

# Casualty Loss Reserve Seminar

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## Managing a Loss Reserving Department and Communicating Results

### Management Perspectives

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- **The CFO calls his actuary into his office**
- **CFO says: “I have to see the CEO in 30 minutes. Give me your latest best estimate of our reserves so that there is no surprise development in the future.”**
- **Actuary comes back and provides the CFO with a number**
- **CFO says: “You have got to be kidding! This number is 10 times greater than your last quarter estimate!”**
- **Actuary says: “Yes, but I am 100% confident that there will not be any future surprises!”**



# Casualty Loss Reserve Seminar

## Senior Management's Goals



- **Need to “properly” inform many audiences**
  - Reserves should be booked (conservatively?) (no surprises?)
- **Reserve information should lend itself to support various decisions**
- **Timely Information**
  - Reserve analysis should be timely to support quick reaction to necessary change(s)



## Casualty Loss Reserve Seminar

### Need to “Properly” Inform Many Audiences

BENFIELD



#### ■ Internal

- Board of Directors
- Senior Management
- Pricing actuaries
- Line managers, underwriters, etc.

#### ■ External

- State insurance regulators
- Rating agencies
- Wall Street analysts & shareholders
- Investment bankers
- Reinsurers



### ■ Financial

- Book low end, high end or somewhere in between?
- Reported projections

### ■ Performance

- Assess profitability by line, state, region, etc.
- Assist in segregating discontinued (or run-off) business

### ■ Reinsurance

- Assist in making reinsurance purchasing decisions
- Assist in making commutation decision, ADC, LPT, etc.



- **Internal changes**

- Claims department staffing level changes
- New system (e.g., claims, reserving, data processing)
- Changes in claims department policies or procedures (e.g., large vs. small claims, use of independent adjusters)

- **External changes**

- Legal (e.g., increase in claims consciousness)
- Regulatory (e.g., statute of limitations)
- Inflation



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## Sample Additional Information



- **Red Flags**
- **Assumptions**
- **Evidence**
- **Rating Agencies**
- **Reinsurers**



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## Sample Schedule P “Red” Flags



- **Material calendar year (CY) reserve development**
  - Material generally means > 10% of surplus or earnings
  - Consistent drag from prior year development
  - Focus on line(s) driving majority of the reserve development
- **Changes in claims settlement rates**
  - Derived from a review of Schedule P (Part 5) claim count data
- **Changes in case reserve adequacy levels**
- **Unstable accident year (AY) development trends**
  - Significant reserve take-down in recent AYs
  - Recent AY redundancies offset adverse development on older AYs
- **Negative IBNR, Negative Ceded**
- **Significant improvement in AY loss ratio**
- **Loss Ratio is stable despite large premium growth in softening market**





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## Sample Assumptions



- **Understand inherent volatility embedded in company's reserves**
- **Provide confidence level**
  - Example: 95% confident that booked reserves will be between \$x and \$y
- **Dramatic difference in industry vs. company patterns**



# **Casualty Loss Reserve Seminar**

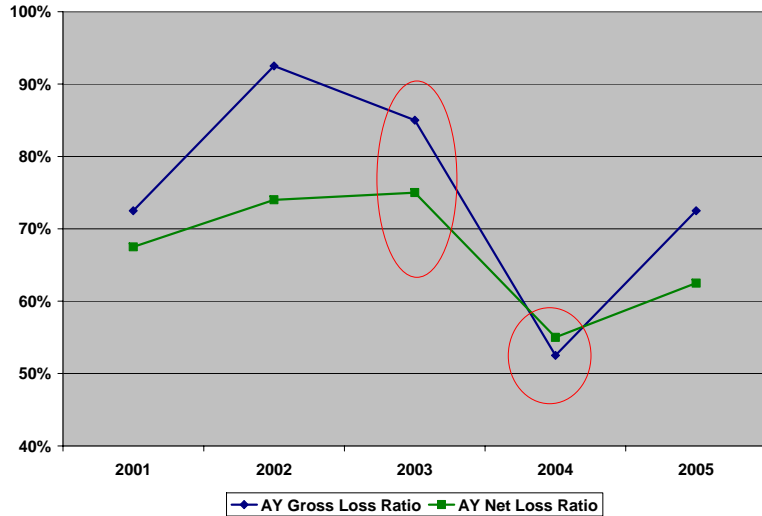
## **Sample Evidence to Support Findings**



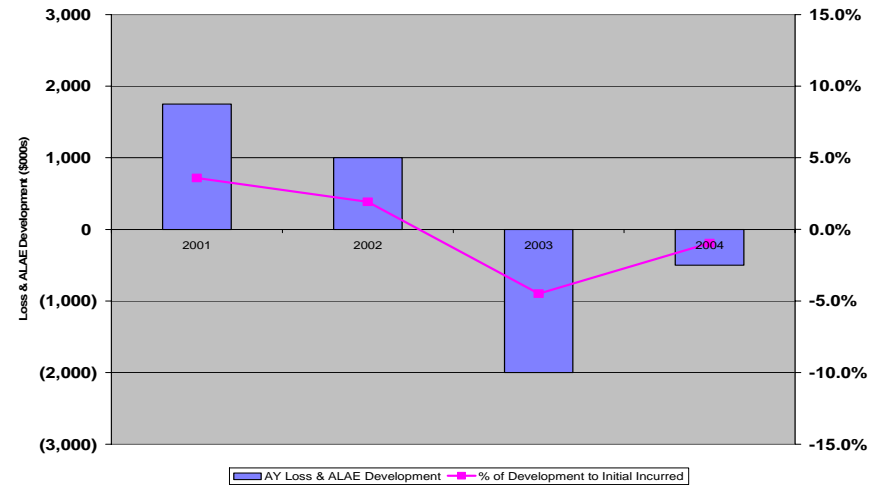
- **Severity/frequency trends, loss cost trends**
- **Statistics regarding claims – number of open claims, closed claims statistics, etc.**
- **Results of internal and external audits**
- **Booked reserves relative to actuarial indication**
- **CY/AY loss development trends**
- **Large loss reports and review/approval process**
- **List recent changes in claims department, e.g., utilizing market leading technology**

# Sample Trends That Cause Rating Agency Issues

## Accident Year Loss Ratio Trends



## Accident Year Development Trends



## Accident Year Development Trends

	Developed from 2004 adver. / (redun.)	Percent of 2004 Reserve	(\$000s)
2004	(3,725)	-7.2%	
2003	(200)	-0.5%	
2002	(100)	-0.2%	
2001	125	0.3%	
2000	250	0.6%	
1999	600	1.5%	
1998	1,300	3.9%	
1997	1,500	3.9%	
1996	125	0.3%	
Prior	(125)	-0.4%	
<b>Total</b>	<b>(250)</b>	<b>-0.1%</b>	

## IBNR Reserving Bulk & IBNR To NPE Reported at Year-End

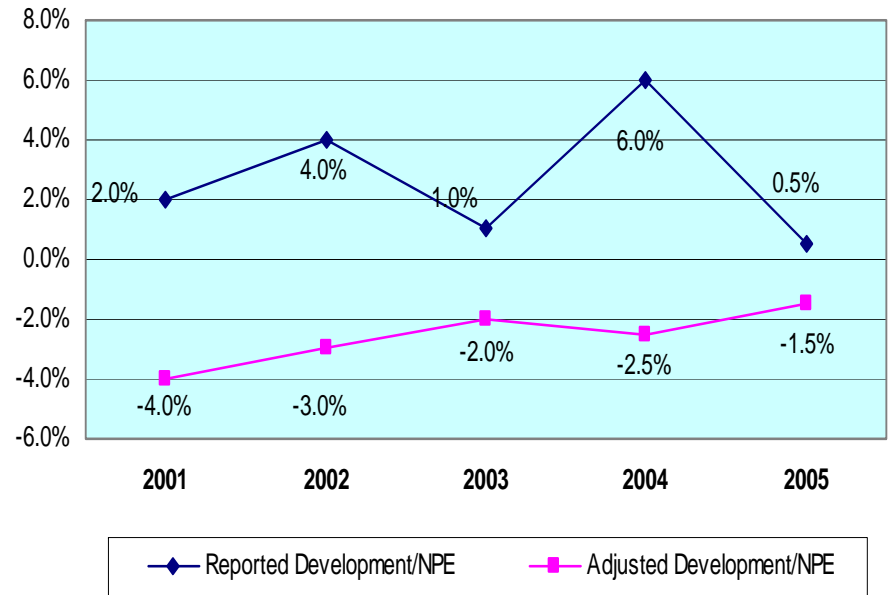
Year Loss Incurred	2000	2001	2002	2003	2004	2005
1996	2.0%	1.0%	0.5%	0.0%	0.0%	0.0%
1997	8.0%	4.0%	1.0%	0.5%	0.0%	0.0%
1998	3.0%	2.5%	-1.0%	-0.5%	-1.0%	-1.0%
1999	6.0%	6.0%	1.0%	-2.0%	-2.5%	-2.5%
2000	12.0%	-10.0%	-12.0%	-6.0%	-5.0%	-4.5%
2001	---	14.0%	-11.0%	-6.0%	-5.0%	-7.0%
2002	---	---	16.0%	-5.0%	-8.0%	-9.0%
2003	---	---	---	20.0%	-7.0%	-9.0%
2004	---	---	---	---	20.0%	-8.0%
2005	---	---	---	---	---	19.0%

## Sample Evidence to Address Rating Agency Concerns

### Case + IBNR Reserving Trends Initial Year % of Incurred

AY	IBNR %	Case + IBNR %	
<b>2005</b>	32.0	54.0	} led to favorable development
<b>2004</b>	34.0	52.0	
<b>2003</b>	31.0	50.0	
			<u>years of development</u>
<b>2002</b>	24.0	33.0	
<b>2001</b>	21.0	31.0	*
<b>2000</b>	13.0	27.0	*
<b>1999</b>	9.0	25.0	Catastrophe
<b>1998</b>	17.0	38.0	adequate
<b>1997</b>	23.0	<b>45.0</b>	redundant
<b>1996</b>	36.0	<b>49.0</b>	redundant

### Restating Schedule P Distortions



### CWIP Ratio Trends

CWIP per Exposure

Year	Age									Projected
	12	24	36	48	60	72	84	96	108	
1997	0.86%	1.45%	1.98%	2.38%	2.63%	2.68%	2.75%	2.76%	2.82%	<b>2.86%</b>
1998	0.84%	1.33%	1.96%	2.31%	2.45%	2.53%	2.59%	2.62%		<b>2.68%</b>
1999	0.73%	1.32%	1.76%	2.15%	2.28%	2.34%	2.39%			<b>2.47%</b>
2000	0.75%	1.34%	1.95%	2.24%	2.42%	2.50%				<b>2.65%</b>
2001	0.75%	1.13%	1.55%	1.92%	2.14%					<b>2.32%</b>
2002	0.67%	0.95%	1.36%	1.71%						<b>1.99%</b>
2003	0.68%	0.97%	1.45%							<b>2.02%</b>
2004	0.66%	0.85%								<b>1.37%</b>
2005	0.68%									<b>1.66%</b>

### Claims Frequency Trends

Reported Frequency (Excluding Incidents)

Year	Age									Projected
	12	24	36	48	60	72	84	96	108	
1997	5.6%	6.4%	6.7%	6.7%	6.8%	6.8%	6.8%	6.8%	6.8%	<b>6.8%</b>
1998	6.2%	6.7%	7.1%	7.1%	7.1%	7.1%	7.1%	7.1%		<b>7.1%</b>
1999	6.0%	6.5%	6.8%	6.9%	6.9%	6.9%	6.9%			<b>6.9%</b>
2000	6.4%	7.2%	7.6%	7.7%	7.7%	7.7%				<b>7.7%</b>
2001	6.5%	7.3%	7.6%	7.6%	7.6%					<b>7.7%</b>
2002	6.6%	7.3%	7.6%	7.6%						<b>7.7%</b>
2003	7.0%	7.5%	7.8%							<b>7.9%</b>
2004	4.3%	4.8%								<b>5.0%</b>
2005	4.6%									<b>5.3%</b>



- **Sound actuarial reserving process**
  - Regular reserve views, monitoring, methodologies, etc.
  - Qualified reserving staff (e.g., credentialed actuaries, experienced reserve analysts, etc.)
- **Historically stable book of business**
  - Less issue with short-tailed lines vs. long-tailed lines
  - Small standard deviation of loss development factors
- **A&E exposure de minimus**
  - Significant A&E reserves add additional volatility
  - Generally like to review actuarial report (prefer 3<sup>rd</sup> party provided)
- **Reserve levels compare favorably versus peers**
  - Conservatively booked loss ratios

The more confident Rating Agencies are in reported results, the better the process will be



### ■ Reserve Development

- If the company had bad development, why won't it happen again?
- If everyone else in the industry had bad development, then convince the reinsurer that you are smarter

### ■ Trends

- Reinsurers will use conservative and industry trends. What evidence can you provide that trends are less than reinsurers will assume?
- Have your companies rates / ILFs kept pace with trend?

### ■ Changing exposures

- Are you offering / selling higher or lower limits than before? Can you re-state history to reflect lower policy limits, and show lower historical losses to high layers?
- Have you experienced ECO / XPL claims, and why won't you have those claims in the future?

### ■ Other adjustments

- What other adjustments to historical information are you making when you do the reserves that will give reinsurers a better picture of your business?

**The more confident reinsurers are in reported results, the better the process will be**



- **Changes to Claims System**
  - Understand nature of the changes that will affect loss patterns and plans to adjust reserve methodologies to account for these changes
  
- **Changes to Claims Management**
  - Meet frequently with new claims management to determine whether these changes will result in revised claim settlement patterns and adjust reserve methodologies if applicable
  
- **Data issues**
  - Frequent audit of claims data, reasonability checks, consultation with claims professionals and regular meetings with claims staff



# Casualty Loss Reserve Seminar

## Challenges in Managing Department



- **Acknowledging significant reserve strengthening**
- **Dealing with uncertainty around reserve estimates**
  - Communicate, properly inform, document
- **Pressure from senior management to achieve desired results**
  - Focus on influencing the desired result in the first place
- **Divergent actuarial opinions (i.e., internal vs. external)**
  - Monitor track record (actual vs. expected)
- **Divergent opinions of profitability (i.e., reserving vs. pricing actuary)**