actually a signal the carrier is short surplus. They are hoping that by raising rates so significantly, lots and lots of premium leaves. It is easier than nonrenewing all that premium. This is called shrinking to volume. In other words, if a carrier is short surplus and cannot increase surplus, it shrinks its premium to match available surplus.

The major problem with this strategy is it results in adverse selection probably 100% of the time. Time may pass before the full effects are felt, but adverse selection will happen.

To recap the situation: A great home with no known underwriting issues in a state with better than normal loss ratios. Why do rates need to increase 20%?

For a moment, let's accept that 20% is required. Is the resulting premium affordable? Unaffordable insurance is a good strategy toward becoming irrelevant. Do you suppose the carrier executives want the carrier to become irrelevant?

I think some carriers take consumers and agents for granted. They don't think the agents will move the business to save the clients and they seem to think consumers won't shop either. Relative to real property, they are thinking loan requirements will make the insurance sticky, and to some extent it does. But many homes are bought with cash today and by private equity, so insurance is no longer mandatory.

If insurance is unaffordable, no one needs insurance companies. Excessively expensive insurance, regardless of whether the rate is genuinely needed or the result of incompetent management, is of no use.

To remain relevant, do not take anyone for granted. Then return to intelligent underwriting and common-sense evaluation of rate increases. Is the problem really an underwriting issue rather than a rate issue? Is the problem really an insurance-to-value issue rather than a rate issue? Is the problem really a risk management issue? Blanketing everything with rate indicates a lack of intelligent thought.

My friend's situation is likely driven by the fear of convective storm damage. Millions of people have moved into these exposed areas. Other than awful hail and windstorms, these cities are attractive places. People are moving from relatively benign cities to cities that have always had greater storm exposure. Nothing new and it is not a climate change issue. After all, Florida has always been hit by hurricanes but before air conditioning, no one really wanted to live there. Texas has always had hail storms – just read the old histories of rural Texas, and their tall Texas tales of riding out the storms including the blue lightning.

Underwriting is likely the key solution. Spread the geographic risk. Many carriers find themselves with concentrations of property risk they built unintentionally. This is pretty easy to manage so one must wonder about their annual underwriting assessments. Much of the risk can be mitigated, and changing underwriting/rating to favor mitigating factors is simple. We know certain roofs withstand hail much better than other roof types. We know certain roofs can withstand far higher winds than other roofs.

But this solution requires thinking. I get the feeling that many companies are investing in technology as an excuse to not think and prevent underwriters from thinking. AI is not a substitute for thinking and if it is, then the board of directors should fire the C-suite because C-suites are paid to think things through. Maybe the job most at risk to be replaced by AI is the C-suite? Nah, that's my own blurred vision.

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For such an old product, does anyone understand insurance?

Insurance is an awfully old product. Standalone insurance policies not attached to contracts or loans were sold in Italy in the 1300's. But reference to insurance dates all the way back to the Hammurabi Code from around 1750 B.C.!

You might think that after 4,000 years, people selling and buying insurance would know what they're selling and buying. But they don't. Not really, only superficially. This is not just my opinion. I've surveyed hundreds of people in the insurance world to learn if they know what they are selling, and the vast majority do not. The answers typically range from, "insurance" (duh!), "piece of mind," "financial security" (undefined, more of an emotion that actual financial security), "protection," and so forth.

These points touch on some ethereal aspect of what's being sold, but not the reality of what's being sold. Insurance is a legal contract transferring risk to another party in exchange for a payment (premium). The risk being transferred is the risk that the policyholder's assets would otherwise be potentially diminished. In more financial terms, the true function of insurance is to protect one's balance sheet and extend leverage opportunities. People rarely think about how insurance extends leverage, but this is a primary function today. People could not get loans, i.e., leverage, if not for insurance protecting the lender.

Virtually no buyers understand the value of what they're buying. As a result, insurance is typically purchased with material resentment attached. This is why sellers purport to be selling "insurance" but in many advertisements, they do not even use the word "insurance" (excluding the name of the advertiser, i.e. ABC Insurance Company). Buyers then buy insurance from someone selling something so toxic that they don't even mention what they are selling.

For example, consider the commercials and agents focused on selling the lowest price. Apples-to-apples, with 1,000 P&C carriers, prices are going to vary, so sometimes a better price for the same coverages is to be had. But quite often the lower price is correlated to less coverage. I've seen situations where certain entities taught their agents to sell homeowners coverage at 80% of replacement cost because insureds don't "really need the other 20%". I've seen agents who advise business owners they really can save a bunch of money by not purchasing workers' compensation on themselves. Obviously, you save money if you don't have any coverage. These agents are simply trying to make sales, not protect anyone's balance sheet and the buyers do not know what protection they are or are not getting.

And I don't blame the buyers. The entire concept that insureds should have to read and understand their policies so they know what they are buying might have been applicable in simpler times when buying insurance under the Code of Hammurabi, but not today.

For anyone thinking, "That's just your own opinion and it's wrong!" I have the advantage of completing many E&O audits, completing due diligence projects, and teaching coverages over the last 30 years. People selling insurance, by and large, have limited knowledge of what they are selling, and even if the insured could read a 25-page insurance contract, it's highly unlikely they'd adequately understand it. When I teach coverages to people with 25 years' experience, they often don't understand what they've been selling, and they've been taking insurance education classes every year!

We therefore have ignorant people selling and ignorant people buying. And the dollars are large. This makes for an attractive target for smart people to take advantage of consumers. When a really smart insurance carrier management team, or even specific kinds of distributors, focus on ignorant agents, pretty good frauds and illusory coverages can be created in this environment. In reading a history of insurance fraud recently, these were key ingredients in many such frauds.

With second grade insurance education enabling the puppet master to infuse the right sales pitch, agents will believe they are selling a great insurance product with absolutely no understanding of what they're actually selling, and consumers will have even less than normal knowledge of what they are buying. I see this possibly happening in selling certain carriers' policies. When a cat storm hits, or when a group health carrier realizes minimal surplus is inadequate to pay claims, the policyholder is always surprised and angry.

Insurance has another feature enhancing these vulnerabilities. Most people and businesses rarely have claims! They have no idea if what they have purchased is any good. And they won't until they have a claim or until they obtain high quality professional advice. Most consumers never read their policies (most agents never read the entire policies either), and even if they did, most are not going to recognize the coverage gaps.

These are matter-of-fact realities for which no studies are required. This reality makes the defense basis of E&O claims that insureds must read and understand their policies an obnoxious legal precedent. There are three parties involved. Two parties are licensed by the state. Neither has an obligation to understand what they are selling in most states. It is the third party, the consumer, the one not licensed, that has the greatest responsibility.

"Hey, Attorney, here is everything you should put into the employment contract I give employees because it is my responsibility to read and understand the contract you are selling me more than it is your responsibility even though you are the one with a legal degree and law license!" Insurance is a legal contract.

Study after study shows the vast majority of consumers and businesses are materially under-insured. These studies are not addressing esoteric or truly optional coverages but the base amounts like having enough coverage on a building. The carriers make significant profits, around $50 billion annually per A.M. Best. They are doing okay, but they'd do better if their agents knew what they were doing, because the solution to the property insurance crisis is not higher rates, but greater coverage and better underwriting. Agents need to address the coverage gaps.

Insurance is such an old product. It is arguably the most valuable financial product ever developed and sold today. It is a shame that a product so critical to people and the economy overall is so easily and so often sold ineptly.

Would you like to rise above the rest and take care of your customers more professionally? The key is to change your primary measures of success. Measure how many people whose protection you materially enhanced today.

In January 2022, approximately 1,000 homes and businesses burned outside of Boulder, CO. The state's study concluded the average home was under-insured by $146,000. The under insurance was a combination of poor replacement cost calculations, applying inadequate replacement cost endorsements, and not having enough ordinance coverage. It was not just one thing. Granted, other factors jacked the cost up because of inept governmental decisions. But focusing on what an agent can control, it was a combination of those three coverages.

Replacement cost estimators are so often wrong that some of those mistakes are at the carrier level. Agents are limited in convincing carriers to use different replacement cost estimators. But a lot of agents don't use replacement cost estimators correctly and others cut corners to get to the price required to make the sale.

Also, not all replacement cost endorsements are the same and yet, a large proportion of personal lines account managers I meet think they are all the same. Some are fantastic and others, I wouldn't buy because of all the conditions attached. Ordinance coverage was a huge factor because the municipalities had become environmentally "correct", and their building codes required that new construction would need to include environmentally correct materials and designs (like solar power). The throw-in ordinance coverage is unlikely to be anywhere near adequate in these situations. In 98% of the files I have reviewed, no one even asks the insured if they want more coverage.

To rise to the professional level, at the very least, do the replacement cost calculations correctly, offer the better replacement cost endorsements, and evaluate the need for additional ordinance coverage. Rising above the cacophony of peddler personal lines agents is pretty easy. Getting heard is the hard part and you do this one client at a time. Advertisements are unlikely to work because insurance is a required word.

Rising above makes life more enjoyable. I've been fortunate to know many good agents who have saved their clients from financial ruin. Over time, they no longer need to even sell because their reputation brings plenty of new clients to them. They have made good money and retired multimillionaires.

And, along the way, they took more vacation days. Sounds like a winning plan to me.

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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.

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