

Comment #3 – 3/27/17 – 4:35 p.m.

I have the following comments on the Proposed Actuarial Standard of Practice (ASOP), Estimating Future Costs for Prospective Property/Casualty Risk Transfer and Risk Funding:

Comments on specific questions:

Q1. Does the proposed ASOP provide sufficient and appropriate guidance to actuaries estimating future costs for prospective property/casualty risk transfer and risk funding?

A1. More guidance is needed for dealing with infrequent events (current paragraph 3.14), particularly when dealing with low volumes of data where there may not be many observations of such infrequent events. The ASOPs that are cited do not cover that issue sufficiently, except possibly for cat events. This is especially important when doing work for a small company or small line of business.

Q2. The proposed ASOP has added reference to “intended measure” for the estimation of all future costs to eliminate any implication that the only appropriate estimate of all future costs was an expected value without any consideration of potential variability. Is it clear what is meant by “intended measure”?

A2. No comment.

Q3. Are the definitions of “risk transfer” and “risk funding” in the proposed ASOP complete from the perspective of all activities in which an actuary is involved when estimating future costs for prospective property/casualty risk transfer and risk funding?

A3. There may be confusion as to the phrase “risk funding” in an ASOP about costs. Is this talking about the offset to costs (e.g., recoveries), or the costs associated with calculating a charge for risk funding?

Q4. Is it clear that this proposed ASOP provides guidance only for the estimation of future costs for prospective property/casualty risk transfer and risk funding? Is it clear that the scope does not include items such as the balancing and interaction of potentially competing objectives related to regulation, business objectives, and actuarial cost estimates?

A4. Yes

Q5. When the role of the actuary is reviewing the estimate of future costs developed by another actuary, is the guidance provided in the proposed ASOP sufficient and clear?

A5. No comment.

Q6. Is the level of disclosure required in the proposed ASOP sufficient and appropriate? If the response is no, what are the issues?

A6. It may be excessive in some interpretations (in that it implies that all assumptions need to be disclosed, even implicit assumptions and immaterial ones). It is also potentially unclear with regard to

disclosing the cost of purchased ceded reinsurance (e.g., for a small property writer in a region with material cat risk and a need to purchase a cat cover to be a viable market).

Comments on specific paragraphs.

Paragraph 3.1 – The second sentence lists examples of the elements of a future cost estimate, with that list relied upon by the reference in paragraph 4.1a (disclosure of costs elements). One element of some future cost estimates that was not mentioned was the cost of ceded reinsurance. While this may be inferred from the wording in paragraph 3.1, this may be too subtle. Recommend adding to paragraph 3.1 the phrase “the cost of ceded reinsurance (where applicable)” to ensure that this point is not missed when providing the disclosures required by paragraph 4.1.a.

Paragraph 3.5 – This paragraph includes the following sentence:

“The actuary should use methods or models, along with reasonable assumptions, that, in the actuary’s professional judgment, have no known significant bias relative to the intended measure.”

Sometimes one component of such analysis (method, model or assumption) has a bias, but the actuary attempts to offset that bias via adjusting another component so as to eliminate or minimize any bias in the final result. The problem is that this paragraph is not clear as to whether each component of the analysis is meant to have “no known significant bias” or whether the test for bias is on the combined final result. This should be clarified.

Paragraph 3.8.2 – This paragraph mentions possible adjustments to the historical data, but does not mention the need to be consistent with how the premium data is adjusted (as mentioned in paragraph 3.8.1). This need for consistency (or to avoid inconsistency) when adjusting both premium and loss data should be explicitly mentioned.

Paragraph 3.14 – The ASOPs referenced in this paragraph deal with data quality, credibility, models outside the actuary’s expertise and cat models. There are sometimes infrequent events such as large losses that need special treatment for estimating costs for low volume data sets, but none of the ASOPs that are listed deal with this issue well. For such a situation some form of loss segmentation is typically helpful, e.g., treating the experience for losses capped at a certain level as being relatively credible, but using either a longer experience period or other assumptions for dealing with the costs from losses above that level. (This is sometimes referred to as a large loss load.) This issue needs to be expanded upon in this (or a later) paragraph, as the current wording is deficient for this issue.

Paragraph 4.1d – This paragraph would require the actuary to disclose “the assumptions used”. This is an overly broad statement, as it could be interpreted to be an open ended requirement that includes all implicit assumptions in the workproduct. For example, the use of a paid development method may implicitly assume that the claim systems didn’t change materially, that the claim department processes didn’t change materially, that the coding didn’t change from year to year, that the business mix didn’t materially change, etc., etc. Recommend adding the word “material” or “material explicit” so as to prevent an open-ended requirement, so that it requires disclosure of “the material explicit assumptions used” or something similar.

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