

## Property Casualty 360

# Use tough times to reshape workers' comp client relationships

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As Warren Buffet said, "It's only when the tide goes out that you learn who's been swimming naked." Insurance agencies with large books of workers' compensation business have been hit especially hard since the great financial crisis of 2008. When payrolls, premiums and commissions plummeted, many agencies discovered they were swimming naked.

Let's first take a look back to the period preceding the economic meltdown. Even though the economy was strong, agencies found themselves in the midst of a protracted soft market. Insurance companies were pursuing workers' compensation market share through aggressive pricing. Most employers recognized that if they "shopped the market," they would likely reduce their premiums. It was--and still is--difficult for agencies to differentiate themselves on any basis other than price.

To close sales, many agencies adopted a "value-added" marketing approach that went something like this: "If we are close on price, will you go with us if we provide you all of these other free services?" Thus, agencies increased their overhead and infrastructure costs by adding claims, human resources and loss control specialists. There was not much discussion as to whether or not this approach violated rebating and unfair inducement statutes, which will be discussed later in this article.

[Read Frank Pennachio's previous article, "Lead with workers' comp on consultative sales."](#)

By itself, the idea of offering additional support for workers' compensation clients is not a bad one. Workers' compensation is unique and, when done right, requires a significant investment of time and resources on the part of the agency.

The flaws of the value-added approach were hidden during the high tide of the booming economy. Agencies were growing along with their clients' businesses. This was particularly evident in the construction industry when some clients doubled, tripled or quadrupled in size. Revenue was flowing into the agency and times felt good.

### **The tide turns**

Then in the fall of 2008, the global financial crisis hit. The tide receded quickly and took out with it much of the revenue realized during the bubble. Agencies discovered that many of the workers' compensation accounts that were profitable during boom times quickly became unprofitable. It was common for the workers' compensation revenue from a construction client to shrink from tens of thousands of dollars to a few thousand at the same time the agency was spending thousands providing free value-added services.

How does an agency that promised human resources, loss control or claims support continue to deliver these services with severely reduced revenue? One might think that a smaller client would not need the same level of support because its business activity and exposures to injury were reduced. However, clients still expect to access the resources that were promised at the time of sale and that they have become accustomed to receiving.

Some agencies probably saw increased use of their human resources staffs as clients downsized. A period of layoffs is a perilous time for employers, and many needed outside help to navigate the process. In some instances, the agency's resources became more necessary and valuable to the employer as the revenue to the agency declined.

The economy is not likely to come roaring back anytime soon, and payrolls, workers'

compensation premiums and commissions will lag even modest growth. We have even heard "jobless recovery." Depending on which expert you believe, we will probably see slow growth at best and a double-dip recession at worst.

In addition, with few exceptions, agencies are probably not going to get a financial lift from increased workers' compensation rates. Even though there are some early signs of cracks in the workers' compensation market, experts predict soft pricing to continue for the next several years. Of course, because workers' compensation pricing varies from state to state, there will be occasional increases.

Agencies with a focus and concentration on workers' compensation have some tough decisions to make and many are in dire need of doing so quickly. So what should a workers' compensation insurance agency do during a protracted period of soft rates combined with a sluggish economy and high infrastructure costs?

### **Help wanted**

Regardless of the economic or premium rate environment, employers still need help with their workers' compensation insurance programs. Now more than ever, employers need to reduce injury costs, increase productivity and manage their experience modification factors to remain competitive. Specifically, employers need assistance in managing premium audits, facilitating return-to-work programs, training their supervisors to better manage injured employees, coordinating medical care and hiring employees fit to do the job.

The need to manage experience modification factors is particularly evident in the construction industry. Most construction work is coming from the public sector, which requires employers to maintain an experience modification factor of 1.0 or below to be eligible to bid on jobs. Many private sector projects have the same requirement. With work so scarce, losing the ability to bid on a single project could be devastating to a contractor.

Agents can play a vital role in helping employers stay in the game and compete for business. These challenging times demand that employers and agents work collaboratively to address issues troubling both parties. This economic crisis presents an opportunity to reshape the business relationship between the agency and its clients.

Cutting back an agency's services simply to sell a policy at a good price is not in the best interest of employer clients. Employers face too many risks and threats to their employees and companies if their workers' compensation programs are not managed effectively. Securing a low-cost policy will not help the employer who can no longer bid on jobs.

### **Sensible steps**

The first step is for agencies to be more transparent with their clients. It is time to have the tough conversations on how times have changed and what may have worked during the boom times does not work during a downturn. It may even be necessary to explain how your boom-time approach to the marketplace turned out to be flawed. Agents must trust their clients to be reasonable and enlightened business people who understand that a strong business relationship has to work for both sides.

Next, agents should comprehensively assess the needs of the employer. Most are not aware of practical and proven methods to reduce workers' compensation costs. Unfortunately, they have learned from insurance agents that the only way to reduce costs is to bid for a lower price every year. Shopping for a low price with workers' compensation is frequently fool's gold. Cost containment strategies are far more complex and every employer has its unique needs and challenges.

Agencies also need to evaluate the services they offer. Too many services are unnecessary, redundant or not specifically directed to an individual employer's workers' compensation needs. For example, if the insurance company provides effective loss control services, then is it smart for the agency to duplicate them? Can the agency's resources be better used elsewhere?

Following a comprehensive workers' compensation assessment, the employer and agent can craft a plan of action that will reduce employee injury threats and improve outcomes. The agent must assume a leadership and consultative role and guide the employer to embed effective practices that will meet the company's objectives.

Agents also should be transparent regarding the agency's revenue earned for managing the employer's workers' compensation program. It may sound counterintuitive, but the employer may need to pay a fee to the agency to address issues that the employer has recognized and agreed to fix. It is important for the employer to be able to compare the costs paid to the work that was done to protect its employees and company. Employers will pay for assistance if they feel the agency will deliver in ways that will provide them a fair return on the investment.

If commission revenue is too low and is not offset by fees, then one of two things usually happen. First, the agency does not provide resources to assist the client, leaving the client at risk. Second, the agency provides the resources and the account becomes unprofitable for the agency. Neither of these scenarios makes sense.

### Revenge and the rebate issue

Another problem with free services has emerged. In recent months, numerous departments of insurance have issued bulletins reminding agents of their responsibilities to comply with rebating and unlawful inducement statutes. These bulletins frequently start with "It has come to our attention that some insurance agencies and companies are offering or providing free or reduced cost services not included in the insurance contract."

So exactly how did this come to the attention of the department of insurance? Could it have been the unseated incumbent agency?

Many agencies are feeling the pain of the recession. If an agency loses one of its largest revenue-producing accounts and feels unfair and deceptive trade practices or rebating were to blame, it is likely to report the agency that took over the account to the insurance department. Is it just a coincidence that there is an increased number of warning bulletins on rebating during the toughest economy of the past 60 years?

Each department of insurance will view this issue differently; some are more restrictive than others. However, it is incumbent upon every agency to make sure its sales and service delivery process does not violate the law. Penalties can include fines, suspensions and civil judgments.

Even if the DOI does not take action, an agency could be sued by a competing agency for unfair and deceptive trade practices. Will your errors and omissions policy defend you against such a suit?

The wise choice for insurance agencies when targeting workers' compensation accounts is to avoid the "if we are close on price, then we will give you these services for free" pitch. Not only is this approach economically questionable, but it may violate the law and put the agency at great risk.

The best agencies have begun to understand the difference between the remuneration they receive for placing a workers' compensation policy and fair remuneration for delivering additional value. For agencies to thrive with their workers' compensation clients during these tough times, they must evolve from a transaction approach of placing policies to a consultative approach of guiding employers into adopting practices that improve outcomes.

As agencies get their arms around the "new normal" way of doing business with workers' compensation clients, they also should look ahead to emerging workers' compensation threats. Most prominent among these risks are the aging workforce and the obesity epidemic.

Older workers get hurt less frequently, but they take longer to recover than younger colleagues and the injuries are more costly. Also, it is well documented that an injured obese employee costs more and recovery takes longer, as well. Managing these demographic changes just adds to the burden already facing agents and employers with workers' compensation. What plans do agents and employers have in place to manage these demographic changes?

In addition, the day will come again, perhaps sooner than later, when insurance companies start to restrict their capacities for writing workers' compensation accounts. Underwriting cycles may be protracted, but they have not been outlawed. Insurance companies are seeing their loss ratios increasing, investment results deteriorating and medical inflation rising unabated.

Now, while capacity is plentiful, is the time to help clean up clients with adverse loss experience. When capacity is diminished, the employers with the worst loss ratios will feel the most pain. When clients are in pain, so are agencies.

Times are tough for workers' compensation accounts and not likely to get significantly better any time soon. However, agencies can leverage these challenging times to reshape their processes and relationships.

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