Small Business Success Podcast:

SMALL BUSINESS INSURANCE 101

The **SCORE Small Business Success Podcast** features interviews with the best and brightest in the world of small business, covering topics such as business plans, financing, marketing, human resources, SEO, social media and more. In this podcast, SCORE mentors chat with Peter Hedberg.

* Peter Hedberg started his insurance career in 2003 at Hayes Company in the midwest. Peter handled management liability lines, and professional and privacy insurance. In 2013, he moved to New York and joined the underwriting side at Hiscox, a global specialty insurance company based in London. He currently manages new and renewal technology, professional, and privacy liability insurance for the Northeast Region of Hiscox.

Fred Dunayer:: Welcome to the SCORE Small Business Success podcast, Been There, Done That. To get free mentoring services, as well as to see the wide variety of resources available for small businesses, visit our website at www.score.org or call 1-800-634-0245. Now, here's your host Dennis Zink.

Dennis Zink: Episode Number 39. Small Business Insurance 101. Fred Dunayer joins me today in our studio as co-host, SCORE mentor, and our audio engineer. Good morning, Fred.

Fred Dunayer: Good morning, Dennis.

Dennis Zink: Our guest today is Peter Hedberg. Peter, welcome to Been There, Done That.

Peter Hedberg: Thanks.

Dennis Zink: Peter Hedberg started his insurance career in 2003 at Hayes Company in the midwest. Peter handled management liability lines, and professional and privacy insurance. In 2013, he moved to New York and joined the underwriting side at Hiscox, a global specialty insurance company based in London. He currently manages new and renewal technology, professional, and privacy liability insurance for the Northeast Region of Hiscox.

Peter, let's start with a topic most of our listeners are familiar with: Homeowners Insurance. Many small businesses begin out of their home. Does homeowner's insurance cover their business?

Peter Hedberg: That's a great question, and it's a good place to start because I think that's what most people are comfortable and familiar buying is homeowners insurance, or auto insurance, or other types of personal lines.

Homeowners insurance is really not written or intended to cover a small business, but a vast majority of individuals who have small businesses actually operate them out of their home. It's kind of a gap in coverage that people don't know about.

Dennis Zink: What does that typically cover?

Peter Hedberg: Your homeowners is really designed to cover stuff that happens to you because you're a homeowner. Property damage, storms, things that damage your roof, water leaks, or that sort of thing. If you have an individual that arrives at your home who is a customer, and say they slip on your stairs. That was a business related activity, and the insurance company isn't intending to necessarily pick that up.

If you have a friend that came over for say a party or just to visit or something, and they slipped, that's a different story. Generally speaking, most homeowners insurance exclude business activities in the home.

Dennis Zink: Then, to cover my business in my home, what do I have to do?

Peter Hedberg: Some people actually choose to call up their homeowners insurance and actually add an endorsement, which is a document that modifies the policy. Add an endorsement that allows for some business activities to take place in the home. A lot of times, the coverage isn't necessarily robust or sufficient for their purposes of business.

A lot of small businesses actually go out and attempt to buy insurance for their business. Commercial level insurance. That's something that we provide at Hiscox.

Dennis Zink: You're saying, then, that that's the preferable way to go? To just get a separate policy that covers your business.

Peter Hedberg: Yeah. The terms and conditions that are issued for commercial insurance tend to be better tailored than, say, what you would just endorse onto a homeowners insurance. The limits tend to be a lot higher as well, because if you're signing contracts with other people that require a limit, it tends to be a lot higher than the homeowners insurance company would be willing to provide as well.

There's also a lot of alternatives in the types of insurance that you can buy as well.

Dennis Zink: What are those alternatives?

Peter Hedberg: You can buy what's called a business owner's policy, or a BOP. I liken it to the Happy Meal of insurance because you get several different lines of coverage in that one product. You can get auto liability in there. You can get general liability. You can get some personal property coverage, and the like.

Dennis Zink: Many of our listeners will be operating a small business out of their home office or back bedroom, what have you. What other kinds of coverage should they be concerned with? Should they be concerned with intellectual property issues, their copier, their printer, their equipment that they may use in their business? In addition to slip and fall and liability insurance, what other things should they be concerned with?

Peter Hedberg: Absolutely. There are several insurance products that they should consider, and that's really determined on their particular situation. I think a big one that gets overlooked a lot in the United States is what's called professional liability, or errors and omissions coverage. What is colloquially referred to as E&O by a lot of people. What that does, is it protects you when you cause a financial harm to another party.

Really good examples of this are lawyers and accountants, and other professions where they're not going to necessarily cause physical damage or bodily injury to somebody else, but they could cause financial harm by making a mistake. Graphic designers have this exposure. Hairdressers have this exposure. Interior decorators have this exposure. Again, it's just for the financial liability.

It's important because it'll pay a 3rd party if you did in fact do something wrong. More importantly, whether you did something wrong or not, you could be accused of doing something wrong. In which case, you need to pay a defense attorney to defend yourself and to figure that out, and to get to a settlement at some point as well. That's one of the big things that that type of insurance pays for.

Dennis Zink: What kind of coverage limits are there? Lawyers can be pretty expensive, and those fees can rack up. Is that part of your coverage when you have a $50,000 limit or $100,000 or something like that? What do you advise the limit should be if I'm asking the right question?

Peter Hedberg: That's a very good question. You'd be surprised. I think that $250,000 or $500,000 limit, a lot of people still purchase, but I don't think that's sufficient nowadays based on what lawyers cost and the way litigation is going. I think a lot of people actually buy $1 million in limit, and that's not that outrageous actually. The pricing is not as outrageous as you might think, either.

There are a couple other lines of insurance outside of E&O that could be considered as well. A big one is worker's compensation. I think a lot of people have difficulty with that because they think because they're a sole proprietor that they don't need to buy that because they don't have employees. They need to actually look at the state laws. They may be required to still buy it. In truth, it's probably a good thing to buy anyway instead of relying on your major medical.

Dennis Zink: Is that something that a sole proprietor or a single person with say an S Corp or an LLC needs to concern himself with, or is it when he adds employees?

Peter Hedberg: When they add employees, depending on how they've added those employees, the state could actually view them as full employees even if they're using them as 1099 or independent contractors. There's this concept called a statutory employee, where if your relationship is close enough with this individual that you're working for and you're paying so much of a portion of their income as well, they could be considered an employee anyway and you have to be doing worker's compensation.

These are good things to bring up with an insurance agent or an attorney or business attorney that you might have, or just consult with the state because each state has its own programs for individual worker's compensation.

Dennis Zink: What type of premium should a small business expect to pay? Does it depend on where he's located?

Peter Hedberg: Absolutely. There are a lot of things that go into the underwriting. We call them exposures. There are different measures that we use to try to calculate a rate, and that then gives us a premium. A good measure of exposure would be your revenue. How big you are as a business. If you are say a $50,000 a year business, that's a lot different than a $500,000 a year business, which is a lot different than a $5 million a year business, obviously.

Which state you're in, obviously, can play into that to a certain extent, because part of that plays into jurisdictional stuff. If you're in a jurisdiction that happens to be very hard on insurance, sometimes that can raise your rates as well.

Dennis Zink: Just in a ball park sense. Again, I'm a small business owner. I'm working out of my house. What should I expect to pay for some minimal coverage that should cover me on most things?

Peter Hedberg: It depends a lot on what you do. If you're an interior decorator versus say an actuary that works as an independent contractor for other companies doing data analysis, your rates could vary wildly. In general, I don't think anywhere between $500 and $1,000 a year for a good policy that pays for everything is out of the question. Again, it just depends on what you want as well. Commercial insurance, like anything else, you could buy a lot more options if you want to be protected. A lot of that has to do with your personal risk tolerance philosophy. If you're somebody that doesn't like a lot of risk, you can transfer a lot of it, too, but again that raises your premium.

Dennis Zink: From what you've seen from small businesses, what are the typical losses that they may confront?

Peter Hedberg: A lot of small businesses struggle with renting a car and then causing a bodily injury. In which case, they didn't have a commercial auto policy and only their personal auto policy applied. There wasn't a lot of limit there. Since they owned a small business, whoever they hurt in that accident sees that there's a business involved and sees that there might be assets, so they don't just take the policy limit that's available because it wasn't enough.

Another one is the slip and fall, and then another one is the E&O. We see those a lot. Both of those can raise defense costs quite a bit.

Dennis Zink: In a BOP, is that typically some of the components that are covered?

Peter Hedberg: Absolutely. Traditionally, BOPs don't actually include professional liability. Hiscox is one of the first companies that have started including that affirmatively, because we think that that should be a part of everybody's insurance mix now.

Dennis Zink: Can you explain what a combined ratio is?

Peter Hedberg: Absolutely. It's important to understand how insurance companies make money, because it allows you to understand the process a little more when you're purchasing insurance. Insurance companies bring in premium, and then they have to pay out losses. In addition to those losses, they have certain expenses like anybody else. They have to pay for office space. They have to pay for personnel and that sort of thing. When you add up the losses and those expenses, at the end of the year most insurance companies hope that that does not actually end up being more than the premium that they brought in. That's called the combined ratio.

If your combined ratio is under 100, the insurance company is doing okay. It's probably making money. If it's over 100, they're probably losing money and that's a good indication that they're going to have to raise rates possibly.

Dennis Zink: When they look at your loss ratios and you're filling out a form to get insurance, does that go against you if you've had losses in the past?

Peter Hedberg: It really depends on the insurance company's philosophy, but I can say in general if you have a lot of attritional losses, which means you have several small losses that just keep happening, yes. That will definitely raise your rates, because the insurance company doesn't want to become a financing vehicle for something that theoretically they think you should be able to control.

On the other hand, if you have one big loss and it wasn't your fault. Say a windshield or a wind storm or something like that. They may not raise your rates, because that wasn't your fault and that was a once in a lifetime event. If you live in coastal Florida, that's different because coastal Florida is prone to having hurricanes. They're going to look at you differently as well.

Dennis Zink: What if a business owner doesn't want to purchase insurance. What would you suggest? Are there any alternatives?

Peter Hedberg: Absolutely. A lot of people think that the purchase of insurance is a compulsory thing. In many cases, it's still very elective and there are different ways to do it. A lot of large businesses use a rubric to establish what their exposure is to certain risks and whether they actually have to buy insurance or not.

The first thing they do is they identify the risk. What is it? Then they evaluate it. When they evaluate it, what they're trying to do is understand if it happens a lot. Is it a frequency thing? Does it happen seldom, but when it does it's really bad? We call that a severity loss.

After that, they have a choice of how they want to treat that risk that they've identified. You can try to control it, and you do that through certain preventative methods. Worker's compensation is a great example of this. Take an oil change place. If you have employees that fall into the pit where they're doing oil changes a lot, maybe you cover that pit up. That's controlling the risk. Or, if you need to have the pit open at all times, maybe you try to prevent the risk by doing loss prevention. You do a grate over it, or you do employee education or something like that. Or, you could do loss reduction. Maybe you put some padding in the bottom of the pit, so if somebody does fall in, it doesn't hurt as bad.

Then, you get over to the other side where you can try to finance the risk. You can retain it, and that's called self-insurance. A lot of corporations elect to do that but they're fairly large and they have enough money set aside to do something like that.

The last thing is you transfer it. When you transfer it, that's when you're buying insurance. You say that "I can't control this risk sufficiently to make me comfortable enough. I can't reduce it sufficiently enough to make me comfortable. I'm going to have to hand it off to somebody else and pay them a premium to take that on."

Dennis Zink: I remember self-insuring one of our businesses for health insurance, and boy was that a mistake. We actually just coincidentally got clobbered in one quarter by several people with pregnancies and all kinds of issues. We said we're not going to do that again.

Peter Hedberg: For a lot of people, it's a very simple lesson to learn.

Dennis Zink: What's the best way to buy insurance for a small business owner?

Peter Hedberg: That's a really good question, and I think that it's very difficult for some people when they're buying insurance because insurance as an industry is still a bit Byzantine and archaic in how it's structured. It's not as easy as just going online, or it wasn't as easy as that. It's becoming that way, thankfully. There are really 3 main methods, though, to buying insurance. That's how I break it down in my mind.

Number one is you can use an independent agent. That's the more traditional route. The independent agent has access to several different insurance companies. Those different insurance companies all have different rates. They all have different application structures. They all ask for different information. What the insurance agent does is they work with you to gather all of that information, and then provide it to each one of these insurance companies. The insurance companies then issue a quote, and then the agent goes through all of those quotes and sits down with you and says "I recommend this one" or "I think this one would be good for this reason, but if you are concerned about this here's another one." Obviously, price is a huge driver when it comes to that but it gives you a lot of latitude because you're able to see a quote from several different insurance companies.

The other way is you can go through an exclusive agent. This is traditionally how most people in the United States purchased their personal insurance. An exclusive agent is an agent that only works for one insurance company. A lot of the storefronts you see in strip malls or other suburban locales. You always get the mail from these individuals, too. They're always individual people who represent this one insurance company.

What's nice about them is that they can make the transaction very simple, because they only ask one set of questions because they're only one insurance company. The challenge there is that you don't have a lot of choice. You don't have a lot of latitude. You just get whatever insurance they provide because it's just one insurance company.

The third and final option for purchasing insurance, and this is becoming a more popular option for a lot of people partially because of the internet and the way we do business nowadays, and that's buying it directly from the insurance company. When you do this, you basically go online or you call up a call center that the insurance company has and you provide information and they give you their quote and their terms and conditions. It's important to note that you're still working with one insurance company, but you're working directly with that insurance company instead of going through an agent. Which means that no commission had to get paid, and if no commission had to get paid that can often lower your premium.

Fred Dunayer: Peter, is there a difference in the kind of insurance you need based on your corporate organization? In other words, if you're a sole proprietor versus a partnership versus a corporation, are there different insurance needs for those different types of organizations?

Peter Hedberg: That's a good question, and I never thought about it that way. Insurance companies may look at that to a certain extent because limited liability corporations obviously have a backstop for corporate assets that can be protected to a certain extent in that your personal assets can't become involved. More importantly, I think it has to do with what you do as a business and less to do with how you're legally structured. When you're getting sued, the plaintiff attorney that's suing you doesn't actually care how you're incorporated. They're just suing you. Those defense costs are going to cost what they do anyway.

Fred Dunayer: If you're a sole proprietorship, I would think that having maybe an umbrella policy or something like that over the top of your homeowners policy would be helpful.

Peter Hedberg: Absolutely, and that's a good point. From that angle, it's important to have insurance. If you're a sole proprietor and your business has particular assets but you're not a limited liability corporation. In other words, if you get sued, the limited liability corporation will protect your house. If you're a sole proprietor or organized that way, they can actually probably go after your house and other business assets that you have. Personal or otherwise. An umbrella is a very nice thing to have in that case. Especially if you purchase an umbrella of like $1 million or more, because then you have added protection and whatever you're being accused of, there might be enough money there to defend you.

Dennis Zink: The umbrella pays after the other policies pay, is that correct?

Peter Hedberg: That's correct. Umbrellas are structured to attach to policies once they've been exhausted, but the reason they call it an umbrella is because it actually blankets and sits over several different insurance products that you buy. The big ones that you purchase would be general liability, automobile liability, worker's compensation, and those types. Those are what called casualty covers. Property is kind of a different deal, but we can discuss that later.

Dennis Zink: How is a premium calculated for a typical business?

Peter Hedberg: Insurance companies calculate premium based on your exposure. We talked about what different exposures are. How many employees you have. What's your revenue? That sort of thing. They have different rates that they've filed with the state. They have to be transparent about that. They file a rate so it'll be x fraction of a cent per $1,000 of payroll, or something to that effect. When they apply those 2 things together, the exposure and the rate they have, that's what produces your premium.

Dennis Zink: Are companies rated?

Peter Hedberg: They are. The main rating agency for the insurance industry is called AM Best. They have a website, and I believe their ratings are free to access.

Dennis Zink: The insurance companies are rated. What about the clients?

Peter Hedberg: The insurance companies do rate the clients in order of what they think their risk profile is, obviously, but that's just part of the standard actuarial process.

Dennis Zink: In other words, if someone was 125% they'd pay more than someone that was 100%?

Peter Hedberg: Very possibly. Again, the circumstances have a lot to do with what actually caused them to be running at 125% of their account. If they've cost the insurance company more than their premium consistently throughout the years, there may be a systemic problem with that insured, too. There may be something that they could fix, but they're refusing to.

Dennis Zink: What kind of discounts, if any, are available to small businesses?

Peter Hedberg: Small businesses have a lot of discounts available to them. In many cases, the auto liability can be discounted with particular behavioral based stuff. Some insurance companies will offer to reduce your rates if you implement a safe driving program.

One of the more basic ones, though, is called a switcher discount. If you move your insurance from one insurance company to another, they'll give you a discount automatically because you moved your business. That doesn't mean that you're going to get that particular discount next year. You'll probably go back up to the premium that you should be at.

Another discount, though, too is if you buy direct. Again, the insurance doesn't have to actually pay for a producer to find that business, so that's a discount automatically right there.

Dennis Zink: Will I benefit as a small business if I have all my policies with you, for example, with one company?

Peter Hedberg: Yeah. A lot of insurance companies when they write their insurance policies, they write them to work together with one another. If you do have multiple losses that affect different lines of coverage, it's a lot easier to have that harmonized with one insurance company versus having more than one insurance company then entering and trying to pick apart the loss.

Fred Dunayer: If you're looking at your information online, it's a lot easier to go to one company to get that information in one place than it is to have to know 4 different insurance companies and 4 different passwords and logins, and trying to keep them all controlled.

Peter Hedberg: That's a great point. From a customer service perspective, it greatly simplifies the transaction.

Fred Dunayer: Peter, I know that we're going to have some further discussions regarding some details on insurance, but as far as this basic 101 situation or discussion, is there anything that we haven't talked about that you think needs to be brought forward? Is there one particular thought you want to make sure that our listeners come away with?

Peter Hedberg: I hope the listeners can understand that there's a difference between what is an insurable loss and what is not an insurable loss. I think a lot of people purchase insurance, and unfortunately they don't read the fine print. It's slightly an unreasonable expectation for everybody to read the fine print because it's very legal jargon in some cases.

It's important to understand that a good example of an insurable loss is the property that you own, the contents in your building, the liability if you have a fold in your rug and somebody trips on that or something like that. If you're in the process of launching a new product, and your product doesn't sell as well as you thought it would. Or, you have a key employee that has gone to another company and you've lost some revenue because of that. Or, you've opened a new office and that office isn't performing so well. Those are just standard business exposures, and unfortunately those just aren't insurable risks.

Dennis Zink: If Fred walks out of the building and he becomes incapacitated and we can no longer do these podcasts, can I insure against that, or not?

Peter Hedberg: Depends on who Fred is and who he is for your business. There is something called key man insurance, and it's an insurance that I don't hear get purchased a whole lot. If something happens to Fred that's not just him moving to another company, you can insure it. If you have a lot of revenue tied up with Fred, then that particular insurance will actually pay out if something happens to Fred.

Fred Dunayer: Well, one of my mottos is never be worth more dead than alive. Hopefully, they won't take out that kind of insurance on me.

Thank you very much.

Dennis Zink: We really appreciate you enlightening our listeners on Insurance 101. Thank you for being our guest today.

Peter Hedberg: My pleasure, guys.

Fred Dunayer: You've been listening to the SCORE Small Business Success Podcast, Been There Done That. The opinions of the hosts and guests are theirs and do not necessarily reflect those of SCORE. If you would like to hear more podcasts, get a free mentor, view a transcript of this podcast, or would like more information about the services we provide you can call SCORE at 800-634-0245 or visit our website at www.score.org. Again, that's 800-634-0245 or visit the website at www.score.org.