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Chairman's Corner

by Richard C. Lambert, CPCU, ARM, AIM, ARP

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It is hard to believe we are well into 2005 already. The first quarter is now a distant memory. The "soft market" is completely entrenched. How long will it be before "market share" becomes a more prevalent term than "underwriting profit"? I hope that point doesn't come, but, then again, I have been around way too long.

When you receive this, your section committee will have already met and finished our planning for this year. There are two very good reasons for you to consider attending the October 2005 CPCU Society's Annual Meeting and Seminars in Atlanta, GA:

- Our seminar subcommittee has planned a dynamite seminar. Partnering with the Ethics Committee, we are presenting a seminar that will focus on agent and broker quoting practices and compensation plans. Considering the activities that have taken place in the past few months, this should be a quite lively topic. **Peter R. Kensicki, D.B.A., CPCU, CLU, FLMI,** of the Ethics Committee, will moderate. If you have ever heard Pete speak, you know it will be entertaining and pointed. His articles on ethics can be found in *National Underwriter*. **Millicent W. Workman, CPCU, CPIW,** who will be the national CPCU Society president-elect at the time of the seminar, will represent the risk management arena. The last two panelists are being finalized, but one will be a prominent leader with the PIA, and the other will be a noted insurance commissioner. This promises to be a can't-miss seminar.
- For years, many national companies have hosted an evening reception or dinner at the Annual Meeting and Seminars to honor their new designees. There has never been an event to honor the new designees who represent the "smaller" independent agents. This year, your Agent & Broker Section will be hosting a dinner in their honor. It will be a "Dutch Treat" dinner at the headquarters hotel. We plan to secure a keynote speaker for the dinner. In addition, we will be informing the attendees of what sections do and specifically, what your section contributes to the Society.

Please put the Annual Meeting and Seminars on your calendar, October 22-25, 2005. Our seminar will be held on Sunday, October 23, 2005, and the dinner will be Monday, October 24, 2005. We hope to see you there, and if you have a new designee in your operation that will be in Atlanta, please ask him or her to attend the dinner with you.

I hope the rest of the year is good to you. Until next time . . . ■

What's In This Issue

Editor's Corner

by Chris O'Donnell, CPCU, ARM, AMIM

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Spring break is just about finished and I'm looking forward to a return to the rigors of our chosen profession. Even the kids are bored enough to want to return to school. I tell them that this is a sure sign of a successful holiday!

As I am sure it is true of most of our readership, there really is no true holiday from the business world anymore. With the Internet, cell phones, voice mail, cable or satellite TV, and other technological marvels, we are never out of touch. Not that I am complaining. I actually find it exciting!

Vacation allows me to work at a slower and self-imposed pace, instead of a reactive one responding to the demands of the office phone, scheduled meetings, and the like. I can choose at which time to respond to what appears on my e-mail systems or voice mails. My choices of times to respond sometimes lead to puzzled reactions from colleagues or associates questioning the late-night e-mail replies or voice mails that I often send while I am travelling.

This same technology allows our industry to farm out to home offices field personnel once tied to local offices. That is a well-established trend . . . nothing new here. I guess it just underscores the fact that our work lives now seamlessly can meld with the rest of our lifestyles. Some may find the trend disturbing, I do not.

Perhaps it is because I started out in the industry in the late 1970s as an outside claims adjuster and found a great comfort level working independently of a traditional office. That was back in the days of company cars, Polaroid cameras (way before digital), and pay phones (way before cellular).

There weren't even personal computers yet, let alone laptops. Apples were still fruit and IBM made large room-sized computers. I understand now that IBM doesn't even manufacture hardware anymore. It just sells service. Sound familiar? Service is all the insurance industry has ever had to offer. Nobody really cares about insurance, except to complain about the price . . . until he or she needs it.

I have been to Florida several times since the four hurricanes last season. No one is complaining about the cost of his or her coverage or even the claims adjustment process. The main problems now seem to surround the construction industry and its service problems.

Nevertheless, it was a difficult challenge to get used to the confines of office life after starting out in the relative freedom of the outside adjuster's life. First went the company car, then gradually I got sucked into an office pattern. Fortunately, the career path I have taken has always permitted me to exercise my wanderlust to some limited degree. Our profession mandates outside involvement! Customer care still requires personal contact. Claims work, litigation management, and public relations require personal attention.

Great industry associations such as ours also allow for travel opportunities for education and networking with associates. I think that the technology revolution merely allows us greater freedom to effectively and comfortably conduct our lives. Now while on business or personal travel, we may stay connected and up to date.

What a great time to be involved! ■

Strategic Options for Independent Insurance Agencies

by Daniel J. Devlin

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Property/casualty independent insurance agencies continue to grow and prosper in today's competitive retail insurance environment. Agency statistics collected by our consulting firm bear this out. Revenue per employee, compensation per agency shareholder, and agency revenue and earnings continue to increase annually. This success has been achieved despite formidable obstacles. The latter include carrier consolidations that reduce markets, bank and carrier entries into the retail marketplace as competitors, higher support staff labor costs, and difficulty finding qualified sales people. Unfortunately, challenges will continue and some may appear daunting. In the process of weighing strategic options, agency owners should be excited about the many choices available to their firms. However, an agency weighing its strategic options can easily be seduced by the temptation to consider the sale of its firm first. Along with the option to sell, agency owners should be certain to understand and weigh all of their strategic choices. Here are some of the most viable.

Sell

Sale prices for independent agencies remain high, driven by a number of factors. First, traditional agency buyers find acquisitions the fastest route to growth. Even after paying premium prices, smart buyers can still enjoy positive cash flow in the first or second year of payback. Secondly, new entrants to the retail marketplace find acquisitions a "turn-key" approach to entering the business quickly. Lastly, investors are attracted to the renewal or annuity profile of property/casualty insurance. But just hanging out a "for sale" sign does not guarantee a seller a premium price. Shrewd buyers will always hold back premium dollars if the seller is not educated on how to justify a premium deal. Obtaining above-average dollars is best achieved when sellers prepare in advance for a sale and seek professional guidance in "packaging" themselves for premium pricing. To financially justify a premium purchase, buyers usually consolidate much of the seller's operation into their own. Only by achieving economies of scale can a potential buyer afford to pay an aggressive price. This can mean closing the seller's location and terminating much of the staff.

Buy

The converse of the "sell" scenario offers excellent buying opportunities for agencies looking to grow. A good acquisition can provide buyers with quality sales and service staff, new markets, and higher profit margins. The latter is possible only if the buyer does his or her homework. When the seller's office is geographically close, the buyer can often shed duplicate expenses through consolidation. These expenses include occupancy, automation, reception, accounting, etc. These cost savings often free up sufficient cash flow to allow the buyer pay the seller a premium price, and at the same time generates positive cash flow to the buyer the first year of debt service.

Being able to offer a cash down payment in an acquisition gives a buyer an advantage when other suitors are in play.

Mergers

Mergers are another viable growth option. Combining firms can improve markets and contingencies, while at the same time generate economies of scale. Both can result in higher profits and improved executive compensation for shareholders. They also typically obtain unanimous carrier approval. However, power and money issues can frequently surface when combining the shareholder ranks of two firms that have historically been independent. And, both agencies require an appraisal to set accurate prices for the stock percentages of ownership in the new entity. Seeking outside professional help on issues of agency value, shareholder compensation, and management roles is advised in all mergers.

Cluster

This is a mature insurance concept that is being "dusted off" by agencies all over the country. By banding together with other independent agencies, participants can increase revenue and decrease expenses. This results in higher profits. In addition, participants obtain "cluster partners" without the potential compensation and power conflicts associated with shareholder partners. A major negative with clusters is the inability of the group to obtain economies of scale in occupancy expenses, since most principals own their building. The looming "wild card" with this strategic choice, as well as the marketing joint-venture choice that follows, is the uncertain future of contingency income.

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Marketing Joint Venture

A hybrid of the cluster, this concept is currently the most popular vehicle to improved revenue and profit growth. The concept has fewer downsides than a cluster, and can be implemented quickly. However, the proper "packaging" of such a group of insurance agencies is an important first step to receiving carrier approvals.

Banks and Credit Unions

Many agencies are partnering with banks and credit unions in a creative fashion. Not every relationship requires an outright sale. Successful relationships result from meeting the needs of both parties. Increasing customer/household counts, earning an adequate profit, and offering a full menu of services to customers usually top the list.

Grow the Business

Internal growth is possible when management commits time and budget dollars to marketing efforts. An ongoing marketing program can position the sales staff to succeed, generating a steady stream of new customers, revenue, and profit. To make it happen, high growth agencies appoint someone to oversee marketing. This marketing manager performs a functional role similar to a sales manager. New business and retention efforts are usually guided by a formal marketing plan. Closely aligned with improved marketing efforts is adding and pruning sales ranks to retain motivated and productive sales staff.

As part of your annual strategic planning process, weigh all options. Obtain as much information as possible about your choices. Seek professional advice where necessary. Once fully informed, take action. The destiny of your firm is not a matter of chance, but a matter of choice. ■

Agent E&O Insurance: Time to Check the Fine Print

As Rates Level Off, Agents Should Focus on Forms and Endorsements

by Linda Blechman and Raymond Wahl

Editor's Note: This article originally appeared in the September 2004 issue of *American Agent & Broker* and is reprinted here with permission.

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In the September 2001 issue of *American Agent & Broker,* we attempted to forecast the future of insurance agents errors and omissions insurance ("Agent E&O Renewals: Don't Wait Until the 11th Hour"). We foresaw the hardening of the market but never expected it to get as bad as it was in the mid-1980s. Now the market is settling down, and we sense a change taking place once again. To better understand where we are now, let's begin with a brief overview of what has transpired during the past three years.

The hardening of the insurance agents E&O market, which began in 2002 and continued into 2004, accelerated when two insurers with significant books of business exited the market. Those two carriers had non-renewed more than $40 million in agents E&O business, and the few remaining markets in that niche also became more selective when underwriting their own books of business. We saw new exclusions used to tighten policy language, reduced limits, withdrawal from certain sizes and classes of business and, of course, significant premium increases. MGAs and wholesalers were viewed as poor risks, just as they were in the mid-1980s, and many were lucky to get coverage at any price, on any terms. Underwriters typically had more business than they could handle and found it easier to non-renew entire classes than to underwrite individual risks.

Standard Main Street brokers often were able to renew with their existing carriers, although at higher prices. While some insurance professionals complained about pricing and tried to get a better deal, they quickly learned that, even with a double-digit increase, they still got good quotes, relatively speaking. A small percentage of agents, oblivious to the hardening market, sought more coverage at lower prices. A few panicked and heavily marketed their renewals, sending applications to multiple brokers and/or markets. For example, one account was submitted to us by seven different producers. The agent did himself a disservice, though; we could hardly take seriously one small account coming in from seven sources.

So where is the market now and where is it headed? We see the agents E&O marketplace leveling off. At this point, we think it unlikely that any more major players will exit the market, and we see no need for additional carriers or capacity. As economists would say, we believe the market is entering a period of equilibrium, similar to that seen in the late 1980s. It probably will be characterized by modest continued price increases, perhaps averaging 5 percent to 10 percent at most, assuming no increase in exposure base. But if your business is up by 50 percent from last year, don't expect a renewal as expiring!

Terms and conditions will probably remain largely unchanged. For the most part, underwriters have already made the changes they wanted and most likely will continue to be selective, with each pursuing the risks it considers most favorable. Such a trend does not bode well for very large operations, nor for MGAs, wholesalers, or reinsurance brokers. Other specialty brokers also will continue to face a difficult market.

What should you expect, and what should you do in the next 24 months? Let's start with pricing. We believe the market's current pricing level—while painful for some—is fair and suitable to sustain a long-term viable marketplace. Most increases will be driven by growth in your operation. We recommend that you focus on coverage and pay particular attention to policy forms and new endorsements, as some of them can be problematic.

Even good forms can provide inadequate coverage if the agents handling them are sloppy or inattentive. When completing an application, make sure you list the insured's full legal name or names on the application. If you are incorporated, include "Inc." at the end of your name. If you are "doing business as," then include "d/b/a." Avoid abbreviations or partial names, since the ensuing policy likely will include the insured's name exactly as it appeared on the application.

If you've changed names, incorporated, merged, or acquired another agency, keep in mind that most policies cover only the entities named on the policy. It doesn't help to have full prior-acts coverage if the entities to be covered are listed incorrectly. For example, let's assume you started out as John Doe d/b/a ABC Agency in 1996. In 1999 you incorporated and became XYZ Inc. If your policy gives retro coverage to 1996 but only covers XYZ Inc., then John Doe d/b/a ABC Agency is not covered. While you can avoid coverage gaps simply by listing both names, we often see requests to change the insured's name on the policy, rather than add the new name. We also see applications for new lines that show the firm established in 1999 but with a 1996 retro date on the current policy, which clearly indicates something is wrong. For similar reasons, you should pay attention to names and retro dates during mergers and acquisitions as well. If you simply buy a book of business (an asset-only purchase), you probably don't want to cover the other entity on your policy—and certainly not for anything it did before your purchase. Be sure to clearly communicate as much to your underwriter.

Other issues are equally important. Some, such as insurer insolvency, get a lot of attention, but you can control this risk by electing not to place coverage with certain carriers or, at the very least, having your client sign a disclosure statement. Nevertheless, carefully review your E&O policy. Some include "A-" wording, which means the insolvency exclusion does not apply if, at the time of placement, the carrier providing the coverage was rated A- or higher by A.M. Best. Note that the last three large carriers to become insolvent were rated A- until close to their demise, so "A-" wording would have protected you. Other forms have full insolvency exclusions, so agents have no coverage under any circumstances in the event of an insurer insolvency. We've even seen one form with B+ wording, which seems better on the surface. However, if you read carefully, you'll find it only offers defense coverage—not indemnity—and then only for a small fraction of the liability limit.

Other, more important, form restrictions attract less attention than they should. Two examples are absolute pollution and employment practices exclusions. We speculate that such exclusions were meant to apply to pollution caused by the agent, or EPLI claims arising out of the agent's status as an employer. However, some forms have absolute exclusionary language that appears to exclude claims resulting from the agent's placement of, or failure to place, pollution and EPLI policies for their clients. If such an exclusion exists in your current policy, it's obviously a major coverage restriction.

Two more ways some E&O forms reduce coverage are by limiting coverage to client-only suits, thereby apparently negating coverage for all claims except those brought by your insureds, and by excluding prior-acts coverage unless you've had continuous coverage in the past and can prove it. (Do you have copies of your last 20 declarations pages?) Review your form carefully, and if you find problematic wording, ask to have it changed.

What about the long-term stability of the marketplace? We believe it depends primarily on underwriters' willingness to maintain underwriting and pricing discipline. During the last quarter-century, the underlying fundamentals of agents' E&O exposures have changed, but not by a great amount or in a sudden way. For all the worries about terrorism, insurer insolvencies, asbestos, etc., the risks have changed along with professional liability trends and with societal changes in general. E&O underwriters, however, especially those with little understanding of the real exposures and no regard for bottom-line results, caused abrupt changes in the market. We can only hope that underwriters have since learned the obvious lesson and, as a result, will avoid sowing the seeds of the next chaotic market cycle in the years ahead. But as realists, we expect to see pricing begin to erode in a year or two and, at some point, a replay of the 1980s. For the long-term good of the marketplace, though, we hope we are wrong! ■

Credit Guard Mania and Loss Control

by Ellen Yamshon, Esq., CPCU

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Yamshon is on the National Panel of Arbitrators for the American Arbitration Association. She has negotiated mortgage loans on behalf of major banks and savings associations for subsequent sale to government programs. She is a former claims supervisor; has held insurance agent and broker licenses; and has been licensed by the National Association of Securities Dealers.

A recognized expert in program development, Yamshon has evaluated conflict resolution operations of government agencies and community-based organizations at home and abroad. She has lectured on conflict management and negotiation in the College of Business Administration, California State University, Sacramento; and is a contributing author on alternative dispute resolution and ethics topics in *Understanding the Law,* a popular textbook. She sits on the National Advisory Board of the Consortium for Alternative Dispute Resolution in Special Education, a National Center for Dispute Resolution funded by the United States Department of Education.

Chances are you already know a fair amount about identity theft. You don't need to be an insurance professional to recognize that identity theft is a big problem. As a consumer, you've heard the horror stories and you get the solicitations for "fraud alerts." If you log onto the Internet, pay credit card bills, listen to the radio, attend sports events, or watch television, you can't miss it. I call it "credit guard" mania. It's ubiquitous.

Non-insurance entities are competing for a segment of the identity theft insurance market. Credit reporting agencies, consumer credit counseling services, banks, and credit card companies have fashioned protection plans touted as your "insurance against identity theft." Competition is intense. In addition, new businesses have emerged and grown as a result of society's fear of identity theft. They include documentation destruction companies, credit restoration counselors, and advocates.

Credit monitoring services are reportedly generating $500 million in annual revenues. Fees vary significantly as do the package of services offered. For $69.95, Equifax, one of the big three credit reporting agencies, will monitor and send e-alerts within 24 hours of any change in your credit. If you incur any expenses in clearing an unauthorized charge, Equifax will reimburse you up to $2,500. In contrast, Experian, another big three company, will monitor and report back to you for $79.95, but that doesn't include reimbursement for the out-of-pocket expenses to clear your credit or time lost at work.

The relentless play on our collective anxiety over identity theft makes rational evaluation of the various insurance products difficult, if not impossible. Recognizing that the menace of identity theft can be controlled, if not completely prevented, will help frame the analysis. Loss prevention does not eliminate the need for insurance. However, insurance dollars should be spent on the unforeseeable and catastrophic, not on risks that are preventable.

Identity theft is perpetrated invisibly, completed in no time, and is generally detectable only after the fact. Identity theft is not a violent crime in the strictest sense because your bodily integrity is not threatened or breached, at least at the outset. They stick it to you painlessly but the financial consequences and reputational harm can be devastating. It can be quite sickening, literally.

Like AIDS, you can get this financial virus without knowing it and unless you are vigilant about discovering it, it can develop into an illness that is difficult to treat. Confirmation of identity theft can be traumatic in and of itself and the recovery process can be lengthy and stressful. If prolonged, it can result in the sort of emotional distress that manifests physically and may need medical attention.

As far as your good name and your credit rating are concerned, though, you could be dead on arrival. The good news is you can resurrect your credit rating and repair your reputation. The bad news is that in the process, you may lose your job, be forced to declare bankruptcy, or accused of committing a crime perpetrated by a larcenist using your identity.

In a recent nationwide survey, Fireman's Fund discovered that almost every homeowner knew about identity fraud (97 percent) and nearly all were concerned, to some degree (90 percent). Furthermore, 80 percent of the homeowners surveyed claim they know what they need to reduce the chances of identity theft, but only 70 percent report that they have taken action. Assuming that action is actually doing something beyond putting together a to-do list, which leaves 30 percent who are especially vulnerable.

I will venture a guess that you too have given some thought to this matter and have taken steps. You're required to shred sensitive documents at the office and you probably do the same at home. Do you use a crosscut paper shredder?

I bet at some point you realized that carrying multiple credit cards was a bad

idea if only because it makes your wallet heavy. So now you only carry a few, right? You never give out your social security number or credit card number to a stranger over the telephone. If you shop the web, you use discretion in placing your account information, right? Speaking of credit cards, you check your statements for unauthorized charges promptly, every time, right?

Think about your mailbox—not your e-mail—your physical mailbox, where you get deliveries from the United States Postal Service. Is it secure? Does it lock?

Let me ask you this: Do you know the exact dates that your bank statements are mailed? Do you have your computer programmed to remind you when to expect your bank statement? Do you call the bank right away if you don't get your statement? Do you reconcile the check register and the statement promptly?

Do you periodically scan your supply of blank checks, in the middle of your checkbook and in storage? Are both blank and cancelled checks under lock and key?

If you are taking these precautions, you are in good shape. You may think that if you are vigilant about following them, it can't happen to you, right? Don't make that mistake. Even if you are doing all the right things, you are not immune. However, vigilance will dramatically reduce the likelihood and severity of any breach of your financial security.

Let me tell you about my brush with financial disaster. I can't claim to have been doing all the right things, but I was conscientious to the extent that I was aware of ways to prevent identity theft. This went a long way to reduce the consequences of the breach. But it still happened. Vigilant is what I need to be now that I have joined the ranks of the one in four people who experience identity theft every year.

I tracked the due dates of my credit card and bank statements. I programmed my PDA to remind me when a statement was due and synchronized it with my personal computer, so that wherever I was I would not forget to track my accounts. I learned in law school that if you put your trash on the curb, it becomes public domain. Ever since, all documents with personal identifying information get shredded.

My house was burglarized over the July 4 holiday weekend last year. My family and I were on vacation. We returned to find the contents of our house upside-down. The burglars rammed in the side door entrance to get in the house, taking out the doorframe. We live on a winding levee road in the unincorporated section of Sacramento County, about 10 miles from the police station. The burglar alarm limited but did not prevent the burglary.

I believed I modeled good risk management behavior in preparing for our vacation. Before we left, my family and I planned how we would secure our valuables. I left my laptop at the office, my son hid his behind the vacuum cleaner in the broom closet, and my husband left his in his closet behind some clothes. The few very special pieces of jewelry I own were in the bank vault along with my credit cards, blank checks, and my social security card.

We did not lose much as a result of the burglary, or so I thought: kids' backpacks, CDs, videos, sports jerseys and shoes, some camera equipment. My husband's laptop was taken, but one of three is better than all. I was grateful for my homeowners coverage and frankly I was pleased that we had thought about spreading the risk of losing all three laptops.

My bank statements are mailed from the bank on the fifteenth of every month. I expect them by the twentieth at the very latest, so when I got that annoying ding from my PDA on July 17, I was mildly concerned. When I didn't receive a statement by the twentieth, I called the bank since I hadn't gotten my checking account statement.

Honestly, I wasn't too concerned and I did not close my account. I was satisfied that the bank was on notice that my statement hadn't arrived and that if there were any wrongful activity, the bank would catch it.

Also, lost mail is not all that unusual where I live. On occasion, my neighbors and I exchange misdelivered mail. I assumed my neighbor had gotten my bank statement in error. I got a duplicate statement from the bank when I found out that it was not misdelivered.

Three weeks later, my banker informed me that three checks cleared my account including one with my account information, but with a man's name and identifying information. The two with my name and personal identifying information, including my California driver's license number, were signed with signatures that were obvious forgeries.

The bank was on notice that my bank statement was lost or missing and three checks totaling $3,000+ cleared before we all figured out what had happened.

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Credit Guard Mania and Loss Control

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Whether the forgeries should have been caught before they went through is not the issue.

Nothing short of closing my checking account could have prevented this outrage, unless you consider I should have locked up my cancelled checks in the first place. I hadn't thought about that.

I shall spare you the agonizing details of what I went through to clear my credit and my good name. It was infuriating that I had to get "me" back from the imposter(s) and the thieves who procured my checking account information.

As an attorney, I am comfortable advocating for myself and navigating the various agencies including the Police Department, State Department of Motor Vehicles, Social Security Administration, and others, which must cooperate to facilitate the resolution of identity theft. I was unintimidated by bureaucratic red tape and I prevailed. It took three months to get a new driver's license and write checks at establishments that subscribe to Tele-Check. Three fraudulent checks with my identifying information were passed, but no fraudulent credit card charges, loans, or crimes were effected in my name. I consider myself lucky.

Like most identity fraud victims, I am not certain how my personal information was stolen, but I have a theory. The thieves did not get my driver's license or credit cards or blank checks. They got my personal identifying information from my cancelled checks and printed their own with my identifying information.

I was immediately aware that something was awry, but I didn't go far enough to prevent it.

Remember the Independence Day burglary? The burglars either got into my filing cabinet or they stole the mail out of my USPS approved mailbox and lifted my personal identifying information from my checking account statement. Neither the filing cabinet nor the mailbox was locked.

The filing cabinet held paid medical bills and general correspondence. I thought locking up blank checks was sufficient. Who would want my paid medical bills and cancelled checks, anyway? Identity thieves want your personal identifying information too. It can happen to you.

Little did I know that there had been a rash of identity theft on the Garden Highway. I should have closed my checking account. Had I known then what I know now, I absolutely would have closed the account.

Credit monitoring and insurance are critical components of personal finance risk management. However, prudence and prompt action reduces the risk and minimizes the consequences of identity theft. Preventing the harm in the first place is the least expensive way to treat the risk of identity theft. Insurance purchasing decisions should be made in consideration of a well-thought-out loss prevention plan and a commitment to implement and monitor. ■

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