23. (1.5 points)

An insurance company recently implemented a new initiative to prioritize the settlement of smaller claims. This initiative has resulted in faster settlement of smaller claims.

a. (1 point)

Discuss why it may not be appropriate for this company to use the following techniques to estimate ultimate claims:

i. Paid Development Technique
ii. Reported Development Technique

b. (0.5 point)

Discuss how to adjust one of the development techniques above to make it appropriate for this company.

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QUESTION: 23

TOTAL POINT VALUE: 1.5

LEARNING OBJECTIVE(S): B4 / B5

SAMPLE/ACCEPTED ANSWERS:

Part a: 1 point

Paid Development Technique

Sample 1:

Since there has been a change in the rate claims are being settled, this would result in an inaccurate estimate. CDFs would change due to the settlement rate changes so the historical factors would not be appropriate.

Sample 2:

Paid development method assumes no change in claim settlement process, therefore it's not appropriate to apply old LDF to recent paid claims.

Sample 3:

If smaller claims settle faster, this may result in lower total paid claims at early maturities as larger claims are settled last. This change in settlement pattern won't be reflected in historic link ratios and the selected ultimate may prove too low.

Sample 4:

If large claims are being settled just as they were before, then using the paid claims technique will overestimate claims as the company now has a higher % of ultimate claims paid earlier.

Sample 5:

We will be seeing changes in the amount of paid claims at each maturity. May increase at early maturities if we are settling a lot of small claims early or may decrease at early maturities if we are taking longer to settle large claims as a result of prioritizing the small ones. Either way, the development pattern for the future isn't the same as the development pattern in the past so old LDFs won't be appropriate and will cause distortions.

Reported Development Technique

Sample 1:

If the claims department is focused on small claims, large claims may develop more than in the past because they are being given less attention. The reported technique would understate claims then.

Sample 2:

If the smaller claims were settled at the case o/s amount then this would not be affected.

Sample 3:

If the reserves were not perfectly adequate, the closing of small claims early may affect the reported pattern. For example, if case reserves put up on the small claims was historically redundant, closing them earlier reduces the reported at early dates. This would lead to an underestimate as low reported to date multiplied by too low historical LDFs.

Part b: 0.5 point

Sample 1:

Look at triangles by size of loss and use BS paid adjustments to restate historical at current settlement rates.

Sample 2:

Track small claims separately from large claims and perform the Berquist Sherman adjustment on each to reflect new settlement patterns in large vs. small claims.

EXAMINER'S REPORT:

General Commentary

Candidate performance on this question was mixed, with candidates scoring well on part a., but struggling on part b.

Part a

Paid Development: The candidate was expected to recognize that the payment pattern determined from the historical data would no longer be applicable to the data after the change in settlement rates. Candidates generally did a good job in recognizing the change in pattern. A common mistake was simply stating that the method would overstate or understate the estimate with no reason why the method was not appropriate.

Reported Development: The candidate was expected to recognize that the change in settlement pattern could impact the reporting pattern and therefore the reported development technique. Various answers were accepted describing situations where the method would be appropriate or would not be appropriate. Common mistakes included:

- Interpreting larger average case reserves for a change in case adequacy. For example, if average case reserves are higher simply because only large claims remain open, this does not indicate that case reserve adequacy has changed or the reported development technique would not be applicable.

- Discussing only the settlement or closure pattern and not discussing the impact on the reporting pattern.

Part b

The candidate was expected to recognize that the Berquist Sherman adjustment would not work in this case. An assumption of the Berquist Sherman adjustment is that paid dollars are proportional to closed claim counts. When there is a shift in settlement by size of claim, this assumption will no longer hold. The paid BS adjustment can exacerbate the misstatement of the technique if paid dollars are not proportional to paid counts. The case outstanding BS adjustment could similarly exacerbate the misstatement if an increase in average case reserves due simply to a different mix of open claims by size was interpreted as a change in case reserving practices. A common mistake was stating that the paid or case outstanding Berquist Sherman adjustment should be applied without recognizing this pitfall.

Another common mistake was to suggest using a different reserving technique, such as the expected loss method. The question did not ask for another technique, but rather asked how to adjust one of the development methods.