



## New Swiss Re *sigma* study: Non-life reserving: improving on a strategic challenge

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**Zurich, 28 May 2008 – Swiss Re’s latest *sigma* study focuses on how the insurance sector can improve its non-life reserving practices. In addition to explaining reserving methodologies, the study suggests that improvements in reserving will be beneficial for the industry as well as its clients and shareholders.**

Claims reserves (or provisions) are funds that are set aside for claims that have not yet been paid. Because claims reserves are often bigger than an insurer’s equity, changes in reserves can heavily impact an insurer’s profits.

According to Swiss Re’s latest *sigma* study, “Non-life claims reserving: improving on a strategic challenge”, claims reserves are particularly important for “long-tail” lines of business, where the identification and settlement of claims can take a long time. In liability, claims reserves on the balance sheet typically represent 300% to 450% of premiums earned in any one year.

“Insurers are increasingly recognising that they have to pay more attention to reserving” explains Rudolf Enz, the author of the study. “Shareholders are becoming more reluctant to accept that blocks of business originally identified as being reasonably profitable could instead trigger substantial losses. At the very least, they want to understand when and why such revisions take place.”

### **Factors that lead to reserving errors**

While insurers use well-tested actuarial approaches to determine reserves, even the best reserving methods will always be subject to adjustments – as the nature of risks and the resulting claims are subject to unforeseen events and other factors, such as technological and legal developments, medical progress and changing attitudes in society and legal developments .

Many of the reserving errors in the past occurred due to factors that were beyond the control of the insurers. Unexpected legal developments have cost insurers billions of USD.

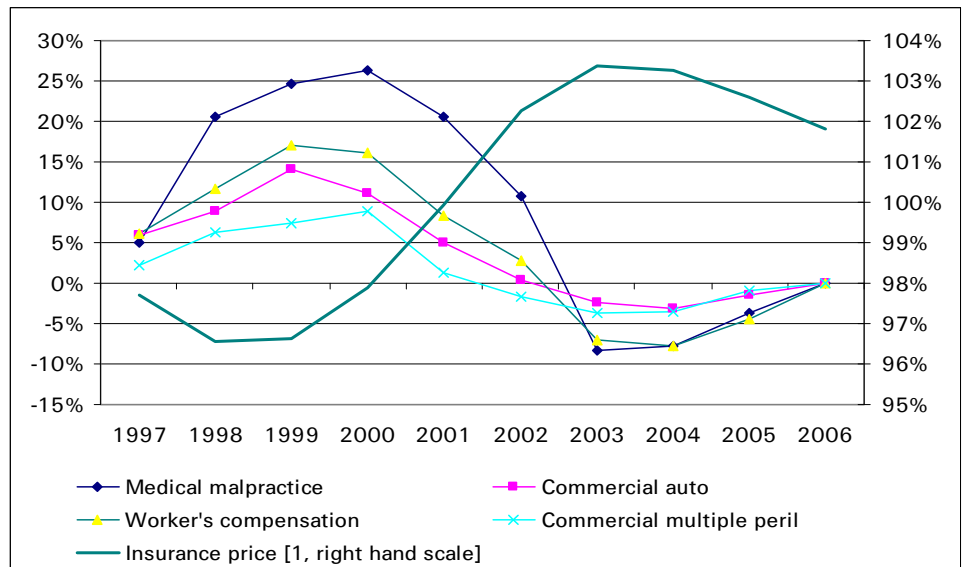
The US asbestos and liability crisis, which led to dramatic reserve adjustments in the 80s, is a prominent example.

The escalation of health and wage costs, coupled with increasing life expectancy, has also had an adverse impact on claims. Although some of the developments may have come as a surprise, others were expected and reserving practices may not have been adapted sufficiently.

**Reserve changes are also tied to the insurance price cycle**

The sigma study also describes how under and over-reserving is tied to the insurance price cycle. The data suggests that low pricing and under-reserving are interrelated.

**Reserve changes in US long-tail lines of business from initial to 2006 estimates, by accident year**



[1] Price for US average commercial insurance, source Goldman Sachs, 1995 basis  
Source: Best's Aggregates & Averages, Property/Casualty, 2007 edition

**Why improved reserving is important**

Rudolf Enz points out that “initial claims estimates will never be perfect forecasts of final claims paid because it is virtually impossible to predict with certainty the factors that could adversely impact long-tail insurance business. Nevertheless, insurers might substantially improve their reserving practices by factoring in the effects of the insurance cycle and by better reflecting trends, such as increasing wages, health costs and life expectancy.”

Better reserving is supported by the trend towards more transparency, which is strongly supported by changes in accounting standards and regulatory rules. According to Rudolf Enz, "policyholders benefit because adequate reserves help insurers avoid the risk of insolvency. Moreover, shareholders benefit because transparent and adequate reserving will help to promote rational pricing and this in turn will lead to more stable and most probably also more profitable insurance results."

### Notes for editors

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#### How to order this *sigma* study:

The English, German, French, Italian and Spanish versions of the *sigma* study No 2/2008, "Non-life reserving: improving on a strategic challenge" are available electronically on Swiss Re's website: [www.swissre.com/sigma](http://www.swissre.com/sigma). The versions in Chinese and Japanese will appear in the near future.

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