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FOCUS

RESERVING MAJOR AND COMPLEX CLAIMS

Setting an accurate and efficient reserve in a timely manner is one of the most important elements of the loss adjustment process, particularly when the financial exposure to the loss directly impacts your company's financial results.

Reserving is one of the most challenging aspect of a Loss Adjuster's role, and one that is vital to get right as the consequences of not doing so run far and deep. As Stephen Thorpe, Managing Director – Asia Pacific Region, Integra Technical Services explains "reserving too low causes challenges with internal reporting and audit teams, it can lead to a 'defending a reserve' mentality; too high and Insurers are tying up capital unnecessarily; and frequent reserve movements or 'step reserving' can erode confidence in the claims management process."

Claims reserving is brought to the fore by the fact that many Insurers now have 'Claims Promises' which require them to pay 50% of a Property Damage reserve within seven days of the Loss Adjuster recommendation. This extra dimension has implications for the Insured's claims management experience. Setting the reserve too low could affect the Insured's cash flow, too high and it could excessively raise expectations as to the amount to be recovered from Insurers.

Whilst each Insurer and Reinsurer will have its own reserving philosophy, ultimately Stephen suggests "sourcing quality and relevant information is important but it is how the Loss Adjuster applies his or her experience and knowledge to the analysis of that information that is the key determinant to producing a cogent and understandable reserve or range of reserves."

When they articulate the reserve, the Loss Adjuster should go to great lengths to explain the assumptions they've relied upon to calculate the reserve or range of reserves. This helps the Insurers and Reinsurers determine how much certainty they have about each of the assumptions. Thereafter, it's important to understand the variable element to each of the assumptions i.e. commodity pricing, production efficiency, etc.

A challenge for the global Loss Adjusting community is to simplify the language they use to describe the financial exposure. In discussions with our Insurer and Reinsurer clients, it appears that there are numerous terms used to describe what historically has been titled 'reserve' i.e. Provisional Exposure, Potential Exposure, Loss Estimate, Financial Exposure, Preliminary Reserve, etc.

The key ingredients to better loss reserving analysis

Information
As with any aspect of the adjustment process the importance of good information cannot be stressed enough.

Industry
Knowledge of processes and operations can be particularly important in sectors where consideration must be given to the ability to make up lost production during the indemnity period, such as in Mining, Oil or Gas Processing.

Implications
With certain types of peril, say earthquake or flood, then the full extent of the damage may not be immediately apparent, the time taken to get rebuilding permits can be longer than expected and extra cost of reinstatement provisions are usually quite onerous. All these aspects can put upward pressure on the reserve.

Factors
The Loss Adjuster should be able to set out clearly what the main drivers of the quantum of the claim are (Property Damage or Business Interruption),the variables and, importantly, risk factors to the ultimate reserve recommendation.

Impacts
How the Policy coverage and specific clauses will affect the insured loss, for example Sub-Limits or Average.

Experience
Awareness of disaster management and recovery processes and the likelihood of success of the different options.

Stakeholders
Understanding that there might be reasons why some parties want to keep the reserve low, for example during renewal negotiations. The Loss Adjuster must make an impartial recommendation – others will set the ultimate reserve.