Strategic Technology Issues in Regulatory/ISO Compliance for P&C Insurers

A Novarica Research Partners Program Report

Underwritten by Insurity

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Introduction

When senior executives talk about their strategic goals for their company, they often refer to speed-to-market, agility, and the ability to rapidly respond to market changes.

But regulatory compliance, a critical capability for a carrier, is also increasingly seen as a key strategic priority, not just a tactical process required to keep the lights on. An insurer that is able to rapidly and accurately respond to regulatory demands is also typically a carrier that is nimble at reacting to market demands as well.

Carriers increasingly see challenges in maintaining compliance when it comes to new and current products. They also see challenges in assuring that the operational processes are consistently being adhered to. For many midsize P&C insurers who rely on ISO to some extent, managing the analysis and interpretation of the circulars, as well as reporting, adds to the compliance load.

The cost of handling compliance related activities is a significant portion of a carrier's IT budget, and carrier expect the costs and the level of regulatory demands to increase in the coming year.

This report provides insights on the challenges midsize P&C carriers face as they continue to drive operational excellence and regulatory compliance.

- Karlyn Carnahan, CPCU, Principal, Novarica

This report presents and discusses the findings of a survey of 15 midsize insurers (annual premiums generally between $100M and $1B) that write commercial lines business and utilize ISO in some fashion.

This report is a product of the Novarica Research Partners Program, which enables industry sponsors to underwrite surveys on topics of interest. These surveys are conducted using the same methodologies and with the same respect for participant privacy as Novarica's independent surveys and reports.
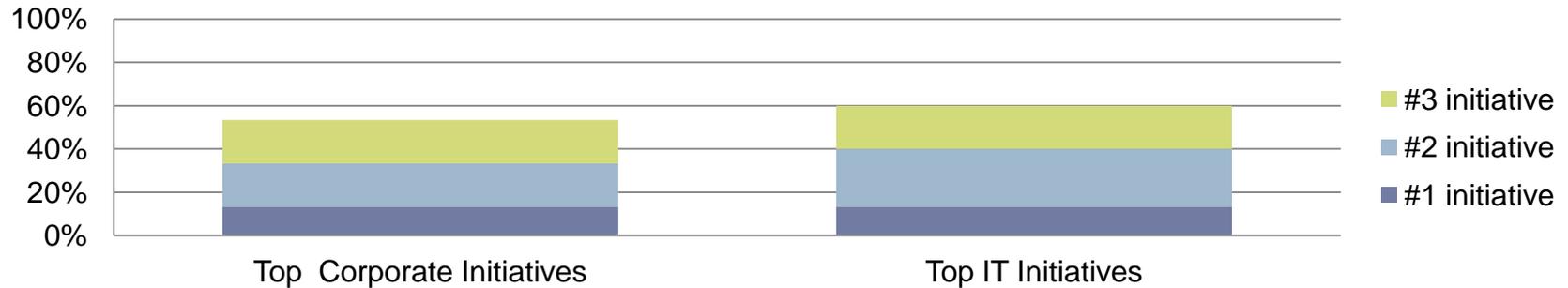
Underwriters have input on question design and general characteristics of target respondents only.

Novarica conducts the survey and analyzes the results independently. Underwriters do not have draft approval or other ability to influence content of the final report.

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Regulatory compliance is a top priority for most carriers

Regulatory compliance is seen as a non-optional capability for all carriers and a majority of carriers place it in the top three strategic priorities for their company.

Percentage of Respondents Citing Regulatory Compliance as a Corporate or IT Priority

Legend: ■ #3 initiative ■ #2 initiative ■ #1 initiative

Categories: Top Corporate Initiatives, Top IT Initiatives

Overall, all carriers see regulatory compliance as a critical requirement. Most consider it one of the top three strategic priorities – and one of the top three IT priorities.

We consider regulatory compliance our number one priority. From a systems perspective, all regulatory changes are implemented before any enhancements. We do not necessarily view compliance as an "initiative". It is treated as a significant aspect of almost every initiative.
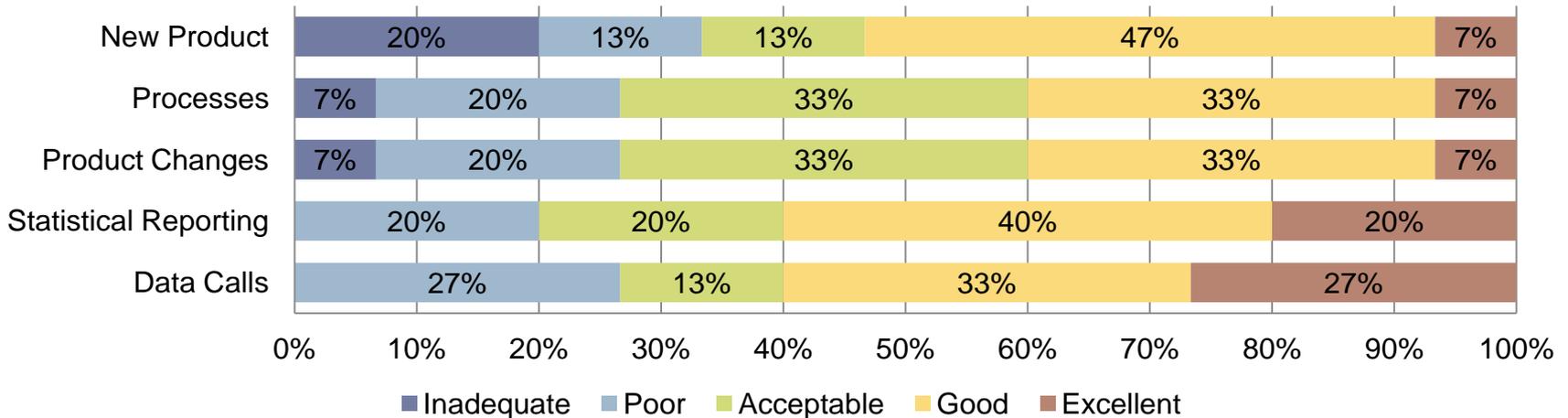
Those who don't place it in the top strategic priorities generally consider regulatory compliance as a tactical requirement but still consider it a requirement for the organization.

We are very cognizant of our compliance requirements, but we do not let that drive our strategic decision-making.

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Level of IT capabilities in support of compliance varies widely

When it comes to assessing how well carriers can respond to regulatory changes, many struggle – particularly with product compliance.

IT Capabilities Assessment

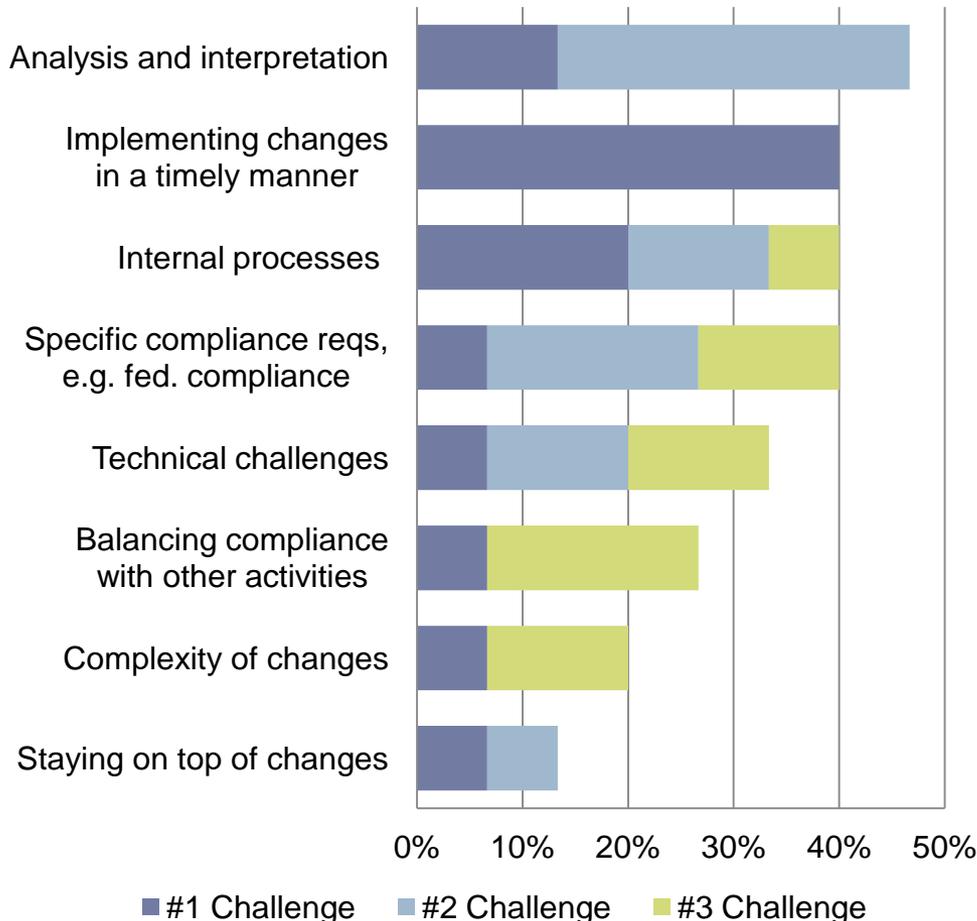|	Inadequate	Poor	Acceptable	Good	Excellent
New Product	20%	13%	13%	47%	7%
Processes	7%	20%	33%	33%	7%
Product Changes	7%	20%	33%	33%	7%
Statistical Reporting		20%	20%	40%	20%
Data Calls		27%	13%	33%	27%

When it comes to keeping products up to date, and verifying that workflows and processes are compliant, carriers have a tougher time. Most feel they have the required capabilities, but some face significant challenges. While a majority of carriers rate the new product launch capabilities as good or excellent, it is also the area that causes the most difficulty for carriers.

Carriers generally see themselves as capable of handling data calls and stat reporting - critical day to day practices. Assessments of IT capabilities varied by carrier depending on how the company manages the data, whether data is outsourced to a 3rd party vendor, and the agility of the IT organization.

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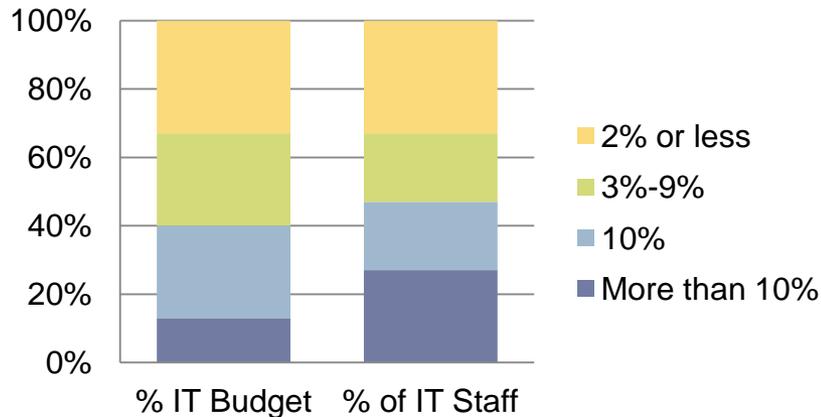insurity

Managing complexity and meeting deadlines is challenging

Top Three Challenges in Managing Compliance

Chart categories (top to bottom):
- Analysis and interpretation
- Implementing changes in a timely manner
- Internal processes
- Specific compliance reqs, e.g. fed. compliance
- Technical challenges
- Balancing compliance with other activities
- Complexity of changes
- Staying on top of changes

X-axis: 0% 10% 20% 30% 40% 50%
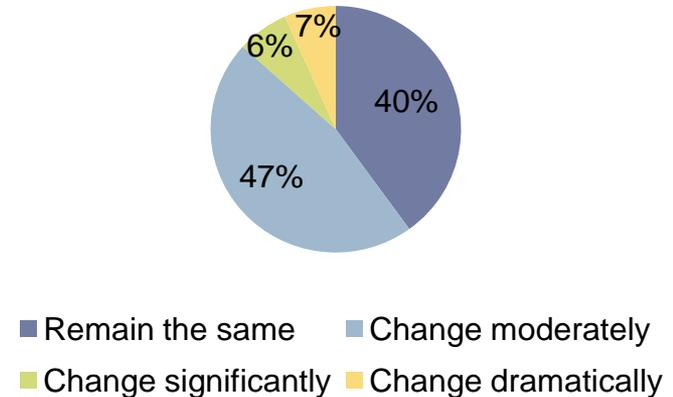
Legend: ■ #1 Challenge ■ #2 Challenge ■ #3 Challenge

▸ The main challenges in managing compliance are connected to the complexity of the evolving regulatory environment, making it difficult to do analysis and interpretation in a timely manner while also managing the sheer volume of required documentation.

▸ Several respondents also cited difficulties in balancing compliance-driven activities with other activities and internal challenges related to prioritization and funding.

▸ Carriers highlighted explicit regulatory issues that were seen as especially challenging, such as Medicare, privacy, or individual state issues.

▸ Technical challenges that come with using a legacy system were mentioned specifically e.g. "dealing with hard-coded edits in our legacy processing."

▸ A number of respondents cited limited resources as a major challenge – yet those same respondents admitted to devoting only 1-2% of IT budget and staff to regulatory compliance. "We don't budget for it effectively," said one CIO.

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The cost of compliance is high and is expected to increase

IT Resource Allocation to Compliance

Legend:
- 2% or less
- 3%-9%
- 10%
- More than 10%

X-axis: % IT Budget, % of IT Staff
Y-axis: 0% to 100%

What changes, if any, do you see in the cost of compliance in 2014?

- 40%
- 47%
- 6%
- 7%

Legend:
- Remain the same
- Change moderately
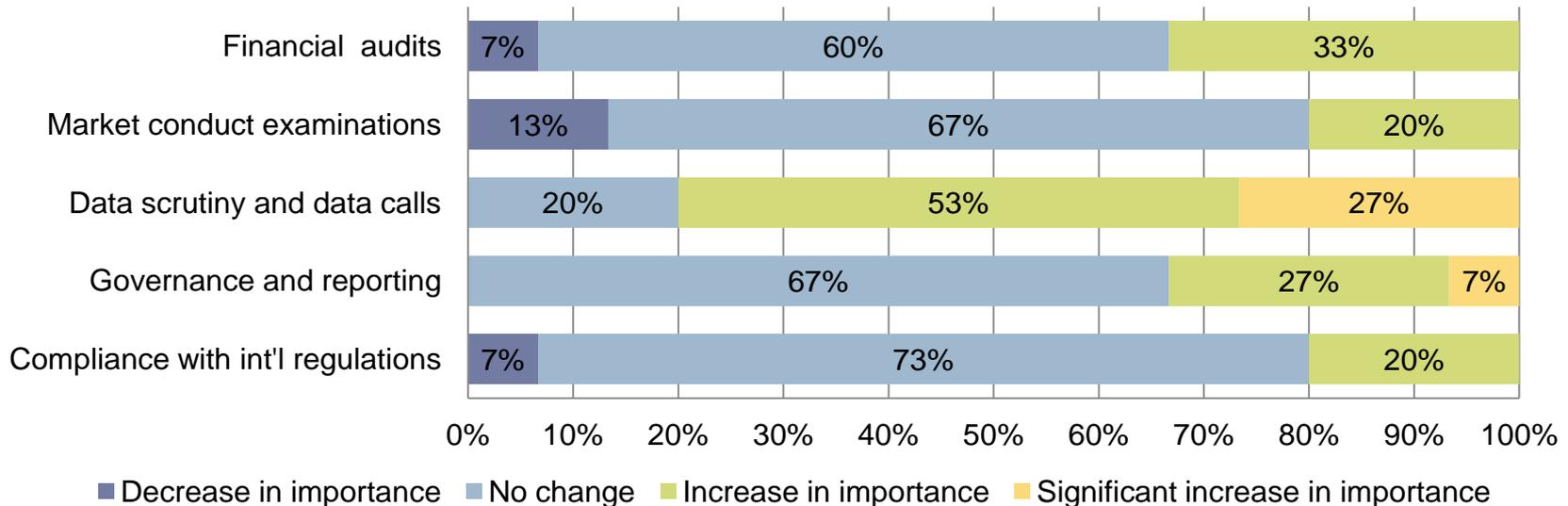- Change significantly
- Change dramatically

Carriers spend significant resources on regulatory compliance – on average over 10% of the IT budget and 10% of the IT staff. The biggest cost element is generally considered the staff time required to analyze compliance-related requirements and make the relevant changes. Other elements of cost include fees to third parties and the cost of technology. Carriers using legacy systems are more likely to mention the cost of staff as the primary driver behind compliance-related expenses.

The majority of respondents expect the cost of compliance to increase in 2014, driven by more scrutiny from regulators.

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Most carriers expect the importance of compliance to grow in 2014

80% of respondents expect scrutiny in data access to increase in importance, at least moderately if not significantly, in 2014.

Expected Changes to Regulatory Landscape in 2014

Category	Decrease in importance	No change	Increase in importance	Significant increase in importance
Financial audits	7%	60%	33%	
Market conduct examinations	13%	67%	20%	
Data scrutiny and data calls		20%	53%	27%
Governance and reporting		67%	27%	7%
Compliance with int'l regulations	7%	73%	20%	

0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%

■ Decrease in importance   ■ No change   ■ Increase in importance   ■ Significant increase in importance
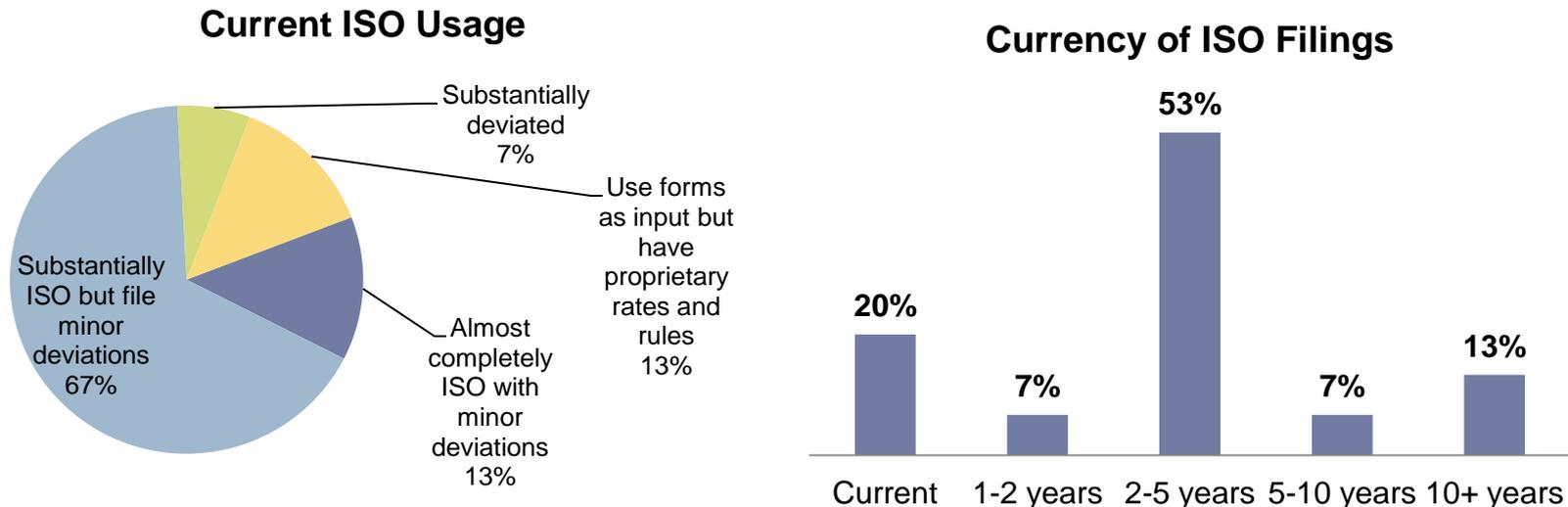
Most expect business-as-usual when it comes to market conduct examinations and financial audits. However, carriers expect to see a great deal more scrutiny surrounding their data and reporting.

"Handling the data calls and the data assembly can be tough depending on the timing. We have a lot of legacy systems and so have to go back, pull a lot of data, and do a lot of data scrubbing."

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Usage rates and currency of ISO is a strategic choice

Most carriers are substantially ISO for most lines of business. Only 20% of carriers are current on ISO with a majority having filings that are 2-5 years behind.

Current ISO Usage

- Substantially deviated 7%
- Use forms as input but have proprietary rates and rules 13%
- Substantially ISO but file minor deviations 67%
- Almost completely ISO with minor deviations 13%

Currency of ISO Filings

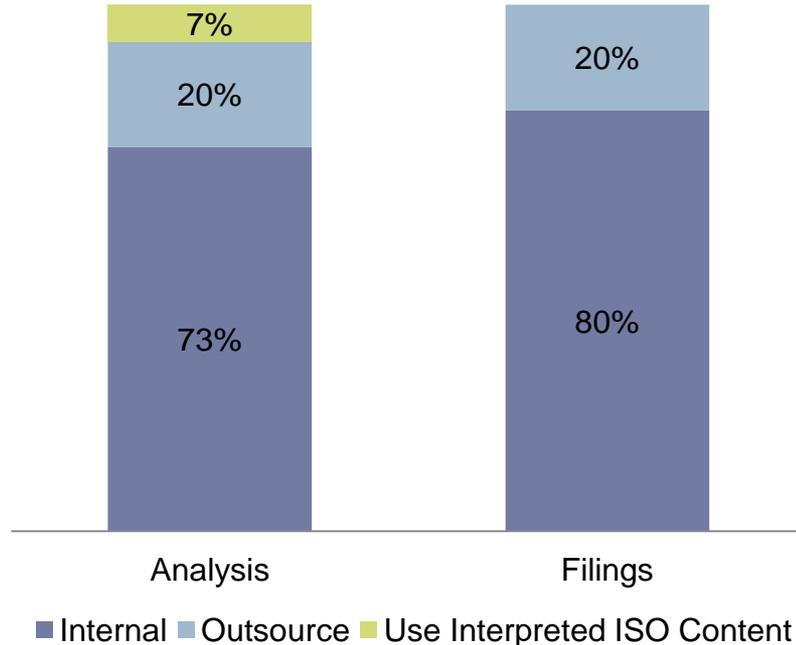| Current	1-2 years	2-5 years	5-10 years	10+ years
20%	7%	53%	7%	13%

The use of ISO during product development and management varies depending on the lines of business the carrier offers and the role that product differentiation plays in its strategy. One respondent stated "all of the above" when asked how he uses ISO – pointing out that some products are 100% ISO, some are completely proprietary, and there are a wide variety of products in between.

The level of filing currency is also a strategic decision. Carriers will often keep their most critical products current while letting other, less strategic products lapse. "We're a small company, and we have 13 products, so we let some of them slip when it comes to products we're not trying to be competitive with." Other reasons for not staying current include legacy systems that increase the complexity of making changes and managing competing priorities.

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Most insurers are self-sufficient in managing ISO

Products and pricing are often seen as the core strategic differentiator of a company. Consequently, most carriers maintain control over how and when to make those changes.

ISO Analysis and Filings

Stacked bar chart:

- **Analysis**: Internal 73%, Outsource 20%, Use Interpreted ISO Content 7%
- **Filings**: Internal 80%, Outsource 20%

Legend: ■ Internal ■ Outsource ■ Use Interpreted ISO Content

- ▸ Most carriers have internal departments that are tasked with analyzing and interpreting ISO. These departments are responsible for deciding what changes to make and when to make them.

- ▸ Some use third parties as a supplement for interpretation and analysis, while others rely on third parties as the primary source of interpretation and analysis.

- ▸ Others who rely on a third party often do so because the service came bundled with the products they utilize. One respondent said, "We're in the process of updating our system.. The ISO Rate Management service was a part of the purchased package."

- ▸ Most handle the actual filings themselves – but even those carriers may use a third party to support them on occasion.

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Statistical reporting is not burdensome

Statistical reporting is seen as relatively easy, and NCCI reporting is seen as substantially easier than ISO or other bureaus.

Challenge of Statistical Reporting
1=Extremely Easy, 5=Extremely Difficult
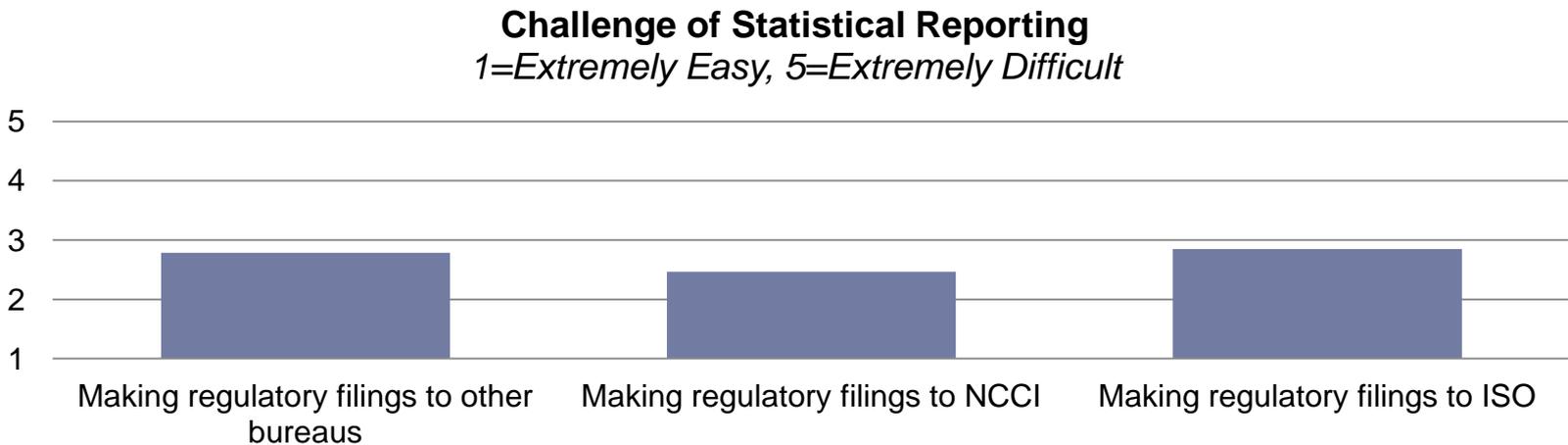
The majority of respondents found making regulatory filings to ISO, NCCI, and/or other bureaus to be relatively easy. Reporting to the NCCI is seen as generally easier than other bureaus. Difficulty of reporting also varies by state. Certain state bureaus were described as difficult, and carriers that had a high concentration of premiums in those states were more likely to rate those filings as difficult.

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Concluding thoughts

▸ **Regulatory compliance is mandatory and high priority.** A majority of carriers place it in the top three strategic priorities for their company, and those who don't generally consider regulatory compliance to be both a tactical requirement and a requirement for the organization.

▸ **Products, processes, and complexity are challenging.** Overall, carriers see themselves as capable of handling data calls and stat reporting – the critical day to day practices. But when it comes to keeping products up to date, and verifying that workflows and processes are compliant, carriers have a tougher time.

▸ **Complexity arises from regulatory uncertainty.** The chief challenge in managing compliance is connected to the complexity of the evolving regulatory environment, making it difficult to do analysis and interpretation in a timely manner while also managing the sheer volume of required documentation.

▸ **Carriers spend significant IT resources on regulatory compliance.** The majority of respondents expect the cost of compliance to increase in 2014, because they expect more scrutiny by regulators. While they expect business as usual when it comes to market conduct examinations and financial audits, they expect a great deal more scrutiny around their data and reporting.

▸ **Lack of ISO currency is a strategic decision.** Products and pricing are often seen as the core strategic differentiators of a company. Consequently, most carriers maintain control over the decisions of how and when to make those changes with internal departments that are responsible for analyzing and interpreting ISO.

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