

Is Your Company Leaving Money on the Table?

Subrogation and Your Bottom Line

Every insurance company executive is tasked with maintaining profitability, especially in tough market conditions. During the recent soft market, companies have taken various actions to remain profitable, ranging from reducing headcount and expenses to new state and product expansion to gain top-line growth.

A key area that should receive high visibility is the effects of salvage and subrogation recoveries on the bottom line.

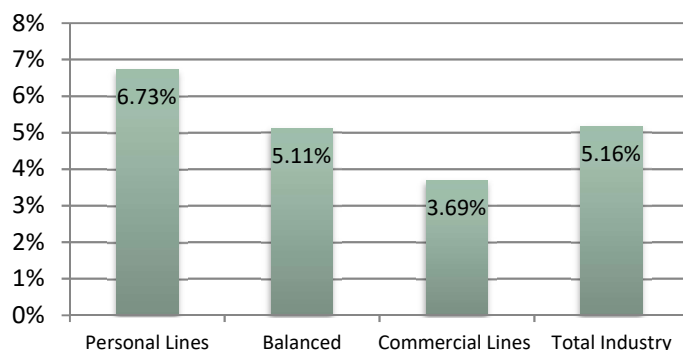
A recent analysis of the P&C industry commissioned by **Praxis Consulting** revealed interesting information about the impact of salvage and subrogation recoveries on profitability.

■ Combined Ratio Effect

Companies spend billions of dollars each year on loss mitigation programs. While these programs are necessary, it is difficult to place a numerical value on their true effect on the company's loss ratio. The impacts of salvage and subrogation operations however, are more apparent.

As shown in the following charts, the P&C industry had a recovery ratio of 5.16% (salvage and subrogation recoveries as a percent of paid losses) in 2008. Personal lines carriers had higher recovery ratios than both the balanced carriers, (write both personal and commercial lines), and the commercial lines carriers. This difference is expected given the higher likelihood of salvageable or subrogable items on personal lines losses.

2008 Salvage and Subrogation Recovery Ratios



2008 Salvage and Subrogation Recovery by Company Type

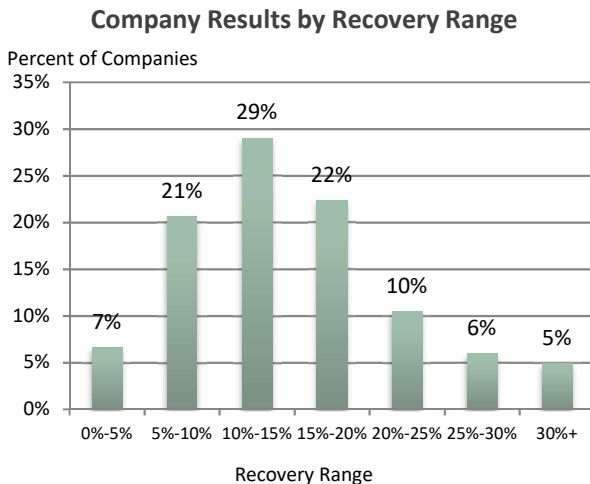
Category	S&S Recovered (000's)	Loss Paid (000's)	Recovery Ratio
Personal Lines	8,710,260	120,762,312	6.73%
Balanced	2,093,662	38,878,993	5.11%
Commercial Lines	3,674,176	95,810,250	3.69%
Total Industry	14,599,945	268,128,636	5.16%

In 2008, the industry's combined ratio was 104.7. If salvage and subrogation recoveries were excluded from this calculation, the industry's combined ratio would have increased 3.3 points to 108.0.

With the difficulty surrounding carriers' investment portfolios in 2008, salvage and subrogation recoveries played an important role in keeping the industry profitable. The industry reported a net income of \$8.6 billion during 2008. Without the \$14.5 billion recovered in salvage and subrogation, the industry would have faced significantly worse results. In fact, 72 companies, 5% of the 1,400 groups included in the analysis, would have posted a net loss in 2008 if not for salvage and subrogation recoveries enabling them to post a profit.

■ Auto Physical Damage Line

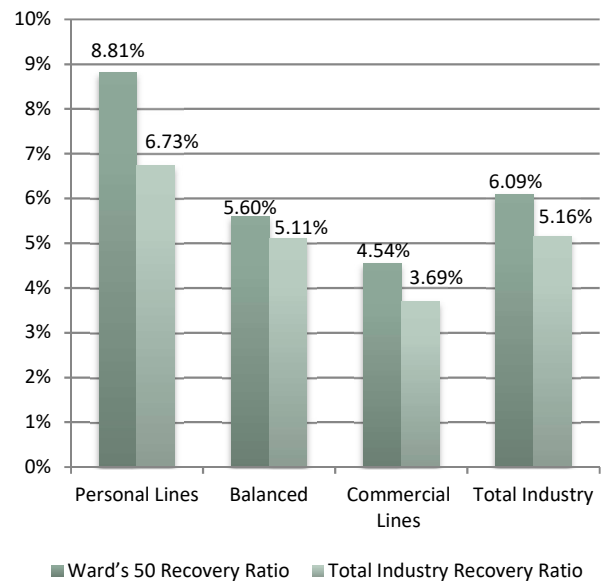
Auto Physical Damage is the line of business with the most salvage and subrogation potential. As illustrated by the graph below, recoveries by company for auto physical damage follow a normal distribution. Over half of the companies with auto collision premiums had recovery ratios between 10% and 20%.



■ Do high performing companies have better salvage and subrogation results?

Each year, Ward analyzes over 3,000 P&C companies and identifies the top 50, selecting them as "Ward's 50" companies for the year. While salvage and subrogation operations are not directly applied to this evaluation, it is worth noting that in every category, the Ward's 50 benchmark outperformed the rest of the industry in terms of salvage and subrogation recoveries.

High Performer Recovery Rates by Lines of Business



■ Subrogation as a Competitive Advantage

A company's handling of salvageable property is a critical aspect of a claim department's job. There is a high degree of consistency in how carriers process automobile salvage due to the fact that a large percentage of carriers use similar national salvage recovery vendors. However, there is greater variance in the subrogation recovery process. Companies that have the highest subrogation recovery ratios have deployed well defined processes that transactionalize the subrogation recovery process, much like a factory assembly line. Every person and activity is strategically placed. For those on the lower end of the performance scale, small, incremental changes can make a difference.

Ward Group
Subrogation Recovery Ratios
by Line of Business

Line of Business	Gross Recovery Ratio*
Personal Auto Collision	16.4%
Commercial Auto Collision	12.7%
Personal Property	1.6%
Commercial Property	2.9%
Workers' Compensation	2.1%
Total All Lines	5.1%

* Gross Recovery Ratio is defined as gross subrogation recoveries divided by gross losses paid in the calendar year.

■ **Impact of Small Increases**

Small increases in subrogation recovery can have significant effects on the loss ratio and play an important role in a company's profit or loss for any given year.

Below is an example of the impact of a 1% increase in the subrogation recovery ratio for a \$500 million insurance company.

	5.1% Recovery Rate	6.1% Recovery Rate	Difference
Premiums Earned	500,000,000	500,000,000	
Losses Incurred (Before Subrogation)	342,465,753	342,465,753	
Subrogation Recovery Rate	5.10%	6.10%	1%
Subrogation Recovered	17,465,753	20,890,411	3,424,658
Losses Incurred (After Subrogation)	325,000,000	321,575,342	
Loss Ratio	65.00%	64.32%	-0.68%

Not only does this company's loss ratio decrease by 0.68%, but \$3.4 million dollars makes its way to the bottom line, adding to the company's profitability.

■ **Return on Investment**

Return on investment is often calculated to determine the benefit a company will receive for the outlay of resources necessary to create that benefit. According to Ward Group's benchmarking research, subrogation expenses make up approximately 11% of the gross recoveries for auto collision lines. This means for every \$100 recovered, a company can expect to spend about \$11 in the pursuit of subrogation. Spending \$11 to make a net recovery of \$89 yields a return on investment of 809%.

Generally, a company's subrogation operating expense is less than 0.25% of a company's total expenses, yet it can often have a higher direct and immediate impact on the bottom line than claims litigation, which on average makes up between 7-10% of a company's budget.

■ **Developing Subrogation Trends**

Identifying where your company falls compared to its peers is a crucial first step in determining whether or not subrogation is a competitive advantage. While the legal environment in certain states may play a role in subrogation recoveries, there are several developing trends that we have seen in the industry, that can increase your recovery ratio, regardless of statute.

1. *Subrogation is a Profit Center.* Not only does a subrogation department's effort help the company's results, they also play a role in customer retention. The quicker that deductibles are returned to a customer, the better the customers claim experience, which is an important factor in a customer's decision to renew their policy.
2. *Centralize the Subrogation Department.* Prior Ward Group subrogation studies clearly show that centralized subrogation departments have higher recovery ratios and shorter subrogation recovery times than decentralized departments.
3. *Develop Frontline Staff.* Increasing awareness among frontline adjusters about the importance of subrogation and providing appropriate training can help increase efficiency and potential recoveries of subrogation adjusters, through more timely referrals and better claim file quality.
4. *Closed File Reviews.* More and more companies are looking to outside service providers to review

closed claim files for missed subrogation opportunities. For a percentage of the recoveries, outside service providers will review closed files for potential subrogation that otherwise would have never be found.

5. *Direct Outsource.* In addition to closed file reviews, carriers have taken the next step and directly outsourced portions of their book of business to subrogation specialists. A recent survey by Ward Group found that nearly 35% of companies are now outsourcing a portion of their subrogation operations, typically ranging from 10-20% of their total subrogation claims. Ward group has seen that companies that outsource just a portion of their claim files to outside service providers have recovery rates 2.3% higher than those that do not.

■ Conclusion

Subrogation plays a significant role in the financial well-being of an insurance company. Failing to push your company's subrogation department to maximize recoveries can leave your company at a significant disadvantage when compared to industry peers and result in your company "leaving money on the table".

■ Contact

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