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Plugging the Drain

Technology is key to reducing claims leakage, but so are adjuster experience, efficient claims processes and forensic accounting.

By Pat Speer

April 1, 2006 - Despite reeling from the worst year in history for claims losses, pundits say the insurance industry plans to increase its spending on claims technology in 2006. For some, the idea of stepping up to new technology sounds like the perfect way to address inefficiencies that continue to plague claims processing. To others, it's yet another Band-Aid that may or may not be effective in solving what has become a hushed, off-the-record issue: claims leakage.

"Claims leakage is the difference between what you spent on a claim and what you should have spent," says one East Coast health insurance claims executive, who, like many sources interviewed for this story, asked to remain anonymous.

A more detailed definition of claims leakage is the preventable outflow of cash related to the claims settlement process. These preventable events include inefficient processing, improper payment, human error and plain, old poor decision-making, among others.

Mark Gorman, senior advisor with TowerGroup, a Needham, Mass., research and consulting firm, maintains that as insurance companies battle the economics of these shortfalls, they also battle the notion with their customers that they are trying to "get away" with paying less on a claim than is owed.

"In the conversations we are having with carriers, the issue is a bit problematic for them because they are working hard at fixing what they believe is a perception that they are not paying their contractual obligation," says Gorman.

Carriers are also in a scramble to manage negatives that might occur as a result of the time between when a claim occurs and the time the file is closed.

"If there is a lag time between payment and claim event, there is a higher payout," notes Gorman. "Insurance companies are trying to manage this expense on the back end, because the quicker they can close a claim, the less likely they will be to face costs from litigation, customer service and ongoing payments."

As controversial as the "leakage" topic itself are the many reasons for its existence: fraud, outdated technology, rework and ineffective internal and external management processes.

According to TowerGroup, fraud is the No. 1 reason for claims leakage, with U.S. insurance companies facing $30 billion in P&C fraud costs annually. This, coupled with the industry's attempts to deal with Katrina and other catastrophic losses, notes Gorman, is prompting carriers to consider more than just their technology spend. "Many companies are looking at their overall claims culture and processing strategies in order to counter loss reduction."

Human element

Some field claims representatives aren't convinced that technology is the only answer to reducing otherwise unnecessary claims costs; rather, they view the human element as an impediment to efficient claims processing.

"The world is looking to the "techies" on how to fill in a box or form, but they've never been in the field to see what is happening or how it happened," says independent adjuster Charles Stevens, Dania Beach, Fla. "There doesn't seem to be checks and balances, and the insurance company executives don't seem to be in touch with what's really going on."

Working with companies such as State Farm Mutual Automobile Insurance Co., Bloomington, Ill., and Chicago-based Zurich North America, has been a pleasure, says Stevens. But not all carriers have claims operations that support the use of qualified adjusters.

And thanks to Katrina, the demand for qualified adjusters has skyrocketed. At press time, online employment service Career Builder included 160 open positions for adjusters in Florida alone.

Stevens estimates that Katrina's wrath damaged 9,000 boats. His firm, which offers a Web site (www.marinebidexchange.com) that allows contractors and private individuals to bid on damaged boats, is currently processing 60 claims.

"This Web site keeps people honest," he says, "because when contractors realize that there is some policing going on, it results in legitimate bidding, and the insurance company's opportunity to pay what's fair vs. what's exaggerated."

As a marine adjuster with 25 years of experience, Stevens has seen it all, from unscrupulous, unlicensed adjusters to fraudulent under-the-table dealings with contractors that drive claims costs through the roof.

"It starts and ends with the leadership of the insurance company," he says. "Technology is only a support mechanism in this case, because they need to hire credentialed adjusters that have actually worked out in the field on real cases," he says, "not the ones who have spent all their time in a cubicle looking at the computer and making decisions on the data they are given."

Technology value

Michael Costonis, managing director of claims services for Bermuda-based Accenture, agrees that to reduce claims costs, carriers need to evaluate their culture, but adds that technology's value should be included when carriers examine the potential for claims' economic improvement.

"Our best practice program requires that we track our insurance clients' savings on yearly claims indemnity and allocate expenses related to 'lost economic opportunity' (the term Accenture prefers over 'leakage')," he says. "In doing that, we noticed carriers experiencing 10% to 15% in savings. Not surprising, that percentage has remained fairly steady over the past few years."

In conjunction with its tracking mechanism, Accenture conducted an activity-based costing study that revealed where and how people were spending time in the claims process.

"What was surprising was that almost half of the average adjuster's day was not contributing to the outcome of the claim," Costonis reports. "People are working in an incredibly inefficient environment, saying, 'Control the chaos! I've got 60 phone calls to make, 90 open files, systems that don't support me and data I can't find ... and you want me to process best practice?'"

Costonis maintains that carriers with a focus on reinvesting in what really matters in terms of the outcome will end up ahead of the "lost economic opportunity" game.

"Don't just buy productivity in terms of expense savings," he says, "because if you are ever going to capture lost economic opportunity you need to be able to surface those best practices to your people at the point of need."

Gorman agrees. "The biggest issue-and challenge-for carriers is their desire to make the whole process transparent. When they turn over a claim they can maintain visibility, they can see where it is, across provider, litigation, adjuster and carrier communities."

Forensic accounting

For Zurich North America, which provides commercial P&C coverage to companies of all sizes, the term "claims leakage" represents a focus on lowering unnecessary loss expenses while providing fair and balanced service, and the company is clear about its strategy to maintain that balance.

"There is no intent to try to give the insured less or more than what they are entitled to," says Albert McComas, Zurich's chief claims attorney. "Our objective is to pay what we owe under the policy, and the best way we can often get to that is through an intensive review of our policyholder's accounting records by a professional in that area."

To that end, the company employs forensic accountants, third-party service providers who work in tandem with Zurich's claims team to evaluate, via independent professionals, the exact value of a claim.

The integration of accounting, auditing and investigative skills, forensic accounting is one of many methods being used by Zurich's in its claims processing strategy.

"It's an evolving situation," says McComas. "Over time we, like many other carriers, have become more sophisticated in the way we address particular types of claims, especially those that deal with complex financial issues. One of the tools that we've used increasingly and have tried to standardize on is forensic accounting."

An example of where forensic accounting is useful is in a scenario in which there has been a commercial property loss due to fire, says McComas.

"Where there is a total loss of the building, we evaluate the property as well as business income loss, which is generally covered under our policies," he says. "Forensic accounting addresses potential disputes between us and the insured over the value of that business income loss.

"By investing in the services of forensic accountants, we can examine the insured's tax records, balance sheet, cash flow statements, etc., to try to reconstruct as best we can what the insured lost in terms of revenue during the period when its business was out of commission due to the fire," McComas says.

For smaller commercial concerns with less sophisticated financial records, Zurich relies on forensic accountants to collect and evaluate secondary evidence, such as receipts and purchases, to try to pull together a picture of the exact value of the loss.

"For larger liability claims and disputes, the insured may argue, for example, that we owe $1 million in attorney fees, so we need to do an accounting of the attorney's hours, whether all that time was legitimately spent on that case or possibly unrelated for the same client," says McComas.

Removing the mystery

Accenture's Costonis says his organization uses a similar approach to combining investigative skills, auditing technology and accounting, but calls it "scientific claims management."

"It's all about predictive modeling and segmentation, a concept that has been in underwriting for years, and applying it in the claims department," he says. "That takes the mystery out of claims that have a certain characteristic or complexity, because there are the right kinds of interventions and best practices that can be applied to give one result or another."

Combining this approach with the ability to recognize that events change over the life of the claim-and that profiles and segments will change with it - makes expenses easier to manage and understand, Costonis adds.

Establishing standardized claims procedures will help lower loss expenses that span forward, notes TowerGroup's Gorman. "Insurance companies that make standardization a priority will reduce litigation risk, improve collaboration with third-party providers and even improve provider performance."

Costonis suggests carriers examine the overall high performance "DNA" of their claims operations. "How is it organized, what kind of technology does it use, what processes does it use, how can it be accessible to those who need it, how can they tap that human element and motivate people, etc.? It's where improved indemnity performance comes from, and will be used to separate the winners and losers."