M2 Basic Reserving Concepts

Topics in Insurance, Risk, and Finance [1]

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[1] References: Chapter 1 of Taylor (2000) | → latest slides

1. Introduction
   - Claims liabilities

Definition

- Generally in insurance, premiums are collected first, before coverage is provided. The insurer can't consider this premium as income before coverage is provided.
- Furthermore, as times goes by, the insurer does not know instantly how much losses it will have to pay (e.g., delays in notification, delays in payments)
- This gives rise to two types of liabilities:
  - **Unearned premium liability**: an amount set aside for covering losses of coverage *not yet provided*, but where a premium has already been collected;
  - **Outstanding claim liability**: an amount set aside for for covering losses corresponding to coverage that *has already been provided*, but where payments are still expected to occur.
- These take a significant proportion of an insurer's balance sheet, often multiple times its equity, as exemplified in the IAG example (forthwith)
- It is the actuary's responsibility to determine those amounts - a huge responsibility!

The case of IAG

Insurance Australia Group is one of the largest Australian general insurers (the largest under some measures)

Its latest Balance Sheet (as at 31 December 2022), see page 20 reads

- Assets
  - Total: 34,428m (100%)
- Liabilities
  - Unearned premium liability: 7,084m (20.6%)
  - Outstanding claims liability: 13,560m (39.4%)
- Equity
  - Total: 6,819m (19.8%)

It is worth noting that IAG holds 2.01 times the APRA "Prescribed Capital Amount" (PCA), see F on page 12.

See https://www.iag.com.au/results-and-reports to dowload the latest financial statements of IAG.

References I

Selected references:

Taylor, Greg. 2000. *Loss Reserving: An Actuarial Perspective*. Huebner International Series on Risk, Insurance and Economic Security. Kluwer Academic Publishers.