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Retail Agents, Wholesale Agents, Managing General Agents: Strategic Advisory Director/Consultant Retained to Find Insurance Company Markets

by Andrew J. Barile, CPCU

Andrew J. Barile, CPCU, is the owner and founder of Rancho Santa Fe, California-based Andrew Barile Consulting Corporation Inc., a strategic insurance and reinsurance-consulting firm providing unique and creative insurance solutions to members of the insurance industry. Barile has more than 40 years of experience in the industry, and has worked with several types of insurance firms, including wholesale insurance brokers, MGAs, reinsurance intermediaries, captive insurers, and many more. For more information, visit www.abarileconsult.com or e-mail abarile@abarileconsult.com.

One of the most important things agents can do for themselves and their agency is to maintain positive, healthy working relationships with the carriers they place business with. Unfortunately, despite their best intentions, maintaining these relationships is often overlooked in lieu of the other activities agents are faced with in their daily lives.

We've all seen this scenario: a carrier suddenly "goes under" after years of being in business. As an agent, maybe you had quite a few accounts with them. Maybe the carrier's insolvency seriously affected your business. How did you handle this? What would you do differently if faced with the same situation today?

What about rating downgrades? Do you constantly monitor the ratings of the carriers you place your business with? Do you know how to identify the telltale signs of a carrier in financial trouble? Where are you going to place all of those accounts if a carrier goes insolvent?

I previously discussed the importance of assembling a strategic advisory board, composed of several members who have expertise in a particular area (IJ West, May 17). One such member should have expertise in agency/carrier relations. This individual will be responsible for maintaining the agency's relationship with insurance carriers on a full-time basis.

The insurance company strategic advisor's responsibilities will be to not only maintain carrier relations, but also serve as your eyes and ears to the marketplace. With careful oversight, your advisor will not only be able to identify the signs of a carrier in financial trouble, he or she will be able to identify a viable market should you need to replace any accounts.

Why Is the Agent-Carrier Relationship So Important?

When the market is soft, the carriers are likely to be pounding on your door for

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business, right? But when the market hardens and availability shrinks, carriers sing a different tune. All of a sudden the phone stops ringing and the agency seems to be all but forgotten by the carrier.

As a producer, you know that the market runs in cycles, and you need to be prepared when the phone stops ringing. How are you going to maintain those relationships you have with carriers when the market goes hard?

The answer is simple: get on a plane with a business plan and proposal and fly around the country to meet with the CEOs of the carriers you represent. You have time, don't you?

Probably not. So you need to consider bringing in a person to maintain those relationships for you. That person is the perfect addition to your strategic advisory board. Working together with your mergers and acquisitions expert, your agency growth expert, and your legal/tax advice expert, your carrier relations expert will enhance your agency's overall performance and growth.

Building Your Agency-Carrier Relationship

Your first step to building your agency-carrier relationship is to review your agency's operating budget. This may seem obvious, but so many agencies neglect to carve out a piece of their budget to maintain carrier relationships! It's important that you allocate a certain amount of commissions in your operating budget to maintain relationships with carriers.

Next, carefully select a member of your strategic advisory board to represent the agency in fostering agency-carrier relationships. As discussed in the previous article, there are several qualities you will want to look for when selecting your carrier relations expert. The ideal candidate has access to senior executives of both insurers and reinsurers and is savvy when it comes to dealing with executives at major industry events and company seminars such as the AAMGA, NAPLSO, and the NAII.

> ***Now that you've got your expert in place, the real work can begin.***

Your expert will also need to have a clear and solid understanding of the reinsurance marketplace. Oftentimes the carrier tells agents that his or her agency contract is cancelled because the carrier has lost its reinsurance, and therefore has to stop writing business. Your insurance company strategic advisor will need to have an in-depth understanding of how carriers structure their reinsurance and how reinsurance drives the underwriting cycle.

Finally, you will want to find someone who has an understanding of yellow financial statements and insurer insolvency, as well as insurance company product development.

Now that you've got your expert in place, the real work can begin.

Your insurance company strategic advisor will be expected to spend a significant time on the road making contact and networking with the heads of the carriers you represent. By doing this, he or she will solidify your agency's presence to the carrier, as well as your relationship with him or her.

The first step an advisor will take is to examine the existing relationship the agency has with a particular carrier. The expert should ask the carrier a lot of questions—simple questions that are important when taken into context. For example, what have the loss runs been for the past two years? How much money is the agency making for the carrier?

Also, take a look internally at your relationships with carriers. How many carriers are in your agency? Which carrier do you feel you have the most significant relationship with? How much commission are you bringing in as a result of that relationship? What works best about that relationship, and what can be improved? Has the carrier asked to change the contracts at all? Has the carrier asked to extend the cancellation terms in the contracts? Has he or she asked for a bigger contingent commission?

Maintaining Your Agency-Carrier Relationship

When your insurance company strategic advisor is not on the road to amplify your agency's presence to the carriers, he or she should be maintaining relationships through good old-fashioned telephone communication. He or she should also be spending time reading rating agency assessments of carriers, monitoring insurance company turnover, and following when insurers are up for sale.

In addition, your advisor can assist in other agency matters as well, such as reading and litigating agency/carrier agreements. He or she should be expected to keep up with what is going on not only in the marketplace as a whole, but with individual carriers. For example, does your carrier place a lot of business with your competitors? Who's retiring in the field? What's going on with a carrier that they are **not** telling you? Your advisor is responsible to gauge the marketplace and help you make decisions that will best benefit the agency.

Finally, your advisor will be responsible for finding new markets when old ones leave the business. He or she should always have "feelers" out in the marketplace to be able to easily identify a source for a new program when needed. ■

An International Educational Experience

by Chris O'Donnell, CPCU, ARM, AMIM

Chris O'Donnell, CPCU, ARM, AMIM, is the director of corporate risk insurance management for M&T Bank, which is estimated to currently be the eighteenth largest commercial bank in the United States. He remains affiliated with M&T's Property & Casualty Insurance subsidiary Matthews, Bartlett & Dedecker, Inc.

Earlier this year your editor had the pleasure and honor to participate in the 24th Annual PIAS Seminar series held in San Francisco, April 19–21. I was asked to put together a seminar about the current state of banks in the insurance business in the United States. The attendees included a few dozen Japanese insurance professional men and women who traveled to the United States for the educational series.

Actually, I was first asked over a year ago through John Kelly, CPCU, of the CPCU Society who referred me as an insurance professional now with a bank to former CPCU Society president Roger Smith, CPCU, who has been instrumental in this program since its inception. My originally scheduled involvement last April was postponed until this year because of the 2003 invasion of Iraq.

This was a unique experience for me since it was the first such presentation I've put on where the audience and I did not necessarily speak the same language, so I did not know what to expect. Sue Noda, president of SGN Pacific of San Francisco, was present to translate my spoken presentation and the questions from the participants. She also translated my PowerPoint slides and handouts beforehand. She did a wonderful job.

What I learned was that I was given a wonderful learning opportunity to a most gracious group of like professionals from Japan. Although the language issue seemed great at the outset, it melted away very soon after I began my presentation. My lovely wife Patricia assisted with the computer graphics while I spoke.

Our new friends and we began with small talk and, of course, the cliché photography. I think we broke the ice when we took out our camera and returned the picture taking with the participants . . . the place erupted in laughter. It generated almost as much laughter as when I tried to greet them with Konichiba, or hello in Japanese.

I also learned that the Japanese recognize the CPCU and ARM professional designations, and that aside from the language difference, we insurance professionals seem to think similarly. As of this year, the CPCU Society has chartered a Japan Chapter.

My topic required me to research the historical development of banks in the insurance business in the United States. I discussed the legal events leading up to Gramm-Leach-Bliley, resulting in the current bank involvement in our business. Many thanks go to the CPCU Society, particularly to Michele Ianetti, AIT, and John Kelly, CPCU, for finding old articles for which my computer searches located only titles. The Society also graciously permitted me to reprint and distribute key articles for my discussion.

My presentation turned into a vigorous discussion with lively classroom participation that any instructor would relish. I'm told that such participation by the Japanese is usually rare; however, the topic was of great concern to them in view of the pending encroachment of the Japanese banks into the insurance markets.

Their concern is not unlike the perspective held in the United States during the nearly 20 years of discussion leading up to the current state of financial deregulation in GLB that permitted the practice here. Our experience was of great interest to them.

Their banks are much larger than ours and hold much more sway in business dealings than ours. Many of the protections to individual privacy and the protection of the independent insurance agent such as proscription of "tying" practices provided here are not present in Japan.

Nevertheless, my message was that superior professional service provided by knowledgeable experts is what makes the deal, not the bank connection by the sales professional. Those banks that espouse such characteristics will be formidable competitors; however, those independent agents that do so already are. ■

Accessing Fronts (Insurers) for Captive Insurance Companies

by Andrew J. Barile, CPCU

Introduction

Property and casualty insurance company management has come to learn that fee income from "fronting" or "policy issuing" can become a very lucrative business to increase the return on investment in their insurance company. The ability to provide:

- A corporate owner of an offshore insurance company with the ability to write in a licensed insurer . . . PEO owners need it desperately for workers compensation insurance, especially within the states of California and Florida.
- Group of insurance agents who jointly own the offshore agent owned captive insurance company a "fronting" vehicle.
- An association of roofing contractors with a "fronting" carrier for its insurance needs, usually general liability insurance.

The above examples, combined with the hard market-underwriting environment, provide the "fronting" insurer with significant fee income in its financial statement.

On this basis any licensed United States insurance carrier can be a front for a captive insurance company as long as the opportunity can be quantified and an agreement made.

In accessing "fronting" carriers you usually encounter a specific department to do this, called the Alternative Risk Transfer Department. However, searches for fronts can be extended to any license carrier and is usually discussed initially with the president of the insurance company.

Understanding the Cost of Fronting

Too often, the fronting fee is simply expressed as 10 percent, or 5 percent pure profit plus actual expenses, and front fees are increasing. Unless you have specifically negotiated a fronting fee, this is all conjecture. The negotiation process must be done by professionals who understand the carrier's true costs when it comes to "fronting."

What would the fronting fee be to provide a workers compensation "front" in California? Look at the top-10 comp writers in California and ask them to "front" a workers comp captive. What would be the ranges of costs to front, 5 percent to 15 percent?

The true cost of fronting where it does have fixed components:

- state premium taxes
- insolvency fund assessments that are going up because of the number of insurance company failures
- insurance company overhead expenses are increasing
- costs of policyholder surplus utilization
- profit margin, meaning the pure profit margin that varies by insurance companies' management financial philosophy

As an example, some insurance carriers spend too much money on office furnishings and, therefore, that cost is reflected in the costs of their fronting fee. Some carriers want to make a minimum fronting fee per captive insurance company account. Some carriers did not even have an economic model to use for fronting, and those carriers are now part of the solvency fund assessment for the carriers that do have economic models to work with when fronting captives.

How do you know when you have the proper price for fronting? When have you exhausted all the possibilities of fronts, which can be 2,300 insurers operating in the United States in an ideal situation? All of which are licensed admitted insurers. The front fee is paying for all the work that goes into maintaining a state insurance company license.

As an aside, the cost of some state licenses have increased to more than $125,000 per state, especially as all the Bermuda reinsurers were searching for U.S. shell insurers. Some 25 years ago, you could purchase a "shell carrier" for $25,000 per state license.

Proposal Going to Front Company

In the negotiating process, for a front company, emphasis must be made on quantifying the opportunity. Corporate owners, agent owners, and even association executive directors, all of whom have captive insurance companies, need to look at this negotiation as an economic exercise.

The captive shows up on the licensed insurer's financial statement as a non-admitted reinsurer. How does the front company protect itself from the captive owner from dividing out all of the capital of the captive once the captive was able to secure the license in the offshore domicile?

Understanding Offshore Insurance Company Domiciles

You, the captive insurer, must understand that the offshore insurance company must be run or managed professionally.

Recent events have caused all of us to look closer at some of the offshore domiciles, and make sure they are managing the captives properly.

What experience does the Board have in running an insurance company? Does the captive want to be rated by the rating organization?

Negotiating the Reinsurance Agreement between the Front and the Captive

The owner of the "front" insurer is looking to protect itself from having to pay claims, and the owner of the captive is trying to prevent the "fronting" from going into liquidation.

Experience has shown over the years that both sides are guilty, and in litigation consulting services, the truth is in the courtroom. Examples of legion fronting agent-owned captives, and Reliance/Kemper fronting corporate-owned captives have taught us many lessons, even "A"-rated fronting companies can cause risk, and have to be evaluated financially.

Captives going insolvent have also become a problem, particularly in areas where the judgments have been so great in the nursing home business that they bankrupt the captive that did not purchase proper reinsurance protection.

Letters of Credit

On the basis that the captive insurance company has to secure the "front" company, letters of credit and/or trust arguments can be used. This has been the way bankers can get into the insurance business because the banks provided the LOCs and the trust arguments. Exploring both options, as well as their respective costs, is also necessary. Some insurers have been known to overfund their letters of credit, so the captive owner better understand the process of quantifying the amounts of a letter of credit for non-admitted reinsurance purposes.

Insurance Trust

The cost of letters of credit and the stacking of letters of credit for each underwriting year to the captive in business have all led, years ago, to the introduction of the insurance trust. The Regulation 114 Trust formulated by the New York State Insurance Department has given the captive another option to secure the "fronting" carrier.

Banks like trusts because the captive owner usually deposits funds in the trust, which the banks like to manage. The amount of the fund, once again, requires professional negotiating, particularly on start-up captives. Fronting carriers like the trust since they can draw upon the trust should the captive be a slow payer.

Significant focus must be paid to concepts like shareholder loans, investments, and losses.

In accessing potential "fronts" if they favor an "LOC" or if they favor a "trust" maybe decided already for the captive owner. The consequences for both should be part of your business plan or initial feasibility study.

Financial Statements of Offshore Insurance Companies

Many of the "front" insurance companies today have financial analysts reviewing the statements of the offshore insurer. Since the chartered accountants do not have to be the big four or is it three, the following reports are closely scrutinized:

1. balance sheets
2. income statement
3. cash flow statements
4. notes to finance statements

Significant focus must be paid to concepts like shareholder loans, investments, and losses. Most of the abuses of single parent-owned captives have come from these three major areas. Estimates of potential losses have been understated giving rise to captive failure, very little of which is known since there is no system instituted to track offshore insurance company insolvencies.

Conclusion

The ability of seeking out the culturally correct fronting carrier requires an in-depth knowledge of the insurance industry. Access to senior management of fronts also helps to eliminate the usual disconnects going on in the large bureaucratic insurers. Remember the cost for a front, 5 percent, 7.5 percent, or 12 percent is totally negotiable; there is no manual, nor are their guidelines to follow. It requires knowledge, options, and the ability to access many carriers to find the ideal fronting insurance company. ■

C

Living a CPCU Life

by Chris O'Donnell, CPCU, ARM, AMIM

Your editor was recently asked to be the keynote speaker for the CPCU Society Buffalo Chapter's Candidate Development Luncheon. This event is held annually and I've attended many over the 20-plus years I've been a CPCU and have heard many such speakers. This is essentially a truncated version of what I said during that event.

Now, I've never considered myself to be among those in the category to be honored as the keynote. Normally that is reserved for eminent speakers, not me! When I reminded **Jim Chavanne, CPCU,** the CPCU Society's Buffalo Chapter Board member who invited me to speak, he mentioned that, in his mind, I was living a CPCU life and that would be interesting as a topic for this event. I never thought about what I've been doing in that way before.

That got me to thinking about that concept . . . living a CPCU life and I guess I am doing exactly that. I just always thought it was my way of earning a living the best way I could.

The CPCU concept was introduced to me by **Bernie Martin, CPCU,** my first manager in the insurance business. He sold the concept to me as the premier professional education program in the insurance industry. He told me that it would provide me with the key to tremendous opportunities in addition to the education.

At the time I was 20 years old and had never heard of CPCU. Heck, only a few months earlier, the only thing I knew about insurance was that it was too expensive, but New York said I needed it to drive my 1972 Ford Pinto. A very safe, sturdy automobile of the era, indeed!

Well, I was young and still single so what else to do with my time? I studied. I have never regretted that decision. In fact, each professional opportunity that has presented itself to me since that time has been directly or indirectly attributable to my association with CPCU. The superb education initially and continuously ever since has helped me in my job performance. More importantly, however, the people that I have met through the experience afforded by my participation in the process are the best reward.

Each job opportunity came directly through the networking and friendships I've developed over the years through Society involvement. Those opportunities allowed me to work with and for some of the finest people in the business community, in my opinion, our fellow insurance professionals. I'm also blessed with the best support people around, many of whom are CPCUs or candidates.

Each job opportunity came directly through the networking and friendships I've developed over the years through Society involvement.

Although the business has been financially rewarding, some of the more rewarding opportunities involved little or no pay. Local service including each of the officer chairs in the Buffalo Chapter helped develop lifelong friendships. Teaching opportunities including CPCU and university courses also came along. In fact, many current local CPCUs were students of mine. After a sabbatical, I was asked to consider national service. Those experiences were and are among my most rewarding.

Being the current editor of *Agent & Broker Solutions* newsletter has expanded my learning opportunities as well as my circle of friends from within this profession. It has also helped me to sharpen my writing skills as well as my typing! Any good secretary will still put me to shame in that department; however, I can now make Mr. Gang, my Salesian high school typing teacher, feel better about the "C+" typing grade that he gave me in 10th grade.

I've recently been traveling quite a bit in the course of my recent professional endeavors. Aside from the semi-annual CPCU Society and NLI business meetings and educational conferences, held in great locales, I've been fortunate to travel, to teach, learn, politic, negotiate, network, and have a little fun along the way.

As a risk manager and member and officer of RIMS, I took part early this spring in "RIMS on the Hill," which it sponsors annually in Washington, DC. It was quite an enlightening experience. Many of the risk managers in attendance were also CPCUs from prominent companies. It is my opinion that we as professionals must, in our own ways, take the time to educate our elected leaders so that they can intelligently tackle the number of problems our industry faces. The RIMS event was merely one means of attempting to do that. I hope to participate again next year.

Upstate New York RIMS, for which I'm the secretary this term, invited me to speak recently on the topic of enterprise risk management. At M&T Bank, we are in the process of developing an enterprise risk management concept so the topic was interesting for me to present.

Earlier this Spring, through association with some wonderful folks I've met through CPCU Society service, I had the distinct privilege of participating in a seminar series offered to a few dozen Japanese insurance agents in San Francisco put on by the PIAS. I've also had the opportunity to travel to London for business. These are trips that I otherwise would not have probably taken.

The international experiences were great learning and networking opportunities. Many of us have shared similar experiences and more that were made possible by our professional success, a great deal of which can be attributed to the opportunity available through association with the CPCU Society.

I mention the opportunities aspect many times herein for a reason. My good fortune to live a CPCU life has afforded me many opportunities, many of which I have chosen to accept. Those who know me have heard me mention that choices are good and that I like options. I have been blessed with many and this career has allowed me to explore many of the dreams I've had—earn a good living, lifelong learning, teaching others, friendship and camaraderie, travel, professional satisfaction, leadership, resilience, and so on.

My career thus far has included claims adjusting, risk management consulting, teaching professionals and undergraduate university students (two very different groups), brokering, and now corporate risk management for a Fortune 500 as well as S&P 500 company. I'm having a great time and I do not believe I've reached the pinnacle yet.

As Marv Levy, former head coach of the Buffalo Bills during their Super Bowl years, used to say, "Where else would you rather be than right here, right now?" For me, it's here, no question. ■

2004-2005 CPCU Society Chapter-Sponsored Workshops Off to a Fast Start!

If you're looking for the latest technical and leadership information, be sure to check out the CPCU Society web site at http://www.cpcusociety.org/?p=16012.

The fall schedule is the most robust we have ever offered, so look for a workshop in your area. Here's the 2004-2005 schedule as of early September; by the time you read this newsletter, it's likely there will be even more opportunities to acquire the knowledge and skills you need to succeed! ■

Date	Location	Title	Cosponsor
9/28/04 (a.m.)	Uniondale, NY	2004 CGL	Long Island Chapter
9/28/04 (p.m.)	Uniondale, NY	Insuring Defective Construction	Long Island Chapter
9/29/04 (a.m.)	Boston	2004 CGL	Boston Chapter
9/29/04 (p.m.)	Boston	Umbrella and Excess Liability	Boston Chapter
9/30/04 (a.m.)	St. Paul, MN	Hidden Coverages	Minnesota Chapter
9/30/04 (p.m.)	St. Paul, MN	Insuring the eCommerce Account	Minnesota Chapter
10/19/04	Princeton, NJ	Contractual Risk Transfer	Central Jersey Chapter
11/12/04	New Cumberland, PA	2004 CGL	Central PA Chapter
11/16/04 (a.m.)	St. Louis, MO	2004 CGL	St. Louis Chapter
11/16/04 (p.m.)	St. Louis, MO	Umbrella and Excess Liability	St. Louis Chapter
11/18/04	Worcester, MA	Executive Liability	Central Massachusetts Chapter
1/20/05	Springfield, MO	Insuring Defective Construction	Ozark Chapter
3/29/05	McLean, VA	Time Management	District of Columbia Chapter
3/29/05	McLean, VA	Analyzing Time Element Exposures	District of Columbia Chapter
4/21/05 (a.m.)	Worcester, MA	2004 CGL	Central Massachusetts Chapter
4/21/05 (p.m.)	Worcester, MA	Umbrella and Excess Liability	Central Massachusetts Chapter

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