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Where Necessity Meets Opportunity: New Avenues Open for Agents

By J. Bruce Cochrane, CIC

An old adage asserts that out of crisis arises opportunity. Not all crises come paired with their own solutions, but a unique confluence of forces affecting Massachusetts' independent insurance agencies is setting the stage for both a profitability crisis and the means to overcome it. Agencies that successfully weather this storm will be those who can foresee it, recognize the opportunity, and mobilize swiftly enough to take advantage of it.

It is a near certainty that private passenger automobile (PPA) rates in the Commonwealth will drop precipitously over the next three years and most agents will realize significant declines in revenue, severely challenging profits with onerous staffing implications. An unprecedented three-year run of abnormally mild weather, huge successes in anti-fraud efforts, and a gasoline price-induced reduction in miles driven have combined to drive down losses in recent years.

Rates in 2006 are already 8.7% lower than in 2005. Auto insurers have recently filed for a 3.7% rate reduction

for 2007, and with the State Rating Bureau recommending a reduction of 8.3% and the Attorney General's filing for a reduction of 18.2%, it is highly likely the final rate will be a reduction of around 10%. Furthermore, the window of experience upon which

The disadvantages to agents with Massachusetts' highly socialistic method of setting private passenger auto rates becomes evident when rates, premium and commission drop. With such a high portion of agents' commission stream concentrated in this line of insurance, even slight reductions in rates can have a disproportionately negative impact on revenues.

2008 rates will be based has already occurred, signaling a high probability of another double-digit rate reduction for 2008. The compounded effects of these three rate reductions could be

as much as 25% over 2005 rates. The message is clear: Declining rates will result in a significant reduction of agent commission income in this one line of insurance.

Massachusetts' unique system of PPA rate setting has its advantages for agents, since commissions are technically set separately from the premium rate, but it also comes with disadvantages. Most direct insurance writers steer clear of the Commonwealth, leaving agents as the dominant distribution mechanism for PPA. Very limited price competition among insurers makes for a stable environment for agents. Massachusetts' agents typically control in excess of 80% of the PPA business, a sharp contrast to other states, where agents' market share averages 35% or less. For many Massachusetts' agents,

J. Bruce Cochrane, CIC, is president of Renaissance Group, a Wellesley, Mass.-based insurance management organization, and president of Minuteman Insurance Company, Ltd., a Bermuda-based reinsurer. He can be reached at bruce@renaissanceins.com.

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PPA represents 50% or more of their business.

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Purists may point out that PPA commissions in Massachusetts are set separately from premium rates, ostensibly based on agents' actual costs of doing business. While this is technically correct, the political impact on commissions cannot be denied. If premium rates drop significantly, due at least in part to what will be cited as "reduced activity," the pressure will be on to reduce commissions as well. Whether proportional to premium reductions or not, significant commission reductions are inevitable over the next three years.

Reduced PPA commissions will be matched by corresponding reductions in profit-sharing revenues. One old industry saying is that claims do not check the rate being charged before they occur. Simple mathematics suggests that if losses were to remain at their current level, as premium drops, loss ratios will rise. Assuming a compounded 25% reduction in premium over a constant loss level, by 2008 what was a 40% loss ratio in 2005 will wind up as a 61% loss ratio in 2008. Underwriting profits will drop and agents' profit share income will fall accordingly. The tremendous run of good PPA experience over the past three years, which resulted in generally high profit-sharing awards, will drop like a shot for even the most profitable agencies, and disappear altogether for many. The combined effect of commission reductions and diminution of profit sharing could result in a reduction of revenue in this critical line by as much as 40%.

Adding insult to injury, these severe revenue reductions will come without any reduction in workload. Agencies will still have the same number of clients with all the same service

needs, so expenses will remain unchanged. Reducing personnel and services to control expenses could cause agencies to lose customers, resulting in even greater lost revenue, compounding the problem. This picture is not pretty.

There is an antidote at hand that can ease or even reverse the impact of PPA rate reductions. The ebb and flow of the traditional insurance cycle just happens to be at the right point to offer opportunity to those agencies that can recognize and react to it.

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The simple answer to revenues flowing out is to increase the flow of new revenues coming in. Agents are fortunate to be in a business where they can directly influence their own revenue through sales. Agents have the ability to grow themselves back to profitability by proactively increasing their new business activities, and it just so happens the timing for this could not be better.

Among the options available to enterprising agencies are sales to new clients, account rounding, and sales of life, accident, and health coverages.

Commercial lines have softened considerably in the past year. Results for the first six-months of the year indicate that the property-casualty (P/C) industry is enjoying another very profitable year. Some experts are predicting 2006 could set another record for underwriting profits, on top of the record set in 2005, so the soft market will last at least through 2007, and likely longer. Soft markets are typified by broad product availability and price competition, a classic recipe for new business success by aggressive sales organizations.

Soft markets are breeding grounds for generating new clients. Not only will sales to new clients help backfill for lost revenues but, down the road, when the soft market turns to hard, accounts gained during the soft side of the cycle will inflate through pricing increases, compounding the positive impact of new sales on revenues and profits.

Account rounding is the term for selling additional P/C products to existing clients. This is not a new concept, but if ever there was a time to aggressively embrace this strategy, it is now. Most agencies profess to account round but, typically, there remain quantifiable opportunities to produce substantial revenues. Covering supplemental client risks also relieves agencies of errors and omissions exposures and further cements the bonds between agents and their clients.

Most agencies generate minimal revenues from the sale of life, accident, and health products, and consequently miss a huge opportunity. Agency clients are buying these products from other sources now, but P/C agents could often make these sales if they only asked for them. Some P/C agencies that go after this business have doubled their commission revenues without adding new clients. In addition, proactive life, accident, and health sales activity can generate new agency clients, who can be cross sold with other P/C products. There are no downsides to life, accident, and health sales. P/C agents simply need to get over the artificial wall they have traditionally erected between P/C and life, accident, and health, a self-imposed barrier.

Any combination of these marketing strategies and other potential revenue-enhancing initiatives can replenish revenues lost by shrinking PPA commissions, but initiatives that are not conceived and implemented have no chance for success. Inaction and reducing services will not get the job done, and may lead to a further downward spiral. Agents need to use their natural sales capabilities to work their way out of this dilemma. Successful agencies will use all the tools at their disposal and will grow stronger for the challenge, while those agencies that do not adapt will face increasing difficulty surviving. ■