Reserving After the Underwriters Leave Town

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Reserving for Runoff vs. Ongoing Business

Discussion of issues associated with different stages:

- Early Stage – when business first placed into runoff
- Middle Stage – after business has been in runoff for few years
- End Stage – many years after placed into runoff

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Early Stage

Biggest issue in Early Stage:

- What's the Loss Ratio for latest year(s)?

Consider – why is business in runoff?

- If strategic decision unrelated to quality of business, perhaps normal analysis is fine
- In many cases runoff is due to business being bad…and bad business tends to get worse from year to year!

Why Does Bad Business Get Worse?

- Attempts to increase rates can lead to adverse selection
- Pressure to maintain topline can lead to
  - Worsening of risk quality
  - Increases in limits
  - Decreases in attachment points
  - Adjustments to terms and conditions

Often actuaries estimate loss ratio by adjusting older years for trend and rate change – but may not consider above issues, and therefore may underestimate latest years for such books

What Can Actuaries Do?

- Use reported claims as early indicator
  - incurred loss ratio at 12 months may not tell you much while reported frequency might
- Review distributions of limits and attachment points by year
  - Are they changing?
- How are rate changes calculated?
  - Do they consider changes in limits or terms and conditions?
- Discuss claims with claims team
  - Any shifts in types of claims emerging?
- Compare composition of book
  - Any changes in types of insureds or coverage?
- Predictive modeling
  - Quantify quality of book by year

Middle Stage

How are historical patterns and key assumptions affected by run-off management?

Potential impact on:
- Claim reporting
- Claim settlement
- Case reserves
- Settlement amounts
- Reinsurance cessions

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What Causes Distortions?

- If liquidation, could have stay on claims reducing or delaying activity, or bar date limiting or speeding up reporting
- "Run on bank" effect
- Staff reductions
- Management changes
- Changes in claims team
- Settlement activity
- Change in reinsurer/reinsured relationship
- Underwriting standards
- Effects of guarantee associations

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What Can Actuaries Do?

- Compare recent diagonals to prior
  - Any changes observed?
- Review diagnostics
  - Average case reserve, average paid, percent closed, paid/incurred
  - Calendar year statistics
  - Can try Berquist/Sherman-type adjustments
- Discuss with claims team
  - Are they doing anything differently? Staffing any different?

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End Stage

It's all about the claims…

- If this is immaterial portion of some overall analysis, maybe sufficient to judgmentally select a tail factor and move on
- If this is significant – either due to size, or due to preparing commutation or settlement, etc., then may want to look at individual claims
  - Two common runoff examples
    - Asbestos
    - Workers Compensation

Asbestos

- Understand insured's underlying exposure
  - How many claimants filing each year, average cost, expenses
  - Can use epidemiological studies to help project future
- Compare exposure to insured's insurance coverage
  - If possible, consider full coverage chart, not just individual insurer
- Allocate ultimate loss and expense to policy
  - Might depend on state, condition of insurers
- Consider exclusions, expense treatment
- Need to provide for insureds that have not yet reported claims
  - How many insureds have emerged in recent report years?
- If such data is not available, can apply various benchmarks

Workers Compensation

- Model individual claims using mortality assumptions
  - May consider actual or rated age
- Indemnity – after some point, assume lifetime payments
  - In certain states escalate for COLA
- Medical – escalate annual payments due to medical inflation
  - Not the same as industry or portfolio medical inflation, which could be much higher due to utilization
  - Some portion of claims may have unexpected increases
- Closures other than death?
- Consider reinsurance attachment points in probabilistic fashion
  - If you get expected value estimate of gross ultimate for claim of $490K, that doesn't mean expected value estimate of amount XS $500K is $0.

ULAE

Relevant question at all stages – what is ULAE reserve?

- What to include?
  - If entire company is in runoff, does that mean all expenses are ULAE? Or same categorization as past?
- If no new business to absorb portion of expenses, all of expenses relate to past claims
  - Have seen instances where ULAE estimate doubles
- Additional costs
  - Severance, complexity of claims, focus on loss control, commutation expenses, increased spending on collections

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Questions?

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