Leakage!

The notion that insurers can better control their claims/indemnity spend through streamlining, cost cutting and efficiency initiatives has gained momentum in Canada in recent years. Many insurance companies are finding ways to plug financial "leakage" in claims handling - a term not always popular with claims managers. Independent adjusters understand the reasons behind this focus on costs, but caution that a proper approach to claims adjudication should prevail.

By: Craig Harris, Freelance Writer

The simple description of leakage is that it's the difference between what an insurer should pay in claims under the contractual policy and what it actually ends up paying. This sounds straightforward; however, the reality of lost dollars due to claims process issues can be remarkably complex.

For example, the International Risk Management Institute (IRMI) characterizes claims leakage as "dollars lost through claims management inefficiencies that ultimately result from failures in existing processes (manual and automated)...The cause can be procedural, such as from inefficient claim processing or improper/errant payment, or from human error, such as poor decision-making, customer service, or even fraud."

A recent study by PwC, called "Stopping the Leaks," also identified failure to detect fraudulent or over-inflated claims, errors in payments made to claimants and missed opportunities as the main culprits behind claims leakage. The consulting firm noted that people, process and technology glitches are the key drivers behind higher than necessary claims payouts.

More Than Just Fraud

"Leakage is more than just fraud," the PwC study stated. "It refers to any instance where the insurer paid more than was appropriate or necessary under the terms of a policy."

Many studies on insurance operations argue that there is plenty of room for improvement in claims handling efficiency. "Over 15 years of research, compiled across more than 70,000 claims reviews, 4,500 interviews with claims professionals, and across companies operating in more than 14 countries, has confirmed that there is significant room for insurers to deliver improved outcomes across loss cost management and expense efficiency," Accenture noted in a report entitled "Claims at a Crossroads."

Just how much leakage actually exists is a question open to debate. Several figures and percentages have been bandied around. "Many are surprised about both the extent of claims leakage and the improvements possible," according to PwC. "The industry benchmark for leakage is about 3 per cent, but in our experience most insurers have levels well beyond that. At some insurers... we have identified leakage of up to 25 per cent."

Inpoint, a subsidiary of multinational insurance brokerage Aon, specializes in helping insurance companies reduce leakage through adherence to best practices in claims handling. According to Inpoint's web site: "The claims leakage of an average insurer is typically 8-12 per cent of claims cost, depending on the line of business, and many insurers have limited strategies or knowledge on how to reduce leakage to best-in-class (typically 2-3 per cent) leaving a significant opportunity untapped."

Inpoint is working with three of the top five Canadian insurers on ways to improve claims performance, notes a source with the company.

Emerging on the Radar Screen

"We have been working in Canada since 2008 and have seen claims leakage really emerge on the radar screen for insurance companies," says Mitesh Suchak, a partner with Inpoint in Canada. "It was a newer topic at that time, but it is more mature today. It has become more important for Canadian companies in measuring this leakage, and it really goes hand in hand with measuring the quality of claims handling."

Other sources have also seen a distinct move towards plugging holes in claims leakage.

"It is a significant focus for many of our clients," comments Jim Eso, senior vice president, property and casualty at Crawford & Company (Canada) Inc. "At a time where claims departments and insurers in general are facing the pressure of rate competition and less than ideal investment returns, along with things like mandatory premium reduction in the auto market, identifying claims leakage and taking steps to control those costs makes a lot of sense."

Patti Kernaghan, president of Kernaghan Adjusters Ltd., says the insurance industry has mirrored other parts of the economy in its focus on cost control.

"Every business makes choices around the resources it will use to solve an issue," Kernaghan notes. "The insurance industry is no different. The question of cost management versus the knowledgeable expertise and time it takes to properly adjudicate a claim is a struggle the industry faces on an ongoing basis."

"We see regular changes and process implementation by insurers designed to improve performance on many levels and some of those are certainly aimed at catching some of the 'leakage' that does occur," notes Fred Plant, president of Plant Hope Adjusters Ltd. "However, the jury is still out on how effective many of those strategies are."

Claims Transformation Strategies

Others see the move towards containing leakage as part and parcel of broader claims transformation strategies.

"Most insurance companies have expended a lot of energy and resources on initiatives to improve their claims operations as a whole," says Pierre Lepage, a partner in the P&C actuarial practice for KPMG in Canada. "We have seen this in three ways in recent years - better claims systems, or getting better information to people handling the claims, improving the internal claims processes, or getting the right file to the right person, and better supply chain management."

"It really is about ensuring that the contractual promise an insurance company makes to customers is fulfilled completely and satisfactorily, but as efficiently and cost effectively as possible," says Scott Shapiro, managing director, actuarial and insurance practice in KPMG's U.S. operation. "These are not conflicting goals. There are always opportunities through data, information and training to be as efficient as you can be - those companies that focus on that will get a competitive advantage."

Most agree that the primary source of leakage is property claims, particularly large events that feature a sharp spike in loss frequency. For example, the massive flooding that hit southern Alberta in the summer of 2013 saw interpretations and reconsiderations of policy language that, in some cases, extended coverage to situations that would otherwise not be indemnified. In other cases, the sheer volume of property rebuilding and a shortage of qualified contractors led to cost overruns.

Speaking generally, Suchak notes that leakage can play a factor in all business lines - auto (AB/BI and PD), property (personal and commercial), casualty and business interruption. "Where insurers find leakage certainly varies from company to company and from line of business," Suchak says. "There are some insurers in the high teens in certain areas, and others much lower. The spectrum is pretty wide based on the capabilities of each organization."

The upside of controlling claims leakage for insurers is obvious - reduced costs. "The good news is that while claims leakage is a complex issue, the process to improve it is relatively straightforward," states the PwC study. "And in most cases can lead to savings of between 5 and 10 per cent. For an insurer spending $500 million in claims, that translates to a bottom line improvement of $25 to $50 million."

Best Practices in Claims Handling

Those numbers certainly sound good, but Suchak says there are several processes that have to take place before leakage issues are fully addressed. For his firm, the first step is measuring the leakage through a proprietary, web-based platform called ClaimsMonitor. Then, insurers can compare industry best practices to their own claims handling procedures - and see where the gaps are.

"The next step is usually around measuring the quality of claims handling, sampling X number of files per adjuster per month," says Suchak. "And then it is having the appropriate improvement planning to go after the issues identified in the audit or review process."

"Some of those are strategic issues that companies will have to address at an overall level," he adds. "For example, there may not be an effective plan for subrogation recovery. Other issues are more individual and may involve coaching issues on training and handling claims."

For insurers, the need to juggle service, costs and satisfaction is a delicate balancing act.

"All of the costs need to be managed correctly," Lepage says. "If you look at internal processes, it has been proven that the faster you can get the file to the right person, the faster you take care of the claim, the better the service to the client and of course the greater benefit of reduced costs. For the insurers I talk to, these are the ultimate objectives they need to balance."

Taking Unnecessary Costs Out

"Taking unnecessary costs out of the claims - both from an indemnity and expense perspective - should be a win/win for the insurer and the insured if it is focused on removing inefficiencies from the process that lead to lower costs and potentially quicker claims resolution," Eso says.

"Completing vehicle repairs more quickly for example by streamlining the estimate process means the insured gets their car back sooner, the insurer saves on rental car expense and the body can repair more vehicles and obtain their payment sooner," he adds.

However, not all sources concur with the "win-win scenario" of insurer approaches to controlling claims leakage. For some, the focus is too much on internal company processes, benchmarks and metrics, which can be misleading to the bigger picture of claim indemnification - and client satisfaction.

"The measure of success on a claim is the compliance with process rather than determination of what should be paid on a claim," Plant notes. "It appears insurers would rather save expense dollars and sacrifice indemnity dollars as there is no effective way to ever compare what should have been paid to what was paid. However, comparing this year's or this quarter's expenses to the same period last year can be done and management is judged on that."

"Insurers should be pricing their product based, in part, on what the real costs of claims are rather than collecting too little in premium and trying to squeeze shareholder return from those dollars at the sacrifice of diligent claims service and proper adjudication," Plant adds.

For Kernaghan, the prime issue is that not all claims leakage strategies are created equal. In some cases, such as telephone adjusting for routine auto claims, she agrees that cost efficiencies can be realized. In other areas, such as the use of unlicensed contractors for property loss adjudication, the results may be disastrous and lead to conflict of interest.

Many Leakage Strategies Don't Perform Well

"We are generally closing our eyes to the obvious - many leakage reduction strategies don't perform well," Kernaghan comments. "Financial leakage is not a surprise; the industry is willing to live with a certain level. Independent adjusting fees are perceived as expenses even though they help control the cost associated with increased indemnity figures. Financial leakage is created when we don't pay attention to the business we're in - selling claims service. Who is watching and measuring the cost of indemnity?"

This latter question is particularly relevant given the tendency of some insurers to directly outsource property insurance claims for rebuilding and reconstruction to contractors. While it's difficult to measure the extent of this practice, Kernaghan says it is a mistake that will create far more problems than solutions.

"Unlicensed people in the field can't see and don't know what to look for in terms of the contract of insurance," notes Kernaghan before rattling off several questions. "Does the unlicensed activity have a self-interest in the outcome of the work necessary to conclude the claim? The basement is full of water but is it over land flooding or sewer back up? Will the unlicensed vendor create an estoppel and the insurer have no choice because the action taken was within the vendor's authority to proceed with emergency repairs? Are we adjusting claims or writing cheques without proper adjudication and oversight?"

Eso observes that a short-term focus on cost cutting or simply removing layers from the claims process can come back to bite insurers if they lose sight of the goal of claimant satisfaction.

"The savings from not paying for a staff or independent adjuster can quickly be lost if indemnity control is not carefully managed or if coverage interpretations are not done accurately," Eso says. "The savings can also be lost if there is perceived lack of customer service or perceived inadequacy in the settlement amount, leading to lower customer satisfaction."

Inpoint's Suchak says some of the initial attempts at claims leakage control may have focused more on the "head count" issue, but he argues that insurers have broadened their approach in recent years.

Driving Quality, Efficiency and Service

"We have seen companies pursue cost cutting by, say, reducing head count, but that can reduce the quality of claims handling and result in higher leakage," Suchak observes. "Now, we are seeing that it is more about driving quality, efficiency, improved service levels and best practices in claims handling."

Others hold that insurers can still keep their eye on the indemnity ball while pursuing greater efficiency - it's not a zero sum game.

"It may look to some like just cutting corners, but there are ways to improve service and reduce costs," Lepage says. "For example, claims service in the past was often seen as going through a series of filters before payment. But it is much more effective to view it as a triage system. Who does the claims need to go to in order to provide the best, most efficient service?"

"The most cost efficient thing you can do is to fulfill the promise of the contract completely," says Shapiro. "You can be very penny wise and pound foolish here, but that is not the motivation I see when insurer clients ask us how to become more efficient or to lower costs. It is never in my experience anything to do with less customer satisfaction or not fulfilling the contract."

Given the recent activity around claims leakage, one point that adjusters and other sources make is the need for a more productive dialogue amongst business partners, including insurers, independents and all players in the claims value chain.

"We believe that an ongoing dialogue with the claims adjusting firm is the best way for the insurer to achieve the best outcome in managing claims costs," Eso notes.

"Adjusters often see inefficiencies in claims processes, but may not always feel empowered to change the processes or may not have a forum with the insurer to make recommendations to change the process."

"We do not see it as a point of friction but rather a sign of a strong partnership when an insurer asks us to help them with cost controls, even if some of the outcome will be reduced claims fees," Eso explains. "In the past, leakage control might have meant things like controlling fraudulent claims or negotiating lower settlements with insureds. However, today's consumers require a more sophisticated, holistic approach that makes the claims process easier by removing unnecessary inefficient processes, while keeping customer service and retention top of mind."

Dialogue and Partnership

Suchak notes that at least part of that dialogue is beginning to take place as insurers take the "quality journey" towards best practices in claims handling.

"Insurance companies are starting to put in place the metrics around measuring quality down to the adjuster level," he says. "This is not just about traditional audits, but moving into self-review of performance, wherein an adjuster reviews his or her own performance."

"We are seeing companies track and measure the level of agreement between adjusters and supervisors and home office on quality of claims handling," Suchak adds. "You can have one claim and have multiple people review and compare how aligned they are in terms of quality."

For Kernaghan, the insurer discussion about quality, costs and best pratices in claims handling should involve a direct dialogue with those knowledgeable in the field - adjusters.

"Independent adjusters are an extension of an insurers' claims department," Kernaghan says. "We are trained to control expenses and watch for unnecessary deviations from the actual contract. We are the gatekeepers for insurers' expenses. Our expertise and presence controls costs. The level of indemnity paid is lower when knowledgeable adjusters are used."

Plant contends that terms such as processes, benchmarks and metrics do not paint the full picture of proper claims adjudication.

"As long as the concept of indemnification is still part of the P&C Insurance process, claims can not be whittled down to algorithms and robots," Plant says. "We are seeing more and more 'processes' employed to move claim along and, so long as the process is followed, the claim resolution is deemed a 'success'. Actually, had a well trained intelligent person been in control of what was paid to whom and when, the claim payment would have been less."

In fact, Kernaghan argues that the pendulum of traditional cost reduction practices may be swinging in favour of more nuanced approaches that take into account all aspects of adjudication and claims performance.

"The trend for applying leakage reduction strategies that don't perform well may be heading in the other direction with a market correction toward proper adjudication, communication and training," Kernaghan concludes. "When companies provide trust and put authority into hands of the adjuster, with clear lines of communication regarding their service requirements, everyone wins."