FACTORS IMPACTING INSURANCE PREMIUMS

David W. Stiltz
Marketing Manager
Agri-Business Insurance Services
Des Moines, IA

Introduction

This presentation is designed to discuss the factors that impact premiums in the agribusiness industry and the techniques that can be used to control those costs. The discussion will include insight on the components of premium, and cost reduction techniques.

Components of the Insurance Premium

Fixed costs also referred to as overhead, normally comprise 25% to 35% of the total premium. These are the costs that are normal to the operations of an insurance company. The breakdown of what comprises these fixed costs is as follows:

Table 1

Selling Expense/Commissions
Underwriting Expense/Rating
Loss Control/Safety Engineering
General Administrative/Clerical
Depreciation/Amortization
Boards & Bureaus/Premium Tax

Profit normally runs about 2 to 5%, varying by the type of insurance. Losses and loss adjustment expenses comprise from 65 to 80% of costs, again varying by the type of insurance. As premiums are collected and held by the insurance companies in advance of losses being paid, insurance companies accumulate substantial reserves. The investment income on those reserves allows insurance companies to have losses in excess of earned premiums.

Major Types of Property/Casualty Insurance

A. To insure against direct loss of physical assets
   1. Fixed plant and equipment – Normally referred to as Property Insurance
   2. Inventory – Also a part of Property Insurance.
   3. Rolling Stock other than autos, e.g. augers, tractors, wagons - Referred to as Inland Marine Insurance.
   4. Autos, trucks and other vehicles licensed for road use. Referred to as Auto and/or Fleet Insurance.

B. To insure against loss of cash flow, e.g., a decrease in revenue or an increase in expenses as a result of a direct loss to physical assets. Referred to as Business Income Insurance.
C. To insure against lawsuits resulting from Bodily Injury to a third party or damage to their property. If the lawsuit results from the use of an auto, Auto Fleet would be the appropriate coverage. If the lawsuit is the result of other than an auto accident, the appropriate insurance is General Liability Insurance.
D. To insure against injury to your own employees, e.g. Workers Compensation Insurance.

Cost Reduction Techniques

Property/Inland Marine Insurance

A. Rating – Rates are generally expressed as a rate/$100 of valuation. Rates multiplied by the limit of insurance determine the base premium.
B. Construction – The more fire resistive, the lower the rate. Concrete carries a lower rate than steel, steel carries a lower rate than frame. The cost per dollar value of commodity will be higher in a frame elevator than it is in a concrete elevator. Consider the type of construction when building.
C. Protection – Characteristics of construction that reduce the chance of loss can reduce the rate. This would include fire suppression systems (sprinklers, extinguishing systems, fire walls), alarms, fences, locks, lighting, wind resistive roofs, etc. Install property protection equipment where cost effective. Determine prior to construction if there is any protection systems that can be installed to lower the insurance cost.
D. Exposure – The proximity of your property to external loss from another source or hazard. Three flat storage grain warehouses 50' apart may be rated as one unit. The same three buildings 100' apart may be considered three separate risks which could result in a lower premium. Other hazards that can influence rating would be to locate in a flood zone, high crime area, locating adjacent to non-owned high-risk property, or locating a concrete elevator with nearby residential, school or commercial exposures. Consider these factors when determining placement of new construction.
E. Valuation – Be sure that all assets are properly valued. Actual cash value (ACV) is generally defined as "replacement cost minus depreciation". Other criteria such as obsolescence and deterioration can be included as part of the definition. Replacement cost (RV) is generally defined as "the replacement of existing property with like and kind materials". If you have a building that would not be replaced, it should not be insured for RV. Most policies have a provision that if a building insured at RV is not replaced, valuation will shift to ACV. Don't waste your money. Review your facilities to determine what valuations should be used. Inland marine equipment is usually insured at ACV. RV options are available with some companies on newer units. Rates are usually the same but the RV costs more because you are using a higher value.
F. Reporting Form – As a general rule, agribusiness facilities should be on an inventory reporting form. Due to the seasonal nature of the industry, reporting allows you to pay inventory premium based on "average" values. Limits are based on maximum exposures.
G. Deductibles – Use deductibles to decrease the cost of your insurance. Credits are normally given for higher deductibles. Determine what deductible level works for your company. Deductible aggregates may also be available to limit the number of deductibles applied in any given year.

H. Self-Insure – Are there any lowered valued building that you can self-insure? It is possible to insure inventory without insuring the building. What is an acceptable amount of risk for you to assume? For inland marine equipment, do you need to insure all of the lowered valued augers and tractors or only the higher valued equipment engines?
I. Ask questions – Request information on specific cost reduction techniques from the insurance company.

General Liability Insurance

A. Rating – Premiums are determined by applying a rate/$1,000 of sales, payroll or a rate/square foot of building. Separate rates will apply to each type of product sold or each type of business activity. Identity preserved, food grade or organic grains can carry higher rates than typical field grade commodities.
B. Premises Exposures – The general condition of the premises will be considered when rating. How the property is maintained, access by the general public, "nuisance hazards" such as abandoned buildings will be a factor in rating. Keep your premises and property maintained in good condition.
C. Off-premises exposures – Do you have any operations that are conducted off-premises? Do you send your personnel and equipment to the farm to pick up grain? If you do, what controls and procedures are in place to limit the potential for damaging non-owned property or persons? Do you let other people "borrow" your equipment with or without a company operator? Review these exposures to determine if the risk is acceptable?
D. Product Losses – Do you make any warranties or representations concerning the quality of your product whether expressed in a contract or implied? What controls are in place to protect the integrity of product from the time it is received until it is shipped? Has the recent acts of terrorism caused you to consider if your facilities provide reasonable protection for products in the food chain?
E. Payroll rating issues – Determine if specific issues related to payroll are being addressed.
    a. Eliminate clerical payroll from rating
    b. Eliminate driver payroll
    c. Eliminate overtime payroll from the rating basis
    d. Limit Executive Office payroll as allowed by the insurance company
    e. Excise or sales taxes should be removed from gross sales
    f. How are inter-company sales handled? Are you paying twice?
    g. Ask if sales and payroll is being properly classified.
    h. Consider property damage deductibles if they are available. What level of deductible should be a "cost of doing business"?

Auto Fleet Insurance

A. Rating – Liability and physical damage rates are normally expressed per the type of vehicle being insured. Factors such as garage location, cost, usage, GVWR and radius of operation factor into the rating on a vehicle.
B. Classification – Ask if all the vehicles are properly classified. Review your list of vehicles to determine if any are used on-premises only. Vehicles used strictly on premises or not licensed for road use may be able to be insured under lower general liability rates. Make sure GVWR ratings and original cost figures are correct.

C. Seasonal Rating – Most insurance companies offer seasonal rating. The use of seasonal rating is more prevalent in fertilizer/chemical operations but it may have merit in grain operations.
D. Self-Insurance – Consider self-insuring comprehensive and collision coverage, at least on older units. One caution, comprehensive or specified perils coverage apply to vehicles damaged by wind, hail and fire. Determine and evaluate the potential for loss if you store a large number of vehicles in one building that would be susceptible to a single loss.
E. Deductibles – Determine what level of deductible is acceptable to your company. The insurance company can supply premium credit information.

Workers Compensation

A. Rating – Job duties are classified into a descriptive code such as Grain Elevator Operations, Hay, Grain & Feed Operations, Clerical, Outside Sales, etc. Each class code has its own rate that varies with the risk of occupational injury and the state where the employee is located. Premiums are determined by applying a rate/$100 of net payroll. An authorized rating bureau, in most states the National Council on Compensation Insurance (NCCI), establishes rates or loss costs.
B. Experience Rating – Unlike General Liability and Auto Fleet Liability, where underwriters determine experience rating, Workers Compensation experience rating is mandatory. The formula used by NCCI evaluates the number and cost of claims in relation to payroll to establish each accounts experience rating. Monitor claim reserves to make sure they are not overstated and adversely affecting the experience modification.
C. Classification – Make sure that payroll is correctly classified. A trend has developed among commercial agribusiness insurance companies to follow strict NCCI rules pertaining to classifying employees. Manual rules require that if a person performs multiple job duties their entire payroll will be assigned to the highest rated class code. Some insurance carriers in the past have allowed payroll to be assigned according to the primary duties of the employee. NCCI rules do allow for splitting payrolls under certain guidelines.
D. Executive Officer Payroll – In most states, Executive Officers can be excluded from Workers Compensation. Determine if this will work for your business.
E. Overtime Payroll – Manual rules allow payroll to be reduced by the cost of overtime payroll. If you are not reporting overtime payroll, this is likely not being done.
F. Self-Insure – Some states allow deductibles or retentions that will reduce the cost of your insurance. Know what is available to you.

Experience/Schedule Rating

A. Experience rating is based on the frequency and severity of claims. Insurance carriers file these credits for each line of insurance or package filed in each state. A typical range of experience rating will be from a 25% debit to a 25% credit.
B. Scheduled rating is based on certain characteristics of an account. Years in business, tenure and experience of management, general housekeeping and maintenance, safety programs and the financial condition of an account are factors used in the rating determination. The more that is done to positively affect these factors, the better. Typical schedule rating filings will be from a 25% debit to 25% credit.

C. Optional Basis – Insurance company underwriters can apply schedule and experience rating to property/inland marine, general liability, auto fleet insurance and workers compensation on an optional basis. Soft markets tend to see a more liberal use of scheduled and experience rating. Package credits/debits can have a sizeable affect on premium.

Safety Programs

"Components of the Insurance Premium" provided information that expected losses comprise between 60-85% of insurance premiums. One way to impact losses is to have an effective safety program that incorporates the following characteristics.

A. Goals – Successful safety programs seek to reduce the number of hazards and risks of injury, decrease the rates of accidents and injury and control the cost of accidents and injuries.
B. Causes – Understand that most accidents result from unsafe acts, not unsafe conditions. An effective safety program will work to influence employees to make decisions with their and others safety in mind.
C. Accountability – Safety standards are words on paper. Accountability is what makes them work. Housekeeping and maintenance schedules are a road map. The process of following the schedules, supervisory oversight that the schedules are being followed and management oversight makes everybody accountable.
D. Evaluation – Establish a system to evaluate and change your safety program to meet changing needs.
E. Measure and Reward – Positive reinforcement is more powerful than negative actions. Timing of rewards, whether positive or negative, is critical. The closer to the event the better.
F. Structure – There is no "one size fits all" structure for a safety program. Every organization needs to constantly change and adapt to fit their programs needs.

Claims Management Program

When claims do occur, your claims management program should be designed to reduce the cost of those accidents. An effective claims management program will incorporate the following characteristics.

A. Claim Reporting Procedure – An expedient claims reporting process that eliminates delays so that notification of a claim is made in a timely manner.
B. Mitigation – A process to minimize the size or impact of a claim. This can range from maintaining a list of contractors with specific equipment that can be utilized to establishing on-site, pre-loss products and tools.
C. Cause/Correction – Procedures to determine the cause of losses that will prompt corrective actions that prevent or reduce future losses.
D. Communications – Develop procedures to maintain lines of communication with claimants (can include employees), health providers, insurance adjustors, legal representatives, etc.

Conclusion

Treat your insurance program like you own it and take an active role in developing the program. Pick insurance agencies and companies that are good stewards of your money.

1. Understand each type of insurance you have, how premium is determined and use cost reduction techniques to control or lower the cost of your insurance.
2. Establish or maintain an effective Safety Program.
3. Minimize the cost of losses that cannot be avoided with an effective Claims Management Program.
4. Select an insurance company and agent that will understand your needs and is committed to commercial agribusiness insurance.