How reliable are your P&C benchmarks in the COVID-19 era?

Strategies to consider for continued success.

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The spring of 2020 will be remembered as a moment of disruption not only for individual's livelihoods and the economy but also for the property and casualty (P&C) insurance sector. The introduction of COVID-19 had an almost immediate influence on insurance yet it may take a long time to fully realize the effects. As a result, typical benchmarks and the process of benchmarking that has worked well in the past may no longer be applicable.

Outside of insurance, wages historically might have been used to determine the value of a worker but in the early stages of the pandemic, many lower-wage professions were considered "essential" while higher-wage earners might not have been. Therefore, wages as a metric for the value of an employee might not have best served its intended purpose. Does this same phenomenon perhaps apply to insurance? Have metrics and benchmarks changed due to COVID-19? Is it possible that what has been valuable, measurable, and comparable in the past might not be so going forward? Let's further examine benchmarking in a new era impacted by COVID-19.

The many applications of benchmarks within insurance

Benchmarks are used by a wide variety of personnel, including risk managers, underwriters, brokers, third-party administrators (TPAs), legal counsel, captive managers, actuaries, C-suite executives, and board members. Each group uses different statistics and may have different purposes but it is common for all to desire internal benchmarks, which examine how a program changes over time compared to itself, and external benchmarks, which compare industry peers or other publicly available statistics.

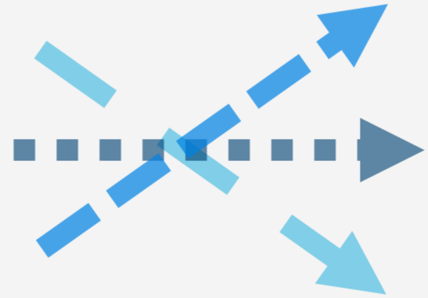
When asked why benchmarking is important, answers may vary widely by user. Many use benchmarks to make important decisions and provide assurance in decisions. Users also may measure and compare the performance of insurance programs to determine future strategic initiatives and even sometimes to promote or advertise the experience of the program. In some instances, benchmarks may be involved in the compensation of individuals involved with an insurance program.

Common benchmarks for claims include loss costs, loss ratios, frequency trends, severity trends, reporting lags, claim closure rates, and overall development of claims. Other aspects of an insurance program may be benchmarked as well, such as retentions, limits, premiums, and expenses. Finance teams often like to benchmark financial decisions such as a discount rate when applying the time value of money to losses.

How benchmarks are utilized also varies by user but commonly have the end goal of saving money. Benchmarks are useful in underwriting decisions, which are of extreme value to an insurance pool and contribute to policyholder retention. They also can be used to improve claim performance and assist management with strategies dedicated toward mitigating losses and shortening the life of a claim. Benchmarks additionally help to reduce other costs such as collateral requirements, letter-of-credit requirements, and premiums. Finally, benchmarks can help formulate the view of a program by outside parties and improve synergy with vendors and partners of an insurance program.

COVID-19's impact on benchmarking variables across all metrics

- Disruption
- Evolving Guidelines
- Closure/Opening Rates
- Furloughs
- Risk Management/Loss Prevention
- Exposure Changes
- Litigation Environment
- Presumption
- Temporary Immunity
- Coverage Questions
- Frequency & Severity Trends
- Claim Development



The process of benchmarking relies on the theory of consistency among as many variables as possible. COVID-19 caused disruption and has almost certainly affected this consistency across various insurance risks. At the early stages of COVID-19, very little was known about the virus, rates of testing varied and hence the science was evolving. Misinformation was often commonplace and safety precaution guidelines could vary week by week. As a result, different regions of the United States were opening and closing at different rates. Not all industries and business sectors were impacted the same way either, as some were considered essential and remained open while others partially closed or had severe restrictions. The economy of the United States was affected, which in turn affected areas of insurance.

Risk managers quickly developed strategies to limit exposure to COVID-19 for its employees and patrons, although they faced difficulties in areas such as access to personal protection equipment (PPE) supplies. Local state guidance varied and thus risk management strategies may have varied by region. In some instances, the full adoption of current guidance and safety protocols by patrons in stores may have further challenged the effectiveness of risk management. Risk management's implementation of COVID-19 loss mitigation may also have varied by company, as not all companies had the same strategies and each dealt with its own unique situation. In some instances, even risk managers were furloughed, which might have an unknown result on future losses.

Many legal teams and claim services faced their own challenges and uncertainties. Litigation stalled or became very slow. Claim activity such as adjusting case reserves, settling claims, or paying claims was minimal during the initial months. In addition, there was some difficulty in determining appropriate levels of reserves for claims related to COVID-19. Coverage issues for COVID-19 also became problematic for some workers. Healthcare workers and first responders, which were extremely involved at the beginning of the pandemic, were offered presumption of workers' compensation coverage but this was later challenged by some employers with some claims being denied. Healthcare workers also have often been viewed as "heroes" in the epidemic and offered temporary immunities from professional liability. As a result, there have been few professional liability COVID-19-related claims filed early on, but many believe this might change as the statute of limitations gets closer. It is also unknown how claim settlements and verdicts will be impacted as many courtrooms become virtual and of course the medical treatment of COVID-19 improves over time.

Brokers and insurers faced many of the same questions as legal teams but with some additional questions. Exposure for some insurance programs changed significantly. Furloughs had an impact on payroll and workers who continued to work often became remote. There were fewer consumers in retail buildings, fewer drivers on the road, and fewer elective surgeries. Brokers and insurers had to determine the impact of these changes and whether it would just be temporary, with exposures catching back up by year-end. How would these changes impact premiums and potential losses? With the introduction of such a disruption, would now be the optimal time to consider changing insurance program structures such as introducing self-insurance or a captive? It became critical for brokers to identify any potential gaps in coverage and ensure that insurance programs were functioning at optimal cost, particularly during this time of new claim trends.

Actuaries dealt with the compounding issues that faced risk managers, legal teams, brokers, and insurers when determining loss projections. Many actuarial principles and methods rely on the past being indicative of the future. With observed changes in claims and exposures, would frequency and severity trends be appropriate? Would COVID-19 claims develop as other claims? How would the development of non-COVID-19 claims be altered in a COVID-19 environment? Actuaries had to understand the strengths and weaknesses of their projections and explain them to the users of actuarial projections. Many benchmarks rely on actuarial projections and data that may be complicated by the COVID-19 disruptions. Likewise, some actuaries use methods that depend on benchmarks and historical statistics.

Strategies to make benchmarks valuable now and post-COVID-19

The key to successfully utilizing and applying benchmarks is to make "apples to apples" comparisons. This assumes that most components and factors going into benchmarks are under conditions similar to the past. Time will tell whether a world impacted by COVID-19 is an apple or orange. Because many in the insurance industry have historically relied on benchmarks, it is important to continue to make them as useful as possible today and in the future. The following are some strategies and considerations.

RECOGNIZE METRICS WON'T BE PERFECT

There will be many potential complexities in comparing the past to current experience, if in fact it turns out that COVID-19 has a major impact in the insurance industry. Until credible experience in a COVID-19 or post-COVID-19 world is gained, assumptions may need to be made. Therefore, users should take more precautions in using benchmarks and understand that they may not be perfect or even as once insightful. However, don't let great be the enemy of good.

TRY TO GATHER CURRENT DATA

Users should try to gather data through various avenues such as business partners, the program's own experience, and publicly available industry sources. It will take time to gather data that is credible and reflective of a COVID-19 or post-COVID-19 world. Try to stay apprised of all current trends. Contact vendors and peers in the industry for insights. Be patient and constantly monitor data to identify any new trends.

DETERMINE WHICH METRICS ARE MOST IMPORTANT GOING FORWARD

Operations of a company and hence its insurance program's initiatives may have been severely altered by COVID-19. It is critical to determine whether benchmarks that were important in the past are still important or if they have been replaced by more critical matters. As resources of a company may also be compromised, it may make sense to measure what is "low-hanging fruit" or short-term goals rather than focus on high-level goals.

MAKE ADJUSTMENTS BASED ON SIMILIAR HISTORICAL CONDITIONS

Benchmarking in this extraordinary time may require looking in the past to identify similar circumstances and conditions to best measure potentials impacts. Are there lessons or information to be gained from events such as the global financial crisis of 2008, the H1N1 influenza virus (or "swine flu"), SARS-CoV (or "SARS"), or the September 11, 2001, terrorists attack? Natural major events such as hurricanes, floods, and winter storms might provide insights into disruptions. Any adjustments to improve statistics that might not now reflect current conditions will provide more meaningful comparisons.

SEPARATE COVID-19 LOSSES, IF APPLICABLE

The development of COVID-19 claims may be different compared to non-COVID-19 claims. Over time, traditional ways of forecasting claims may be determined not to work well, perhaps distorting overall benchmarking results. To avoid any distortion by COVID-19 claims, it may be best to isolate the losses and separate them from the rest. This approach might improve the value of traditional benchmarking of non-COVID-19 claims against historical statistics and lead to fewer false indications.

STRATIFY BENCHMARKS TO A FINER LEVEL

More homogenous groupings historically may make for better comparisons by limiting "noise" or other distractions in the data. Benchmarks that are at a finer level of detail, such as by a particular injury type, cause of loss, or location of loss, may be less influenced by COVID-19 disruptions and interference. Likewise, if all variables are the same except for COVID-19, then these benchmarks can provide insight into the direct impact from COVID-19 such as how frequency and severity are changing. The ability to isolate COVID-19 might vary by industry and by line of business, but at finer detailed groupings it might be possible to remove the random fluctuations.

CREATE RANGES AND SCENARIO TEST WITH FREQUENT UPDATES

When a situation is new, with very little known data, a reasonable approach to benchmarking is to run multiple scenarios under different assumptions and compares results. This may produce ranges of current benchmarks that can be applied to historical benchmarks. Depending on the comparison desired, it may be best practice to "on-level" historical benchmarks to account for COVID-19 expected impacts, such as through frequency, severity, and exposure adjustments. The ranges may become more narrow as time goes by and assumptions are more finely tuned. Benchmarking assumptions and results should be reviewed more frequently as the insurance industry assesses how the pandemic has made an impact and refines best practices by organizations and insurance programs. As with all benchmark results, users should understand strengths, weaknesses, potential downfalls, and how to properly use the information.

Going forward with attentiveness

Users of benchmarks should fully understand the assumptions and inherent uncertainty in modeling COVID-19 losses and the impact on non-COVID-19 losses until better data and knowledge is obtained. In early stages of data collection, new data could be "bad" or misleading if misused and not fully understood by the user. In addition, some users may be able to realize desired outcomes by simply relying on subsets of information or performing other manipulations. These results can then be further shared, so precaution is also advised as well as communication by parties that fully understand the underlying calculations and resulting information gleaned.

Time will tell whether COVID-19 is simply just an anomaly or a true defining moment in P&C insurance that will change experience and the landscape. Until this is known, there still may be value in benchmarking because what is typically measured is what gets done in an organization. Complicated by a hardening market, benchmarking may be requested more frequently by many within insurance programs. With proper strategies and appropriate adjustments, insurance programs might be able to keep true to their original long-term goals despite disruptions. Now, more than ever, strong partnerships with business partners will best ensure continued success. In fact, independence in estimating benchmarks might be what provides the most unbiased and transparent benchmarks.

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