Forensic Underwriting: A CSI Approach to Lowering Benefit Costs

By Robert Stumper | Senior Benefits Consultant | 8/27/2014

Over the past several years, television has glamorized the work of crime scene investigators, also known as CSIs. CSIs arrive at the scene, snap on blue latex gloves, collect evidence, analyze it at the lab, and solve a mystery—all in 60 minutes.

Admittedly, insurance underwriting is hardly dramatic enough to warrant a TV show, but there is a forensic component to the annual renewal process. Cost control strategies for group employee benefits require special analytical skills, what I refer to as forensic underwriting.

Underwriting is the practice of identifying risk and developing adequate price points. Forensic underwriting is the act of auditing the employer's existing insurance rate structure and working with carriers to reduce annual increases. Understanding how carriers formulate insurance rates is the foundation of forensic underwriting and the first step to reining in annual renewal hikes.

Underwriting, as we all know, is the premise of carrier profit. With that in mind, insurers are focused on two kinds of costs: *fixed and variable.*
There are two basic types of fixed costs, which are retention and pooling charges.

- **Retention:** In fully insured arrangements, retention costs are the administration component of rates associated with the paying of claims, carrier margins and risk charges. These costs are associated with the administration of health plans, and include carrier profit margins.
- **Pooling charges:** This is a fixed cost that helps the insurer guard against any individual large claimants.

There are two variable costs: claim charges and reserves.

- **Claim charges:** These are the cost of actual paid and/or incurred claims under the current plan.
- **Reserves:** This is the amount of money held by carrier in a fully insured arrangement

after the plan terminates. No doubt you are familiar with the acronym IBNR, or “incurred but not reported.” IBNR is the total amount owed by the insurer to all valid claimants who have had a covered loss but have not yet reported it. Reserves can be negotiated.

Reserves, which are held by the insurance carrier until plan termination, are typically calculated very conservatively. The reserve amount changes from year to year depending on actual claims. These are all components of incurred claims, which is why it’s important to focus on the forces driving claim costs. The forces include plan design/structure, copays, risks factors associated with those claims, and the ability to identify those factors, etc.

Retention and reserves—one a fixed cost and one a variable cost—are where insurers make their profit in fully insured scenarios. This means if an employer is paying $1 million in premiums, 5% of may translate into pure profit to the insurance company.

Year over year renewal cost increases may seem like a fact of life, but there is a way to create new scenarios. It’s critical that your broker ensures that the carrier is accountable for the pricing and can justify it. There’s always room to negotiate. In fact, negotiation is where the value of the forensic underwriting process comes into play. And, negotiations are more successful if the broker speaks the insurer’s language and understands what drives their position on rate changes.

Carrier underwriters are often amenable to negotiation as long as counter offers are logical and make sense and the resulting renewal rate is sustainable. Negotiation should not be an adversarial approach; the insurer won’t react positively to an offer that is unfair or doesn’t make mathematical sense. As long as brokers approach insurer underwriters with the goal of developing a win/win scenario, it’s possible to create a beneficial outcome for everyone.

How does it work? Here’s one scenario: the insurer has a reserve set at $230,000. If your broker can make a case that $230,000 is too high and should be closer to $180,000, the negotiation can begin. Often the insurer will counter, but the possibility exists for you to save tens of thousands of dollars on your renewal right out of the gate.

Here’s a real-life example: We recently evaluated a prospective client’s claims over five years. During our evaluation, we identified and mitigated each component of the renewal rate, then presented four or five scenarios to the employer. We were able to forecast a $600,000 to $700,000 reduction in premium based on our calculations. This client quickly understood the power of evaluating data, especially claims history.

To work like a CSI, follow the clues and evidence. Start by asking your insurers these questions:

- How are current and future rates going to be developed? What are the moving parts that will be considered?

- Is the insurer's philosophy competitive, adequate, consistent and sustainable in terms of pricing?
- Can the pricing and respective components be justified and explained?
- Is the insurer willing to explain and justify their pricing?

Here are questions employers should ask their brokers:

- What tools and strategies are you using to negotiate with the carriers? *(A quick note here: we collect data and create forecasting models based on actual data to improve outcomes in the future. Predictive modeling is a very robust tool)*.
- Can you conduct an audit process of my current rates?
- What are the inherent risks of the plan I have right now?

Remember, you don't have to settle for unjustified yearly increases. Start asking questions. Like a CSI chasing clues and evidence, your broker should dig into the numbers with a forensic underwriting approach.

Understandably, many employers have been focusing on their responsibilities related to Healthcare Reform, but they may have lost sight of the need to consider cost-control strategies in their current plans. While Affordable Care Act compliance is very important, it's equally critical to understand underwriting's role in the development of an effective cost-containment strategy. Cost control is central to the long-term success of the benefit program, for both the employer and employee. Underwriting is a perfect blend of art and science. You have to know what you're looking at, what makes sense and what doesn't. Auditing the current rate structure is critical to the whole forensic concept. You have to understand how you got to where you are today before you can improve it. Insurers are in the risk game. The broker's responsibility is to ensure the employer's share of that risk (and respective renewal calculations) are fair and sustainable.

For more information, please call **1.877.426.7779**