

Cologne Commutations Rendez-vous 2010

# Fair valuation of liabilities for exit solutions and commutations

Nick Watford and Mark Lawson  
March 2010

# Agenda

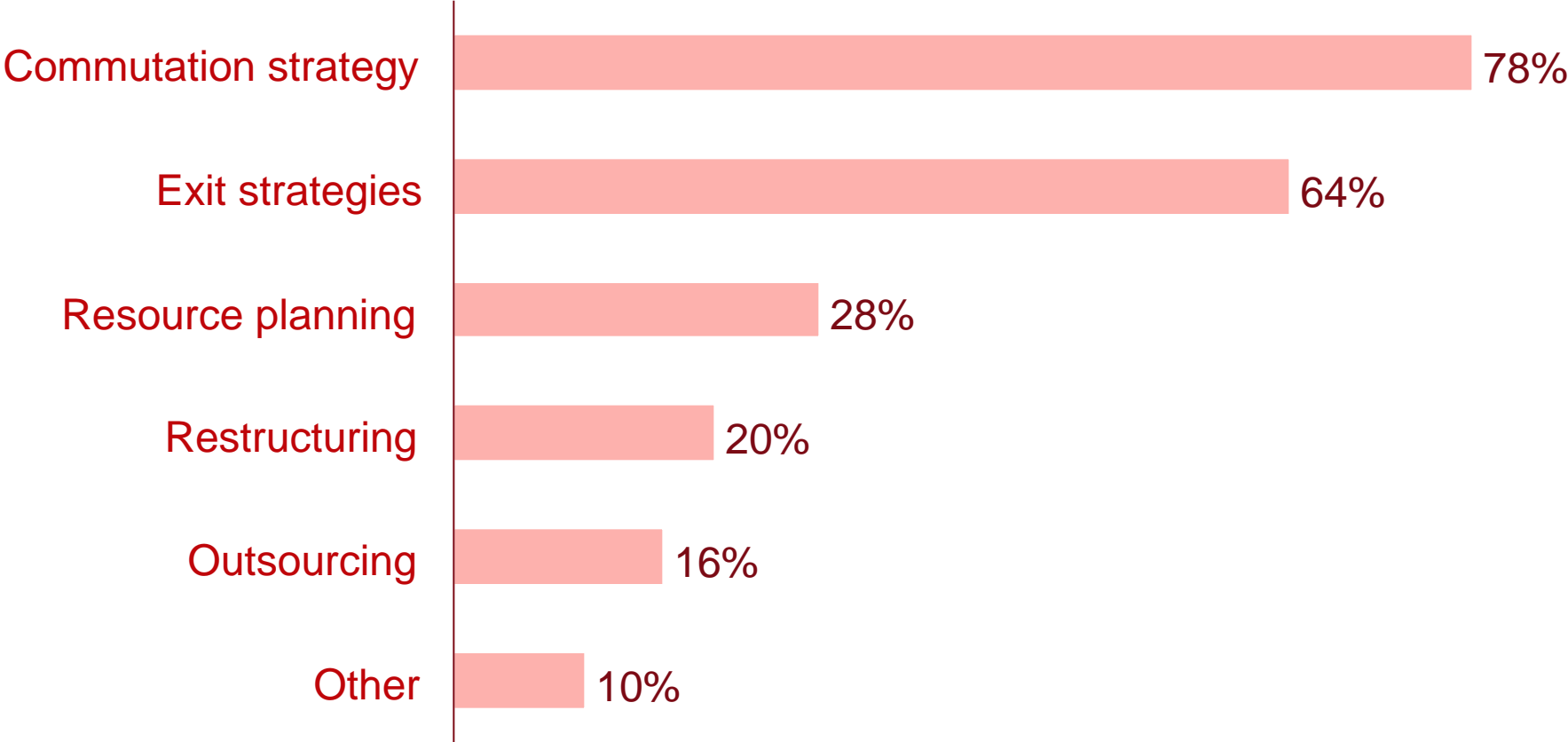
- Introduction
- Why is valuation important?
  - European run-off plans
  - The run-off toolkit
- Valuation approaches
  - Insured level vs aggregate level
  - Direct vs reinsurance
- Uncertainty in the valuation process

# Key messages



Valuation underpins the run-off toolkit

# Key features of European run-off plans



Source  
PricewaterhouseCoopers LLP

# The run-off toolkit

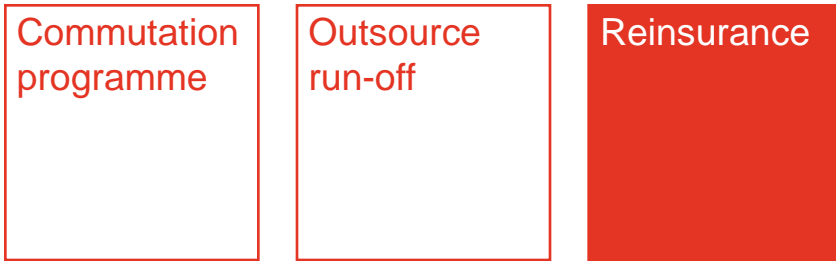
Commutation  
programme

# The run-off toolkit

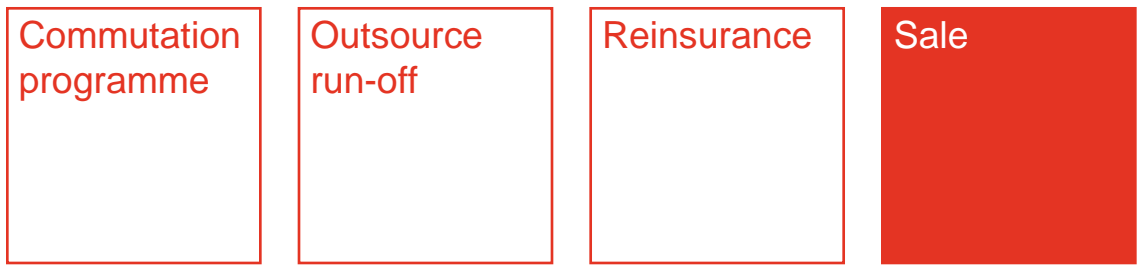
Commutation  
programme

Outsource  
run-off

# The run-off toolkit



# The run-off toolkit



# The run-off toolkit



# The run-off toolkit



# The run-off toolkit

Commutation  
programme

Outsource  
run-off

Reinsurance

Sale

Business  
transfer

Solvent  
scheme

“ The most valuable commodity  
I know of is information ”

Gordon Gekko  
Wall Street (1987)

# Importance of data availability

- Increased data volume and quality provides:
  - Flexibility regarding choice of methodologies
  - Understanding of sensitivities and outcomes
- Methodology will depend on volume and type of data available:
  - Loss types with claims history
  - Loss types with no claims history



Insured level valuation

VS



Aggregate level valuation

# Insured level valuations



# Insured level valuation



Insured conducts its own analysis

Better support for negotiations

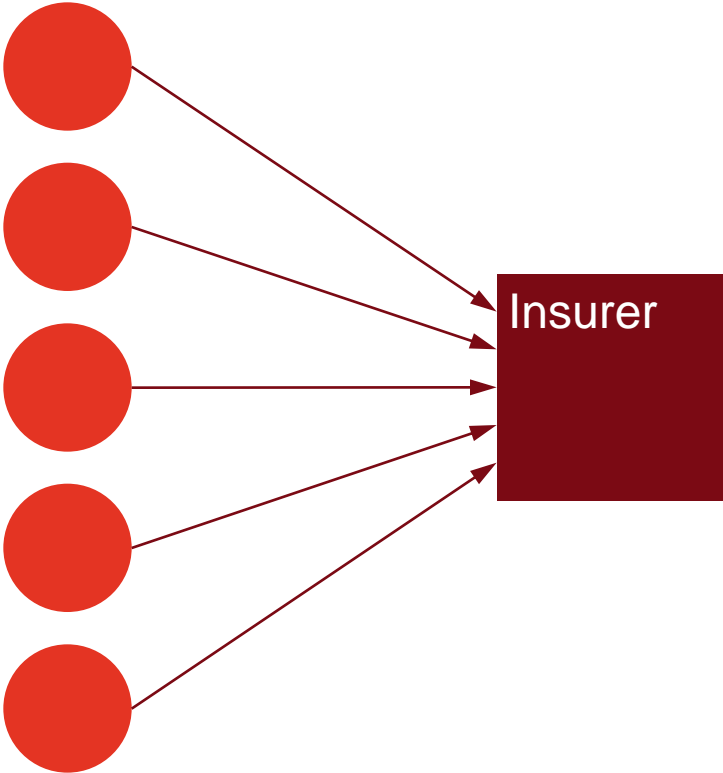
Application to aggregate level  
reserving

Focus on underlying information

Valuation of outwards reinsurance

# Insured level valuation – direct claims

Insureds



# Insured level valuation – underlying approaches

## APH

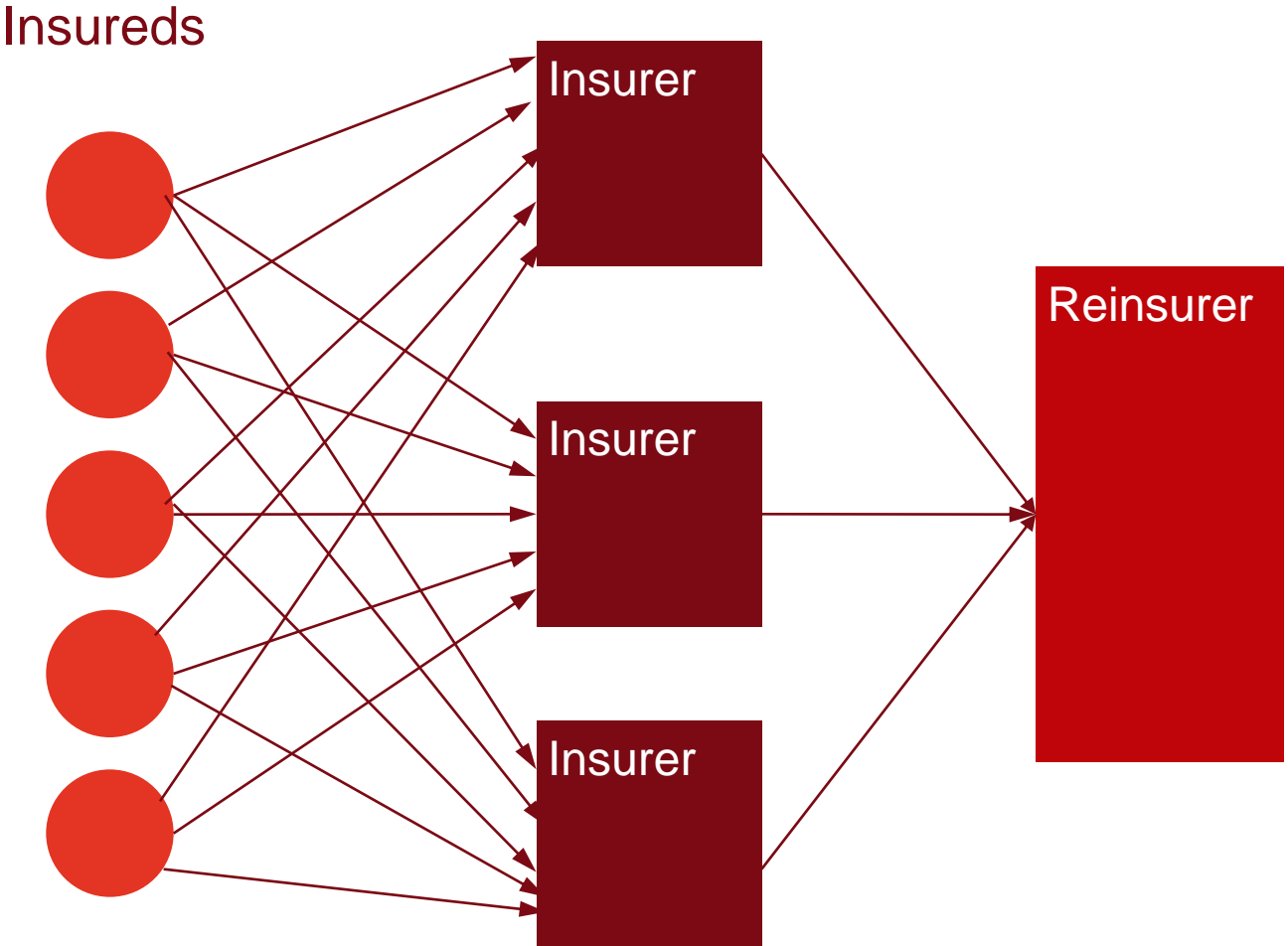
### Direct

- Estimate ground-up liability to insured using different approaches for different claim types
- Allocate liability across coverage period
- Apply to insurance programme

# Insured level valuation – underlying approaches

	APH	Short tail / non-APH
Direct	<ul style="list-style-type: none"><li>• Estimate ground-up liability to insured using different approaches for different claim types</li><li>• Allocate liability across coverage period</li><li>• Apply to insurance programme</li></ul>	<ul style="list-style-type: none"><li>• Frequency and severity approach applied to each year in the coverage period to estimate losses arising against insured</li><li>• Apply to insurance programme</li></ul>

# Insured level valuation – reinsurance claims



# Insured level valuation – underlying approaches

	APH	Short tail / non-APH
Direct	<ul style="list-style-type: none"><li>• Estimate ground-up liability to insured using different approaches for different claim types</li><li>• Allocate liability across coverage period</li><li>• Apply to insurance programme</li></ul>	<ul style="list-style-type: none"><li>• Frequency and severity approach applied to each year in the coverage period to estimate losses arising against insured</li><li>• Apply to insurance programme</li></ul>
Reinsurance	<ul style="list-style-type: none"><li>• Analyse underlying insured losses using a variety of approaches depending on type of inwards business and data available</li><li>• Apply inwards losses to outwards reinsurance programme</li></ul>	

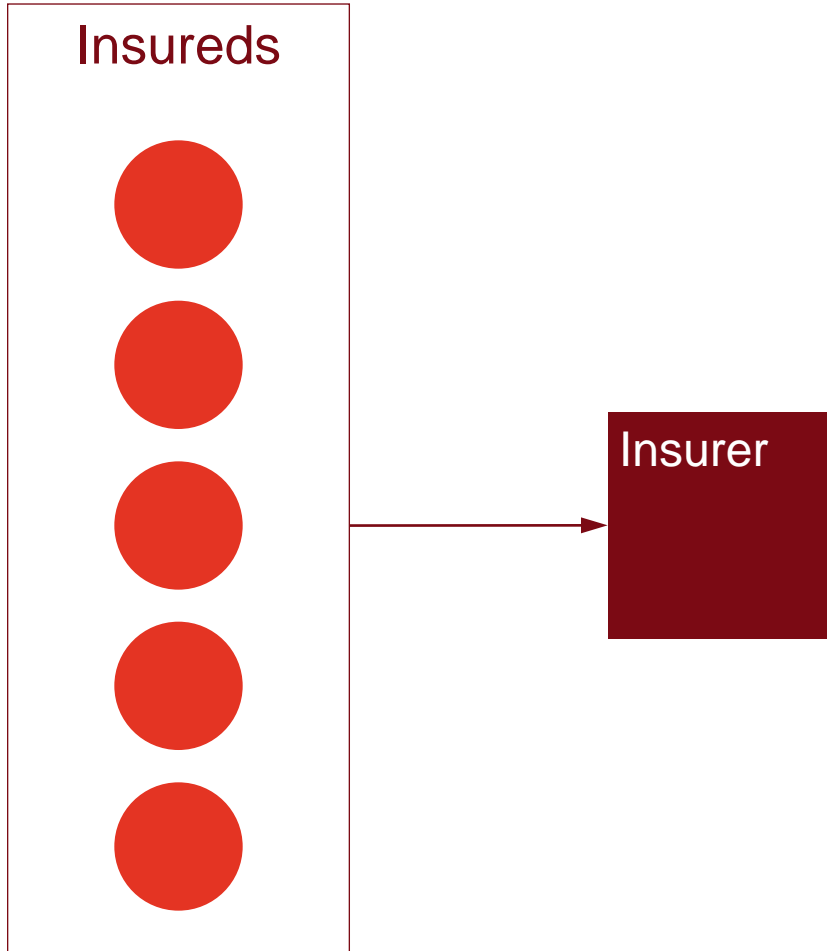
# Insured level valuation – cedant experience approaches

- Consider a cedant's historical **outwards** claims experience with reinsurer using
  - Statistical projections e.g. chain ladder method, decay method
  - Use of available market knowledge e.g. benchmarking against paid, outstanding and incurred claims amounts

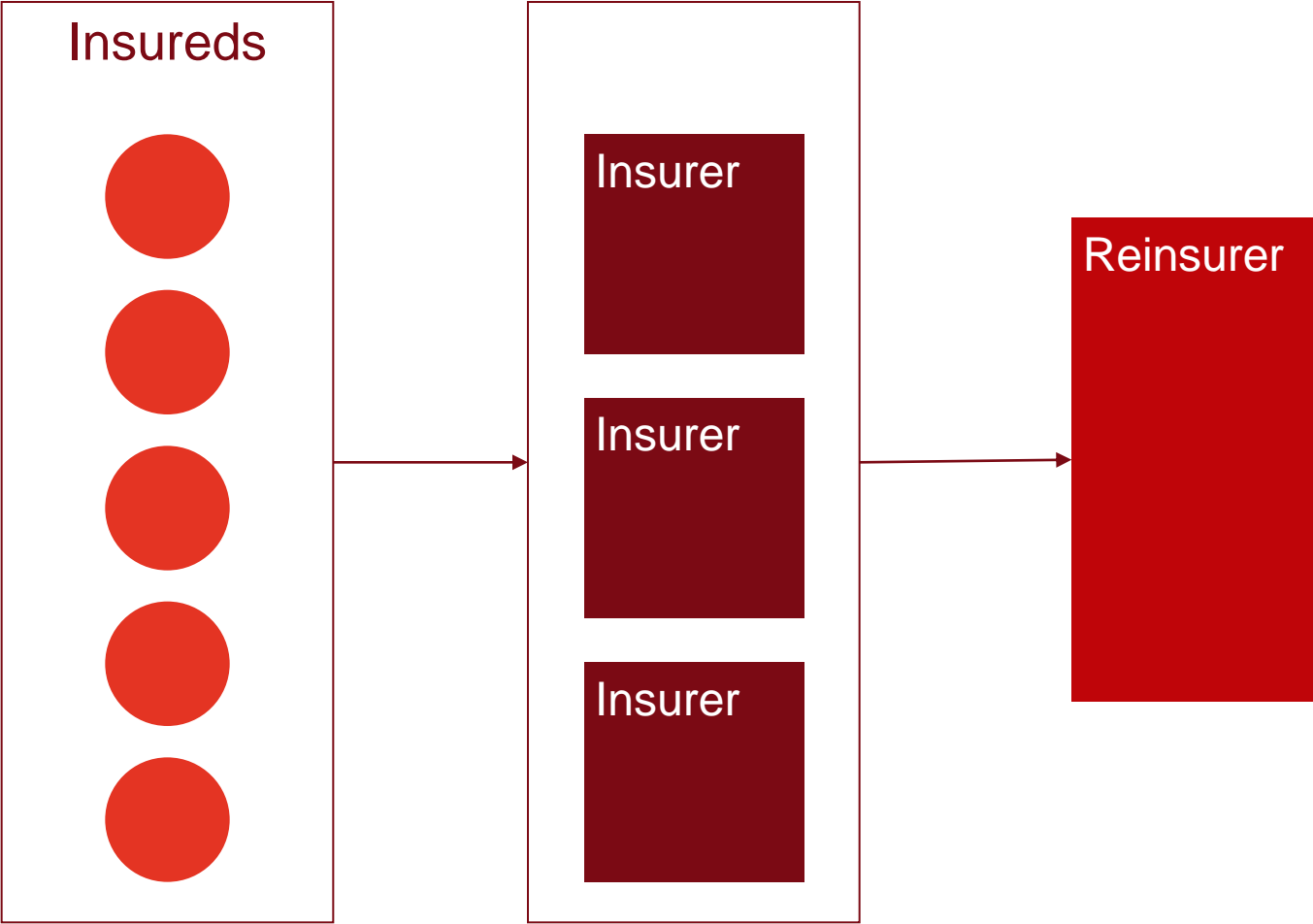
# Aggregate level valuation



# Aggregate level valuation – direct claims



# Aggregate level valuation – reinsurance claims



# Uncertainties in the valuation process

- Production of a range of results to allow for uncertainty in the valuation process
- Unknown vs supportable assumptions
- Legal outcomes

## Key messages



Valuation underpins the run-off toolkit

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PricewaterhouseCoopers LLP, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

© 2010 PricewaterhouseCoopers LLP. All rights reserved. 'PricewaterhouseCoopers' refers to PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom) or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity.