



Institute of Actuaries of Australia

# XIth Accident Compensation Seminar 2007

## **Latent Claims – What we know about things we don't know about**

**© Latent Claims Working Group 2007**

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## Introduction and Overview

- What are latent claims?
- Reserving issues – accounting vs actuarial
- Our analysis
- Management options
- Key conclusions

## Background

- Latent claims working group formed by IAAust Accident Compensation Sub-Committee
- Key focus claims other than asbestos
- How is the Australian insurance industry addressing latent claims issues?
- Paper to be finalised following your input

## What are latent claims?

“what matters to the insurer is the long delay and the fact that the claims were not anticipated “

- Common features:
  - Long reporting delays since exposure
  - Admissible claims with no underwriting/pricing
  - Gradual Exposure
  - Often no clear Event Date
- A full taxonomy is given in the paper

## What are latent claims? Taxonomy

### Claim Characteristics

#### Claim Nature

Disease  
Injury  
Negative impact to individual

#### With Disease

Illness or fatality  
Treatable or not  
How long the illness lasts  
Medical impact

#### Within Negative Impact

Property Damage  
Financial loss

#### Trigger point

Exposure (e.g. employment period)  
Manifestation  
Injury in fact  
Continuous trigger

#### Latency period

Long-tail  
Short tail

#### Reporting delay

Short  
Long

### Exposure Characteristics

#### The Cause

Substance  
Acts  
Environment

#### Causal Link

Established  
Un-established  
Also of relevance under casual link  
Scientific evidence

Medical evidence and epidemiology  
Social Norms  
Legal Interpretation  
Case law  
Law and regulation.

#### Exposure status

Ceased  
Substantially ceased  
Continuing - but controlled  
Continuing and unchanged

### Legal Aspects

#### Propensity to claim

Low  
Medium  
High

#### Legal Status

Established and or stable  
As yet unclear  
Extent of knowledge about the causal link or potential causal link  
Whether advocacay and or support groups exist  
Whether formal legal frameworks are in place to manage claims and promote claims  
Whether the claim type has become established or whether it is emerging in the legal sense  
Whether the claim would be presented as a single claim or within a mass tort or class action

#### Legal Costs

Inefficient  
Efficient

### Underwriting Status

#### Emerged

i.e. where underwriting has taken into account  
Excluded through terms or or by refusing cover

Priced - with conditions

Excluded from claims occurring - covered within claims made

Pending consideration

#### Emerging

i.e. where small numbers of claims have emerged

#### Potential

- i.e. where a potential causal link has been noted but few or no claims have yet emerged

#### Closed

i.e. where an issue was put forward as a potential claims but no claims have emerged or the causal link has been ruled out

## What are the different types of latent claims?

- Insurer's perspective - Five key groups:
  - Emerged e.g. asbestos
  - Emerging e.g. skin cancer
  - Potential e.g. mobile phones
  - Closed e.g. repetitive strain injury
  - Unknown ?
- May differ from insurer to insurer

## Potential Latent claims

- Collecting your thoughts
- Think about financial loss as well as illness
- Please note exposure where you see the potential

# Latent claims reserving: Reconciling accounting and actuarial requirements

- Several Standards apply
  - Professional Standard 300
  - AASB 4: Insurance Contracts
  - AASB 1023: General Insurance Contracts (AIFRS)
  - Prudential Standard GPS 310



# Latent claims reserving: Reconciling accounting and actuarial requirements

## **PS300:**

The central estimate is the mean of that distribution

## **AASB1023: Paragraph 5.1**

An outstanding claims liability shall be measured as the central estimate of the present value of the expected future payments for claims incurred.

## **AASB1023: Paragraph 5.1.4**

If all the possible values of the outstanding classes liability are expressed as a statistical distribution, the central estimate is the mean of that distribution

## **Framework for the Preparation and Presentation of Financial Statements**

A liability is recognised at the amount at which the settlement is expected to take place and where it can be measured reliably.

# Latent claims reserving: Reconciling accounting and actuarial requirements

Statistical  
Mean

vs

Measured  
Reliably

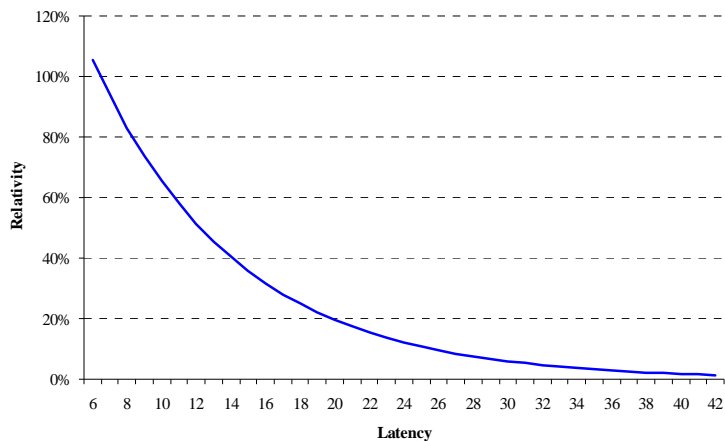


## Latent claims experience

- Requested latent claims data from major insurers and schemes
- Limited response – largely relates to workers' compensation
- No exposure data available
- Data limitations – in particular, coding of claim types and reliability of incident dates

## Latent claims experience

### Potential latent claims distribution

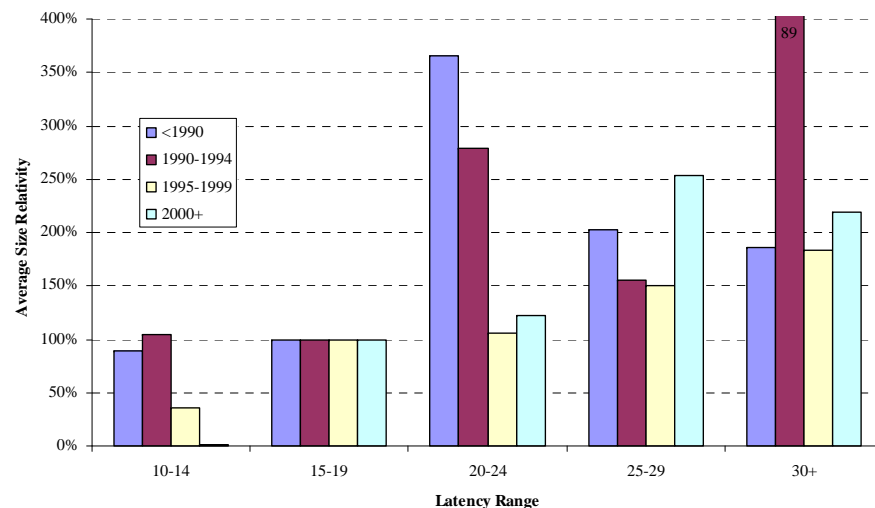


Assumes 05/06 is a steady state

Implies for LC's reported after 5 years:

- 46% reported in years 6-10
- 25% reported in years 11-15
- 14% reported in years 16-20
- 12% reported in years 21-30
- 4% reported in years 30+

### Average Incurred Cost Relativities



- Worker's Comp only
- Excluding asbestos and deafness
- Illustrates that average claims size increases with latency period
- Clear trend despite volatile experience

## Monitoring of latent claims

- Time is the enemy
- Claims data
  - 30+ years of history
  - well defined injury/disease definitions and causes
- Exposure data
  - history also required
  - nature of cover, including industry
- Industry-wide approach appears essential to generate useful data

## Latent claims management

The paper covers four areas:

- Pricing options
- Contractual options
- Reinsurance options
- Reserving options & implications

# Latent claims management: Contractual options

- Learning from reinsurers
- Options
  - Exclusions
  - Claims Made
  - Time Barring
  - Deductibles, Policy Limits, Reinstatement Limits

# Theoretical reserving framework potential & unknown latent claims

- Based on history of emerged latent claims in Aust. (frequency and size)
- Time function from exposure to emergence
- Distribution of market ultimate cost
- Insurer's proportion of market



# Latent claims management: Reserving options & implications

- Emerged – should be allowed for as a matter of course
- Emerging – less clear when an allowance should be made (timing, quantum). Arguably implicit but will it be enough?
- Potential and unknown – is history sufficient to require an historical average allowance
- What impacts the mean, the risk margin, the capital?

## Key conclusions

- Further work that considers the extent to which emerging, potential and unknown latent claims may emerge is warranted
- An industry-wide approach to collecting and reporting latent claims data would be of genuine value

## Key conclusions (cont)

- Further work towards harmonisation of the reserving requirements between actuarial, APRA and accounting standards is warranted.
- Has enough been done to insurance contracts and structures to manage latent claims exposure?