



# SIGMA Circle Solutions

## *Negotiating Security Requirements*

The methodology utilized to establish the amount of a security requirement is not always obvious. The risk manager or broker should have as much input as possible. In most cases, the unique experience of the company is given as much credibility as is reasonable. However, when unique data is utilized, biases and anomalies in the data should be thoroughly discussed at the beginning of the negotiation. The following checklist of issues affect both completed and projected periods.

- A frequent cause of inaccurate or misleading analysis of loss involves large claims. Limit the effect of a large claim when applying loss development factors and trend factors. Otherwise, the assumption is made that an adverse occurrence will be repeated, in some cases, multiple times.
- Use multiple methods to estimate the security requirement. This is appropriate because any mathematical system used in determining estimated ultimate losses is always subject to variation in both internal and external influences. Explore methods which detect changes in mix of business, changes in claim closing patterns and changes in case reserve adequacy.
- Discuss a change in claims handlers, reserving philosophy or the implementation of a loss control program. Any factor which causes patterns in the underlying data to be unrepresentative of the current situation can produce a distortion.
- Factor in the implications of a new program that encourages the pursuit of claim recoveries and the use of second-injury funds.
- Consider separate analyses for each division of the same company when the loss volume of each division is credible. A division with excellent loss experience could be penalized if not analyzed separately. A separate analysis allows a more effective detection of differences in loss development patterns and differing frequency and severity characteristics.
- Consider negotiating a range because a point estimate may not be sufficient. A probability distribution can be an important measure of variability and volatility.
- Discuss the possibility of discounting. Where losses are settled over an extended period of time, the money held in reserves earns interest, and the time value of money can be a major factor. For those exposures with long-tail reserves, the recognition given future investment earnings can have an important bearing on needed security levels.
- Rapid growth in operations is generally accompanied by a deterioration in loss experience due to an increasing number of inexperienced workers. Discuss professional services such as job training, loss control and utilization review which have been important in controlling the growth of workers compensation claims under these circumstances.
- Often, downsizing or closing a plant can have a negative effect on loss experience. When projecting losses, do not let an obvious one year anomaly bias the analysis.
- When projecting losses, exclude the effects of the divestiture of a division with poor loss experience.
- Adjust for any relevant state laws that have been changed or enacted.

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