

The Economic Landscape and

Operational Performance Metrics

Bulletin

Property & Casualty Claim Officer Survey #4



Introduction

This is the fourth installment of Towers Watson's Property & Casualty Claim Officer Survey conducted by the company's Claim Management practice. It focuses first on the impact of the economic climate on claim operations — including loss costs, litigation levels and expense management — and second on the use and development of claim performance metrics related to expenses.

A recent Towers Watson survey of finance executives in all industries showed that 42% of respondents had suffered revenue decreases of 10% or more, and the vast majority were going to great lengths to conserve cash. In addition, more than half the respondents to that survey, conducted in October 2009, predicted that the recession would not end until the second half of 2010 or the beginning of 2011. In short, claim officers are not alone in their continuing concerns about the economy, nor in their efforts to influence the bottom line.

Specific to the insurance industry, our first survey, conducted in late 2007, explored company approaches to managing claim results. In this most recent survey, we delved deeper to look at the claim metrics underlying results measurement, such as claim frequency and severity, litigation, fraudulent claims, cost drivers and cost controls, budgets and performance indicators, as well as how these measures are evolving.

This series of surveys is conducted once or twice each year on topics identified by survey participants as key to successful management and performance of claim operations.

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Economy Impacts Claim Loss Costs

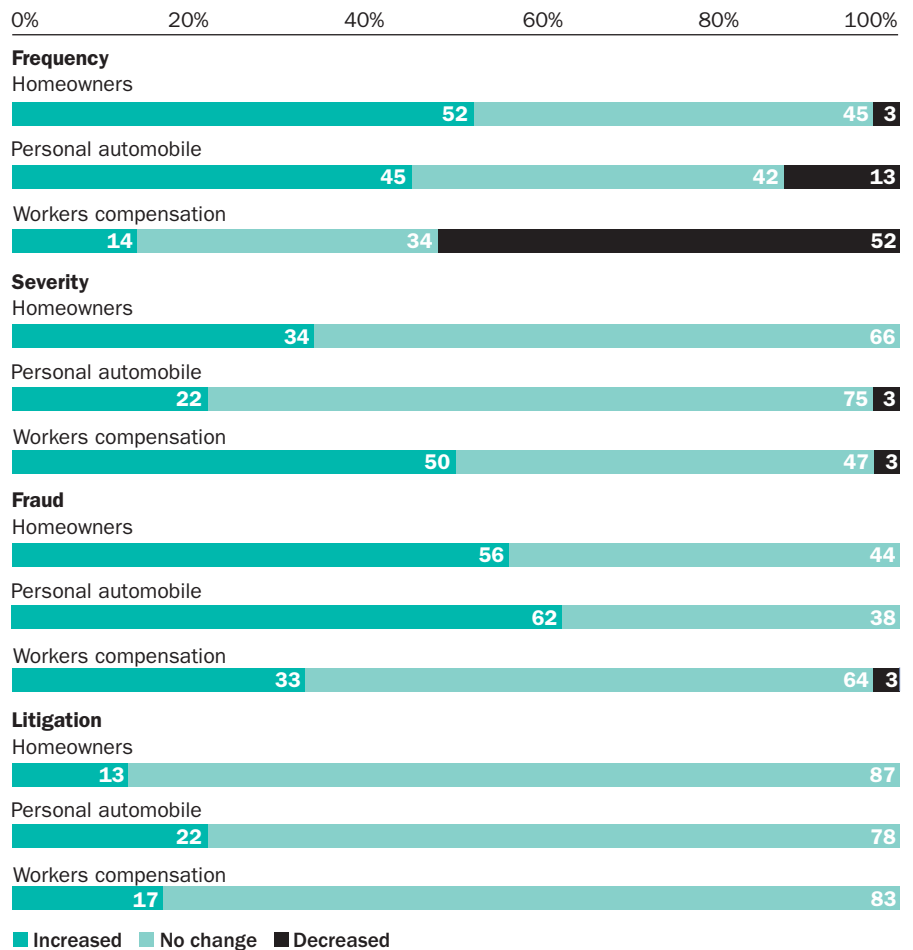
Survey respondents said they consider the economy a relevant factor in rising claim loss costs. With the exception of workers compensation (WC), claim frequency and severity were reported either as unchanged or on the rise for most property & casualty lines of business. This finding tracks with industry trends suggesting that pure premiums are increasing and confidence in market stability is shaky. For personal lines, the indications point to increasing claim frequency and severity, with clearly adverse pure premium implications. While more companies reported a drop in WC claim frequency, fully half noted an increase in claim severity in this line of business, creating uncertainty in the loss cost outlook.

Drivers for the divergence in WC frequency could include employee anxiety about job loss, fewer inexperienced workers and an aging workforce concerned about losing health coverage, among others. Companies and individuals experience the impact of economic uncertainty and the spectrum of layoffs and plant closings differently based on factors such as market segment, skill levels, location and so on. For example, construction and hospitality industries are more likely to see increases in fraudulent activity in WC claims than are less cyclical industries. While retained employees are often too worried about keeping their jobs to test their luck with fabricated or exaggerated claims, claims by terminated employees are known to increase during periods of recession. Not surprisingly, potential fraud claims for survey participants rose during the recession, particularly in personal lines (*Exhibit 1*).

Interestingly, responses related to claim impacts from the economy were relatively consistent regardless of carrier size and market segment. Since our previous survey results indicated notable dissimilarities based on company size and/or market segment to other issues, this finding is unusual. Clearly, the economy affects everyone.

There were clear differences, however, based on line of business. Significantly, personal lines recorded higher incidence than commercial coverages in every adverse cost indicator. This is a major concern in a line that has been profitable for a very long time and has experienced decreasing frequency over many years. Also noteworthy because it is consistent with our findings: On a macro basis, the Towers Watson 2009 Tort Cost Study found 2008 personal tort costs were up by 3.7% over 2007, while commercial tort costs dropped by 0.4% in the same period.

Exhibit 01. WC Trending Differs From Personal Lines of Business



Litigation Trends Vary by Region

The poor economy also seems to stimulate third-party losses, as a number of respondents reported increases in general liability and personal automobile litigation. In general, respondents say they saw either no change or increases in new litigation, and virtually no respondents said they expected any decreases in litigation for any line of business as a result of the economy. While the percentage of carriers expecting increases in new litigation varied by coverage, the direction of the change was clear and consistent.

In exploring litigation geographically, the percentage of carriers reporting increases varies widely by region. The Southeast had the largest percentage of carriers reporting increases in new litigation, followed by the West, where a moderate percentage of carriers indicated increases. These two regions have also been hit hard in the housing market. Other areas also indicated litigation increases, but the percentages of respondents reporting increases were smaller (*Exhibit 2*).

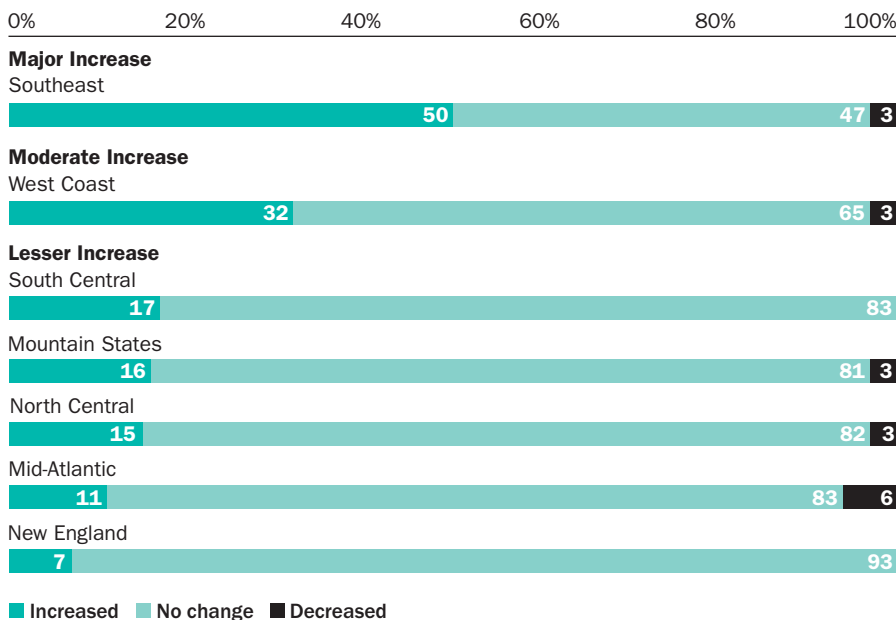
“The Southeast had the largest percentage of carriers reporting increases in new litigation, followed by the West, where a moderate percentage of carriers indicated increases.”

Claim Operations: Across-the-Board Response to Expense Management

Clearly, companies are working to manage expenses, but they have been prudent by not risking long-term performance for short-term gains.

Legal expenses are receiving the most scrutiny from claim officers, and appropriately so, since they significantly influence loss costs, often represent the largest component of claim expenses and are among the toughest costs to effectively manage. In addition, allocated loss adjustment expense (ALAE) costs beyond legal are receiving significant attention.

Exhibit 02. Litigation Increases Vary Significantly by Region



Respondents are also taking action to both tighten cost controls and increase productivity by reducing staff (primarily through attrition) and making operational modifications (such as increasing adjuster caseloads and supervisory spans of control, regardless of carrier size or market focus). Similarly, they report that they are making efforts to accelerate case closings. Other cost-reduction strategies mentioned by participants include wage freezes, general expense reductions and cutbacks, automation improvements and travel restrictions.

In related efforts, carriers are decreasing their use of external appraisal and adjusting resources, as well as other outside experts. However, participants indicate only low to moderate shifts in the use of outside experts, external counsel and medical management providers (*Exhibit 3*).

Performance Metrics Focus on Expenses

Respondents cited expense control, a major driver in 2009, as the fastest way to positively impact bottom-line results. However, despite cost pressures, carriers have not slashed expenses or made other knee-jerk responses. Instead, they appear to be taking measured steps to control their costs. Companies still rely primarily on lagging indicators when measuring claim department performance, while some respondents use both lagging and leading indicators. We expect a slow shift toward more leading indicators as carriers continue to upgrade their claim systems and increase utilization of vendor data. In addition, a majority of participants reported higher satisfaction levels with current operational effectiveness metrics than loss cost-containment metrics. This is more so for personal lines than commercial lines due to their mature metrics and breadth of available benchmarking data.

There is also a trend toward greater linkage between claim department performance and other business areas. In fact, a number of respondents reported an increase in the number of claim department goals shared with other departments. Data management, a critical element in the emerging area of claim analytics, is a major focus across the board. What's more, companies are better positioned to measure a broader number of performance metrics given their continuing investments in technology (*Exhibit 4*).

Exhibit 03. Pressure on Claim Budgets Is Highest on Legal and Other Allocated Expenses

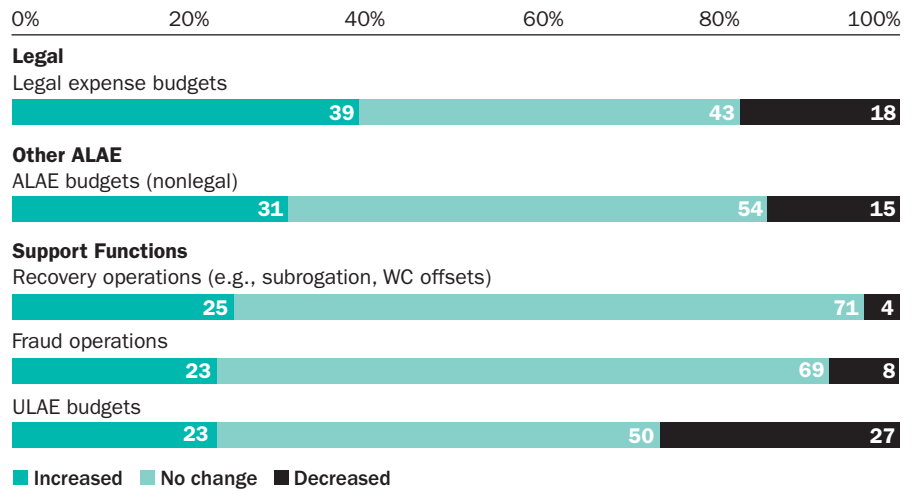
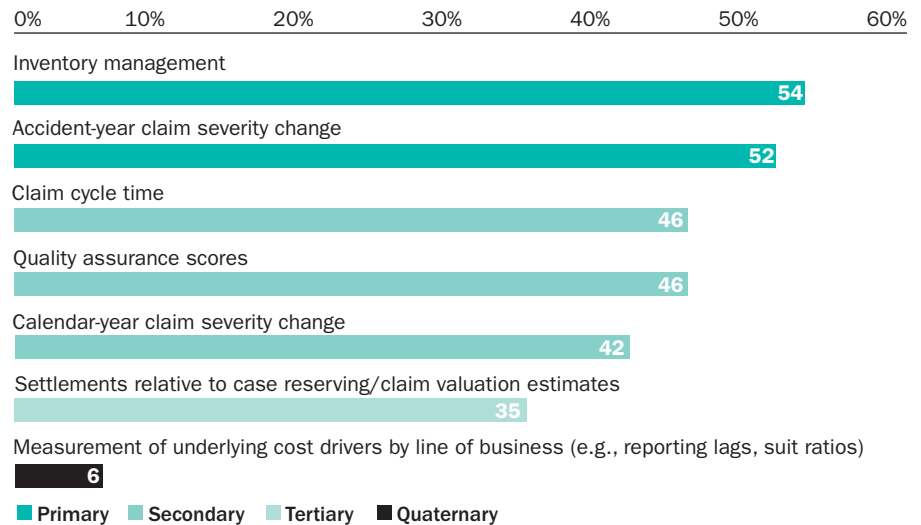


Exhibit 04. Companies Use an Array of Performance Metrics in Measuring Claim Severity and Loss Cost Containment



Participant Profile

In this survey, 52 claim officers (66% of registered members) participated. Since all survey questions were not applicable to all companies, the respondent base varied from question to question. Respondents represented a balanced mix of small, medium and large carriers.

Exhibit 05. 2008 Annual Direct Written Premium Business for All P&C Lines

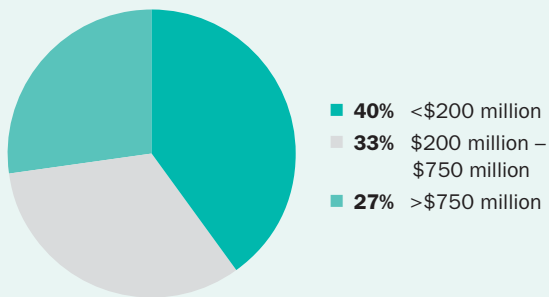


Exhibit 07. Primary Personal Lines of Business

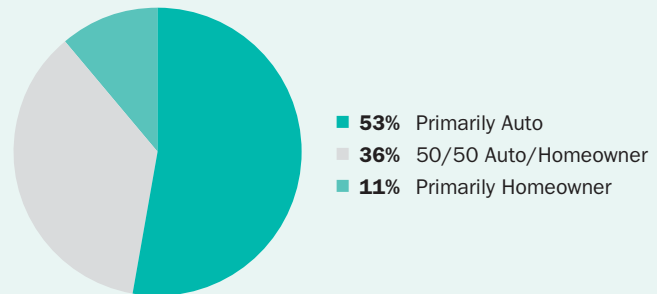


Exhibit 06. Business Split Between P&C Lines

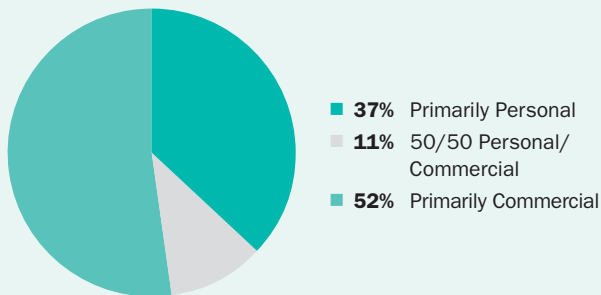
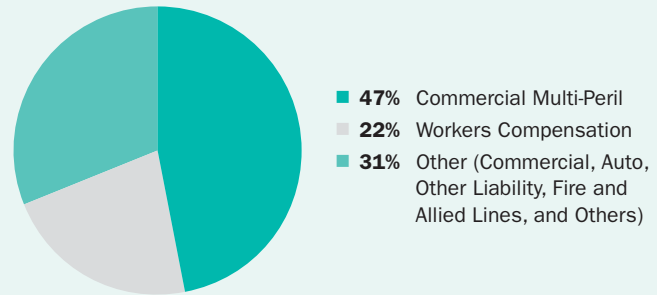


Exhibit 08. Primary Commercial Lines of Business



For more information, contact:

Kathleen Cullen, CPCU
860 843 7060

katie.cullen@towerswatson.com

Brian Stoll, FCAS, ARM
860 843 7129

brian.stoll@towerswatson.com

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