



One-Year Reserve Development ratio:

$$\frac{\text{Incurred Loss (current)} - \text{Incurred Loss (prior)}}{\text{Net Position}}$$

The One-Year Reserve Development ratio seeks to measure the development of reserves (the "unknown") in relation to the size of a pool's surplus. Within the insurance industry, this ratio might be used to look for red flag markers of possible insolvency due to inadequate reserving.

Although the word "reserve" is used in the title of this ratio, the figures used in the numerator are based on incurred losses. By using the current year incurred losses minus prior year incurred losses, the ratio examines changes in reserves as well as changes in paid loss amounts and newly reported claims.

A pool with \$33 million of incurred losses currently, compared to \$30 million of incurred losses for the same set of coverage years from last year, has a \$3 million increase in reserve development. \$3 million divided by the pool's net position of \$50 million equates to a OneYear Reserve Development Ratio of 6 percent.

General guidance from the insurance industry suggests reserve development above 20 percent is indicative of impending insolvency. If a reserve development ratio is positive, reserves are said to be "deficient" because the prior reserve levels need to be increased. If the ratio is negative, reserves might be referred to as "redundant." Monitoring this ratio over time helps evaluate financial stability or viability of a pool's book of business.

There is no currently known "standardized range" of the One-Year Reserve Development Ratio for pools - which is one of the reasons AGRiP is working on the FBI.