Burand's Insurance Agency Adviser

Resources and Information for the P&C Insurance Industry

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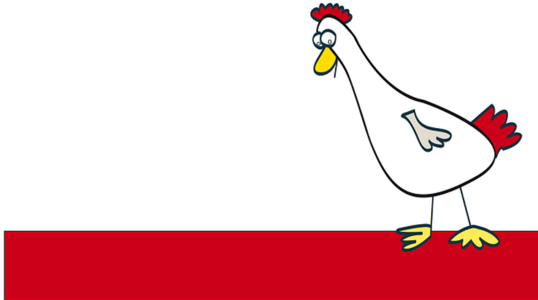

The Sky is Falling!

The insurance industry's law of large numbers is broken eight ways from Sunday. And it is broken due to a lack of critical thinking skills combined with minimal accountability.
Read more.

Carrier Terminology, Part II

Several readers requested more articles related to insurance company financial terminology. I appreciate these requests because I would have thought it would be one of the most boring subjects possible for anyone other than insurance geeks.
Read more...

Overview of the Insurance Industry 2025 Webinar

Recently, Chris was honored to be a guest on the Institute of WorkComp Professionals' webinar, where he and Kevin Ring discussed the Insurance Industry in 2025. Click on the following link to listen to this valuable conversation:

https://myadvisortools.wistia.com/medias/8p5ed07lmf

How do agencies lose by choosing the wrong carriers?

When an agency moves business, especially if forced to move business because a carrier leaves a market or otherwise jacks rates so significantly an agency must move accounts to keep the accounts, the true cost can exceed several years of commissions. This means significant profits are lost.

Also, growth is impaired because the time required to move accounts is time that otherwise could be spent growing. Obviously, if your producers cannot sell, this is not a factor but then you have bigger problems.

E&O exposures increase when an agency moves business because inevitably the client may lose some coverages. Maybe the new forms are overall better, but when you move accounts, the coverage Mirror Test applies and if any coverages are lost, you had better be informing the client of such lost coverages.

Which carriers are the most likely to cause you to have to move business? My proprietary analytics have been proven to be prescient in identifying which carriers are most likely to cost you profits and growth. The same analytics show which carriers provide platforms enabling you to grow more quickly, sometimes even when your producers are incompetent.

Isn't it time to quit the insane behavior of pounding your head against the brick wall trying to knock some sense into carriers to write quality business when that carrier simply is not positioned to help you grow? You'll feel much better with my analytics, unless of course, you really enjoy the pain inflicted by choosing the wrong carriers.

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

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The Sky is Falling!

The insurance industry's law of large numbers is broken eight ways from Sunday. And it is broken due to a lack of critical thinking skills combined with minimal accountability.

I'll use Florida as a starting point. If the law of large numbers is applicable, then the way loss ratios should be reviewed is over a long period of time. This is an especially important statistical approach because according to Wikipedia, about 121 hurricanes have hit Florida since 1851 (per the NOAA Hurricane Research Division, aoml.noaa.gov/hrd/hurdat/All_U.S._Hurricanes.html).

121 hurricanes in 173 years equals 0.7 hurricanes per year. Because not even one hurricane strikes Florida annually and because in that 173-year span, on multiple occasions Florida was not struck by a hurricane for two or more years at a time, the law of large numbers must include a long time span. Last year's hurricanes, on a frequency

basis, are simply catching up to the average and yet carriers and markets act like the sky is falling.

I analyzed Florida's homeowners loss ratios over the last 11 years (all the years I could access). The average adjusted loss ratio is 60.3% with a median of 54.1%. What is the national average over the last ten years? The net loss and LAE ratio is 73.3%! (All numbers are per A.M. Best).

Better not write in Florida! A carrier might make more money than normal!

While that's an overstatement because underwriting expenses in Florida are higher offsetting some of the profits, my point is that over time, i.e., application of the law of large numbers, Florida is not a bad place to write. It might not be great, but it's better than average.

The law of large numbers is also broken because the concept presumes all accounts, good and bad, are placed in the same pool with limited underwriting ability to predict which accounts will have claims. Therefore, rather than spending too much time and money underwriting, price the entire pool adequately, and everything will work out fine. And if one loses a little, raise rates spreading the pain just enough to make a profit but not causing too much pain clients will shop.

But predictive modeling, if you believe it works, ruins that model quickly.

And a carrier does not need predictive modeling if the carrier is willing to do the real work of underwriting. The parties that do this are moving huge portions of the commercial premiums into various forms of captives. The results there are far more profitable and as the pool of the best clients placed in alternative markets grows (the last estimate I saw from Aon showed more than 50% of all commercial premiums are now in the alternative space), the regular market becomes concentrated with poorer accounts. And one of the most important underwriting rules is, "You can't charge enough for a bad risk."

With 50% plus of premiums moved to alternative risk transfer markets, the law of large numbers in the regular insurance pool is dwindling.

This means that markets and brokers capable and willing to spend the calories required to critically think have more opportunity than ever. This is the kind of market that can reward true intelligence and effort. This industry is a fairly lazy thinking industry, or at least that is what I've experienced over the last 35 years. Most carriers and brokers will never realize what is happening until it is too late.

As evidence of this trend even in the standard market, 10 carriers now have 52% of all premiums out of approximately 1,000 P&C carriers. The top 20% or so of carriers are averaging profit margins 14 full percentage points better than average on a CONSISTENT basis. That means the other carriers are inadequately profitable to survive. And my latest

analytics clearly show who the winners and losers will be in case you're interested in being a winner.

The law of large numbers model rewards lazy thinking and if the law of large numbers is dead, not much hope exists for lazy thinking.

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Carrier Terminology, Part II

Several readers requested more articles related to insurance company financial terminology. I appreciate these requests because I would have thought it would be one of the most boring subjects possible for anyone other than insurance geeks.

Words truly do matter. It's funny, often ridiculous, and sometimes bordering unethical when I hear carrier employees, executives, and claims adjusters say things like, "Well, the contract does read that way, but that's not what we mean so there's nothing to worry about." If it's not what was meant, then change the contract! If that is too hard because it involves filings, then do a manuscript endorsement for the agent that is smart enough to request it. That's what manuscript endorsements are for. Otherwise, that perspective seems rather disingenuous to say the least.

The same thing happens on carrier financials but it is easier to disregard the issue because financial terminology knowledge is so lacking at the carrier level, even at the carrier CFO level, as well as the agent/broker/producer level. Below is additional guidance regarding what these terms mean.

Loss Ratio:
As I described in part one, but well worth repeating, most people do not know the true definition of the loss ratio they're looking at and that is not their fault. The problem is that carriers, over the years, have created all sorts of definitions and usually have lost track of those definitions, which is why on one report the loss ratio is 65% and the next report, all else being equal, the loss ratio might be 67%.

Loss ratios are defined, 100% of the time, by some mathematical formula. The definition can be described in words which resemble the old-fashioned math word problems that most people hated in school. It's easier to see the actual formula. At the very basic level, the formula is:

Incurred Losses/Earned Premium = Loss Ratio

However, different definitions of earned premium exist, and many different definitions of incurred losses seem to exist because carriers have different ways of recording incurred losses.

Also, not all loss ratios even use earned premiums. Some carriers, for reasons that I fail to understand, use written premiums. Sometimes they use direct written premiums and sometimes they use net written premiums.

Then you get into whether losses include reserves and if so, what kind of reserves. Do losses include loss adjustment expenses?

If an actuary or a high-quality underwriter is examining or modeling loss ratios, doing so with different inputs, say with and without reserves, provides clarity as to how the book is or should perform. But when those numbers are presented to field people, or are shown on production reports, whoever is reading the report needs to know the applicable definition. This is incredibly important when comparing lines of business, carrier vs carrier loss ratios, and contingency loss ratios because quite often, the definition of loss ratios in the contingency calculations is different from the definition used on the production documents.

One of my favorite questions to ask carriers when they are discussing loss ratios is, “What definition of loss ratio are you using?” To date, I’ve never received an immediate straight answer. The best carrier people will say they will research it and return with a definitive answer.

Loss Adjustment Expense (LAE):
This term is fairly self-explanatory. How much does it cost to adjust claims? This covers investigations, third-party reviews, data acquisition, and so forth. However, there are two kinds of LAE, allocated and unallocated. The former is specific to the claim(s) and the latter is associated with overhead such as salaries for claims staff, IT, and so forth.

Understanding LAE’s is important for understanding loss ratios and because some carriers use LAEs in their contingency calculations, it is important to understand how they are assigning these expenses. The answer sometimes is that the carrier does not understand how they’re assigning these expenses.

I'll use a story from long ago because age makes it a safer story to tell. That being said, by no means should anyone think this is an out-of-date scenario. The carrier for which I was an underwriter gave me, and all the underwriters and all the agencies, monthly production reports. As an underwriter, my goal was a loss ratio of X%. I’m a pretty careful analyst and after missing the mark, I decided to analyze my loss ratios every month the following year. I began the year strong but then my loss ratio began creeping up. I began analyzing my claims data and the claims data did not support the loss ratio being reported. I did a deep dive into why and learned that every month, my loss ratio was being increased due to unallocated loss adjustment expenses. The unallocated allocations were significant and barring a true loss ratio of maybe 35% or less, I was never going to achieve the required loss ratio.

When I inquired as to what was going on, the home office advised it was all a mistake, don’t worry about it, and they’d correct it. But they didn't it because I missed my target,

and they did the same thing the next year.

Operating Ratio:
Operating Ratio is the KING of profitability measures. The combined ratio is what carriers most often report which is the combination of expense and loss ratios. On the income statement, this is basically the equivalent of the expense portion. The combined ratio lacks a full accounting of the revenues. Combined ratios only include premiums. As Warren Buffett said long ago, insurance companies are nothing more than poorly run mutual funds because they almost never make money in underwriting (the average combined ratio over the last ten years is approximately 100%, thereby proving his point) and their investment yields are nothing to get excited about.

The operating ratio includes investment income and because investment income provides 100% of the profits in many scenarios, the idea of leaving investment income out of the profitability measures is ridiculous.

The amount of investment income earned relative to premium varies tremendously from one carrier to another. Some carriers make as much as 20% of all their income from investments. While others make only 1% - 2%. That difference can make or break a carrier.

Whenever you are reviewing carrier financials, it is critical you know what definition is being used. Even at the A.M. Best and NAIC level, the definitions are not consistent from one report to another and figuring out the differences can be mentally painful. The differences between the carriers' reports, even internal reports, can be far more painful. But knowledge is power and when I coach agents on these points, they gain tremendous power.

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Chris Burand is president and owner of Burand & Associates, LLC, a management consulting firm that has been specializing in the property/casualty insurance industry since 1992. Burand is recognized as a leading consultant for agency valuations and helping agents increase profits and reduce the cost of sales. His services include: agency valuations/due diligence, producer compensation plans, expert witness services, E&O carrier approved E&O procedure reviews, and agency operation enhancement reviews. He also provides the acclaimed Contingency Contract Analysis® Service and has the largest database and knowledge of contingency contracts in the insurance industry.

Burand has more than 35 years' experience in the insurance industry. He is a featured speaker across the continent at more than 300 conventions and educational programs. He has written for numerous industry publications including the Insurance Journal, American Agent & Broker, and National Underwriter. He also publishes Burand's Insurance Agency Adviser for independent insurance agents.

Burand is a member of 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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