The Beat Goes On, and On, and On and On…. Thoughts on Reserving for Long-Tailed Lines

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Agenda for this Session

1. Introduction

2. Overview of Issues in Reserving for Long-Tailed Lines

3. Two Specific Examples
   1. Workers Compensation
   2. Asbestos & Environmental

4. Emerging Practices

5. Summary
Key Issues/Considerations

- Latency/Late Reporting
- Inflation
- Medical Technology/Costs
- Longevity
- Judicial Interpretation
- Litigation
Workers Compensation – The Basics

• No-Fault coverage for work-related injuries or illnesses

• Mandatory for ALL employers in the US, either through purchase of insurance or self-insurance

• Three major types of benefits
  • Medical
  • Lost Income (Disability)
  • Death (Survivor benefits)
Disability Benefits

- Workers Compensation Board determines whether:
  - Temporary total disability
  - Permanent total disability
  - Permanent partial disability

- Total disability benefits
  - Calculated as a % of individuals wage, or state’s avg. wage
  - Adjusted for inflation

- Permanent partial – scheduled benefit
Survivor Benefits

- Cover:
  - Burial costs
  - Benefits to surviving spouse and dependent children
Significant Potential for Fraud

• Why:
  • Workers compensation benefits are tax-free
  • Significantly higher than comparable health benefits for same injury

• Many companies have fraud detection units
  • Is the individual truly disabled?
  • Was the accident work-related?
Economic Conditions Affect Claims

- Return to work programs are effective
  - Employer “cares” and wants injured worker to get better
  - Injured worker feels productive and “engaged”
  - But, light duty jobs are not available in tough economic times

- Layoffs affect claims reporting, particularly for soft tissue
  - Beforehand, worker is reluctant to report
  - Following layoff announcement, claims “surge”
Reserving Characteristics

- Claims can “move” between types of disability
- Most claims close within 7 years
- A few claims (lifetime benefits) are significantly longer
  - Must consider both indemnity and medical costs
  - Typical payout can be 60+ years (and getting longer)
- Many companies offer structured settlements
- Medical is a HUGE portion of these claims
Typical Reserving Practices

• Apply multiple reserving methodologies
  • Development Methods
  • Bornhuetter-Ferguson Methods

• Where credible, segregate indemnity from medical
  • Indemnity claims are fairly well-behaved
  • Medical advances (and inflation) play havoc on development

• Capture as much data as possible in development triangles
  • Standard casualty lines – 10 years
  • Workers Compensation – 25+ years
Complexities - Data

- Never enough data - What to do about “tail”
  - Modest differences in the “tail estimate” can be significant
  - Current practice
    - Many companies use curve fitting techniques
    - Others capture calendar year activity and incomplete triangles
  - Emerging practice
    - If # of claims is relatively small, focus on individual claim details
    - Such analysis can provide insight on potential aggregate claim emergence
Complexities - Inflation

• Impact of changes in inflation are evident in triangles

• Typically, different inflationary effects for medical vs. indemnity

• Needs to be considered either explicitly or implicitly

• Example:
  
  • Today’s relatively low inflation rate means modest changes
  
  • BUT, if high inflationary period is expected, is observed development appropriate?
Complexities – Medical Costs

• Medical inflation is typically 10%+, driven by:
  • Medical advances
  • Prescription drugs
  • Long-term care

• Consider:
  • MRIs were not available 20 years ago, now standard
  • Escalation of opiate use / cost of drugs
  • Change in life conditions that necessitate change in care
    (parents die or are unable to care for injured child)
Asbestos

• Fibrous mineral – strong, durable & resistant to heat/fire
• “Miracle” product – used extensively
• Signature disease (mesothelioma) – linked to exposure
• Ceased being used in new products beginning in late 1970's
• BUT, extremely long (30+ years) latency
• Asbestos-related losses could top $85 billion (US only)
The Litigation “Wave”

• Manufacturers of asbestos were the first-hit
  • Johns-Manville corporation – 1982 Bankruptcy
  • Virtually all manufacturers are now bankrupt

• The Next Wave – Companies that used asbestos
  • Joint & Several liability
  • A “gold mine” for plaintiff's attorneys – surge in # of claimants

• An even wider net
  • Beyond products to premises/operations coverages
### An End in Sight?

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US $, IN BILLIONS
Complexities

• Which policies respond?

• Impact of “joint and several” – last one standing

• Longevity of those exposed (avg 1950’s worker is now 80+)

• Impact of loss mitigation efforts

• Costs of litigation – ALAE is a significant part of ultimate cost
Typical Reserving Methodologies

• Early on, anchoring to industry aggregate estimates
  • Claim detail sparse; policy information not readily available
  • % of market

• Survival ratio
  • 10 – 14 times calendar year payments
  • Implicit discounting of reserves

• Better practice - detailed policyholder reviews
  • Difficult for excess coverage (data not easily available)

• Discontinued programs
Environmental Liability

- Uncertainties regarding coverage
  - Companies attempted to modify policy language to exclude – “sudden and accidental”
  - Judicial interpretation varied by state but generally expanded coverage

- Similar issues to asbestos
  - Multiple policy years involved
  - Insurers had differing strategies for claim handling
  - Litigate or settle”
Let’s Celebrate!

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