

---

# **Getting Off to a Clean Start**

## **Why Point-of-Sale Verification Improves Pricing Accuracy**

April 2008

**Quality Planning**   
Corporation  
*An ISO Business*

## Executive summary

- Rating errors — accidental, deliberate or the result of failure to regularly update policyholder information — cost U.S. auto insurers approximately \$17 billion in lost premium revenue each year.
- Insurers that make it a priority to identify auto rating errors are able to recoup premium leakage and dramatically improve income by correcting flawed information at renewal.
- Recent studies conducted by Quality Planning Corporation (QPC) reveal that many rating errors are introduced during the sales process — before a consumer becomes a customer. Until now, those errors were hard to detect and remained invisible until a rigorous check of policyholder information was conducted 6 to 12 months later.
- New techniques and web technology make it possible to detect flawed, false, or fraudulent policyholder information at the point of sale.
- By placing sophisticated rating integrity technology at the front end of the customer life cycle, insurers can realize the following benefits:
  - accurate initial pricing
  - early identification of true risk
  - improved rating integrity
  - significant premium uplift
  - lower loss and combined ratios
- This white paper reviews the benefits of early detection of rating error, identifies which rating factors can be validated in real time, and discusses considerations for the successful implementation of point-of-sale rating information verification.

## **Rating errors corrode insurer profitability**

In 2006, the private passenger auto insurance industry lost \$16.6 billion because of premium rating error.<sup>1</sup> This represented 10 percent of the total \$166 billion in personal auto premium written for the year. QPC predicts that similar percentage losses will manifest themselves in 2008 — and beyond.

Why? Despite the best efforts of leading auto insurers, the rating information on which policyholder premium is based is often inaccurate. Some of the inaccuracies are almost impossible to eliminate because change is a constant: people change jobs, change residences, and change driving habits because their lives are in constant flux.

Underwriters know that it's quite likely that the rating factors established for a driver as a new customer will require validation within one to three years to ensure accuracy. To combat rating error, some insurers implement rigorous checks and validation of policyholder data at regular intervals, with a focus on ensuring the data is correct at renewal. Those procedures routinely catch flagrant cases of fraud, along with substantial instances of policyholders who are trying to minimize their premium by understating annual mileage, not declaring younger drivers, or trying to benefit from claiming the vehicle is garaged in a safer, less expensive location.

## **Are new customers toxic?**

New customers are the lifeblood of any business. Insurers spend millions of dollars to attract and retain new customers in order to maintain and increase market share. Predictions for industry growth of private passenger insurance currently peg it at around 10 percent. So, a company with a 90 percent retention ratio, aiming to achieve industry-average growth, is deriving some 20 percent of its business from new customers.

But who are these new customers? Some are drivers with no previous driving experience or record. Others might be "switchers" who have been attracted by a great marketing campaign. And others could be "shoppers" who have been forced to look for a new insurer. The point is, most insurers have little or no information about these prospects yet are naturally eager to start doing business with them based on information provided at point of sale.

Is that sufficient? Definitely not. Recent research conducted by QPC reveals that the average insurer's screening process is woefully inadequate. Here's a question on the minds of all insurers: Do new business customers provide insurers with accurate information at the point of sale? A sampling (see table) of New York and Florida driver data from five auto insurers reveals significant new business error rates.

Rating variable	Policies with errors
Garaging location	4%
Assigned driver	16%
Commute band	35%
Annual mileage	52%
Undisclosed drivers	3%
Unreported vehicles	4%

<sup>1</sup> "How Cunning Policyholders Continue to Boost Auto Premium Rating Error," Quality Planning Corp., 2006.  
[http://www.qualityplanning.com/QPC\\_Resources\\_Public/reports/QPC%202006%20Rating%20Error%20Report.pdf](http://www.qualityplanning.com/QPC_Resources_Public/reports/QPC%202006%20Rating%20Error%20Report.pdf)

The ongoing effort by many insurers to identify and correct rating error at policy renewal has led some insurers to think harder about the cause of the inaccuracies: how or where do they occur? One thing is certain: some rating errors are introduced at the inception of the policy during the sales process.

Snapshots of real cases from leading insurers reveal that the problem is commonplace and illustrate how point-of-sale verification can identify inaccurate rating information:

### **Case 1 — Mileage Estimate**

A female driver, aged 60, estimated her annual mileage to be 1,500 miles.

A real-time point-of-sale rating integrity check flagged the policy and estimated the annual mileage at 9,110. A subsequent, more comprehensive, rating verification confirmed her annual mileage at 9,500 miles.

Estimated annualized premium uplift: \$41.

### **Case 2 — Vehicle Usage**

A male driver, aged 68, declared his usage of a 2003 GMC Sierra to be pleasure/low commute.

The point-of-sale rating system alerted the agent that the individual was also a licensed building contractor. Further conversation convinced the client that his vehicle should be rated for business use.

Estimated annualized premium uplift: \$66.

### **Case 3 — Commute Distance**

One household, two drivers. One driver estimated his one-way commute to be 3 miles; the other estimated hers to be 5 miles.

The point-of-sale rating system estimated the commute for each driver at 16 miles. A follow-up conversation revealed the true figure for each driver should be 20 miles.

Estimated annualized premium uplift: \$66 and \$57.

### **Case 4 — Additional Driver**

One household, two drivers, aged 53 and 54.

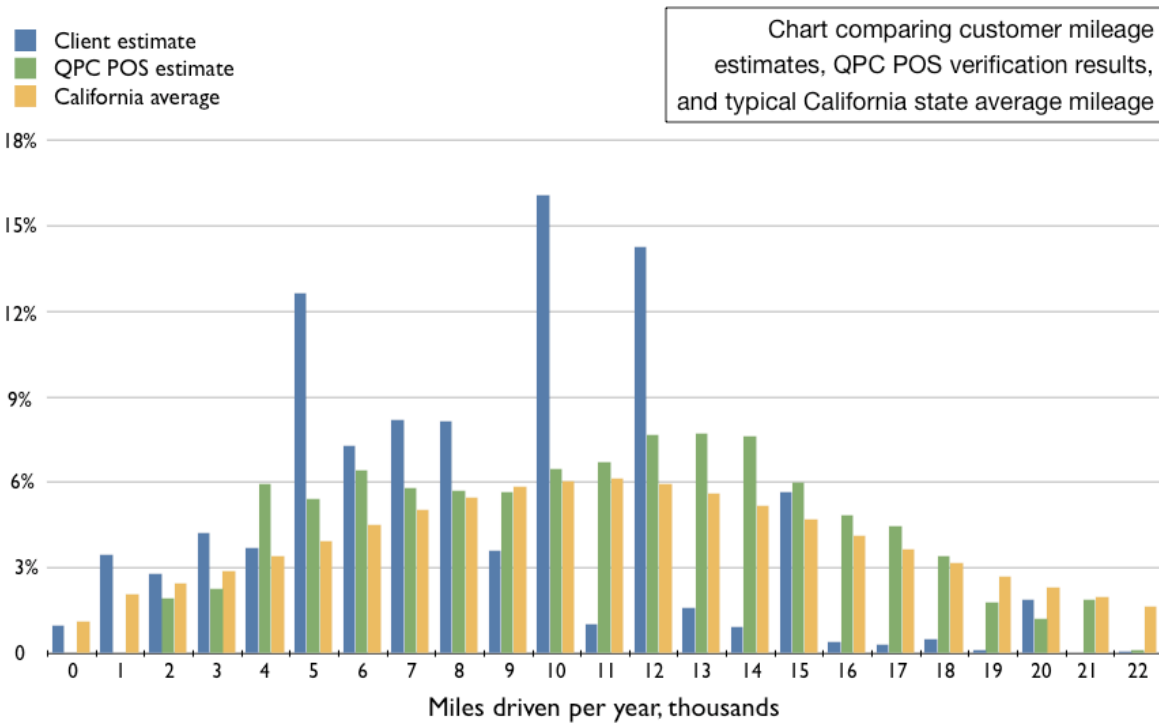
The point-of-sale rating system identified a possible additional driver, aged 22. This was confirmed in a follow-up interview.

Estimated annualized premium uplift: \$650.

## Why not get it right from day one?

QPC's studies clearly demonstrate that underwriting new customers without conducting thorough audits is risky. Quite often the initial rating information is suspect and will result in an underpriced policy at best and quite likely in losses that eliminate any possibility of first-year profitability.

QPC's audits have shown that new business booked at inadequate rates costs auto insurers hundreds of millions of dollars each year. The primary cause of the inadequacy is unverified, customer-provided information that's false, dated, or incomplete.



## Introducing information integrity at the point of sale

---

Moving rating integrity checking to the point of sale is certainly desirable. To maximize its potential, insurers should ideally deploy the latest analytic technologies to the front line and verify new business in real time. Sounds great — but how?

The latest techniques enable integrity checks to be performed from an agent's or customer service representative's desktop. Introducing a point-of-sale rating integrity check on new customers raises four important considerations:

The check should be performed on essential rating factors.

It should be integrated with existing systems and workflows and performed in real time.

Potential negatives related to the customer experience must be identified and addressed.

Point-of-sale rating integrity checks should be integrated with periodic routine reviews.

### ***1. Which rating factors can be verified at the point of sale?***

Today, real-time validation of driver rating variables is not as comprehensive as an analysis performed at policy renewal. However, the latest techniques enable real-time verification of crucial rating elements from new business applications for accuracy, currency, and legitimacy — and these checks can be aligned with an insurer's rating plan and business objectives.

Within seconds, the customer service representative (or, in some instances, the underwriter) is provided with a comprehensive analysis of the reviewed data. By knowing that information at the point of sale, an underwriter or underwriting system can accurately assess each risk, accept or deny the application, and properly price accepted risks.

Real-time verification can be applied to determine:

- reliable estimates of annual mileage for each vehicle
- reliable estimates of commuting distance for each vehicle
- likelihood of business usage for each driver
- likelihood of additional drivers in the household
- likelihood of commute for each driver
- likelihood of an inaccurate garaging location
- identification of salvage vehicles
- identification of inaccurate VINs and model years
- identification of incorrect Social Security numbers

## 2. Integration considerations

From an IT perspective, integrating real-time rating information checks into an insurer's point-of-sale system need not be complicated, especially if the system employs recognized industry standards for data exchange. Conceptually, it's ideal if the point-of-sale verification process is based on web services and service-oriented architectures, since this will enable the insurer to adopt a flexible and lightweight IT strategy.

Best results are obtained if the verification process is fully integrated with the point-of-sale process, enabling real-time rating information checking prior to the issuance of a policy. That approach maximizes the possibility of flagging erroneous or fraudulent data and enables validation or correction of information or rejection of the application *before* a policy is issued.

However, for those situations where total integration is not possible — at least initially — a phased approach can be taken whereby rating information checks are performed in the 45 to 60 days after policy issuance. That will at least enable an insurer to revisit premium pricing with the policyholder in the light of any anomalies discovered during rating information verification.

## 3. Customer experience considerations

By implementing a real-time check of rating information, an insurer seeks to identify anomalies in the information provided by a potential customer. Let's discuss how to manage customer interaction during validation of contentious information.

Over the course of the many thousands of customer interviews that QPC has conducted on behalf of auto insurers, the company has developed a set of best practice to ensure a polite and non-confrontational customer experience. While every insurer will need to carefully institute company-specific policies before implementing point-of-sale verification of rating information, the following recommendations are intended to help set overall objectives and tone for customer interaction at point of sale:

- a. **Good information = best price.** At the beginning of the interaction, establish with the customer the need to secure accurate rating information in order to ensure that the policy is priced competitively and fairly.
- b. **Ask the right questions and avoid confrontation.** All customer interactions must be handled professionally to avoid negative customer reaction. In particular, tact is crucial to avoid confrontation. Keep in mind that the insurer has more flexibility to highlight discrepancies with a *potential* customer than with an *existing* customer. Similarly, the questions asked during the screening process can be more demanding than those asked at renewal. And at point of sale, it is appropriate to request proof or documentation to verify specific rating variables.
- c. **Experience and technology make a difference.** Consumers expect a high level of professionalism and consistency from frontline employees, and the skillful application of the latest call-center techniques can make a big difference to a customer's experience — for instance by calling the customer at the appropriate time of day. Modern call-center techniques can also ensure that questions are optimally phrased and sequenced to encourage cooperation and elicit truthful responses.

#### 4. *Taking a holistic approach to rating integrity*

Thus far, the discussion has focused on real-time auto rating data validation and confirmation at the point of sale or during the underwriting review period immediately following issuance. While the advantages of point-of-sale verification are certainly obvious, it is important to situate this concept within a broader approach aimed at ensuring rating integrity.

Those insurers that take a holistic approach to ensure accurate rating data can easily reduce premium leakage by as much as 60 percent in a single policy period. This approach, already in place with several leading auto insurers, uses a three-step process that begins at the point of sale:

1. **Get it right at the point of sale.** Employ the latest technologies and conduct sophisticated data analysis before the policy goes to final underwriting.
2. **Get it right at renewal.** Whether or not a policy is reviewed at point of sale, great likelihood exists that changes in everyday lives will create a different risk profile over time. A change in marital status, job change, new car, new house, or “new” 16-year-old — all create a very different risk. Staying on top of these changes can be accomplished by reviewing renewals each year. Moreover, validation at renewal can be more rigorous and substantive, yielding more accurate rating information.
3. **Develop a long-term approach.** Once an insurer has completed steps 1 and 2 — and scrubbed its auto book of business — a baseline of accurate information then exists to enable regular maintenance of a rating integrity program. This baseline will help enable affordable rating integrity effectiveness in the coming years. The key is to avoid lapses that could allow rating error to creep back in. Studies show that changes made during re-underwriting have a life span of two to three years. That means there is substantial lifetime value in a rating integrity program that goes far beyond the first-year cost of execution.

Implementing an effective, ongoing approach to rating integrity can ensure:

- premium leakage is reduced to a minimum;
- policyholders pay the right premium for the risk they represent;
- customer retention is steady;
- loss and combined ratios are lowered.

But perhaps the biggest benefit for underwriters is that a consistent, holistic approach to maintaining rating integrity makes the job easier as time goes by. Get started today.

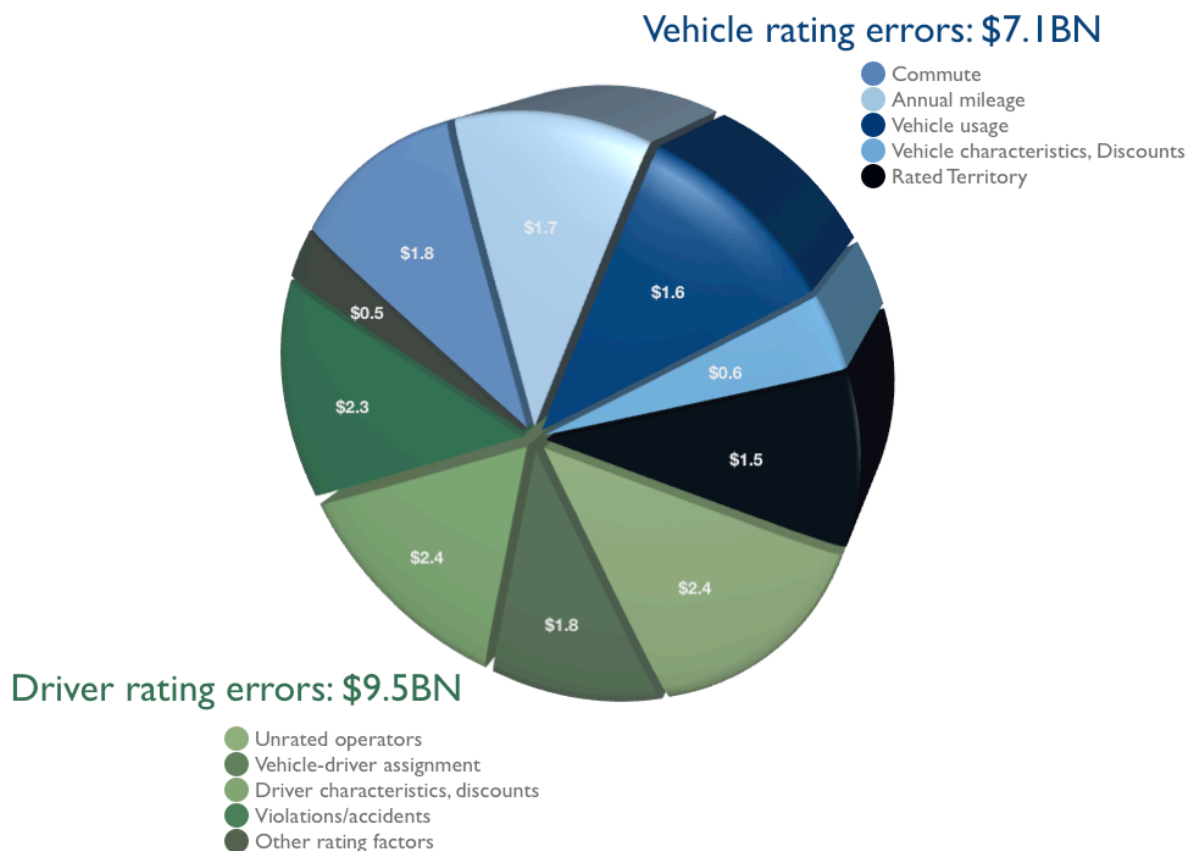
For more information about rating error, read the next section, which examines the salient causes of rating error and identifies the associated costs.



## Coming to terms with rating error

### Types of Rating Error

During its ongoing analysis of policyholder rating information for top auto insurers, QPC routinely encounters substantial rating error in all common factors used to determine auto premium. The following table presents estimated premium loss by rating factor for 2006. It's important to understand how this error is broken down, revealing areas where leakage can — and should — be prevented.



Rating error costs were found to vary greatly by individual insurer. The amount and kind of rating error varies by many factors, including characteristics of the book of business, geographic location, distribution channels, rating plan, rate pursuit history, state regulatory environment, agent relations, and underwriting standards.

### What are the business costs associated with flawed rating data?

#### Direct premium loss

For individual carriers, opportunities for profit gains in rating error reduction are significant. If, for example, an insurer had profits equal to 5 percent of premium, then

every 1 percent reduction in error would result in a 20 percent profit gain. Likewise, every 1 percent of error left uncorrected results in a 20 percent profit loss.

### **Risk management costs**

Rating error leads directly to failures in risk management. For instance, policies with unrated 16-year-old male drivers in the household experience an average loss ratio of more than 200 percent.

### **Moral hazard costs**

An often-overlooked cost of rating error is moral hazard. Analyses repeatedly demonstrate that individuals who misreport policy rating information are associated with high loss experience. For example, an individual driving 20,000 miles per year but reporting mileage of 5,000 will, on average, have higher claim costs than an individual driving and reporting 20,000 miles. Rating error also causes honest insureds to subsidize dishonest insureds, which results in low-risk drivers subsidizing high-risk drivers.

Similarly, the majority of agents who work to accurately determine premium have a strong interest in rating integrity. In the absence of meaningful controls, however, the honest agent is placed at a competitive disadvantage by the minority of agents willing to misrate a policy to close a sale.

### **Business management costs**

The modern insurer relies on rating and underwriting data in all primary areas of corporate management. Policy data provides key inputs to marketing, sales, business segmentation, financial planning, corporate planning, and staff compensation, among others. Errors, or worse still, systematic biases in underwriting data, deteriorate performance in all management functions. Each is subject to the same law of information: garbage in, garbage out.

## ***Can rating error be avoided or mitigated?***

In short, yes, it can. It's important to understand that rating error can be introduced at all stages of the underwriting cycle. On average, and after initial policy screening, 82 percent of rating integrity audits and some 40 percent of all written policies uncover policies lacking enough premium to cover the intended risk. By efficiently revealing flaws in rating data, carriers can take the steps necessary to correct costly errors and restore rating accuracy to a book of auto policies.

## ***About Quality Planning***

Quality Planning Corporation, the rating integrity solutions company, was founded in 1985 and is headquartered in San Francisco. A member of the ISO family of companies, QPC is focused exclusively on providing decision integrity solutions to the insurance industry. QPC works with insurance companies to identify areas of significant premium leakage using sophisticated database management, statistical analysis and modeling, customized survey design, and highly targeted customer interaction. For more information, visit [www.qualityplanning.com](http://www.qualityplanning.com).

## ***About ISO***

A leading source of information about risk, ISO provides data, analytics, and decision-support services to professionals in many fields, including insurance, finance, real estate, health services, government, human resources, and risk management. Using advanced technologies to collect, analyze, develop, and deliver information, ISO helps customers evaluate and manage risk. The company draws on vast expertise in actuarial science, insurance coverages, fire protection, fraud prevention, catastrophe and weather risk, predictive modeling, data management, economic forecasting, social and technological trends, and many other fields. To meet the needs of diverse clients, ISO employs an experienced staff of business and technical specialists, analysts, and certified professionals. In the United States and around the world, ISO helps customers protect people, property, and financial assets. For more information, visit [www.iso.com](http://www.iso.com).