



MITRATECH

White Paper

Claims Defense Automation

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Executive Summary

- Pressure on claims departments is mounting as claim defense expenses and losses grow while profitability from float investments has declined. Claims managers must now figure out new ways to reduce defense costs and narrow losses.
- The automation of key claims defense work processes can help claims managers rein in claims defense costs, use best practices to identify optimal settlement budgets, and avoid unnecessary arbitration and trials while upholding the overarching goal of settling claims fairly and accurately to preserve client relationships. Litigators need tools to help select the right claims for trial.
- Claims defense costs and losses have a direct bearing on a carrier's combined ratio. One significant contributor to poor performance in the loss and expense ratios is the cost of claims defense and higher than necessary losses in claims settlements. Automation of claims defense can affect an improvement in the combined ratio.
- The cost of defending a disputed claim can be unnecessarily high due to sub-optimal information sharing processes and supporting technology. With iterations of discussion amongst diverse stakeholders occurring in disparate systems, as well as through manual processes, the work required to defend a claim may be performed inefficiently.
- Losses may also be unnecessarily high when claims defense stakeholders collaborate through a collection of conventional technologies, such as phone calls, fax, paper-based manual systems, and so forth. In a non-automated system, knowledge of potential settlement options, patterns, and best practices may not be available uniformly throughout the claims defense operation. The extended team managing a claim going to trial needs to be able to organize and prepare in an optimal time frame.
- Claims defense automation typically involves placing the workflow, documents, task assignments, key dates, and stakeholders on a common Web based interface where they can manage the claims defense process. In an automated claims defense automation scenario, stakeholders have greater and more streamlined access to critical information they need to resolve the disputed claim in a shorter cycle time than in a conventional mode of claims defense. Even relatively mundane tasks, such as sharing files, are more cost effective in an automated setting, with resulting decreases in claims defense costs.
- It is possible to calculate a distinct return on investment (ROI) for claims defense automation. By estimating the automation's impact on claims defense cost as well as losses, claims managers can correlate the ROI directly to the combined ratio.

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Introduction

The insurance industry is at a critical inflection point. While increases in claim defense expenses and losses are driving combined ratios up, profitability from float investments are down. Mergers and acquisitions add further complexity and potential duplication in systems and processes. Pressure on claims departments is mounting as never before to reduce both the expense and loss ratios in order to improve company profitability. One significant contributor to poor performance in the loss and expense ratios is the cost of claims defense and higher than necessary losses in claims settlements. The automation of key claims defense work processes can help claims managers rein in claims defense costs, use best practices to identify optimal settlement budgets and avoid unnecessary arbitration and trials while upholding the overarching goal of settling claims fairly and accurately to preserve client relationships. This paper outlines some of the causes of poor combined ratio performance as they relate to claims defense and examines ways that claims defense automation technologies can contribute to a solution to this multi-faceted set of challenges.

The Insurance Industry in 2009

The recession of 2008-2009 has put the insurance industry in a three-way headlock. The economic slump has resulted in an increase in both real and fraudulent claims¹. Operational budgets, including claims defense, are under intense scrutiny and facing cuts across the board. At the same time, investment returns from the stock market and real estate, two staples of insurance float management, are off 20 to 30% from the beginning of 2008. It's harder for an insurance company to earn a profit today than it has been in a generation.

Claims managers face quite a challenge dealing with an increase in claims (more of which are fraudulent than previously) while simultaneously cutting back on costs. To make things even more stressful, there is also pressure to reduce losses in this more litigious environment. For every claim that looks as if it is going to go into litigation, the claims manager faces a set of complex resolution choices that are more fraught than ever with risk to the company's overall financial performance.

Claims Defense and the Combined Ratio

With investment income down, an insurer's combined ratio has gained importance for the overall financial health of the business. In previous years, an insurer could run a combined ratio of .99 or even higher and still earn good profits from float investments. This is less and less the case, and the result has been an increase in pressure for a strong combined ratio.

To review, an insurer's combined ratio is composed of the company's expense ratio (total expenses of running the business divided by net premiums) and its loss ratio (total loss payments made on policies divided by net premiums). The combined ratio is a measurement of profitability for an insurer's

¹ Nguyen, Daisy, and Fowler, Bree – *Desperate Car Owners Turn to Insurance Fraud* – Associated Press 6/29/09

underwriting business. In Table 1, for example, an actual insurance carrier reported the following financial data:

Premium Income	100%
Claims Expense (Loss)	65%
Expense for paying claims	14%
Service and Admin fees	21%
Underwriting Gain/Loss	1%
Loss Ratio	0.647
Expense Ratio	0.346
Combined Ratio	0.99

Table 1 – Actual combined ratio of a North American insurance carrier

Its combined ratio is .99, calculated as follows. To keep the example simple, assume that the company had \$1 billion in premium revenue.

- Expense Ratio = \$346/\$1000, or .346
- Loss Ratio = \$647/\$1000, or .647
- Combined ratio = Expense Ratio (.346) + Loss Ratio (.647) = .99

(Figures in millions)

A .99 combined ratio means that the insurer’s underwriting operation is slightly profitable. Normally, income from investing the premium “float” would add to those underwriting earnings and generate a good net income for the insurer. However, as Table 2 shows, if the combined ratio goes over 1, which is often done, and float investing does not yield good returns, the insurer can experience a loss (shown in colored section of the chart.) That is what is happening today.

Float Income (as % of Net Premiums)						
	0.01	0.02	0.03	0.04	0.05	0.06
0.98	0.03	0.04	0.05	0.06	0.07	0.08
0.99	0.02	0.03	0.04	0.05	0.06	0.07
1.00	0.01	0.02	0.03	0.04	0.05	0.06
1.01	-	0.01	0.02	0.03	0.04	0.05
1.02	(0.01)	-	0.01	0.02	0.03	-0.04
1.03	(0.02)	(0.01)	(0.00)	0.01	0.02	0.03
1.04	(0.03)	(0.02)	(0.01)	-	0.01	0.02
1.05	(0.04)	(0.03)	(0.02)	(0.01)	-	0.01
1.06	(0.05)	(0.04)	(0.03)	(0.02)	(0.01)	-
1.07	(0.06)	(0.05)	(0.04)	(0.03)	(0.02)	(0.01)

Profitable underwriting operations

Table 2 – The impact of increasing combined ratio on profitability. Note that the loss (shaded) increases as the combined ratio goes up and the float income rate goes down.

Claims Defense and Its Impact on the Expense Ratio

The cost of defending disputed insurance claims, whether they reach actual litigation or not, represents a portion of an insurance company’s expense ratio. For many carriers, the cost of claims defense is higher than it needs to be. This is the result of inefficiencies in the claims defense workflow, overly long

claims defense schedules, ineffective vendor management, and unnecessary arbitrations and trials. At their roots, these problems are associated with sub-optimal information sharing, communication, and data management in the claims litigation process.

Claims defense is a time and resource intensive activity. However, claims defense is often made more costly than it needs due to inefficiencies in communication and data sharing in the claims defense process. Figure 1 shows the high level process flow for settling an insurance claim. In many cases, a claim is settled promptly, with little or no contestation. Often enough, though, there is a dispute which triggers the claims defense process.

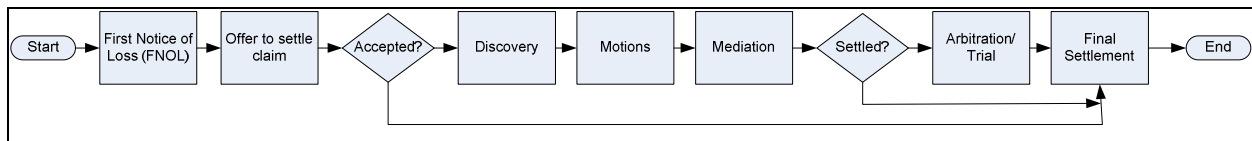


Figure 1 – First Notice of Loss (FNOL)

High-level process flow for claim settlement process

As shown in Figure 2, which is based on the worker’s compensation model, the claims defense process is a multi-party work flow that consists of three iterative loops of activity amongst stakeholders. At the start, if the claims adjuster cannot resolve the claim, he or she typically hands it off to the legal department for claims defense. The first iterative loop involves the carrier’s staff attorney or panel (outside) counsel discussing the dispute internally at the carrier and notifying the insured and plaintiff’s attorney, if there is one. Multiple layers of management may be notified and engaged in discussion of the claim if the loss exposure is substantial.

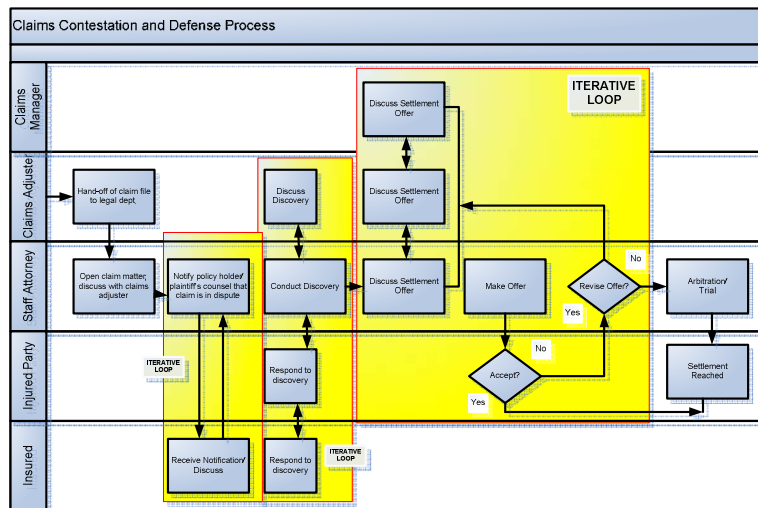


Figure 2 – Claims contestation and defense process, consisting of three iterative loops amongst key stakeholders: Discussion of claim; discovery and settlement

The second loop occurs as the claims defense process proceeds to discovery. In discovery, each party may demand documents and other information from the other, necessitating sub-loops of discussion

and tasks on each end. As the claims proceeds to settlement, there is an iterative loop that involves offers, counter-offers, and discussion of settlement terms. The process may or may not proceed to arbitration or trial, though each escalation of this type creates further iterative looping of communication and information sharing amongst stakeholders.

To see why claims defense, with its iterative work flows, can be inefficient and excessively costly, it is necessary to understand how information flows through the process. Figure 3 illustrates the way that information about disputed claims can get randomly distributed in a variety of silos as multiple stakeholders communicate about the claim through email, phone, meetings, and legacy systems. The result is a situation where locating information needed to settle a claim requires excess effort and time, if it is actually found.

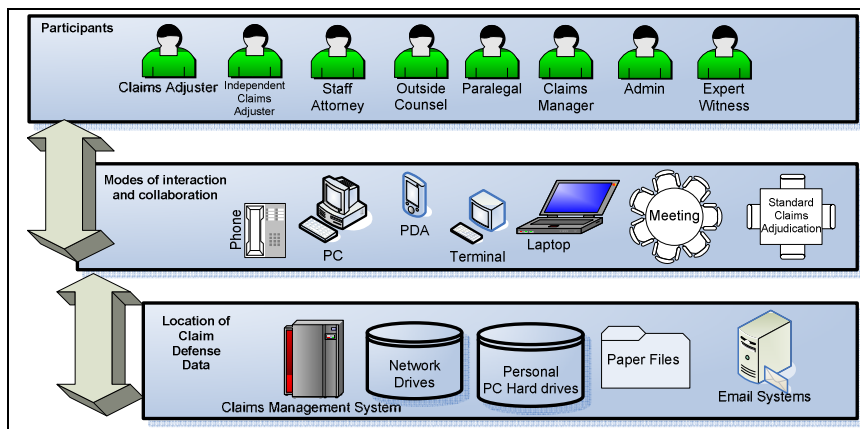


Figure 3 – Flow and location of data in claims contestation and defense process

Examining the steps involved in a typical claims defense workflow reveals the potential sources of inefficiency that can consume excess resources. Figure 4 illustrates the process of sharing a document by email. If the sender must first locate an email that requires a response, and then locate the document to be shared, there are up to five work steps needed to share the document. The recipient must then read the document. If the recipient wants to discuss the document, he or she can respond in email or initiate a phone conversation.

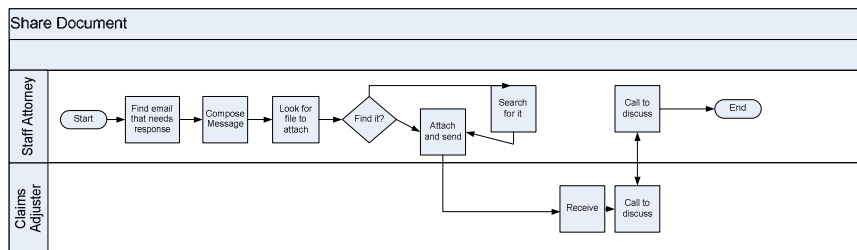


Figure 4 – Task analysis – share a document by email and discuss on the phone

An email is asynchronous and efficient, though it creates additional data about the claim that can get lost and be hard to located subsequently. A phone conversation is worse, potentially, as it creates claim related information that likely ceases to exist once the phone call is over. Table 3 breaks out a time

estimate for each process step. If there is a 5 minute conversation at the end of the process, sharing the document takes 16 person/minutes. At an allocated cost of \$120 per hour², that's a \$32 process. This may not seem like much, but if you consider the volume of claims and the number of such tasks, it is easy to see how claims defense can run into billions of dollars per year at a large carrier.

Process Step	Staff Attorney - Time Spent	Claims Adjuster - Time Spent	Total Time
Find email that needs response	0.50		
Compose message	1.00		
Look for file to attach	0.50		
Search for it further	3.00		
Recipient reads		1.00	
Call to discuss	5.00	5.00	
Total	10.00	6.00	16.00

Table 3 – Time breakdown of cost steps for document sharing through email

The poor flow and storage of information can negatively affect the cost of claims defense by extending the time it takes the carrier to resolve the disputed claim. The longer the process takes, the more it costs. If stakeholders do not have reliable, streamlined access to all the information they need to settle a claim quickly, the process will drag on, creating a cost accruing “snowball effect.” The worst case scenario here is the potential that a claim will escalate to arbitration, or even trial, without needing to go that far along in the process. The carrier’s costs in defending a claim through arbitration are significantly higher than they would be in the typical settlement offer and counter-offer process.

Overspending on vendors in settling a case is a related cost problem that also stems from poor information management and communication amongst claim stakeholders. A disputed claim can trigger spending on experts, outside counsel, and other consultants. Overspending can occur for two reasons. If the carrier does not have an effective vendor budgeting and bill review process, it risks accidentally exceeding the defense allocation it has set for the claim. For example, if a carrier sets a \$50,000 defense budget for a claim, but the outside counsel firm charges \$60,000, \$10,000 of which was accrued but not billed prior to settlement, the carrier can get stuck with a \$10,000 overage that shows up after the fact. And, not all bills are the same, or have the same purpose. Hourly billing, task based billing and matrix severity/complexity billing have different uses and their respective pros and cons. Some forms of billing better serve management reporting and comparative billing between panel and staff counsel.

Overspending on vendors can also naturally flow from an overly long claims settlement period. As the claim settlement process drags on, the associated vendors keep billing and billing, driving up the carrier’s cost and expense ratio at the same time. The key is to spend intelligently. Under-spending in some cases can be catastrophic, while overspending is simply a waste of money. Claims managers need tools to help them make these important judgment calls.

² The average corporate attorney earns \$236,000 per year, or \$120 per hour in a 2000 hour work year

Claims Defense and its Impact on the Loss Ratio

The way that claims are defended also has an impact on a carrier's loss ratio. Most carriers have a thorough process for minimizing loss. However, even with the best of intentions and diligent work, it is possible for claims professionals to miss critical pieces of information that could lead to more effective settlement of claims from a loss perspective. Information can get missed for several reasons, including misplacement of data in disaggregated systems. Patterns of settlement and best practices related to settling certain types of cases can also disappear if they are not developed and stored in an accessible technology solution. The net effect of this accidental information mismanagement is sub-optimal settling of claims.

If information relevant to settling a claim gets stuck in silos, claims defense stakeholders can miss the chance to figure out the lowest possible loss scenario for the claim. Keep in mind the inefficient and scattered data flow depicted in Figure 3. For example, a claims adjuster and staff attorney, paired on a claim, may notice that they were able to settle it for less than they expected, due to some specific data related to the claim, e.g., Rehab costs are lower in a particular region than claims settlement estimation systems might predict. If the adjuster enters this observation into the notes on the claims management system, it will be difficult, or even impossible, for a staff attorney handling a similar claim to be aware of the money-saving insight. The more siloed the organization, the more likely this kind of poor information dissemination is likely to occur.

Sometimes, the most telling aspects of a claim are present at the very beginning of the claims defense process. When a claim is assessed at this first moment of handoff between the claims adjuster and the legal department, it may present itself with certain telltale signs that it is potentially big loss situation, even if the superficial facts do not add up to this conclusion. Every insurance carrier can relate to the typical industry "war story" of a driver who broke his finger and walked away with a \$500,000 check. What makes one claim different from another? In some cases, experienced claims professionals can identify them by eye. In other situations, intelligent software can search for patterns of loss data and correlate them to similar surprise settlements that occurred elsewhere in the carrier's policy base. Again, however, if the data flow has not been set up for this kind of effective early case assessment, the claims stakeholders may miss the opening to prepare for an effective defense against a big loss. Similarly, ineffective data management can mask a fraudulent claim as it flows from the claims adjuster to the legal department. If the fraudulent claim is allowed to continue undetected, the carrier may experience a loss on a claim that should never have been settled in the first place.

Claims Defense Automation Technology

Claims defense automation technology, though not a panacea for combined ratio performance, can have a beneficial impact on both the expense and loss ratios if it is deployed properly. By enabling claims defense stakeholders to organize information and store it in a central, accessible system, with orderly workflows and accountability, the technology can optimize the expense and loss aspects of claims defense process.

Legal matter management software is typically the core element of an effective claims defense automation solution. Designed for the efficient handling of legal matters, but adapted specifically for disputed insurance claims, a matter management application allows selected groupings of personnel to manage documents, tasks, and workflows in a secure, auditable setting. Matter management software enables staff legal department stakeholders to set up and monitor litigation budgets, indemnity reserves, outside counsel spend, key dates, and open tasks. When paired with spend management software, which handles electronic billing (e-billing) and spending analytics, the matter management solution can give litigation managers strong financial control over the litigation portfolio and useful insight into the performance of outside counsel firms.

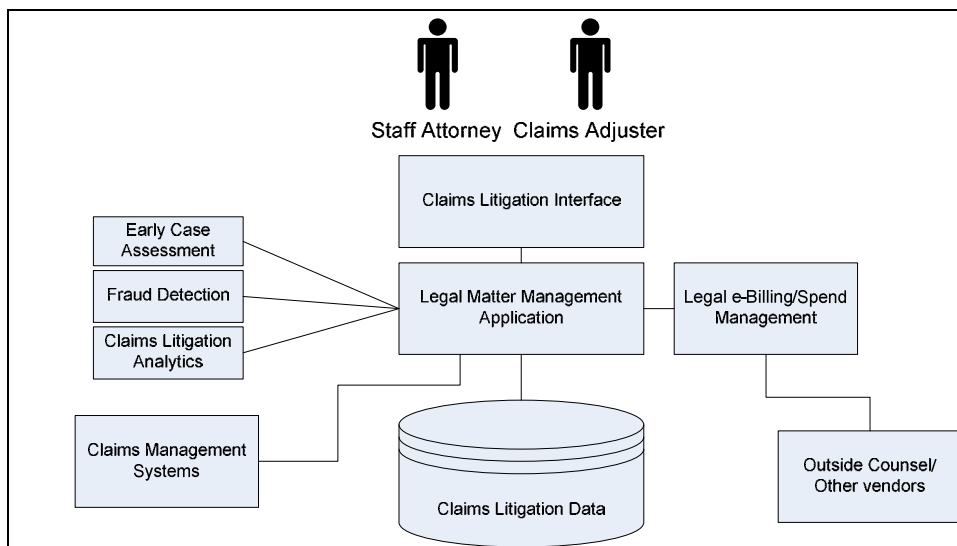


Figure 5 – High level reference architecture for a claims defense automation solution

Transforming a matter management application into a claims defense automation solution involves coupling the core matter software with claims litigation analytics, fraud detection, and early case assessment capabilities. When these elements are combined, claims defense stakeholders can gain an information advantage in defending claims. Figure 5 shows a high level reference architecture for a claims defense automation solution. To work, the solution needs to have some level of integration with the carrier's main claims management system. This integration should automate the handoff of disputed claims between the adjuster and the legal department.

The net effect of the solution is to tie all tasks, documents and workflows associated with a disputed claim to a single, easy to access online location. Cost savings efficiencies arise from claims defense automation as information flows in a more controlled, centralized way. Claims defense automation can also help reduce costs associated with generating required correspondence, which is typically a major drain on time and resources in non-automated claims management situations.

Figure 6 illustrates the streamlined flow of information amongst stakeholders in an automated claims defense solution. Contrast with Figure 3, where information about a disputed claim can get stuck in a

variety of silos and dead ends. Everyone involved in the disputed claim is interacting with the same system, accessing the disputed claim with a unique legal matter identifier.

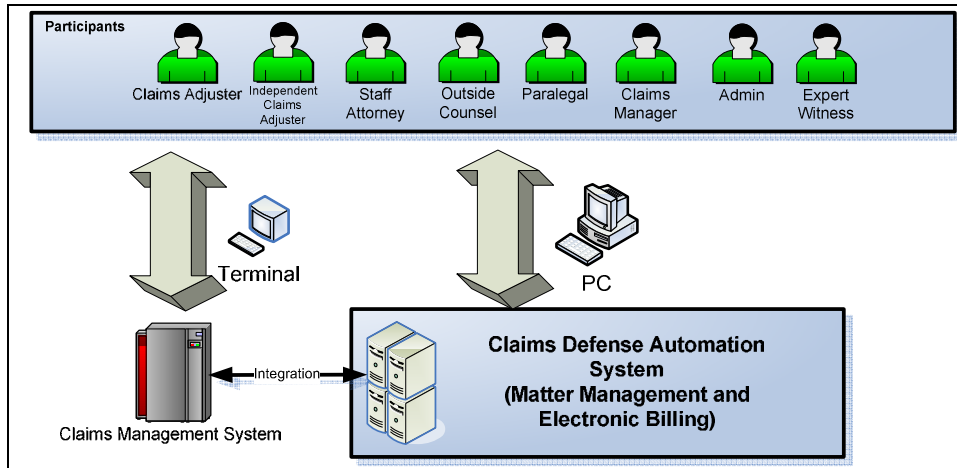


Figure 6 – Potential flow and location of data in claims contestation and defense process with the addition of a claims defense automation system

To demonstrate the specific cost saving potential of claims defense automation, compare the routine file sharing task shown in Figure 4 with the new work flow for the same process shown in Figure 7. With an automated claims defense solution, the “sender” uploads the document to the corresponding matter in the application. The “recipient” gets notified that the document is now on the system through an automated notice. He or she can read the document and post a comment back to the application in lieu of the phone conversation. The sender gets an automated notice that the comment has been posted.

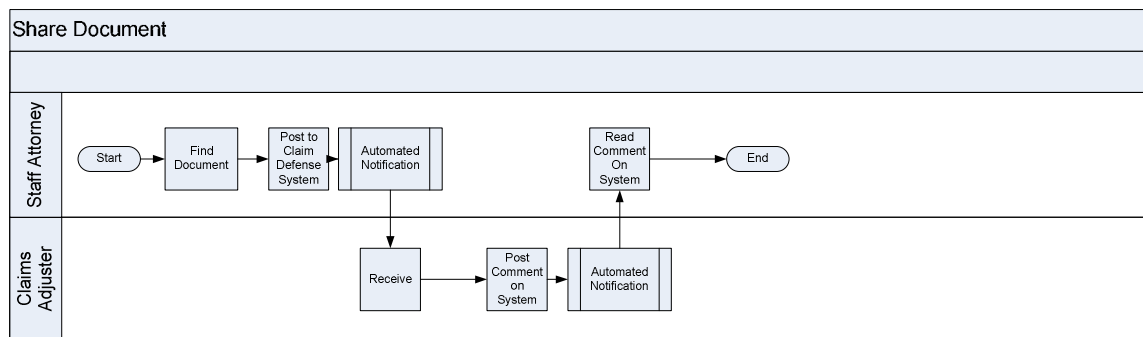


Figure 7 – Workflow for file sharing process (shown earlier in Figure 4) using a claims defense automation solution

The streamlined workflow for document sharing cuts the cost of the process. Table 4 compares the work flow steps, time to complete, and allocated costs for the two approaches to sharing a document.

Assuming a 2 minute phone conversation to discuss the posting of comments, the file sharing task is 47% faster and cheaper with the automated solution. Multiplying this kind of increased efficiency across the entire claims defense organization, you can see the potential for automation to drive improvements in the expense ratio.

Process Step	Through email			With Claims Defense System		
	Staff Attorney - Time Spent	Claims Adjuster - Time Spent	Total Time	Staff Attorney - Time Spent	Claims Adjuster - Time Spent	Total Time
Find email that needs response	0.50					
Compose message	1.00			1.00		
Look for file to attach	0.50			0.50		
Search for it further	3.00					
Recipient reads		1.00			1.00	
Post Response					1.00	
Read Response				1.00		
Call to discuss	5.00	5.00		2.00	2.00	
Total	10.00	6.00	16.00	4.50	4.00	8.50
Allocated cost per hour for time	\$ 120					\$ 120
Total cost	\$ 32					\$ 17
Cost and time improvement	47%					

Table 4 – Comparison of task breakdown and costs for document sharing through email vs. an automated claims defense solution

Going beyond pure efficiency, claims defense automation also has the potential to bring about a number of intangible benefits that can drive improvement in the expense ratio. By aggregating data about disputed claims in a single system, a claims defense automation system gives claims managers real time data about claims' status. Innovative business intelligence and dashboard type interfaces can highlight problematic claims to managers and trigger rapid responses. Budgetary and financial analysis can also give managers insight into the performance of individual claims litigators and outside vendors.

On the loss ratio front, claims defense automation can confer several improvements. If fraud detection is part of the solution, then fraudulent claims that evade detection earlier in the claims adjustment process can be identified and the loss avoided. With a unified, automated system it also becomes easier for claims defense stakeholders to share best practices and organizational knowledge about losses. When coupled with a knowledge management program that encompasses both technological and non-technological aspects of knowledge dissemination, the automated claims defense system can drive improvements in knowledge-based loss reduction.

Calculating Return on Investment for Claims Defense Automation

Claims defense automation requires an investment of money and other resources. If the program is realized well, it should deliver worthwhile gains to the combined ratio. However, it is important to understand how your specific company might respond, in financial terms, to a claims defense automation solution. Table 5 shows an approach to estimating the return on investment (ROI) that a carrier could realize from claims defense automation.

	As is		After Claims Defense Automation		Delta	Delta %
Net Premiums	\$ 1,000		\$ 1,000		\$ -	0.0%
Losses due to non-litigated claims	\$ 290	29.0%	\$ 290	29.0%	\$ -	0.0%
Losses due to litigated claims	\$ 290	29.0%	\$ 281	28.1%	\$ 9	3.0%
Losses due to fraud	\$ 60	6.0%	\$ 58	5.8%	\$ 2	3.0%
Total Losses	\$ 640	64.0%	\$ 630	63.0%	\$ 11	1.6%
Operating Expense, excluding claims defense	\$ 250	25.0%	\$ 250	25.0%	\$ -	0.0%
Claims defense expense	\$ 100	10.0%	\$ 97	9.7%	\$ 3	3.0%
Total Expense	\$ 350	35.0%	\$ 347	34.7%	\$ 3	0.9%
Loss Ratio	0.640		0.630		0.011	1.6%
Expense Ratio	0.350		0.347		0.003	0.9%
Combined Ratio	0.990		0.977		0.014	1.4%
Annual return on Float	5%		5%		-	0.0%
Float income	\$ 25		\$ 25		-	0.0%
Company profitability	\$ 35		\$ 49		13.50	38.6%
Company profitability as a percent of net premiums	4%		5%		0.01	38.6%

Table 5 – Estimate of improvement in the combined ratio and carrier profitability based on a 3% improvement in claims defense loss, claims expense, and fraud-based loss

For claims defense automation, ROI estimation requires several inputs: The carrier's losses due to litigated and non-litigated claims, as well as from fraud. And, it requires the expense figures for claims litigation as well as for all other expenses. Hard-dollar ROI is based on savings in the loss and expense categories. How much can claims defense automation save the carrier? Estimating potential savings involves conducting an analysis of the claims defense workflows and infrastructure already in place at the carrier, and calculating the potential cost reductions for litigated claim loss, fraudulent claim loss, as

well as the litigation expense itself. With these savings estimates, it is possible to project the impact of claims defense automation on the combined ratio.

Factoring in an estimate of investment income from “float,” it is possible to extend the estimate to include a projection of changes to net income to the carrier resulting from the investment in claims defense automation. In the example depicted in Table 5, the investment yields 3% improvement in loss and expense, which translates into a one point decline in combined ratio and a 38% increase in net income. For a carrier with \$1 billion net premium revenue, that would mean a profit gain of \$13.5 million.

Mitratech’s Claims Defense Automation Solutions

Mitratech has offered claims defense automation solutions for more than twenty years. The core of Mitratech’s claims defense solution is TeamConnect, a platform and application designed to manage legal matters and outside legal spend. TeamConnect provides a unified, secure, Web-based interface where claims defense stakeholders can collaborate on resolving disputed claims. With litigation-specific workflows, rules, tasks, and document management functions built in, TeamConnect allows select individuals to work on sensitive, privileged information in an efficient way.



Figure 8 – TeamConnect Legal gives claims defense stakeholders a single, secure online application through which to conduct claims settlement work

Figure 8 shows the TeamConnect matter management interface. In this example, the dispute involves a worker’s compensation claim. TeamConnect is able to capture the relevant information about the dispute and associate it with a specific outside counsel firm. Once the matter has been established in TeamConnect, all key stakeholders can work through the application to assign tasks, track important dates, monitor outside counsel spend, and so forth. TeamConnect is also able to set up customized workflows that represent the specific claims defense processes of a particular carrier. It can integrate with claims management systems in order to reduce the friction of the claim handoff to the legal department.

For claims managers, TeamConnect provides executive dashboards, as shown in Figure 9. TeamConnect collects vendor billings and matches them against the associated matter and budget. As a result, the application can aggregate the spend and budget performance of each matter, or all matters. In the dashboard shown in Figure 9, an executive can click on a matter number (shown at the left) and see an instantly produced graph of the latest actual spend vs. budget for that matter. The dashboards are available live at mitratech.com.

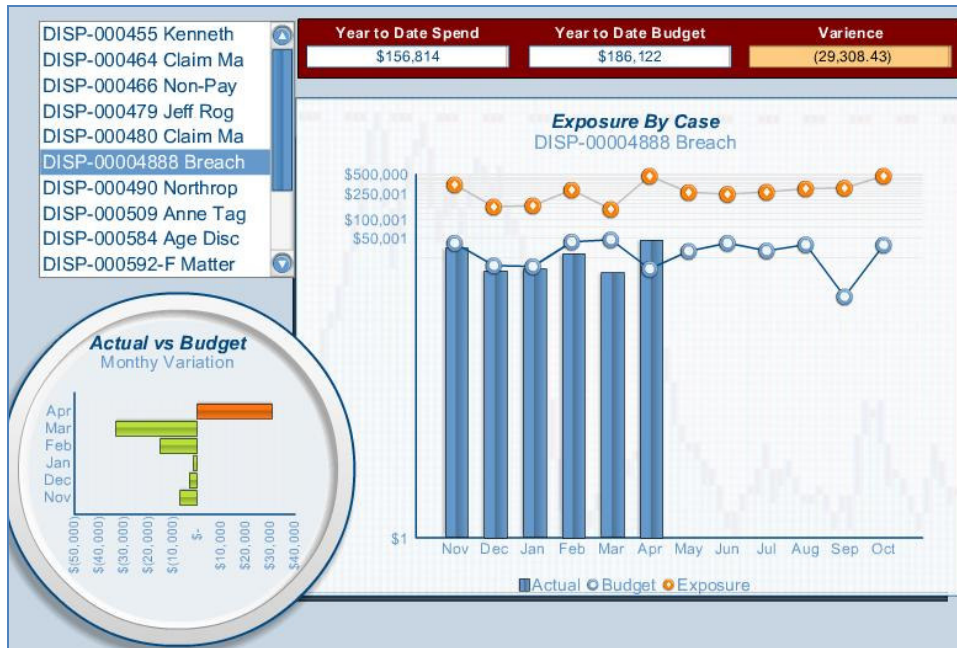


Figure 9 – A TeamConnect Executive Dashboard, showing expense and budget on a matter by matter basis

Mitratech's claims defense solutions are built on the core TeamConnect matter management application. For claims defense, the company has developed an Insurance Claims Litigation Solution Framework, which adds claims defense functionality to TeamConnect Legal. The framework is designed to provide claims managers with accurate, real time data on how claims are being litigated across a large claims organization. It includes capabilities for litigation trend analysis and fraud detection. This practical intelligence about claims enables improved productivity for the claims department, which contributes to an improved expense ratio for the carrier. By helping staff attorneys gain a better understanding of effective claims defense practices, as well as detecting fraud, the framework helps narrow the carrier's loss ratio.

Conclusion

Technology, in the form of Claims defense automation solutions, can be a major contributing factor to improvement in claims defense costs and loss results. At the same time, automating claims defense with technology is really just part of the overall cost and loss reduction picture. Understanding how a claims organization manages the claims defense process, who is involved, what information the need, and so forth, is essential to making the best use of claims defense automation technology. Acquiring the insights into how technology can make an impact on a specific information and process management modalities may involve partnering with an experienced consulting organization that has helped other carriers work through the same issues. The key is to be able to quantify the potential savings from claims defense automation and develop an investment plan that matches the organization's specific needs and ways of getting the work done.

About Mitratesch

Mitratesch is an enterprise software company that enables corporate leaders to strategically manage legal and compliance operations. In more than two decades of successful operation, Mitratesch software has powered Fortune 100 legal and compliance departments, claims litigation at major carriers, and case management at government agencies. Mitratesch's versatile TeamConnect platform was built from the concept of collaborative accountability, enabling businesses and their trusted partners to work together in a flexible but highly secure environment that reduces exposure to risk and sharpens operating discipline. TeamConnect applications span corporate legal automation and governance, risk, and compliance, with functional focus on matter management, legal e-billing, and litigation holds.

www.mitratesch.com



MITRATECH

White Paper

Claims Defense Automation

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Introduction

The insurance industry is at a critical inflection point. While increases in claim defense expenses and losses are driving combined ratios up, profitability from float investments are down. Mergers and acquisitions add further complexity and potential duplication in systems and processes. Pressure on claims departments is mounting as never before to reduce both the expense and loss ratios in order to improve company profitability. One significant contributor to poor performance in the loss and expense ratios is the cost of claims defense and higher than necessary losses in claims settlements. The automation of key claims defense work processes can help claims managers rein in claims defense costs, use best practices to identify optimal settlement budgets and avoid unnecessary arbitration and trials while upholding the overarching goal of settling claims fairly and accurately to preserve client relationships. This paper outlines some of the causes of poor combined ratio performance as they relate to claims defense and examines ways that claims defense automation technologies can contribute to a solution to this multi-faceted set of challenges.

The Insurance Industry in 2009

The recession of 2008-2009 has put the insurance industry in a three-way headlock. The economic slump has resulted in an increase in both real and fraudulent claims¹. Operational budgets, including claims defense, are under intense scrutiny and facing cuts across the board. At the same time, investment returns from the stock market and real estate, two staples of insurance float management, are off 20 to 30% from the beginning of 2008. It's harder for an insurance company to earn a profit today than it has been in a generation.

Claims managers face quite a challenge dealing with an increase in claims (more of which are fraudulent than previously) while simultaneously cutting back on costs. To make things even more stressful, there is also pressure to reduce losses in this more litigious environment. For every claim that looks as if it is going to go into litigation, the claims manager faces a set of complex resolution choices that are more fraught than ever with risk to the company's overall financial performance.

Claims Defense and the Combined Ratio

With investment income down, an insurer's combined ratio has gained importance for the overall financial health of the business. In previous years, an insurer could run a combined ratio of .99 or even higher and still earn good profits from float investments. This is less and less the case, and the result has been an increase in pressure for a strong combined ratio.

To review, an insurer's combined ratio is composed of the company's expense ratio (total expenses of running the business divided by net premiums) and its loss ratio (total loss payments made on policies divided by net premiums). The combined ratio is a measurement of profitability for an insurer's

¹ Nguyen, Daisy, and Fowler, Bree – *Desperate Car Owners Turn to Insurance Fraud* – Associated Press 6/29/09

underwriting business. In Table 1, for example, an actual insurance carrier reported the following financial data:

Premium Income	100%
Claims Expense (Loss)	65%
Expense for paying claims	14%
Service and Admin fees	21%
Underwriting Gain/Loss	1%
Loss Ratio	0.647
Expense Ratio	0.346
Combined Ratio	0.99

Table 1 – Actual combined ratio of a North American insurance carrier

Its combined ratio is .99, calculated as follows. To keep the example simple, assume that the company had \$1 billion in premium revenue.

- Expense Ratio = \$346/\$1000, or .346
- Loss Ratio = \$647/\$1000, or .647
- Combined ratio = Expense Ratio (.346) + Loss Ratio (.647) = .99

(Figures in millions)

A .99 combined ratio means that the insurer’s underwriting operation is slightly profitable. Normally, income from investing the premium “float” would add to those underwriting earnings and generate a good net income for the insurer. However, as Table 2 shows, if the combined ratio goes over 1, which is often done, and float investing does not yield good returns, the insurer can experience a loss (shown in colored section of the chart.) That is what is happening today.

Float Income (as % of Net Premiums)						
	0.01	0.02	0.03	0.04	0.05	0.06
0.98	0.03	0.04	0.05	0.06	0.07	0.08
0.99	0.02	0.03	0.04	0.05	0.06	0.07
1.00	0.01	0.02	0.03	0.04	0.05	0.06
1.01	-	0.01	0.02	0.03	0.04	0.05
1.02	(0.01)	-	0.01	0.02	0.03	-0.04
1.03	(0.02)	(0.01)	(0.00)	0.01	0.02	0.03
1.04	(0.03)	(0.02)	(0.01)	-	0.01	0.02
1.05	(0.04)	(0.03)	(0.02)	(0.01)	-	0.01
1.06	(0.05)	(0.04)	(0.03)	(0.02)	(0.01)	-
1.07	(0.06)	(0.05)	(0.04)	(0.03)	(0.02)	(0.01)

Profitable underwriting operations

Table 2 – The impact of increasing combined ratio on profitability. Note that the loss (shaded) increases as the combined ratio goes up and the float income rate goes down.

Claims Defense and Its Impact on the Expense Ratio

The cost of defending disputed insurance claims, whether they reach actual litigation or not, represents a portion of an insurance company’s expense ratio. For many carriers, the cost of claims defense is higher than it needs to be. This is the result of inefficiencies in the claims defense workflow, overly long

claims defense schedules, ineffective vendor management, and unnecessary arbitrations and trials. At their roots, these problems are associated with sub-optimal information sharing, communication, and data management in the claims litigation process.

Claims defense is a time and resource intensive activity. However, claims defense is often made more costly than it needs due to inefficiencies in communication and data sharing in the claims defense process. Figure 1 shows the high level process flow for settling an insurance claim. In many cases, a claim is settled promptly, with little or no contestation. Often enough, though, there is a dispute which triggers the claims defense process.

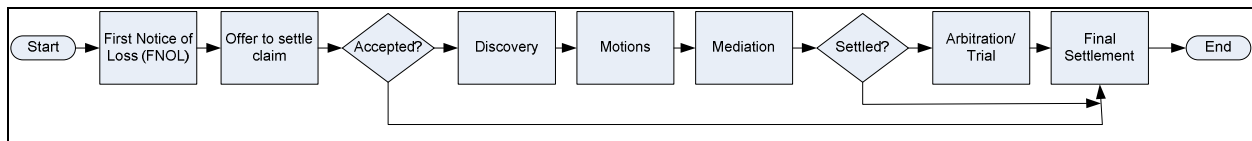


Figure 1 – First Notice of Loss (FNOL)

High-level process flow for claim settlement process

As shown in Figure 2, which is based on the worker’s compensation model, the claims defense process is a multi-party work flow that consists of three iterative loops of activity amongst stakeholders. At the start, if the claims adjuster cannot resolve the claim, he or she typically hands it off to the legal department for claims defense. The first iterative loop involves the carrier’s staff attorney or panel (outside) counsel discussing the dispute internally at the carrier and notifying the insured and plaintiff’s attorney, if there is one. Multiple layers of management may be notified and engaged in discussion of the claim if the loss exposure is substantial.

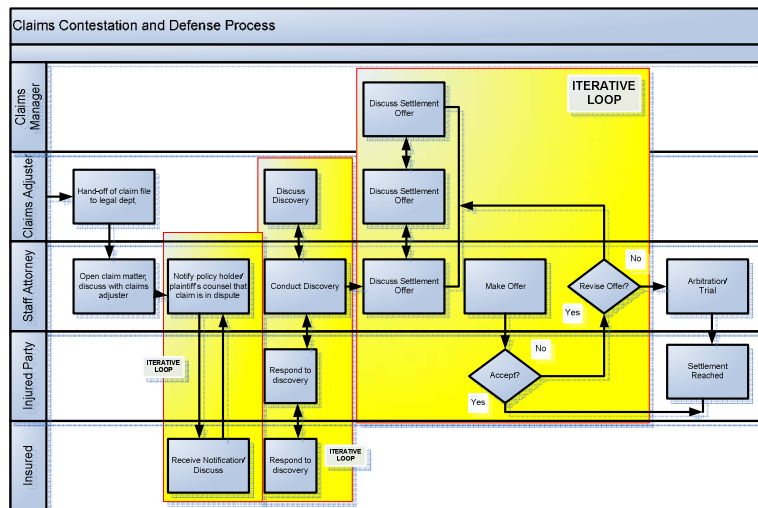


Figure 2 – Claims contestation and defense process, consisting of three iterative loops amongst key stakeholders: Discussion of claim; discovery and settlement

The second loop occurs as the claims defense process proceeds to discovery. In discovery, each party may demand documents and other information from the other, necessitating sub-loops of discussion

and tasks on each end. As the claims proceeds to settlement, there is an iterative loop that involves offers, counter-offers, and discussion of settlement terms. The process may or may not proceed to arbitration or trial, though each escalation of this type creates further iterative looping of communication and information sharing amongst stakeholders.

To see why claims defense, with its iterative work flows, can be inefficient and excessively costly, it is necessary to understand how information flows through the process. Figure 3 illustrates the way that information about disputed claims can get randomly distributed in a variety of silos as multiple stakeholders communicate about the claim through email, phone, meetings, and legacy systems. The result is a situation where locating information needed to settle a claim requires excess effort and time, if it is actually found.

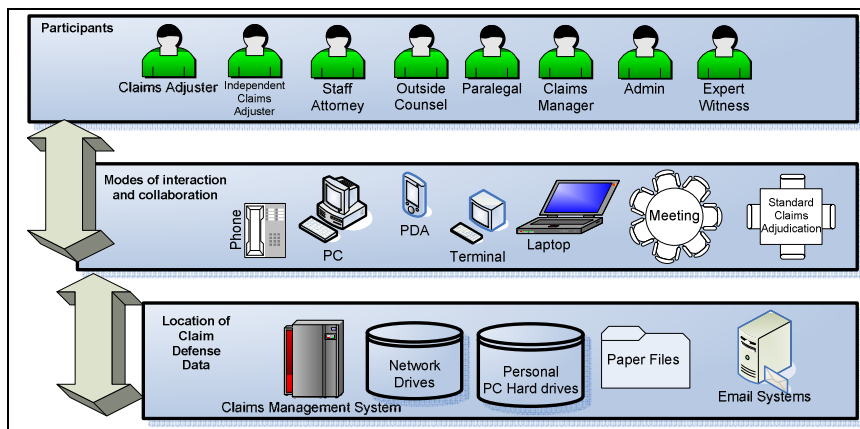


Figure 3 – Flow and location of data in claims contestation and defense process

Examining the steps involved in a typical claims defense workflow reveals the potential sources of inefficiency that can consume excess resources. Figure 4 illustrates the process of sharing a document by email. If the sender must first locate an email that requires a response, and then locate the document to be shared, there are up to five work steps needed to share the document. The recipient must then read the document. If the recipient wants to discuss the document, he or she can respond in email or initiate a phone conversation.

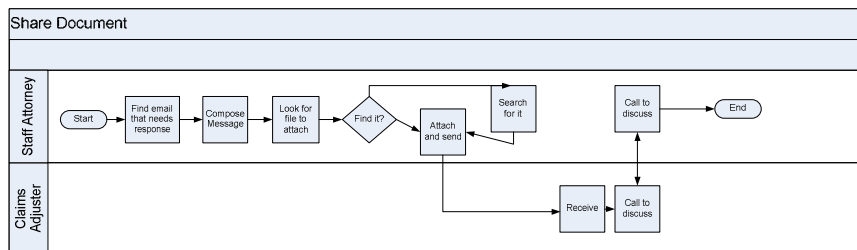


Figure 4 – Task analysis – share a document by email and discuss on the phone

An email is asynchronous and efficient, though it creates additional data about the claim that can get lost and be hard to located subsequently. A phone conversation is worse, potentially, as it creates claim related information that likely ceases to exist once the phone call is over. Table 3 breaks out a time

estimate for each process step. If there is a 5 minute conversation at the end of the process, sharing the document takes 16 person/minutes. At an allocated cost of \$120 per hour², that's a \$32 process. This may not seem like much, but if you consider the volume of claims and the number of such tasks, it is easy to see how claims defense can run into billions of dollars per year at a large carrier.

Process Step	Staff Attorney - Time Spent	Claims Adjuster - Time Spent	Total Time
Find email that needs response	0.50		
Compose message	1.00		
Look for file to attach	0.50		
Search for it further	3.00		
Recipient reads		1.00	
Call to discuss	5.00	5.00	
Total	10.00	6.00	16.00

Table 3 – Time breakdown of cost steps for document sharing through email

The poor flow and storage of information can negatively affect the cost of claims defense by extending the time it takes the carrier to resolve the disputed claim. The longer the process takes, the more it costs. If stakeholders do not have reliable, streamlined access to all the information they need to settle a claim quickly, the process will drag on, creating a cost accruing “snowball effect.” The worst case scenario here is the potential that a claim will escalate to arbitration, or even trial, without needing to go that far along in the process. The carrier’s costs in defending a claim through arbitration are significantly higher than they would be in the typical settlement offer and counter-offer process.

Overspending on vendors in settling a case is a related cost problem that also stems from poor information management and communication amongst claim stakeholders. A disputed claim can trigger spending on experts, outside counsel, and other consultants. Overspending can occur for two reasons. If the carrier does not have an effective vendor budgeting and bill review process, it risks accidentally exceeding the defense allocation it has set for the claim. For example, if a carrier sets a \$50,000 defense budget for a claim, but the outside counsel firm charges \$60,000, \$10,000 of which was accrued but not billed prior to settlement, the carrier can get stuck with a \$10,000 overage that shows up after the fact. And, not all bills are the same, or have the same purpose. Hourly billing, task based billing and matrix severity/complexity billing have different uses and their respective pros and cons. Some forms of billing better serve management reporting and comparative billing between panel and staff counsel.

Overspending on vendors can also naturally flow from an overly long claims settlement period. As the claim settlement process drags on, the associated vendors keep billing and billing, driving up the carrier’s cost and expense ratio at the same time. The key is to spend intelligently. Under-spending in some cases can be catastrophic, while overspending is simply a waste of money. Claims managers need tools to help them make these important judgment calls.

² The average corporate attorney earns \$236,000 per year, or \$120 per hour in a 2000 hour work year

Claims Defense and its Impact on the Loss Ratio

The way that claims are defended also has an impact on a carrier's loss ratio. Most carriers have a thorough process for minimizing loss. However, even with the best of intentions and diligent work, it is possible for claims professionals to miss critical pieces of information that could lead to more effective settlement of claims from a loss perspective. Information can get missed for several reasons, including misplacement of data in disaggregated systems. Patterns of settlement and best practices related to settling certain types of cases can also disappear if they are not developed and stored in an accessible technology solution. The net effect of this accidental information mismanagement is sub-optimal settling of claims.

If information relevant to settling a claim gets stuck in silos, claims defense stakeholders can miss the chance to figure out the lowest possible loss scenario for the claim. Keep in mind the inefficient and scattered data flow depicted in Figure 3. For example, a claims adjuster and staff attorney, paired on a claim, may notice that they were able to settle it for less than they expected, due to some specific data related to the claim, e.g., Rehab costs are lower in a particular region than claims settlement estimation systems might predict. If the adjuster enters this observation into the notes on the claims management system, it will be difficult, or even impossible, for a staff attorney handling a similar claim to be aware of the money-saving insight. The more siloed the organization, the more likely this kind of poor information dissemination is likely to occur.

Sometimes, the most telling aspects of a claim are present at the very beginning of the claims defense process. When a claim is assessed at this first moment of handoff between the claims adjuster and the legal department, it may present itself with certain telltale signs that it is potentially big loss situation, even if the superficial facts do not add up to this conclusion. Every insurance carrier can relate to the typical industry "war story" of a driver who broke his finger and walked away with a \$500,000 check. What makes one claim different from another? In some cases, experienced claims professionals can identify them by eye. In other situations, intelligent software can search for patterns of loss data and correlate them to similar surprise settlements that occurred elsewhere in the carrier's policy base. Again, however, if the data flow has not been set up for this kind of effective early case assessment, the claims stakeholders may miss the opening to prepare for an effective defense against a big loss. Similarly, ineffective data management can mask a fraudulent claim as it flows from the claims adjuster to the legal department. If the fraudulent claim is allowed to continue undetected, the carrier may experience a loss on a claim that should never have been settled in the first place.

Claims Defense Automation Technology

Claims defense automation technology, though not a panacea for combined ratio performance, can have a beneficial impact on both the expense and loss ratios if it is deployed properly. By enabling claims defense stakeholders to organize information and store it in a central, accessible system, with orderly workflows and accountability, the technology can optimize the expense and loss aspects of claims defense process.

Legal matter management software is typically the core element of an effective claims defense automation solution. Designed for the efficient handling of legal matters, but adapted specifically for disputed insurance claims, a matter management application allows selected groupings of personnel to manage documents, tasks, and workflows in a secure, auditable setting. Matter management software enables staff legal department stakeholders to set up and monitor litigation budgets, indemnity reserves, outside counsel spend, key dates, and open tasks. When paired with spend management software, which handles electronic billing (e-billing) and spending analytics, the matter management solution can give litigation managers strong financial control over the litigation portfolio and useful insight into the performance of outside counsel firms.

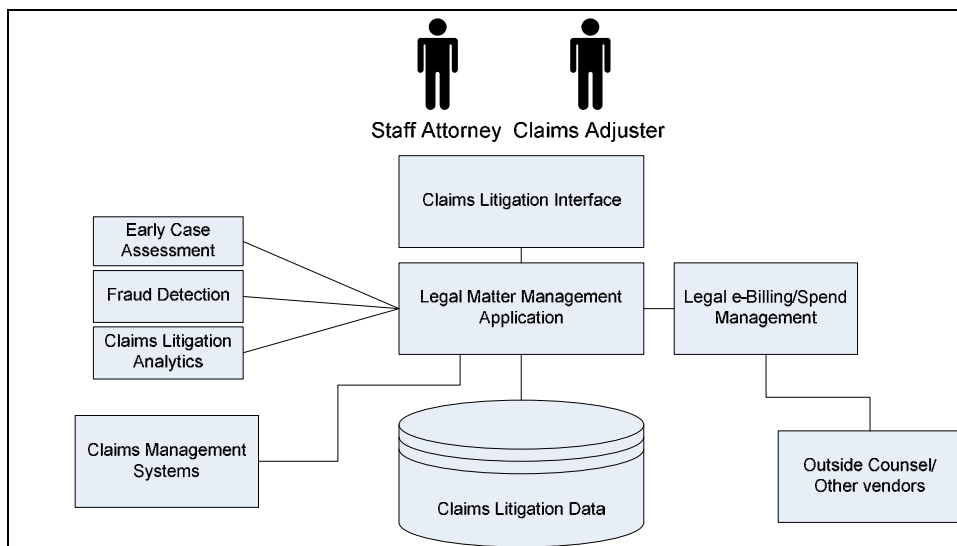


Figure 5 – High level reference architecture for a claims defense automation solution

Transforming a matter management application into a claims defense automation solution involves coupling the core matter software with claims litigation analytics, fraud detection, and early case assessment capabilities. When these elements are combined, claims defense stakeholders can gain an information advantage in defending claims. Figure 5 shows a high level reference architecture for a claims defense automation solution. To work, the solution needs to have some level of integration with the carrier's main claims management system. This integration should automate the handoff of disputed claims between the adjuster and the legal department.

The net effect of the solution is to tie all tasks, documents and workflows associated with a disputed claim to a single, easy to access online location. Cost savings efficiencies arise from claims defense automation as information flows in a more controlled, centralized way. Claims defense automation can also help reduce costs associated with generating required correspondence, which is typically a major drain on time and resources in non-automated claims management situations.

Figure 6 illustrates the streamlined flow of information amongst stakeholders in an automated claims defense solution. Contrast with Figure 3, where information about a disputed claim can get stuck in a

variety of silos and dead ends. Everyone involved in the disputed claim is interacting with the same system, accessing the disputed claim with a unique legal matter identifier.

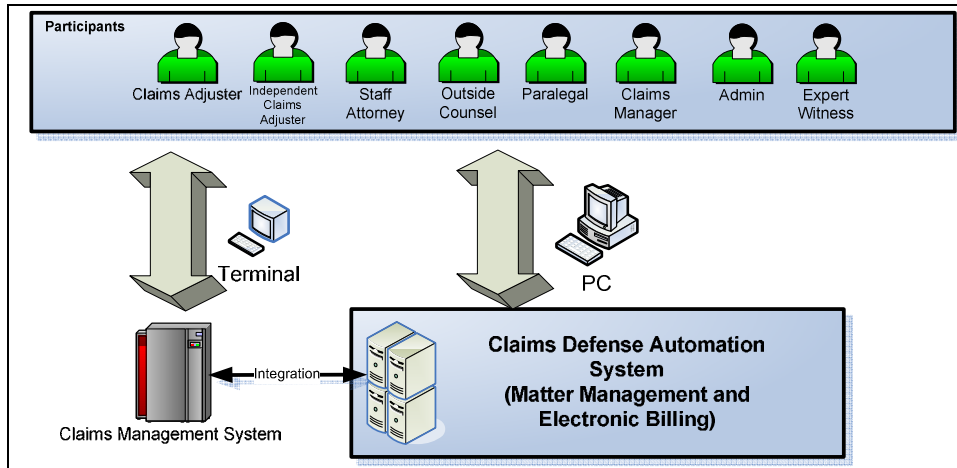


Figure 6 – Potential flow and location of data in claims contestation and defense process with the addition of a claims defense automation system

To demonstrate the specific cost saving potential of claims defense automation, compare the routine file sharing task shown in Figure 4 with the new work flow for the same process shown in Figure 7. With an automated claims defense solution, the “sender” uploads the document to the corresponding matter in the application. The “recipient” gets notified that the document is now on the system through an automated notice. He or she can read the document and post a comment back to the application in lieu of the phone conversation. The sender gets an automated notice that the comment has been posted.

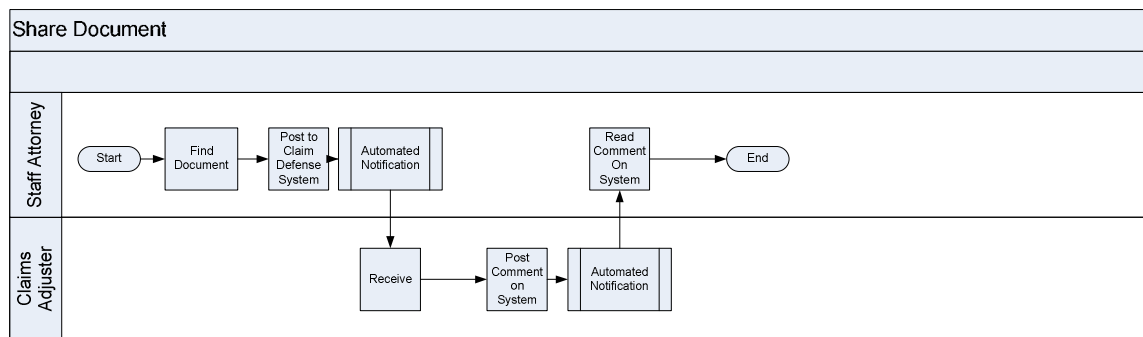


Figure 7 – Workflow for file sharing process (shown earlier in Figure 4) using a claims defense automation solution

The streamlined workflow for document sharing cuts the cost of the process. Table 4 compares the work flow steps, time to complete, and allocated costs for the two approaches to sharing a document.

Assuming a 2 minute phone conversation to discuss the posting of comments, the file sharing task is 47% faster and cheaper with the automated solution. Multiplying this kind of increased efficiency across the entire claims defense organization, you can see the potential for automation to drive improvements in the expense ratio.

Process Step	Through email			With Claims Defense System		
	Staff Attorney - Time Spent	Claims Adjuster - Time Spent	Total Time	Staff Attorney - Time Spent	Claims Adjuster - Time Spent	Total Time
Find email that needs response	0.50					
Compose message	1.00			1.00		
Look for file to attach	0.50			0.50		
Search for it further	3.00					
Recipient reads		1.00			1.00	
Post Response					1.00	
Read Response				1.00		
Call to discuss	5.00	5.00		2.00	2.00	
Total	10.00	6.00	16.00	4.50	4.00	8.50
Allocated cost per hour for time	\$ 120					\$ 120
Total cost	\$ 32					\$ 17
Cost and time improvement	47%					

Table 4 – Comparison of task breakdown and costs for document sharing through email vs. an automated claims defense solution

Going beyond pure efficiency, claims defense automation also has the potential to bring about a number of intangible benefits that can drive improvement in the expense ratio. By aggregating data about disputed claims in a single system, a claims defense automation system gives claims managers real time data about claims' status. Innovative business intelligence and dashboard type interfaces can highlight problematic claims to managers and trigger rapid responses. Budgetary and financial analysis can also give managers insight into the performance of individual claims litigators and outside vendors.

On the loss ratio front, claims defense automation can confer several improvements. If fraud detection is part of the solution, then fraudulent claims that evade detection earlier in the claims adjustment process can be identified and the loss avoided. With a unified, automated system it also becomes easier for claims defense stakeholders to share best practices and organizational knowledge about losses. When coupled with a knowledge management program that encompasses both technological and non-technological aspects of knowledge dissemination, the automated claims defense system can drive improvements in knowledge-based loss reduction.

Calculating Return on Investment for Claims Defense Automation

Claims defense automation requires an investment of money and other resources. If the program is realized well, it should deliver worthwhile gains to the combined ratio. However, it is important to understand how your specific company might respond, in financial terms, to a claims defense automation solution. Table 5 shows an approach to estimating the return on investment (ROI) that a carrier could realize from claims defense automation.

	As is		After Claims Defense Automation		Delta	Delta %
Net Premiums	\$ 1,000		\$ 1,000		\$ -	0.0%
Losses due to non-litigated claims	\$ 290	29.0%	\$ 290	29.0%	\$ -	0.0%
Losses due to litigated claims	\$ 290	29.0%	\$ 281	28.1%	\$ 9	3.0%
Losses due to fraud	\$ 60	6.0%	\$ 58	5.8%	\$ 2	3.0%
Total Losses	\$ 640	64.0%	\$ 630	63.0%	\$ 11	1.6%
Operating Expense, excluding claims defense	\$ 250	25.0%	\$ 250	25.0%	\$ -	0.0%
Claims defense expense	\$ 100	10.0%	\$ 97	9.7%	\$ 3	3.0%
Total Expense	\$ 350	35.0%	\$ 347	34.7%	\$ 3	0.9%
Loss Ratio	0.640		0.630		0.011	1.6%
Expense Ratio	0.350		0.347		0.003	0.9%
Combined Ratio	0.990		0.977		0.014	1.4%
Annual return on Float	5%		5%		-	0.0%
Float income	\$ 25		\$ 25		-	0.0%
Company profitability	\$ 35		\$ 49		13.50	38.6%
Company profitability as a percent of net premiums	4%		5%		0.01	38.6%

Table 5 – Estimate of improvement in the combined ratio and carrier profitability based on a 3% improvement in claims defense loss, claims expense, and fraud-based loss

For claims defense automation, ROI estimation requires several inputs: The carrier's losses due to litigated and non-litigated claims, as well as from fraud. And, it requires the expense figures for claims litigation as well as for all other expenses. Hard-dollar ROI is based on savings in the loss and expense categories. How much can claims defense automation save the carrier? Estimating potential savings involves conducting an analysis of the claims defense workflows and infrastructure already in place at the carrier, and calculating the potential cost reductions for litigated claim loss, fraudulent claim loss, as

well as the litigation expense itself. With these savings estimates, it is possible to project the impact of claims defense automation on the combined ratio.

Factoring in an estimate of investment income from “float,” it is possible to extend the estimate to include a projection of changes to net income to the carrier resulting from the investment in claims defense automation. In the example depicted in Table 5, the investment yields 3% improvement in loss and expense, which translates into a one point decline in combined ratio and a 38% increase in net income. For a carrier with \$1 billion net premium revenue, that would mean a profit gain of \$13.5 million.

Mitratech’s Claims Defense Automation Solutions

Mitratech has offered claims defense automation solutions for more than twenty years. The core of Mitratech’s claims defense solution is TeamConnect, a platform and application designed to manage legal matters and outside legal spend. TeamConnect provides a unified, secure, Web-based interface where claims defense stakeholders can collaborate on resolving disputed claims. With litigation-specific workflows, rules, tasks, and document management functions built in, TeamConnect allows select individuals to work on sensitive, privileged information in an efficient way.



Figure 8 – TeamConnect Legal gives claims defense stakeholders a single, secure online application through which to conduct claims settlement work

Figure 8 shows the TeamConnect matter management interface. In this example, the dispute involves a worker’s compensation claim. TeamConnect is able to capture the relevant information about the dispute and associate it with a specific outside counsel firm. Once the matter has been established in TeamConnect, all key stakeholders can work through the application to assign tasks, track important dates, monitor outside counsel spend, and so forth. TeamConnect is also able to set up customized workflows that represent the specific claims defense processes of a particular carrier. It can integrate with claims management systems in order to reduce the friction of the claim handoff to the legal department.

For claims managers, TeamConnect provides executive dashboards, as shown in Figure 9. TeamConnect collects vendor billings and matches them against the associated matter and budget. As a result, the application can aggregate the spend and budget performance of each matter, or all matters. In the dashboard shown in Figure 9, an executive can click on a matter number (shown at the left) and see an instantly produced graph of the latest actual spend vs. budget for that matter. The dashboards are available live at mitratech.com.

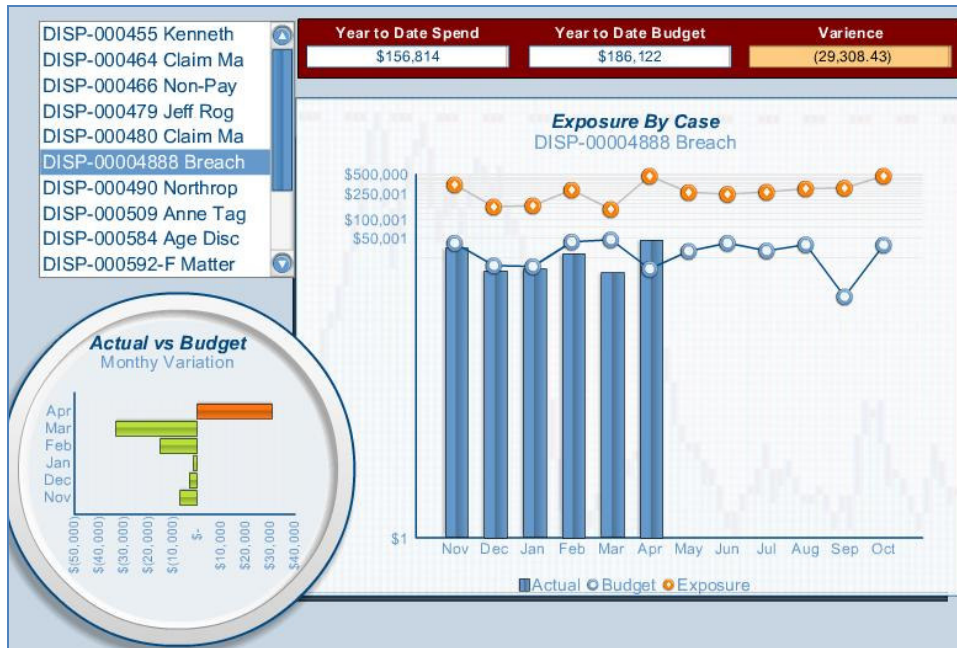


Figure 9 – A TeamConnect Executive Dashboard, showing expense and budget on a matter by matter basis

Mitratech's claims defense solutions are built on the core TeamConnect matter management application. For claims defense, the company has developed an Insurance Claims Litigation Solution Framework, which adds claims defense functionality to TeamConnect Legal. The framework is designed to provide claims managers with accurate, real time data on how claims are being litigated across a large claims organization. It includes capabilities for litigation trend analysis and fraud detection. This practical intelligence about claims enables improved productivity for the claims department, which contributes to an improved expense ratio for the carrier. By helping staff attorneys gain a better understanding of effective claims defense practices, as well as detecting fraud, the framework helps narrow the carrier's loss ratio.

Conclusion

Technology, in the form of Claims defense automation solutions, can be a major contributing factor to improvement in claims defense costs and loss results. At the same time, automating claims defense with technology is really just part of the overall cost and loss reduction picture. Understanding how a claims organization manages the claims defense process, who is involved, what information the need, and so forth, is essential to making the best use of claims defense automation technology. Acquiring the insights into how technology can make an impact on a specific information and process management modalities may involve partnering with an experienced consulting organization that has helped other carriers work through the same issues. The key is to be able to quantify the potential savings from claims defense automation and develop an investment plan that matches the organization's specific needs and ways of getting the work done.

About Mitratesch

Mitratesch is an enterprise software company that enables corporate leaders to strategically manage legal and compliance operations. In more than two decades of successful operation, Mitratesch software has powered Fortune 100 legal and compliance departments, claims litigation at major carriers, and case management at government agencies. Mitratesch's versatile TeamConnect platform was built from the concept of collaborative accountability, enabling businesses and their trusted partners to work together in a flexible but highly secure environment that reduces exposure to risk and sharpens operating discipline. TeamConnect applications span corporate legal automation and governance, risk, and compliance, with functional focus on matter management, legal e-billing, and litigation holds.

www.mitratesch.com



MITRATECH

White Paper

Claims Defense Automation

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Executive Summary

- Pressure on claims departments is mounting as claim defense expenses and losses grow while profitability from float investments has declined. Claims managers must now figure out new ways to reduce defense costs and narrow losses.
- The automation of key claims defense work processes can help claims managers rein in claims defense costs, use best practices to identify optimal settlement budgets, and avoid unnecessary arbitration and trials while upholding the overarching goal of settling claims fairly and accurately to preserve client relationships. Litigators need tools to help select the right claims for trial.
- Claims defense costs and losses have a direct bearing on a carrier's combined ratio. One significant contributor to poor performance in the loss and expense ratios is the cost of claims defense and higher than necessary losses in claims settlements. Automation of claims defense can affect an improvement in the combined ratio.
- The cost of defending a disputed claim can be unnecessarily high due to sub-optimal information sharing processes and supporting technology. With iterations of discussion amongst diverse stakeholders occurring in disparate systems, as well as through manual processes, the work required to defend a claim may be performed inefficiently.
- Losses may also be unnecessarily high when claims defense stakeholders collaborate through a collection of conventional technologies, such as phone calls, fax, paper-based manual systems, and so forth. In a non-automated system, knowledge of potential settlement options, patterns, and best practices may not be available uniformly throughout the claims defense operation. The extended team managing a claim going to trial needs to be able to organize and prepare in an optimal time frame.
- Claims defense automation typically involves placing the workflow, documents, task assignments, key dates, and stakeholders on a common Web based interface where they can manage the claims defense process. In an automated claims defense automation scenario, stakeholders have greater and more streamlined access to critical information they need to resolve the disputed claim in a shorter cycle time than in a conventional mode of claims defense. Even relatively mundane tasks, such as sharing files, are more cost effective in an automated setting, with resulting decreases in claims defense costs.
- It is possible to calculate a distinct return on investment (ROI) for claims defense automation. By estimating the automation's impact on claims defense cost as well as losses, claims managers can correlate the ROI directly to the combined ratio.

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Claims managers face quite a challenge dealing with an increase in claims (more of which are fraudulent than previously) while simultaneously cutting back on costs. To make things even more stressful, there is also pressure to reduce losses in this more litigious environment. For every claim that looks as if it is going to go into litigation, the claims manager faces a set of complex resolution choices that are more fraught than ever with risk to the company's overall financial performance.

Claims Defense and the Combined Ratio

With investment income down, an insurer's combined ratio has gained importance for the overall financial health of the business. In previous years, an insurer could run a combined ratio of .99 or even higher and still earn good profits from float investments. This is less and less the case, and the result has been an increase in pressure for a strong combined ratio.

To review, an insurer's combined ratio is composed of the company's expense ratio (total expenses of running the business divided by net premiums) and its loss ratio (total loss payments made on policies divided by net premiums). The combined ratio is a measurement of profitability for an insurer's

¹ Nguyen, Daisy, and Fowler, Bree – *Desperate Car Owners Turn to Insurance Fraud* – Associated Press 6/29/09

underwriting business. In Table 1, for example, an actual insurance carrier reported the following financial data:

Premium Income	100%
Claims Expense (Loss)	65%
Expense for paying claims	14%
Service and Admin fees	21%
Underwriting Gain/Loss	1%
Loss Ratio	0.647
Expense Ratio	0.346
Combined Ratio	0.99

Table 1 – Actual combined ratio of a North American insurance carrier

Its combined ratio is .99, calculated as follows. To keep the example simple, assume that the company had \$1 billion in premium revenue.

- Expense Ratio = \$346/\$1000, or .346
- Loss Ratio = \$647/\$1000, or .647
- Combined ratio = Expense Ratio (.346) + Loss Ratio (.647) = .99

(Figures in millions)

A .99 combined ratio means that the insurer’s underwriting operation is slightly profitable. Normally, income from investing the premium “float” would add to those underwriting earnings and generate a good net income for the insurer. However, as Table 2 shows, if the combined ratio goes over 1, which is often done, and float investing does not yield good returns, the insurer can experience a loss (shown in colored section of the chart.) That is what is happening today.

Float Income (as % of Net Premiums)						
	0.01	0.02	0.03	0.04	0.05	0.06
0.98	0.03	0.04	0.05	0.06	0.07	0.08
0.99	0.02	0.03	0.04	0.05	0.06	0.07
1.00	0.01	0.02	0.03	0.04	0.05	0.06
1.01	-	0.01	0.02	0.03	0.04	0.05
1.02	(0.01)	-	0.01	0.02	0.03	-0.04
1.03	(0.02)	(0.01)	(0.00)	0.01	0.02	0.03
1.04	(0.03)	(0.02)	(0.01)	-	0.01	0.02
1.05	(0.04)	(0.03)	(0.02)	(0.01)	-	0.01
1.06	(0.05)	(0.04)	(0.03)	(0.02)	(0.01)	-
1.07	(0.06)	(0.05)	(0.04)	(0.03)	(0.02)	(0.01)

Profitable underwriting operations

Table 2 – The impact of increasing combined ratio on profitability. Note that the loss (shaded) increases as the combined ratio goes up and the float income rate goes down.

Claims Defense and Its Impact on the Expense Ratio

The cost of defending disputed insurance claims, whether they reach actual litigation or not, represents a portion of an insurance company’s expense ratio. For many carriers, the cost of claims defense is higher than it needs to be. This is the result of inefficiencies in the claims defense workflow, overly long

claims defense schedules, ineffective vendor management, and unnecessary arbitrations and trials. At their roots, these problems are associated with sub-optimal information sharing, communication, and data management in the claims litigation process.

Claims defense is a time and resource intensive activity. However, claims defense is often made more costly than it needs due to inefficiencies in communication and data sharing in the claims defense process. Figure 1 shows the high level process flow for settling an insurance claim. In many cases, a claim is settled promptly, with little or no contestation. Often enough, though, there is a dispute which triggers the claims defense process.

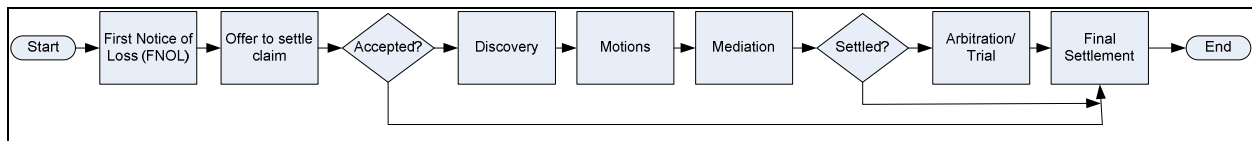


Figure 1 – First Notice of Loss (FNOL)

High-level process flow for claim settlement process

As shown in Figure 2, which is based on the worker’s compensation model, the claims defense process is a multi-party work flow that consists of three iterative loops of activity amongst stakeholders. At the start, if the claims adjuster cannot resolve the claim, he or she typically hands it off to the legal department for claims defense. The first iterative loop involves the carrier’s staff attorney or panel (outside) counsel discussing the dispute internally at the carrier and notifying the insured and plaintiff’s attorney, if there is one. Multiple layers of management may be notified and engaged in discussion of the claim if the loss exposure is substantial.

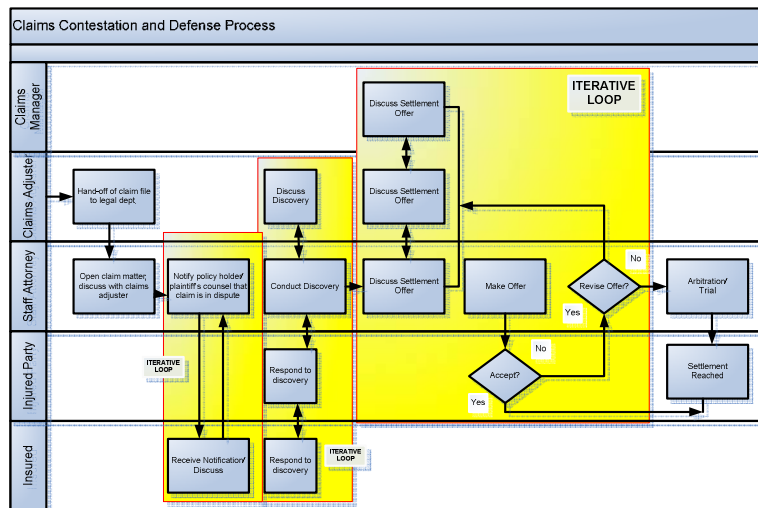


Figure 2 – Claims contestation and defense process, consisting of three iterative loops amongst key stakeholders: Discussion of claim; discovery and settlement

The second loop occurs as the claims defense process proceeds to discovery. In discovery, each party may demand documents and other information from the other, necessitating sub-loops of discussion

and tasks on each end. As the claims proceeds to settlement, there is an iterative loop that involves offers, counter-offers, and discussion of settlement terms. The process may or may not proceed to arbitration or trial, though each escalation of this type creates further iterative looping of communication and information sharing amongst stakeholders.

To see why claims defense, with its iterative work flows, can be inefficient and excessively costly, it is necessary to understand how information flows through the process. Figure 3 illustrates the way that information about disputed claims can get randomly distributed in a variety of silos as multiple stakeholders communicate about the claim through email, phone, meetings, and legacy systems. The result is a situation where locating information needed to settle a claim requires excess effort and time, if it is actually found.

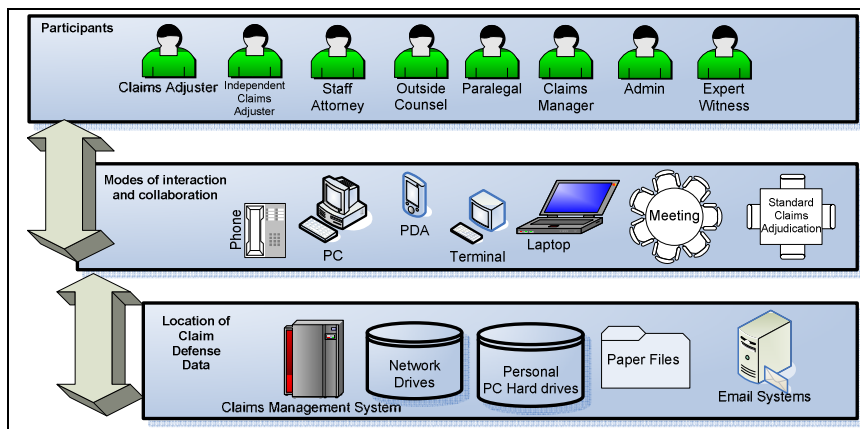


Figure 3 – Flow and location of data in claims contestation and defense process

Examining the steps involved in a typical claims defense workflow reveals the potential sources of inefficiency that can consume excess resources. Figure 4 illustrates the process of sharing a document by email. If the sender must first locate an email that requires a response, and then locate the document to be shared, there are up to five work steps needed to share the document. The recipient must then read the document. If the recipient wants to discuss the document, he or she can respond in email or initiate a phone conversation.

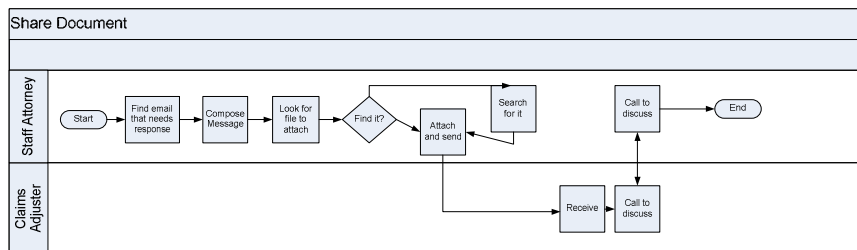


Figure 4 – Task analysis – share a document by email and discuss on the phone

An email is asynchronous and efficient, though it creates additional data about the claim that can get lost and be hard to located subsequently. A phone conversation is worse, potentially, as it creates claim related information that likely ceases to exist once the phone call is over. Table 3 breaks out a time

estimate for each process step. If there is a 5 minute conversation at the end of the process, sharing the document takes 16 person/minutes. At an allocated cost of \$120 per hour², that's a \$32 process. This may not seem like much, but if you consider the volume of claims and the number of such tasks, it is easy to see how claims defense can run into billions of dollars per year at a large carrier.

Process Step	Staff Attorney - Time Spent	Claims Adjuster - Time Spent	Total Time
Find email that needs response	0.50		
Compose message	1.00		
Look for file to attach	0.50		
Search for it further	3.00		
Recipient reads		1.00	
Call to discuss	5.00	5.00	
Total	10.00	6.00	16.00

Table 3 – Time breakdown of cost steps for document sharing through email

The poor flow and storage of information can negatively affect the cost of claims defense by extending the time it takes the carrier to resolve the disputed claim. The longer the process takes, the more it costs. If stakeholders do not have reliable, streamlined access to all the information they need to settle a claim quickly, the process will drag on, creating a cost accruing “snowball effect.” The worst case scenario here is the potential that a claim will escalate to arbitration, or even trial, without needing to go that far along in the process. The carrier’s costs in defending a claim through arbitration are significantly higher than they would be in the typical settlement offer and counter-offer process.

Overspending on vendors in settling a case is a related cost problem that also stems from poor information management and communication amongst claim stakeholders. A disputed claim can trigger spending on experts, outside counsel, and other consultants. Overspending can occur for two reasons. If the carrier does not have an effective vendor budgeting and bill review process, it risks accidentally exceeding the defense allocation it has set for the claim. For example, if a carrier sets a \$50,000 defense budget for a claim, but the outside counsel firm charges \$60,000, \$10,000 of which was accrued but not billed prior to settlement, the carrier can get stuck with a \$10,000 overage that shows up after the fact. And, not all bills are the same, or have the same purpose. Hourly billing, task based billing and matrix severity/complexity billing have different uses and their respective pros and cons. Some forms of billing better serve management reporting and comparative billing between panel and staff counsel.

Overspending on vendors can also naturally flow from an overly long claims settlement period. As the claim settlement process drags on, the associated vendors keep billing and billing, driving up the carrier’s cost and expense ratio at the same time. The key is to spend intelligently. Under-spending in some cases can be catastrophic, while overspending is simply a waste of money. Claims managers need tools to help them make these important judgment calls.

² The average corporate attorney earns \$236,000 per year, or \$120 per hour in a 2000 hour work year

Claims Defense and its Impact on the Loss Ratio

The way that claims are defended also has an impact on a carrier's loss ratio. Most carriers have a thorough process for minimizing loss. However, even with the best of intentions and diligent work, it is possible for claims professionals to miss critical pieces of information that could lead to more effective settlement of claims from a loss perspective. Information can get missed for several reasons, including misplacement of data in disaggregated systems. Patterns of settlement and best practices related to settling certain types of cases can also disappear if they are not developed and stored in an accessible technology solution. The net effect of this accidental information mismanagement is sub-optimal settling of claims.

If information relevant to settling a claim gets stuck in silos, claims defense stakeholders can miss the chance to figure out the lowest possible loss scenario for the claim. Keep in mind the inefficient and scattered data flow depicted in Figure 3. For example, a claims adjuster and staff attorney, paired on a claim, may notice that they were able to settle it for less than they expected, due to some specific data related to the claim, e.g., Rehab costs are lower in a particular region than claims settlement estimation systems might predict. If the adjuster enters this observation into the notes on the claims management system, it will be difficult, or even impossible, for a staff attorney handling a similar claim to be aware of the money-saving insight. The more siloed the organization, the more likely this kind of poor information dissemination is likely to occur.

Sometimes, the most telling aspects of a claim are present at the very beginning of the claims defense process. When a claim is assessed at this first moment of handoff between the claims adjuster and the legal department, it may present itself with certain telltale signs that it is potentially big loss situation, even if the superficial facts do not add up to this conclusion. Every insurance carrier can relate to the typical industry "war story" of a driver who broke his finger and walked away with a \$500,000 check. What makes one claim different from another? In some cases, experienced claims professionals can identify them by eye. In other situations, intelligent software can search for patterns of loss data and correlate them to similar surprise settlements that occurred elsewhere in the carrier's policy base. Again, however, if the data flow has not been set up for this kind of effective early case assessment, the claims stakeholders may miss the opening to prepare for an effective defense against a big loss. Similarly, ineffective data management can mask a fraudulent claim as it flows from the claims adjuster to the legal department. If the fraudulent claim is allowed to continue undetected, the carrier may experience a loss on a claim that should never have been settled in the first place.

Claims Defense Automation Technology

Claims defense automation technology, though not a panacea for combined ratio performance, can have a beneficial impact on both the expense and loss ratios if it is deployed properly. By enabling claims defense stakeholders to organize information and store it in a central, accessible system, with orderly workflows and accountability, the technology can optimize the expense and loss aspects of claims defense process.

Legal matter management software is typically the core element of an effective claims defense automation solution. Designed for the efficient handling of legal matters, but adapted specifically for disputed insurance claims, a matter management application allows selected groupings of personnel to manage documents, tasks, and workflows in a secure, auditable setting. Matter management software enables staff legal department stakeholders to set up and monitor litigation budgets, indemnity reserves, outside counsel spend, key dates, and open tasks. When paired with spend management software, which handles electronic billing (e-billing) and spending analytics, the matter management solution can give litigation managers strong financial control over the litigation portfolio and useful insight into the performance of outside counsel firms.

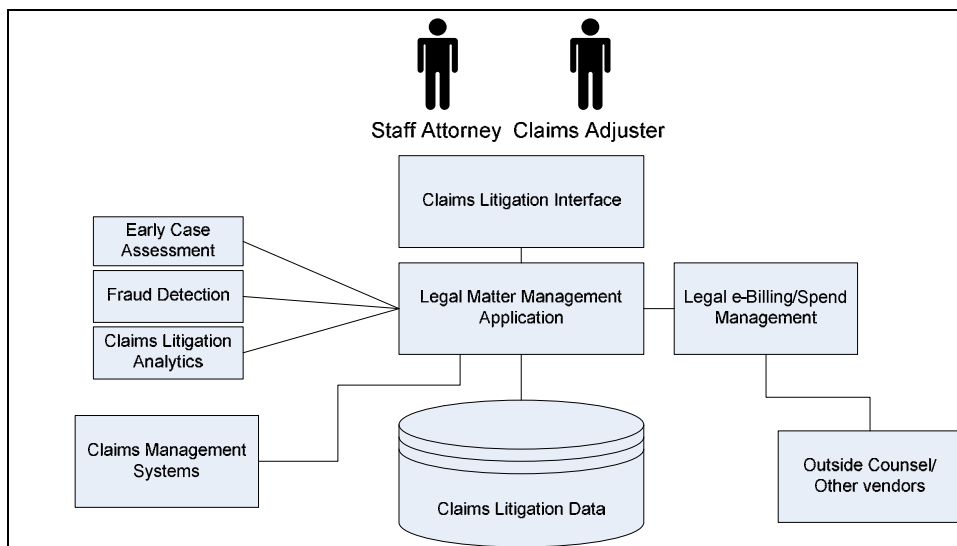


Figure 5 – High level reference architecture for a claims defense automation solution

Transforming a matter management application into a claims defense automation solution involves coupling the core matter software with claims litigation analytics, fraud detection, and early case assessment capabilities. When these elements are combined, claims defense stakeholders can gain an information advantage in defending claims. Figure 5 shows a high level reference architecture for a claims defense automation solution. To work, the solution needs to have some level of integration with the carrier's main claims management system. This integration should automate the handoff of disputed claims between the adjuster and the legal department.

The net effect of the solution is to tie all tasks, documents and workflows associated with a disputed claim to a single, easy to access online location. Cost savings efficiencies arise from claims defense automation as information flows in a more controlled, centralized way. Claims defense automation can also help reduce costs associated with generating required correspondence, which is typically a major drain on time and resources in non-automated claims management situations.

Figure 6 illustrates the streamlined flow of information amongst stakeholders in an automated claims defense solution. Contrast with Figure 3, where information about a disputed claim can get stuck in a

variety of silos and dead ends. Everyone involved in the disputed claim is interacting with the same system, accessing the disputed claim with a unique legal matter identifier.

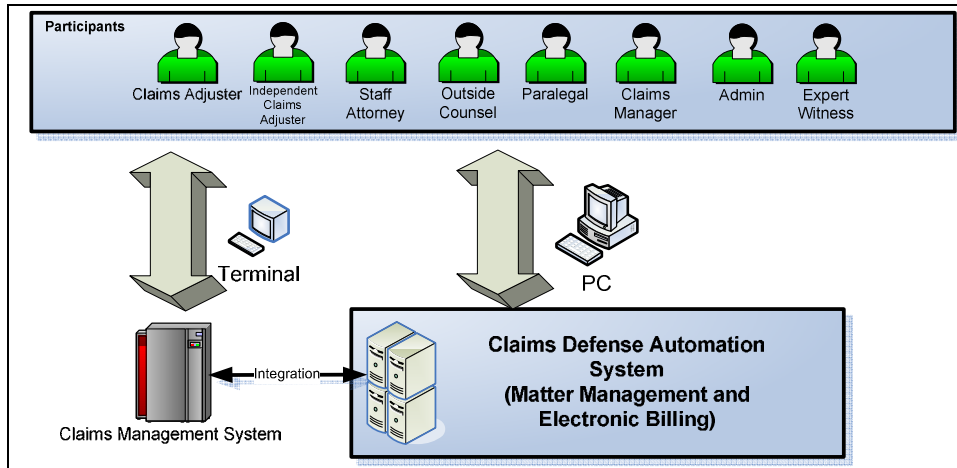


Figure 6 – Potential flow and location of data in claims contestation and defense process with the addition of a claims defense automation system

To demonstrate the specific cost saving potential of claims defense automation, compare the routine file sharing task shown in Figure 4 with the new work flow for the same process shown in Figure 7. With an automated claims defense solution, the “sender” uploads the document to the corresponding matter in the application. The “recipient” gets notified that the document is now on the system through an automated notice. He or she can read the document and post a comment back to the application in lieu of the phone conversation. The sender gets an automated notice that the comment has been posted.

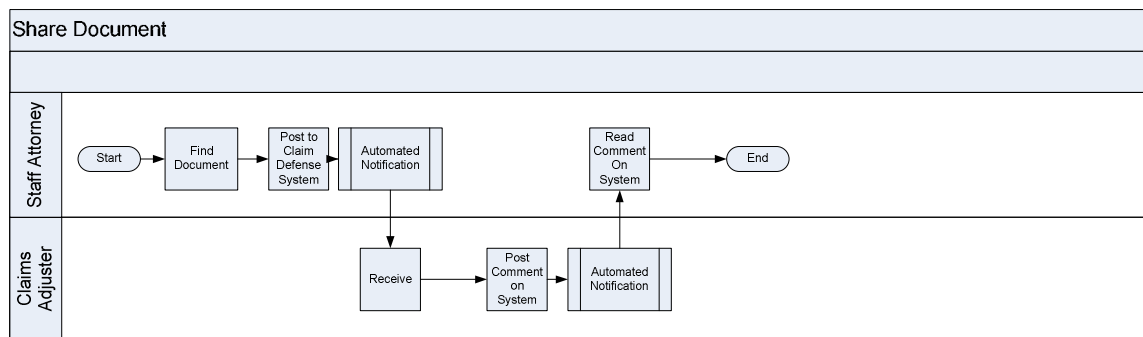


Figure 7 – Workflow for file sharing process (shown earlier in Figure 4) using a claims defense automation solution

The streamlined workflow for document sharing cuts the cost of the process. Table 4 compares the work flow steps, time to complete, and allocated costs for the two approaches to sharing a document.

Assuming a 2 minute phone conversation to discuss the posting of comments, the file sharing task is 47% faster and cheaper with the automated solution. Multiplying this kind of increased efficiency across the entire claims defense organization, you can see the potential for automation to drive improvements in the expense ratio.

Process Step	Through email			With Claims Defense System		
	Staff Attorney - Time Spent	Claims Adjuster - Time Spent	Total Time	Staff Attorney - Time Spent	Claims Adjuster - Time Spent	Total Time
Find email that needs response	0.50					
Compose message	1.00			1.00		
Look for file to attach	0.50			0.50		
Search for it further	3.00					
Recipient reads		1.00			1.00	
Post Response					1.00	
Read Response				1.00		
Call to discuss	5.00	5.00		2.00	2.00	
Total	10.00	6.00	16.00	4.50	4.00	8.50
Allocated cost per hour for time	\$ 120					\$ 120
Total cost	\$ 32					\$ 17
Cost and time improvement	47%					

Table 4 – Comparison of task breakdown and costs for document sharing through email vs. an automated claims defense solution

Going beyond pure efficiency, claims defense automation also has the potential to bring about a number of intangible benefits that can drive improvement in the expense ratio. By aggregating data about disputed claims in a single system, a claims defense automation system gives claims managers real time data about claims' status. Innovative business intelligence and dashboard type interfaces can highlight problematic claims to managers and trigger rapid responses. Budgetary and financial analysis can also give managers insight into the performance of individual claims litigators and outside vendors.

On the loss ratio front, claims defense automation can confer several improvements. If fraud detection is part of the solution, then fraudulent claims that evade detection earlier in the claims adjustment process can be identified and the loss avoided. With a unified, automated system it also becomes easier for claims defense stakeholders to share best practices and organizational knowledge about losses. When coupled with a knowledge management program that encompasses both technological and non-technological aspects of knowledge dissemination, the automated claims defense system can drive improvements in knowledge-based loss reduction.

Calculating Return on Investment for Claims Defense Automation

Claims defense automation requires an investment of money and other resources. If the program is realized well, it should deliver worthwhile gains to the combined ratio. However, it is important to understand how your specific company might respond, in financial terms, to a claims defense automation solution. Table 5 shows an approach to estimating the return on investment (ROI) that a carrier could realize from claims defense automation.

	As is		After Claims Defense Automation		Delta	Delta %
Net Premiums	\$ 1,000		\$ 1,000		\$ -	0.0%
Losses due to non-litigated claims	\$ 290	29.0%	\$ 290	29.0%	\$ -	0.0%
Losses due to litigated claims	\$ 290	29.0%	\$ 281	28.1%	\$ 9	3.0%
Losses due to fraud	\$ 60	6.0%	\$ 58	5.8%	\$ 2	3.0%
Total Losses	\$ 640	64.0%	\$ 630	63.0%	\$ 11	1.6%
Operating Expense, excluding claims defense	\$ 250	25.0%	\$ 250	25.0%	\$ -	0.0%
Claims defense expense	\$ 100	10.0%	\$ 97	9.7%	\$ 3	3.0%
Total Expense	\$ 350	35.0%	\$ 347	34.7%	\$ 3	0.9%
Loss Ratio	0.640		0.630		0.011	1.6%
Expense Ratio	0.350		0.347		0.003	0.9%
Combined Ratio	0.990		0.977		0.014	1.4%
Annual return on Float	5%		5%		-	0.0%
Float income	\$ 25		\$ 25		-	0.0%
Company profitability	\$ 35		\$ 49		13.50	38.6%
Company profitability as a percent of net premiums	4%		5%		0.01	38.6%

Table 5 – Estimate of improvement in the combined ratio and carrier profitability based on a 3% improvement in claims defense loss, claims expense, and fraud-based loss

For claims defense automation, ROI estimation requires several inputs: The carrier's losses due to litigated and non-litigated claims, as well as from fraud. And, it requires the expense figures for claims litigation as well as for all other expenses. Hard-dollar ROI is based on savings in the loss and expense categories. How much can claims defense automation save the carrier? Estimating potential savings involves conducting an analysis of the claims defense workflows and infrastructure already in place at the carrier, and calculating the potential cost reductions for litigated claim loss, fraudulent claim loss, as

well as the litigation expense itself. With these savings estimates, it is possible to project the impact of claims defense automation on the combined ratio.

Factoring in an estimate of investment income from “float,” it is possible to extend the estimate to include a projection of changes to net income to the carrier resulting from the investment in claims defense automation. In the example depicted in Table 5, the investment yields 3% improvement in loss and expense, which translates into a one point decline in combined ratio and a 38% increase in net income. For a carrier with \$1 billion net premium revenue, that would mean a profit gain of \$13.5 million.

Mitratech’s Claims Defense Automation Solutions

Mitratech has offered claims defense automation solutions for more than twenty years. The core of Mitratech’s claims defense solution is TeamConnect, a platform and application designed to manage legal matters and outside legal spend. TeamConnect provides a unified, secure, Web-based interface where claims defense stakeholders can collaborate on resolving disputed claims. With litigation-specific workflows, rules, tasks, and document management functions built in, TeamConnect allows select individuals to work on sensitive, privileged information in an efficient way.



Figure 8 – TeamConnect Legal gives claims defense stakeholders a single, secure online application through which to conduct claims settlement work

Figure 8 shows the TeamConnect matter management interface. In this example, the dispute involves a worker’s compensation claim. TeamConnect is able to capture the relevant information about the dispute and associate it with a specific outside counsel firm. Once the matter has been established in TeamConnect, all key stakeholders can work through the application to assign tasks, track important dates, monitor outside counsel spend, and so forth. TeamConnect is also able to set up customized workflows that represent the specific claims defense processes of a particular carrier. It can integrate with claims management systems in order to reduce the friction of the claim handoff to the legal department.

For claims managers, TeamConnect provides executive dashboards, as shown in Figure 9. TeamConnect collects vendor billings and matches them against the associated matter and budget. As a result, the application can aggregate the spend and budget performance of each matter, or all matters. In the dashboard shown in Figure 9, an executive can click on a matter number (shown at the left) and see an instantly produced graph of the latest actual spend vs. budget for that matter. The dashboards are available live at mitratech.com.



Figure 9 – A TeamConnect Executive Dashboard, showing expense and budget on a matter by matter basis

Mitratech's claims defense solutions are built on the core TeamConnect matter management application. For claims defense, the company has developed an Insurance Claims Litigation Solution Framework, which adds claims defense functionality to TeamConnect Legal. The framework is designed to provide claims managers with accurate, real time data on how claims are being litigated across a large claims organization. It includes capabilities for litigation trend analysis and fraud detection. This practical intelligence about claims enables improved productivity for the claims department, which contributes to an improved expense ratio for the carrier. By helping staff attorneys gain a better understanding of effective claims defense practices, as well as detecting fraud, the framework helps narrow the carrier's loss ratio.

Conclusion

Technology, in the form of Claims defense automation solutions, can be a major contributing factor to improvement in claims defense costs and loss results. At the same time, automating claims defense with technology is really just part of the overall cost and loss reduction picture. Understanding how a claims organization manages the claims defense process, who is involved, what information the need, and so forth, is essential to making the best use of claims defense automation technology. Acquiring the insights into how technology can make an impact on a specific information and process management modalities may involve partnering with an experienced consulting organization that has helped other carriers work through the same issues. The key is to be able to quantify the potential savings from claims defense automation and develop an investment plan that matches the organization's specific needs and ways of getting the work done.

About Mitratesch

Mitratesch is an enterprise software company that enables corporate leaders to strategically manage legal and compliance operations. In more than two decades of successful operation, Mitratesch software has powered Fortune 100 legal and compliance departments, claims litigation at major carriers, and case management at government agencies. Mitratesch's versatile TeamConnect platform was built from the concept of collaborative accountability, enabling businesses and their trusted partners to work together in a flexible but highly secure environment that reduces exposure to risk and sharpens operating discipline. TeamConnect applications span corporate legal automation and governance, risk, and compliance, with functional focus on matter management, legal e-billing, and litigation holds.

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