

Streff Insurance Services provides a wide range of actuarial consulting support to property and casualty insurance companies, self-insurance funds, and state insurance departments. We trace our roots back to 1983, when Jim Streff started J. Streff & Associates.

Steve Streff joined in 1993 and the firm moved to picturesque Red Wing, Minnesota in 1995. Since then our client base has steadily grown and our relationships with our other insurance vendors have strengthened.

We are known for our concise and informative reports, independent views, and affordable rates. Open communication and a sharp focus on the end product are the keys to meeting project deadlines and keeping clients satisfied.

Our areas of specialty include loss reserves, pricing, reinsurance analysis, start-up feasibility studies, strategic management, and industry research.



Running in Place - Rising BCAR's and Flat AM Best Ratings

One of the highlights of our summer is the arrival of AM Best's Key Rating Guide and CD-ROM. This year we downloaded an early copy from Best's website. After exporting the data to an Excel worksheet, it was a simple matter to construct pivot tables to analyze the current ratings.

The table below shows key median statistics for the current ratings. The median, or the middle number, is a better measure of the "typical" rating unit than the average because there are many specialty companies with peculiar financials that distort the averages.

Summary Financial Statistics					
Rating	Net Written Premium	NWP to Surplus Ratio	Combined Ratio	Expense Ratio	BCAR
A++	1,486,693	0.9	94	23	284
A+	654,824	1.2	96	27	237
A	115,761	1.1	94	29	234
A-	42,952	1.2	97	32	194
B++	16,480	1.2	99	35	169
B+	15,683	1.5	97	34	141
B	7,621	1.5	101	34	125
B-	11,625	1.8	98	34	109

(Continued on page 3)

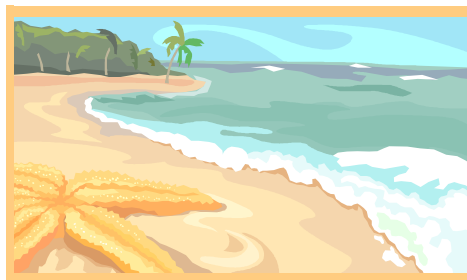
Granular Claim Extracts

In most companies, loss experience reports are summarized. The Annual Statement, despite being a very good document, is summarized. All Auto Liability coverages are combined, for example.

There are many occasions when an analyst needs more

detail. That is when a granular claim extract is invaluable. A claim extract is simply putting the most important

information about a claim into a spreadsheet such as Microsoft Excel. Many good things are possible once the claim detail is available.



(Continued on page 4)

Projecting Storm Losses

With the summer storm season nearly over, this is the time to address how to handle storm losses in the reserve setting process. Without proper consideration, it is easy to over-project reserves in catastrophe years.

Claims arising from storms are generally related to property damage and are reported and settled quickly. Storms most often occur in the summer and are fully paid by year-end. Such storm losses require special treatment when setting year-end reserves.

Only extraordinary weather events should be given consideration, such as a widespread hailstorm or a catastrophic tornado. Garden variety storms that happen every year are best left in the traditional reserve projection process.

Let's use an example from Homeowners, a line composed of property and liability, and prone to storm losses. A spring tornado results in losses of \$750,000. Since they are reported and settled by the end of summer, there are no reserves at year-end. Total paid losses for the year are \$4.25 million. We project reserves based on the paid losses two ways. The first way makes no adjustment for storm losses. The second method backs out the storm losses then projects the adjusted losses and reserves.



“companies not adjusting for storms are at a competitive disadvantage”

<i>Without Storm Adjustment</i>	
1) Total Paid Losses	4,250
2) Paid Projection Factor	1.4
3) Projected Losses (1)x(2)	5,950
4) Projected Reserves (3)-(1)	1,700

<i>With Storm Adjustment</i>	
1) Total Paid Losses	4,250
2) Storm Losses	750
3) Adjusted Losses (1)-(2)	3,500
4) Paid Projection Factor	1.4
5) Projected non-Storm Losses (3)x(4)	4,900
6) Projected Total Losses (2)+(5)	5,650
7) Projected Reserves (6)-(1)	1,400

Difference Between the Two Methods	300
------------------------------------	------------



Companies not adjusting for the storm losses would carry \$300,000 more in reserves than necessary. These extra reserves would add a level of safety and there is nothing wrong with that, especially for the current accident year. Still, it's money that could be better applied to another line or dropped down to surplus. Most companies adjust for storms in their reserves and those not doing so are at a competitive disadvantage.

Running in Place - Rising BCAR's and Flat AM Best Ratings (continued)

Best's Capital Adequacy Ratios (BCAR's) compare a company's available capital to its required capital. A ratio above 200 reflects a well capitalized company while a ratio below 100 warns of pending doom.

The BCAR calculation is built on a proprietary AM Best model. It is composed mainly of cold financial measures such as asset type and premium, but has just enough subjective inputs to keep things interesting. For example, the adequacy of the reserves must be estimated by Best and there is a penalty for a company's lacking underwriting and geographic diversity.

Small companies need to score a huge BCAR if they are to get a high rating, but large companies can get away with low BCAR's. For example, Zurich US with a premium over \$7 billion and a BCAR of 145 sports an A rating. Now consider Marysville Mutual from Kansas. Although it is small with premium of \$13 million it has a BCAR of 301. Its rating? B+. The lesson is that much more goes into a rating than a company's BCAR.



A high BCAR is not enough			
Company	Premium	BCAR	Rating
Zurich US	\$7 billion	145	A
Marysville Mutual	\$13 million	301	B+

“small companies need to score a huge BCAR if they are to get a high rating, but large companies can get away with low BCAR's”

BCAR's have risen since 2002 as shown in the table below. The median BCAR is now higher for all ratings than two years ago. This helps explain why companies feel like they are running in place with ever stronger balance sheets and no upgrade to show for their efforts. Ten years ago an A- rating was considered marginal. Today that same rating is worth a lot more. The median BCAR for A++ companies is nearly 300.

Rising BCAR's				
Rating	2004 BCAR	2003 BCAR	2002 BCAR	Two-Year Change
A++	284	230	184	100
A+	237	238	236	1
A	234	221	218	16
A-	194	192	182	12
B++	169	158	152	17
B+	141	140	127	14
B	125	116	102	23
B-	109	100	100	9



Our sense is that Best is still refining its BCAR model with the hopes of developing a crystal clear relationship between a company's BCAR and its letter rating. Getting to that point in perhaps a decade could be an exciting ride.

Streff Insurance Services

406 West Third Street, Suite 300
Red Wing, MN 55066
www.streffinsurance.com

651-385-7500

651-385-7502 (fax)

cheryl@streffinsurance.com

jim@streffinsurance.com

steve@streffinsurance.com



Loss Reserves and Sarbanes - Oxley

Sarbanes - Oxley (SOX) has been with us for a several years and has had an impact on many facets of company operations. It requires management to have a thorough understanding of financial issues. The requirement of the Board of Directors is less but there still needs to be some familiarity by them.

In loss reserve studies, actuaries have a responsibility to help management meet these SOX requirements. It may not be good enough to conduct our loss reserve studies so another actuary can read them. Loss reserves need to be estimated and documented so that management can "take ownership" of the work.

To that end, actuaries need to:

- ◆ clearly document all underlying assumptions.
- ◆ explain how changes can affect the estimate.
- ◆ give as much forward thinking advice as possible.
- ◆ write a report so that management can read it.

A high level summary should be prepared for the Board of Directors. An example of this can be found on our website www.streffinsurance.com. Look under Executive Summary. If your loss reserve study creates a gap of understanding, discuss this with the actuary and determine what is needed to better meet SOX requirements.

Granular Claim Extracts (continued)

In loss reserving, it is possible to measure and monitor:

- ◆ changes in reserve strength by claim size.
- ◆ trends in the rate of claim settlement patterns.
- ◆ claim inflation, especially by layer of loss.
- ◆ separate patterns by coverage.

In Pricing, it becomes possible to:

- ◆ consider the effect of "cause of loss".
- ◆ adjust for large loss smoothing.
- ◆ know the effectiveness of deductibles and policy limits.

To learn more about how to build a Granular Claim Extract, visit our website: www.streffinsurance.com and click on "Granular Claim Extract".

