



The Cost of Misclassified Claims

A certain simple mistake when classifying catastrophe claims, if it's repeated enough, can erode your company's retentions, deprive it of reinsurance recoveries, and even impair earnings. Ultimately, it can contribute to a falling stock price. And it's a simple mistake claims adjusters make unwittingly every day: misclassifying catastrophe claims. According to data from Verisk Insurance Solutions, insurers fail to attribute as many as 30 percent of hail-related claims to the appropriate date of loss. In many cases, this can lead to non-catastrophe claims classification. As a result, insurers could stand to lose millions of dollars in lost reinsurance recoveries.

The misclassification of catastrophe claims may have had a direct and tangible impact in early 2013. Over that summer, several insurers revealed earnings declines caused (at least in part) by catastrophe losses. And that was in one of the quietest first halves in the past ten years. Attritional perils, such as hail, wind, and thunderstorms, were sufficient to warrant Property Claim Services® (PCS®) catastrophe designation but not severe enough to cause a significant reinsurance impact.

Historically, this simple problem has presented serious challenges for claims adjusters. A lack of reliable weather analytics has hampered catastrophe teams' best efforts to organize and deploy resources after an event. The ability to identify your company's exposure quickly and respond efficiently can have many benefits: reduced cycle time, increased customer satisfaction, and lower loss costs and loss adjustment expense (LAE) — all of which have near-term impact on future revenue growth. However, the most immediate opportunity to mitigate losses comes from the improved accuracy of dates and causes of loss. This results in adjusters classifying catastrophe claims correctly, which can lead to larger reinsurance recoveries or even simply the attachment of reinsurance.

YOU DON'T KNOW WHAT YOU DON'T KNOW

For catastrophe claims adjusters, the stakes are high. Insureds send in claims rapidly as the catastrophe team seeks to gauge the impact of the event and coordinate a fast, thoughtful, and effective response.

High stress levels can lead to misclassifying catastrophe claims (as noncatastrophe). While error rates vary across the United States and Canada, Verisk Insurance Solutions estimates (by analyzing industry claims records and attendant weather data and analytics) that adjusters misclassify approximately 30 percent of hail-related claims.

Five Largest PCS-Designated U.S. Hail Events (2004–2013)

Event	Estimated Claims	Estimated Insured Loss
2010 – CAT 46	720,000	\$7,300,000,000
2011 – CAT 48	755,000	6,900,000,000
2010 – CAT 31	305,000	2,700,000,000
2011 – CAT 67	300,000	2,500,000,000
2011 – CAT 74	370,200	2,500,000,000

Source: PCS

In 2013, PCS designated 25 catastrophe events in the United States with the hail peril, resulting in an estimated 1.7 million claims and \$12.2 billion in insured losses. Applying the Verisk Insurance Solutions estimated misclassification rate, that would translate to hundreds of thousands of those claims assigned an improper date of loss. Last year in Canada, six PCS-designated catastrophe events resulted in an estimated 119,000 claims and \$3.2 billion in insured losses. Based on Verisk Insurance Solutions estimates, tens of thousands of those claims were misclassified.

Five Largest PCS-Designated Canadian Hail Events (2009–2013)

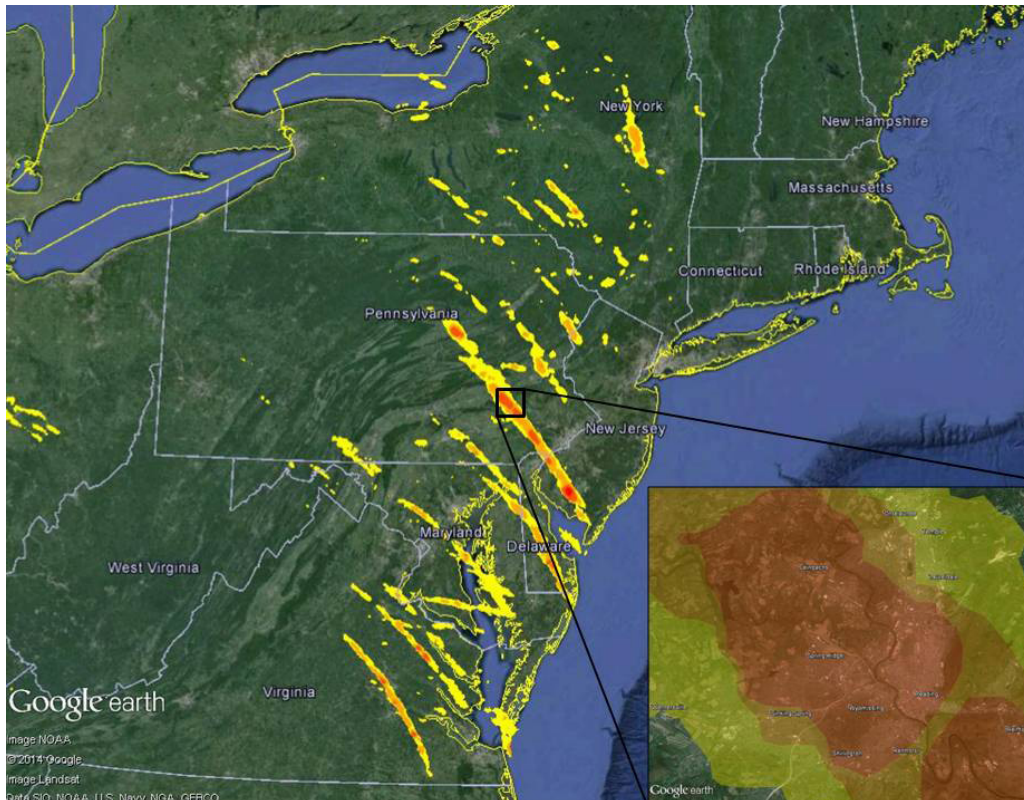
Event	Estimated Claims	Estimated Insured Loss
2013 – CAT 42	26,500	\$1,722,000,000
2012 – CAT 38	56,000	530,000,000
2010 – CAT 25	63,000	500,000,000
2009 – CAT 17	31,000	355,000,000
2010 – CAT 28	30,000	210,000,000

Source: PCS

Catastrophe adjusters haven't been able to address this problem effectively — one that's always assumed to have existed — because the tools at their disposal weren't robust enough to help them determine the full set of claimants affected by a catastrophe event. And not knowing which claims are attributable to a catastrophe event can have repercussions through the entire response. By helping catastrophe adjusters make more informed decisions earlier in the catastrophe life cycle, you can help them classify claims properly and equip them to protect their companies.

A NEW VIEW OF EXPOSURE

How an insurer responds to a catastrophe is determined primarily by how the company sees the underlying cause. Examining weather data and maps, the catastrophe team effectively defines the claims attributable to a catastrophe. For a particular hail swath, for example, the insureds in the range are classified as catastrophe-affected, while those on the fringe (or just past it) may not be. Even slight inaccuracies in weather pattern visualizations could cause adjusters to misclassify claims, potentially costing insurers — and their shareholders — millions of dollars a year in reinsurance recoveries.



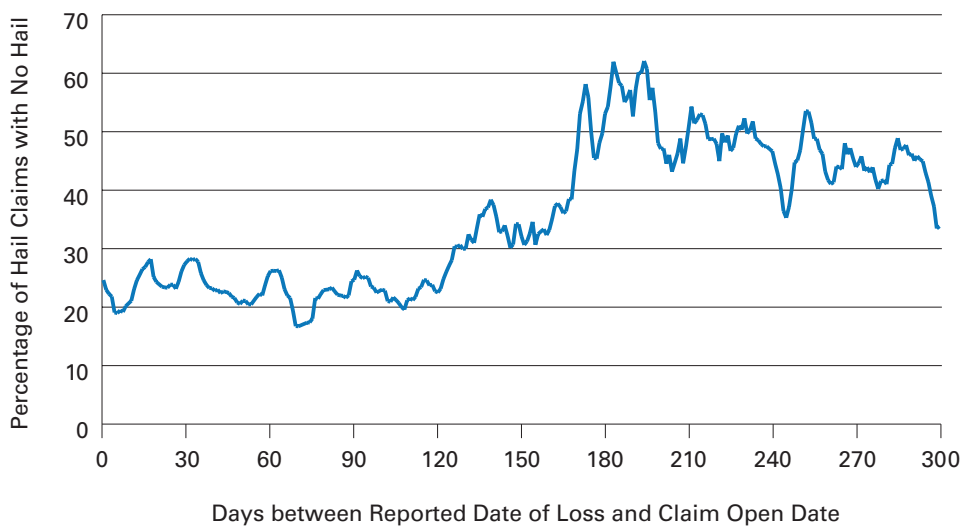
Source: Verisk Insurance Solutions

Before a catastrophe even occurs, catastrophe teams monitor weather patterns to identify events with the potential to warrant a significant response. Using Respond™ weather analytics from Verisk Insurance Solutions, they can determine not just the potential for weather activity to become a catastrophe but also areas most likely to be affected. Catastrophe response thus can begin even before the event has been declared a catastrophe. As the event develops, catastrophe coordinators can modify plans to address the emerging situation. When it's time to deploy adjusters, they can do so faster, reducing cycle time and increasing customer satisfaction.

As part of this process, catastrophe coordinators can also get a better sense of affected areas. Claims that adjusters may have classified as noncatastrophe will receive PCS catastrophe serial numbers, increasing reinsurance recoveries to offset company losses through recoveries.

After the event — and sometimes several times in the subsequent months — catastrophe teams and claims managers can apply Verisk Insurance Solutions weather analytics to claims to make sure they use the right dates and causes of loss. This serves as an additional check on the catastrophe response process to ensure that claims have not been misclassified. By identifying the actual date of loss for a particular claim, an insurer may find that it falls within the event dates defined in the PCS catastrophe bulletin, contrary to initial expectations. This is particularly likely for losses reported well after the event date, when a claimant may provide a date of loss outside the PCS-determined range.

Percentage of Hail Claims with No Hail on the DOL (+/-1 Day)



Source: Verisk Insurance Solutions

This is also true for causes of loss. Claims adjusters may need to revise initial judgments of perils based on Verisk Insurance Solutions weather analytics. This can cause an adjuster to attribute a claim to a different peril — perhaps one named in the PCS catastrophe bulletin.

Using advanced weather analytics to verify dates and causes of loss could lead to insurers including more claims in a hail catastrophe event (per Verisk Insurance Solutions analysis). This could mean the difference between attaching reinsurance and missing out on potentially significant recoveries.

BROAD IMPLICATIONS FOR “BIG WEATHER DATA”

Of course, reinsurance recoveries are only part of the problem that misclassifying claims causes. Insurers regularly refer to — and mine — their claims data for many important reasons. As a result, the implications of claims misclassification can linger for decades.

In the near term, catastrophe activity can affect insurance agents’ compensation, because insurance agents are generally spared the impact of catastrophe losses when calculating the combined ratio of business they place with a particular insurer. Improved catastrophe claims identification could result in increased agency loyalty (through improved compensation), which could potentially drive future business to the insurer in a hypercompetitive market. The modest short-term compensation expense is an investment in future profitable revenue growth.

In the long term, new product development, new state entry, financial market reactions, and even merger and acquisition decisions can include an analysis of catastrophe claims activity. Frequently, catastrophe claims are netted out during the evaluation of such decisions, and underreporting could make noncatastrophe underwriting look less effective than it really is. As a result, misclassification can affect the most important strategic decisions an insurance company makes.

The decisions an insurer makes once a catastrophe strikes can affect everything from near-term reinsurance recoveries to product performance and future markets. Putting a PCS catastrophe serial number on the appropriate claim affects every stakeholder your insurance company serves. By giving your adjusters the tools to apply their skills and experience thoroughly, they’ll be well equipped to help policyholders and shareholders for years to come.



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