Property/Casualty Competitive Benchmarking for Specialty Lines

The Importance of Industry Performance Metrics

Within the property and casualty insurance market, the availability of industry performance statistics varies greatly, depending on the products written. Where the industry statistics are limited, or in some cases completely unavailable, management is left to make crucial business decisions with an incomplete understanding of the market characteristics. Under these conditions, management lacks key competitive insights that would otherwise influence decisions over such key levers as pricing and distribution. Specialty writers in particular are living with this reality every day.

Especially in the current highly competitive market conditions, insurers need to position their products in the marketplace with the utmost precision. There are competitive advantages available to those players who know the characteristics of their chosen specific market best. In this article, we will discuss how the use of competitive benchmarking in support of performance-related decisions can be a "game changing" difference for management. Effective benchmarking can help to differentiate winners and losers in the insurance marketplace. In particular, we will consider how benchmarks enable management to make better decisions, review options for companies to attain benchmarks, and present a benchmarking case study.

Uses of Competitive Benchmarking Information

Benchmarking is all about understanding the markets in which a company currently operates – or is considering to enter – in order to make informed decisions. Today, many property and casualty carriers (especially specialty lines writers) rely predominately on their own performance trends. Insurers monitor how particular products and segments have performed relative to each other and to past years. High-powered internal data warehouses – which enable this self-focused analysis – are good when there is an extensive amount of data. However, such analyses may be lacking when questions center on whether performance issues are due to the external environment or internal company actions. Internal data also fall short when decisions require information on markets in which the company does not have credible data, such as evaluating new markets.

To win in the marketplace, insurance company executives often need to answer important strategic questions about their business, including:

- What markets have more attractive trends in pricing, losses, growth, and so forth?
- How do my payment and reporting patterns compare to the industry?
- Should I stay in my current markets or shift to other markets? How do I improve my mix of business?

- How does the performance of my niche within a segment compare to the overall segment?
- Should I shift to different lines of business altogether in order to increase exposure to better performing segments?
- Should I reconsider or adjust my underwriting approach based on over or underperformance to peers?
- If my company's performance is trending downward, is that a matter of general market conditions or something that can be adjusted internally?
- We are profitable in certain niches, aside from large losses. Are these large losses a characteristic of this niche, or do we need to look more closely at our underwriting for severity?

Also, actuaries advising their finance and underwriting colleagues may find themselves forced to make decisions on results by segment based on a history that is not sufficiently credible in volume, or sufficiently long in history to understand the tail. They may ask themselves:

- Does the tail in this niche run longer or shorter compared to the larger line of business?
- How can I increase my confidence in the reporting or payment patterns used in my reserve estimates?
- What is an appropriate expected loss ratio to use in reserving?
- What frequency and severity loss trends can we expect in this niche?

Sources of Benchmarking Information

The most common sources of competitive benchmarking information include rating bureaus, public filings, or advisory firms that can collect specific information on behalf of insurers.

Rating bureaus such as the Insurance Services Office or the National Council on Compensation Insurance collect large amounts of information from a significant share of the market. This data can be rich in its statistical credibility and its ready availability. Trends and loss ratios can be fairly reliable for larger market segments, such as Personal Auto or Workers' Compensation overall. However, these benchmarks have limited application toward specialty niches. For example, Excess and Surplus lines market data is generally not collected by the bureaus, and certain segments, such as business underwritten by brokerage or binding authority producers, are not readily split by the statistical coding. Another shortfall is that, for many commercial classes, much of the market does not report detailed statistics to the bureaus, which may limit usefulness of the data. Concern is also often expressed over the data quality and the care taken by companies in reporting to the bureaus.

However, for the pure volume of information collected, and the detail of the statistical plans, bureaus can be an important source of benchmarking information.

Public filings, such as the statutory yellow book and SEC documents, can provide another wealth of information. Reporting patterns, performance data, and disclosures on risks are all examples of benchmarking information that can be gleaned from these sources. However, there are limitations. The definition of segments is usually drawn at the highest level. Comparability between companies is especially difficult from SEC filings. In addition, statutory data can be somewhat misleading when making company-to-company benchmarking. For example, pooling arrangements and quota share reinsurance can mix together many types of business into broad pools, which may not be readily apparent to the user. However, due to the mandatory nature of the reporting, public filings can provide a wealth of financial information across broad swaths of the industry.

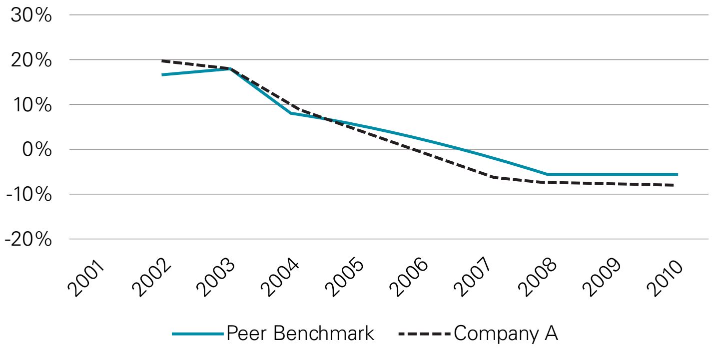
A third option is to use commercial sources. Consulting firms can draw on vast stores of information to compile more specific industry benchmarks for niches. Compared to using public source information, this approach should provide a basis for analysis at the product and segment level, and the data will also be subjected to "reasonableness" checks. This approach may be limited by the extent of relevant data that can be sourced, and there will be a cost associated with sponsoring the relevant reports. However, to obtain management relevant information for decision making at the detail niche or segment level at which many companies operate, a benchmarking study may be a very viable option.

How Market Benchmarking Works – A Case Study

To better understand how targeted, specific benchmarking has helped, consider these benchmarking results based on real-world examples. In this example, an insurer was evaluating a segment for which internal data lacked sufficient credibility. Prior to benchmarking, decisions were based more on market rumors than hard data. To address problems in this segment, the company used a third-party advisor to collect data on pricing, industry loss ratios, large losses, and trends.

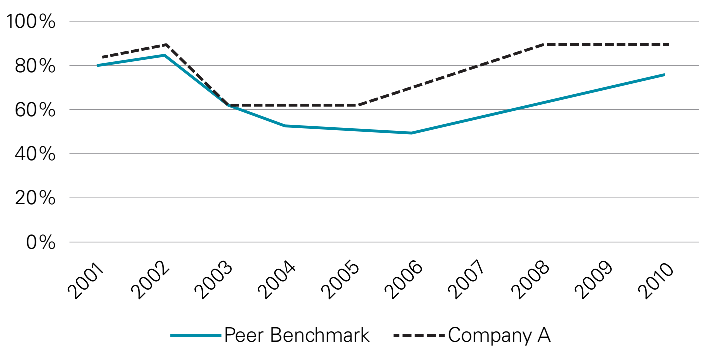
Sample Report for a Professional Liability Segment

Price Changes



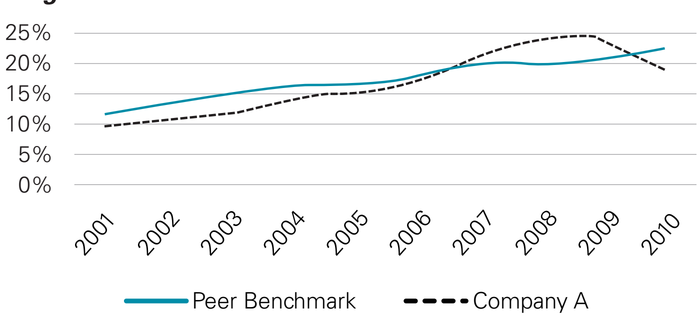
Based on the industry pricing data, the company realized that declining prices even in the face of adverse experience was a current market characteristic, not just specific to their book. While management knew they had to address price, this also told them that overall price increases were unlikely to be a universal solution.

Loss Ratio



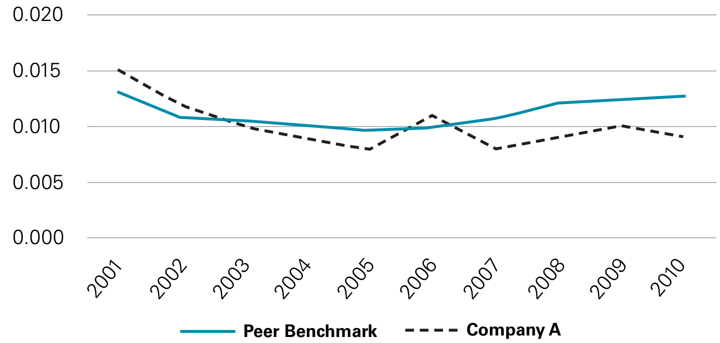
The company's loss ratio increased to levels higher than those of the benchmark. The company's relative underperformance might be due to claims handling, underwriting, pricing, market position, or other factors – and based on this information, all received further consideration and analysis.

Large Loss Ratio



Before benchmarking, Company A was unsure if the increase in large losses in their book was due to change in underwriting, changes in the environment, or just bad luck. Based on the comparison, they were able to determine the increase in large losses was being experienced by peers as well.

Frequency



From 2003 onward, the company's frequency tracked lower than the benchmark, with the exception of a brief upswing in 2006. This was an indicator that conditions in the overall market were not improving.

Based on all of these findings, the company implemented a conservative approach to this market segment. An underwriting strategy was adopted based on highly segmenting within the niche, including geography, nature of the operations, size of the insured, the nature of the management (partnership, public, proprietorship), and distribution channels. A supporting pricing strategy was identified, which included increases on a targeted basis, but not expecting strong overall movement. Underwriters focused on distribution channels with the best chance for maintaining a profitable market.

When considering the adverse results that could have occurred from alternative strategies made in the absence of hard information, competitive benchmarking definitely paid dividends. For example, a strategy of pushing unilateral price increases could have further impacted selection. Blaming the poor results on large losses and continuing to pursue the growth strategy could have created a much larger loss.

The company continued to update and monitor the benchmarking information, as competitors failed to react timely and ultimately overreacted with their pricing. The company was well positioned to seize the opportunity early, and updated their strategy to expand the span of targeted niches, profitably growing their overall book.

Based on this success, the company adopted the same data-driven business intelligence approach across all of their specialty niches.

Actionable Benchmarking to Build Sustained Competitive Advantage

While some managements will always see effective business intelligence as a cost that can be cut or avoided, others recognize the opportunity to gain the "unfair competitive advantage" they have been looking to achieve. Targeted and specific benchmarking can be a game changer for participants that can significantly impact their results over the long term and can help define the winners and the losers.

The future of the insurance market remains uncertain as economic trends, catastrophic events, and regulatory developments continue to unfold. Judicial changes, market changes, and legislative changes can all impact niche markets in disproportionate ways. Effective decision making must rely on detailed strong pricing models, improved underwriting processes, and portfolios that balance business opportunities, performance, and risk appetite. Equally important, these factors must be considered within the context of peer performance and market trends. Effective benchmarking information can play a role in evaluating all of these aspects.

Effective benchmarking can help management to:

- Adapt quickly to the changing business environment by recognizing it earlier and with more confidence than competitors
- Support underwriting decisions pricing, terms and conditions, and limits, by providing more credible information on business drivers
- Seize market opportunities earlier and more confidently
- Move more quickly and confidently to address problem markets
- Move swiftly to identify, address, or even avoid costly mistakes
- Support a long-term, nimble strategy that balances risk and performance.

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