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Watchlists for Effective Management of Significant P&C Insurance Risks

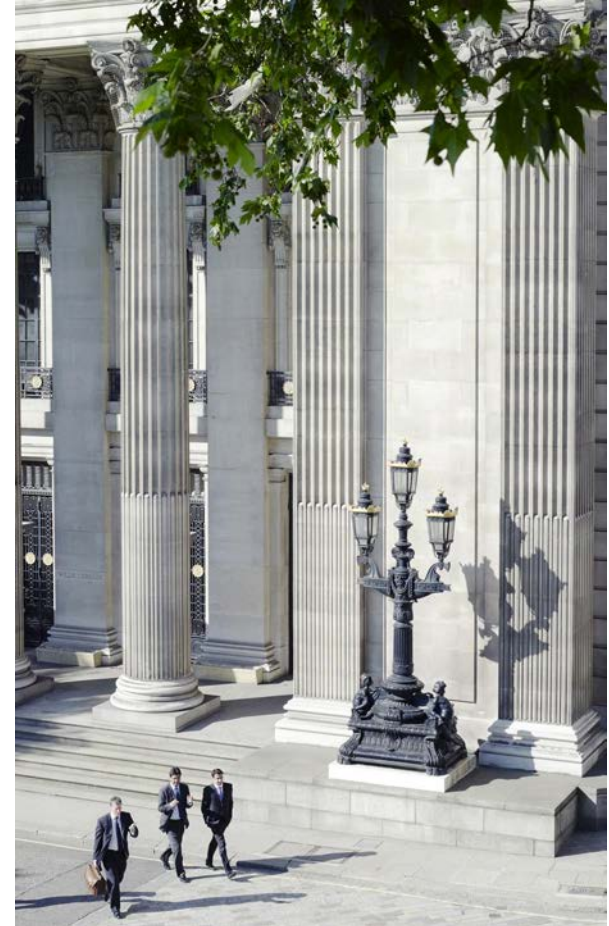


In the News...

“XYZ Insurance Company takes significant reserve increase for excess liability claims; placed under state supervision”

“ABC Company Stock plunges after announcement of reserve increase”

“Audit finds DEF Insurance Company materially under-reserved for legacy asbestos claims, drives purchase of adverse development cover”





Agenda

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What is a Watchlist?

2

Benefits to an Effective Watchlist Process

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Getting Started

- Defining the stakeholders, vision and roles & responsibilities

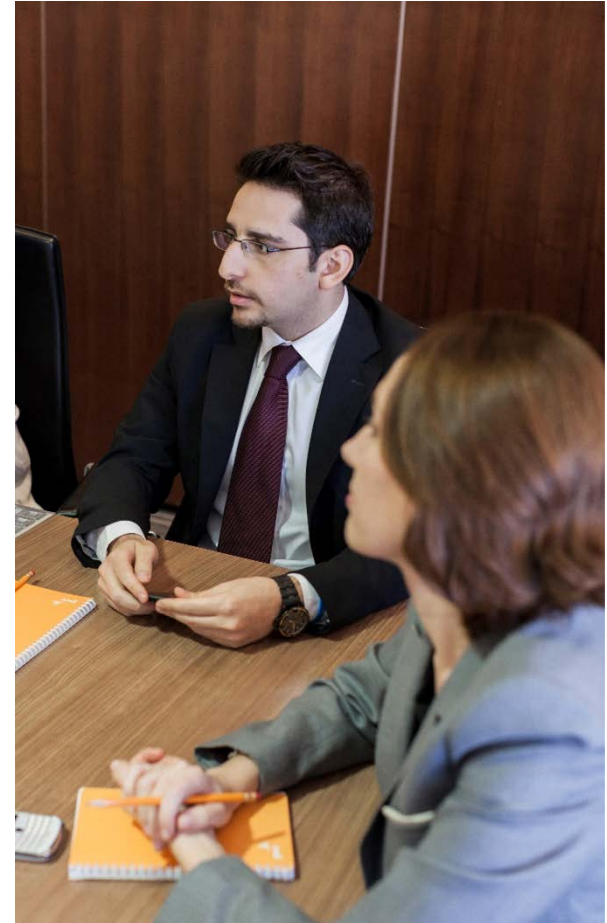
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Establishing the Process

- Identifying exposures
- Information to include

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Leveraging the Output





What is a Watchlist?



Merriam-Webster defines a watch list as follows:

“A list of people or things that are being closely watched because they are likely to do or experience bad things in the future.”



What is a Watchlist in the Context of the P&C Industry?

A means of monitoring defined (potential) claim exposures for potential impact on reserving, pricing, claims management, underwriting and future business decisions.





Benefits of an Effective Watchlist Process

- Acts as an early warning system to flag potentially large claims
- Streamlines the assignment of claims handling resources with the appropriate level of expertise
- Assists in determining appropriate pricing and reserving treatment in the actuarial analyses
- Facilitates a more thorough understanding of a company's exposures, including:
 - Potentially impacted lines of business
 - Financial risk
 - Litigious issues that drive adverse development



Impact of Watchlists

- ➔ **Impact can reach the**
 - **Claims**
 - **Actuarial**
 - **Underwriting**
 - **Marketing**
 - **Ceded reinsurance departments**
 - **Depending on the magnitude of the exposure, even the C-suite**
- ➔ **Reduces risk of negative headlines around reserve deficiencies**





Getting Started – Define the Stakeholders

To make effective use of watch lists, a company should have a thoughtful and comprehensive process in place to determine which exposures to monitor and how management should consider this information.

Core to this process is identifying and establishing Key Stakeholders whose representatives will form a Committee to oversee the process:

Actuarial

- Evaluation of IBNR
- Evaluation of Industry Reserving Trends/Items

Underwriting

- Impact on renewals and new business
- Effect on mix, geographic focus, class of business

Claims

- Early identification of underlying exposures
- Regulatory, Legislative or jurisdictional trends
- Segregation of claims, improved claims management

Reinsurance

- Impact on reinsurance needs, collection issues

Finance

- Impact on cashflow



Getting Started – Establish Vision Statement

Those leading the initiative should establish a clear vision statement to include the following key components



Identifies the stakeholders



Defines the scope and purpose of the initiative



Determines exposures or claims to be included



Ensures the proper focus of the watch list over time



Getting Started – Clarify Roles & Responsibilities

Process Owner to lead the Watchlist initiative

- Typically chief reserving actuary, or a claims department leader
- Establishes accountability
- Facilitates the timely sharing of information among various stakeholders
- Guides a consistent approach to identifying which exposures to include on the watch list
- Stays abreast of current developments and emerging trends
- Facilitates the execution of the defined watch list process

Process Managers who oversee assessment processes

- Establishes and oversees protocols and processes to ensure accurate and timely gathering and assessment of information
- Actively participates in identifying exposures to assess
- Ensures *Open lines of communication* for effective information gathering/Sharing among underwriting, reinsurance, claims, actuarial and risk management
- Manages workflow to appropriate and available resources to ensure:
 - Consistent reporting of facts, coverages and issues
 - Exposure calculations under various scenarios
 - Specific reporting formats
 - Routine intervals for reporting
- *Develops report* findings to internal stakeholders for potential remediation initiatives



Getting Started – Clarify Roles & Responsibilities

Process resources

Claims personnel

- Deep knowledge of the underlying exposures
- Early awareness of emerging loss trends
- Comprehend the impact of changes in case law
- Play an important role in identifying exposures to include on a watch list
- Prepare the assessments

Actuarial function

- Analyze aggregate data, emerging claim types, industry and reserving trends
- Quantify the potential liability associated watch list claims
- Establish incurred but not reported (IBNR) reserves
- Identify potential impact on underwriting, pricing and reinsurance purchasing



As the insurance world turns...

Case scenario:

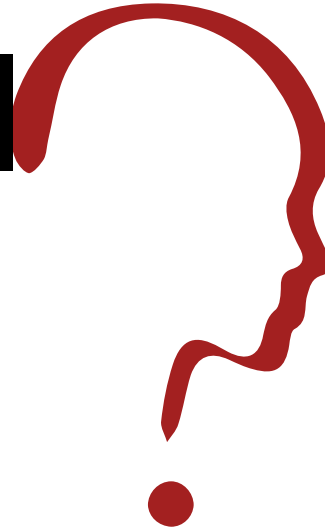
- 50-year old small P&C carrier specializing in manufacturing of food products and pharmaceuticals. Starting to insure manufacturing of medical devices.
- Writes primary limits typically \$5M and low level excess with limits typically \$10M excess of \$5M.
- High surplus, low liquidity.



As the insurance world turns...

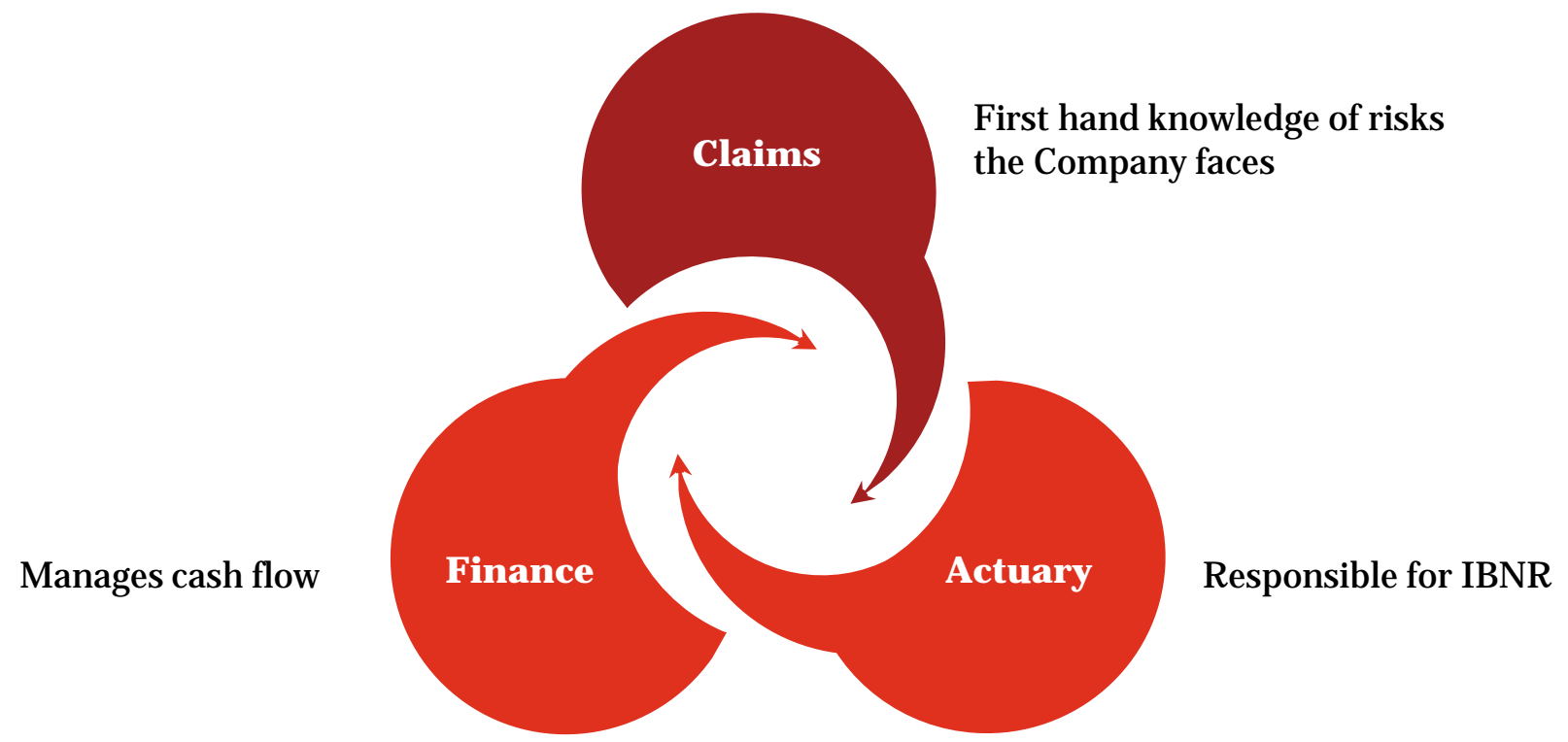
Who should own the process?

- A. Claims
- B. Actuarial
- C. Finance





Process Owner – Food for Thought





As the insurance world turns...

Which definition best fits the scope of the initiative?

- A. To assess existing (incurred and precautionary) losses for adverse development
- B. Assess existing (incurred and precautionary) losses for adverse development as well as industry developments for claim types the Company currently does not face, but relate to lines of business written by the Company





Scope – Food for Thought

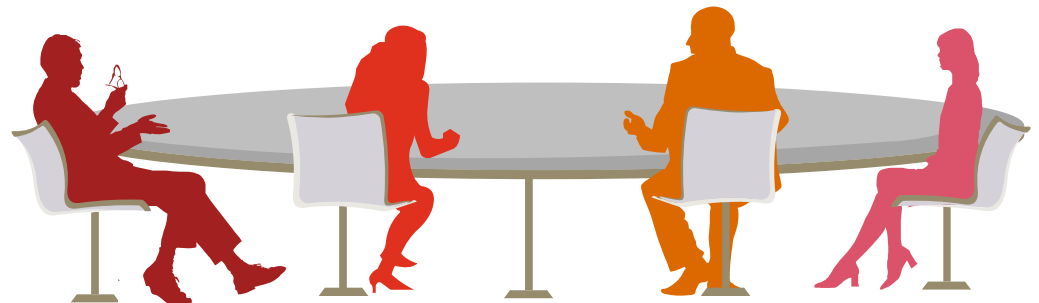
- A. Assess existing (incurred and precautionary) losses for adverse development may be an appropriate approach for organizations with specific lines of business that are not inclined to face emerging risks**
- B. Assessing existing (incurred and precautionary) losses for adverse development as well as industry developments for claim types the Company currently does not face, but relate to lines of business written by the Company may be an approach for organizations writing lines of business that are inclined to face emerging risks**



As the insurance world turns...

***How often will watchlist claims
be assessed?***

- A. Bi-annually
- B. Annually





Frequency – Food for Thought

- A. Bi-annually may be best suited for specific volatile books subject to frequent developments
- B. Annually may be best suited for claims that are typically subject to litigation which may result in developments occurring on a slower basis

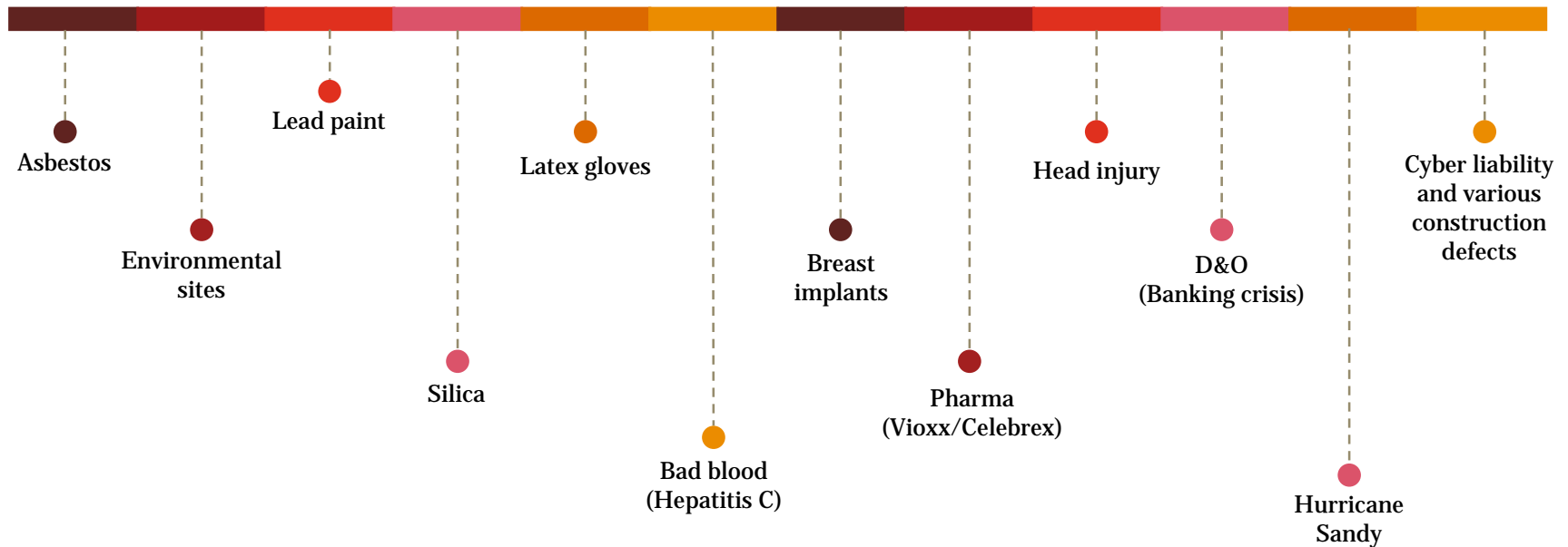




Process – Identifying Watchlist Exposures

The external environment, including changes in laws and regulations, drives the exposures selected to appear on a watch list. The evolving nature of watch list exposures necessitate routine assessment of and adjustment to the criterion underlying the watchlist assessment process.

Historical items commonly appearing on watchlists:





Process – Defining the Claims to Watch

Criteria used to assess exposures

- Types of coverage, time periods and geographical regions of business underwritten
- Limits and attachment points
- Legal trends tied to current and new business strategies (i.e. new court filings, legal interpretations, procedural requirements, and jury verdicts)
- New claim filings (inclusive of underlying carrier exposures), reserve and payment patterns by industry, company, and carrier
- New business strategies
- Discontinued business exiting strategies
- Materiality

Claims with unusual exposures or catastrophic potential typically followed include specific characteristics such as:

- Significant loss potential, either high severity for an individual claim or an aggregated group of low severity claims, e.g. class action;
- Unusual exposures, or those that are not well represented in the historical data;
- Heavily litigated exposure; and
- Claims with questionable insurance coverage.

Organizations should assess the need to monitor both *incurred* claims -- those which have already been reported; and *potential* claims, which relate to incidents or exposures that may lead to an incurred claim in the future.

- Establishes the ability to treat potential claims differently in the IBNR reserving process
- Allows for appropriate leveraging of resources



As the insurance world turns...

Case scenario:

Primary policies typically issued with a \$50,000 deductible, and \$5M in limits

Excess policies written with \$10M in limits excess of \$5M

Reinsurance requires a \$250,000 retention

25% of losses are WC

75% of losses are GL

50% Pharma Products

25% Environmental

25% Mix



As the insurance world turns...

What exposures or claims are to be included?

- A. Specific existing products, key new products entering commerce on a large scale, or any Environmental files with potential for development in excess of \$250K.
- B. Any claim with potential development over \$250K.





Exposures to include – Food for Thought

- A. Specific existing products, key new products entering commerce on a large scale, or any Environmental files with potential for development in excess of \$250K defines exposures that fall out of the “norm” and could have significant impact. Best suited for large organizations.
- B. Any claim with potential development over \$250K may result in too many claims requiring assessment. However, if the organization is small, this may be a good strategy as the company clarifies its underwriting strategies.



Information to Include – Existing Claims

- Claim number
- Account
- Line of business
- State where loss occurred
- Policies currently exposed
 - Period/Terms
 - Coverage afforded
 - Policy limits/Attachment points
- Exposure
 - Remaining limits/Aggregate
 - Deductible balances
 - Exhaustion of underlying coverage
 - Loss/Expense paid to date
 - Outstanding Reserves
 - Estimated ultimates
- Description of loss
- Date of loss
- Jurisdictional/Coverage issues
- Potential Outcomes





Information to Include – “As If” Scenarios

Scenario testing and litigation risk analyses

- Best suited for complex exposures and associated coverage interpretation issues
 - what constitutes an occurrence allocation methodology of exposure across various defendants or carriers
- Several assessments applying different assumptions as to:
 - Legal outcomes
 - Level of damages
 - Claims volume
 - Inflationary trends
- Provides a range of possible outcomes to consider
- Facilitates early identification of claims with the potential to breach underlying layers
 - Avoids unexpected reserve development
 - Allows for claims/Litigation management intervention
 - Promotes notification to reinsurers
 - Avoids denials due to late reporting of claims
 - Leads to prompt payment



Information to Include – Precautionary Claims

- **Potential loss identifier**
- **Line of business**
- **State where loss occurred**
- **Policies potentially exposed**
 - **Years underwritten**
 - **Coverage afforded**
 - **Volume of policies written**
- **Exposure**
 - **Typical policy limits/Attachment points**
 - **Exhaustion of underlying coverage**
 - **Estimated ultimates**
- **Description of loss**
- **Jurisdictional/Coverage issues**
- **Potential Outcomes**



As the insurance world turns...

If three different “As If” Scenarios are presented, each yielding a different outcome, and you are charged with setting IBNR for the account, how would you determine the value?

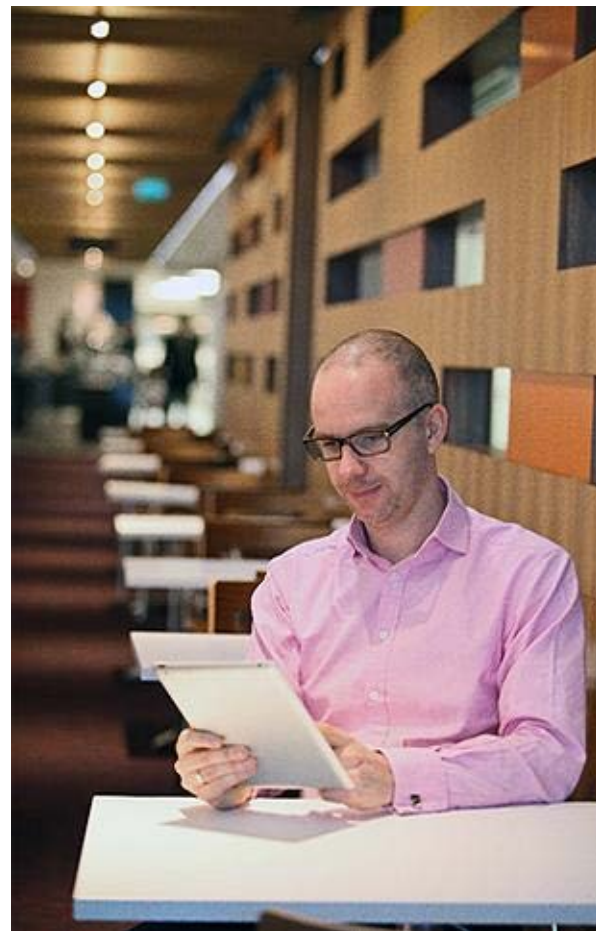
- A. The mid point between the lowest exposure value shown on any of the “As if” scenarios and the highest value shown on any “As if” scenario.”
- B. A weighted average based upon each “As if” scenarios chance of prevailing.
- C. Rely on the Claims Managers selection of which “As if” scenario is most likely to play out as “ultimate.”





“As if” Scenarios – Food for Thought

“As if” scenarios are unique to the facts of each case and related potential outcome. Determining the appropriate reserve (IBNR or otherwise) requires specific expert analysis and may vary across the industry.





Information to Include – Reinsurance

- Reinsurance program identifier
- Description of structure
- Attachment point/Limit
- Gross and net positions current and potential
- Confirmation of notice
- Potential reinsurance coverage issues





As the insurance world turns...

At what point would you agree to remove an item from a watchlist?

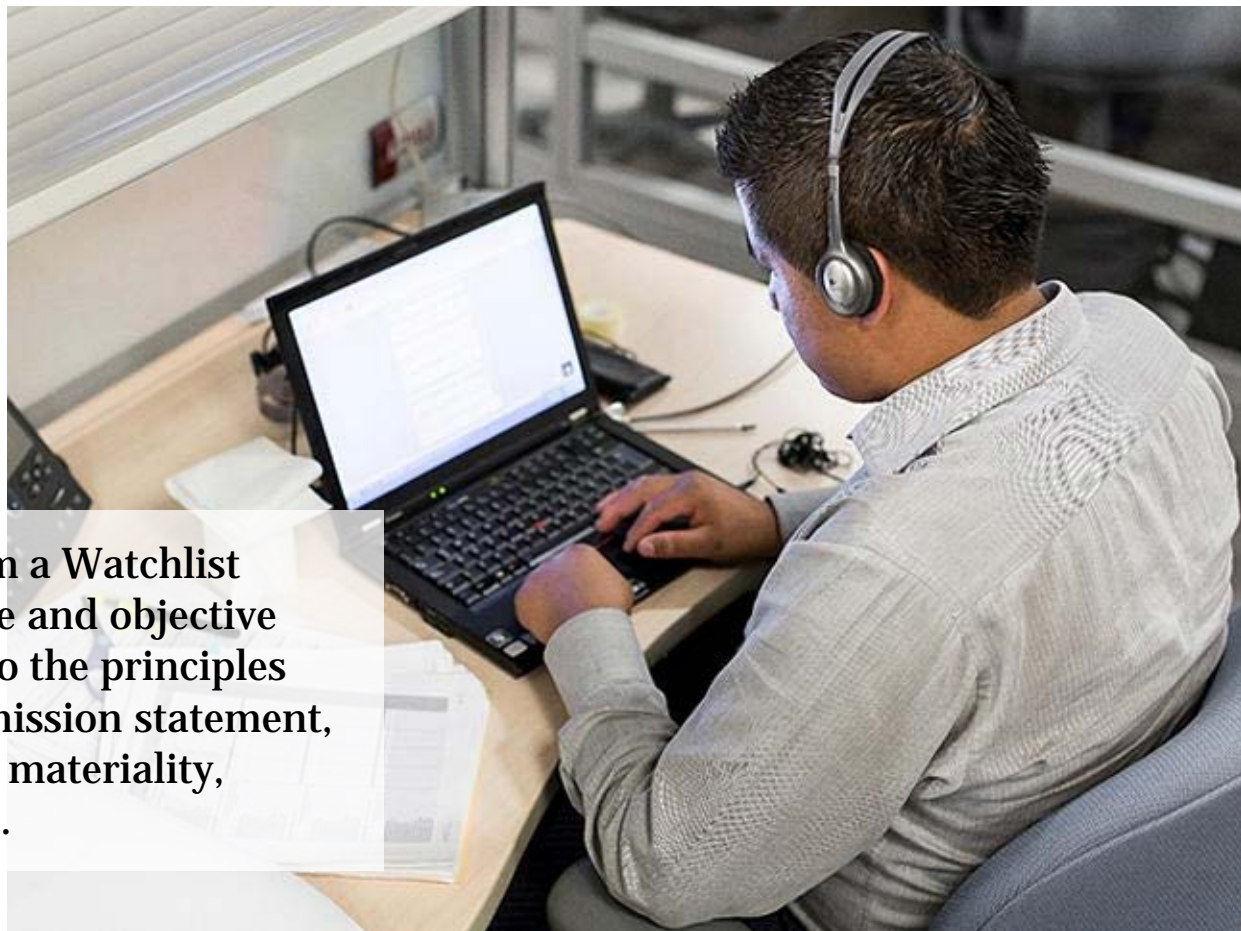
- A. When the statute of limitations has run and the last claim has been resolved.
- B. When the Company loss trending has consistently moved downward year over year for 5 years and industry trends are pointing downwards.
- C. When the probable cumulative potential exposure is viewed as non material and new business strategies avoid the risk.





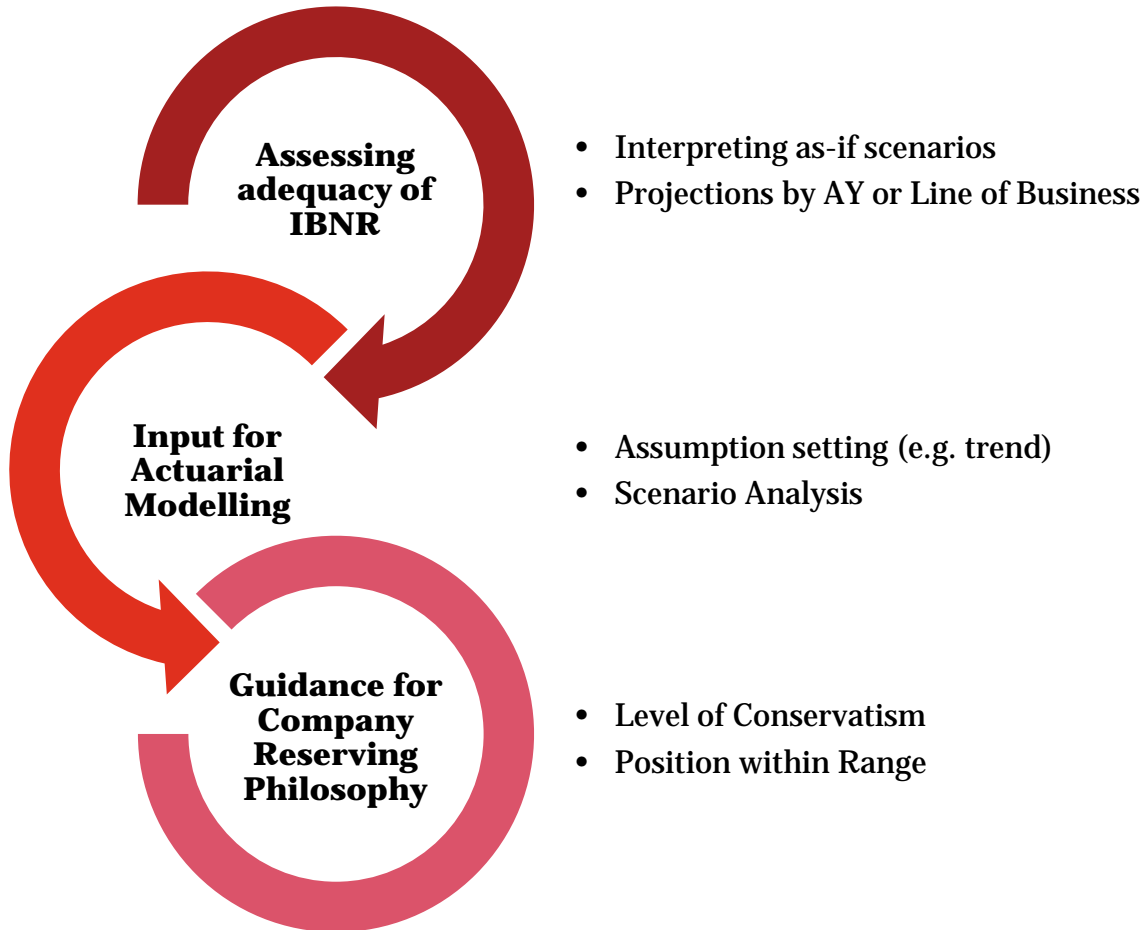
Removal from Watchlist – Food for Thought

Removing an item from a Watchlist should be a subjective and objective assessment following to the principles defined in the vision/mission statement, while considering risk, materiality, business strategies, etc.





Leveraging the Output – The Actuary





Leveraging the Output

Claims management

Identification of claims with significant loss potential early in the life of a claim allows the claims department to handle the claim proactively and establish an appropriate litigation strategy. Doing so can reduce the loss potential of the claim and avoid unexpected adverse reserve development and stair stepping of reserves.

Industry trends

Maintaining an awareness of trends in the industry may help an insurer identify potential exposures from existing policies, allowing it to employ targeted claims management strategies and reduce its loss exposure.

Underwriting/Pricing/Marketing strategy

An insurer may decide to discontinue an unprofitable book of business, add exclusions to its policy language or target a different segment of customers. Correcting underpricing soon after the identification of a significant loss exposure will help to reduce the impact of related claims on the insurer's financials.

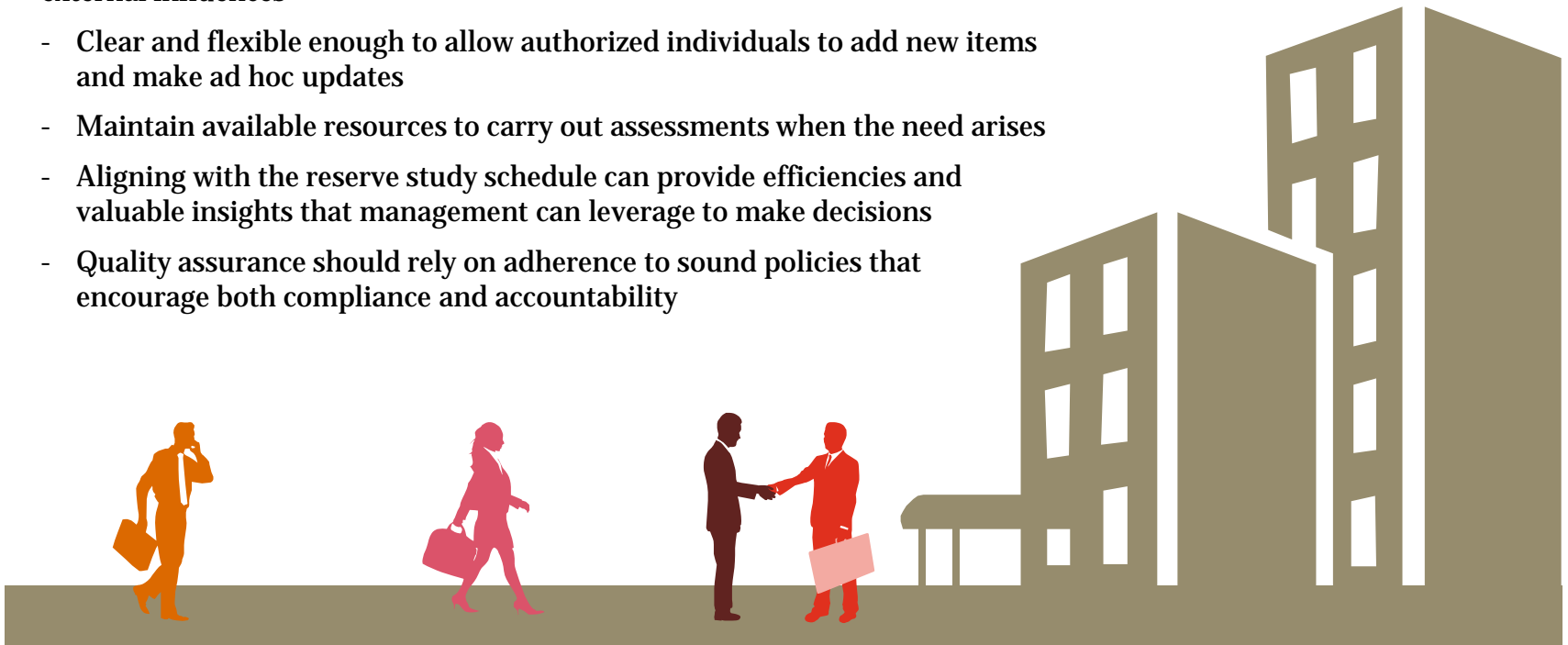
Reinsurance

Today's leading practices suggest addressing both gross and net exposures related to watch list claims. This approach is particularly important for companies with complex reinsurance structures. The additional focus facilitates timely notice of loss to reinsurers and appropriate recognition of any reinsurance coverage in the financial reporting process.



Challenges and Opportunities

- Coordinating involvement of various functional areas within the company
- Ensuring watch list items are in line with scope and purpose, but also remain flexible to changes over time
- Timeliness of updates, assessments and quality review: Challenge is speed with which unexpected new developments occur in the underlying exposures or external influences
 - Clear and flexible enough to allow authorized individuals to add new items and make ad hoc updates
 - Maintain available resources to carry out assessments when the need arises
 - Aligning with the reserve study schedule can provide efficiencies and valuable insights that management can leverage to make decisions
 - Quality assurance should rely on adherence to sound policies that encourage both compliance and accountability



Thank you!