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INSURANCE PRODUCTS AND UNDERLYING COVERAGES

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Abstract

Product is a lifeline of any company and there should be no ambiguity about a product definition, unfortunately, this is generally not a case especially where there are too many products in a company or when a product itself is too complicated to understand which is usually the casewith financial products. In the insurance industry, there is often no clear or consistent definition of products.

Insurance companies rely heavily on data to find out their ideal customer and in deciding product or coverages they should sell to that ideal customer. Coverages roll up to define a particular insurance product, and various kinds of data are generated based on coverages that are analyzed at product level. Data on products can well lead to incorrect conclusions if the underlying coverages rolls up to the wrong product. Things can go extremely wrong if the fundamentals or the product definition is faulty or inconsistent, and will lead to the insurance

company aligning the wrong set of coverages or product to its ideal customer.This often results in low customer satisfaction and a higher attrition rate. Customer analytics, management reporting, reserves vs product premiums, and even external financial reporting all can suffer due to such inconsistencies.

On the other hand, when a customer does not understand coverages properly, and simply buys standard coverages, this can result in the customer remaining under covered or over covered.

A clear definition of products can help insurance companies reach their most profitable customer, provide them with right coverages, and have right reserves for risks a company is exposed to. At the same time, better understanding of coverages will help the customer make right selections to cover his/her risks. Such a scenario would create a win-win situation for both the insured and the insurance company.

Insurance Products and importance of understanding underlying coverages

Product is one of the most important things in the whole organization, regardless whether the product is tangible or intangible. It is this product that a company sells to a customer to make money and provide returns to its investors.Data on products is another critical variable and companies invest heavily these days on customer analytics to identify their ideal customer and identify ways to penetrate their customer base. If the data used for customer analytics or market research is faulty then it a recipe for disaster and a company will reach wrong conclusions and will make bad decisions and strategies without realizing what's going wrong until it is too late. In a big insurance company with many coverages or products it becomes critical that sales, marketing, actuarial, operations and finance teams be on the same page with a clear understanding of coverages and products as to what they are selling, what they are reporting,and exposure they are using to calculate reserves. Such practice will help pricing actuaries see accurate results of theirpricing strategy and will also help reserve actuaries making sure that the reserve they are calculating at a product level will be covering right risk exposures.

But it is not uncommon in an insurance company to have different product mappings or product hierarchies in different departments resulting in different definitions for the same product, and this can have serious consequences for the company. Analysis of data at product level to which coverages roll up to can result in making bad decisions and strategies around its customers because depending on product mappings, such coverages could be rolling into a wrong product. Such discrepancies could also result in misalignment between premiums reported by the Finance department on a product and reserves calculated on that product by the actuarial department resulting in bankruptcies. There could be compliance issues too with not reporting data correctly to shareholders or external agencies.

Another glaring or unacceptable process in insurance companies is that product is often defined by profit centers (or other variables)and not by coverages. Lots of companies choose to live with such inefficiencies and that result does damage to the business they have built over the years. To begin with, such issues arise because during the early stages of a company, profit centers are kept as the base,to define almost everything including a product which is totally wrong. Typically,Profit centers represent divisions of a company selling policies and they usually become prevalent much earlier in a company; so everything is defined based on profit centers because of their importance, but this creates issues down the line. As a company matures and starts selling multiple products, right definitions should be set up for products and the right number of coverages codes should be added in financial applications todefine new products the company adds to its portfolio. Profit centers,which now might be selling multiple products instead of one product,may not remain a good idea to define a product anymore.

To fix such anomalies, a big transformation effort is usually needed in a company. Such transformation requires changes in underwriting systems that are hard to make. Transformation would include opening the right number of new coverage codes, adding new coverages to product hierarchies, and underwriting systems, and fixing policy and claims history in all the required financial applications. But regardless of efforts, the right way to represent product is to have right coverage codes in place that roll upto a right product. Once you define product based on coverages and have all departments using the same product definitions, they product data would be meaningful and financial statements by product would be accurate.

While it is beneficial for a company for their analysis and reporting, that product definitions are the same across the board, it is important for customers to clearly understand the coverages that each insurance product provides. When it comes to coverages, most customers just know that they are buying auto or home insurance etc. but do not have much understanding of what precise coverages they are getting, at least until they have a claim to make and then comes surprises. Customers are usually also not aware of the full range of coverages available to them and need to be educated e.g. not many customers know about Mechanical Breakdown Insurance (MBI)and one can usually opt for MBI only within 15 months of buying a car, after which it is too late. Secondly, customers might be paying for a coverage that is already available to them from the manufacturer for free; for example, lots of car manufacturing companies provide limited time free road side assistance. Then, there are warranty companies that cover utilities at home thatare not covered by your regular home insurance policies and is an important factor to consider, and one may want to consider umbrella or Excess coverage in addition to a regular policy from an insurance company. Customers who want a cheaper policy give up important coverages but those are usually the ones that hurt a customer in a longer run, so it becomes important for insurance companies to provide customer guidance on such coverages, as insurance is meant to cover risk but if a customer is under covered then they are not best utilizing the benefits of insurance.

In our next article, we will discuss at length various consumer and commercial products and kinds of coverages available under those products to make the consumer more knowledgeable about insurance coverages.