

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

## Session 1: Impacts of Current Liability Reporting

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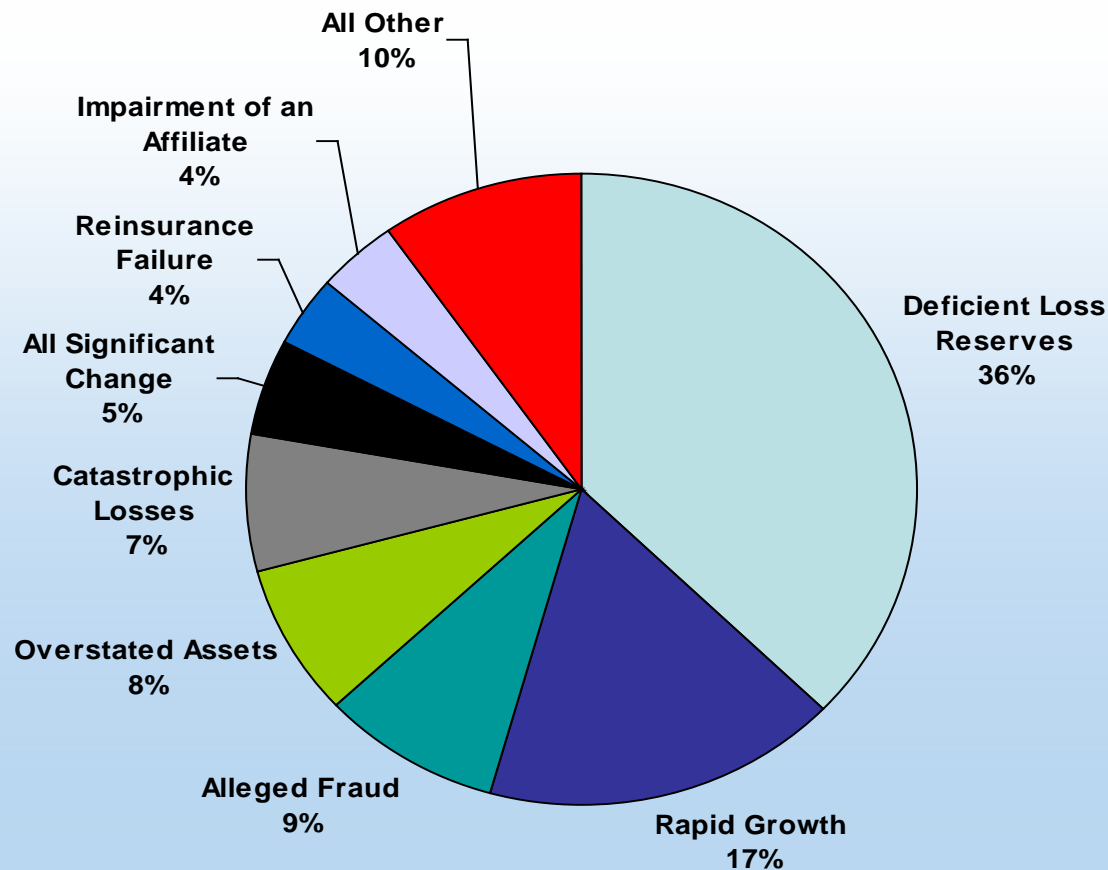


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# Primary Causes of P&C Impairments (1969-2002) – AM Best



# Understanding Liabilities – Importance

- Reserves remain largest risk on a company's balance sheet
  - Inadequate reserves most likely cause of P&C insurance company insolvencies
  - Large percentage of recorded liabilities on balance sheet
  - Subject to much historical volatility (fairly or unfairly)
    - Mostly casualty but also property (catastrophe related)
  - Need to focus on drivers of variability



# Understanding Liabilities – Importance

- Benefits to management and external reviewers:
  - Give rise to more informed capital adequacy decisions
  - Understanding of risk/reward tradeoffs for certain lines of business
  - Facilitate better discussions regarding culture of management
    - Book a point estimate or range – where in the range is booked estimate?
  - Identify points of interest from quarterly close process
    - Reserve increases or releases
  - Improved communications with board of directors around Own Risk & Solvency Assessment



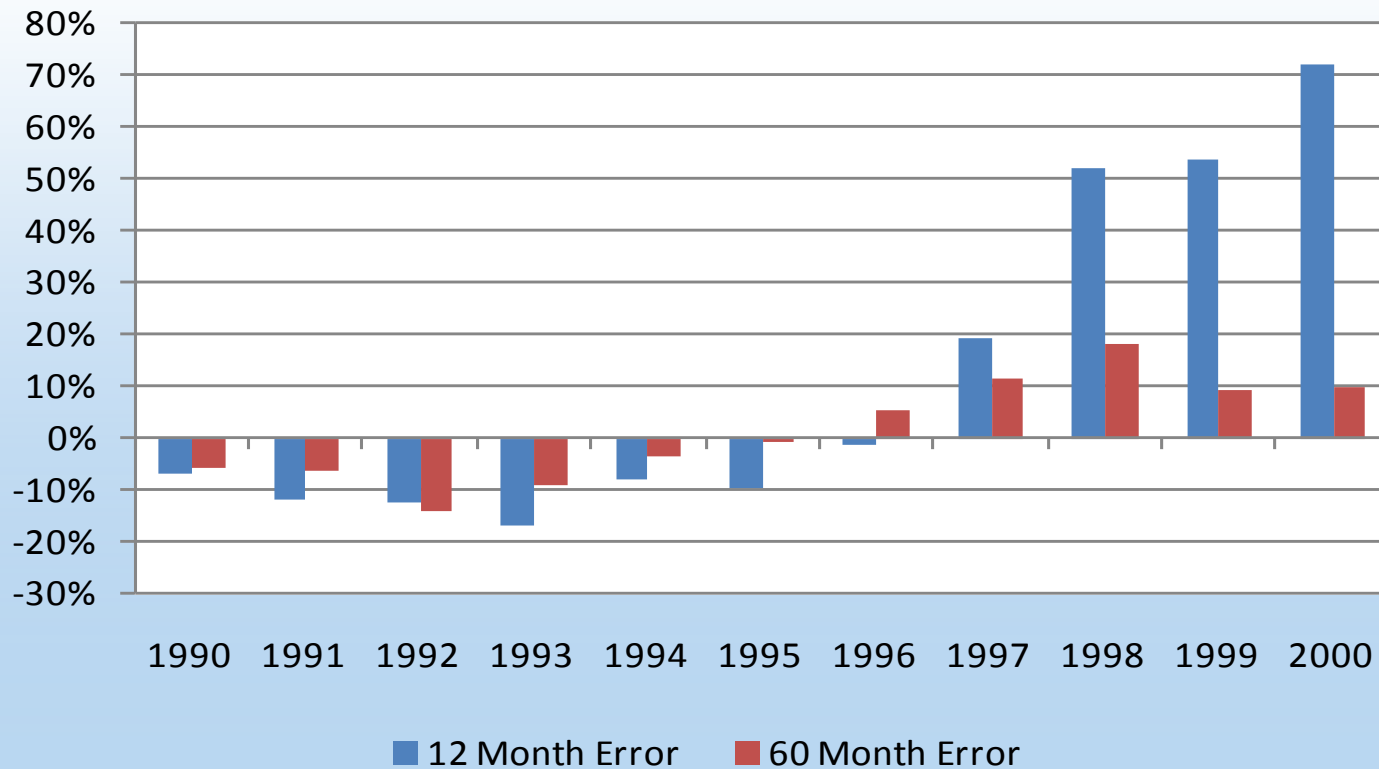
# Historical Volatility of Reserves

- Reserves by their nature are volatile for many reasons
  - Inability to identify changing trends
    - Propensity to sue, judicial reforms, medical inflation, societal attitudes
  - Reinsurance issues
    - Inadequate amount, misunderstanding of coverage, potential for dispute
  - Misestimating where insurance industry was in the pricing cycle
    - Primary rate change, tort costs, focus on production vs. underwriting
  - Shocks to the system
    - Legislative reforms, asbestos and pollution, aggregation of exposures
- Focus on lessons learned
  - Appreciate the possibility for history to repeat itself
    - Why is this time different?
  - Beyond traditional methods and analyses



# Historical Reserving Errors – Excess of Loss Reinsurance

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



# Measuring and Understanding Liabilities

## ■ Reserving Process

- More than estimation, adequacy, and profitability
- Feedback mechanism on underwriting process and claims adjusting
- Strong opportunity for management to communicate results and focus on what causes results and potential favorable/adverse events

## ■ Drivers of Reserves – Identification

- Adverse claims trends
- Leading indicators
  - Claim frequency, large loss notices, industry information, ceded issues
- Hyper correlation of exposures (credit crisis)
- Large policy limits in targeted sectors
- Poor underwriting strategy/inadequate handle on pricing





# Impacts of Current Liability Reporting



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