Insurance Coverage Purchase Strategies

By Albert L. Sica *June, 2016*

In order to be certain your purchase of insurance is an effective “risk mitigation strategy” you need to approach the exercise thoughtfully and professionally. Otherwise, what you end up with might be as “real” as the town in Mel Brooks’ movie Blazing Saddles... a good facade without much substance.

Owners purchase insurance to protect their businesses; however, the general process of how to go about securing competitive coverage is deeply flawed and prevents buyers from fully understanding what they are buying. The business owner must choose an insurance broker, give them information and, generally, hope for the best. Savvy business owners do not purchase other services or products that way. Generally, they are very thoughtful and clear in understanding the technical solution and information they provide to get the best result. With insurance, the “salesperson” takes your information, gets you a quote or several quotes, gives you some general understanding of the best choice and you say “OK…bind” – that is just not the way this process should work.

Insurance should properly protect a company's assets, insulate it from liabilities and give senior leadership the ability to “avoid surprises”...that is the general idea. Unfortunately, insurance is often one of those products that until you use it, you don't know it is “broken.”

I gave a seminar to a group of CPAs recently and likened insurance to the company's guard dog. The business owner purchased a guard dog from what was, reportedly, a great kennel which specialized in training guard dogs. The kennel owner delivered the dog, walked the dog, he said, and cautioned the business owner not to let others train, play with, or walk the dog. “Those others can't be trusted and you never know what might happen to the dog if they do,” the kennel owner warned.

At some point, a thief broke into the company’s premises and stole everything the business owner had, everything the business owner worked his entire life for! How could such a thing happen with the trained guard dog on duty? The kennel owner had assured the business owner that the dog would protect his assets. When the business owner walked over to the dog instead of barking and growling at him the dog ran over with his tail wagging and tried to give him a kiss. Turns out the business owner never had the protection he thought he had as instead of a vicious guard dog he had a friendly pet. Unfortunately, he didn’t find this out until it was time for the “dog” to respond. s expected. So, the business owner went over to the dog and tried to wake him up only to find the dog was a stuffed animal and the business owner never had the protection he really thought...ever...unfortunately he never knew that until it was time for the "dog" to respond.

Insurance is very similar to the pet vs. guard dog story. Most insurance buyers don’t understand the product they buy. Buyers rely on salespeople, and insurance brokers, for the most part, who earn according to what they sell. Rarely do insurance salespeople, or even the insurance purchase process itself, provide a detailed explanation of the coverage, limitations, exclusions and policy conditions.

1. **Understand Your Risks** - think about your business, “what can go wrong and how bad can it get” – that is essentially what you are trying to insure against. We encourage our clients to think about risks in the three (3) categories listed below.

- **Basic Risks** – are easily insurable and include property risk, business income risk, claims from third parties (customers, tenants, and your workers), automobile risk and employee theft are just some of the risks to consider.

- **Intermediate Risks** – arise when insurance may not be readily available and can include cyber-data breach risks and supply chain risk or some type of "dependency" that your business has on another – an anchor store in a strip mall perhaps.

- **Advanced Risks** – are not easily insured. Cover for this kind of risk may not exist at a commercially reasonable price. These risks can include reputational risk and third-party performance risk, loss of trade secrets or intellectual property.

After you are aware of the risks that your business faces, consider what you can do to mitigate those. For instance, you probably use counsel when signing contracts; that counsel offers you the ability to transfer risk using the strongest contractual transfer language. Your buildings may have excellent protection (sprinklers, fire/smoke detection) and new roofs, plumbing and electrical. Make sure your insurance proposal clearly spells out these areas so that potential carriers understand how you manage your operation.

2. **Create an Underwriting Presentation** – selling your organization to underwriters is your job. No one knows your businesses as well as you do. Think about the presentation made to a lender willing to provide capital to your business. You probably offered a detailed presentation, leadership biographies, and a thorough explanation of your business and why it represents a sound financial risk. That same comprehensive diligence should go into your efforts to secure insurance. After all, the insurer is pledging their capital for you.

3. **Choose Insurance Brokers Wisely** – interview the brokers, ask for referrals and interview the service team who will handle your account. Plan to competitively bid your coverage at least every three years. Understand the broker's compensation for placing your coverage. New York State passed a very good piece of compensation disclosure legislation, NY State Insurance Dept. Reg. 194.

Unfortunately, the divided nature of many insurance brokers creates "producers" who sell the business and "account managers" who complete the technical work, review the coverage and sometimes have a deeper understanding of the coverage. Many large brokers form compartmentalized specialty teams, such as a property team, a liability team, or an environmental team. Know who will handle each part of your account, but also know who, ultimately, has responsibility so you can contact that person if problems do not get resolved speedily.

4. **Drive Competition** – take control! It is possible to obtain competitive bids from multiple brokers but doing so is complicated in order to affect the desired results. In the property and casualty world, the first broker (or wholesaler) to submit "anything" formally to a carrier, gets that carrier – even if the "submission" is poor or inaccurate. Many brokers use wholesalers to get to insurance carriers. Using two different brokers that will go to the same wholesaler will derail your competitive efforts pretty quickly.

   Orchestrating a competitive and proper broker/insurer tender process is possible but there are some "rules of the road" that you need to be aware of when you start the process.

5. **Review & Analyze Quotations –** the insurance you are buying is intended to protect everything you worked for. Take the time and understand every part of it. Ask about each exclusion, ask what the conditions or warranties are. What is the penalty if I want to cancel the coverage early? Insurance is complex and you should expect a complete and thorough presentation from the broker(s) you have engaged. Don't settle for some sales presentation which gives you premiums, deductibles, 1-page of "coverage highlights" and 20-pages of broker sales material or disclaimers. Insist on more!

Today's commercial insurance market remains extremely competitive in most coverage sectors. However, so that underwriters can understand your company and your management practices, you must position yourself as an above-average risk. This is not a one-dimensional approach; rather, it is a nuanced process that artfully presents your company, your management team and your history in its best light.

Don't end up with the coverage that looks like a guard dog but is really a pet. We can ensure your company finds the best coverage, and the strongest carriers, for your new and emerging risks.

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About The ALS Group

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