PERSPECTIVE

How do you Decrease Cost, Increase Efficiency, and Strengthen Relationships Even When the Going is Rocky?

Abstract

The property and casualty (P&C) insurance business has experienced some difficult times. With unpredictable climatic change the world over, the last few quarters have seen rates harden and ratios come under immense pressure. Executives are looking for new ways to stay profitable and competitive. This paper talks about the various avenues available internally to P&C insurers to look at improving cost structures.

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Background

The global property and casualty (P&C) business has witnessed a challenging 24 months. Insurers have witnessed unprecedented natural catastrophes in the last 24 months. As we move along in 2013 the continued focus on increasing climatic change and possibility of perils casts a shadow over the industry.

As a result, all three segments – personal lines, commercial lines, and the US reinsurers – are expected to report relatively large underwriting losses. The industry's policyholder's surplus is anticipated to decline modestly and return measures are expected to be in low single digits. It is estimated that net premiums written increased 3.5% to US$442 billion in 2012[1]. The P&C industry's year-end combined ratio closed at 108.2, higher than the 107.5 in 2011 and 101.0 in 2010[2].

Impact of Global Weather Conditions on the US P&C Industry

From December 2012, the New York Department of Financial Services started reporting the claim volumes and cycle times for claims related to Hurricane Sandy. A brief analysis of the top five insurers showed that Allstate had received 72,504 claims and 183 complaints for a ratio of 0.25%, the New York regulator said on its website. Policyholder-owned State Farm Mutual Automobile Insurance Co., the largest US auto and home insurer, had received 48,109 claims and 84 complaints, a ratio of 0.17%. The AIG ratio was 0.08%[3].

About 66% of Allstate's (US's largest P&C insurer) catastrophe claims in October came from New York, and New Jersey accounted for 20% of catastrophe claims, the Northbrook, Illinois-based company said.

The CIO of Grange Insurance, Michael Fergang, in a recent interview said, "The extended market challenges and uncertain investment landscape will continue to challenge carriers to 'do more with less' and to continue focusing on initiatives that cut cost, increase efficiencies, and enhance relationships with our agents and policyholders. This is the 'new normal,' and will continue to challenge us for the foreseeable future. To compete in the independent-agent market, we have to align our efforts with the needs of the agents to drive value and make them want to write business with us."

[1] Source: Bloomberg

[2] Source: Insurance Journal Feb 6 2012 & A.M. Best and Property and Casualty 360

[3] The New York Department of Financial Services (http://www.dfs.ny.gov/)

On the Other Side of the Atlantic

The weather has not had much of an impact on the combined ratios of insurers, but:

- A staggering 18% increase in the proportion of third-party accidents involving bodily injury (third-party bodily injury / third-party damage ratio) from 2010 to 2011. Estimates suggest that this rise goes with unprecedented activity by claims management companies. This change alone increased costs to insurers in excess of £400 million and as a result it is likely that motor insurance premiums will rise.
- Third-party bodily injury (TPI) claim frequencies increased by 5% in 2011.
- Accidents giving rise to third-party claims are on the decline according to our 2011 data. Possible causes for this could be the rise in petrol prices leading to less discretionary travel and higher use of public transport. This is the sharpest drop in the last five years, representing a decrease of 11%.

Source: 2012 report on third-party motor claims and periodic payment orders (PPOs) from the Institute and Faculty of Actuaries

2013: What will Insurance Companies do to Stay Profitable?

The big priorities for all insurance companies in 2013 will be looking to manage costs, reduce long-tail claim expenses from the P&C business, and push gross written premiums. Impacts of the costs of Hurricane Sandy have been quantified. It was estimated that the combined cost on insurers and reinsurers was close to US$50 billion[4]. The equity market has been rather flat and unexciting, so little can be expected in terms of investment revenues. Insurance carriers will look to prioritize any big IT transformation spends and discretionary expenses.

[4] Source : Wall Street Journal Dec 2012

So What can Insurance Carriers do In-house to Help Them Address the Situation?

The distribution of costs that impact the profitability of insurance companies across the value chain and lifecycle can be broadly split up as shown:

Distribution	Product management	Administration	Investment management	Investment management administration
45%	*18%*	*27%*	*5%*	*5%*

Source: Infosys Insurance BPO Center of Excellence

Let's look at each of these segments and consider the options available to P&C insurance carriers to address CXO objectives: stay profitable, grow the business, and deliver value to shareholders, customers, and employees.

Areas	Key focus areas	Impact on objectives
Distribution and sales	• Continue to drive profitable distribution through multiple channels • Agents and insurers continue to develop new models such as predictive analytics to identify profitable business	Medium to low
Product mix	• Hardening cycles call for more efficient underwriting • Consolidation across insurance companies into specialized products aimed at certain segments	Medium to high
Existing administration costs	• Drive efficiencies in existing operations • Look to deploy cost-effective outsourcing • Reduce any long-term, non-strategic spending • Reduce layers and organization structures • Cross-utilize or share services	High
Investment management and administration	• Diversify investment management into balanced and secure money market instruments • Rising rates and improved underwriting returns should help offset declining investment returns • Focus on bridging short to medium cash flow issues as a result of increased P&C claims and long-tail expenses	Low

Impact on objectives has been qualified based on a quantifiable analysis of factors such as ease of deployment, realization of benefits, and upfront investments required to deploy initiatives.

Insurers have a few high impact levers that can be executed in the short to medium term, to help them derive the significant savings from their administration functions. Most of these administrative functions are either completely in-house or range from partially to completely outsourced.

Impact of Strategic Initiatives on Costs Across the Value Chain in 2013

David Bidmead, CEO (US) of Marsh Inc., in a recent interview said, "Another challenge in 2013 will be maintaining operational excellence. Marsh has enjoyed substantial growth in the US over the last few years. To be able to continue to support that growth we need to identify areas of the business where we can simplify our processes for the benefit of our clients."[5]

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Let's take a closer look at each of these possible avenues and their consequential impacts on the objectives.

1. Removing Failure Demand in the System

Failure demand is the customer demand that gets created in insurance operations, as a result of failure to do something right the first time. All insurers have peaks and troughs in their service operations. The operational call to reduce service in one area to cater to another usually drives failure demand in the system. Failure demand can usually drive up to 10% to 12% of the customer demand in the system[6]. Follow-up calls by customers on claims and repeat requests for policy changes are all examples of failure demand that can be monitored. Service delivery leaders must weigh their options, to balance capacity constraints and ensure that sensitive customer touchpoints are catered to, thereby reducing failure demand and effectively using capacity.

Failure demand is not usually visible through standard business metrics. Customer demand usually rises with an increase in volumes, however some of this increase can be apportioned to failure demand. Insurers will need to be innovative and non- conventional in their approach to measure themselves. Moving away from standard business metrics like service level, accuracy, and ageing, as a gauge of quality of service is the first step in that direction.

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[5] Source: Dec 2012 interview in Property and Casualty 360

[6] Source: Infosys Insurance Center of Excellence

2. Process Reviews / Claims Reviews

Claims costs are the bulk of expenses that P&C carriers incur. Given the limited control on 'black swan' events, companies are smartening up their underwriting systems and processes to move towards writing more profitable business.

Claims leakage is the amount that can be attributed to claims being overpaid, or incorrectly paid due to human error or system failures. In an ideal world, insurers would expect to have zero claims leakage. Best practice driving and performing claims reviews regularly can help bring this down. Process reviews or claims reviews is the task of carrying out an end-to-end review of the process, using a statistically valid sample size to identify opportunities and points that are more prone to human error.

Process reviews require commitment from operations teams to help map out the process and critically analyze areas where improvements can be made. Deloitte, in the September 2010 Insurance market update suggested that claims reviews can help reduce claims leakage to 2-3%, and some insurers have achieved this.

3. Cross-skilling Resources Based on Peaks and Troughs

Cross-skilling is a service delivery lever that helps drive versatility across team members in administration teams. P&C insurance has a variety of back-of-the- house tasks, which are quite intricate and complex. Functions such as renewals, binder management, credit control, and catastrophe modeling are very knowledge intrinsic and have a high impact on effective business operations. Traditional team operating models are such that people are aligned to the task depending on the volumes. Mathematically, expressing this would be:

Capacity (C) = (total units x standard time taken) / total production hours (less shrinkage)

The above model looks at each team as an individual unit and usually derives capacity to manage work in silos, without accounting for aspects such as trends, seasonality, idle time, and skill enhancement as a function of tenure. These factors will always create some smaller amounts of available capacity in each team, but due to lack of available training and practice they cannot be cross-utilized or deployed to areas that are experiencing volume fluctuations.

One of the biggest constraints to service delivery leaders recognizing this capacity is the lack of intelligent MIS that helps leaders gauge effectiveness and utilization.

Mathematically, the cross-skilled element in an operations area can be calculated as below:

Cross-skilled capacity (C) = actual tasks trained / total available resources x total tasks in an operations cluster

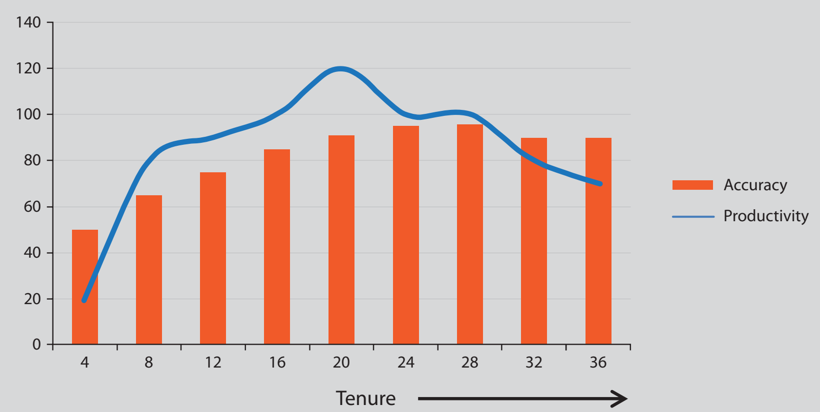
Driving the cross-skilled capacities in each team will help the business units cross-utilize resources in high-volume and high-demand periods, such as long-tail claim processes, and reduce support from temporary staffing or overtime, thereby bringing down costs.

Insurers can look to rely less on temporary or contract staff to fill gaps, and could effectively manage existing capacity to cater to peaks and troughs. Cross-skilling will also help carriers address capacity constraints when 'black swan' events hit insurers in succession. In such situations, carriers have to cater to increased FNOL volumes as well as follow-on long-tail procedures, creating a big capacity vacuum.

4. Short-term to Long-term Outsourcing

P&C insurers will experience capacity constraints, due to the long-tail nature of the claims. Given the impact of the events on property and the surrounding ecosystem not being able to cope with the pace of refurbishment, the cycle times

Relationship between employee tenure with productivity and accuracy



The relationship between employee productivity and accuracy is linear to employee tenure in insurance processes. As employees get trained in the organization their productivity increases. Given the intricate nature of work and a lot of legacy-based systems, insurance administrative staff need to spend adequate time in the learning curve to be able to meet the productivity and accuracy numbers. Over time, productivity also sees a declining trend, unless there are adequate job rotation and learning opportunities.

Source: Infosys Insurance Center of Excellence of all long-tail claims are expected to be longer than usual.

Capacities will have to be managed and created. Expectations are that insurers will resort to methods like temporary staffing, overtime, and cross-utilization to manage volumes. This could be the perfect opportunity to engage with service providers, who bring in the expertise in areas, across the value chain to engage in short-term to long-term outsourcing. Functions like claims setup and claims fulfillments are perfect candidates for short-term to long-term outsourcing. Large-to-medium sized service providers have existing competencies and large practices in these areas to help reduce start up and transition times, and address capacity constraints.

Using Service Providers to Deploy Outcome-based Transformation

Large service providers today have built dedicated insurance practices with a focus on operational and service excellence. The first step in the journey of any such engagement with a service provider constitutes converting the operations unit from the back office of a P&C insurer to a service delivery organization of a provider with metrics and performance measures. Deployment of methodologies such as Six Sigma and Lean, help improve operations with an end view to improve the service to the end customer. Insurers could look to engage with service providers to carry out such transformation initiatives within their existing operations to help improve metrics and create capacity within the existing resources, by deploying more efficient and effective processes. Such initiatives are usually short to medium term in deployment time. These initiatives are also low on significant upfront investment, as they are mostly self-funded (the cost of transformation is lower than the benefits delivered from transformation). Some common engagement models to drive transformation are listed below.

Time- and effort-based

Insurers have already identified what needs to be done, and have narrowed it down to few areas within an existing area. They are only looking for skilled resources to execute the job and deliver against a set of outputs.

Consulting approach

In this approach, service providers and specialists are engaged with the insurer to carry out due diligence or a discovery exercise within the operations, based on which they come out with improvement areas, benefit roadmaps, and execution plans. Insurers would then go back internally and evaluate the significance of executing, some or all of them, and internally execute the recommendations.

Outcome-based transformation

Probably the most apt and effective engagement model. Service providers are engaged to address specific business problems and bring about improvements. The model works on risk and reward, where the service provider is compensated part (a share) of the benefits derived from the improvements. All costs of resources and analysis are managed by the service provider.

The Way Forward

2013 will continue to be a challenging year for all P&C insurers, with the continuing impact of the North American weather conditions forecasted. As rates go into a hardening cycle, increased regulatory pressure and an almost flat investment market will drive insurers to explore newer and innovative options to improve expense and cost ratios. Without undermining the impact and advantages of technological deployments to bring down long-term costs, P&C insurers have a host of avenues in-house that can be explored to create cost efficiencies and drive profitability.

About the Author

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Ashish has more than 15 years of experience in the insurance space and has played a variety of roles in insurance BPO across L&P and P&C segments – spanning delivery, transition, process excellence, and solution design. In his current role, he engages with potential customers on strategic engagement models, as well as driving transformational initiatives across the existing service lines. He also manages the analyst and advisory relations, and interactions for Infosys BPO with the influencer groups.

Ashish is a B.Com (Hons) graduate from Delhi University, along with a certificate in insurance from the CII UK. He is also a certified Six Sigma practitioner.