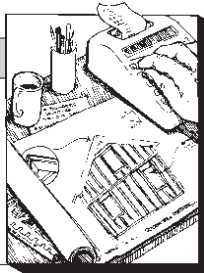


Softening the Insurance Crunch

by Richard E. Schmidt



Look, no one likes having to pay for insurance, and I am no exception (insurance consultants pay premiums, too). But if you intend to lead a prudent financial life as a contractor in the field, you must come to grips with this beast. Otherwise, insurance costs can eat you alive.

For example, say you bid a job based on such-and-such an insurance rate. If your renewal policy comes in at triple the cost while you are still committed to the job you bid at the old rates, it can be very hazardous to your company's economic health. But good management of your insurance program can help.

There are several ways to reduce insurance costs. The easiest and quickest is to eliminate unnecessary coverages.

Unfortunately, determining what is unnecessary can be difficult—and you may not find a willing partner in your agent. As good a person as yours may be, agents are capitalists, too, and tend to have a genuine bias for insurance over self-insurance.

Assuming Risk

When you cancel or delete coverage, you are assuming the risk yourself. Some people call it "self-insurance," but it really has nothing to do with insurance. Assuming risk is possible because of these two situations:

- The risk is very small or remote.
- The cost of the claim can be readily absorbed as a business expense.

If neither of these situations applies, risk assumption (sometimes called "going bare") is not for you.

The issue does not end here, however. If you feel squeamish about going without coverage, how about going halfway by increasing the size of any deductible which might apply (or, in the case of many liability policies, adding a deductible provision to your policy)?

Be guided by the following principles when selecting the size of the deductible:

- If you are having a relatively high frequency of smaller claims, set the deductible high enough to absorb these costs yourself.
- Take a modest chunk of the action yourself via deductibles in those cases where your chance of a claim is low, but where the asset you are insuring must be protected.

In the first instance, let me say that small, frequent claims drive insurance companies crazy, particularly when the cost of claim adjustment exceeds the amount of the damage.

More important, any insurer worth its salt will jack up your premium at the next renewal in order to cover these claims. On top of claim costs, they'll add your agent's commission, their profit, as well as some dollars to cover taxes on the premium.

Assuming some degree of risk at the low end of the scale almost always makes sense.

The second principle takes a little more thought.

In fire insurance, for example, most companies will discount your premium at least 15 percent if you agree to absorb the first \$1,000 of any claim. All that's left to do is make a comparison between the amount of premium saved and the number of claims you're going to have to pay yourself.

Say the fire insurance premium on your building is \$10,000, and you're carrying the standard \$100 deductible. Increase the deductible to \$1,000, and you pocket \$1,500. Now you ask yourself, how many claims do I have each year, and what would be the "action" in the \$900 area of risk that I have just assumed (the difference between \$100 and \$1,000)?

I am amazed at the number of insurance buyers who carry standard, low deductibles and yet have never had a claim. Playing with deductibles is one of the quickest ways to adjust premiums downward.

Look back at the last three to five years. If you feel past patterns will continue, compare your anticipated premium savings with anticipated claims. If you come out ahead, increasing your deductible is prudent. Ask your agent for a comparison for every coverage in your insurance program.

I am constantly amazed at the number of insurance buyers who carry standard, low deductibles and yet have never had a claim.

Playing with deductibles is one of the quickest ways to adjust premiums downward—assuming that you go about it properly by acknowledging the costs of the increased risk.

What I am about to suggest here is that you embark on a more long-term project and get to know something about how premiums are calculated. Think of the following exercise the way you would when breaking down bid numbers.

Most insurance is based upon a rate, that is, a unit cost times a volume of something (usually payroll, revenue, number of items insured, etc.). This means your insurance premium varies with quantity, or how much you do of a given thing.

The more you do, the more you pay—fair enough.

Behind the facade of your insurance costs is an elaborate mathematical process the complexity of which would do Rube Goldberg proud. Happily, there are only two major things about insurance rating (the way

your premium is calculated) that you will need to know:

- First, if you qualify based upon size or hazard of your operations, your premiums may be influenced, in part, by your past claims. The calculation is called *experience rating* because your loss experience is a major determinant of your current rates.

In workers compensation, data-entry errors are so prevalent that almost all calculations of experience modification have flaws.

- Second, the rate, which already takes into account your chances of producing a claim, can be affected by the judgement of the insurer's underwriter. That's that terrible person who passes over your application and decides how much insurance to give you, as well as how much you must pay for it. He can rate you up or down, subject to certain limits, almost as he pleases.

Experience rate. If you qualify to have your individual claim history influence your rating, ask to see the claims and amounts that went into the calculation.

Many times, the amounts used are overstated because of poor communication or clerical error, and you may be in a unique position to get the claim eliminated or reduced (increasing your chance for a discount based on reduced claim amounts).

This is particularly true in worker's compensation, where data-entry errors are so prevalent that almost all calculations of experience modifications have some flaws in them.

Schedule/judgement rates. The theory behind this concept is that there are characteristics about your operation which may increase or reduce claim frequency (number) or severity (size).

For example, if you have installed a safety program, you probably deserve some consideration for rate reduction. After all, you're a better "risk."

Once again, if you don't ask your agent about the availability of this judgement discount, you may never receive it. Conversely, if you are being surcharged for an adverse characteristic (housekeeping, for example), most plans provide reasons why surcharges are applied, and you should be informed.

Why? If the charge is based on alterable physical conditions, you can have the charge removed by correcting the situation (depending upon the cost/benefit ratio, which is premium saved vs. cost of the correction). Again, however, you have to ask.

Knowledge of the rating process is not something that is bound to excite you. After all, if you wanted to know this much about insurance, you would have gone into the business.

But insurance is too important a cost these days for us to continue languishing in ignorance. I am struck by the number of my new clients who have no idea how premiums are arrived at; there's almost a feeling of resignation about it (in addition to anger and frustration, of course).

My point is that you should see the rating sheet and understand the basic mathematics involved, the "hows" as opposed to the "whys," for starters.

If your agent can't or won't show you the figurings (known as "rating data" in the business), then you probably should be dealing with someone else. How can an agent sell you something that not even he or she can explain properly?

Getting Religion on Safety

Let's go back to experience rating for a moment (please don't tell me you've already forgotten!), the system that translates your claim history into insurance costs.

The fewer worker's compensation, automobile and general liability claims you have, the lower your premiums tend to be.

So how do we go about having fewer claims?

I'm not going to insult you by trying to sound like an inspector from OSHA or your state labor department, but it is gospel that the soundest long-term way to control insurance costs is to reduce the size and number of claim-producing accidents. It would probably surprise you that insurance companies are not nearly as dismayed by truly catastrophic, six-figure claims as they are with the nickel-and-dime variety. In fact, all experience-rating schemes limit the amount that you can be charged for a large claim.

Here are, however, some bottom-line guidelines:

1. If you're not consciously devoting some time solely to the safety of your operations, you are not doing enough.
2. Sloppy premises or work sites produce claims—period. In addition, insurance company inspectors get turned off, and they invariably go back to the local office and tell the underwriter what they saw. If you get the coverage at all, you're probably going to pay more than you should.

3. Anyone allowed to drive a company vehicle should have his or her motor vehicle record checked prior to getting behind the wheel.

This seems to be so basic and common-sensical, but I actually had a client who hired a driver who had lost his license due to traffic citations. The driver went out and was involved in a fairly serious accident.

Try defending that one in court.

4. The surest way to safe operations (and reduced premiums) is to hire capable people. Slacking off in the hiring process, particularly for workers compensation costs, can be deadly.

One last thing you can do to control and lower insurance costs is to bring the competitive forces of the marketplace to bear—that is, you go to bid.

You can do it two ways:

- Having your current agent submit you to a number of his companies.
- Selecting a number of local agents and turning them loose.

I tend to favor the second method, because you get to see all of the quotations that way.

You can also (ahem!) hire an outside consultant, but in truth, many of you may not be paying enough insurance bucks to justify the cost.

While relations with your insurance agent are based on trust and good faith, qualities which should not be held lightly, the fact remains that if you are in a competitive bid business, your insurance agent should be, too.

Don't be penny-wise and insurance-foolish

The most important, yet least understood, aspect of insurance is coverage. You may be paying too much for insurance, but improper coverage is really asking for it.

Your liability coverages should be written on a comprehensive form and any property insurance should be written for the perils of "all risks of physical loss." My experience has been that if you don't buy the broadest protection, you will meet trouble down the road.

Maybe you'll dodge the bullet and luck out, but failing to plug all the gaps is, to my way of thinking, playing Russian roulette with your business.

Specifically, your agent should be giving you the following coverages:

General liability.

Comprehensive form including the Broad Form Endorsement (some states use the Commercial General Liability policy, which packages everything you need).

Auto insurance. Use symbol "1" for the Comprehensive Liability coverage (covers all business automobiles basically) and symbol "2" for physical damage insurance (assures automatic coverage for new automobiles).

Worker's compensation.

Include Voluntary Compensation and make sure that coverage applies automatically in any state.

Property and equipment.

Nothing short of "all risk" coverage will do.

Job or bid specs. Have your agent review the specs for each and every job in order to tell you if there are any special insurance purchases which have to be made. No exceptions.

I'm sure that none of you is delighted by the prospect of paying more for insurance, but consider this: You will be hurt more by the uncovered claim than you will by paying too much in premium. Get the right coverage first; cut costs second. —RS

Test the market at least every five years.

And that's how to save money on insurance: cut coverages, raise deductibles, understand premium calculation, become a better risk and use the forces of competition.

I don't claim to have exhausted the possibilities, but at least this gives you some things to work on.

So what are you waiting for? ■

Richard E. Schmidt is a risk management consultant in Binghamton, N.Y. This article originally appeared in the October 1987 issue of RSI Magazine (Edgell Communications, 7500 Old Oak Blvd. Cleveland, OH 44130; 216/243-8100) and is reprinted with permission.