



Guernsey Financial
Services Commission

Insurance Reserving

Thematic Review 2024



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1. Executive Summary

This Thematic Review assessed the suitability of reserving methodology and practices in place at general insurance firms across the industry. It covers both known open claims and Incurred But Not Reported (IBNR) claims. A representative sample of 20 insurers was selected.

The rationale for focusing on reserving is that insurance liabilities are foundational to an insurer's capital position, financial strength and solvency, and therefore it is critical that these are captured and measured as accurately as possible. High quality policies and procedures are more likely to result in more accurate reserves estimates. This is of particular concern following a recent bout of economic and claims inflation, in which claims costs have increased rapidly.

A further driver for the Thematic is that the International Association of Insurance Supervisors (IAIS) Insurance Core Principle (ICP) 8.1.3 states that an insurer's risk management system should cover reserving. ICP 8.6.4 further explains that the actuarial function should include advice on an insurer's insurance liabilities, including policy provisions and aggregate claim liabilities. Section 24 of the Principles covers macroprudential supervision, with section 24.2.4 noting that 'The supervisor should conduct horizontal reviews to reveal the range of practices among insurers relevant to a common subject (for example, the assessment of the appropriateness of insurers' assumptions used for reserving). A horizontal review may help to determine which insurers are outliers, and as such provides the supervisor with a reference for potential further actions.'

The scope of reserving methodology and practices reviewed as part of this thematic was restricted to a review of, as it relates to reserves, staffing and resources; policies and procedures; oversight and controls; and reporting to boards and/or committees. The presence of deficiencies in any of these areas heightens the risk that calculated reserves may be inaccurate. However, a technical review of the reserving methodology, as well as an assessment of the appropriateness of that methodology, was out of scope for this thematic. Moreover, the final calculated reserve values, including consideration of the accounting regime under which the reserve was calculated, was also out of scope.

The thematic identified a number of good practices within industry. The nature and sophistication of approaches varied with the size and complexity of the firm, as expected. Most firms are well structured and are supported by knowledgeable and experienced staff members and systems. In general, reserving methodology met expectations, with strategic policies and controls in place with regard to both the setting of the initial reserves, and also the reserve updating function in the life of the claims file. There was evidence of some firms tailoring their approaches to the particular type of policy.

There were, however, some areas that firms should consider as part of their governance of claims reserves, including:

- Ensure that there is sufficient oversight of fronting insurers and outsourced claims functions. For example, suitably detailed service level agreements should be in place.
- Ensure that case reserves are regularly reviewed and updated, as appropriate, to reflect emerging experience. This includes cases where reserves are provided by third parties and, in the case of reinsurers, fronting companies.
- Reserving policies should be kept up to date and consider the impact of inflation over time. Revisions should be evidenced appropriately.
- Consider whether reserving procedures and controls should be tailored to the individual policy type, where these are notably distinct.

A detailed self-assurance checklist is included as an Appendix at the end of the report, to assist Boards in ensuring best practice is being followed in this area.

2. Terminology

For the purposes of this report,

- “Insurance Business Law” means the Insurance Business (Bailiwick of Guernsey) Law, 2002
- “Insurance Solvency Rules” means the Insurance Business (Solvency) Rules and Guidance, 2021
- “Firm” and “insurer” means firms licensed under the Insurance Business Law.
- “Insurer” includes reinsurer when buying reinsurance.

3. Scope

A sample of 20 firms was chosen out of the general insurers’ population for the Thematic Review. This sample population consisted of a mix of insurers and reinsurers in the commercial, retail and captive spaces, representing 19% of total claim reserves. The sample was focused on complex or volatile policy types, rather than those with a very short tail, e.g. claims which are settled immediately and for which minimal or no reserves are established.

The majority of the sample were managed insurers, utilising the expertise of Guernsey’s insurance industry to administer the insurance company. As such, many of the smaller or less complex insurers utilise the standardised policies, procedures and controls of the insurance manager. The sample was selected to ensure that the firms chosen were managed by a representative mix of insurance managers.

4. Current Responsibilities of Licensees

The key responsibilities of licensed insurers in respect of reserving and associated governance are set out in the Insurance Business Law and the rules, codes and guidance published under that law. These can be summarised as follows:

- A licensed insurer must maintain reserve risk capital equal to the sum of reserve risk capital for each line of business, less a diversification adjustment.¹
- A licensed insurer’s board is required to set and oversee the implementation of the insurer’s business objectives and strategies for achieving those objectives, including its risk strategy and risk appetite, in line with the insurer’s long-term interests and viability.²
- A licensed insurer’s board is required to provide oversight in respect of the design and implementation of sound risk management and internal control systems and functions.³
- A licensed insurer is required to establish, and operate within, effective systems of risk management and internal controls.⁴

¹ See section 4.2.14 of the Insurance Solvency Rules.

² See Principle A:1 to the Finance Sector Code of Corporate Governance.

³ See Principle A:9 to the Finance Sector Code of Corporate Governance.

⁴ See Principle A:10 to the Finance Sector Code of Corporate Governance.

- A licensed insurer is required to have an effective risk management function capable of assisting the insurer to identify, assess, monitor, manage and report on its key risks in a timely way.⁵
- A licensed insurer is required to have, or to have access to, an appropriate and effective internal audit function capable of providing the board of the insurer with independent assurance in respect of the insurer's governance, including its risk management and internal controls.⁶
- A licensed insurer's board should carry out an annual review of the effectiveness of its corporate governance and internal controls.⁷

Reserve risk is defined in the Insurance Solvency Rules as being the risk that the value of claim settlements will be greater than the value of claim provisions.

5. Approach

The Thematic Review consisted of five stages:

- 20 licensed insurers representing different policy areas and insurance managers were selected from a population of approximately 350 insurers, by examining the policies written and levels of reserves held against those policies reported in the most recent annual return, identifying those policy types which may experience the largest volatility in claims over their life, complexity in setting reserves, or where poor reserving would pose a threat to retail customers. Where there was a large range of policy types offered by an insurer, the review focused on a small selection of the policies which presented the most significant reserving risk.
- A questionnaire was sent to the 20 selected insurers seeking responses in several areas relating to their claims handling, policies and procedures, oversight and controls, and reporting. The responses to the questionnaire are covered in section 6 of this report.
- An initial review of the documentation supplied by the firms was performed. This included evaluating the completeness and accuracy of both the quantitative and qualitative information submitted via the questionnaire.
- The Thematic Review Team selected a sub-sample of five insurers. This sub-sample included some of the more complex insurers, and covered four different insurance managers, as well as a local non-managed insurer, so that a range of companies' procedures were assessed. With the assistance of an external consultant, onsite/in-person interviews were conducted to confirm that the written policies are adhered to in practice, observe systems in action and obtain further clarification where there were any gaps in the documentation received.
- The framework developed by the external consultant was logical and straightforward to follow (i.e. documenting each entity's responses to the questionnaire and assessing whether any risk or issue was identified, together with any recommendations). It was therefore applied to the remaining 15 insurers in the form of an offsite desktop review.

The following pages, based on the Commission's analysis, summarise how firms are managing their insurance reserving framework.

⁵ See Principle A:12 to the Finance Sector Code of Corporate Governance.

⁶ See Principle A:15 to the Finance Sector Code of Corporate Governance.

⁷ See Principle A:17 to the Finance Sector Code of Corporate Governance.

6. Key Findings: External Questionnaire

In this section, we examine the responses by firms to the questionnaire. Areas of good practice, or those which should be considered, are highlighted throughout.

6.1 Claims Handling

In this section the focus was on the staffing and resources available to the claims handling function, as well as the controls in place and the training provided to handlers on reserving of claims. This is important as claims handlers may be involved in the setting of initial reserves, and the data they provide feeds into the models used by actuaries and others.



GOOD PRACTICE:

Overall, the firms' staffing and resources for insurance reserves are adequate. Most firms have written authorities in place with appropriate values and limitations for those staff who are able to commit to a settlement decision or payment. One firm issues to each counterparty carrying claims authority a Claims Handling Authority letter, setting out the authority limits that apply to the handler for handling and settling claims. Generally, there were written agreements in place with claims staff for claims handling, with service level agreements and key performance indicators to ensure a minimum service level is maintained. Training is generally provided to claims handlers and regularly updated.



AREAS TO CONSIDER:

Where firms act as reinsurers for fronting companies, they should ensure they exercise adequate oversight over the fronting entity. This could, for example, take the form of an appropriately detailed service level agreement (including training). Similarly, having a comprehensive service level agreement in place for external claims handlers is a useful control. Moreover, the claims handling process should form part of ongoing compliance monitoring.

6.2 Policies and Procedures

This part looked at the reserving process itself, including the policy for large reserves, IBNR and monitoring the adequacy of aggregate and individual reserves. This was the main key thrust of the Thematic, as noted in the Executive Summary.



GOOD PRACTICE:

The processes in place for monitoring the level of reserves were observed to be adequate for the sample selected. The majority of firms utilise an actuarial resource, either internal or independent. It is accepted that this is more relevant for larger, more complex policies. Those firms that are part of a larger group have access to additional assessments and reviews by other teams. The firms generally have adequate

reserving policies in place. There are clear processes for setting reserves and these are reviewed regularly (e.g., monthly or quarterly as appropriate) either independently or internally.

Large loss reserves are generally escalated to an appropriate level of seniority. Some firms produce separate large loss reports, which may include commentary on movements in reserves for particular claims. One firm promptly notifies key members of staff of large losses incurred.

The observed controls for the management of liquidity and capital positions are adequate. Liquidity is generally monitored regularly (daily/monthly). Some firms produce both best estimate and worst-case scenario estimates, as well as sensitivity modelling. Capital is routinely monitored, albeit less frequently than liquidity, and reviewed in the event of large claims.

For IBNR reserving, firms have adopted a range of approaches, often appointing actuaries where this is required, or this is felt appropriate. Other firms have implemented a simplified method, such as a multiple of claims paid and payable, which may be tailored to the type and age of the policy. Where firms have no IBNR reserve in place, this is due to the nature of the business whereby claims are notified promptly, so any IBNR amount would be immaterial.

In order to monitor the adequacy of reserves, firms utilise varying methods (such as loss ratios and actuarial estimates) depending on the nature and volume of policies written. Reserves are generally monitored at Board level.



AREAS TO CONSIDER:

Where standard initial reserves are in place for particular classes of business (e.g. a set amount pending further specific claims information), these should be regularly reviewed and updated, if appropriate, to take into account inflation. Reserving policies should be suitably comprehensive, covering, for example, information on how reserves are set, what degree of challenge there is, referral limits, large loss/catastrophic reserve procedures, the process for managing reserve movements, how reserves are reported to reinsurers (i.e., logged, approved and tracked); and how reserves feed into liquidity and capital monitoring.

The use of reinsurance (even if 100%) does not remove the need for claim reserves including IBNR; reinsurance is not a guaranteed ‘magic bullet’ and carries risks such as credit and liquidity. Hence the reserve and reinsurance recovery should be shown gross and not netted against each other.

6.3 Oversight and Controls

Here we considered the compliance programme in place over claims handling, as well as risk mitigation and root cause analysis of any issues identified. This is important as the claims data feeds into the reserves figures, as noted in 6.1, as well as from a conduct perspective (albeit this was not the primary focus of the Thematic).



GOOD PRACTICE:

Overall, the firms' controls in ensuring claims compliance are adequate. These included, for example, review and approval of reserving and IBNR methods, claims reserves and insurance claims by the board and/or underwriting committee, or a detailed claims protocol being in place with the reinsurer(s). In terms of identifying risks with particular claims, one firm operated a flag system whereby a green, yellow or red 'flag' is raised against a claim depending on the location of the loss, or due to any sanctions/financial crime issues identified.



AREA TO CONSIDER:

Where claims functions are outsourced, the strategic oversight thereof should be documented adequately.

6.4 Reporting

This section considered the level of reporting provided to boards and committees regarding reserving. It is essential that sufficient appropriate data is provided to those charged with oversight on a suitably regular basis so that good decisions can be made.



GOOD PRACTICE:

Overall, the firms' controls over the reporting of insurance reserves are adequate. Reserving is discussed at Board level at all the firms surveyed, as well as in underwriting committees where applicable. The minutes of these meetings generally provided evidence of thorough discussion of the relevant issues and sufficient management information being provided. Some firms have specific meetings focused solely on reserving, which provides good evidence of adequate attention being directed towards this area.

7. Conclusion

The standard of general insurance reserving policies and procedures within the firms sampled was generally adequate. Staff members tend to be knowledgeable and experienced, and the systems are appropriate to support the level of complexity of the organisation in question. There are suitable policies and controls in place in respect of the setting of initial reserves, and also ongoing updates.

There were, however, some areas that firms should consider as part of their governance of claims reserves, including:

- Ensure that there is sufficient oversight of fronting insurers and outsourced claims functions. For example, suitably detailed service level agreements should be in place.

- Ensure that case reserves are regularly reviewed and updated, as appropriate, to reflect emerging experience. This includes cases where reserves are provided by third parties and, in the case of reinsurers, fronting companies.
- Reserving policies should be kept up to date and consider the impact of inflation over time. Revisions should be evidenced appropriately.
- Assess whether reserving procedures and controls should be tailored to the individual policy type, where these are notably distinct.

There follows a detailed self-assurance checklist as an Appendix, which Boards and firms are encouraged to consider carefully in order to ensure best practice is being followed in this area.

8. Appendix: Self-Assurance Questions

| No. | Question |
|-----|--|
| 1 | Are written authorities in place with appropriate values and limitations (which take into account key considerations such as the knowledge and experience of the individual) for all those claims staff who are able to commit to a settlement decision or payment? |
| 2 | Is initial and ongoing training provided to claims handlers regarding the reserving of claims? |
| 3 | Does the reserving policy cover: <ul style="list-style-type: none">• Large loss/catastrophic reserve procedures?• Reserving movements?• Reporting to reinsurers?• Approvals?• Tracking?• IBNR?• Monitoring the adequacy of aggregate and individual reserves?• Independent review (eg internal/external audit)? |
| 4 | Is there a suitable compliance resource and framework in place for reviewing and monitoring claims handling? |
| 5 | How do we ensure that both in-house teams and third party administrative staff handling claims are aware of, understand and are following specific claims handling guidance and service level agreements? |
| 6 | Where risks are identified with claims, how do we maintain oversight of them? |
| 7 | Where issues are identified with claim processes, what process do we adopt to understand and rectify the root cause? |
| 8 | Is claims management information being presented to the appropriate committee and/or the Board? |
| 9 | Is an appropriate level of reporting on reserving being presented to committees and at Board level? |