SPECIAL REPORT

STRAIGHT TO THE BOTTOM LINE RISK MANAGEMENT

(07-11-2014)

This Special Report was written by Kenneth R. Hale, J.D., CPCU, AAI, LIC of Marsh & McLennan Agency LLC. Mr. Ken Hale can be contacted at 734-525-2412 or khale@mma-mi.com. More Special Reports are available at www.mma-mi.com.

I. Make a difference now in the short and long term cost of your property and casualty insurance and risk management program.

A. These costs are in part:
- premiums for insurance for covered losses;
- indirect costs of covered losses (time, reputation, increased premiums, long term loss of customers, contract penalties, tax implications); and
- direct and indirect cost of uncovered losses (same as above, plus loss of asset value and loss of additional profits).

B. The risks of loss that you face are in part:
- damage to your building or a leased building and personal property;
- damage to property of others in your possession;
- loss of income and extra expenses arising out of disruption caused by damage;
- loss arising out of automobile accidents (liability and physical damage);
- loss arising out of premises injury or injury arising out of your products;
- loss arising out of employee claims for injury and loss of wages;
- loss arising out of products recall expense;
- crime loss for employee theft of your property and customer property;
- loss arising out of transportation of product or equipment;

- loss arising out of management practices (directors and officers, employment practices, and fiduciary liability); and
- loss arising out of environmental accidents (cleanup and third party injury).

II. Agent Selection

A. In Michigan, your insurance agent is really your agent, and the acts of your insurance agent are binding on you when dealing with insurance carriers. An inaccurate application for insurance by your insurance agent can cause denial of a claim by your insurance carrier. Selection of your insurance agent is a critical decision and much more important than who has the lowest premium.

B. Most insurance agents sell insurance policies on the basis of the lowest premium and are not competent to be risk managers. You need a risk manager first and an insurance buyer second.

C. A risk manager

- understands insurance policy terms and conditions and is able to negotiate favorable changes in these terms and conditions as well as premiums.
- understands the risk management implications of leases, purchase orders and other agreements that you sign.
- is competent in human resource issues; can review employee manuals and job applications; and can field employment practices questions. Appropriate advice in this area can prevent management practices claims against you by employees.
- understands how to assist you in transferring your liability to others by way of indemnification agreements. For example, having subcontractors hold you harmless from claims arising out of their activities.
- understands how to reduce or eliminate your losses.
- can assist you in filing, monitoring and resolving claims that you file.
- understands how to create tension with your insurance carrier to reduce your premiums and improve your terms and conditions.

D. Evaluating Your Agent

- Assume incompetence in the quality of the terms and conditions and pricing of your insurance program. This is typically what we find.
- Typical insurance agency structure involves reactive "service" by a CSR (service rep) with little experience. Watch for "800" phone numbers.
- Typical insurance agency mission is to sell policies and move on.
- Assume a conflict of interest between your agent and that agent's
  - employer and
  - your insurance carrier.
- Assume agents from direct writing insurance carriers are more incompetent than independent agents. A direct writer has employee salespeople. They have a produce or die concept with purely reactive service with little analysis or negotiation of terms and conditions.
- Assume you can do a better job of selling your company to the underwriter for the insurance carrier than the typical agent. You should have a direct relationship.
  - High level people in your organization should be meeting directly with the insurance company underwriter that sets the price and terms and conditions, and they should also be meeting with the loss control inspectors.
  - Be prepared to demonstrate how you manage risk, such as selection of employees, driver safety, indemnity agreements with others, safety committee, safety managers and safety programs.
- Evaluate the credentials of the person that actually services your account from your insurance agency as opposed to the account executive (salesperson) who you gave the initial order and who you may see occasionally. Look for some or all of these credentials:
  - J.D. – Attorney
  - CPA – Certified Public Accountant
  - ARM – Associate in Risk Management
  - CRM – Certified Risk Manager
  - CPCU – Charter Property and Casualty Underwriters

    - CIC – Certified Insurance Counselor
    - AAI – Accredited Advisors of Insurance
- Use an outside risk manager if needed.
- Use an outside policy terms and conditions auditor to review your agent's performance and to create tension between you and your insurance carriers.

III. Insurance Carrier Selection

A. Direct writers – Competitive on price, but not on terms and conditions or risk management. They get business by having the lowest price.
B. Independent agent carriers – Can be competitive and some may negotiate terms and conditions, but many provide little meaningful risk management advice.
C. There are limited choices of national insurance carriers. (Chubb, Travelers, Hartford, Fireman's Fund, Citizens-Hanover, C/N/A, Amerisure, Liberty, etc.) Regional carriers typically are not sophisticated, but there are some exceptions.
D. Don't burn out the market by shopping every year.
E. Don't make the lowest premium the major reason to select an insurance carrier.
F. There are risks in changing insurance carriers.
    - After the fact inspections can impose expensive requirements, such as having to upgrade sprinkler systems.
    - Retroactive audits that change payroll or sales classifications after the policy expires because of misstatements or misrepresentation.
    - Rescission or denial after a claim if there are misstatements in an application by your agent.

G. A loss control department is really just an inspection department for most carriers. Seldom do they provide true consultation in how to prevent or reduce losses.
H. Assume no good will with your insurance carrier. They pay only what they have to pay and when they want to pay it.
I. The worst that can happen to an insurance company is that it will have to pay the claim and maybe some interest.
J. The worst thing that can happen to you as an insured is that you will be out of business because you cannot be paid fast enough or

in sufficient amounts to survive. You may eventually collect, but you are still out of business and cannot recover attorney fees.

K. Find out the real reputation of the carrier that you have or want to place business with.
   - www.michigan.gov for insurance carrier complaint ratios.
   - Try to get your insurance agent to tell you candidly the real reputation of the insurance carriers they represent, but there is a conflict of interest.

L. Don't worry about the wrong things such as the lowest premiums versus favorable terms and conditions and reputation.

M. "Non-admitted" (unlicensed) compared to "admitted" (licensed) carriers. Generally, you want "admitted," but not always.

N. Best Ratings. (You want an "A" or better, preferably "A+" or "A++.")

O. Don't ever assume your insurance carrier won't become insolvent or otherwise go out of business.
   - Two examples are Reliance and Kemper.
   - These were all "A" rated carriers in 1998.

P. Negotiate terms and conditions to make your insurance program as bullet proof as possible.

Q. Don't over shop. You will burn out the limited market. If you get quotes every year to keep your current carrier "honest," the few available carriers will not take you seriously when you actually want to change carriers.

IV. Terms and conditions that will make a significant difference in your bottom line premiums and direct or indirect claims cost and/or survival are:

A. Property Insurance
   - All Risk or Specified Perils – You want All Risk.
   - Coinsurance – You never, ever want this.

     Coinsurance Formula = $\frac{\text{Did Insure}}{\text{Should Insure}} \times \text{Loss}$

     Example: $\frac{\text{\$10,000,000 limit on insurance policy}}{\text{\$20,000,000 appraised building value after loss}}$ = 50% reduction on loss recovery
   - Blanketing – You always want this when you have multiple buildings.

     Example of Specific Limits   Example of Blanket Limits

Loc. 1:	$1,000,000	Loc. 1:	Included
Loc. 2:	$1,000,000	Loc. 2:	Included
Loc. 3:	$1,000,000	Loc. 3:	Included
			$3,000,000

Don’t overinsure values that are blanketed, but do have a rationale or substantiate for the individual values so the insurance carrier does not claim fraud or misrepresentation and deny a loss.

- Ordinance or law – You always want this. Covers difference in building codes and delays in rebuilding because of those codes.
- Property of others – Examine your responsibility for damage, but you always want this.
- Unscheduled locations – You want an automatic limit.
- Transit – You want this. Don’t limit to your vehicles or to specific vehicles. Don’t rely on your truckers because their liability is limited.
- Equipment breakdown – You always want this.
- Environmental – Covers accidental spills, cleanup and injury. You probably have an exposure, but do not realize it.
- Loss of income extra expense – You always want this. Don’t limit this to 12 months reconstruction time. It will likely take you one to two years to be up and running after a total loss and longer to recover lost customers. Consider excluding hourly ordinary payroll from continuing expense coverage which will reduce the limit that you are required to insure.
- Extended period of recovery – This is different than reconstruction time. It covers the time it takes to recover after reconstruction. You will lose customers, and it takes time to get business back. Ask for at least 365 days extension or “unlimited.”
- Pick limits for buildings, personal property and loss of income that are well thought out and generous. Repair and replacement is always much higher than you think.
- Vacancy clauses – Major coverage penalties if a building is vacant for more than 60 days. You never want this. No bursting of pipes or overflow of plumbing, no theft or vandalism and other losses will be reduced by 15%.

- Protective safeguards clauses – You never, ever want this. If a sprinkler system or alarm system fails, you may not collect anything on a fire or burglary.
- Property rates – Sprinklered: $1,000 per million; non-sprinklered: $2,000 per million or higher. You need to look at system densities. A plastics operation requires higher sprinkler system densities than a metal worker.
- Deductibles – Take at least a $10,000 deductible.
- EDP exposure – Inside and outside attacks. Check backup procedures.
- Insuring outside landlords on your policy for building insurance. Avoid doing this. Negotiate leases without this obligation.

B. Entities
- List all – No forgiveness.
- Inside landlord – Problems. This is where the business owner forms an entity to own the building and leases it to the business.

C. Autos and Trucks
- Owned. (Who owns?)
- Personal autos on company fleet. Avoid this if personally owned.
- Non-owned exposures. It is your liability if employees have an accident on your time. Always purchase non-owned auto coverage.
- Add employees as additional insureds to your auto policy – This prevents your insurance carrier from suing your employees if they have an auto accident on your time.
- Limits – The biggest judgment in Macomb county in 2005 was $58,000,000.
- Deductibles on physical damage – Take higher deductibles.
- Rental cars and trucks – Purchase a damage waiver from the rental company.
- Driver selection – Pre-hire and post-hire.
- CDL requirements for heavy trucks – Random drug testing, etc.

D. Liability – Primary and Excess Umbrella
- Premises injury.
- Products injury.
- Products recall expense – Generally unavailable for automotive.

- Limits – Think in terms of $10,000,000 at a minimum. 30% of wrongful death claims in 2005 exceeded $5,000,000.
- Tenants legal liability for building damage – Limited coverage provided. You always need a waiver of subrogation in the lease.
- Foreign exposures for products liability and other damage – You may need an international policy.
- Automatic additional insured clauses – If required by your customer agreements. Always have this.
- Employee benefits legal – COBRA and other exposures. You always need this.
- Don't assume excess liability umbrella is really excess liability – It is often less broad than your first layer of coverage.
- Hostile fire pollution exclusion – This is a major problem. Insist that this exclusion be waived.
- Fumes from heating systems exclusions – Also a problem. Get the exclusion waived.
- Liability rates – What to look for.

E. Workers' Compensation
- Classifications – Can be negotiated up front.
- Rates between carriers and even with the same carrier vary significantly.
- Experience modification – Check the worksheets as well as your safety program.
- Deductibles – Letter of credit is a major problem. Need premiums of $1,000,000 for this to make sense.
- Group self-insurance – Great concept without the LOC problem.
- Individual self-insurance – Same letter of credit problem.
- Entities – List them all.
- Independent contractors – Always need indemnification agreement and certificates of insurance. Certificates alone are worthless.
- See if dividend plans are available which will return premiums if your losses are favorable.

F. Crime
- Employee dishonesty of owned property, money or securities.
- Employee dishonesty of third party property – Seldom provided, but always needed.

- Computer fraud.
- Funds transfer.

G. Management Practices
- Officers and directors – <u>Include entity</u> coverage.
- Employment practices – <u>Include third party</u> coverage.
- Fiduciary liability – Special issues if self-insured for benefits because of the bodily injury exclusion. You need fiduciary liability because of <u>personal liability</u>.

V. Premium Negotiations

A. Factors for property insurance
- Construction.
- Deductible.
- Base rates.
- Commissions.
- <u>Discretion of the underwriter</u>.
- Limits.
- <u>Losses</u>.

B. Factors for liability insurance
- Classification.
- Commissions.
- <u>Discretion of the underwriter</u>.
- Sales or payroll basis.
- <u>Losses</u>.

C. Factors for Workers' Compensation
- <u>Losses</u>.
- Experience modification.
- Size.
- Which set of rates a given carrier uses.
- Dividend plans.
- Deductible.
- <u>Discretion of the underwriter</u>.

D. Factors for Auto and Truck Insurance
- <u>Losses</u>.
- Physical damage deductibles.
- Driver selection.
- Cost of new vehicles.

- <u>Discretion of the underwriter</u>.

E. General Factors

- Insurance market – It is currently soft for accounts with <u>a favorable loss history</u> and is hardening for less than stellar accounts.
- When you examine proposals, ask for premiums by line of coverage. You want to see the individual cost for buildings, personal property, equipment breakdown, computers, liability, etc. The more detailed the better. This will alert you to how much you are paying for what could be expendable coverage.