19. (2.25 points)

For each situation below an insurer uses the reported development technique based on its historical accident year data to set reserves. For each situation:

i. Discuss the effect on estimated ultimate claims and
ii. Identify either an alternate technique or an adjustment to the reported development technique to improve the estimate, if necessary.

a. (0.75 point)

Mid-year the company institutes a new policy for setting case outstanding for open claims, in which case outstanding is set at policy limits.

b. (0.75 point)

The company had historically stable writings, but undertakes an advertising initiative in the second quarter and increases its premium volume written through the end of the year by 300%.

c. (0.75 point)

At the beginning of the year, the company began offering a general liability product covering losses in excess of its basic limits.

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QUESTION 19	
TOTAL POINT VALUE: 2.25	**LEARNING OBJECTIVE: B4, B5**

SAMPLE ANSWERS

Part a: 0.75 point

The increase in case outstanding will cause historical LDFs to be too high when applied to higher reported claims. Estimated Ultimate Claims would be overstated.

Acceptable answers for subpart ii:

- Berquist-Sherman
- Paid techniques
- Expected Claims Ratio (Expected Loss Ratio)

Part b: 0.75 point

The average accident date will shift to later in the year, causing the most recent year to be less mature than prior years at same evaluation point. Estimated Ultimate Claims would be understated.

Acceptable answers for subpart ii:

- Split data into accident quarters (or any other smaller interval than years)
- Expected Claims Ratio (Expected Loss Ratio)

Part c: 0.75 point

Accepted Answer 1
Excess product will develop slower, meaning the LDFs would be understated. Estimated Ultimate Claims would be understated.

Accepted Answer 2
Development Technique is ideal for high frequency, low severity lines; estimated ultimate claims would be volatile (highly leveraged, inaccurate) due to volatile (thin) excess losses.

Acceptable answers for subpart ii:

- Use industry (benchmark) data
- Adjust development pattern to account for slower development (apply new tail factor)
- Expected Claims Ratio (Expected Loss Ratio)

EXAMINER'S REPORT

The candidates were expected to state whether each situation caused the estimated ultimate to be overstated or understated, to explain why that was true, and an alternate technique or adjustment to improve the estimate.

Generally candidates did very well on part a, but struggled with parts b and c.

Common mistakes included:

- Simply saying that the ultimate would be distorted (instead of over or understated)
- Neglecting to answer all parts of the question, especially for part c

This question was challenging, and required the candidates to synthesize knowledge across multiple components of the syllabus. Candidates who clearly had a solid understanding of the reported development technique scored well.

Part a

Candidates needed to know that the estimate would be overstated because of the reserve strengthening or because historical LDFs would be overstated due to the increased reported claims

Most candidates were able to correctly identify another technique to improve estimated claims. The most common mistake was to argue that the case reserves would be decreased and thus the estimated ultimate would be understated. This answer was not accepted because it is unreasonable to assume the company had been setting reserves above policy limits prior to the change.

Part b

Candidates needed to know that the estimate would be understated because the average accident date shifted to later in the year.

Most candidates knew that splitting up the data into quarters would improve the estimate. The most common mistake was to argue that the estimated ultimate would increase proportionately as premium/exposure increased, which would produce an accurate estimated ultimate. This neglects the fact that a rapid increase in writings will cause the average accident date to shift and understate the ultimate.

Part c

Candidates needed to know that the estimate would be understated because of the slower developing excess product or that excess data is volatile which could cause a highly leveraged ultimate estimate.

Common mistakes included:

- Arguing that excess losses develop differently from basic losses rather than specifying that they develop slower.
- Mentioning that the excess data should be analyzed separately without specifying an alternate technique was identified to analyze the new excess losses.
- Some candidates said to apply an ILF or excess loss provision on top of the basic limits without identifying a specific technique to analyze the excess.