

NAIC's Center for Insurance Policy and Research Summit: Exploring Insurers' Liabilities

Session 2: Property/Casualty Panel

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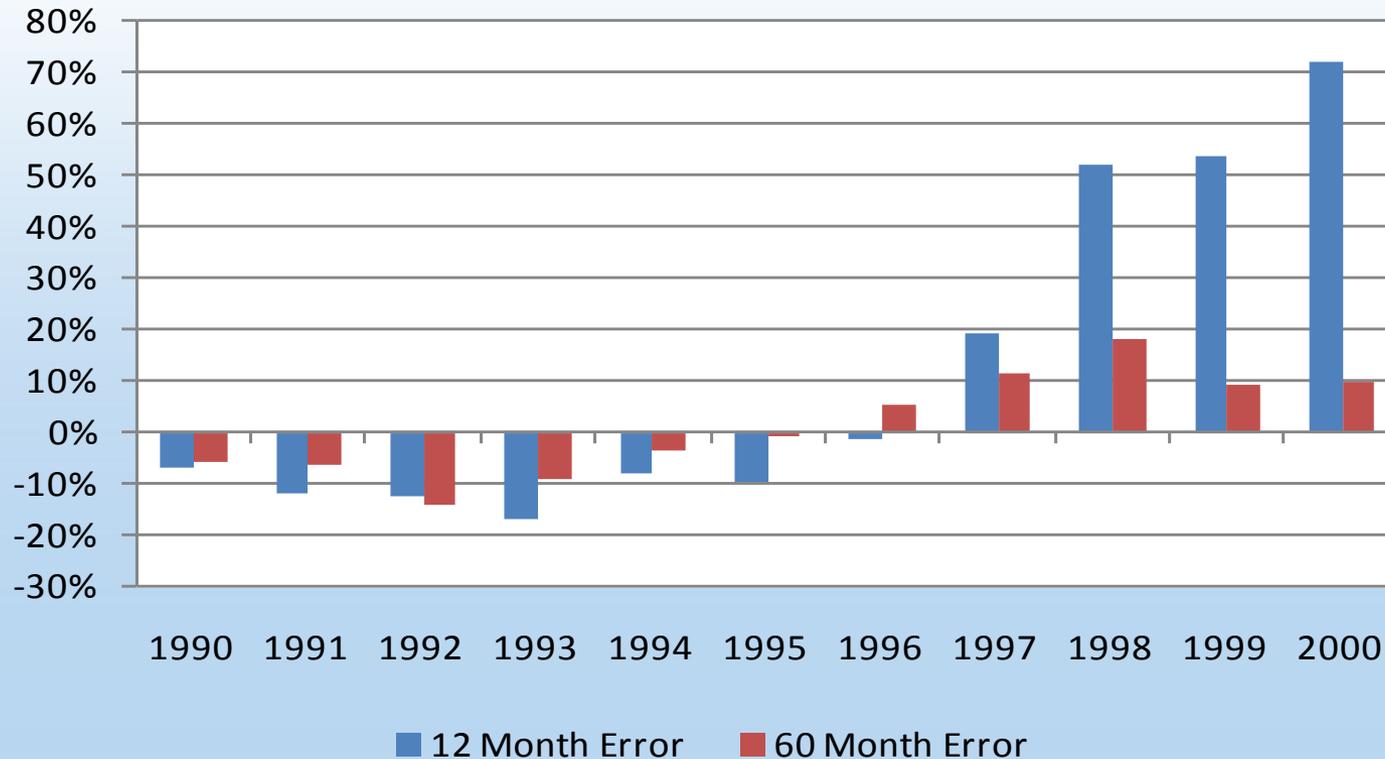
About the American Academy of Actuaries

The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualifications, practice, and professionalism standards for actuaries in the United States.



Historical Reserving Errors – Excess of Loss Reinsurance

Percentage Difference Between 12/60 Month Estimates and Ultimate
(Sch P – Reinsurance B)



Understanding Liabilities – Look Inside the Company

Interactions with Actuaries

- Internal actuaries – management’s best estimate (booked) vs. actuarial estimate
 - Are there biases in actuarial estimate or process?
 - How do estimates move?
 - Reserving philosophy of the company
 - Book the low end, book above actuarial best estimate
 - Management, reserve department, pricing, underwriting, and claims input

- Actuaries within the audit firm
 - Necessary check and balance (should be value added versus a mechanical exercise)
 - Provide external view that company actuaries may miss
 - Reflect competitor behavior/actions



Understanding Liabilities – Look Inside the Company

Interactions with Actuaries (continued)

- Outside actuaries (external consultants)
 - Independent viewpoint – most helpful if unbiased
 - Engaged by management or Board
 - Provide further external view and typically more detailed analysis
 - Enable company to better understand signal versus noise from auditors
 - Two external points versus one

- Best practice is to have a session with all three actuaries to discuss differences at an appropriate level of detail
 - Focus on both overall difference, and cells where there might be offsetting differences



Understanding Liabilities – Interpreting the Actuarial Dialogue

- Statement of Actuarial Opinion
 - Scope of Opinion – what is in/out
 - Ceded to international affiliates; look for consolidation
 - Understand disclosures
 - Risk of Material Adverse Deviation and Relevant Comments on risks and uncertainties
 - Multiple jurisdictions – who is signing the various parts



Understanding Liabilities – Interpreting the Actuarial Dialogue

- Considerations and disclosures
 - Uncertainty – both ways
 - What are the pockets of adverse uncertainty?
 - What are areas that you feel are “rock solid” and why?
 - New businesses or products being written
 - Historical development
 - What is company track record?
 - Has anything changed (company philosophy or actuarial estimation)?
 - Hard market versus soft market philosophy (prudence)
 - Presence or absence of catastrophe losses (attritional incurred but not reported [IBNR])
 - Unbiased indication – actuarial estimate versus unbiased estimate
 - Track difference over time
 - Industry trends/competitor behaviors
 - Current year loss ratio relative to prior years (considering market conditions)
 - “Word on the street” or earnings calls



Understanding Liabilities – Divide and Conquer

- Categorize reserves in broad categories for discussion
 - Focus discussion with management on big issues
 - Short tail (catastrophe versus non-cat)
 - Current accident year, prior accident year, all prior
 - Case outstanding (O/S) to IBNR ratios; IBNR to earnings/price (EP) ratios
 - Liability business
 - Reinsurance (excess vs. proportional)
 - Primary (excess and umbrella versus first dollar)
 - Separate outlier segments (personal auto, workers' compensation, contractors)
 - Loss ratio for recent years; IBNR to case O/S for older years
 - Actual versus expected and actuarial reaction
 - Comparison to industry expectation
 - Large reserves groups
 - Asbestos, construction defects, pollution, credit crisis, catastrophes
 - Relevant metrics: survival ratios, exposure analyses, large movements
 - Other – good, understandable definitions
 - Catastrophe exposed lines with no events, personal accident, etc.



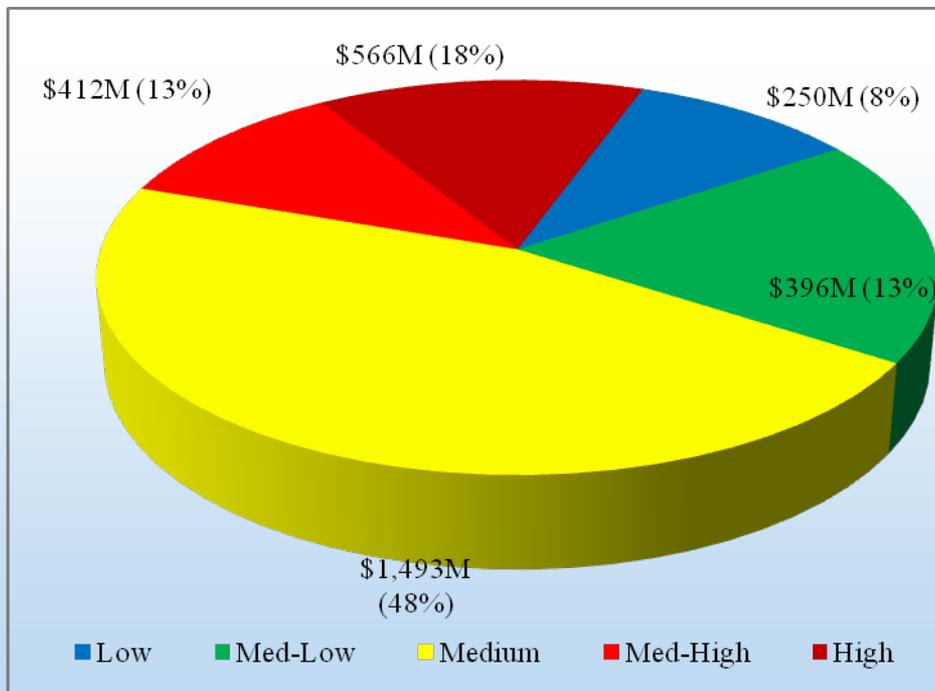
Understanding Liabilities – Divide and Conquer

- Booked vs. actuarial estimates
 - Internal vs. external actuaries
 - LISTEN – signal versus noise
 - Changes in actuarial estimate vs. unbiased estimate
- Be in a position to have a good dialogue – small group



Measuring and Understanding Liabilities

(numbers used below are hypothetical)



- Majority of reserves are at a medium risk level
- Broad category composition is as follows:
 - High Risk – certain casualty classes
 - Medium-High – treaty casualty, excess and umbrella casualty
 - Medium – some casualty (claims made) and property lines
 - Medium-Low – reinsurance property lines
 - Low Risk – auto physical damage, accident and health, losses booked at policy limits

	Case O/S	IBNR	IBNR/Case	AY 2008 - 2012		
				EP	LR	IBNR
H	306	408	133%	793	86%	284
MH	132	405	307%	419	80%	215
M	665	1,627	245%	2,983	62%	1,025
ML	291	631	217%	2,079	53%	402
L	228	268	118%	2,798	71%	198
Total	1,621	3,339	206%	9,072	67%	2,124



Understanding Liabilities – Impact on Pricing

- Does company perform robust price monitoring?
 - Identifying changes in terms and conditions – directional more than decimal point precision
 - Strong versus slight or moderate

- How is feedback mechanism valued?
 - Reserving versus pricing information (underwriting ratios, higher frequency of claims than normal)
 - Incorporating the historical performance
 - Priced versus booked ultimate loss ratios, rate changes relative to historical results

- Is there general understanding of the relative risk of the business – qualitatively?
 - Deployment of capital, consumers of capital
 - Diversification for diversification's sake does not make economic sense
 - Has company made the tough but easy calls with regard to high risk business?



Understanding Liabilities – Impact on Pricing

- Is there an appreciation for learning from the past?
 - Rate changes were grossly understated, creative coverages, too much reliance on experience rating/ignoring exposure rating

- How does the company identify the current market conditions?
 - External publications, feedback from industry events

- Is there evidence of a disciplined process?
 - Team approach (underwriting, claims, actuarial pricing)
 - Separate the technical pricing from the underwriting decision and/or business decision
 - Actuarially-priced loss ratio gets booked



Property/Casualty Panel



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