



The 2020 SIGMA Collateral Survey

Results and Analysis

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In the last quarter of 2020, SIGMA Actuarial Consulting Group invited a group of insurance brokers, risk management consultants, and risk management staff of self-funded concerns to participate in a survey regarding collateral. SIGMA first conducted this survey in 2009 because of the preceding financial crisis and continued the survey through 2014. The collateral survey was discontinued after 2014 because collateral market trends, from our perspective, stabilized. Due to the hardening market and uncertainties surrounding the pandemic, SIGMA has conducted the collateral survey again in 2020. This survey is similar to the ones conducted by SIGMA in 2009 through 2014.

The goal of the survey was to assess, on a national basis, trends in collateral negotiations, exposures, reviews, arbitration, litigation, and other factors that SIGMA actuaries have been seeing with our own clients. Collateral issues vary significantly based on the line of coverage, the number of years collateral has been posted, the type of industry, and most importantly, the carrier. It is important to recognize that this survey does not constitute in-depth statistical research. However, we believe the results of this survey provide valuable information on collateral.

Keep in mind that this is a broad survey, and your specific situation could vary from our results. SIGMA works with clients and brokers in a wide range of industries and geographies. However, the sample of our clients may not fully reflect or capture national trends.

Summary of Results:

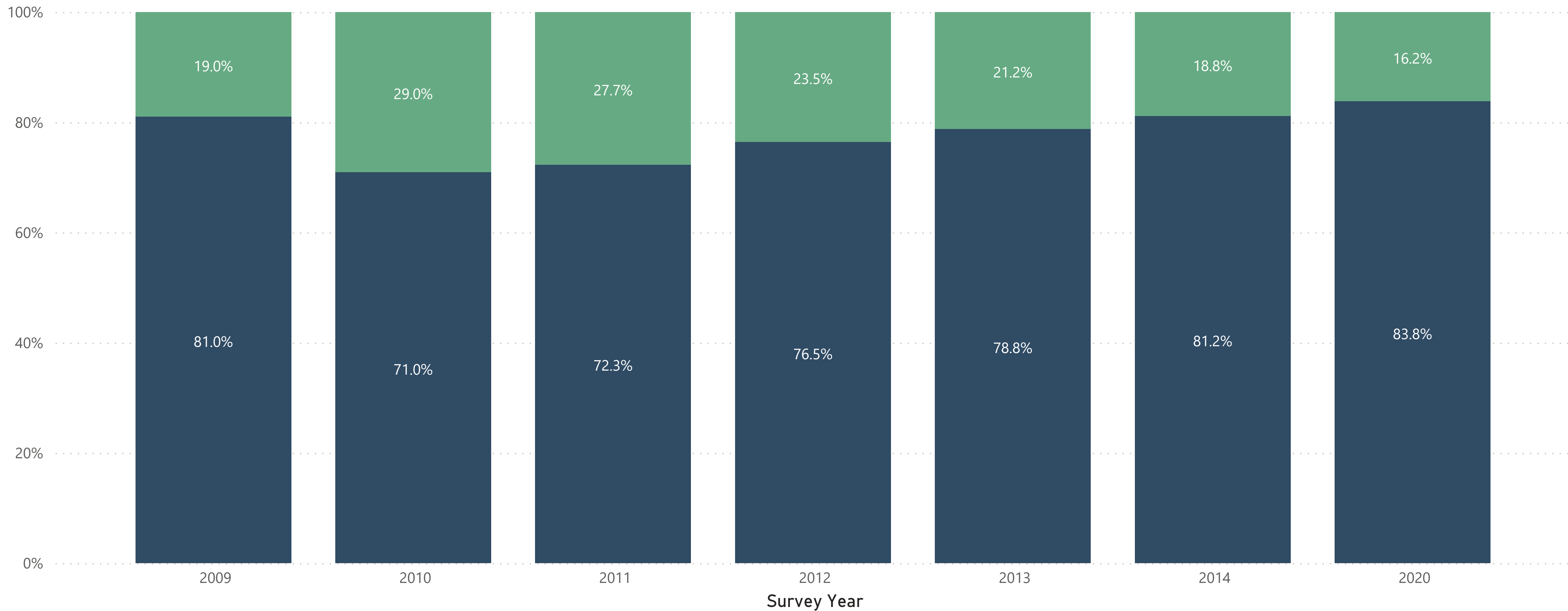
Six new questions were added to the 2020 survey. Highlights of the 22 question survey, which received 68 respondents, show:

- In 2020, the responses for most questions remained consistent with the prior 2014 responses.
- Around 15% of respondents indicated that collateral has been increased due to the COVID-19 pandemic.
- Since 2009, the percentage of respondents that saw collateral being affected significantly due to rapidly changing exposures increased almost 10%.
- In 2020, the number of respondents indicating an increased cost of collateral related to workers compensation grew 13.8% compared to 2014.
- The percentage of respondents indicating that some of the parameters of the agreement were negotiated has increased compared to 2014. The percentage of respondents indicating that the parameters of the agreement were not negotiated decreased significantly compared to 2014.
- The percentage of respondents indicating they used actuarial consultation or analysis in support of collateral issues is consistent with the results seen in 2009 to 2014.
- Workers compensation continues to be the primary risk for collateral posted.

Details of the survey, including commentary for each question, follow. At the end of this report, we present recommendations for improving an entity's collateral picture and a list for further reading.

1) Which best describes your professional role in collateral issues?

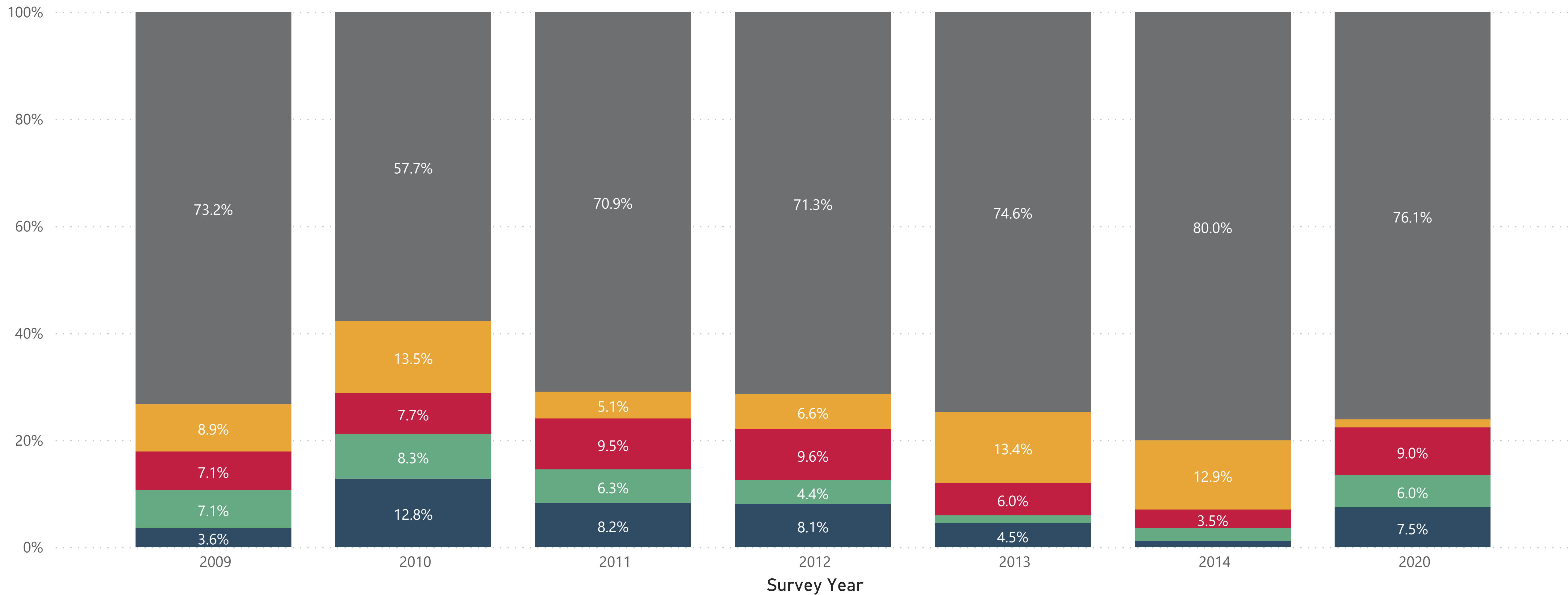
Answer ● I am an insurance broker or risk management consultant to a client with self-funded concerns ● I work directly for a company or entity with self-funded concerns



The first survey question addressed the professional role of the respondent. In 2020, approximately 84% of the respondents represented a client as a broker or risk management consultant, and approximately 16% worked directly for a company with collateral concerns. Survey instructions guided risk managers and brokers to respond to the survey multiple times if they wished to respond on behalf of multiple clients. Therefore, each survey response should reflect the collateral situation for a single entity. The professional role of the respondent varied little over the seven years of surveys.

2) Which category best represents the number of years you have posted collateral for self-funded liabilities?

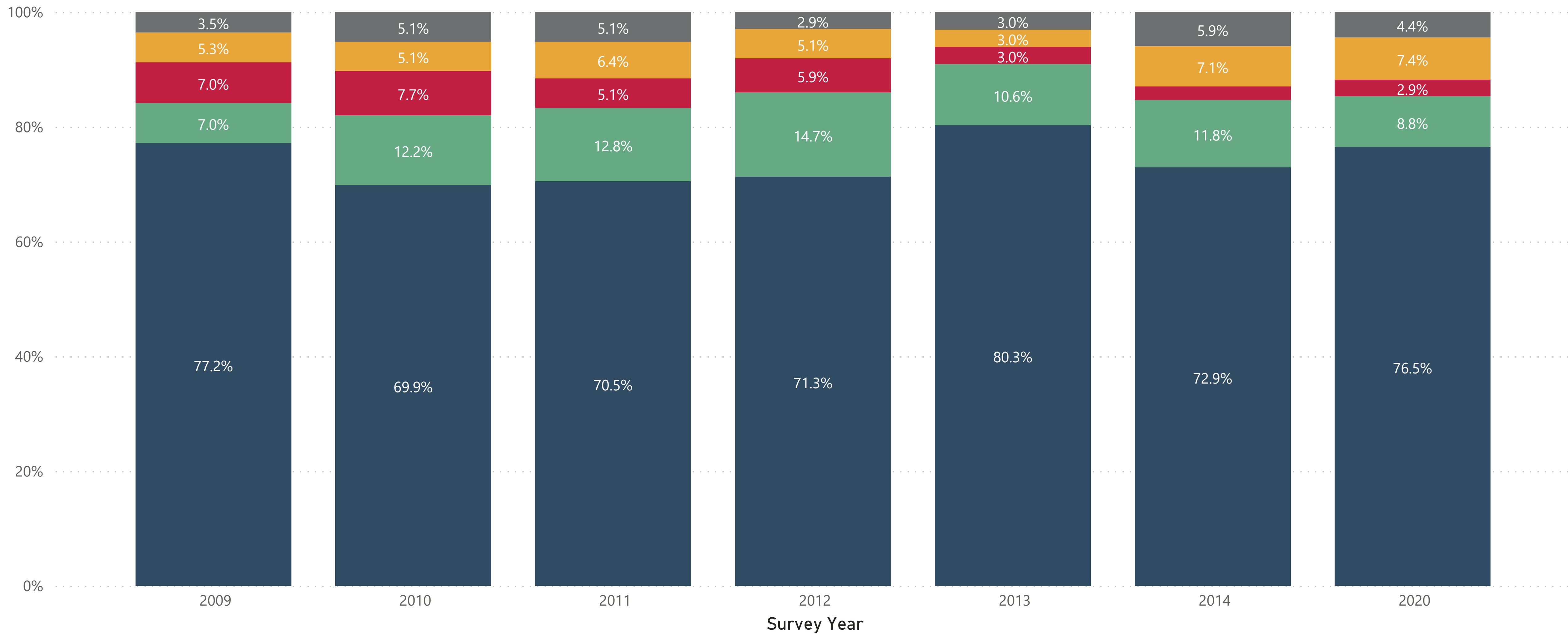
Answer ● 0-2 years ● 2-4 years ● 4-6 years ● 6-8 years ● More than 8 years



The results from the 2020 survey did not differ significantly from the 2014 results for companies that have posted for collateral for more than 8 years. As we noted in our prior collateral reports, companies that have posted collateral for several years have a greater likelihood of being in a stable position. This means that the “add-on” collateral related to exposures for the upcoming year is approximately offset by payments being made on the more mature policy periods. Companies that have only recently started posting collateral can often see significant increases in required collateral as new years are added. This is especially true for workers compensation, general liability, and other long-tailed coverages since these coverages have a long payout pattern (losses pay out over several years).

3) Which instrument best describes the type of collateral instrument used for your self-funded liabilities?

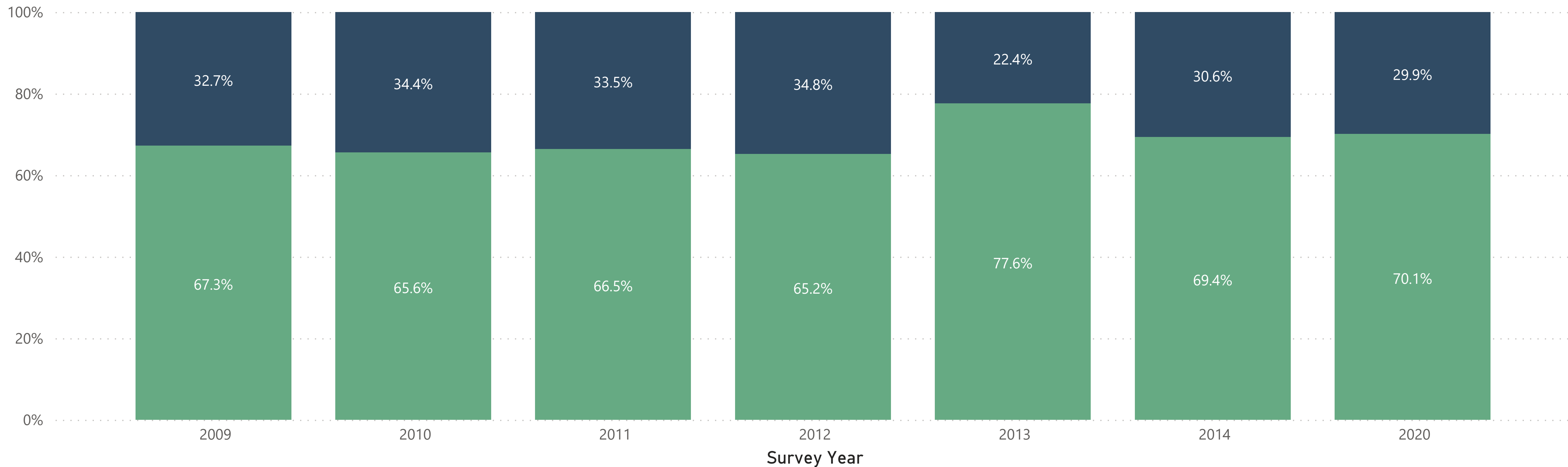
Answer ● Letter of Credit ● Cash ● Bond ● Trust ● Other



The third question addressed the type of collateral instrument used. Compared to 2014's results, the use of cash, bond, trust, or other as a collateral instrument decreased slightly in 2020. The use of letters of credit as a collateral instrument showed a slight increase of 3.6% from 2014.

4) Did you have actuarial consultation or analysis in support of collateral issues?

Answer ● Yes ● No



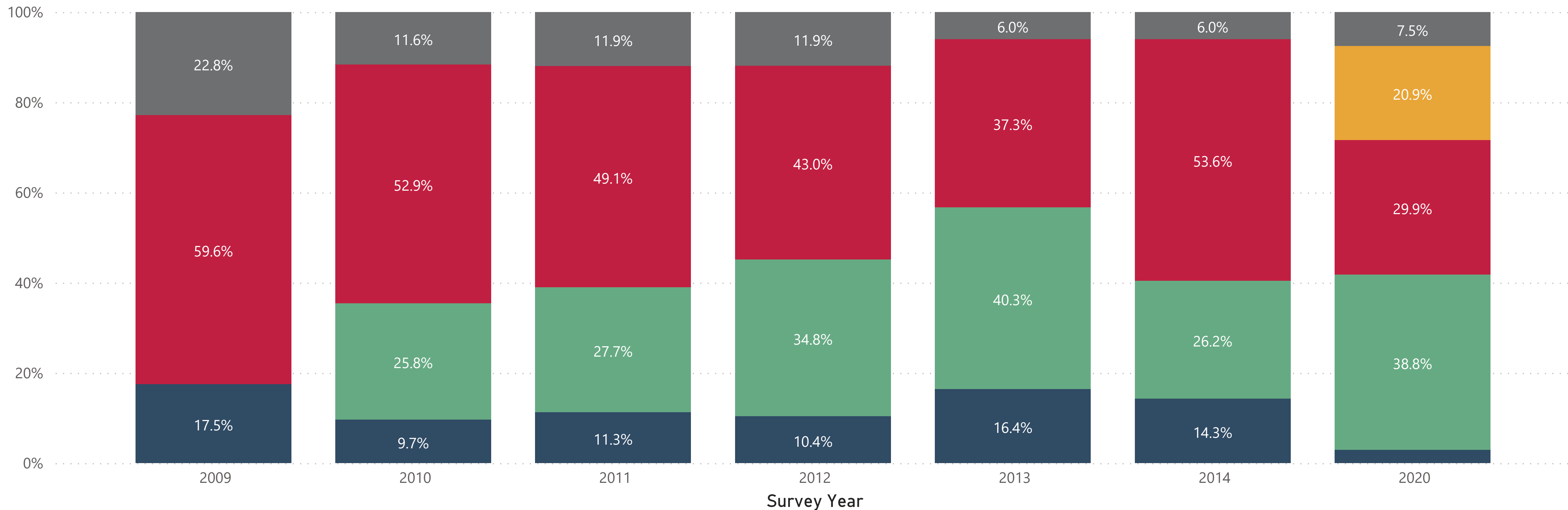
Question 4 addressed the use of actuarial services. The number of respondents using actuarial support ranged from 65% to 78% in 2009 through 2014. The response in 2020 was consistent with the responses from the previous six surveys.

It is important to note that the question did not delineate between using an annual actuarial report versus engaging actuarial consultation and analysis specifically related to collateral concerns. Annual actuarial reports often contain a significant amount of information that could be useful in collateral negotiations. However, the evaluation date of an actuarial report may differ from the evaluation date used by a carrier for collateral calculations and reviews.

Normally, actuarial support involves calculating the required reserves for specified collateral years. Required reserves are determined by calculating estimated ultimate losses and subtracting the paid losses as of the evaluation date. If a carrier provides work papers, the carrier's actuarial analysis can be compared to the collateral analysis to determine key differences. The differences are commonly related to loss development factors or methodology related to risk margins.

5) To what degree were the parameters negotiated prior to the policy inception?

Answer ● None of the parameters ● Some of the parameters ● Most of the parameters ● All of the parameters ● No specified agreement



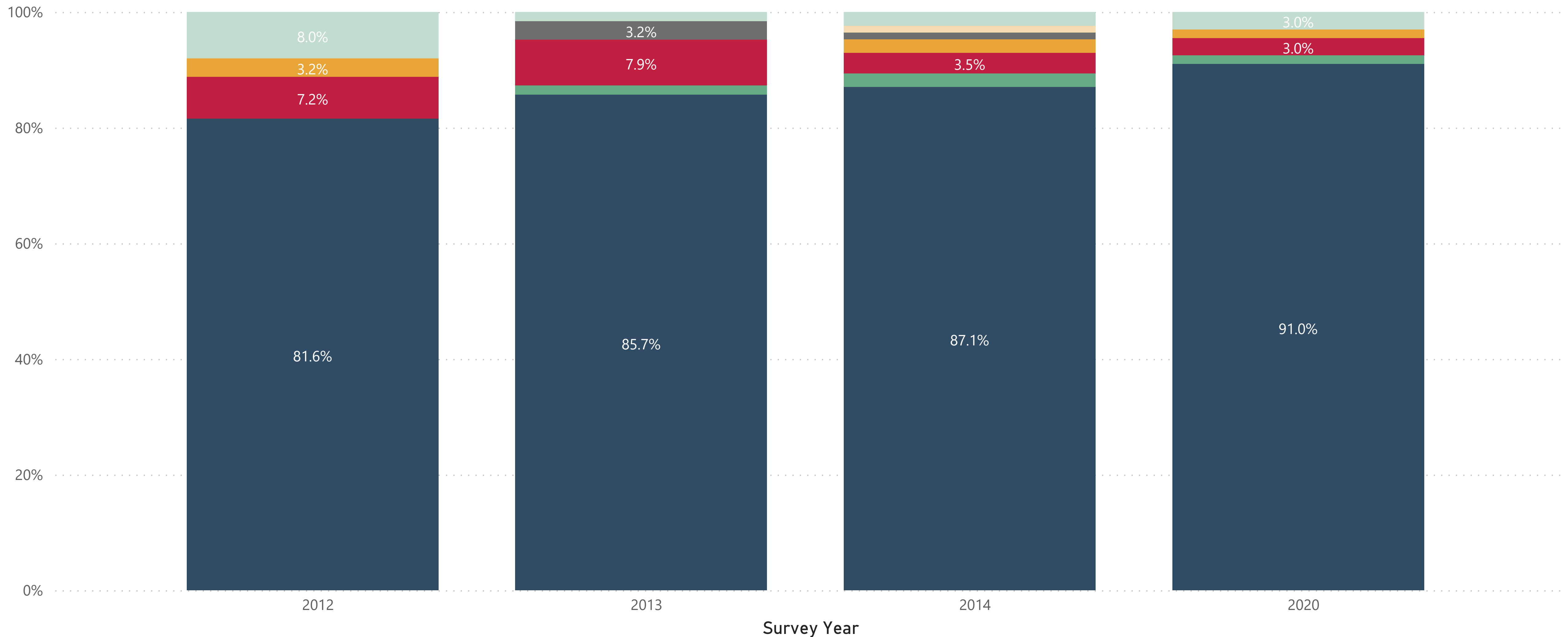
In our consultative practice, SIGMA often only becomes involved in collateral negotiations after the collateral has been posted for one or more years. Frequently, these negotiations are hindered due to a lack of a front-end collateral agreement. This question attempted to gauge the percentage of companies that establish an agreement prior to entering a collateral partnership.

A response option was added to the 2010 survey: "Some of the parameters." SIGMA added this option after we read and processed the results of the 2009 survey. Based on the 2009 responses, many companies secured an agreement and had negotiated at least some of the parameters of the agreement. This year, we added an additional response option: "All of the parameters."

The response indicating that none of the parameters were negotiated decreased over 10% since 2014. From 2009 to 2013, the number of respondents indicating that most of the parameters were negotiated declined, while the number indicating that some of the parameters were negotiated increased. In 2020, around 21% of the respondents indicated that all of the parameters were negotiated prior to policy inception.

6) What is the primary risk for which collateral is posted?

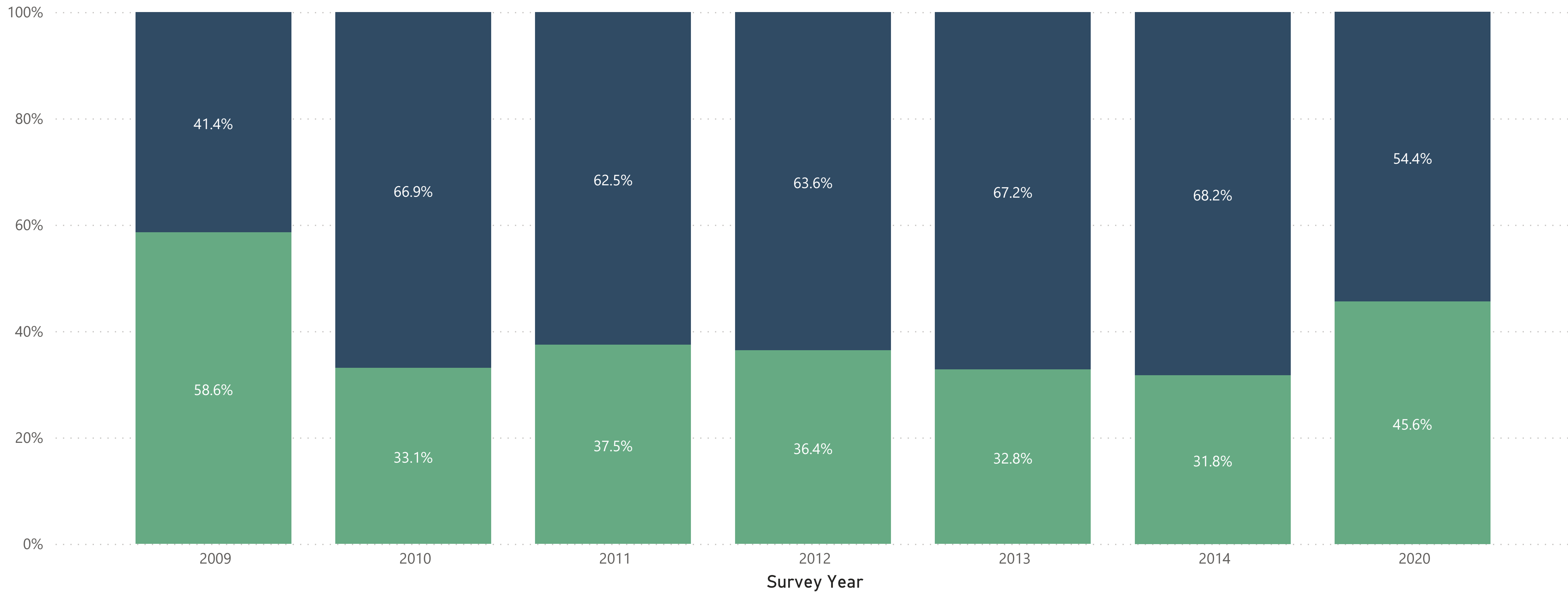
Answer ● Workers Compensation ● Automobile Liability ● General Liability ● Medical Professional Liability ● Products Liability ● Property ● Other



Question 6 attempted to monitor the primary risks related to the survey responses. Since 2012, workers compensation has been the primary risk for collateral posted. In 2020, workers compensation represented 91.0% of the primary risk. It should be noted that "products liability" and "automobile liability" options were not available to respondents in 2012.

7) In regards to collateral posted for workers compensation self-funded liabilities, did you experience increased cost of collateral instrument?

Answer ● Yes ● No

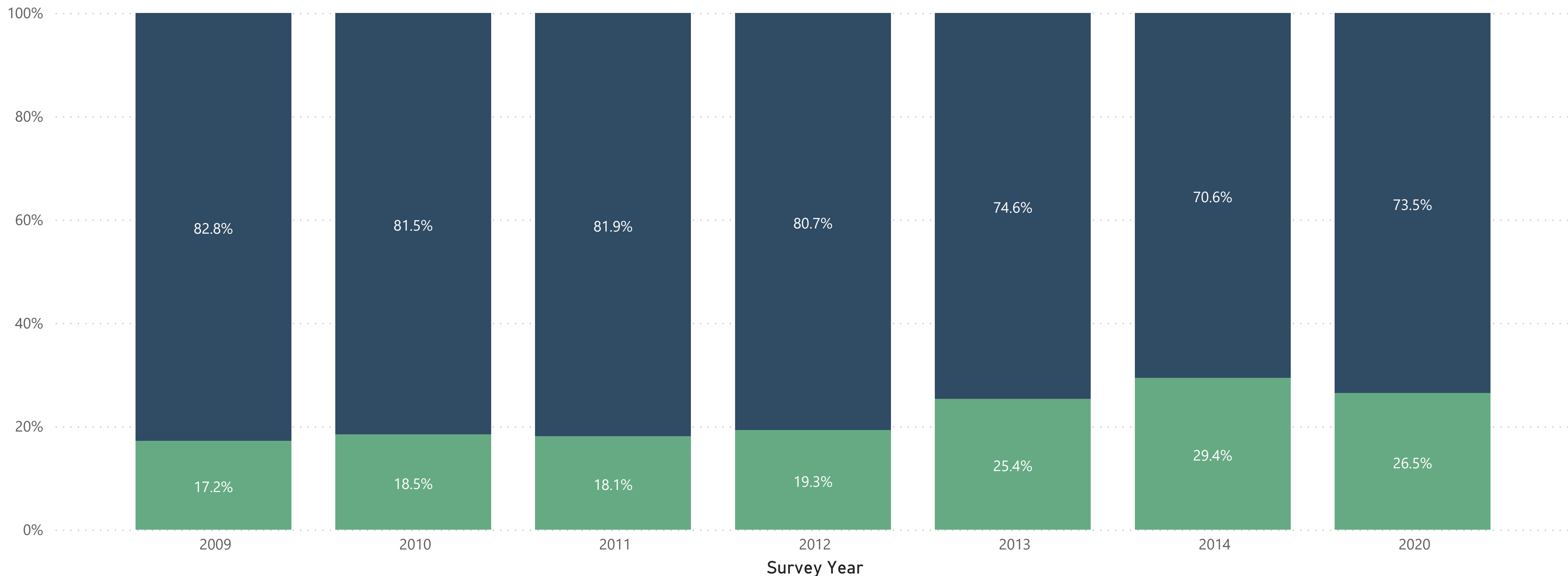


Questions 7 focused on changes that occurred in the company's workers compensation collateral situation related to the cost of collateral during 2009 through 2020.

This particular question showed the biggest movement in responses from 2009 to 2010. The responses stabilized between 2010 to 2014. In 2020, the number of respondents indicating an increased cost of collateral grew 13.8% compared to 2014.

8) In regards to collateral posted for workers compensation self-funded liabilities, did you experience rapidly changing exposures that significantly affected collateral?

Answer ● Yes ● No

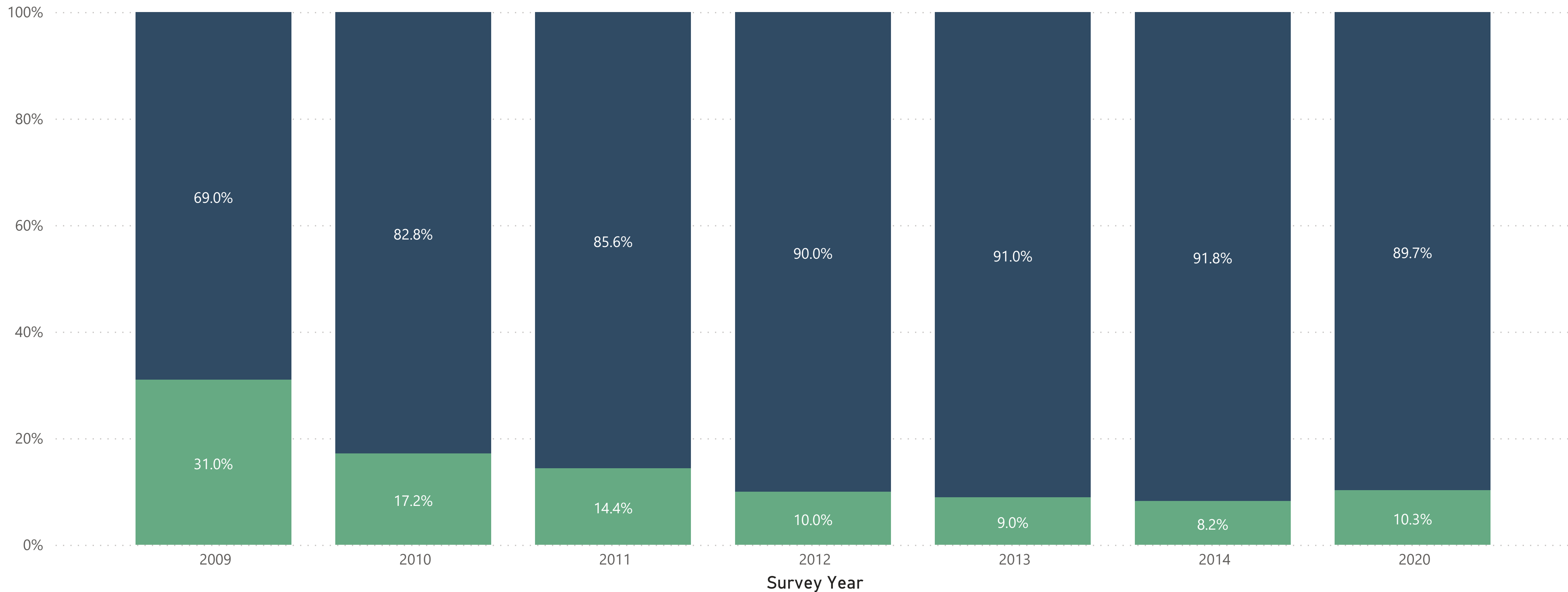


This question focused on changes that occurred in the company's workers compensation collateral situation related to exposures during 2009 through 2020. Recently, some companies have been experiencing significant exposure changes related to the pandemic. Plant shutdowns and restaurants closing were some areas where we saw decreases in exposures, while similar increases were seen in delivery service industries and grocery stores. This is important to note in non-run off situations because collateral for the add-on year could change significantly due to changes in exposures.

Since 2009, the number of respondents that saw collateral being affected significantly due to rapidly changing exposures has increased by almost 10%.

9) In regards to collateral posted for workers compensation self-funded liabilities, did you experience difficulty securing collateral due to market credit capacity?

Answer ● Yes ● No

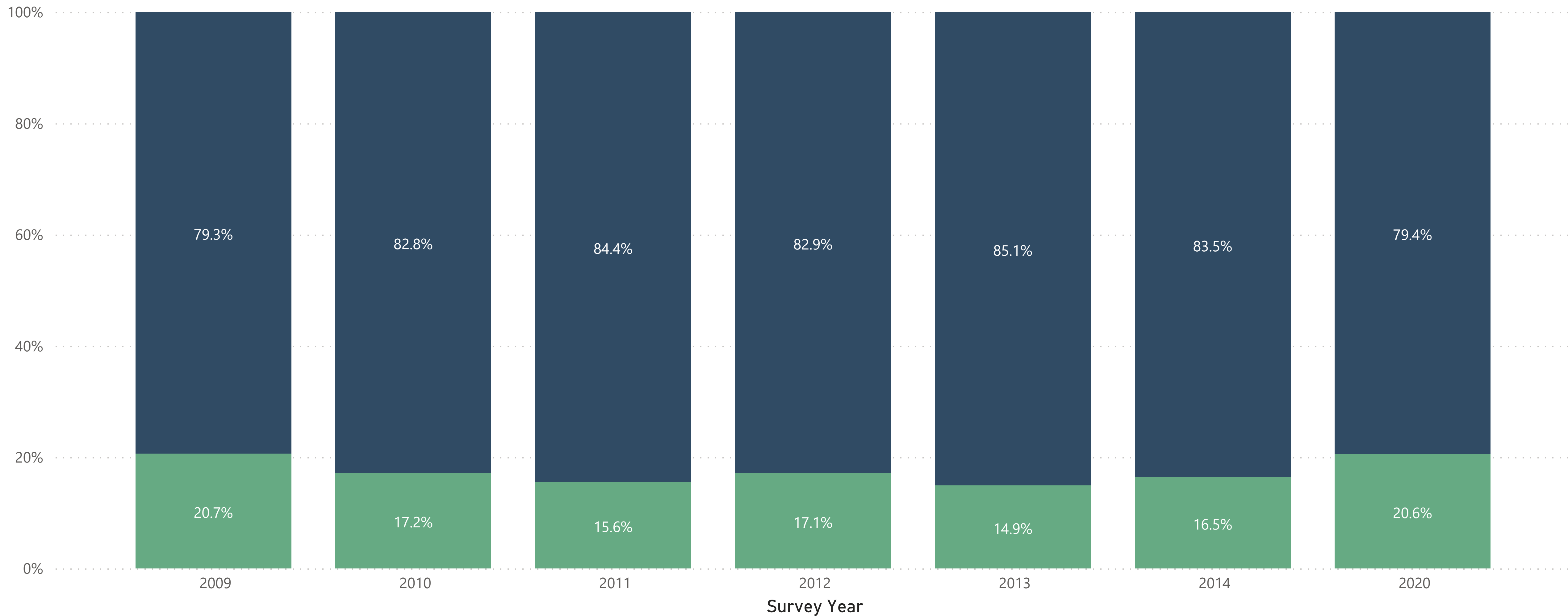


Question 9 focused on changes that occurred in the company's workers compensation collateral situation related to market credit capacity during 2009 through 2020.

This question showed the biggest movement in responses from 2009 to 2010. In general, the number of respondents indicating no difficulty related to securing collateral due to market credit capacity stabilized between 2010 to 2014. Around 90% of the respondents did not experience any difficulty securing collateral due to market capacity during 2020.

10) In regards to collateral posted for workers compensation self-funded liabilities, did you experience carrier requested change in collateral instrument (either type or issuing institution)?

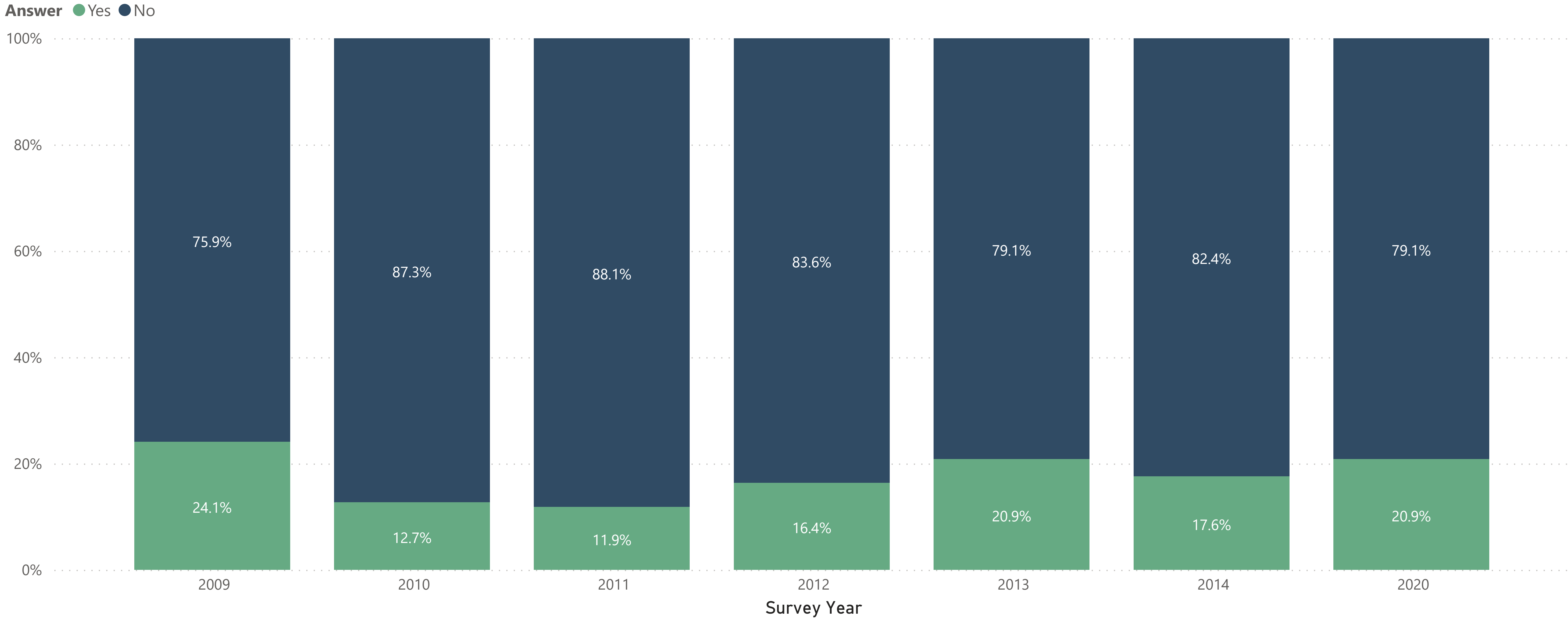
Answer ● Yes ● No



Question 10 focused on changes that occurred in companies' workers compensation collateral situations related to carrier requests during 2009 through 2020.

Responses were stable over the years, with around 80% of respondents indicating they did not experience a request from carriers to change the collateral instrument (either type or issuing institution).

11) In regards to collateral posted for workers compensation self-funded liabilities, did you experience changes in terms and conditions of collateral agreement or requested increases in collateral amount without discussion or negotiation?

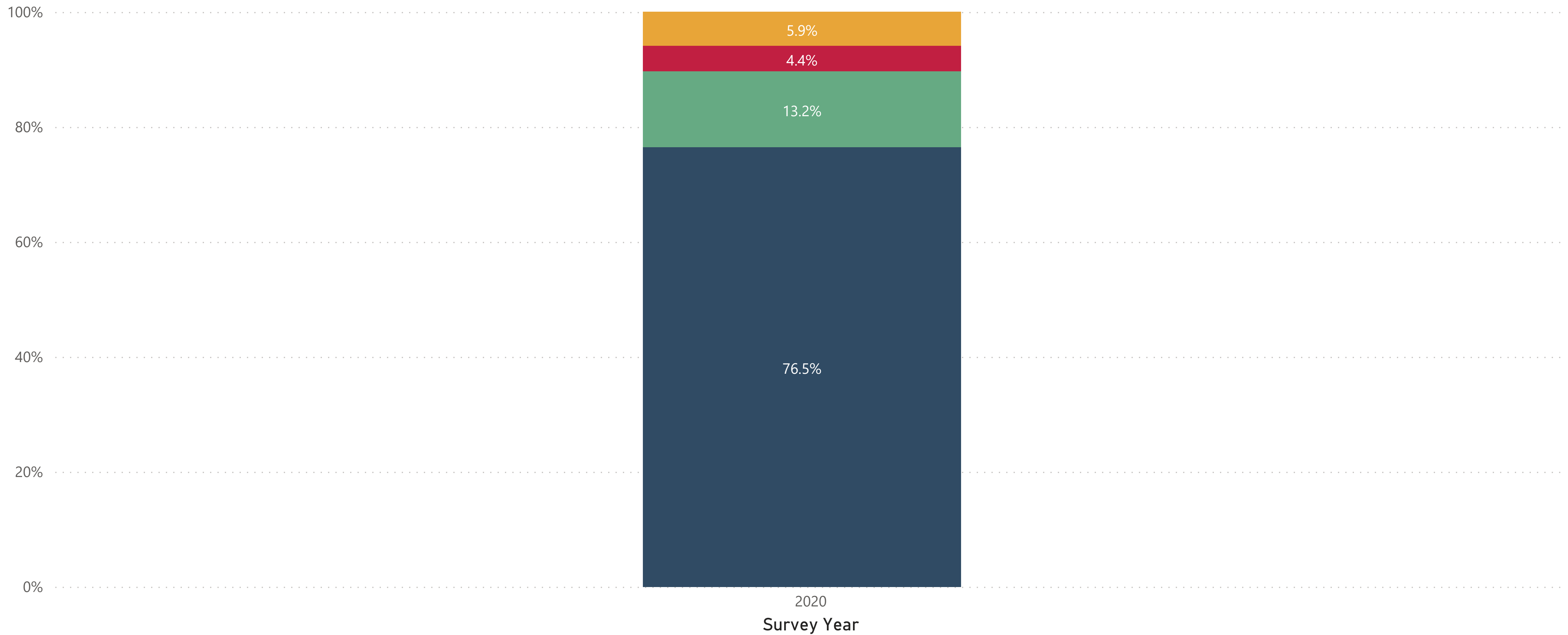


Question 11 focused on changes that occurred in the company's workers compensation collateral situation related to changes in terms or conditions or collateral amounts during 2009 through 2020.

The number of "Yes" responses decreased in 2010 and increased again in 2012 and 2013, reaching its highest percentage in 2013. 2014 saw a slight decrease from 2013 and in 2020, the number of "Yes" responses were at the same level as 2013.

12) How often is your collateral reviewed?

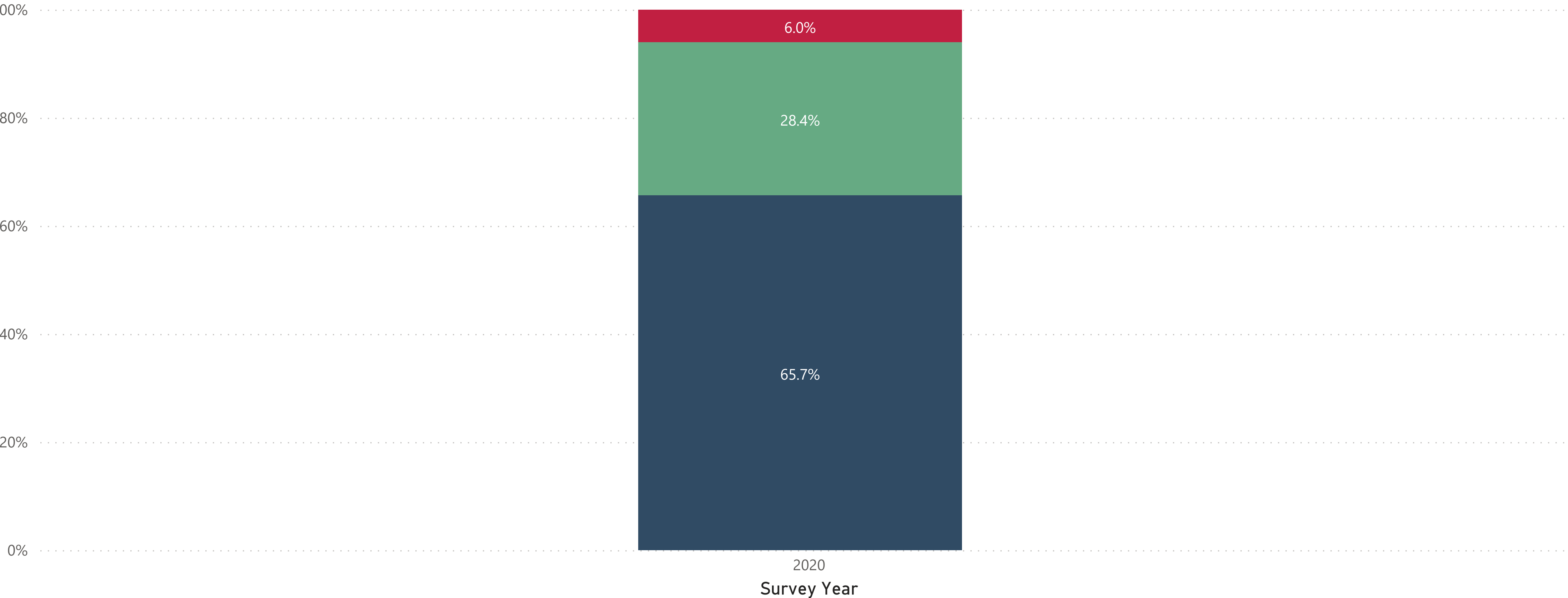
Answer ● Once a year ● Twice a year ● Once every two years ● Other



Question 12 is a new question that attempted to monitor how often collateral is reviewed during the year. The most common response was that collateral is reviewed once a year and represented 76.5% of responses. Some respondents indicated that collateral is reviewed monthly or as needed; others noted that the frequency of collateral review is dependent on the program and market.

13) Which of the following describes how collateral is posted?

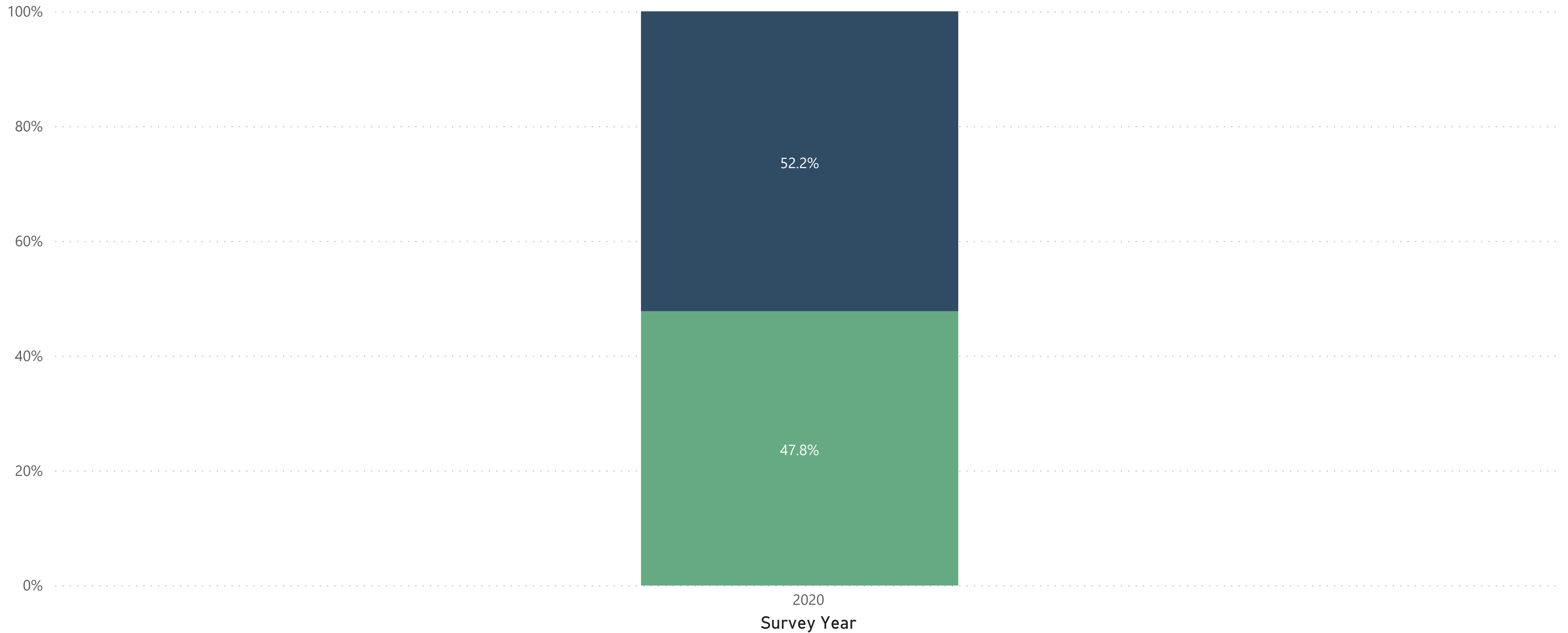
Answer ● Aggregated for all liabilities across all years ● By Policy Year ● Other



Question 13 is a new question that attempted to monitor how collateral is posted. Around 66% of the respondents indicated that collateral is aggregated for liabilities across all years. 28% indicated that collateral is posted by policy year.

14) Is collateral being held for any year(s) with no open claims?

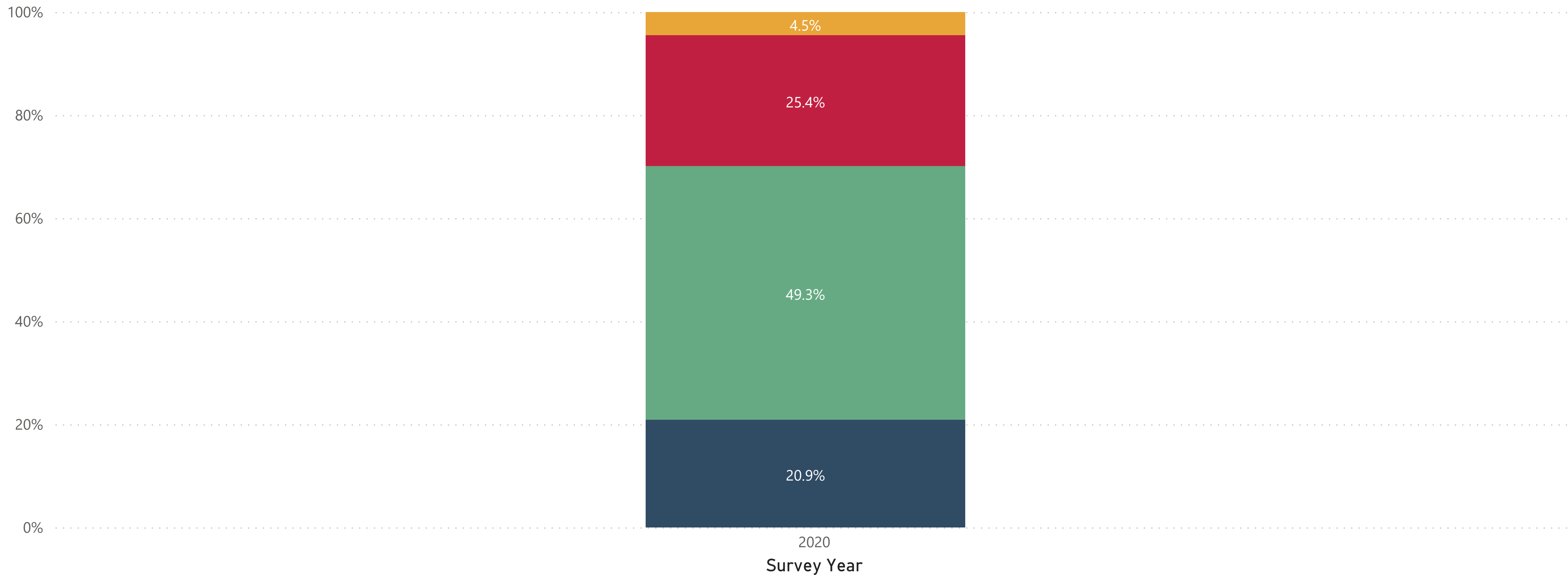
Answer ● Yes ● No



Question 14 is also a new question that attempted to monitor collateral for years without any open claims. The response for this question was fairly evenly split between "Yes" and "No," with slightly over half of the respondents indicating that no collateral is held for years with all claims closed.

15) Which of the following best summarizes the documentation you received related to your carrier's collateral review?

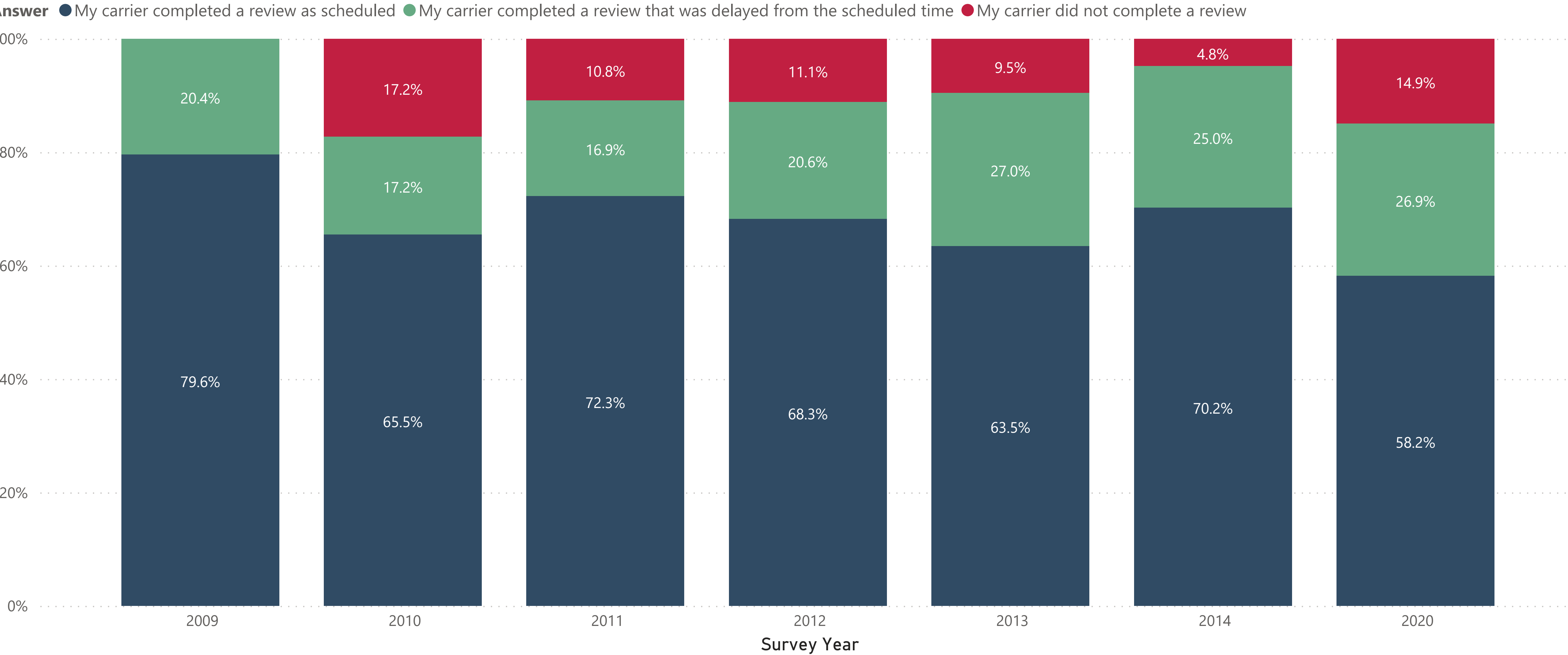
Answer ● Full workpapers with calculation, methodology, and total collateral indication ● Summary exhibit with total collateral indication ● Total collateral indication only ● Other



This question, also new for 2020, attempted to monitor the type of documentation respondents received related to their carrier's collateral review. As the methodologies used for calculating collateral vary significantly from one carrier to the next, it can be difficult to reconcile to the carrier's numbers if full workpapers are not released.

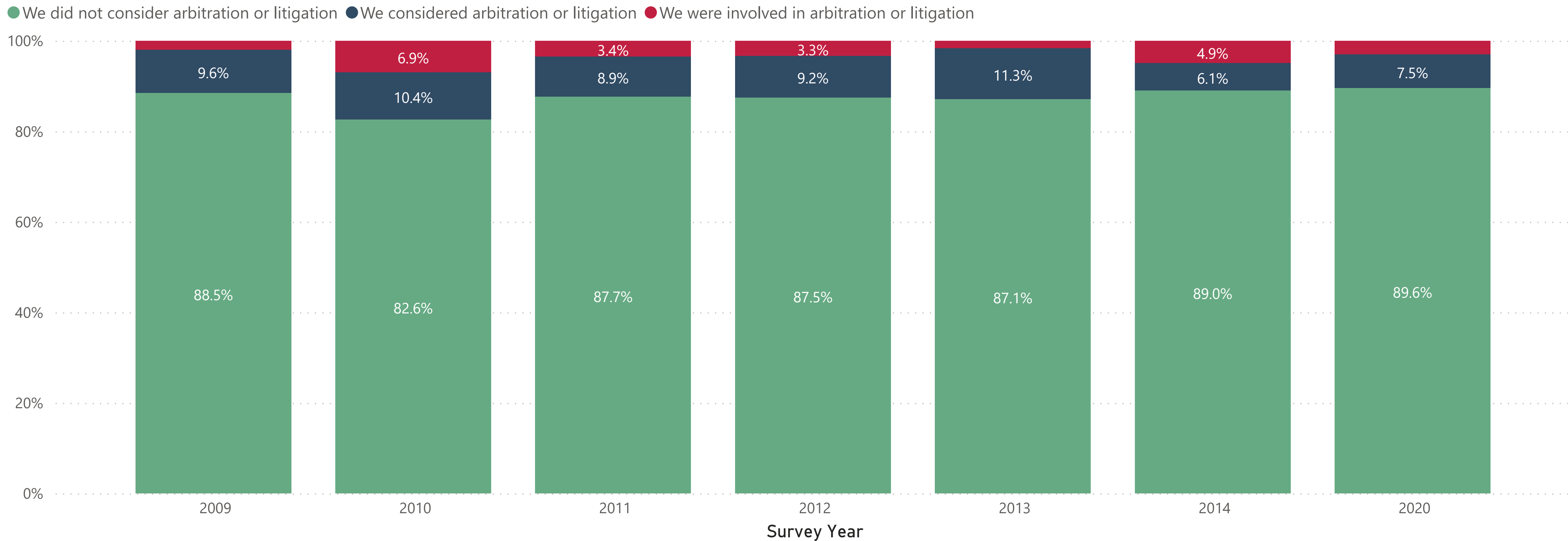
Around 21% received full workpapers with calculation, methodology, and total collateral indication, around 49% received a summary exhibit with a total collateral indication, and approximately 26% only received the total collateral indication.

16) Which of the following best describes how your carrier reviewed the collateral held in the year?



Question 16 focused on carrier collateral reviews. It should be noted that, in 2009, the option "My carrier did not complete a review" was not available to the respondents. The response "my carrier completed a review as scheduled" has varied from 63.5% to 79.6% between 2009 to 2014. In 2020, there was a notable decrease of 12% in "my carrier completed a review as scheduled." Around 15% indicated "my carrier did not complete a review," the second highest since 2010.

17) Which of the following best describes your collateral situation?

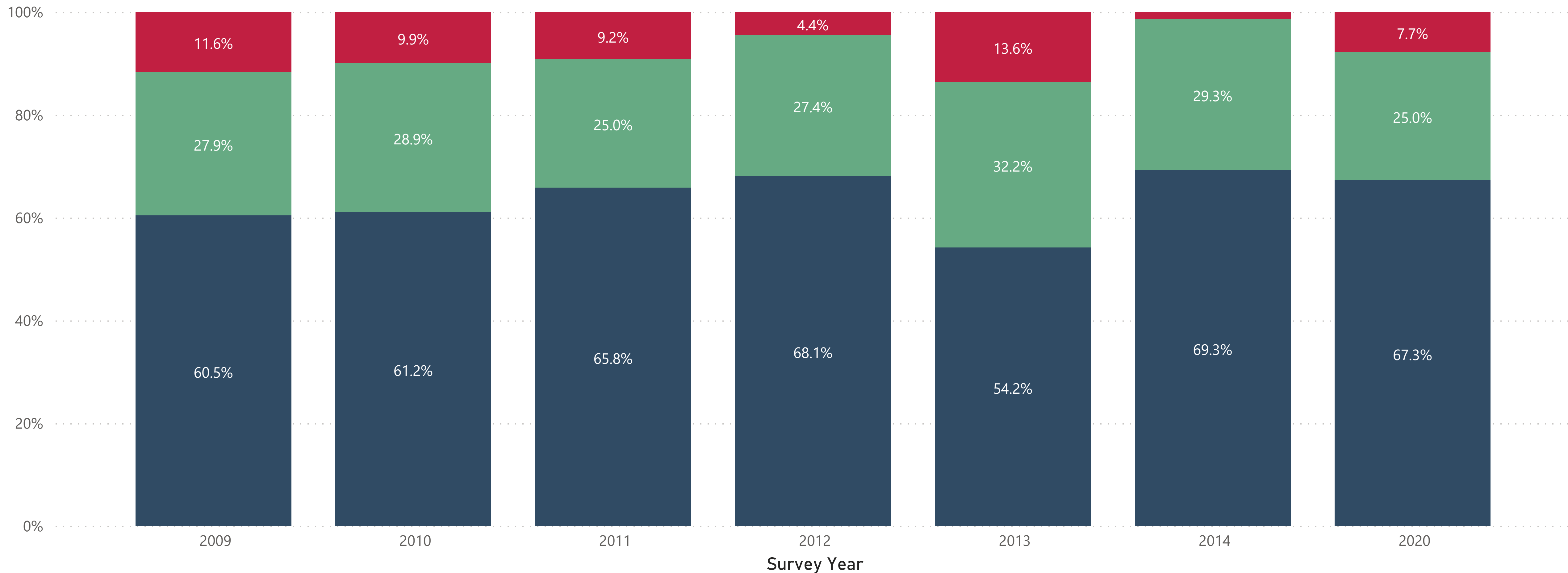


Over recent years, SIGMA has experienced an increase in requests for actuarial support in litigation or arbitration related to collateral issues. This support can include the completion of an expert report or expert testimony. Question 17 attempted to gauge the percentage of companies considering or involved in litigation. In 2010, there was an increase in the number of companies involved in litigation or arbitration (from 1.9% to 6.9%) and an approximate corresponding decrease in the number of companies that did not consider arbitration or litigation. From 2011 to 2014, the results were similar, and a decrease occurred over the 2010 level in the number of companies that considered arbitration or litigation. The 2020 results reflected a similar pattern compared to 2014, a possible indication that the litigation or arbitration related to collateral issue environment has held steady.

Collateral litigation often focuses on two key areas: the interpretation of the agreement language and the actual calculation of the collateral amount. In our experience, litigation and arbitration are more common in run-off situations, which are addressed in the next two questions.

18) Which of the following best describes the run-off collateral release?

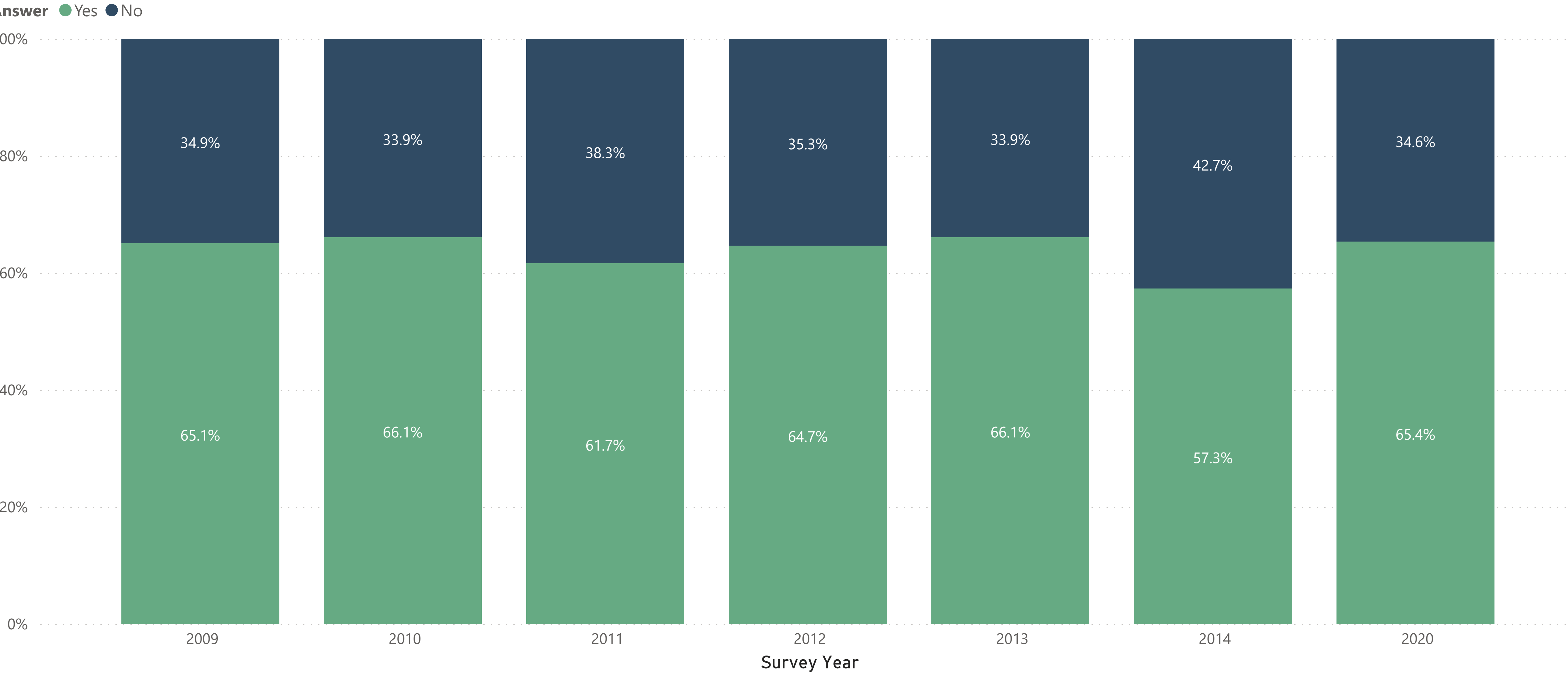
Answer ● The collateral held has been regularly reviewed and released as needed ● The collateral held has been regularly reviewed but not released ● The collateral held has not been regularly reviewed



Questions 18 to 19 of the survey focused on collateral issues related to “run-off” situations. This occurs when a company has collateral held by a carrier that is no longer their current carrier. In this situation, there is no “add-on” collateral, and the old years are winding down as claim payments are made. Historically, we have found that, in these instances, a carrier often may be less willing to negotiate the collateral amount.

The responses to this question were very consistent between 2009 and 2011. In 2014, respondents indicated a significant decrease in the percentage indicating collateral has not been regularly reviewed and an increase in the percentage indicating collateral has been regularly reviewed and released as needed. In 2020, there was a 6.4% increase in the percentage indicating that the collateral has not been regularly reviewed.

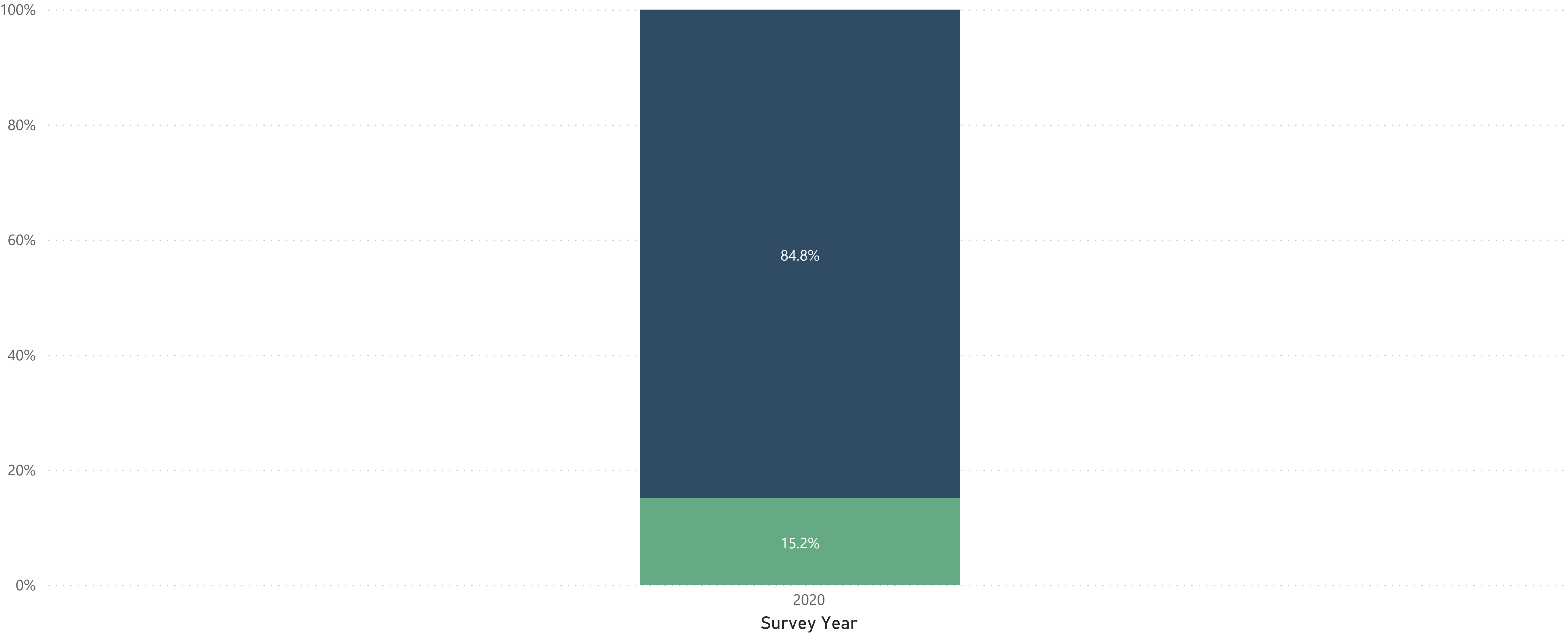
19) Do you have actuarial support in regards to the collateral held for the run-off program?



Question 19 indicated that 57% to 66% of the respondents utilized actuarial support in regards to run-off collateral over seven surveys. With the exception of 2014, this percentage closely correlated with the overall percentage from Question 4 regarding use of actuarial support.

20) Has your collateral increased due to the COVID-19 outbreak and related financial implications?

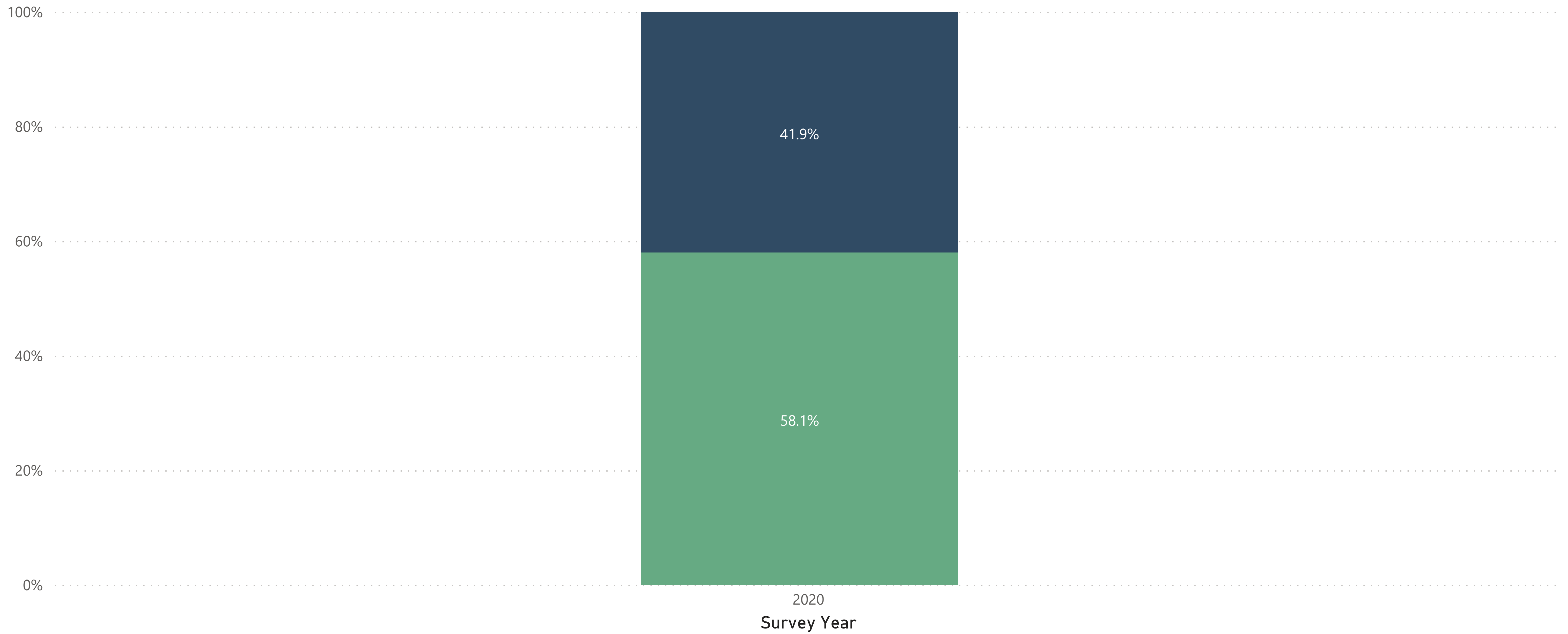
Answer ● Yes ● No



The effects of the emerging risks associated with the novel coronavirus (COVID-19) and resulting economic implications may remain unknown for years. This question attempted to track and monitor the changes in collateral due to the COVID-19 outbreak. Around 15% of the respondents indicated that collateral has been increased due to the COVID-19 outbreak.

21) Do you work with captive insurance companies that have collateral considerations?

Answer ● Yes ● No



Question 21 is also a new question that attempted to monitor collateral considerations related to captive insurance companies. A slight majority of the respondents indicated that they work with captive insurance companies that have collateral considerations.

Open Comment: Please provide any additional comments regarding collateral issues you have faced during recent months.

The last question of the survey allowed the respondent to make open comments. The majority of the open comments focused on collateral problems. There were two major categories of problems that most respondents mentioned: (1) carriers were not releasing the collateral and (2) carriers were unwilling to lower collateral. These comments were consistent with the comments received from 2010 to 2014. A lack of transparency and consistency has also been indicated as an issue by some respondents this year.

In our prior collateral survey results, we included several suggestions for improving collateral negotiations. These suggestions are:

- 1) Contact your carrier in advance of the collateral review date and ask if there will be any changes in the procedures or methodology. Ask if there will be changes in the loss development factors or in the source of the loss development factors.
- 2) Ask for the carrier's collateral work papers. Verify the data used in the calculations and look for any add-on provisions for risk margin related to experience or credit risk assessment. Review exposure information, especially if exposures are rapidly changing. This is particularly important during the pandemic, as changes in exposures could result in large swings in collateral. Document and support revised exposure projections.
- 3) In run-off situations, carefully review open claims. This is especially important if there are only a small number of open claims. Gather reopened claim data and claim reporting lag data. A claims audit may be useful in the situation where there are only a few open claims.
- 4) Use industry professionals as needed. This includes using your broker, actuary, and risk management consultant to assist in negotiations.

We would appreciate feedback on the survey and its results. Let us know which questions we can improve and what questions we should consider adding. We look forward to the next survey and your participation.

Further Reading

More suggestions and observations related to collateral and our survey are available in the following papers published by IRMI (International Risk Management Institute) by SIGMA authors. We have limited reprints available, so please let us know if you are interested:

"Collateral Trends, Issues, and Tactics." *Risk Financing Perspectives*, March 2010, by L. Michelle Bradley.

"Reducing Collateral Uncertainty: A Primer for Negotiations." *Risk Financing Perspectives*, 2006, by L. Michelle Bradley and Lloyd Kelly.

"Reducing Collateral Uncertainty." *Risk Financing*, Section III.L, 2008, by L. Michelle Bradley and Lloyd Kelly. (Updated in 2020)

"Current Collateral Trends." *Risk Financing Supplement*, June 2011, by L. Michelle Bradley.

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