# Prior Year Development
## (for P&C Insurance)

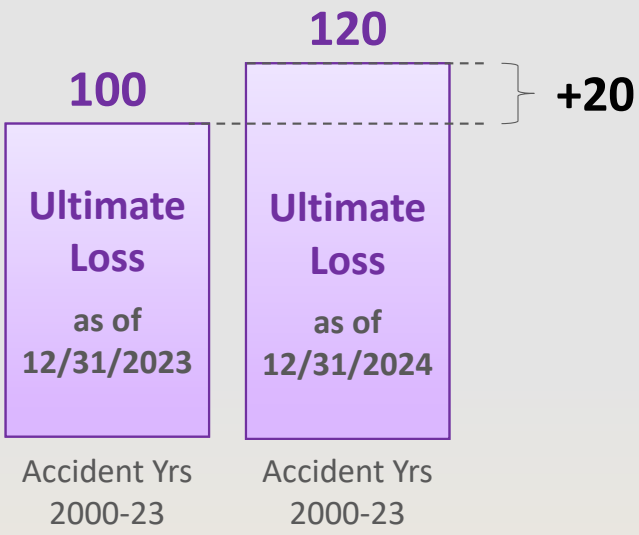
**Prior year development** is the change in estimates of **ultimate loss** between two evaluation dates for identical prior accident periods.

The accident periods between respective evaluations must be identical, otherwise the comparison is not on an apples-to-apples basis.

The sample scenarios below compare estimates of **ultimate loss** between the respective year-end 2023 and 2024 evaluations for accident years 2000 through 2023.

These scenarios illustrate *adverse* and *favorable* prior year development. Although not described separately, another common scenario is *no* prior year development.

### **Scenario A:** Adverse Prior Year Development

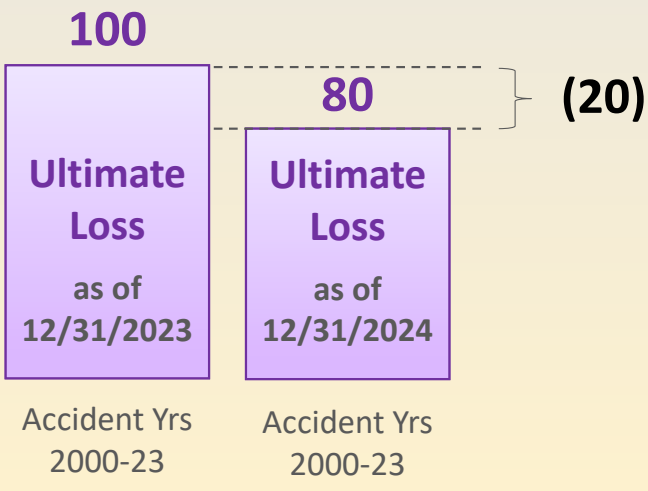



An increase in estimates of **ultimate loss** between respective evaluations for identical accident periods is called **adverse prior year development** or "reserve strengthening".

Implications include:

- A decrease in the insurer's earnings.
- Recognition that the insurer's estimates of **ultimate loss** at the earlier evaluation were inadequate (based on information known at the later evaluation).

### **Scenario B:** Favorable Prior Year Development




A decrease in estimates of **ultimate loss** between respective evaluations for identical accident periods is called **favorable prior year development**, or a "reserve release".

Implications include:

- An increase in the insurer's earnings.
- Recognition that the insurer's estimates of **ultimate loss** at the earlier evaluation were redundant (based on information known at the later evaluation).

# Prior Year Development
## (for P&C Insurance)

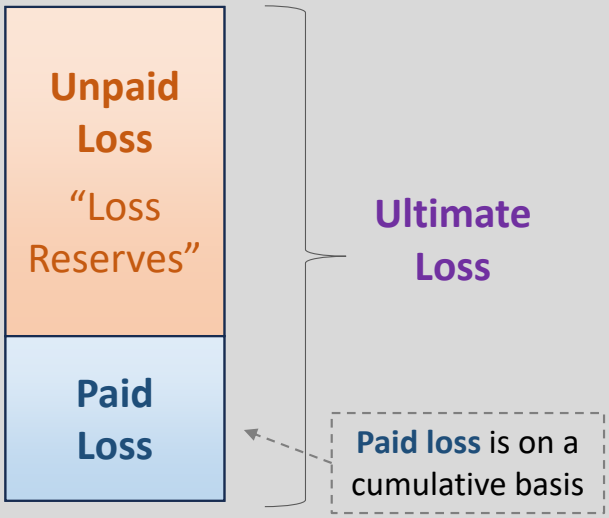
ARCHER ACTUARIAL

### Paid and Unpaid Components of Ultimate Loss

**Ultimate loss** can be broken into its two primary parts: **paid loss** and **unpaid loss** (or "**loss reserves**").

Separately illustrating the components demonstrates the fact that a change in **ultimate loss** does not necessarily correspond to a change in **loss reserves**.

Over time, for a fixed accident period, cumulative **paid losses** tend to increase while **loss reserves** tend to decrease. This tendency is more likely to hold true when evaluated between long periods of time.




### Scenario C: Adverse Prior Year Development (with breakout)


Accident Yrs 2000-23 as of 12/31/2023

Accident Yrs 2000-23 as of 12/31/2024

The table below calculates **prior year development** as the sum of changes in its respective components: **paid loss** and **loss reserves**.

| Change in Paid Loss | + | Change in Loss Reserves | = | Change in Ultimate Loss |
|---|---|---|---|---|
| 25 | + | (5) | = | 20 |
| *= 75 - 50* | | *= 45 - 50* | | *= 120 - 100* |

As suggested by this formula, **prior year development** can be defined as the sum of:

- **paid loss** in a calendar period, and
- the change in **loss reserves** during the same period.

The **ultimate loss** estimates in Scenario C increase by $20 between the respective evaluations. Some may call this increase "**reserve strengthening**". This terminology can be misleading. In this example, note that the **loss reserves** *decreased* by $5 during the period.

It is important not to confuse "reserve strengthening" with "reserve increase". In this example, **loss reserves** decreased during the period due to $25 of **loss payments**, which were partially offset by $20 of **loss reserve** "strengthening" during the same period.