

# PRA raises concerns around reserving and exposure management

## AT A GLANCE

November 2020

### What's new?

- The PRA published a ['Dear CRO' letter](#) for general insurance firms on 13 November 2020. The letter outlines findings from the PRA's review across the general insurance sector focusing on reserving and exposure management, including observations on contract uncertainty in light of COVID-19.
- The letter raises concerns around reserve adequacy and weakening case reserve estimates across financial lines and general liability classes of business. In addition, the PRA sets expectations that as part of their year-end reserving exercise, firms should take into consideration additional complexity and uncertainty in estimating losses due to COVID-19.
- The PRA notes that exposure management frameworks for non-property classes of business are less mature than for property classes. It therefore urges firms to continue to develop exposure management frameworks in the light of the evolving nature of risks from both natural and man-made perils.

### What does this mean?

#### *Reserve adequacy*

- The letter highlights an increasing risk of reserve deficiencies particularly for long-tailed lines of business. The PRA flags the risk of bias in setting reserve estimates where firms tend to focus on favourable claims development despite evidence of worsening incurred claims experience. The PRA also notes that reserving assumptions and case reserve estimates have weakened over time while firms continue to experience deterioration in their claims experience. The PRA has previously noted similar concerns around reserve risk and this will continue to be an area of supervisory scrutiny going forward.
- The PRA states that firms' estimates for COVID-19 losses on casualty classes may be optimistic. Therefore, the PRA reminds firms to make sufficient allowance for the uncertainty related to COVID-19 losses on their case estimates and incurred but not reported (IBNR) reserves. The PRA also recommends that firms consider the impact of a downturn in the economy on claims and reserve estimates. In addition, the PRA notes that historical claims experience may not be a good guide for estimating future COVID-19 related losses. It urges firms to apply alternative approaches such as the use of benchmarking and exposure-based analyses alongside more common reserving methodologies to ensure reserve adequacy.

#### *Impact of COVID-19*

- The PRA expects firms to identify those policies that are impacted by the pandemic, reflect any uncertainty in expected losses in their reserve estimates and to continue to track claims development patterns for those policies.
- The PRA expects boards to consider the impact of COVID-19 on their reinsurance arrangements. The PRA wants firms to stress-test the assumptions related to reinsurance recoveries to understand the impact of reinsurance not responding as expected, and then to ensure sufficient allowance is made for this uncertainty when setting reserves.

### Contacts

**Kartina Thomson**  
Director

T: +44 (0) 7483 416510  
E: [kartina.thomson@pwc.com](mailto:kartina.thomson@pwc.com)

**Anirvan Choudhury**  
Senior Manager

T: +44 (0) 7483 423721  
E: [anirvan.choudhury@pwc.com](mailto:anirvan.choudhury@pwc.com)



# AT A GLANCE

November 2020

## *Exposure management*

- The PRA notes that the state of man-made catastrophe risk assessment remains significantly behind that of natural catastrophe risk assessment. Therefore, the PRA expects firms to review their risk appetites and exposure management controls for new and emerging risks and deploy relevant tools and techniques to support forward-looking risk assessments of man-made perils and losses from cyber and specialty lines. The PRA has previously noted similar concerns around exposure management and this will continue to be an area of supervisory scrutiny.
- The PRA also notes examples of good practice in exposure management and encourages all firms to adopt a consistent approach to exposure management across the whole portfolio which is supported by strong data governance and consistent data capture across lines of business.

## *Contract uncertainty and unintended exposures*

- The PRA notes that certain perils (e.g. pandemics) can contain a severity potential that is not well understood. As a result, these events have the potential to expose firms to unintended and unmonitored aggregations across several lines of business. Therefore, the PRA encourages firms to consider whether their risk and capital management frameworks and stress testing capabilities take into account risks due to uncertainty in contract wording and misalignment of underlying exposures to coverage under existing reinsurance policies.

## **What do firms need to do?**

- Firms need to assess how the themes raised in the 'Dear CRO' letter impact them in order to inform board discussions. Specifically on reserving and exposure management, firms may wish to conduct detailed analysis to assess their existing capability against the PRA's expectations.
- As part of the year-end reserve sign-off process, boards are expected by the PRA to review key judgements, material assumptions and ensure that reserve estimates are not influenced by optimistic business plan assumptions.
- Firms may wish to benchmark their exposure management capabilities against the good practices noted in the letter to address any gaps in data, tools, and expertise for assessing natural and man-made catastrophe risks. Firms are also expected to assess interdependencies and accumulation of risks between geographies, perils, and lines of business.
- Firms need to monitor the emergence of any additional risks presented by the pandemic. For example, insurers with exposure to business interruption policies may consider carrying out sensitivity analysis around the robustness of their policy wordings to estimate the impact of the outcome of the FCA's test case.
- Firms need to develop an action plan to demonstrate to the PRA how they plan to address any identified weaknesses highlighted in the letter. Firms may wish to engage with their supervisors early on, to ensure the regulator is aware of any ongoing improvement or remediation activities.

## **Contacts**

**Kartina Thomson**  
Director

T: +44 (0) 7483 416510  
E: [kartina.thomson@pwc.com](mailto:kartina.thomson@pwc.com)

**Anirvan Choudhury**  
Senior Manager

T: +44 (0) 7483 423721  
E: [anirvan.choudhury@pwc.com](mailto:anirvan.choudhury@pwc.com)

## **Next steps**

Firms should share the letter with their CRO, Chief Actuaries, Head of Exposure Management, their Reserving Committees and Risk Committees, and arrange for the letter to be discussed by the board. The PRA expects the CRO to monitor how the firm plans address the issues raised in this letter.

[www.pwc.co.uk/regdevelopments](http://www.pwc.co.uk/regdevelopments)

This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

© 2020 PricewaterhouseCoopers LLP. All rights reserved. PwC refers to the UK member firm, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see [www.pwc.com/structure](http://www.pwc.com/structure) for further details.

