Why CFOs hate insurance

How to understand and manage insurance costs **Interviewed by Kristen Hampshire**

Insurance is purchased in a confusing marketplace. There's no sticker price on property and casualty (P&C) insurance and the cost structure can be difficult to comprehend. P&C insurance prices are based on complex market fluctuations and numbers that make it difficult for many to understand.

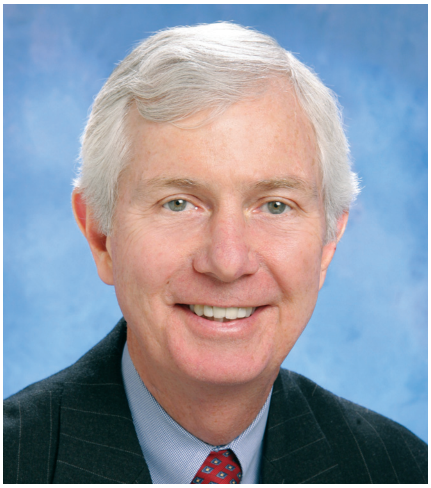
That can be frustrating to those used to having control over the costs in a business, says Bill Goddard, director of insurance consulting at Brown Smith Wallace LLC, St. Louis, Mo.

"Insurance pricing is cyclical and difficult to predict, causing unexpected budget surprises," says Goddard.

Over the last several years, the cost of property and casualty insurance has been decreasing. With this gradual decline in cost, companies have gotten comfortable with their insurance premiums and, as a result, may be paying less attention to loss claims and best practices that can help mitigate insurance costs.

This is about to change because 2012 is bringing price increases to property and casualty insurance — another reason why CFOs will now hate this unpredictable cost.

Smart Business spoke with Goddard about why insurance pricing is difficult to understand and how businesses can better prepare to manage the cost.



Bill Goddard
Director of insurance consulting
Brown Smith Wallace LLC

Why is insurance a difficult area?

First, insurance has its own language. Who has time to learn it? Second, it's not a logical marketplace in terms of pricing. You can't simply compare costs apples-to-apples and choose a plan. There are variables because of the actuarial pros working behind the scenes. Third, you get calls from salespeople all the time, which can be overwhelming.

Also, the insurance world is very short on ideas about how to control costs. If your insurance prices are going up, you need innovative ideas to help you control the cost. That's why bringing in a professional consultant with insurance experience is so valuable.

Finally, there is a lack of good benchmarking data in property and casualty insurance. You can't compare the cost of insurance at one business to another and can't determine if what you are paying is higher or lower than average because there are so many factors involved.

What is causing prices to increase this year?

Insurance is cyclical in nature, and the cost is impacted by many factors, one of which is the availability of capital. When the stock market is an unappealing place to invest, investors instead may choose to infuse capital into the insurance industry, where they could potentially see a better risk-reward result.

For example, those who invested in writing earthquake insurance would have earned sizable profit in the last seven years or so because there have not been any major earthquake events in the United States. These investments in insurance increase the supply, which decreases the price for businesses that need policies.

The dynamic behind rising property and casualty insurance pricing is that, with the stock market loosening up and investors making other choices besides insurance for their capital, there is less supply in the insurance market, resulting in a greater cost for those who demand the product.

What kinds of companies are going to feel the most pain from increased insurance prices, and what can they do about it?

Businesses with a bad loss history will be the first to feel the insurance cost increases. For example, take a company that pays $300,000 for workers' compensation insurance and maintained that premium for years despite losses of $320,000. Because the insurance market was soft, the insurer didn't want to lose that company's business, and the company continued paying the same premium despite losses that exceeded this dollar amount.

Now, that company could hear differently from its insurance company, which may increase costs to $390,000 to make up for past years' losses and net a profit this year. The key is to watch your losses: Does your history make you a risky business for an insurer?

If the answer is yes, you should work to position your company to earn a better premium by putting in place safety programs or improving claims procedures.

A consultant who specializes in insurance can help you identify ways to work with your broker to reduce your premium despite industrywide price increases.

What will the impact be on companies that have a good loss history?

There is an opportunity for these companies to save money on insurance rather than absorb cost increases if they choose to take on more risk. This could be accomplished by increasing their deductible and, as a result, paying a lower premium.

This can be risky for companies that do not have a firm grasp on their loss history — you must know your numbers before you take on more risk. Otherwise, you'll watch more money go out the door, because if you increase your deductible, pay less premium, but have several loss claims, you'll cancel out any savings. Perform a risk analysis and then determine whether your company can afford to take on more risk.

How can CFOs get a handle on their companies' insurance?

The best solution is to bring in an independent adviser who has deep experience in the insurance industry and who can carefully analyze your risk, benchmark your business, help choose the best insurance provider based on your size and scope, and act as a consultant working with your broker to protect your bottom line.

Many companies do not have in-house insurance experts. An independent consultant with insurance industry expertise can provide real value on an as-needed basis. The consultant can act as your part-time risk manager, representing you in this difficult marketplace. <<

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