

Swiss Re

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CAS Special Interest Seminar | October 5th, 2012 | Chris Najim

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III

## Agenda

- Quick Review
- Jurisdictional Developments
- Line of Business and Policy Limit Relationships
- Insurer Size and Claims Practices
- Conclusion

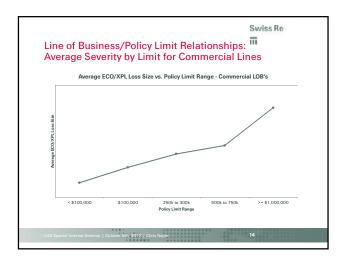
S Special Interest Seminar I. October 5th. 2012 J. Chris Najim

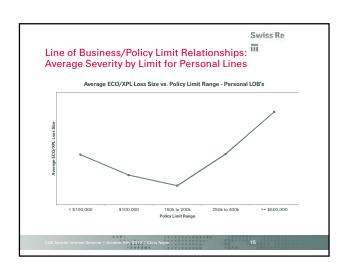
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Quick Review	
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Quick Review: Basic Information	īī
■ ECO/XPL losses occur in addition to or outsi caused by allegations of faulty claim handlin	g by the insurer.
<ul> <li>ECO/XPL losses are a significant component clash treaties, but the proportion depends o the ratio of treaty retention to maximum poli</li> </ul>	n the lines of business and
<ul> <li>Low ratio, Work Comp included small</li> <li>High ratio, Work Comp not included h</li> </ul>	igh proportion
<ul> <li>Traditionally a judgmental rate-on-line appro ECO/XPL.</li> <li>A model-based approach provides consisten</li> </ul>	
available data.	
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Quick Review: Braithwaite and Ware Paper	
A good basic resource: "Pricing Extra-Contractual Obligation:	s and Excess of Policy
Limits Exposures in Clash Reins  Braithwaite and Ware, Journal of Rein	surance Treaties"
■ Gives basic form of an exposure rating mode	
<ul> <li>Identifies underwriting considerations when</li> <li>States</li> <li>Lines of Business / Policy Limits</li> </ul>	pricing ECO/XPL, including:
Size     Claims Management Quality	
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Quick Review:	m .		
Braithwaite and Ware Model  Basic formula for exposure rating model for ECO/XPL expected loss:			
■ Basic formula for exposure rating model for ECO/APL expected loss:  E[L] = Premium * Constant * Limit / Attachment   f(x)dx			
	f(x)dx		
Premium = subject premium			
Constant – set so as to achieve desired overall fre then modified by underwriting charac	teristics		
f(x)dx - reflects expected average severity priced	y on the layer being		
■ Severity distribution – two-parameter Pareto			
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Jurisdictional Develop	ments		
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Jurisdictional Developments: Overview	m .		
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■ Good sources of information: PCI, IRC, large reinst			
■ The past few years have seen numerous attempts harmful to the insurance industry.	to pass bad faith bills		
26 negative bills introduced in several states in 2011, but nothing was enacted.			
CA, CO, DC, FL, GA, IL, IA, MD, MI, MS, NE, NH, NJ, NY, OR, PA, UT			
Most efforts at bad faith reform also failed.			
■ Expect return of negative legislation in several stat	es.		
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Swiss Re **Jurisdictional Developments:** Florida ■ Florida is by far the worst bad faith environment - mainly but not limited to personal auto o Extremely short time periods in which to offer limits o Written settlement demand not required Burden placed on insurer to tender policy limits without any demand
 No rules on how cases are to be settled o No right to cure in third party cases No mandatory policy limits
 Presence of lawyers who take advantage of the situation ■ An effort to implement bad faith reform failed earlier this year. ■ 2003 Med Mal tort reform – safe harbor provision, caps on pain and suffering. However, FL Supreme Court is reviewing. Seminar | October 5th, 2012 | Chris Najim Swiss Re **Jurisdictional Developments:** Other States ■ Next tier of states with worst bad faith environments: WA, CA, IL (Cook County, Madison County) ■ Washington: 2007 law eased restrictions on filing bad faith lawsuits, significantly eased restrictions on punitive damages. ■ California: denial of coverage on GL/CMP ■ There have been some successes at implementing reform. ■ West Virginia: 2005 reform law replaces courts with an administrative procedure for handling bad faith cases, has reduced auto liability costs. ■ Tennessee: 2011 reform law limits ability to sue and punitive damages. Reform bills currently under discussion in GA, LA, WV. S Special Interest Seminar | October 5th, 2012 | Chris Najim Swiss Re Line of Business and Policy Limit Relationships

# Swiss Re Line of Business/Policy Limit Relationships: \*\*\* Overview ■ Frequency hierarchy by line of business: 1) Personal Auto (low limits, strict timelines) 2) $\operatorname{GL}/\operatorname{CMP}$ (denial of coverage, complex language) Commercial Auto 4) Other - Personal Liability, Professional Liability, Work Comp Severity by line of business harder to delineate, but have experienced a number of very large losses recently involving personal auto bad faith. ■ Frequency by policy limit: in general, there is higher potential for ECO/XPL at low policy limits. ■ Severity by policy limit: assumption that expected average severity increases as policy limit increases has been challenged by recent personal auto experience.





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o Frequency of claims audits  ■ Other insurer characteristics: o Complexity of exposures o Writers of niche business o Use of manuscript policies	<ul> <li>Level of authority and supervision given to TPA's</li> </ul>				
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o Writers of niche business o Use of manuscript policies					
o Use of manuscript policies					
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# Swiss Re Insurer Size and Claims Practices: **Quantitative Measurements** ■ A number of these characteristics can be measured quantitatively: o Average claims staff years of experience o Total number of pending files Number of pending per claim handler Number of claim handlers per supervisor (evaluation also depends on whether supervisors handle claims) o For small companies: number of states written ■ For renewals, all of this information can be obtained from claims audit reports ■ For new business, information might be obtainable from the client or the broker Swiss Re īπ Conclusion ■ An exposure rate for an expected ECO/XPL loss can be constructed using a model which o is multiplicative, c an be divided into frequency and severity components, o and allows for the presence of interactions ■ Potentially a good candidate for predictive modeling? ■ Problems: o lack of data / coding of data o extreme values o Pareto distribution $\hfill \blacksquare$ Will have to rely on less rigorous approaches to estimate parameters.



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