

## Property/Casualty

By Michael Cronin and Paul Stulgaitis

Are process enhancements without product design changes really just an empty shell?

# Upgrading Commercial Lines

While the property/casualty industry has invested untold millions of dollars in automation and gained tremendous efficiencies, much of the work has been superficial: moving data from paper to the computer. Yet the real power of automation is not streamlining existing processes, but opening up entirely new processes.

Safeco's recent announcement of automated quoting for midmarket commercial accounts is a good example. More than a streamlining of established activities (or replacing the U.S. mail with e-mail), Safeco's change appears to be an entirely new process, with real-time, automated risk evaluation. At least that's what the press release says. What it doesn't say is that underlying the *process* change is a major *product* change.

The current pricing and underwriting model for most small and midmarket commercial packages (under, say, \$20,000 annual premium)—with a simple rating foundation and underwriters studying individual risks to develop final prices—could never be piped through such a real-time process. Long before the agent interface could be programmed, the products had to be redesigned to establish objective, well-defined classifications, rating factors and business rules.

At the root of this product redesign is a shift in mindset from *qualitative* to *quantitative* product design and management. This doesn't mean the actuaries have taken over the process; it means that every aspect of commercial lines should be considered in terms of how much and how many.

- How many unique classifications does a given program have?
- How many different characteristics influence risk?
- How much is the difference in loss costs between two classes?
- And, how can we describe them all in terms of objective conditions, lists and tables?

The answers lie, in part, in the premium and loss experience a carrier has accumulated. To the extent that loss experience can be segmented into unique characteristics and classifications, the answers to the *how much* and *how many* questions are fairly straightforward.

What to do, though, when the loss data is not there? Often the required data has never been captured or can't be retrieved in a useful format. Whatever the cause, how do we answer the quantitative questions without reliable numbers?

The same experience and intuition that a commercial lines underwriter uses to assess an agent's book of business can be put to work on a systematic basis to develop the quantitative framework for a product. Instead of considering a specific risk or small portfolio, a product designer must consider the range of risk possibilities across an entire line;

make and document explicit assumptions about risk and cost; and, define the evaluation and outcome in clear and objective terms.

Often, the market feedback that insurers see is qualitative and anecdotal. More useful to a product designer is a market analysis that emphasizes direct, quantitative comparisons to responsible benchmark competitors. This will highlight the highs and lows in prices and provide data to fill in gaps in a company's loss experience.

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In the personal auto line, the product management function developed, in part, to pull these pieces together. Product managers integrate the loss experience traditionally analyzed by the actuaries, the judgment and processes of the underwriters, and the marketing savvy of the regional marketing staff and agents.

The marketplace will soon tell us if Safeco's system works as well as it claims. If so, Safeco should expect to see, in addition to the improvement in its quoting process, an even greater dividend in the form of consistency:

- Similar risks will be priced and covered similarly.
- Changes to prices, risk acceptance, and terms and conditions can be implemented universally.
- Problem classes will be isolated and corrected with surgical precision.
- Fewer classes will be abandoned due to poor results.
- And, performance will be more reliable and net income, smoother.

Wonderful benefits, all. But they derive not so much from the interface—the front end that agents see—but rather from the product design: the underlying foundation that is a prerequisite to the automation. As is so often the case in business and in life, the greatest challenge is the preparation. Time spent getting the product design right will make the process improvements much easier and more successful. BR

*Contributors: Michael Cronin, right, is a product management consultant with Cronin Consulting Services Inc., Kernersville, N.C. Paul Stulgaitis is the president of Blue Rock Consulting, Portland, Maine. They can be reached at insight@bestreview.com.*

