Managing Reputational Risk Through PE

By James R. Jones,
CPCU, AIC, ARM, AIS

One key business imperative for insurers today is managing enterprise risk. Rating agencies consider it in their ratings, board members consider it as part of their corporate governance, regulators consider it when evaluating the financial risks of insurers, and public accounting firms look at it when issuing their opinions. Consequently managing enterprise risk has entered the radar screen for senior management at insurance companies. Many of them now mention how they are managing their various risks in their annual reports. Managers today must have processes to identify risks that affect the company, and make sure that these risks are adequately monitored and controlled. One of the more significant risks is the risk to a company's reputation. In April of 2007, Aon completed a study which determined that reputational risk (damage to a company's reputation) was the top concern cited of all the companies surveyed. This was rated as a higher concern than business interruption, changes in the market environment, regulatory changes, and financial risks. To understand this, consider the value of a good reputation. In her book on *Managing Reputational Risk*, Jenny Rayner identifies several reasons for the importance of having a positive reputation.

An insurer's reputation can influence:

- Investor's decision to hold its shares,
- The cost of capital,
- Consumers' willingness to buy insurance or pay higher premiums,
- Prospective employees eager to join it, and existing employees motivation to stay,
- Regulators' attitude toward it,
- Vendors' willingness to partner with it,
- Media coverage and pressure group activities,
- Stakeholders' willingness to give it the benefit of a doubt when a problem or crisis occurs.

Given the importance of reputation, it is understandable why it was ranked so highly. However, it is particularly worrisome that more than half of the survey's respondents in the Aon study said they were *not* prepared to manage this risk. Risk management, in general, means employing techniques which can reduce the frequency

of the occurrence of the risk, reduce the severity, or transfer the risk. Because there isn't an effective way to transfer risk of reputational damage, companies have to manage this risk by finding ways to reduce the frequency of the risk occurring or by reducing the severity of the consequences of the risk once it occurs. Half the study respondents indicated that they did not yet have in place good techniques to help reduce the frequency or severity of this risk.

Arguably, the modern world places a company's reputation at greater risk than in the past. Research in the 1970's found that that every dissatisfied customer told, on average, 10 people about their complaint. In the world of the Internet and blogosheres this seems almost laughable. Consider the recent case of Cigna Corporation. On December 23rd, the Associated Press ran a story about the family of a 17-year-old leukemia patient who blamed Cigna Corporation for her death, alleging that "the health insurance giant's" initial refusal to pay for a liver transplant contributed to her death. On that day a Google search of this story of a teenager, denied a liver transplant would have yielded 9800 hits. Four days later there were 46,000 hits using the same search and one week later there were over 98,000 hits. This example is not intended to suggest anything about the merits of the case, but it does point out how broad and how fast a story can spread, and these stories can quickly damage the reputation of the company. To quote Warren Buffet, the CEO of Berkshire Hathaway, "It takes 20 years to build a reputation and five minutes to destroy it."

What is the role of the claims function in managing this risk? The claim function, because it is responsible for delivering the promise that insurance consumers' purchase, has a primary role in managing reputational risk. This is not to suggest that other insurance professionals have no role. Certainly, insurance producers play a role in providing consumers with the appropriate insurance coverages, and properly communicating with policyholders. The marketing function has a role in establishing and protecting the brand. The legal function has a role in ensuring that the brand is protected and that frivolous lawsuits are properly defended, and the communication function has a role in quickly responding to a crisis and presenting the company's message effectively. However, when it comes to reducing the frequency of legitimate complaints and lawsuits filed against insurers, the claims function has a primary role. The critical nexus for reputational risk is the point at which the product or service promise is delivered (or not). With respect to insurance the claim function is chiefly responsible for delivering the promise for insurance consumers. Complaints and lawsuits about an insurer's claims practices can be especially damaging.

The following are ways in which the claims function can help manage reputational risk:

- Hire competent, qualified people to handle claims,
- Establish policies and procedures that are fair to all stakeholders,
- Document and monitor claim processes to ensure that they are fair to all stakeholders,
- Give claim practitioners an appropriate workload to handle,
- Conduct audits to make sure that claims are handled fairly,
- Communicate with policyholders and others in a timely fashion.
- Make decisions in a timely manner,
- Create a culture of accountability but not fear,
- Create a culture of learning and acceptance to change,
- Provide needed professional education and timely training on both technical and "soft skills."

How does professional claim education and training play a role in helping to manage this risk? To answer this first consider the following kinds of actions that lead to legitimate complaints and lawsuits:

- Improper denials because the adjuster did not understand the coverage provisions of the policy,
- Delays in communicating coverage or liability decisions because the adjuster was not capable of making the proper determination independently,
- Making an offer that is too low because the adjuster did not understand how to properly assess damages or liability,
- Unnecessarily angering a policyholder or claimant because of poor communication or negotiation skills,
- Failing to recognize a conflict of interest that could affect the fair treatment of stakeholders,
- Failing to properly document or explain a coverage or liability decision,
- Adversely affecting policyholders by failing to recognize subrogation potential, retain key evidence that would help recovery efforts from other responsible parties,
- Not knowing when to request an expert to assist with the claim.

In nearly every one of the actions listed above, professional training and education could have helped in either reducing the likelihood of the complaint or lawsuit, or at the least, in reducing the severity of the consequences to the company.

Technical claim education on insurance coverages and policies is required to help adjusters to better understand how to interpret policy language, how to apply previous court rulings to assist in interpreting the policy, and ensuring that exceptions to exclusions, additional coverages, and policy updates are considered. This can reduce the likelihood of an improper claim denial. Education on the theories of liability and training on investigative techniques for determining liability can help adjusters make more accurate and timely liability decisions. It can also help in the recovery of money owed from other legally responsible parties. Training on how to properly gather evidence and document decisions can help protect the company's defenses and reduce the severity of the complaints and lawsuits lodged against the company. Education that would help adjusters develop awareness of ethical issues and provide them with a framework for making ethical decisions could also reduce the frequency and severity of complaints and lawsuits related to things such as conflicts of interest, covering up mistakes, using unfair settlement tactics, or shortcutting ethical decisions. Training on tactful communication and negotiation can help reduce the number of complaints and lawsuits that stem from adjusters being curt, or failing to recognize the emotional complexities associated with handling claims.

It would be naïve to think that all complaints and lawsuits could be eliminated by having better educated claim personnel. In fact, there are circumstances in which better educated, and more ethical claim professionals could generate additional complaints and lawsuits but those would be the exception to the rule. Common sense, and experience, would suggest that a better trained and educated claim professional is going to generate fewer legitimate complaints and lawsuits, and will be better able to protect the company's reputation should a complaint or lawsuit be filed. Overall, the reduction in the number of legitimate complaints and lawsuits related to the handling of insurance claims can help manage the risk of reputational damage to insurance companies.

A final conclusion of the Aon study was that corporate boards now recognize the criticality of risk management and are engaged in the review of risk issues. The board members stated that identifying and understanding their risks is a top priority for the next two years. Given the significance of reputational risk and the lack of management of this risk, it is safe to assume that senior management will be focused on employing ways to manage it. Now is a good time to make the business case for investing in proper claim training and education as a way of addressing this key risk. ■

Jim Jones is Director of the Katie School of Insurance and Financial Services. He can be reached at jrjone2@ilstu.edu.