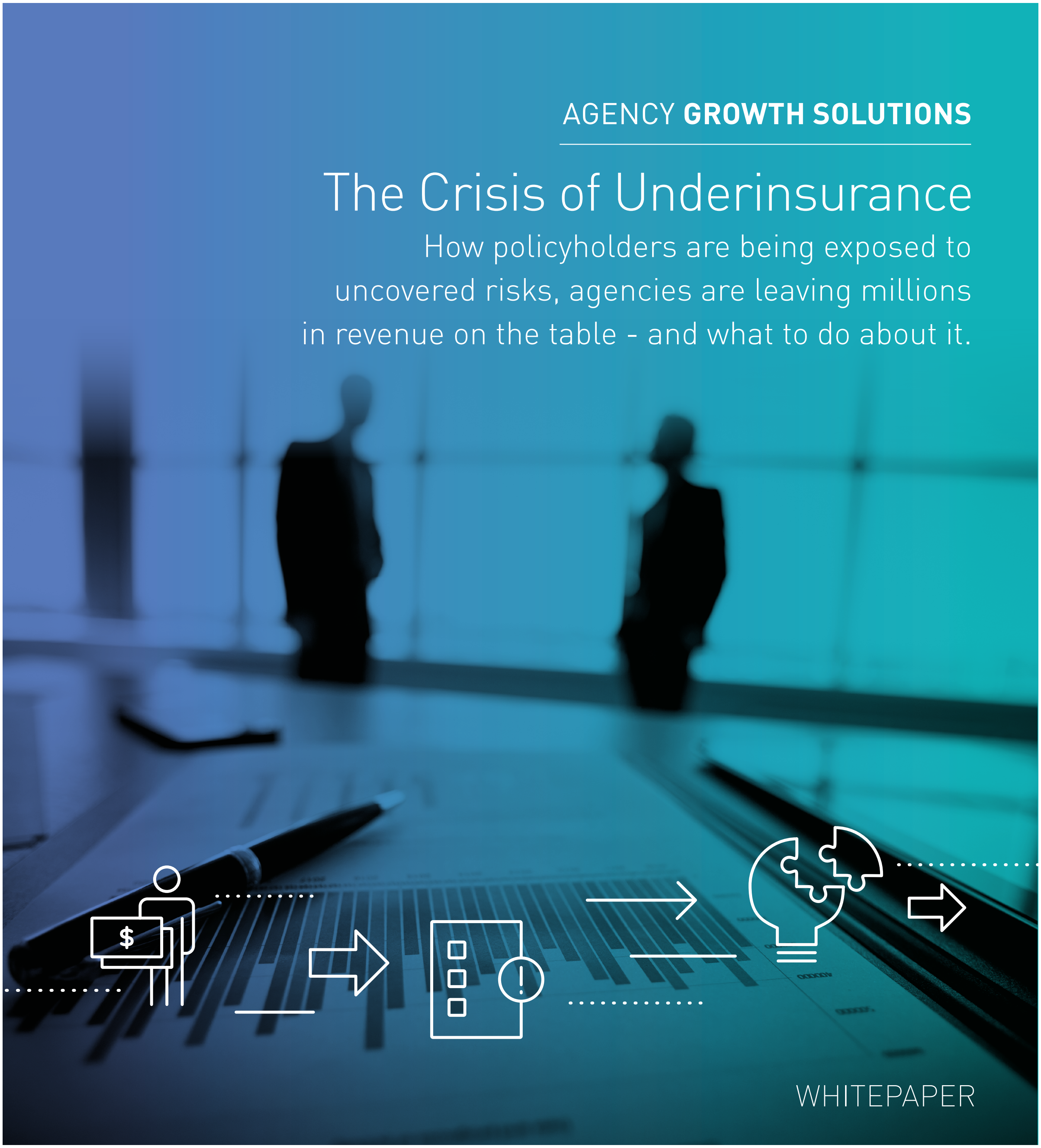
AGENCY **GROWTH SOLUTIONS**

The Crisis of Underinsurance

How policyholders are being exposed to uncovered risks, agencies are leaving millions in revenue on the table - and what to do about it.



WHITEPAPER

AN UNDERINSURANCE CRISIS

The insurance industry sells peace of mind. But for many business owners, the events of the past few years have left them feeling anything but tranquil. The COVID-19 crisis and its ongoing fallout have exposed and exacerbated several weaknesses in their insurance coverage. Whether it's issues with business interruption, the global supply chain, the scourge of ransomware and cyber security attacks, wildfires, or increasingly severe weather, it's clear insureds are facing threats from many directions.

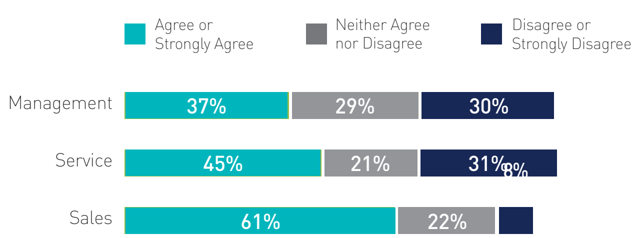
The most frightening part is that commercial policyholders are often woefully and chronically underinsured, the result of a confluence of drivers. A hardening market means that carriers are likely narrowing coverage as rates increase. Buyers have become habituated to shopping for insurance at the lowest cost possible, and agents are hesitant to contradict them. Producers themselves often lack the technical acumen to fully understand the coverages they sell, and may bind policies without even reading them. And finally, there's the complacency that comes with increasing revenues thanks to a hard market (which won't last forever), and from the fact that client turnover is extremely low. Renewals are, in a very real sense, theirs to lose.

At the same time, agents and brokers are under threat. They've become pushers of an increasingly commoditized product. They face unprecedented competition from insurtech companies with online, self-service business models that bypass agents entirely, as well as from increasingly ambitious large agency consolidators.

RENEW "AS IS"

Renewing an account without updated information is risky for both insureds and agencies. But it is a common occurrence. Almost two-thirds of producers say they rarely instruct service staff to "renew as is," but only 45% of service staff and 37% of management agree.[4]

Our producers rarely instruct service staff to renew "as is."



UNDERINSURANCE BY THE NUMBERS

40% of actual insured personal and commercial property value falls beyond quoted sums

3 OUT OF 5 homes in the U.S. are underinsured by an average of 20% below full value

34.6% of insurable North American average annual loss (AAL) is uninsured, resulting in an estimated **$32.7B** in unreimbursed cost to policyholders

45% of AEs think producers renew "as is"

[1] *Ronken, Leo, "Avoiding Underinsurance - Why an Accurate Sum Insured is Vital (but Often Neglected)," Gen Re Property Matters, January 2020.*

[2] *AIR, Global Modeled Catastrophe Losses, AIR Worldwide Corporation, November 2020.*

[3] *Feinman, Jay, "The Protection Gap in Homeowners Insurance: An Introduction," Rutgers Center for Risk and Responsibility, 2019.*

[4] *Insurance Journal, The Cost of Misaligned Insurance Sales and Service Teams, 2020.*

To combat these challenges, agents and brokers must rethink their roles. Rather than following along with a client's request, agents must take the lead with a risk-management approach that guides insurance buyers toward self-discovery of the risks they face. Accomplishing this requires a two-pronged strategy: agents must become more technically proficient to confront an increasingly complex market, and they must develop stronger leadership and sales skills.

THE BUSINESS AND PERSONAL COST OF UNDERINSURANCE

Does underinsurance truly rise to the level of crisis? Let's look at the numbers. Insurer Gen Re has found that that in the U.S., 40% of actual insured personal and commercial property value falls beyond quoted sums.[1] On the personal property insurance side alone, three out of five homes in the U.S. are underinsured by an average of 20% below full value, according to property data aggregator CoreLogic.[2] And risk assessment firm AIR Worldwide reports that 34.6% of insurable North American average annual loss (AAL) is uninsured, resulting in an estimated $32.7 billion in unreimbursed cost to policyholders.[3] Think for a moment what this means to a homeowner or business owner. They sleep soundly at night, assured by their agent that their $1 million investment was fully covered, only to learn after a catastrophe that they will have to spend anywhere between $200,000 and $400,000 out of pocket to rebuild.

That agent hasn't just failed to serve their client well. He or she has also cut the agency's commission revenue by the same 20% to 40%. For an agency with $5 million in revenue, that's at least a cool million left on the table, and potentially double that amount.

THE COMPLEXITY ISSUE

No question about it, insurance is complex, and policy forms and endorsements are a tangle of legal details that can obscure high levels of risk if not reviewed carefully. Coverage limits are just the tip of the iceberg, and what the big print on the coverage page giveth, so to speak, the small print on the forms taketh away. It boils down to this: An insurance form covers everything—except what it doesn't cover. Neither the buyer nor the agent should make assumptions about exactly what a policy contains, lest they receive some very nasty surprises in the event of a claim

An insurance policy is a contract, and it is the obligation of policyholders and their agents to read it. The cost of not doing so can be life-changing for a policyholder, with consequences that include financial ruin.

Here are just a few examples of oversights and incorrect assumptions we've come across among clients:

- **Insured name:** Getting the name of the insured entity correct should be a simple matter of looking it up in a state's business database, yet it's shocking how often agencies fail to do so. Of the 2,540 policy name errors flagged in a 12-month study conducted by ReSource Pro, 208 (8%) required endorsements to the carrier and could have led to a denial of claim if unaddressed.

- **Building replacement value:** The replacement value of a building does not include bringing it up to current building codes. Without building ordinance insurance, for instance, this can add significant uncovered costs.
- **Demolition of unaffected structures:** When government officials condemn a structure and order its demolition following a direct physical loss to the structure, who pays for it? Only if the risk was identified and addressed explicitly with an ordinance or law coverage policy would the carrier cover the loss. Typical commercial property policies limit such coverage significantly, creating the possibility of uncovered losses.
- **Loss of income:** The typical length of a commercial property's loss-of-income coverage is 12 months. But it is more likely that rebuilding, say, a manufacturing facility would take 24 - 36 months. Similarly, loss of income due to power loss off the premises (for example, at the utility's facility) may require additional coverage.
- **Food spoilage:** By the same token, food spoilage caused by an off-premises power loss might also require additional coverage.
- **Property in transit or stored off-premises:** Knowing when a business takes ownership of property in transit is crucial. Is it when it leaves the factory? When it's loaded onto trucks or rail cars? Or when it arrives at the policyholder's loading dock? One client told us they needed $50,000 in coverage for property in transit, because that's the value of the goods they delivered to their own customers (a designation known as "free on board" or FOB). However, the client happened to mention that they receive $250,000 in product delivered weekly. With more digging, we discovered the product was shipped FOB Origin, meaning they owned it as soon as the delivery began – making the client seriously underinsured.

- **Auto policies:** Commercial auto liability coverage can vary significantly from policy to policy, depending on symbols. Symbol 1 covers all vehicles used for business purposes, while Symbol 7 covers only those vehicles listed on the policy in the event of an accident. It is imperative, then, to supply an exhaustive list of all vehicles used while conducting business. Many insurance companies have been shifting their policies from Symbol 1 to Symbol 7, but many agents remain unaware of the change.
- **Flood insurance:** Lenders typically require flood insurance when a business is located within a flood zone. But increasingly, not being inside a flood zone is not a guarantee against flooding. If flood insurance is not required, businesses often don't purchase it. In fact, 60% of US businesses at risk of flooding are not in a designated "flood zone" and likely do not have flood insurance.[1]
- **Workers' compensation:** Employees who leave the insured business's home state are not covered by workers' compensation unless the policyholder has adequate "other states" coverage, which requires specifically listing covered states in the policy. If a worker is injured while traveling in an unlisted state, the insurance company may not pay the claim.

- **USL&H coverage:** United States Longshore & Harbor (USL&H) is a federal act providing workers' compensation coverage for businesses working adjacent to or near the navigable waters of the U.S. and engaged in maritime employment. Coverage falls under the jurisdiction of the U.S. Department of Labor rather than the states. Businesses that operate near or on navigable waterways may be required to carry this additional insurance coverage. Failure to do so puts the business owners' and officers' personal assets at risk.

THE RISKS OF UNDERINSURANCE

POLICYHOLDER RISKS

Any one of the above oversights – or a myriad of others – can result in denial of a claim, leading to a common refrain from policyholders: "How did this happen? I thought we were covered."

This issue is a direct result of the interaction that all too often takes place during policy renewal and new business: The client hands over copies of their policies and loss runs to the agent and says, "Give me apples-to-apples coverage at the lowest possible cost." As we'll explain below, "apples-to-apples" is nothing more than a myth. This often results in rampant underinsurance, which can leave business owners unknowingly at risk of adverse financial events that could change their lives and those of their employees, customers, and communities.

AGENCY RISKS

Agencies, too, lose out when their customers are underinsured. First and foremost, they are failing their customers. Nobody wants to do this, yet that is exactly what agencies are doing when they don't take a risk-aware leadership role. In addition, agencies fall into the "commodity trap" and compete on price. This is no more than a race to the bottom, and likely multiple instances of underinsurance.

Agencies and their producers are also leaving money on the table. Insurance agencies often tout their "value-added" services. Instead, they should assist their clients in making intelligent and intentional risk management and risk transfer decisions. With the right risk assessment process, clients will likely purchase more policies and coverage, aligning policyholder interests with the agency, which will see increased revenue.

CARRIER RISKS

Carriers, too, are leaving money on the table by failing to invest in agent education and training. Carriers have been known to spend thousands of dollars sending high performers on junkets, but little to help them sell more coverage and diversify their risks across lines of business. In addition, carriers take on a huge reputational risk whenever they deny claims – even legitimately. For example, business interruption losses due to COVID-19 are estimated to exceed $300 billion per month for small businesses. While carriers and industry groups have stated that pandemic losses are not intended to be covered, some businesses have responded by initiating lawsuits against their insurers, and the threat of reputational harm and legislation requiring involuntary coverage on a retroactive basis remains very real.

When the market hardens, carriers limit coverage to keep prices competitive. Given the factors behind this hard market, it's likely to continue. The frequency and severity of natural catastrophes, such as fires, hurricanes, and tornadoes, leads to rising payouts, as does social inflation resulting from an increase in litigation and legal costs, including so-called nuclear verdicts: massive judgments by juries (exceeding $10 million), that usually arise from auto accidents or product injuries.[2]

THE PROBLEM LIES IN THE AGENT-CUSTOMER RELATIONSHIP

While a lack of technical acumen is a contributing factor in the underinsurance crisis, it is not the only one. The second factor is the agent-customer relationship. In an effort, perhaps, to close sales, producers typically follow direction from prospects and customers when they should be taking the lead.

THE MYTH OF APPLES-TO-APPLES COMPARISONS

As we mentioned previously, apples-to-apples comparisons between insurance policies from different carriers simply don't exist. A buyer will tell an agent they want the best price because they assume policies with the same coverage are identical. And yes, coverage limits can appear the same. But those comparisons are meaningless without understanding the coverage form, which dictates exactly what's covered and what's not. In a hardening market, insurers need to either increase premiums and narrow coverage or add exclusions to keep their pricing competitive. Here's a hint: The thicker the policy, the less likely you have coverage. Few buyers notice these changes, and as noted above, producers often don't focus on them, either. In worst cases, producers renew policies as is. A recent survey conducted by ReSource Pro and Insurance Journal revealed that just 42% of agency service staff say that their agencies rarely renew policies "as is".[4] Renewing policies "as is" ignores changes to the policyholder's business and assets in the preceding year as well as changes to the policy itself.

THE E&O PARADOX

Agency errors and omissions (E&O) training could also be adding to the problem. E&O workshops may advise agents not to delve too much into the details of a policy, believing that this will minimize the possibility of misinterpretation. Yet, failing to identify an exposure and recommend a solution is also one of the most frequent sources of E&O claims.[3] Producers need a more balanced approach to liability—one that empowers them to provide the context their clients need to make informed decisions. However, few producers and account executives have the bandwidth to review policies with this level of care.

MISALIGNED INCENTIVES

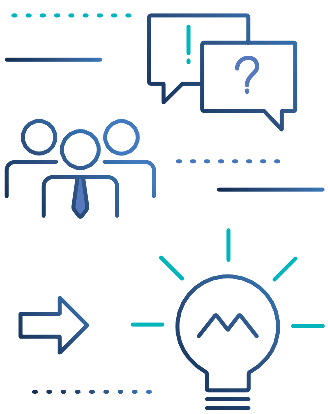
Typically, agencies create financial incentives for producers around growth and how many policies producers and service staff support. That structure de-incentivizes agents from taking time to focus on fully understanding a policyholder's needs, business, assets, and preferences, let alone doing a careful read of the policy language. Reviewing policy details goes well beyond rote policy accuracy checks and toward a full analysis of policy adequacy.

FOLLOWING THE PATH OF LEAST RESISTANCE

Agents tend to follow the path of least resistance when working with policyholders. Instead, they should be executing leadership. The problem is that policyholders rarely have a full grasp of the risks they face. The reasons for this are part financial and part psychological. It is the result of recency bias: a common psychological tendency to make judgements based on recent events over those that may or may not have occurred in the past. If a policyholder hasn't had a loss in thirty years, then they assume they won't have a loss in the future. This assumption is simply not true. Insurance protects against events that are, by definition, rare but devastating. So, when a client says, "I'm only interested in the best price," it's likely because they are discounting the very real risks they are assuming.

THE NEW PARADIGM: AGENTS AS LEADERS

What if that same agent took the lead and elevated the conversation by telling their client: "Listen, cost is one factor to consider. But you also need to contemplate the 150 employees here that are depending upon you. You're part of the community. You have a family that might take over this business one day, and certainly depend on it as a going concern. Isn't it fair to assume you care about a whole lot more than just the price? If something tragic were to happen, would you even be thinking about your insurance premium?"



TAKE THE LEAD

How can an agent take the lead? Notice the language the agent uses above. She doesn't tell the client they need X, Y, and Z coverages. That will only create resistance. Instead, she opens a dialogue by piquing their curiosity with an emotional appeal. Without being alarmist, she is preparing her client to discover that they are unknowingly facing risk of adverse financial events that could change their life for generations. After listening to their response, she'll then ask, "What if we took a different approach? What if you told me more about your business so that together we can better understand the risks you face, and which ones make sense to transfer to insurance?" The process must be collaborative, involving a structured dialogue with the client about every aspect of their business. Without that leadership skill set, all the technical acumen in the world will not solve the problem of underinsurance.

BECOME A SPECIALIST

That's not to say, by the way, that technical acumen is unimportant. Quite the contrary. The collaborative discussion between agent and client should be informed by the agent's knowledge of the industry and of the insurance markets that best serve it. An agent cannot simply look at a policy alone and know whether that coverage is adequate unless they know how the business operates. That's why we believe that agents should be specialists rather than generalists. It's virtually impossible to do a good job for a business that has unique and complex risks otherwise. Buyers are looking for industry knowledge from niche players. They want an agent who understands the risks they face and helps them identify and assess them. They want concrete data (for example, a comprehensive real property appraisal rather than a valuation) to guide them toward an intelligent, informed decision about the risks they are willing to assume, how they will finance them, and which ones they prefer to transfer to their insurer.

STAYING AHEAD OF THE GAME

How do we get producers to become leaders and practice specialists? It requires an ongoing process of training, self-driven learning, and mentoring. Typically, agencies send producers to one source for sales training, to another for technical training, and to yet another for prospecting training. They may even engage outsourced coaching.

All these training components must work together to be successful. The message you use to get in the door has to align with the experience your prospects receive once you engage with them. The skills needed to elevate the conversation and to help buyers make more informed decisions must be taught in a way that also leverages technical capabilities. Look for a training professional whose approach toward prospecting, sales, producer development, and coaching is intended to work together to differentiate and elevate the conversation while technically assessing and reducing risks for clients.

Despite the many challenges facing insurance agencies and their producers, we believe that today is a great time to be an agent, albeit a new kind of agent. The future is bright for those who elevate the client conversation with knowledgeable, intelligent service leadership. This kind of agent leads clients toward informed decisions that ensure they understand the risks they face and know the extent of the insurance coverage they purchase to mitigate them. These agents are not box checkers, nor can they be easily replaced by an AI algorithm. They are the future of our industry.

A STEP-BY-STEP PLAN FOR PRODUCERS

As we've shown above, producers who want to succeed need to grow their knowledge and experience in risk assessment as well as up their communication and leadership skills. Below is a quick summary of the steps involved.

A STEP-BY-STEP PLAN FOR PRODUCERS

- ☐ **Choose a specialty.**
  What industry or functional areas (such as real estate) are your most profitable clients and prospects in? Learn everything you can about it to speak directly to their needs and concerns.
- ☐ **Do your research.**
  Keep ahead of the trends and topics of interest not only in your clients' industries, but also in the local economy and the insurance market in general. Focus on data that supports your arguments.
- ☐ **Elevate the conversation.**
  If a client or prospect pushes a copy of their policy across the table and asks for a less expensive, "apples-to-apples" alternative, be prepared to explain why that is not possible and not in their best interest.
- ☐ **Ask questions.**
  Leverage your industry, local, and technical knowledge to ask questions that help your client see the full range of their risk exposures and the options available to transfer these risks to an insurer.
- ☐ **Read every page of every policy.**
  Make sure you know what is and is not covered in the policy. Be aware of changes carriers may have made and new endorsements. The sooner you abandon the myth of "apples-to-apples," the better you will be able to serve your clients.
- ☐ **Hand off to account executives**.
  Once you've closed the sale, take the time to introduce your new client and do a full debrief with the account executive or manager who will oversee the day-to-day management of their account. This allows the account executive to focus on taking care of your customer while you focus on generating revenue.
- ☐ **Get expert assistance.**
  Look for a training and coaching partner offering an integrated approach to improving the leadership and technical skills you need to succeed.

A STEP-BY-STEP PLAN FOR ACCOUNT EXECUTIVES AND MANAGERS

Account executives and managers face a development path that parallels and complements that of agency producers. They must work hand-in-hand with producers with technical acumen and support them at renewal time. The following are the next steps you should take.

A STEP-BY-STEP PLAN FOR ACCOUNT EXECUTIVES AND MANAGERS

- ☐ **Work with your producers.**
  Make sure your producers understand that they can hand clients off to you after closing the sale, so that you are collaborating on building stronger client relationships alongside new revenue.
- ☐ **Build your technical acumen.**
  Like producers, you should have a clear understanding of coverage details, so you can address any changes that arise in your clients' needs.
- ☐ **Take a proactive stance.**
  Make sure your clients know that you are available to handle any questions or concerns they have about their account. Reach out with proactive check-ins to learn about potential changes that will affect their coverage.
- ☐ **Provide support at renewal time.**
  Transmit your ongoing knowledge of your clients' business to your producers so they are better informed and positioned to provide the full complement of coverage your clients need.

LET'S CONTINUE THE CONVERSATION

YOU CAN SOLVE THE UNDERINSURANCE CRISIS.

ReSource Pro's Agency Growth Solutions practice provides the strategies and training to support producers and account executives in leading their clients through robust risk assessment processes. This sets insurance agencies on the path to greater differentiation and profitability.

Contact us to learn how Agency Growth Solutions can help your agency generate profitable, organic growth, or visit resourcepro.com/growth-solutions.

ReSourcePro

ABOUT THE AUTHOR

FRANK PENNACHIO

Frank Pennachio has spent more than 30 years in the insurance industry as an agent and producer, expertise he's leveraged to personally train more than 1,000 insurance professionals. In 2009, he sold his agency and co-founded Oceanus Partners with his partner, Susan Toussaint. Oceanus Partners was acquired by ReSource Pro in 2019, and Frank now serves as Practice Leader, Growth Solutions, helping independent insurance agents and insurance carriers develop risk management expertise and drive new business.

Frank is an expert in the technical elements of workers' compensationensation, emphasizing the need for agents to understand all aspects of protecting an employers' workforce to provide true value. In addition, Frank is knowledgeable in agency sales and marketing strategies designed specifically to reduce reliance on contingency commissions and increase agency revenues.

Highly regarded as a speaker and thought leader, Frank regularly presents at conferences and publishes articles in outlets such as Risk & Insurance, Professional Insurance Agent, WCEC, HR Magazine, and Insurance Journal. When speaking, he hopes to educate, entertain, and provoke his audiences to think in a new way about emerging challenges.

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