RMQ

Risk Management Section Quarterly

Vol. 18 No. 1
February 2001

CPCU SOCIETY

Agent/Broker Differentiation—A Risk Manager's Perspective

by D. Theodore Flores Jr., CPCU, and Earl D. Kersting, CPCU

As brokers and agents encounter increased competition, not only for new business but also for existing clients, they continue to seek a competitive edge. This article identifies a number of attributes that risk managers (clients) value in their agents and brokers (brokers). From a client's perspective, many of these attributes hold true without regard to the size of the broker's organization or the method of compensation.

Competence is a fundamental attribute that all clients value. The core competency of all brokers is their ability to obtain broad coverage at an equitable premium consistent with the needs of their clients. For the purpose of this discussion it is assumed that all brokers possess this core competency equally. Obviously, this may not be the case in real life. Incompetence can only be camouflaged for a short period of time.

Intertwined with the above competency is the broker's knowledge and understanding of the client's business, its ability to identify the client's specific needs, and to create solutions. Knowledge of the client's industry or trade is useful, but not sufficient. It is impressive when a broker can demonstrate knowledge of the client's specific business. Client-specific knowledge is not necessarily the ability to recite financial details, but is evident in the quality and depth of questions asked. This depth of knowledge is necessary in order to generate ideas useful to the client.

A broker will be successful if it can establish itself as a business partner with the client. A broker's ability to build internal and external partnerships was identified by risk managers as the number one satisfaction driver in a survey conducted by the Quality Insurance Congress (QIC) in cooperation with the Risk and Insurance Management Society. But how does an agent or broker become a business partner?

Trust is the key to any lasting business partnership. Many people believe that trust is built on technical competence, while it is actually built on a foundation of clear and honest communication that flows in both directions.

As a business partner, a broker can expect that its advice will be sought in a variety of matters outside of its core competency. These matters may include claims advice, loss control consultation, risk management information, business advice in matters of contracts and leases, business contingency planning, mergers, acquisition and divestiture due diligence and subsequent business integration, and more. Thus, this becomes a natural area for differentiation. The need for assistance in these areas will depend on the level of internal expertise possessed by the client.

The broker must make its resources known and readily available to its clients. The "readily available" part is important. If it is cumbersome for clients to access the resources within its broker's organization, the client may give up in frustration and this, in turn, can begin to erode the relationship. It can also be damaging when a client learns of current or new broker services from other risk managers rather than directly from the broker.

Becoming the eyes and ears of its clients and providing cutting-edge information can be another competitive edge for the broker. Inform clients of developments in the insurance market, and of the introduction of new products or services. It is an advantage to the broker if it can provide its clients with industry-specific information, such as legislative, regulatory, litigation trends or case law, technology, etc. It is an advantage to the client to be well informed in front of his or her superiors. The broker should be sensitive to the client's planning, budgeting, and fiscal year-end needs so that information can be provided when the client needs it.

Web-based communication between the broker and client can be a positive enhancement. This can allow for the paperless gathering and storage of risk information, and streamline the insurance application process. The inclusion of hyperlinks to other frequently used risk management web sites and/or to the client's insurer's claims database could be useful. The more web-entangled a

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client and broker become, the more difficult the breakup of the relationship.

Finally, even though a broker may enjoy a long-term relation with a client, the client should be treated as a "prospect" from time to time. The broker needs to take the time to ask in-depth questions about the client's business and its strategic plans. The partnership will be stronger if the broker knows where the client's business is going. However, don't overlook the basics just because you've been there before. You may miss an opportunity.

There is nothing magical about the above guidelines, but simply good business. ■

D. Theodore Flores Jr., CPCU, *is corporate risk manager, Griffith Laboratories International, Inc., managing all aspects of the company's risk management programs. Flores has a bachelor's of business administration degree from the University of Iowa, and holds the ARM (Associate in Risk Management) and AIC (Associate in Claims) designations in addition to CPCU. Ted has served on the Risk Management Section Committee since 1993, the past three years as chairman.*

Earl D. Kersting, CPCU, ALCM, ARM, AAI, AIC, *is the safety, health and claims manager for the Kroger Co., Delta Division. He earned his bachelor's degree in risk management and insurance with honors from Ohio University, and has worked at Kroger since 1974. Kersting has recently been appointed to the CPCU Society's Risk Management Section Committee.*

Spotlight on Risk Management Committee Members

Earl D. Kersting, CPCU, was born in St. Charles, Missouri, but his career relocated him to his current home, Memphis, Tennessee. He earned his bachelor's degree in risk management and insurance, graduating summa cum laude from Ohio University. In addition to earning the CPCU designation, he has earned the ALCM (Associate in Loss Control Management), ARM (Associate in Risk Management), AAI (Accredited Advisor in Insurance), and AIC (Associate in Claims) designations.

Earl began his current career with Kroger as a sacker in high school. During his 26-year career at Kroger, his one and only employer, he worked his way through the ranks, having worked in practically every department in the store before advancing to store management, and then administrative management. He has been in the Risk Management Department since 1986, where his roles include safety, health, claims, and regulatory compliance, and where he supervises three workers compensation and two general liability adjusters, and a support staff to handle the needs of 110 stores located in five states.

Having earned his CPCU designation in 1998, he has already progressed to the position of president-elect of the Memphis Chapter and writes and publishes that chapter's monthly newsletter, a task he undertook following his second chapter meeting.

Earl decided to become a Risk Management Section Committee member because he wanted to have hands-on involvement and wanted to learn more about the field of risk management beyond a retail environment, and as he loves to write, hopes to regularly write articles for the *Risk Management Quarterly*. ■

Contract Analysis: Value-Added Service or E&O Exposure?

by Jack P. Gibson, CPCU, CLU

In the October 2000 issue of *IRMI Update*, International Risk Management Institute's e-zine, I expressed my opinion that U.S. agents and brokers should review contracts to analyze the risk and insurance implications for their clients whether or not it increased their E&O exposures. Since insurance distribution transactions can be completed in an ever-growing number of ways, agents and brokers who fail to provide demonstrable value added beyond the transaction will have indeed have reduced E&O exposures—because they will be writing less business!

Agents and brokers must provide these types of value-added services to prosper in a dramatically changing insurance environment. Such services can give a competitive edge over other firms, causing clients to consider something other than price when choosing insurance advisers. The risk management process should then be applied to handle the resulting E&O exposures. Account teams must be well trained, they must be given the resources necessary to provide a professional level of service, and standard procedures must be implemented to assure a quality work product.

Interestingly, this topic was also tackled by a panel, "The Agent and Broker as Risk Manager: An E&O Time Bomb," at the CPCU Society's 56th Annual Meeting and Seminars last October. The panelists seemed to all agree that agents and brokers need to provide value-added services beyond providing access to insurers, and one of the services mentioned included reviewing contract provisions. The panelists also said that the E&O exposures from these activities should be handled with risk management and insurance. For example, they recommended sending copies of the contracts reviewed to the underwriter for discussion.

The benefit of an e-zine is that readers can easily respond to the editor, and I asked our readers for their opinions. I received 68 e-mail responses. Below are some unedited excerpts from them. They are very enlightening, and most overwhelmingly support the opinion that contract analysis is a needed and necessary value-added service. However, a few readers do not agree. As can be seen from the comments, this is a hotly debated topic, but it is clear that risk managers expect these services and agents are trying to differentiate their firms by providing them.

Opinions on the Value-Added Service Versus E&O Exposure Debate

"I expect the broker to be giving advice and recommendations in the area of risk management. Otherwise what are we paying them for?"

–Corporate Risk Financing Manager

"Not only is reviewing contracts and other agreements for clients part of our services, but also it is often necessary in order to transact insurance appropriately. Who better to interpret how a contract or lease impacts an insurance program than an insurance broker or agent?"

–Agent/Broker

"I think it is the unauthorized practice of law and would subject the agent offering such advice to criminal prosecution and civil penalties in addition to increasing the agent's exposure to malpractice suits. Unless the agent is licensed to practice law, he or she must not give legal advice about the legal import of any contract."

–Attorney

"Agents can't put their heads in the sand and just sell insurance. To succeed and grow, agents must look for ways to add value to their relationship with their customers. Increased E&O exposures go along with increased service and increased knowledge. But that's why we're here."

–Agent's E&O Insurance Market Representative

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"The so-called value-added service, from my perspective, is an essential element of the sales process. The exposure to lawsuits is greater for providing inadequate or improper coverage than it is to hiding your head in the sand. Moreover, if you do not provide the analysis, someone else will, and you will lose the business."

–Attorney

"The panelist was correct in pointing out the fact that we are increasing our professional liability exposure. But, he fails to mention that, by using proper loss control techniques, such as disclaimers on your coverage opinions, you can greatly reduce your exposure to a professional liability loss."

–Agent/Broker

"It's a fine line from contract review with advice to a client and Unauthorized Practice of Law (UPL) . . . I personally agree with you, because I review contracts all day long, and provide factual statements and advice to my company project managers. This isn't rocket science, but it's no wonder you were cautioned against it."

–Paralegal

"The CPCU Society, ARM designation, and IRMI have provided extensive analysis and valuable information in the matter of risk transfer without practicing law. In fact, it seems many attorneys have participated in these research projects. The qualifier that risk management, and not legal advice, is being offered, and a suggestion that an attorney review advice should reduce the exposure."

–Agent/Broker

"I agree with you wholeheartedly. If we follow the attorneys' advice, we do nothing. If we do nothing we've no way to separate ourselves from the hoards of agencies and brokerages that currently do nothing. How do they justify their fees and commissions? What real value are they bringing to their clients? It sure would be easy to do nothing, but in the long run the cost in lost business to those that provide these services would be too great. Fight the good fight and let's strive to do more not less for our customers."

–Agent/Broker

"I wholeheartedly agree with your view on the value-added services agents, brokers must provide. If a client (such as myself) were to bring that type of expertise in-house, it would be cost prohibitive."

–Corporate Risk Manager

"One could argue that to not take this action increases E&O exposures for not fully doing your job—more than one judge and jury has ruled that insurance agents are the experts, not the clients. Failure to not properly evaluate a risk and their exposures can not only lead to litigation, but also opens your book of business to those professionals who see this as an opportunity, not a liability. It all comes back to the old saying 'knowledge is power!'"

–Agent/Broker

"Attorneys just don't want to see non-attorneys 'practicing' law."

–Director of Environmental & Safety Affairs

"Once you present yourself out as an expert, you raise the level of duty, care, and responsibility you are required to meet. With this in mind, there is a fine line drawn here and I think the level of concern is a function of the situation and the risk appetite of the broker and client. . . . Valued added can be managing risk more efficiently and effectively. It can also be sharing risk management ideas and concepts. These things should not be an E&O exposure."

–Risk Manager

"As an attorney, I feel the tug of the inevitable temptation to assume that only attorneys can review contracts or advise on risks. But a knowledgeable risk manager or insurance broker has a wealth of experience and can provide invaluable advice. It would be a shame to waste it."

–Attorney

"Risk management is risk management. Sales are sales. I know some people who are capable of wearing both hats, and they're good at it. But I would never underwrite their E&O exposure."

–Consultant

"Guys like me with 40+ years as an agent/ broker, raised on the importance of knowing the technical aspects of what we provide our clients, are getting to be a vanishing breed. . . . My view is that if you are going to be sued either way, you may as well do the best job for your client that you can and take your chances. The inner-satisfaction that you receive from providing your clients with your best efforts is what makes being an insurance and risk management professional worthwhile to me."

–Agent/Broker

"I think that the agent who does not perform (or facilitate) professional insurance (and some basic risk management) functions has a much bigger problem than one who does and may be missing opportunities for success. Most of the (few remaining) national brokers are focused on selling professional services to large clients, rather than just insurance. But I think it isn't just for the Fortune 500 client. Here are four reasons:

- First, EXPECTATIONS OF THE CUSTOMER: Is 'selling' insurance, without some basic exposure analysis and relating that information to a coverage analysis, likely to meet the reasonable expectations of the client? What are the E&O implications of that course of action?
- Second, COST VS. PRICE: Often, price rules until a claim occurs; then, how well the client is served is measured on a different yardstick. Price can't be severed from product; the product that doesn't meet the client's needs isn't worth much. When the product doesn't meet their insurable needs at a critical time. . . .
- Third, THE SURVIVORS: The customer and the insurance company have an increasing number of alternative avenues to discover one another, why choose an agent? Can the agent make a convincing case without adding value in these areas?
- Finally, PROFESSIONAL SUCCESS: Satisfied customers are the ones who have their needs met well and problems resolved satisfactorily, according to the 'surveys and experts'. . . . Is it more rewarding for the agent to give a higher priority to serving and retaining good customers or prospecting to replace the ones that left in search of a better experience?"

–Insurance Company Representative

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Jack P. Gibson, CPCU, CLU, ARM, *is president of International Risk Management Institute, Inc. Gibson majored in risk management at the University of Georgia where he received a bachelor's of business administration, cum laude, in 1977, and a master's of business administration in 1979. In 1996, he was honored as Georgia's Outstanding Insurance Alumnus of the year.*

Gibson is the co-author of 11 reference works on insurance and risk management, all of which have been published by IRMI. Included among these works are Contractual Risk Transfer, Commercial Liability Insurance, *and* The Additional Insured Book. *He is also editor-in-chief of IRMI.com, his company's new web-based risk and insurance magazine. A sought-after seminar speaker, Gibson has been a presenter at many industry conferences, including the RIMS and CPCU Society annual meetings. He co-chairs the annual IRMI Construction Risk Conference, and has been a highly rated presenter at all of them. Gibson has also been very active in the CPCU Society, having served as a national director, on three national committees, and as president of the Dallas Chapter.*

Insurance Options

Editor's note: *This article is an excerpt from a monograph published by the Insurance Institute of America (IIA) titled* Capital Market Products for Risk Financing. *Michael W. Elliott, CPCU, AIAF, authored the monograph while employed by the IIA. Elliott now works in Philadelphia as a senior vice president of MMC Enterprise Risk, a division of Marsh & McLennan Companies.*

The last issue of RMQ highlighted the role of insurance-linked securities in transferring insurable risk. This article continues our discussion of capital market products for risk financing by describing insurance options, which also can be used to transfer insurable risk. The last section of this article compares insurance options to insurance policies.

In order to understand insurance options, it is important to understand options in general. An **option** is an agreement that gives the holder the right but not the obligation to buy or sell an asset at a specific price, called the **strike price**, over a period of time. A **call option** gives the holder the right to buy an asset. By contrast, a **put option** gives the holder the right to sell an asset.

A call option on a stock gives the holder the right but not the obligation to buy the stock at the strike price during a specified period of time. If the market price of the stock rises above the strike price during the period of time specified in the contract, the holder most likely will exercise the option because he or she can make a profit by purchasing the stock at the strike price and immediately selling it at the higher market price. If the market price of the stock does not rise above the strike price by the end of the option period, the holder is not able to exercise the option, and it expires with no value.

As an example, assume you have an option to purchase 100 shares of AT&T stock at a strike price of $70 per share over the next year, and the current market price is $60 per share. If, during the year, the market price of AT&T rises to $80 per share, you are likely to exercise the option. By exercising the option, you can purchase 100 shares at $70 for $7,000 and immediately turn around and sell those shares in the market for $8,000 ($80 x 100). You would realize a $1,000 profit on the transaction.

Figure 1 illustrates the relationship between the value of a call option to the buyer and the value of the underlying asset.

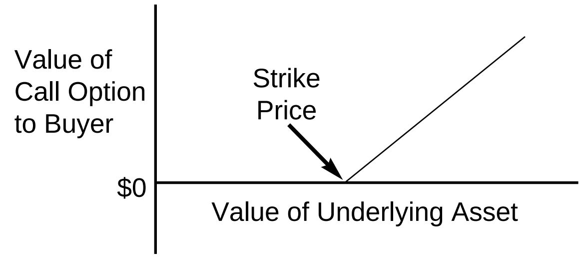

Figure 1

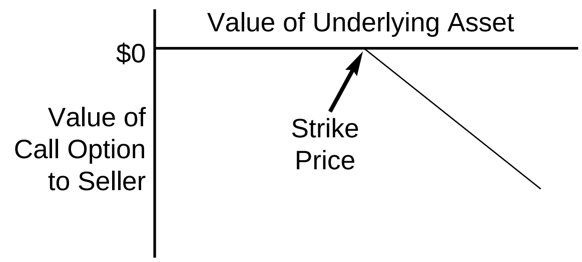

Figure 2

Figure 1 can be related to the example previously given. When the price of AT&T stock is above the strike price ($70 per share), the value of the call option to the buyer is positive. When the price of AT&T stock is below the strike price (less than $70 per share), the value of the call option to the buyer is $0.

The value of the call option to the seller is shown in Figure 2 as a mirror image of Figure 1.

As illustrated by Figures 1 and 2, when the value of the underlying asset exceeds the strike price, the option has a positive value to the buyer because it can exercise the option and realize a gain. If the buyer exercises the option, the seller realizes a loss equal to the buyer's gain, and the buyer receives cash from the seller. If the value of the underlying asset is below the strike price, the buyer is not able to exercise the option.

Table 1

Insurance Policy	Insurance Option
• Premium is paid by the purchaser.	• Premium is paid by the purchaser.
• Deductible or self-insured retention can apply to a single occurrence or to aggregate losses for the policy period.	• Strike value can apply to a single occurrence or to aggregate losses for the option period.
• Purchaser is indemnified if the level of insured losses exceeds the deductible or self-insured retention.	• Option increases in value to the purchaser if the level of underlying insurable losses exceeds the strike value.
• Has a policy limit.	• Theoretically, has no limit.

The seller of the option receives a premium from the buyer. The premium compensates the seller for accepting the risk that it will have to pay cash if the value of the underlying asset exceeds the strike price and the buyer exercises the option.

Insurance options have the same cash flow characteristics as insurance policies. For a call option, imagine that the underlying asset is individual insurable losses and that the **strike value** (similar in concept to a strike price but involving a value other than price) is set equal to the deductible or self-insured retention level under an insurance policy. In this case, the call option is an insurance option that serves the same function as an insurance policy with a deductible or a self-insured retention. The buyer of the insurance option pays a premium and receives cash when the value of the insurable losses exceeds the strike value (deductible or self-insured retention level) during the period of the option (the policy period). The seller of the option is in the opposite position (similar to that of an underwriter) because he or she receives the premium and must pay cash if the value of the insurable loss exceeds the strike value.

Table 1 compares an insurance policy with an insurance option.

Conclusion

This article explained the cash flow similarities between insurance options and insurance policies. However, insurance policies usually have a limit of liability, while pure insurance options do not. The next issue of *RMQ* will continue our discussion of insurance options by explaining the concept of an option spread and how it can perform the same function as an excess insurance policy by imposing an upper limit of liability. ■

From the Editor . . .

by Kathleen A. Murphy, CPCU

This issue includes two articles with essentially the same message. In today's world, agents and brokers must provide these services in order to survive and differentiate themselves from their competitors. A third article continues earlier discussions of alternative risk financing techniques.

We invite and welcome your comments on the articles included, not only in this issue but in any issue.

We continue to seek volunteers to write original articles, or submit previously published articles, of interest to members of the Risk Management Section.

You may e-mail comments and articles to me at: kandbmurphy@mediaone.net. ■

In this issue . . .

Risk Management Section Quarterly is published four times a year by and for the members of the CPCU Society's Risk Management Section.

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