

Claims and Loss Control

*The success or failure of your alternative risk transfer program may depend on your claims-and-loss-control service provider. Here's what you need to consider.*

## A Marriage Made in Heaven: Choosing the Right Service for Your Alternative Risk Program

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**T**he benefits of an alternative risk transfer (ART) mechanism can be enormous. Self-insured and captive plans can provide stability against spikes in insurance prices or a refuge from troubled insurance markets. They may improve cash flow or even ease tax burdens. But companies that do not seek to reduce one of the largest cost-drivers of a risk-transfer program — losses — may not reap the full benefits of their alternative risk program. In a guaranteed-cost setting, losses may account for about 75 percent of the insurer's costs. Losses could easily

represent the bulk of an ART mechanism's costs, as well. By controlling losses, an ART buyer can make significant inroads to reducing costs. However, all too often, potential savings evaporate due to poorly managed claims and piecemeal loss-control initiatives. Choosing the right claims-and-loss-control service provider can be as important as the actual decision to enter the ART market.

Prior to arriving at a long-term workable arrangement with a service provider, the risk manager needs to step back and reassess his or her company's needs.

In an ART environment, no longer can claims be dropped into an insurer's claims processing system for payment and then be forgotten. Under an ART mechanism, controlling claims becomes a means of lowering costs. Claims costs can be a specific line item in a budget and can be allocated to departments. As such, they will ideally motivate department managers to work with loss control to reduce and avoid or mitigate future losses. The choice of a third party administrator (TPA) and loss-control consultant can make or break an ART program.

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### Core Values Help Define Service Needs

Too often, the selection of a service provider narrowly focuses on the external capabilities of the provider — managing claims and mitigating losses — and ignores the company's own internal corporate values. This omission can have grave consequences. In practice, a service provider can help a client to reduce costs and enhance a company's reputation and prestige or anger customers, incite litigation, instigate negative publicity, demoralize employees, or inflame labor union issues.

Depending on the types of claims a TPA handles, it could interact with customers, company management, regional offices, line employees, and the families of each of these constituencies. Therefore, the TPA's approach to handling claims should reflect and reinforce the client company's overall corporate mission. A TPA's tough stance on settling workers compensation claims would be ill-suited to a corporate culture that has a high commitment to employee morale. Alternatively, if product integrity is an integral component of a corporate strategy, then an ardent defense against a products liability claim might be appropriate. These expectations need to be communicated to the TPA. In entering an ART program, a company ties its fate to the ability and attitude of its service providers, who should be thought of as the public relations arm of a company's risk management function — its representative to the world.

### Company Self-Assessment

Long before a risk manager begins interviewing service providers, he or she needs to have articulated and defined the corporate values. By doing so, expectations related to service levels will emerge. The clearer a company can be about its expectations, the more focused the selection process will be.

The risk manager also needs to understand the company's loss profile. Risk managers should be able to pinpoint those lines of business in which claims occur, as well as where they occur and whether they tend to be simple or complex losses. For instance, a large national grocery chain may require a wide geographical distribution of loss-control services and speed and efficiency in handling large volumes of slip-and-fall claims. On the other hand, a large urban hospital system most likely needs specialized property-conservation loss control and expertise in managing sophisticated liability claims. In gaining an understanding of the company's loss profile, a risk manager can begin to define the types of services that his or her company needs and formulate a line of questioning with which to approach prospective vendors.

This self-assessment also underscores the uniqueness of the hiring decision. Because of the many twists and turns that the process may take, there is no hard-and-fast template that can be superimposed on the process. Because of its complexity, the process may take as long as a year to complete.

### Impact on Areas of Responsibility

In hiring a service provider, a company turns over the nuts and bolts of its claims and loss-control functions to the service provider, but it doesn't cut the line of responsibility. Implementation of loss-control initiatives may require action by internal staffing resources throughout the company at different times, and a TPA's oversight of claims management will have a direct impact on areas such as human resources and finance, as well as risk management. Thinking about the impact that an ART program will have on different areas of responsibility beforehand will help a company pave the way for the interactions with its service provider when they occur. Among these many considerations are:

- Will losses be funded through a separate bank

account or authorized through a company bank account?

- How will funds be managed internally?
- Who will authorize the replenishment of funds?
- How will the service provider's fee be reported internally within the corporation?
- At what level should claims-payment authorization be set?
- Should the TPA notify the company of a denied claim? Which type?

#### **Resolution of Conflicting Objectives**

A self-assessment of the company will not only help establish service levels but also help uncover potentially conflicting objectives. For example, recognizing a company's high commitment to customer service might translate into setting a standard with the TPA that 90 percent of claims should be settled within a month of notification. However, if the company's financial controls allow only a relatively low claims-payment authorization for the TPA, such a limitation would result in slow payment and could frustrate customers or employees who have suffered losses. A good service provider will help a risk manager recognize and resolve similar areas of conflict that may not have been articulated in a guaranteed-cost program.

#### **No Quick Fix**

Much like a decision tree, a self-assessment can branch off in many directions, with some branches leading down routes toward selecting a vendor that are seemingly viable, but that arrive at a dead end only after considerable work has been invested in exploring any particular route. Growing frustration increases the appeal of a quick fix, and perhaps the most tempting quick fix is relying on one source for the recommendation of a service provider. Whether the source is a fellow risk manager, broker, or association colleague, it is unlikely that the source will know the company as well as its risk manager, and even more improbable that one company's solution will neatly fit the exact needs of another. A better approach is to ask what process a colleague undertook

to find a vendor and what pitfalls and successes were encountered.

#### **Guidelines for Selection of a Service Provider**

While there is no road map to direct a risk manager through the selection processes, there are some signposts that can be used to find the way.

#### **Financial Strength**

A service provider's long-term viability is a key indicator of future service levels. A risk manager's standards for hiring a service provider should be as stringent as those for placing business with an insurer, because both the insurer and the TPA need to "be there" for the long term. There are, however, no agencies that rate the financial strength of service providers. Performing this financial analysis rests with the buyer.

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Financial statements provide some insight to a provider's stability, but they may not be available if the provider is a privately held corporation. In this case, an examination of the company's ownership backing could be used as a substitute for corporate financials, as it may offer some insight into a privately held corporation's financial stability.

An equally reliable measure of loss-control proficiency and claims expertise is an evaluation of staffing. Salary levels, staff experience and turnover rate, and the size and number of caseloads can reflect a service provider's stability. Questions geared to specific capabilities will yield the best information for comparison. Asking only about the size or number of caseloads per adjuster merely grazes the surface. A better line of questioning would involve additional details about the caseloads, such as: How many new lost-time workers compensation claims does an adjuster handle on a monthly basis? The risk manager

can then compare that answer with the information given by another vendor. This investigation often requires multiple rounds of questioning to reach equivalent comparisons.

### Price

Decisions made solely on the basis of front-end costs may be ill-fated, as poor service levels could add disproportionate costs at the back end, causing average claims costs to soar. Looking beyond the service provider's initial low fee, a risk manager may find high turnover and inadequate staffing, substantial increases in fees at plan anniversary, or, under the worst-case scenario, indications of probable bankruptcy down the road.

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Joining forces with a troubled TPA can cause response times to be slow, claims to remain open, costs to soar, and claimants' frustrations to flare. If a TPA declares bankruptcy and the company's and TPA's bank account funds were commingled, the result may be the loss of deposited funds needed to pay losses. Bankruptcy of the TPA will certainly leave a client company scrambling to find another service provider. As bad as this scramble may be, it is only the beginning. The eventual transfer of operations to even the most capable TPA can create enormous disruptions in service. It is unlikely that staff at the bankrupt TPA will be available to perform such tasks as prioritizing claims, providing loss runs to check the receipt of files, listing open claims, identifying cases with pending trial or workers compensation hearings, making advance payments to injured employees, or performing a myriad of other requirements that are typically fulfilled during a transfer from a solvent TPA. Without information from the prior TPA, the staff at the new TPA would need to review each file to determine its status — an effort that would be reflected in its fee should the TPA decide to take on the account.

### Organization

In general, there are three types of service providers: wholly owned subsidiaries of an insurer or broker; independent vendors; and shell operations that share staff resources among the broker or insurer and other clients, such as a TPA.

A shell operation requires careful consideration due to the unique way each one operates. In some shell operations, an adjuster may work on an insurer's or broker's cases one minute and other client files the next. On the surface, this sharing of resources may not seem to affect performance, but consider the mission of a TPA: to fulfill the expectations of the client company and to protect its assets rather than the assets of the insurer or broker. The seemingly subtle difference in philosophy between an insurer that needs to protect its own interests and a TPA can play out in the practical way in which an adjuster approaches claims investigation and interacts with a client's employees and customers. Switching between the mindset of an insurer-adjuster and a TPA-adjuster can be a tricky feat, especially in the midst of frequently hectic workdays.

Distinguishing between a shell operation and an independent vendor or wholly owned subsidiary can be a challenge. One method is to ask to see the organization's license. States frequently require a corporate license for the TPA and individual licenses for adjusters. New York and Texas require that individuals who perform certain types of loss-control services also be licensed.

Even if organizational structure is a secondary concern, checking that service providers have the appropriate license should be part of the selection process. It not only provides some assurance of competency but can prevent potential fines that may be levied against a client company for doing business with an unlicensed TPA.

### Ability to Be a Full-Service Provider

Finding a vendor that can meet all or most of a company's needs will increase coordination and communication among stakeholders, which, in turn, will create efficiencies and reduce costs. At a minimum, loss-control and claims services should be provided by one vendor, because the effectiveness of these services is heavily interdependent. Access to reliable claims data creates a communication loop that feeds loss-control efforts, allowing identification of the cause of losses by location or coverage and development of recommenda-

tions that will mitigate claims. Parceling these functions to different vendors breaks the formal communication loop and virtually eliminates the possibility of informal interaction that often yields considerable benefits. Whether discussions are about a flurry of slip-and-falls or a loss-control recommendation forgotten by the client, exchanges between the claims adjuster and loss-control consultant serve to reinforce cost-control initiatives.

This dynamic is equally true of other services that a company may need, such as bill review, medical case management, or managed care. Outsourcing individual functions to different providers reduces the overall effectiveness of the process.

### Willingness to Work Through Issues

There are myriads of interactions that occur between the service provider and client at all levels of the organization. From authorization of claim payments to conversations about loss mitigation to coordination and implementation of modified job responsibilities, stakeholders — line supervisors, human resources, loss-control consultants, and claims adjusters, among others — need to form a relationship built on “what *we* can do to save money” rather than “what *you* can do to save us money.” Finding a service provider that is willing to work through the stream of daily issues translates into cost control and loss mitigation rather than just case-by-case claims settlement.

### Technology

Many of the buzzwords about system-interfaces complicate a rather straightforward requirement. In hiring a service provider, a risk manager needs to know two things:

- Can the provider interact with the claims adjusters and view claims information over an Internet-based product?
- Can the data the client company needs be captured and retrieved?

Other issues are peripheral.

### Substance Behind the Marketing Glitz

When the bright promises of marketing presentations give way to the realities of performance, the interactions

of the service provider’s staff with the risk manager will demonstrate the quality of the provider’s services. Risk managers should get to know the people who will be talking to their customers and employees.

Distinguishing the “just say yes” mentality of marketers from the reality of a provider’s performance capabilities is vital. A TPA may agree to a performance guarantee that links a provider’s compensation to its performance, knowing that vague performance standards such as “prompt response” are difficult for a client to measure and are often abandoned. Listening to a service provider’s response to the company’s request for a performance guarantee will shed light on its approach to doing business and the diligence that it brings to the job.

### Referrals

There is perhaps no better endorsement than a slew of recommendations from current and former clients, but the reasons for other companies’ satisfaction or dissatisfaction may not match the needs identified by a company self-assessment. Referrals are pieces of information that should be evaluated against the overall needs of a company.

### Summary

The cost savings of an ART mechanism are linked to the performance capabilities of a claims-and-loss-control service provider. Selection begins with a rigorous self-assessment of the company’s core values, service expectations, loss profile, and internal resources. From this self-assessment, a risk manager will be able to define the company’s service needs and to focus the selection process on the most appropriate providers — all of whom should meet established standards of financial stability and service capabilities.

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