Insurance Premiums Only a Small Part of the Insured's Total Cost of Risk

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So many insureds complain about the price of their insurance. Rarely does a client say, "*That premium seems fair; the insurance company is getting adequate premium to cover its exposure and I'm getting the protection I need*." No, the most often heard complaint is, "*I can't believe I have to pay out all this money. The insurance company is killing me; can't we get the premium down*?"

Carriers such as GEICO, Progressive and now Allstate are playing to the belief that insurance is all about the premium/price. But is it the price or the cost the insured needs to calculate? Insureds must understand or be taught that the premium (price) is only part of their "**Total Cost of Risk**."

Every insured is subject, in varying degrees, to the "total cost of risk" concept, from the personal lines client up to the largest Fortune 500 Corporation. Six "costs" in addition to the premium combine to develop the insured's true cost of risk: 1) Deductibles/Self-Insured Retentions; 2) The cost of uninsured and/or self-insured losses; 3) Legal costs; 4) Loss control and safety costs; 5) Claims management; and 6) Opportunity costs.

Deductibles and Self-Insured Retentions
Premium savings is often accomplished by increasing the deductible or self-insured retention. But any price savings must be weighed against the "out-of-pocket" cost directly related to the deductible. The Price:Cost comparison is easy with smaller clients that have relatively few losses. A small commercial client, for example, may enjoy a premium savings of $2,000 by going from a $1,000 property deductible to a $5,000 property deductible; but one loss could "cost" the insured $3,000 more than staying with the lower deductible.

The Price:Cost comparison is complicated when the premium difference is in the multiple-thousands of dollars range. Successfully calculating the true cost savings requires an analysis of the loss history and the development of loss projections. While there is no guarantee that what happened in the past (as all losses (past and future) are random events), it's the only way to develop some comparison.Larger corporations are major proponents of high deductible programs because there is the immediate premium savings (as seen on the balance sheet). But when compared to the actual cost of loss experience such plan may be more expensive (but the cost may be spread over multiple accounting periods).

Basically, premium savings are eaten away by the cost of deductibles and self-insured retentions.

Uninsured and Self-Insured Losses
In an effort to cut the insurance price, insureds may intentionally or worse, unintentionally self-insure certain risks. Intentional self-insurance requires careful study of loss frequency and more importantly loss severity before implementation. Unintentional self insurance is what happens when price is the main concern and coverages are chopped to lower the premium.