

Market Cycle Reserve Development

Projecting Future Loss Ratios

Why Does Reserve Development Move with the Cycle?

- Management pressure to show better results
- Optimistic LR assumptions in a soft market
- Undetected changes in U/W or Claims
- Incorrect pricing information
- Undetected distributional shifts
- Inadequate monitoring tools

Optimistic Assumptions

- During a soft market we tend to build in changes which theoretically improve results
- We seem to ignore some of the underlying uncertainties which reduce profitability
 - Changes in U/W (Terms & Conditions)
 - Changes in Claims
 - Changes in Agency Management
 - The economy

Changes in U/W or Claims

- Shifts toward more difficult classes
- Changes in scope of loss control
- Effects of predictive modeling
- Changes in CAT Risk (Geographical Mix)
- Changes in Reserving Practices
- Changes in Managed Care

Incorrect Pricing Information

- Poor monitoring of price – inadequate detail and no adjustment for exposure
- No re-evaluation of loss ratios due to pricing changes different than initial assumptions
- Changes in terms and conditions that are not adjusted for
- Once the initial pricing assumption is used to set LR pegs, actual pricing is sometimes ignored

Undetected Distributional Changes

- Geographic Mix
- Business Segment Mix
- Line of Business Mix
- New vs. Renewal Mix
- Policy Size Mix

Inadequate Monitoring Tools

- Actual vs. Expected needs to be done monthly
- Monthly monitor of mix, price and any other assumptions used in the LR planning process
- Not willing to adjust LR's throughout the year for any reason but loss emergence
- Monitoring allows you to justify LR movement throughout the year

Considerations for Improved LR Estimates

- Sophisticated Price Monitoring Tool
- Integrated Planning Process – Premiums, Loss Ratios and expenses
- Use multiple years of past loss experience instead of latest year
- Be prepared to make adjustments based on improvements which can be quantified and monitored – also, consider practices which may worsen results

Price Monitoring

- Separate for New & Renewal business
- Monthly Detail – History and Future
- By state, business segment, LOB
- Break into component pieces
 - Filed Rate (Changes in base rates, PMF, LCM)
 - Tier Shifts (risk movement between Co or tier)
 - Discretionary (Schedule Mod Changes)
 - Experience Rating
 - Exposure Changes (NOT PURE PRICE)

Intregrated Planning Process

- Plan New and Renewal Premium by month
 - Change in New counts, price & avg policy size
 - Renewal Retention, price and avg policy size
 - Estimate Audit/Endorsement Premium
 - Detail – by State, LOB and Business unit
- Plan New and Renewal Loss Ratios
 - Same detail as the premium data
 - Use price monitor to on-level
 - Update quarterly

Other Adjustments

- Assumed Changes in U/W
 - Loss Control
 - Retention by predictive modeling score
 - Changes in Appetite
 - Changes in CAT risk
- Changes in Agency Management
 - Terminations
 - New Appointments
 - Improvement Plans