
Lloyd's Casualty Market Study

Market Reserving & Capital / Underwriting / Claims

June 2020

Agenda

- Scope of the Study
- Findings from the Study
- Next Steps

Firstly, thank you to the participants

Scope of the Study

Joining (all of) the dots

Review has focussed on a “policy lifecycle”, there are wider considerations

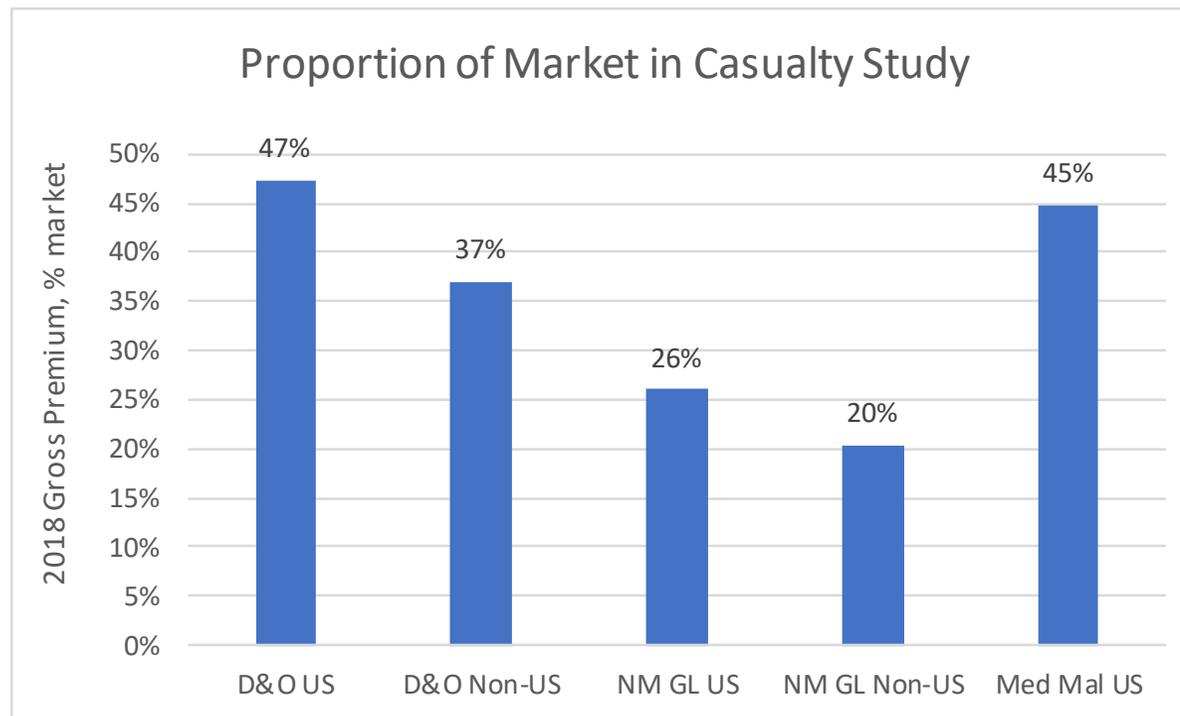


- Review has focussed on the links between underwriting claims and reserving
- Essential that consideration of uncertainty is made within capital and the wider risk management framework
- For liability risks is there:
 - Potential systemic issues
 - Links to other risks (inflation)
 - Disproportionate tail dependence
- Are these uncertainties:
 - Understood and communicated internally
 - Validated using stress/scenario tests (and others)
 - Appropriately contributing to capital on a diversified basis

High Level Scope

Classes of focus and syndicates involved

- Joint study between Underwriting, Claims and Reserving
- Conducted in 2020 Q1
- Involving 14 managing agents; 15 syndicates
- Focusing on
 - NM General Liability (US and non-US)
 - D&O (US and non-US)
 - Medical Malpractice



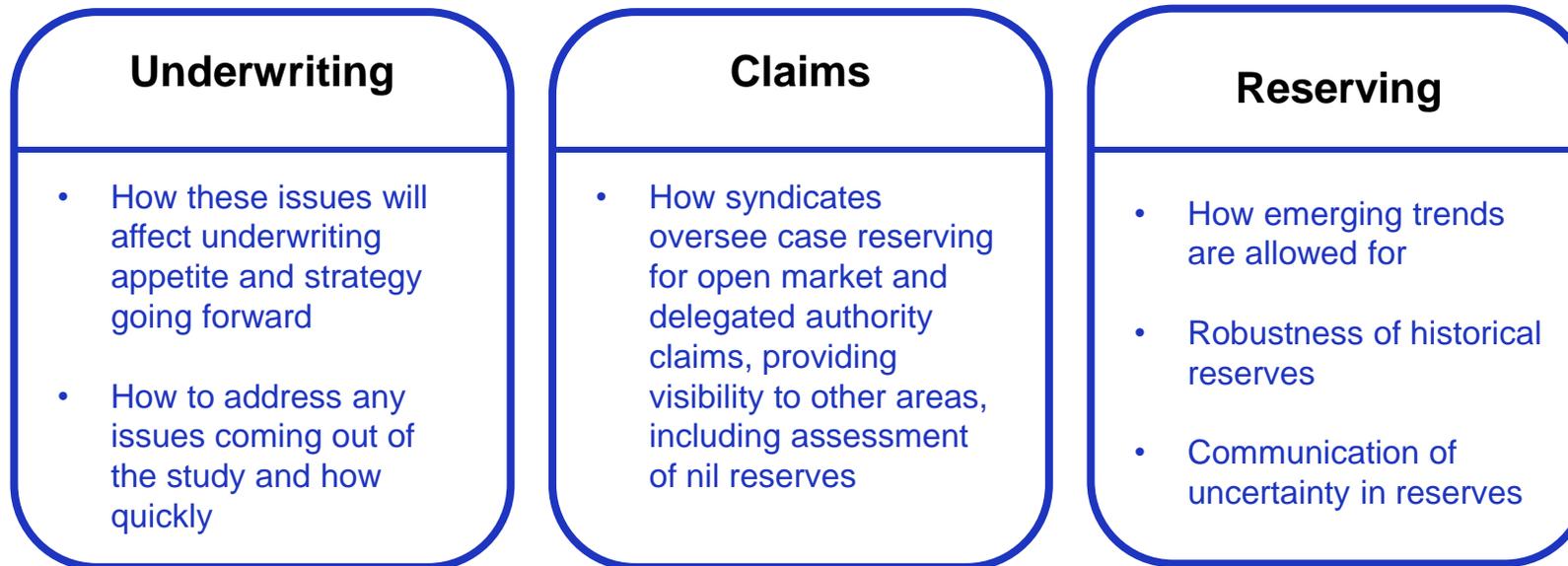
High Level Scope

Key questions we aimed to answer as part of the Study

Following recent increased noise, including in the financial press, regarding concerns about Casualty classes of business, Lloyd's wanted to understand the extent to which any problems exist or may materialise in the Lloyd's market, and how these should be addressed.

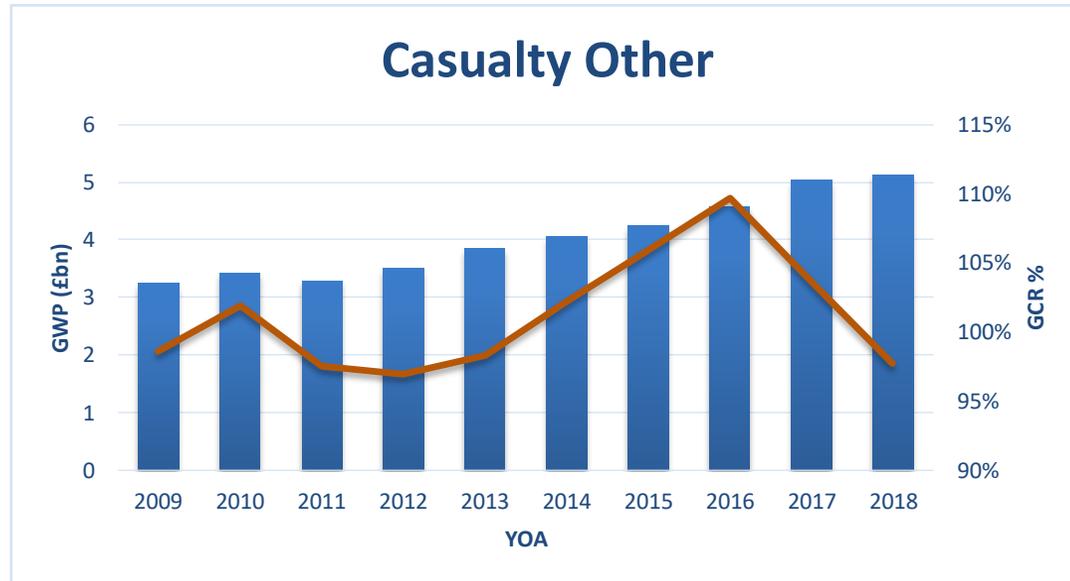
In particular:

- What trends are Lloyd's Managing Agents seeing
- What is meant by social inflation?



Selection of Classes

From Underwriting Perspective



- US Med Mal has been a consistent poor performer and has seen continued deterioration
- Overall levels not very profitable
- Increasing trend in loss ratios until last two years which reflect re-underwriting actions. But still poor loss ratios
- GL US has seen continued increase in premium volumes



- Excluding Cyber, D&O (US) and Professional Indemnity (Non US) have seen highest levels of growth of all Casualty lines during 2020 SBF
- GCR % higher recent YOAs, and not very profitable

Selection of Classes

From Reserving Perspective



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Dear Chief Actuary

Feedback from recent PRA reserving reviews

3. **Inadequate claims inflation allowance:** We have seen insufficient consideration being given to how inflation could impact long-tailed classes of business. Allowance for inflation is often implicit only and poorly substantiated. Portfolios with significant casualty line exposures are particularly vulnerable to the underestimation of reserves.

Our case reserving thematic work has found examples where there are significant differences between the claims inflation observed by claims teams and the claims inflation assumptions used by other areas. Some claims teams' views of annual claims inflation were 5-10% higher than allowed for within the loss ratio assumptions used in reserving, pricing and business planning, without adequate justification for these lower assumptions. A failure to recognise claims inflation experience could undermine the adequacy of both reserving and pricing within firms.

Firms would benefit from better articulation on how they have gained comfort over their allowance for claims inflation in their reserve assessments, including an explicit consideration of the different views held by different teams. We draw particular attention to excess casualty, D&O and financial lines, where social and cultural drivers of inflation can impact materially the ultimate cost of claims.

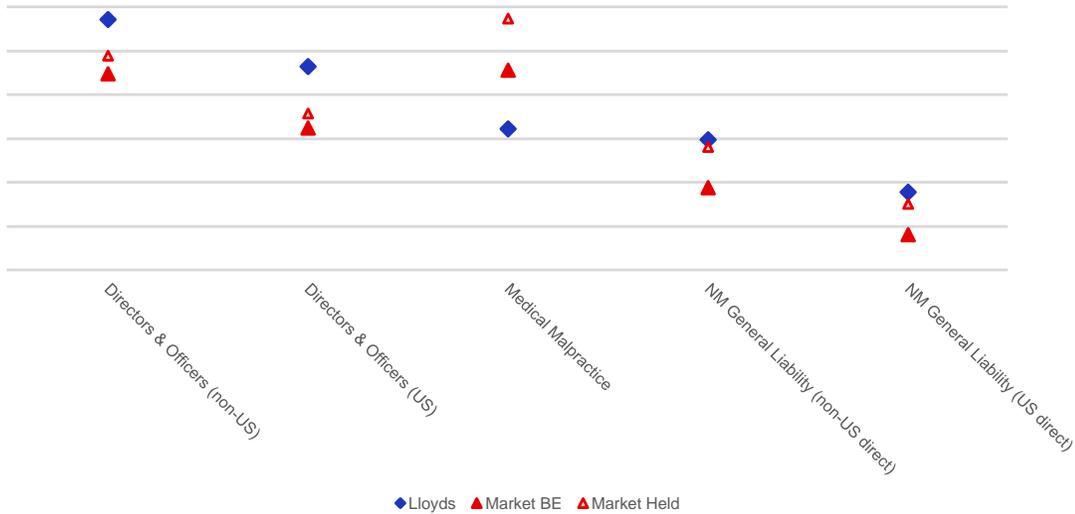
2. **Weakening of case reserving basis:** We illustrated the weakening in case reserving in our September 2018 letter. We continue to see evidence of weakening case reserves (see Appendix Figure 2) and would encourage firms to review the adequacy of case reserving across their portfolio. We draw particular attention to Casualty Financial & Professional Liability, Medical Malpractice and US General Liability classes, where analysis we have seen points to higher paid-to-incurred claims ratios on more recent years. This indicates a possible weakening in the case reserving basis.

We have also observed firms who have been slow to react to bad news in their reserving, increasing the risk of subsequent reserve deterioration.

Selection of Classes

From Reserving Perspective

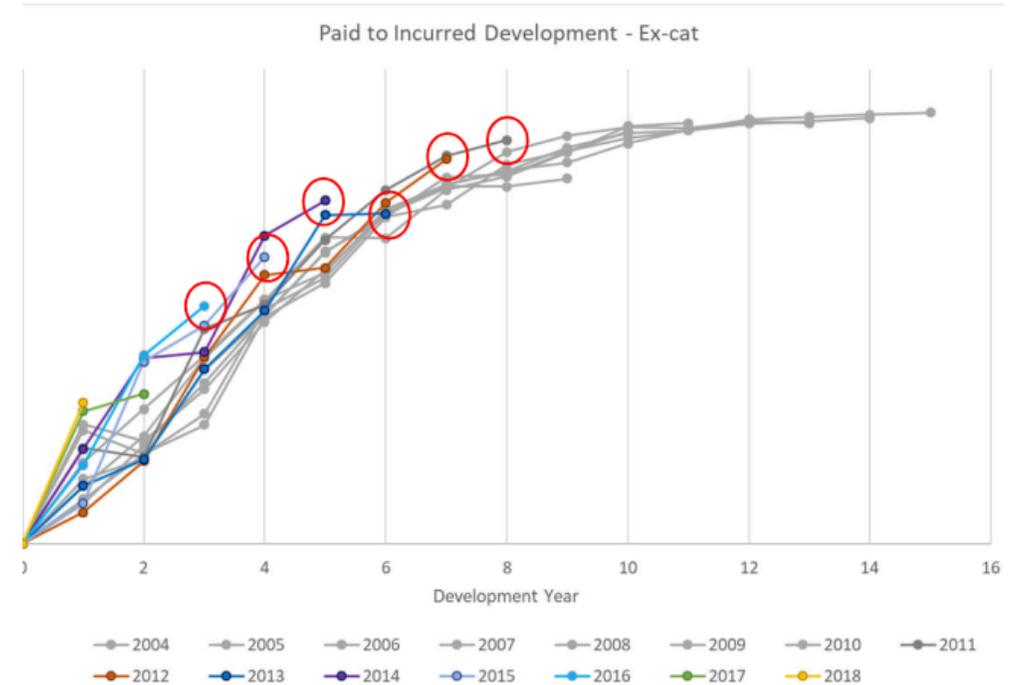
Casualty LLCOB: Comparison of Market Best Estimate and Lloyd's net earned reserves (excl ULAE)



Except Med Mal, all classes had a material best estimate deficit versus MRC as at 2018 YE.

Evidence of case reserve weakening across long-tailed casualty classes.

Medical Malpractice (US)



Focus on Processes

Reserving perspective: Lloyd's has no appetite for deficient reserves or deficient reserving processes

Deficiencies in processes are more likely to mean a greater risk of reserve deficiencies and underwriting underperformance.

In order to address the issues impacting the Casualty market, syndicates should have in place adequate and adapted processes in order to ensure ongoing management of the associated risks.

Process Areas

The study looked at six areas regarding Syndicates' processes:

- Underwriting Appetite and Segmentation;
- Measuring Underwriting Performance;
- Feedback Loops;
- Claims Inflation;
- Emerging Trends; and
- Reserve Robustness.

Reserve deficiencies need to be considered at class of business level.

Reserve adequacy at whole account level is not sufficient. Surpluses in shorter-tailed classes can not be used to offset deficiencies in longer-tailed classes.

Key findings

Key Findings at Market Level

General Themes and Class specific

- Increasing sophistication and organisation of plaintiff counsels, particularly in the US, and no corresponding market effort to counteract the change in the plaintiff counsel's tactics
 - This makes it more difficult to defend against claims
- General consensus that the claims environment has changed in recent years and some participants suggested the market is unclear how long the increasing severity of claims would continue
 - This makes it harder to forecast claim severity

In response, most participants are carefully managing line sizes and attachment points, but the effectiveness of this action is uncertain.

Some Managing Agents are adapting their processes in light of additional uncertainty, such as using third party data/insights.

Rates are hardening across all classes, but uncertainty remains around whether this is just keeping up with increasing claims costs and on pricing adequacy. This is an area that requires further oversight.

Findings – Themes by Class of Business

D&O (US and Non-US)	NM General Liability (US and Non-US)	Medical Malpractice
Number of class actions increasing across US and Non-US (particularly in Australia)	US business claims severity generally increasing	Large amount of consolidation of healthcare providers
Change in manner in which claims are brought	Particularly for insureds that interact with consumers	Generally resulted in better risk management
Line sizes and attachment points are being managed	Impacted by social media, populism and general anti-corporate feeling	Generally agents can manage claim frequency through risk profiling
Proportion of US exposed business are being monitored	Impact on non-US business not as clear	But claim severity is difficult to manage
Limiting Side C exposure	Line sizes and attachment points are being managed	Line sizes are being managed

Underwriting feedback

Appetite and Segmentation

Best* Practice

1. Evidence that underwriting has responded to trends (reacting to feedback loops with claims and reserving). For instance, increase in attachment points as a result of analysis of claims and other external trends;
2. Change in appetite is clearly set out for all underwriters within the team. Best examples showed regularly updated Underwriting Guidelines with commentary around risk appetite and how to respond to different types of risks; and
3. Real time dashboards used by management to track business written against appetite and segmentation targets.

General Findings

Some syndicates interviewed were less able to fully articulate how they were responding to specific trends and did not have any formally documented articulation of their appetite.

** "Best" practice on these slides refers to the best practice seen within the sample of Syndicates within the Study*

Underwriting feedback

Measuring Underwriting Performance

Best Practice

1. Use of multiple tools (such as AvE) to show impact of any actions to remediate or change make up of their portfolio;
2. Regular comparisons of historical loss ratios and planned loss ratios;
3. Regular formal reviews at Underwriting Committees or similar;
4. Consideration of performance against Reserving Philosophy both at case and portfolio level, for direct and delegated claims;
5. Developing the use of available quantitative claims data to oversee performance against expectations for reserve timeliness and accuracy in line with an articulated appetite for the same; and
6. Evidence to suggest consideration of case reserving practices where operating in both a lead and follow capacity. For example, some syndicates record and track instances where they recommend manual case reserves.

General Findings

A number of syndicates were unable to articulate how they measured success of underwriting actions and were limited by lack of appropriate data.

The way in which syndicates measured underwriting performance against underwriting actions was mixed. Lloyd's expectation would be that they establish a methodology through regular feedback with Reserving and Claims to account for estimating this impact in their Best Estimate figures.

Claims and Reserving feedback

Feedback Loops

Best Practice

1. **Key meetings** for each function (Underwriting, Claims and Reserving) are **attended by representatives from the others**, so that they are all kept up to date with trends and topics;
2. There is **open dialogue** when required between the three functions to discuss material claims and trends **outside of formal meetings**;
3. When presentations from or discussions with external subject matter experts take place, representatives from all three areas of the business **(Underwriting, Claims and Actuarial) are invited** and attend;
4. **All teams feedback** to the rest of the business at different stages of the reserving process;
5. **Formalised meetings** are scheduled regularly between the teams;
6. In addition to formal meetings, syndicates provided anecdotal evidence of **ad-hoc meetings** taking place between underwriting, claims and reserving as different issues arise
7. Use **of robust qualitative oversight tools** such as peer review, second set of eyes and audit (both internal and external), and ensuring any **learnings are fed back** into the business; and
8. Comprehensive **Case Reserve reporting packs for the Board**.

General Findings

The poorer examples based on our sample lacked a sufficient number of formal meetings between the different business areas, with heavy reliance on informal discussions and reliance on individuals to initiate these on an ad-hoc basis.

Claims and Reserving feedback

Emerging Trends

Best Practice

1. All three teams (Underwriting, Claims and Actuarial) contribute to work on emerging trends;
2. Formal presentations are given to the Board on a regular basis to highlight emerging trends along with their potential impact to the syndicate;
3. Clear evidence is available on how emerging trends are incorporated within the reserves
4. Identification and tracking of emerging risks clearly drives underwriting strategy, feeds into underwriting guidelines and pricing models as required;
5. There is clear ownership of the process to identify emerging trends;
6. Prompt response is taken to emerging trends, with a clear plan for actions;
7. Extensive use of external subject matter experts / information aids the identification of emerging trends;
8. Claims watchlists include details such as specific IBNR on multiple reserving bases or claims being ranked as high / medium / low risk and include movements over time to test the utility of the watchlist; and
9. There is controlled use of monitoring counsel intelligence for trends and commissioning of specific studies, emerging risk and horizon landscaping, with evidence of consumption and relevant application.

General Findings

There were some syndicates based on our sample that could only demonstrate the use of claims watchlists as the main way of monitoring emerging trends. There was also cases where communication to follow insurers could be improved.

Claims and Reserving feedback

Reserve Robustness

Best Practice

1. A history of generally stable or improving [ultimate loss ratios over time](#) or had taken effective significant action to address increasing loss ratios by performing deep dives and changing assumptions;
2. Quarterly processes to [validate robustness of previously selected ultimate claims](#), such as an actual versus expected analysis at an appropriate level of granularity and identification of emerging trends which get reflected in reserving assumptions in a timely manner;
3. Either had a best estimate surplus at class level versus the external signing actuary's estimate or used the signing actuary's estimate to help identify if any material issues had not been considered by the syndicate. [Material differences between the two estimates were discussed and understood by the Board](#);
4. Held [formal meetings during the reserving process](#) that allowed reserve selections to be appropriately [challenged by senior management](#) as well as other areas of the business; and
5. Consistent application of a clear timeliness and accuracy Case Reserving Philosophy [at all levels and by all service providers](#) (including third party claims administrators).

General Findings

There were syndicates based on our sample that had a general trend of increasing loss ratios, with very little evidence to suggest work was being done to understand and / or address this. In addition some syndicates had not appropriately considered material deficiency in the focus classes against the external actuarial view. Finally delegated authority reserving oversight has potential for improvement, as well as use of peer review as a tool for qualitative assessment.

Claims and Reserving feedback

Claims Inflation

Best Practice

1. **Explicit** consideration / allowances for claims inflation in reserves;
2. Assumptions on claims inflation are **regularly reviewed and validated** between claims, actuarial and underwriting;
3. Data and knowledge within the managing agent is supplemented by **external data sources**, including intelligence on developing or decided litigation outcomes which may set precedents;
4. **Sensitivity testing** of assumptions used to derive inflation rates is performed to identify the material assumptions that influence the estimated reserves; and
5. There is clear **feedback** between pricing and reserving leading to updates **to pricing models**.

General Findings

There were some syndicates based on our sample that did not consider claims inflation as part of the reserving process. This was either due to syndicates not believing they have the required data or due to syndicates assuming that inflation would be captured by rates charged for risks. Some others make implicit allowance for claims inflation which does not allow for appropriate challenge to the assumption.

Overall Summary of Findings

In general, comfort was gained on the processes employed by Syndicates and how they had been adapted for the issues facing the Casualty market

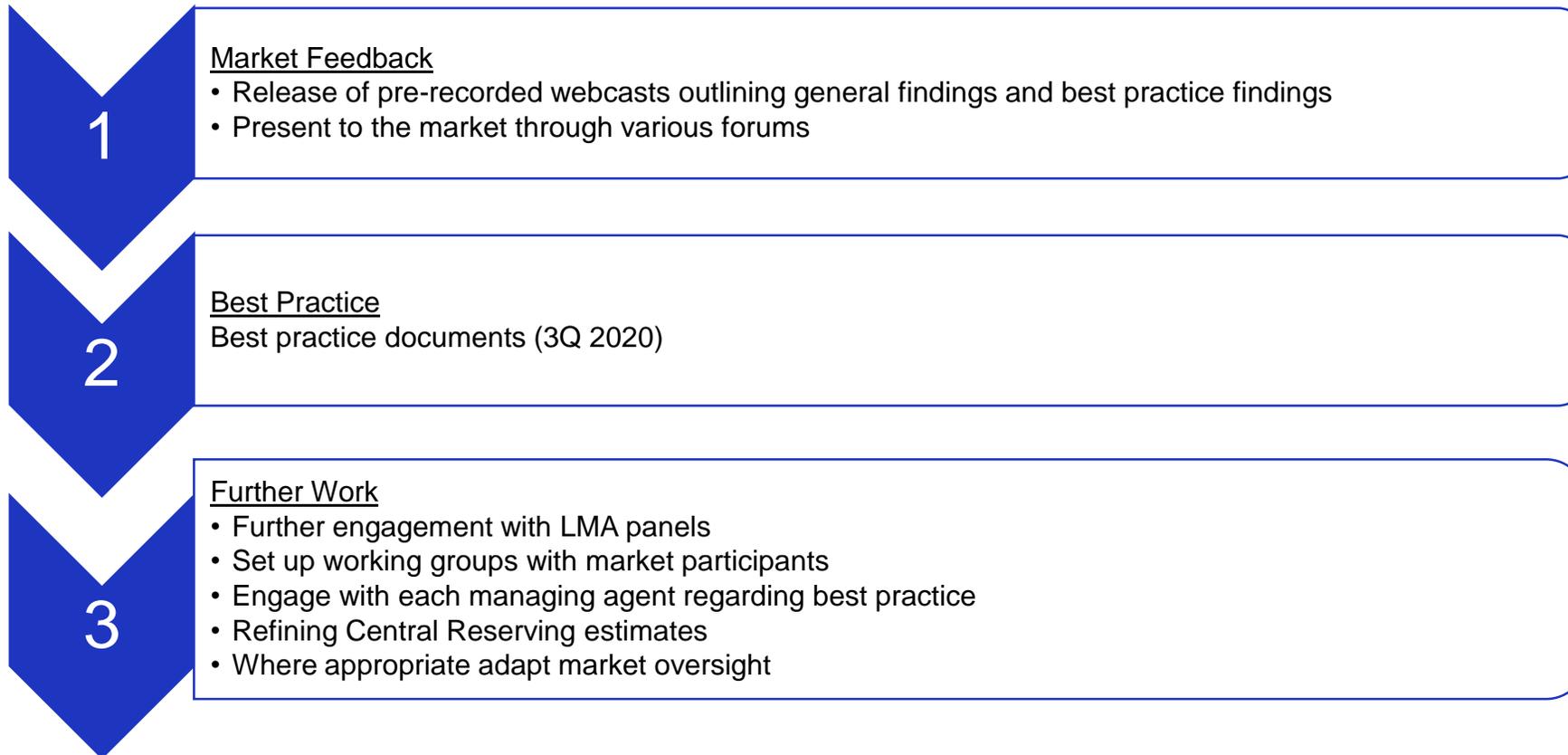
But...

...there was a wide range in process sophistication and adequacy

Next steps

Next steps for Lloyd's

Underwriting, MRC and Claims working together



Next steps for the Market

Expectation from Lloyd's is for...

Managing Agents to benchmark their current processes against study group's better practices, including those Managing Agents that in Lloyd's view are more appropriately adapted for the current challenges in the Casualty Market.

Questions?

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