

Our Legal Reality



The Cause & Effect of Insurance Premium Increases for Component Manufacturers by Kent J. Pagel

"Buying insurance can be very complicated. A proactive purchasing approach is essential....you do need enough knowledge to ask the right questions and demand effective services."

Loyal SBC readers will recall that in the [May 2000 issue](#), I cautioned component manufacturers to expect property and casualty insurance premium increases. Three years later I never would have imagined general liability, vehicle liability, umbrella liability and property policy cumulative increases of up to 500 percent in some instances. Today's climate, at least with general liability insurance, has been termed a "General Liability Insurance Crisis" by NAHB.

Why has this happened and why are insurance premium increases so significant in the residential construction industry? In my opinion the answer is twofold: (1) cyclicity in the insurance industry, insurance company greed (decreased profitability compared to previous cycles) and underwriting ignorance (poor loss tracking and a lack of understanding of specialty industries and their loss records) converging at the same time, and (2) the continued growth of construction defect litigation, which is perhaps the most significant issue at hand.

Those of you who buy property and casualty insurance know there are times of a "soft market" and a "hard market." When insurance company losses are low and the stock market is thriving, insurance companies are chasing buyers to produce cash in the form of premiums that can be invested. Conversely, when losses are high and the stock market depressed, insurance companies are primarily interested in writing business at high premiums where the loss exposure is predictable.

What we experienced from the early 1990s to the present is an insurance industry cycle rapidly moving from a soft market to a hard market. Do you remember the 1990s when investors, which included insurance companies in a big way, were making substantial gains with their portfolios? Keep in mind that the insurance industry net worth is estimated at greater than \$300 billion. Investment returns of more than 25 percent per year can produce a lot of cash when a large portion of that net worth is invested. Because of the urge to put more money to work in stocks, we began seeing intense competition from insurance companies for the business of the insurance buyers (i.e., collect more premiums so that more money can be invested, producing even higher returns).

Yet at the same time, insurance policy losses from claims and defense costs were increasing.

This brings me to the issue of the convergence of greed and ignorance. In 2000 for example, the insurance industry recorded a \$32.3 billion loss, the second highest in industry history. This did not evolve overnight; losses were increasing during the end of the soft market yet insurance companies were greedily chasing new business with lower premiums in hope of having more dollars to invest.

On 9/11/2001, the insurance industry experienced an additional convergence of new events: the insurance losses from the World Trade Center (estimated at a total of \$45 billion) and the collapse of Enron and other large Fortune 500 companies. These business collapses impact the insurance industry in a big way because of the large dollar claims that follow with respect to directors and officers liability, fiduciary liability, professional liability and surety bond losses. In total, the insurance losses for 2001 were \$52.9 billion and the net-after tax loss was \$7.9 billion for the U.S. property and casualty insurance business.

Guess what? These events have moved us from a soft market to a hard market with a fast and abrupt thump. For the residential construction industry the thump was even uglier. The higher judgments and settlements in construction defect litigation cases have spawned even more cases to be filed, which only serves to increase the insurance losses for those insurance companies selling to builders, trade contractors and material suppliers such as the component manufacturer.

Given these events, what can component manufacturers do today to help themselves? Here are a few recommendations:

Treat insurance buying as a very important task within your company. This does not mean you should simply rely on the agent you have used for years and whom you may have met at some networking function. Buying insurance can be very complicated. A proactive purchasing approach is essential. How many people within your organization, for example, are involved in preparing your year-end federal income tax return? Compare that with the number of people involved with respect to purchasing insurance.

To manage an insurance program, you do not necessarily have to be an expert on insurance and risk management—you do need enough knowledge to ask the right questions and demand effective services. WTCA is currently working on developing an online training and certification program that will deal strictly with insurance as a risk management and liability avoidance tool. The goal with this online series is to provide component manufacturers with information and tools/techniques on how to: (1) understand insurance coverage and how different insurance policies deal with a variety of risks (e.g. general liability, automobile liability, umbrella liability, property insurance and workers compensation); (2) improve insurance coverage and reduce premium expense; (3) understand what insurance policies cover and what they do not cover; (4) deal effectively with insurance brokers and agents; and (5) effectively use your insurance company and agent with respect to claims management. Our goal is to have a more general training program, as ultimately, some understanding of insurance is essential for every manager, salesperson and truss technician within a company. We will also have a more specific certification program for those managers (e.g., company officers, risk managers and insurance buyers) that need even more in-depth knowledge.

Create and utilize programs to make yourself more attractive to insurance companies. The

recommendations and suggestions contained in the WTCA-sponsored Risk Management and Liability Avoidance program is a good starting point. The program involves a great number of risk management and liability avoidance techniques that begin with the bid/proposal to the customer and end with thoughts and suggestions on handling construction defect lawsuits that may be filed years after the trusses are delivered. Other WTCA publications and programs can also be helpful: In-Plant WTCA QC, Truss Technician Training (TTT) and WTCA's Jobsite Safety Package. These programs are all developed to reduce your risks which should help to lower your insurance premiums.

WTCA is also embarking on locating and training insurance brokers/agents who can be retained by component manufacturers and who will have experience with the risks and business practices of component manufacturers. It is essential that component manufacturers use their insurance brokers and agents more effectively so that they may thoroughly evaluate various insurance coverage alternatives, promote relationships with underwriters, present claims history in the best light, and prepare for insurance renewal early.

Help teach brokers, agents and insurance underwriters how In-Plant WTCA QC and Truss Technician Training Levels I and II should result in more affordable premiums. The goal of these programs is obviously to improve quality in design and manufacturing. The programs both offer a documentation system for the purpose of tracking results over a given period of time. Improvements in quality of design and manufacturing really need no explanation as to the positive benefits that will accrue to all businesses that use them to full advantage. A secondary goal, which many may overlook, is that component manufacturers who understand these programs and take advantage of the features that should make themselves more attractive to insurance underwriters.

Participate in data gathering with WTCA. Years ago, WTCA outlined a program of compiling a product incident database. The idea was to report on product incidents that caused personal injury or property damage involving finished trusses. If such incidents were reported, prevalent incident types could be determined and could ultimately lead to a WTCA program or recommendation, with a goal of reducing component manufacturers' loss exposure. Based on the increasing number of member requests recently, WTCA is moving this program up on its priority list and hopes to have it developed in the near future.

Until we get this program finalized, please feel free to report your experience with product incidents or other claims (inside the plant or at the jobsite) to me on a confidential basis. Such incidents or claims can then be developed into case studies (excluding company name of course), for purposes of education and development into future association educational programs and lead our industry to be known as an industry with strong risk management practices.

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SBC HOME PAGE

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