

## Can't stomach your annual insurance presentation? Imagine what we hear every day.

Each January we reflect on the past year's client-partner successes. As with everything we do, levity is a fundamental ingredient in our ability to continually drive client-partner outcomes. As part of our annual exercise, we record the most preposterous statements or "fluffers", as they're known, that we hear from the insurance industry through our engagements. You would assume, with the new level of scrutiny (Spitzer factor) the industry is facing, that coming up with this year's *Fluffer List* would be a challenge. Quite the opposite is true and actually 2004 offered so many "best in class," it was the first year we could not all agree on the single best whopper.

So, in our ongoing effort to demonstrate the challenge corporate insurance buyers face and bring more transparency to the industry, we offer for your entertainment, in no particular order, the top ten of 2004. In all fairness to the industry, we should point out that we are not getting our material from unsophisticated brokers or customer service representatives, but rather from senior industry players serving corporations with annual insurance budgets greater than \$1,000,000.

1. When asked why the proposal didn't follow the specifications and lacked the requested coverage detail:

**Broker:** If you want to get specific insurance that's related to you as your own company, then that would be different than what we are recommending in our presentation today.

**Policyholder:** I can't believe what we're hearing.

**Outcome:** Our client-partner selected a broker who took the time to understand our client-partner's business, risks and objectives.

2. At the end of each broker presentation (on a particular day in 2004 that was filled with broker presentations to this client-partner), our client-partner describes, in great detail, a likely loss scenario they want the broker to explain how they would address. Here is that day's hands-down winner:

**Broker:** ...that thing you say that could happen to you might possibly be covered under some policy – not sure we've sold you one for that, though.

**Outcome:** With the full understanding that the grass may not be greener in the other pasture, our client-partner printed a list of three brokers (not including the above), put it up on the wall, and threw a dart to select their new broker, with the belief that the new pasture couldn't possibly be browner!

3. When we asked why our client-partner should select their proposal over those offered by higher-rated (financial strength) insurers, the broker responded:

**Broker:** The only major difference in ratings is that our lead insurer is A- rated (AM Best rating) and I wouldn't worry about that since it's only for the first million of coverage.

**ARI:** We know *you're* not worried because you're not the one taking the credit risk. If the primary insurer becomes unable to meet its financial obligations, how have you addressed the first excess (and therefore every layer thereafter) policy's clause that states that its payment for loss is based *solely* on the primary insurer making payment of its full limit?

**Broker:** Honestly, I have not reviewed the excess policies, so I'll have to get back to you.

**Outcome:** The reality was, layer for layer, all but one insurer had lower *Coverage Value*. Long tail exposures require insurers with greater financial wherewithal. Our client-partner agreed and paid the higher premium to get a financially stronger carrier in the “burn layer”.

4. One example of what can happen if you leave your insurance program attended just by your broker:

**Broker:** We heard you hired an insurance consultant. Frankly, we’ve never worked with a consultant before. They said they would be getting us detailed specifications including your property values (and COPE) this year...that's great; we usually don't ask you to go through all that trouble, we just roll forward the ones we got off your policy when we first wrote your account 6 years ago, with a five percent increase each year.

**ARI:** We looked at our client-partner with a big smirk. Client-partner’s brow tightened and vein in forehead appeared.

**Outcome:** Once the broker received our specifications, they called to have us explain several of the (standard) requirements, having never seen or heard of them before. It was apparent that our client-partner had outgrown their broker years ago. After the competitive bid, our client-partner realized that by not addressing this earlier, it not only cost them watered down coverage (hence uninsured claims they had to pay) but excessive premiums (remember, if your broker is not asking the insurer for the appropriate or expanded coverage and aggressively negotiating premiums, the insurer is likely not volunteering either).

5. In response to what was promised by the broker in their verbal and written proposals (which we disagreed with), we asked the insurer taking the risk to confirm it in writing as well:

**Broker:** Received word from your insurer. They simply do not like to give things in writing - this is frustrating. The issue has been talking with the right person willing to give us confirmation in writing. I’ll keep going up the ladder and will continue to do so until I get the answer I promised. The coverage is there, it’s just asking the right person to give us the info in writing. With all of the mess in the insurance industry, getting things done is like pulling teeth.

**ARI:** Get the letter from the insurer or we’ll get our client-partner to give you one you’ll need to forward to your Errors & Omissions insurer (notice of potential claim)!

**Outcome:** What happened to this broker? You’ve heard Donald Trump say it during prime time.

6. Large deductible (\$250,000+) policyholder asks their insurer who owns their loss data?

**Insurer:** Good question - I'm not sure.

**Policyholder:** Do we have access to it after the policy term?

**Insurer:** Yes, but there's an additional charge...

**Policyholder:** Then either you own it or you're selling something you don't own?

**Insurer:** We'll decide when you need it!

**Outcome:** Obtained written agreement to have access to the data for 5 years following the policy term, without additional cost.

7. Incumbent broker's negotiating strategy and "professional guidance" for our client-partner's Directors & Officers Liability renewal:

**Policyholder:** In regard to the D&O renewal, does our insurer have a renewal application or do I not answer the warranty questions (in the full, 'mainform' application)?

**Broker:** Your insurer requires the application we supplied. In this market, we do not recommend not completing the warranty questions, as it will only delay the process, and we believe the insurer will not yield.

**Policyholder:** Listens to ARI and completes application without answering the warranty question(s).

**Broker:** We noticed that you elected not to complete the warranty questions regarding circumstances that could give rise to claims. Please be aware that your insurer has required this information. We will send along the application and see if it is accepted. However, we still suggest that if you can complete the questions in the affirmative (i.e., no claims or no knowledge of any circumstance that may give rise to a claim), then we eliminate any chance that the insurer could void the policy due to the application, should a claim arise.

**Policyholder:** Your quote indicated continuity (of coverage) back to 2001. Are you saying if we provide a fresh warranty statement we would not be reducing coverage that the quote apparently grants?

**Broker:** That is my understanding, as long as the answers are favorable (prove to be true).

**Policyholder:** Our consultant based their analysis of the quotes on not signing a fresh warranty, given that the renewal quote indicated a continuity date of 2001. I will need to know ASAP if the insurer is going to require the questions to be answered. If so, I will need to update the Board, who may decide to purchase an alternative quote that does not require a fresh warranty. We await your confirmation.

**Broker:** The continuity date as quoted is October 2001. The quote is subject to signed and completed application, as indicated in our proposal. We have performed our responsibility to you with vigor and competence, and followed all instructions correctly. We supplied an accurate renewal proposal with the application subjectivity clearly indicated. I cannot comment on your consultant's analysis not including a complete application (including a fresh warranty), as it was not agreed to by the underwriter, nor indicated as such by us. If you wish to discuss this with me, I suggest we do it over the phone.

**Policyholder:** I don't know all the ins and outs of D&O insurance, but it seems that if we give a fresh warranty, we are losing coverage or at minimum giving the insurer leverage should a claim arise. Please advise.

**Broker:** The underwriter is out on vacation until November, so we cannot comply with your instruction. We are not being difficult -- we are trying to help. We cannot put in writing anything other than factual information. If you wish to discuss some of the potential nuances of this, I would be happy to speak on the phone, and give professional guidance. Of course, any insurer responses etc., we would document in writing. Again, bear in mind that what we are telling you is that your insurer required, in writing, a "complete" application. We sent the one you gave us, but the underwriter has not "red flagged" it for the missing answers. I am only suggesting that he may..., we have not brought it to his attention. To do so may open up Pandora's Box. I really do think we should discuss on the phone rather than continuing this dialog in writing.

**Policyholder:** This is ridiculous. You need me to put everything in writing, but you want to have a call to provide your *professional guidance*. Does our insurer only have one D&O underwriter?

**Outcome:** Severability of both the application and policy exclusions is paramount in any D&O policy. Buying a policy without it, would be like buying a car without seatbelts. ARI called the insurer and spoke with the manager of the D&O department who indicated that they never requested a fresh warranty as it would have reduced coverage, which was not their intent.

8. A Broker obtains the policyholder's business primarily based upon a written fee for service agreement, rather than unknown commission-based compensation. At binding, the broker suggests that commission-based compensation offers "more flexibility" and is willing to offset the commissions against the previously agreed fee.

**ARI:** What "flexibility" are you talking about?

**Broker:** Many things, like some insurers have minimums...

**ARI:** Well, doesn't the Insurer receive just the net amount anyways?

**Broker:** There are still minimums...and commission gives us other leverage...

**ARI:** Let's assume we agree that what you are now proposing is beneficial to our client-partner, what happens to the commission amount above the fee?

**Broker:** We'll net it out.

**ARI:** The fee is \$250,000, what's the commission?

**Broker:** I haven't been paying a lot of attention to that.

**ARI:** We have, and the commissions are excess of \$500,000. How does your firm "net out" commission that's more than double the agreed fee?

**Broker:** <silent>

**Outcome:** When brokers tout their "leverage", most buyers think about the advantages the broker will yield on *their* behalf. As we're now finding out, their definition of "*their*" was not necessarily related to the best interests of the policyholder. We requested that the broker honor their fee (rather than their suggestion to move back to commissions) agreement and added a clause that allowed our client-partner the ability to audit their account. We suggested an early start on interviewing other brokers for the following year.

9. Incumbent "friend of the policyholder's CEO" broker renewal presentation for the excess casualty program.

**ARI:** The outline for the Umbrella and Excess Liability in your proposal only states the Insurer, Limit, and Premium. What is the extent of the coverage/exclusions?

**Broker:** The coverage is very broad.

**ARI:** The price is significantly lower than the other quotes -- how is it rated? And what's the rate?

**Broker:** Per thousand dollars in revenue and I'll have to get back to you on the actual rates.

**ARI:** Did you utilize the revenue projections in our specifications?

**Broker:** I'm sure my marketing department did...the last client I did was "flat" rated (no audit).

**ARI:** "Can we have a copy of the base policy form and any endorsements as requested in our specifications?"

**Broker:** The underwriter does not like to give out the form until you buy the coverage.

**ARI:** What happens if we do not like the coverage terms after we buy it?

**Broker:** I wouldn't be concerned -- all Umbrella and Excess policies are pretty much the same.

**ARI:** If you cannot give us a copy of the policy, then can we have a copy of the quote you received from the underwriter?

**Broker:** I'll ask my marketing department, but it is probably confidential information.

**Outcome:** The broker finally released the underwriter's quote, which mentioned that the policy was rated on only half of the projected revenue in our specifications and contained, in addition to standard policy exclusions, the following exclusionary endorsements: "Care, custody and control - real & personal property exclusion; employers liability (Coverage B - workers' compensation) exclusion, liquor liability exclusion (policyholder sells liquor at every location, which is approximately 30% of their revenue), personal injury and advertising injury limitation, owned automobile liability exclusion (policyholder has multiple vehicles), punitive damages exclusion, mold/fungi exclusion (policyholder sells cheese based products), designated premises limitation, employment practices liability exclusion.

**Policyholder:** If this is the "very broad" coverage what does the standard "less broad" policy cover?

10. Brokers response to an ARI Business Income policy audit.

**ARI:** How did you arrive at the \$20,000,000 Business Income limit?

**Broker:** We analyzed the client's maximum exposure at their largest location.

**ARI:** But the policy you structured is valued at 100% (all locations), including all payroll.

**Broker:** If you complete a business income worksheet, I'll get an "Agreed Amount" endorsement that won't allow the insurer to apply the coinsurance penalty.

**ARI:** Wasn't that a requirement of the quotation for coverage in the first place?

**Broker:** Yes, but the underwriter never followed up on it.

**ARI:** Are you sure that waives the requirement?

**Broker:** Huh?

**ARI:** Do you understand that if we completed the business income worksheet at 100% of the value, it would result in a value of approximately \$100,000,000?

**Broker:** Don't worry. I've been doing it this way for my clients for more than 20 years.

**ARI:** Okay, here's the worksheet. We look forward to you delivering on your promise.

**Broker:** More than two weeks passed and finally the broker responded with the following: Your insurer cannot offer the Agreed Amount endorsement, given the substantial increase (there was no increase in exposure the calculation was now just done correctly) in value, nor does it have the capacity to offer the full \$100,000,000. It would be our suggestion that we find a new insurer at the renewal (7 months away) and that you avoid having a Business Income loss in the meantime.

**Policyholder:** Are you \*\*\*\*ing kidding me?

**Outcome:** We worked within the current insurer's capacity by revising the policy to limit ordinary payroll to 30 days and applied a 50% coinsurance clause (Loss Limit was not available). Although we solved the "insurance to value" problem, the insurer wanted significantly more premium, that we convinced the broker to absorb on the basis that it would be less expensive than the uninsured portion (\$16,000,000) of a \$20,000,000 loss.

We highlight these snippets partly in (insurance) jest, but also to bring into light the uncertainty that surrounds virtually every insurance transaction. It's the uncertainty of do you *really* know if the person selling the insurance product(s) is telling you all you need to know? We've all heard of the industry's crimes of omission, now we're learning about crimes of commission (Spitzer's investigation). Even if it's universally proven or legislated that insurance brokers (intermediaries) owe their policyholders a fiduciary duty, we believe corporate buyers still need an advocate that's not tied to the transaction. Given the new reality and focus on corporate governance, the fact that insurance brokers, the ones delegated the responsibility to provide the corporate safety net continue to accept commissions, contingent income and

enter into profit sharing agreements with the insurers (manufacturers) is amazing to us. Even more astonishing is how many management teams still do not seek independent counsel. We believe such a decision will undoubtedly come to haunt them.

## Epilogue

While putting the finishing touches on this quarter's article, we heard the 2005 winning fluffer only a couple weeks into the year. If it's not a winner, then your new insurance program should include some premium-sized bets in any legal gaming venue.

Here's the scenario: A global broker is the exclusive intermediary for a foreign-based, publicly traded (with U.S. listed ADR's) multinational conglomerate. One of its U.S. operating units is sold to another foreign-based, publicly traded concern. In the days leading up to the transaction, the acquiring company instructs management of the U.S. operating company to establish their own insurance program. Having relied on the foreign parent for insurance, local management had very limited formal experience with insurance, so they contacted the former parent's global broker to establish the new program for them.

Although the global broker had previously arranged an insurance program that incorporated the U.S. operating company, surprisingly the broker had no credible information or real knowledge of the client's exposures as they pertained to the U.S. operating company, so they cobbled together a separate program. Not surprisingly, a couple months after the transaction, management was looking to cut expenses and the insurance program was one of their top 5 expenses. Realizing that you don't ask the fox to watch the chicken coup, management engaged ARI to assist them in their initial objective of reducing costs.

Upon our initial review, we identified the property insurance as the area where the premium savings could be enormous. We met with the global broker and they explained, from their point of view, the current state of the insurance program, the serious deficiencies of which they blamed on the client for not providing sufficient or timely information. During our meeting, we reviewed the broker's files, wherein we identified that the broker had requested a \$100,000 EDP (computers) sub-limit, even though the client had reported \$25,000,000+ in EDP values (out of \$150,000,000 in total values). Although the renewal had taken place just a few months earlier and the client's property exposures are located in several catastrophic zones, the broker indicated that if they "partnered" with us, they could fix all the material deficiencies and cut the property premium by 75% right away. This all transpired in a meeting of less than 2 hours.

So you're asking, where's the award winning fluff?

Well, this is where the story gets very interesting. The following day, we are discussing our findings on the property, when the client asks us to review the Directors and Officers Liability application they are completing. As our client-partner hands us the application, we immediately recognize that the application is for privately-held companies. We ask why they were completing a private company application when they are (and were) a 100% owned subsidiary of a publicly-held organization? They respond by saying that they instructed their broker to obtain the same insurances they had under the previous parent company's program and this was the application they sent the client to complete.

In researching the past D&O placement, the policy now in a 3 year run-off, we discovered that it too was a private company form with exclusions for the Parent as well as for all Securities Claims (among many other coverage reducing clauses). It appears that the parent company had a top down D&O program with

a self insured retention (SIR) of \$20,000,000, so the global broker proposed filling the SIR by having the US operating company purchase their own D&O policy (without express grant for the excess program – a whole article in itself) and must have felt if they deleted the coverage for the parent and securities claims that the less expensive private company form was the way to go. So when the new local operating company management asked their broker to obtain the same, without thought, they sold them another private company D&O policy and basically just switched the names on the parent company exclusion.

Realizing how wrong this (placing a publicly-held company on a private company form) is in general, never mind the onerous exclusions that basically render the policy claim-proof (from the insurer's perspective), we attempted to reach the actual broker who placed the risk. After days of waiting for a response (we got many telephone calls from the account executive, but not a direct response to our questions) we contacted the underwriter who issued the binder. It was a short call, as it started and ended with one simple question: Are you aware that the company you bound private company coverage on is 100% owned by a publicly traded foreign entity? The answer: "no, that was never communicated by the broker".

News of our direct call to the underwriter traveled fast (who are the real "partners" in the insurance business?) and the broker's D&O practice leader called us within 3 business hours of that call to the underwriter. Here's an excerpt of that conversation, many of the comments from which undoubtedly qualify as the 2005 winning fluffer:

**Broker:** Nice to see you're finding more low hanging fruit, it's a shame that it keeps happening with us.

**ARI:** Not true, the entire industry is full of low hanging fruit since, by design, the industry's fruit grows on bushes.

**Broker:** I've taken a look at the policies and can see why you're so concerned. <lists problems>

**ARI:** How did so many people miss the basics, like how does a publicly held subsidiary obtain D&O coverage for a private company, *twice*?

**Broker:** You know we only had a few days to put this together and the client had no real information.

**ARI:** You didn't have enough information to do the appropriate job protecting the client, but you *did* have enough to place the "coverage" and collect your commission?

**Broker:** Where was the client in all of this? Don't you think they are culpable too? How clueless is the client to allow these exclusions to be attached? We're not taking all the responsibility for this sh\*t placement. The whole thing seems like a parade of imbeciles.

**ARI:** That's rich. Insurance, like Latin, is difficult to understand, so maybe a more appropriate and noble (sounding) tagline for your organization should be: "Caveat Emptor" (really Carpe Emptor).

**Broker:** We'll see what we can do, but you know the insurer will want more premium to fix this.

**ARI:** The client has consulted with legal counsel and they're of the opinion that you should do whatever it takes to get it right, since you'll be paying either way.

After further discussion amongst themselves, both the broker and insurer want a meeting without the client or the client's legal counsel present. We asked them if they thought the client may be offended seeing how the insurance "sausage" is made. In reality the above process is the insurance sausage factory at work and now the broker must push the insurance sausage back through the grinder with the expectation that a pig will fly out the backend. Maybe this is where their proclaimed "leverage" (of a global broker) comes into play?

Isn't it unbelievable that once you give the broker what they all covet, the exclusive right to handle your insurance, they still perform miserably? And when they're called to the mat, they start pointing the finger at the client who trusted them to do the right thing in the first place. Whatever happened to the business of utmost good faith?

As the experiences of these client-partners demonstrate, there is no substitute for knowledgeable, independent insurance counsel who knows how to navigate the corporate insurance buying process. It's not only knowledge of the products, policy language, and insurer strengths that you need, but a true advocate who understands your organization's risks, knows how to navigate the system and negotiate exclusively on your behalf, in order to yield the optimal outcome. In the end, our client-partners realize that they are not outsourcing their risk management but rather sourcing capability that may turn out to be critical to the health of the organization.