# Rising tides on liability lines (LOB-3)

Monitoring the state of trends underlying liability coverages

Phil Natoli, FCAS, MAAA
Jay Votta, FCAS, MAAA
Peter Venetis, JD

Building a better working world

# Disclaimer

- The views expressed by the presenters are not necessarily those of Ernst & Young LLP or other members of the global EY organization.
- These slides are for educational purposes only and are not intended to be relied upon as accounting, tax or other professional advice. Please refer to your advisors for specific advice.

# Introduction

Property losses have dominated the headlines since Hurricanes Harvey, Irma and Maria

# Introduction

## However, tides are rising on liability lines of business

- Long-term trends on liability lines of business do not grab headlines as easily as property catastrophe events.

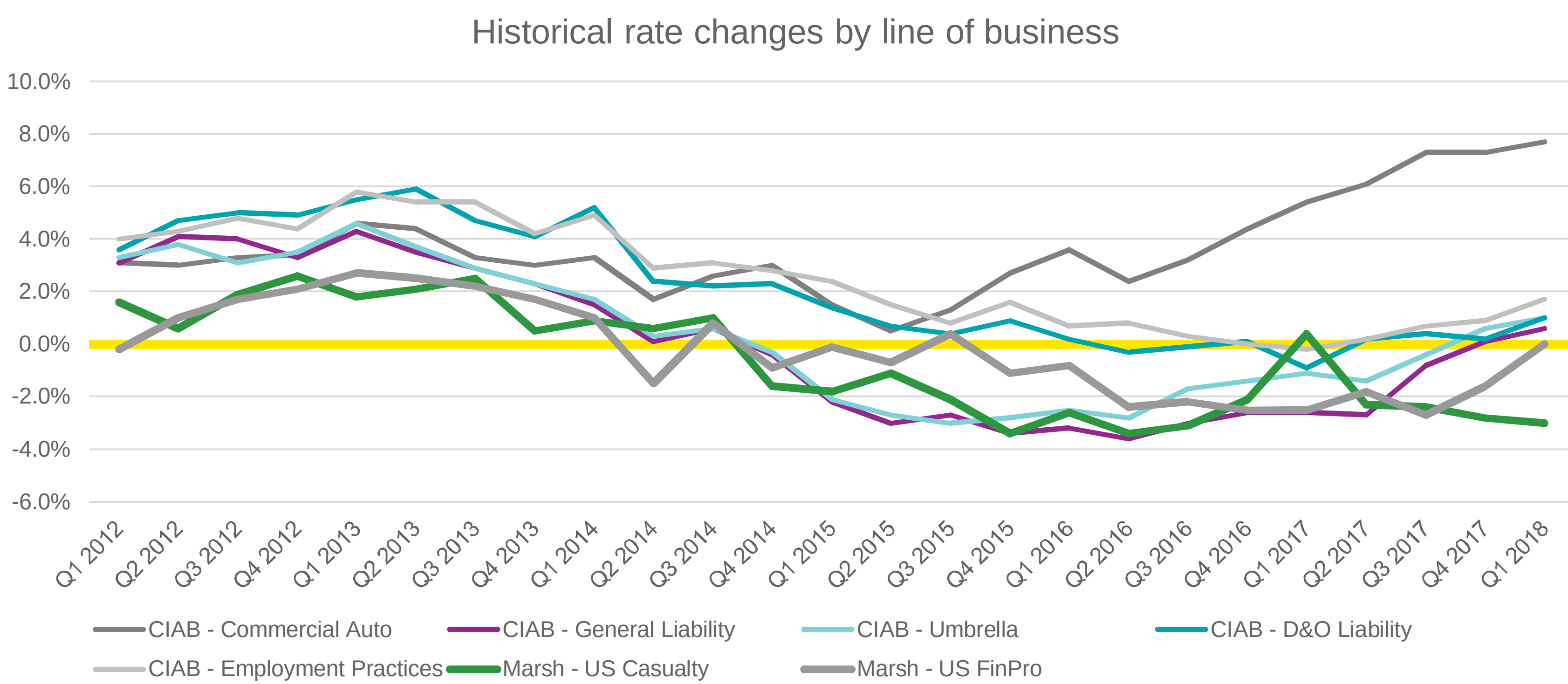
Liability insurance – insurance that protects the purchaser from the risk that they are held legally liable for something such as injury, property damage or financial loss

- However, trends underlying liability lines of business warrant serious consideration from insurers writing these coverages.
- Soft market rates, eroding adequacy of reserves, inflationary effects and claims severity trends threaten the profitability of liability lines of business.
- Our focus in this presentation is general and professional liability coverages.

# Rate environment – The industry has felt the effects of long soft market, but is relief in sight?

# Latest rate survey results

## Surveys suggest flat to negative rates over last four to five years



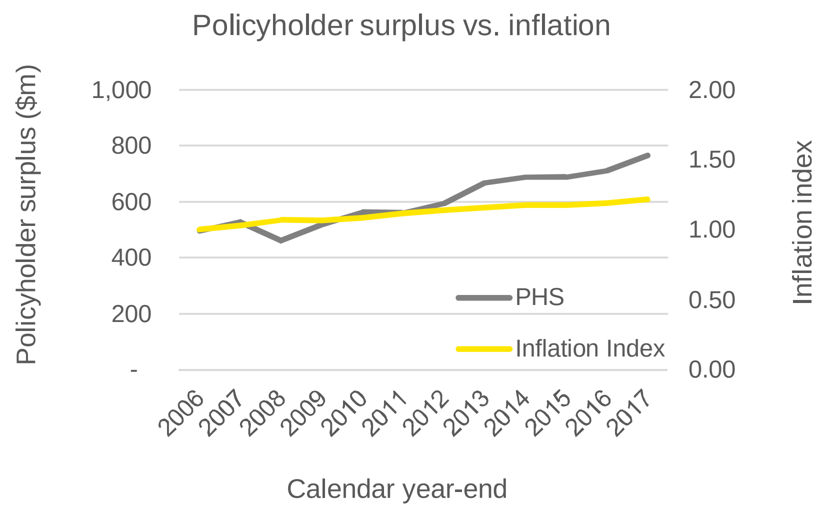

Source: Council of Insurance Agents & Brokers (CIAB) and Marsh McLennan Surveys

- A soft rate environment has persisted for almost five years.
- Inflation, reserve adequacy and severity trends will put pressure on companies to raise rates.

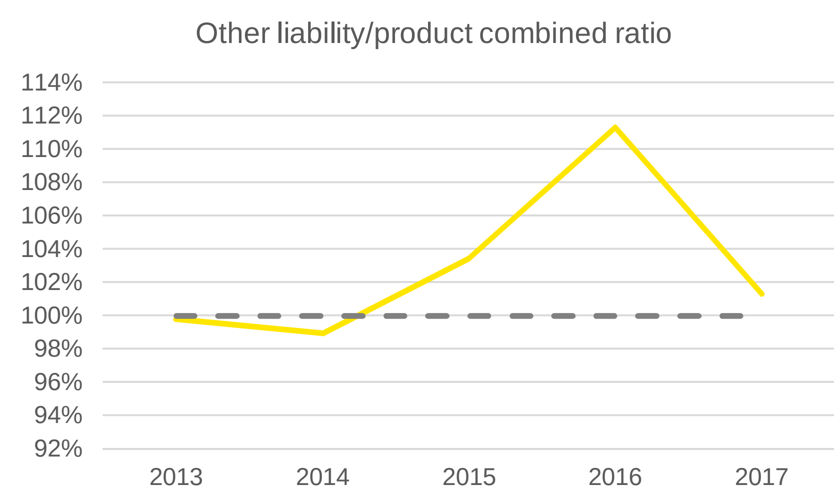
# Excess capacity has held rates down

## Difficult to raise rates in ultra-competitive market

- Policyholder surplus (PHS) is the highest its ever been and is growing at a faster rate than inflation.




- Industry combined ratios for other/product liability has breached 100% in each of the last three calendar years.




Source: Aggregated US Statutory Annual Statement Data

# Boards are aware of the issue

## Pricing trends were highlighted in several earnings calls

- Early 2018 earnings calls highlighted rate adequacy on casualty and professional lines of business as an area of interest for analysts.

- The tone of late 2018 earnings calls regarding pricing will be something to watch for.

# Looking ahead

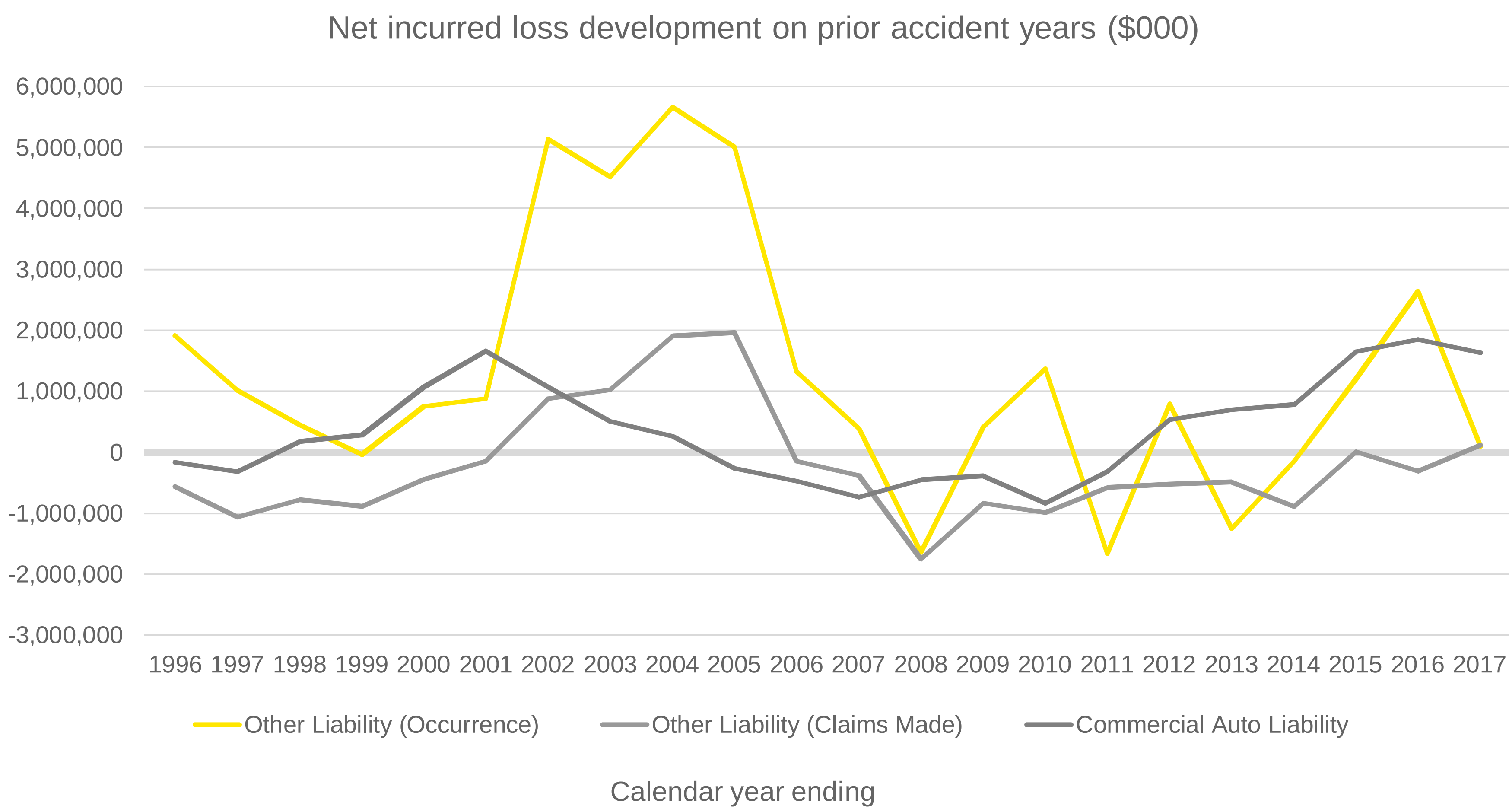
## Relief may be in sight for liability insurers

- As 2018 continues, it appears insurers have been able to achieve marginally positive rate changes based on the pricing surveys and earnings call feedback.
- This is a favorable sign, but it's likely that more needs to be achieved in order to fully restore underwriting profitability at the industry level.
- Despite rates moving in a positive direction, rate levels per the survey results remain below recent estimates of inflation, and the claims severity environment adds additional uncertainty.

# Reserve adequacy concerns growing

# Prior year development leaning adverse

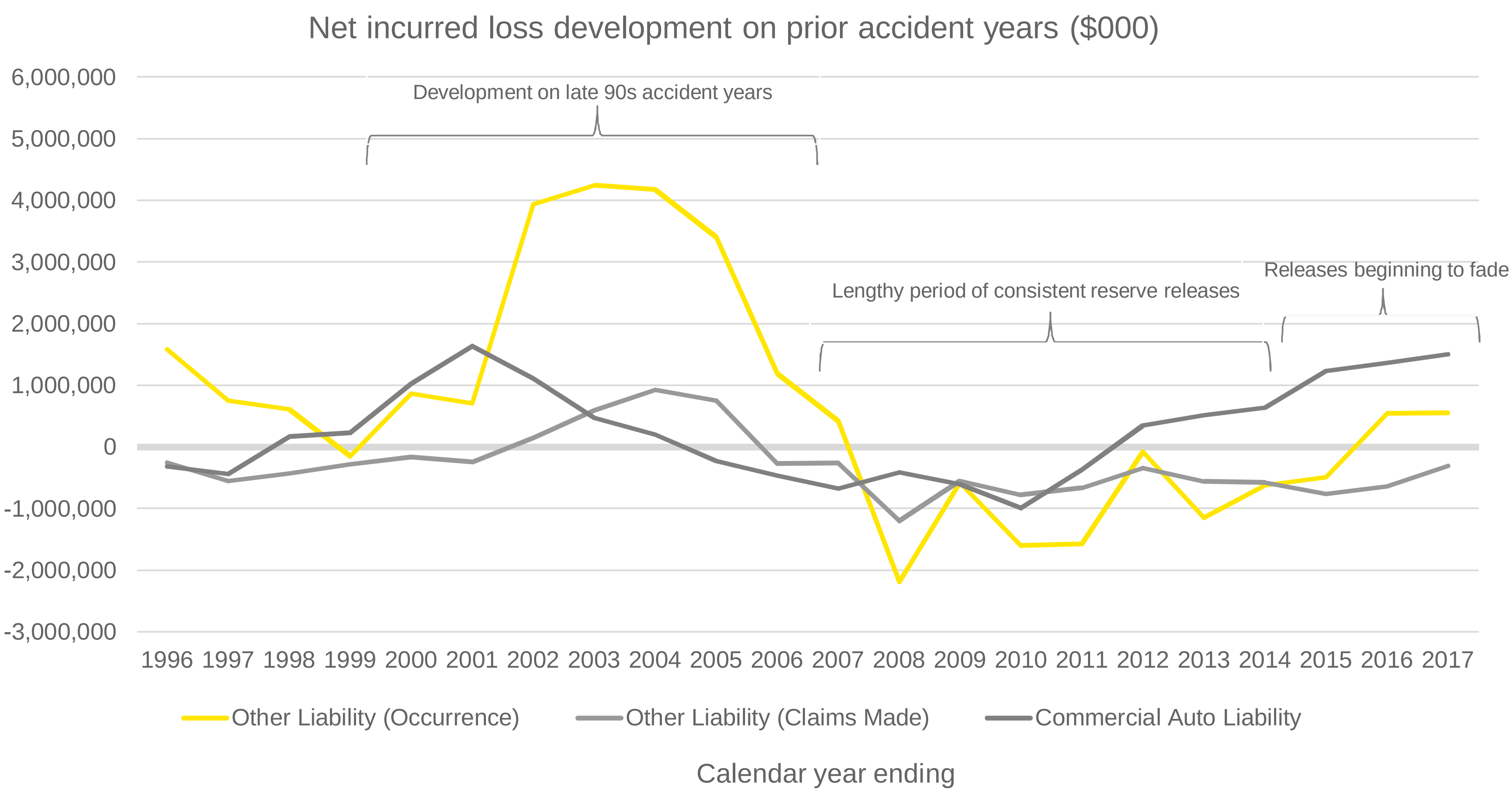
## Liability lines of business have required reserve strengthening actions




Source: US Statutory Annual Statement Data

# Prior year development leaning adverse

## Liability lines of business have required reserve strengthening actions

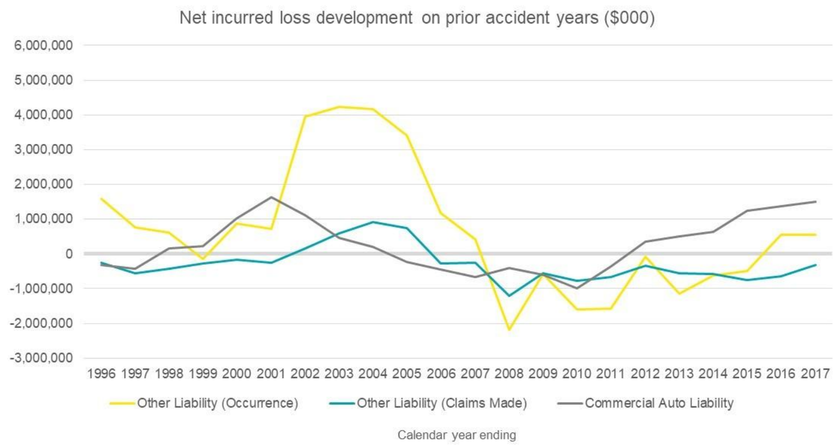



Source: US Statutory Annual Statement Data, excluding AIG

# Prior year development leaning adverse

## Variability remains by line of business

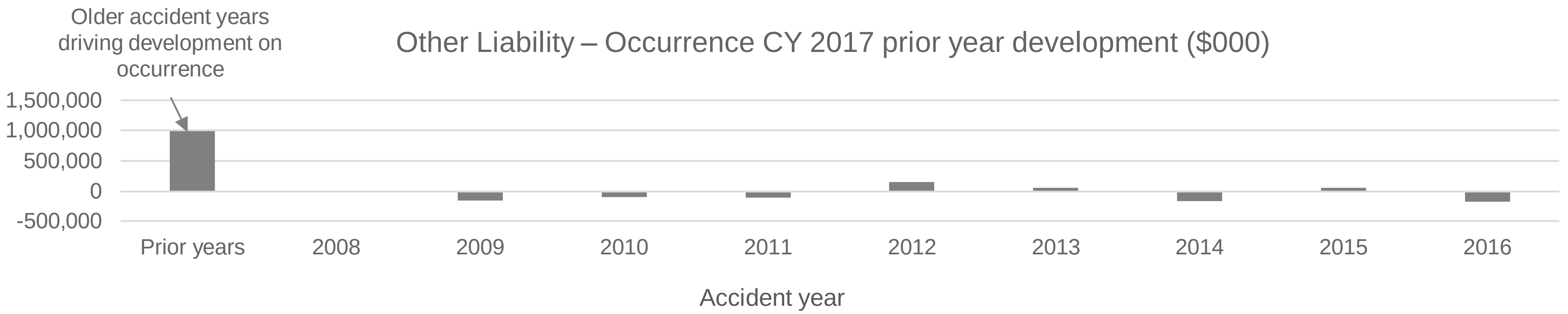
- Other Liability – Occurrence reserves have run off adversely in the last two calendar years.
- Other Liability – Claims Made continued to run off favorably; however, releases have fallen in the last three calendar years.




- Commercial Auto Liability reserves have continued to run off adversely, with adverse development growing year over year since 2011.
- Across all lines of business in 2017, these adverse movements were offset by continued favorable development in workers' compensation.

# Prior year development leaning adverse

## Accident year drivers vary by line of business



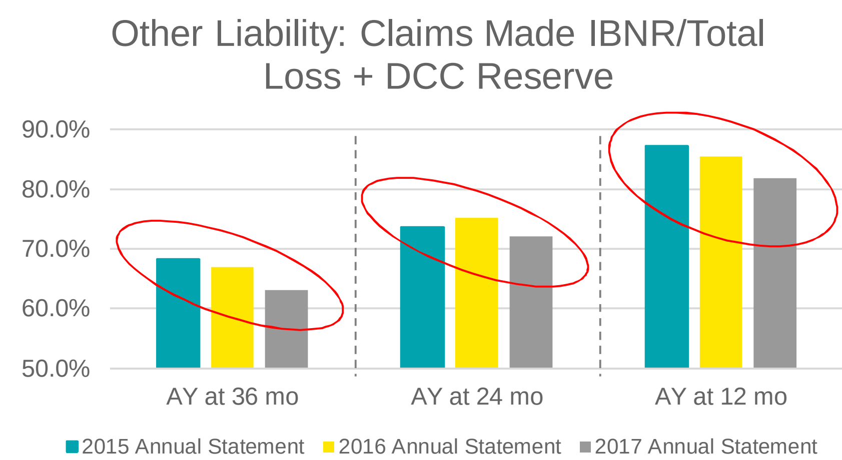



Source: US Statutory Annual Statement Data

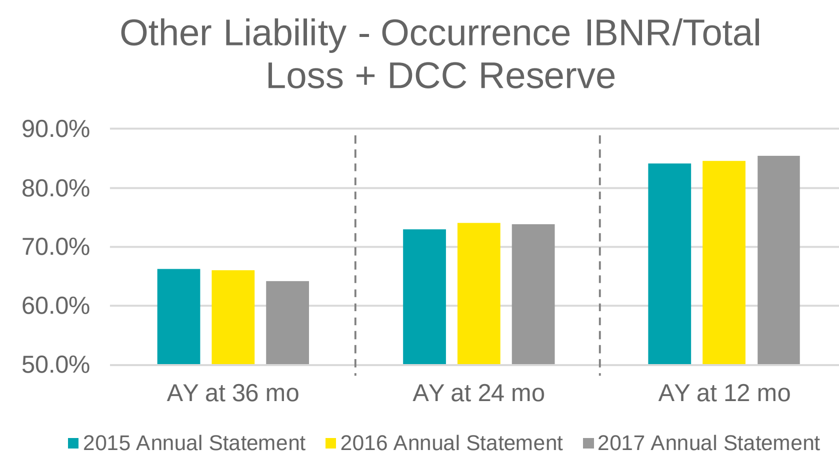
# IBNR relative to case reserve changing

## Other Liability – Claims Made ratio showing downward trend

- IBNR as a percent of total reserves has fallen year over year for the most recent accident years for Other Liability – Claims Made.



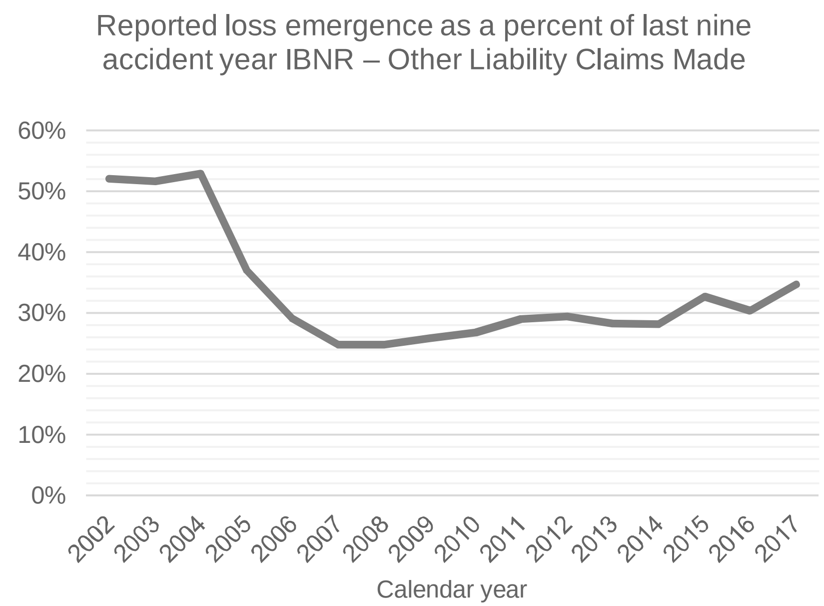

- Trends are less apparent when analyzing Other Liability – Occurrence at this level.

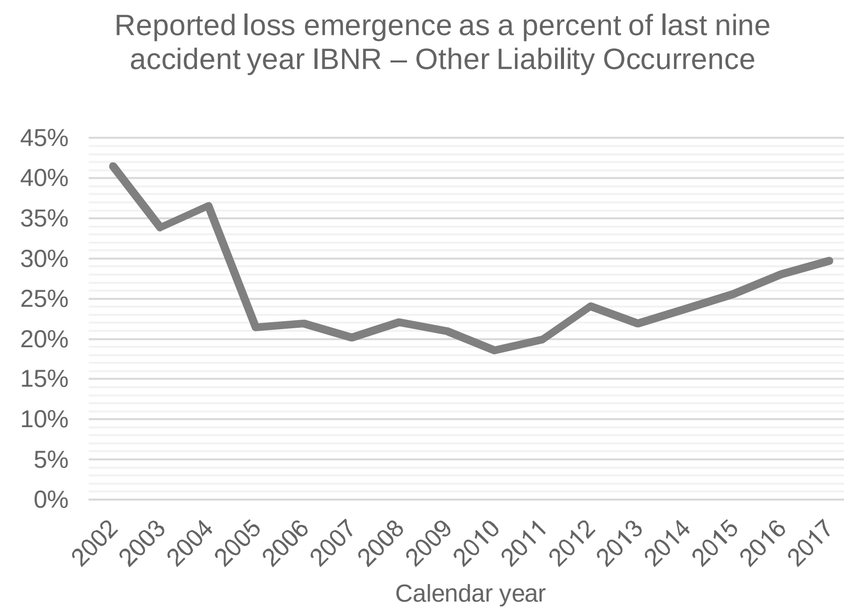



Source: US Statutory Annual Statement Data

# Loss emergence as percent of IBNR

## IBNR eroding more quickly in more recent years




Includes only emergence and IBNR on the most recent nine accident years

- Both Other Liability classes show an upward trend in consumption of prior year IBNR, suggesting possible erosion in adequacy of reserves.
- High levels of this ratio were seen in the early 2000s during a period of continued reserve strengthening across the industry.

Source: US Statutory Annual Statement Data

# How will third-quarter reviews emerge?
Do trends indicate incoming reserve charges?

- Diagnostics suggest reserve adequacy may be eroding at an industry level.
- As reserve adequacy erodes, the risk of reserve charges grows.
- Reserve charges may reveal the need for further rate actions through the reserving and pricing feedback loop, as companies reassess the profitability of historical accident years.

# Inflationary winds picking up

## Economic and social trends drive results of liability lines

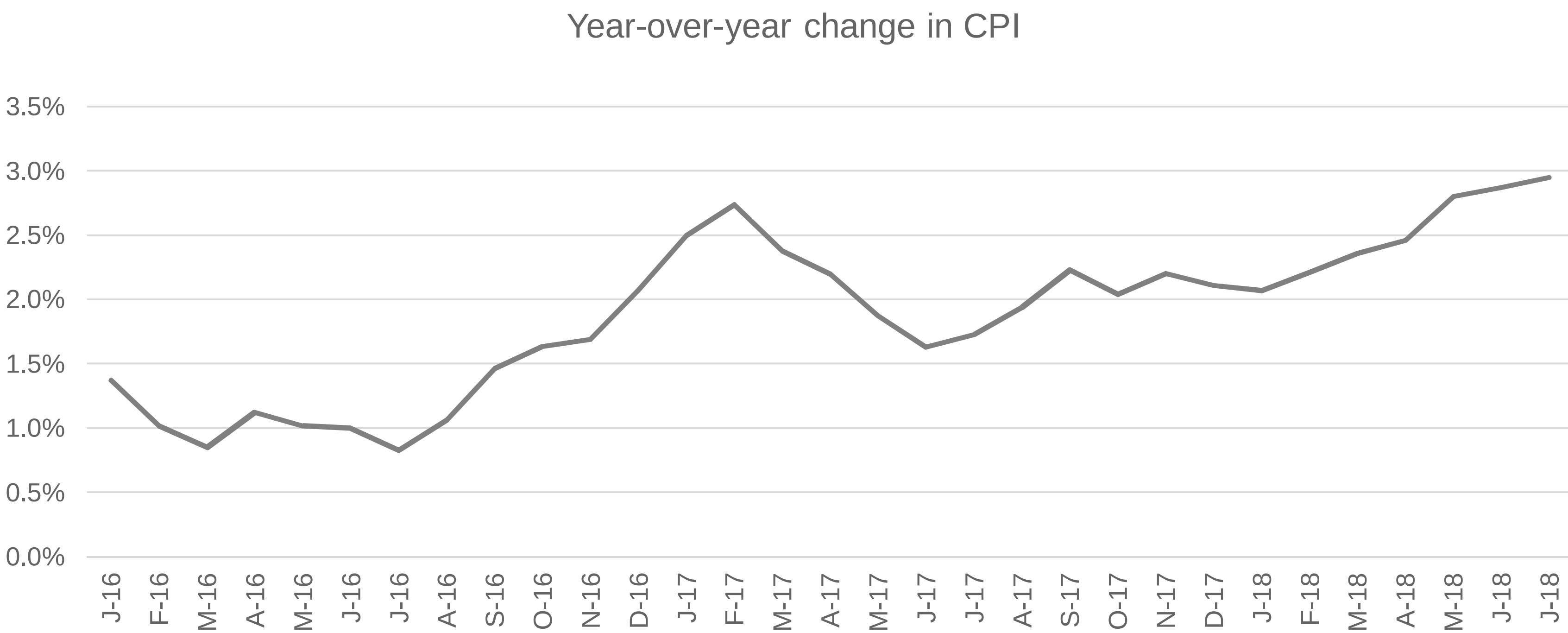
# Inflation – economic and social

## Insurers are impacted by both

- Inflation – The rate at which the general level of prices for goods and services is rising
- Economic inflation – Inflation driven by monetary policy or other economic factors
- Social inflation – Inflation driven by propensity to sue, trends in jury award sizes, regulatory changes or changes in the tort environment
- Social inflation is a major driver of property and casualty loss costs, particularly claims severity for liability coverages, and is notoriously difficult to quantify and predict

# Economic inflation

## CPI creeping higher in recent months

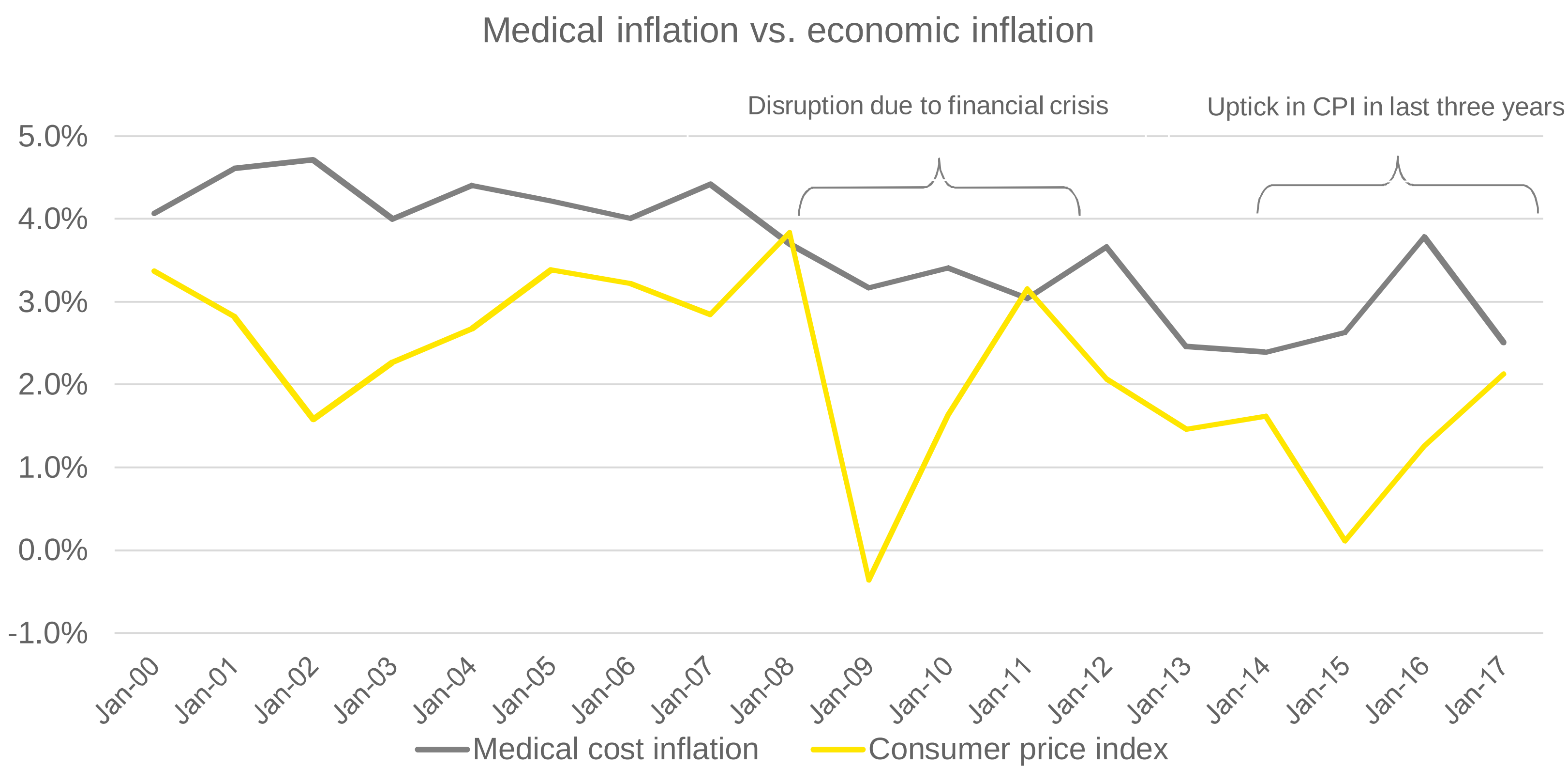



Source: Bureau of Labor Statistics

- The Consumer Price Index (CPI) has steadily risen over the last three years, reaching 2.9% year-over-year change in July 2018.
- Increases in the CPI have implications on insurance loss costs, as increases in costs of repair, medical costs and other costs can have a direct impact on the cost of paying claims.

# Economic inflation

## Medical care costs consistently outpace overall inflation index

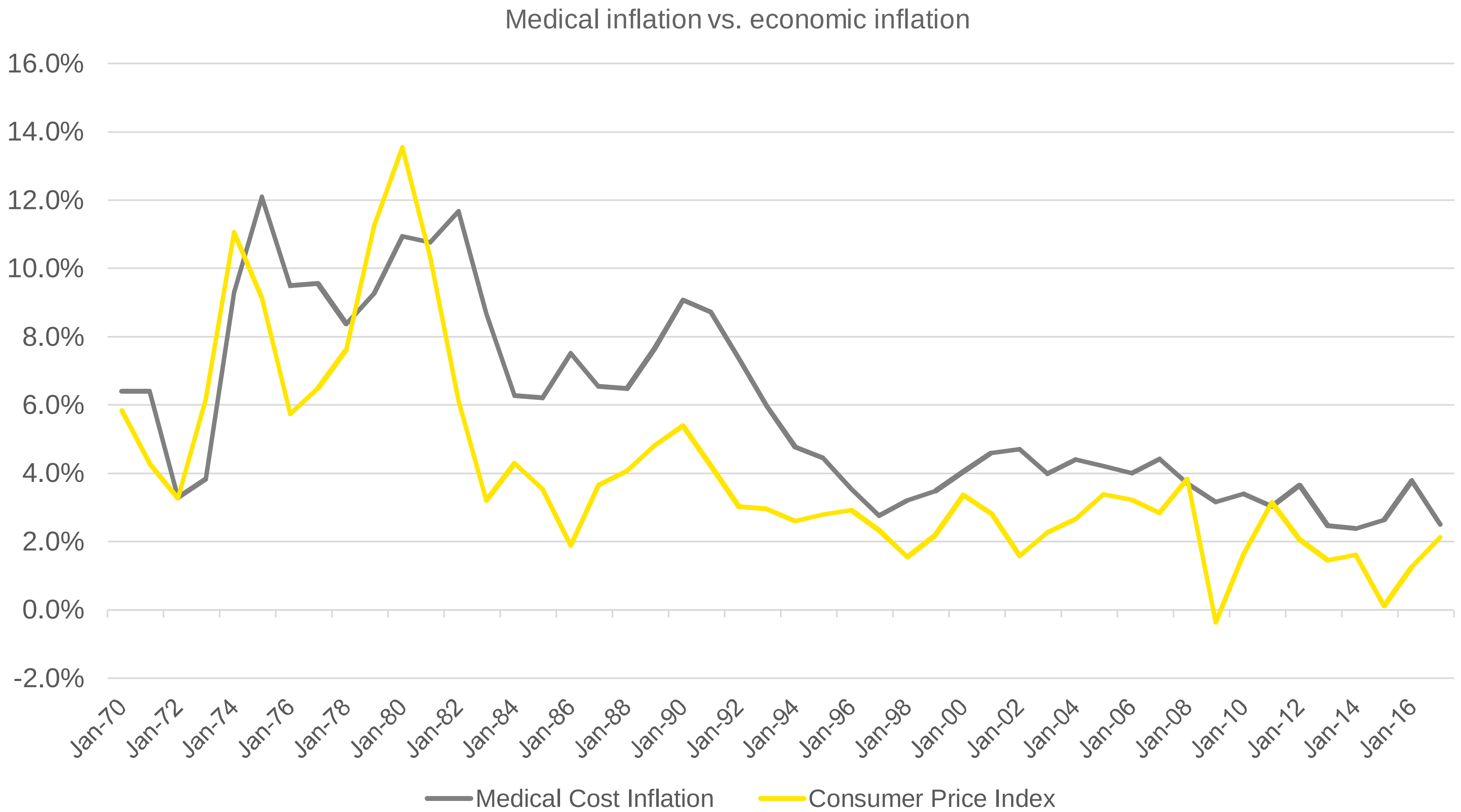



Source: Bureau of Labor Statistics

- Over the past 20 years, CPI has grown at an average annual rate of 2.2%, while the level of medical inflation has grown at an average annual rate of 3.6% – about 70% faster.
- Although overall CPI inflation dipped during the 2008 recession, medical inflation held steady.

# Economic inflation

## Inflation remains low relative to historical standards




Source: Bureau of Labor Statistics

# Accounting for inflation in your reserve review

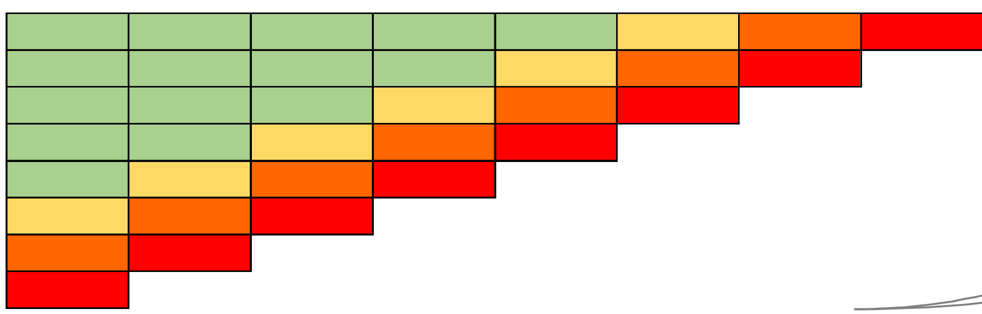
## Looking out for fattening of the tail

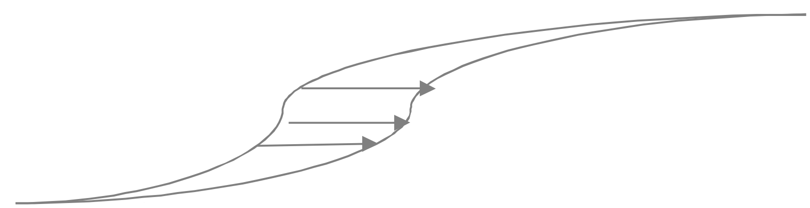
- Inflation events tend to emerge as a calendar year effect.
- Inflation plays a role in almost all lines of business in some way, in particular for longer tail lines of business.
- An unexpected change in levels of inflation can adversely impact the accuracy of an actuary’s projections.
- In the event an unexpected change in levels of inflation is considered material by the actuary, its impact should be addressed within the review.

# Accounting for inflation in your reserve review

## Effects of inflation will manifest across accident years

- Inflation emerges as a calendar year effect, impacting multiple historical accident years.
- An unexpected increase in inflation will result in a rightward shift, possibly temporary, of the development pattern.





# Accounting for inflation in your reserve review

## Looking beyond traditional actuarial methods

- Methods using paid losses tend to be impacted more by inflation than methods using incurred loss, due to the longer tail associated with paid losses.
- Several methods within the actuarial literature can be used to identify, isolate or quantify the effects of inflation.
- In an extreme case, such as reserving for countries experiencing hyperinflation, it may be necessary to employ nontraditional methods to estimate reserves.

# Large claim severity

## Insurers adversely impacted by large claim settlements

- Large claims are a driver of loss costs for insurers exposed to liability claims.
- Per a 2017 AGCS report, losses over EUR1 million made up over 74% of the total value of claims.
- Recent trends in claims severity impact large claims, particularly excess layer claims, more than attritional claims.

| Loss level | Total number of claims received | Total value of claims | Number share | Value share |
|---|---|---|---|---|
| €0 to €100,000 | 94,203 | €840,820,425 | 94% | 10% |
| €100,000 to €1m | 5,116 | €1,447,492,477 | 5% | 16% |
| > €1m | 754 | €6,558,898,673 | 1% | 74% |
| **Total** | **100,073** | **€8,847,211,575** | **100%** | **100%** |

Source: Allianz Global Corporate & Specialty "Global Claims Review"

# Claims severity trend perspectives

## Discussion with a claims and legal professional

# Drivers of continued increasing severity

## Societal trends have impacted professional liability claims

- Safe workspaces in the era of the active shooter
- #MeToo movement
- Cyber crimes:
  - Data losses
  - Social engineering
  - Privacy losses
- Mergers and acquisitions

# Drivers of continued increasing severity

## More active plaintiff bar has contributed to higher GL losses

- Third-party litigation has become more commonplace, and several recent newsworthy cases have been impacted by this trend.
- Opioid dependency due to the pain associated with surgical procedures can further increase costs of claims, which continues to gain national attention and drive up severity.
- Increased frequency of traumatic brain injury allegations has led to additional testing and procedures in cases which may not have required them in the past.
- Jury verdict sizes increasing due to changes in the tort environment, exemplified by recent talcum powder litigation.

# Thank you!

EY | Assurance | Tax | Transactions | Advisory



1808-2840749
ED none

ey.com