



ACTUARIAL STANDARDS BOARD

**Actuarial Standard
of Practice
No. 20**

**Discounting of Property/Casualty
Unpaid Claim Estimates**

Revised Edition

**Developed by the
Casualty Committee of the
Actuarial Standards Board**

**Adopted by the
Actuarial Standards Board
September 2011**

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September 2011

TO: Members of Actuarial Organizations Governed by the Standards of the Actuarial Standards Board and Other Persons Interested in Discounting of Property/Casualty Unpaid Claim Estimates

FROM: Actuarial Standards Board (ASB)

SUBJ: Actuarial Standard of Practice (ASOP) No. 20

This document contains the final version of a revision of ASOP No. 20, *Discounting of Property/Casualty Unpaid Claim Estimates*.

Background

ASOP No. 20 was originally adopted by the ASB in April 1992. The ASB charged the Casualty Committee with preparing this revision to ASOP No. 20 to reflect current terminology and practice, and to provide more consistency with the language in ASOP No. 43, *Property/Casualty Unpaid Claim Estimates*.

Exposure Draft

The exposure draft of this revised ASOP was issued in December 2010 with a comment deadline of May 1, 2011. The Casualty Committee carefully considered the five comment letters received and made changes in several sections in response. For a summary of the issues contained in these comment letters, please see appendix 2.

The ASB thanks everyone who took the time to contribute comments and suggestions on the exposure draft.

The ASB adopted this revised standard at its September 2011 meeting.

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The ASB establishes and improves standards of actuarial practice. These ASOPs identify what the actuary should consider, document, and disclose when performing an actuarial assignment.

The ASB's goal is to set standards for appropriate practice for the U.S.

ACTUARIAL STANDARD OF PRACTICE NO. 20

**DISCOUNTING OF PROPERTY/CASUALTY
UNPAID CLAIM ESTIMATES**

STANDARD OF PRACTICE

Section 1. Purpose, Scope, Cross References, and Effective Date

- 1.1 **Purpose**— This actuarial standard of practice (ASOP) provides guidance to actuaries when performing professional services relating to discounting an unpaid claim estimate to present value for property/casualty coverages. Any reference to “unpaid claims” in this standard includes (unless explicitly stated otherwise) the associated unpaid claim adjustment expense even when not accompanied by the estimation of unpaid claims.
- 1.2 **Scope**—This standard addresses the discounting to present value of unpaid claim estimates for property/casualty coverages. In determining the undiscounted unpaid claim estimate, the actuary should be guided by ASOP No. 43, *Property/Casualty Unpaid Claim Estimates*.

This standard applies when performing professional services related to developing discounted unpaid claim estimates only for events that have already occurred or will have occurred, as of an accounting date, exclusive of estimates developed solely for ratemaking purposes. This standard applies when estimating discounted unpaid claims for all classes of entities, including self-insureds, insurance companies, reinsurers, and governmental entities. This standard applies to estimates of gross amounts before recoverables (such as deductibles, ceded reinsurance, and salvage and subrogation), estimates of amounts after such recoverables, and estimates of amounts of such recoverables.

This standard applies only with respect to discounted unpaid claim estimates that are communicated as an actuarial finding in an actuarial document (as described in ASOP No. 41, *Actuarial Communications*). Actions taken by the actuary’s principal regarding such estimates are beyond the scope of this standard.

The terms “reserves” and “reserving” are sometimes used to refer to “unpaid claim estimates” and “unpaid claim estimate analysis.” In this standard, the term “reserve” is limited to its strict definition as an amount booked in a financial statement. Services described above are covered by this standard, regardless of whether the actuary refers to the work performed as “reserving,” “estimating unpaid claims” or any other term.

This standard does not address the appropriateness of using discounted unpaid claim estimates in specific contexts.

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This standard does not address the appropriateness of including a risk margin in specific contexts.

This standard does not apply to the estimation of items that may be a function of discounted unpaid claim estimates or claim outcomes, such as (but not limited to) loss-based taxes, contingent commissions and retrospectively rated premiums.

This standard does not apply to unpaid claims under a “health benefit plan” covered by ASOP No. 5, *Incurred Health and Disability Claims*, ASOP No. 6, *Measuring Retiree Group Benefit Obligations*, or included as “health and disability liabilities” under ASOP No. 42, *Determining Health and Disability Liabilities Other Than Liabilities for Incurred Claims*. However, this standard does apply to health benefits associated with state or federal workers’ compensation statutes and liability policies.

An actuary may develop a discounted unpaid claim estimate in the context of issuing a written statement of actuarial opinion regarding property/casualty loss and loss adjustment expense reserves. In such context, the actuary should be guided by ASOP No. 36, *Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves*, to address additional considerations associated with the issuance of such a statement.

If the actuary departs from the guidance set forth in this standard in order to comply with applicable law (statutes, regulations, and other legally binding authority) or for any other reason the actuary deems appropriate, the actuary should refer to section 4.

- 1.3 Cross References—When this standard refers to the provisions of other documents, the reference includes the referenced documents as they may be amended or restated in the future, and any successor to them, by whatever name called. If any amended or restated document differs materially from the originally referenced document, the actuary should consider the guidance in this standard to the extent it is applicable and appropriate.
- 1.4 Effective Date—This standard is effective for any actuarial work product covered by this standard’s scope issued on or after January 1, 2012.

Section 2. Definitions

The terms below are defined for use in this actuarial standard of practice.

- 2.1 Book Value—The value of an asset or assets, as included in a financial statement or other financial reporting context.
- 2.2 Discounted Unpaid Claim Estimate—The actuary’s estimate of the present value of the

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unpaid claim estimate.

- 2.3 **Investment Risk**—Uncertainty surrounding the realization of a specified investment income stream.
- 2.4 **Present Value**—The value on a given date of a future payment or series of future payments, discounted to reflect the time value of money.
- 2.5 **Risk-Free Interest Rate**—The theoretical rate of return of an investment with zero risk with respect to payment timing and amount.
- 2.6 **Risk Margin**—A provision for uncertainty in an unpaid claim estimate.
- 2.7 **Unpaid Claim Estimate**—The actuary’s estimate of the obligation for future payment resulting from claims due to past events. For clarity and unless otherwise indicated, this estimate is on an undiscounted basis and the terms “unpaid claim estimate” and “undiscounted unpaid claim estimate” are used interchangeably throughout this standard.

Section 3. Analysis of Issues and Recommended Practices

- 3.1 **Appropriateness in Context**—The actuary should be aware of the context in which the discounted unpaid claim estimate is to be used. The actuary should use a methodology and assumptions in the discounting process that are appropriate for that context.
- 3.2 **Relative Significance of Assumptions**—If both an undiscounted unpaid claim estimate and a discounted unpaid claim estimate are determined, the actuary should be aware of the differences in the relative significance of various assumptions between undiscounted and discounted unpaid claim estimates. For example, a development factor at an advanced maturity (such as a “tail factor”) is less significant to a discounted unpaid claim estimate than to an undiscounted unpaid claim estimate. Conversely, a change in the timing of loss payments may be more significant to a discounted unpaid claim estimate.
- 3.3 **Payment Timing for Discounting**—The actuary should derive the discounted unpaid claim estimate based on assumptions regarding the timing of future payments. A range of estimates for the timing of payments may be reasonable.
 - 3.3.1 **Assumptions**—The actuary should consider the reasonableness of the assumptions underlying the estimated timing of future payments. Assumptions generally involve significant professional judgment. Assumptions may be implicit or explicit, and may involve interpreting past data or projecting future trends. The actuary should use assumptions that, in the actuary’s professional judgment, have no known significant bias to underestimation or overestimation of the identified intended measure and are not internally inconsistent.

The actuary should consider the sensitivity of the timing of future payments to reasonable alternative assumptions. (See section 4.1(f) for related disclosure requirements.)

The actuary may provide the principal with results based on a set of assumptions that differ from the actuary's assumptions, subject to appropriate disclosure as described in section 4.1.

- 3.3.2 Reconciliation of Estimates—The cumulative amount of payments used by the actuary for discounting should be consistent with the amount of the unpaid claim estimate, even if the latter has not been derived by techniques based on payment data.
 - 3.3.3 Consistency of Assumptions—The actuary should use assumptions in estimating the timing of payments that are consistent with the assumptions used in developing the undiscounted unpaid claim estimate to the extent appropriate.
 - 3.3.4 Consistency with Expected Future Conditions—The actuary should determine estimates of the timing of payments that are consistent with conditions expected to prevail during the future payment period. If such conditions are expected to be different from those prevailing during the historical evaluation period, the actuary should make appropriate adjustments.
 - 3.3.5 Data—The actuary should refer to ASOP No. 23, *Data Quality*, with respect to selection of data to be used, relying on data supplied by others, reviewing data, and using data.
 - 3.3.6 Recoverables—The actuary should consider to the extent appropriate the timing and amount of expected recoverables (for example, deductibles, ceded reinsurance, and salvage and subrogation) when projecting the timing of future payments.
 - 3.3.7 Unpaid Claim Components—The actuary should consider whether such components that have a material effect on the timing and amount of future payments have been reflected appropriately when projected future payments are comprised of multiple components (for example, line of business, accident year, claim adjustment expense).
- 3.4 Discount Rates—Projected future payments are discounted to present value using discount rate assumptions.
- 3.4.1 Discount Rate Basis—Discounted unpaid claim estimates may be used in a variety of contexts and the appropriate selected discount rates are a function of the context. A range of discount rates may be reasonable. Common approaches to selecting a discount rate include:

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- a. Risk-Free Approach—The selected discount rates in this approach approximate risk-free interest rates. Risk-free interest rates can be approximated by rates of investment return available on fixed income assets having low investment risk and timing characteristics comparable to those assumed in the discounting of unpaid claim estimates.
- b. Portfolio Approach—The selected discount rates in this approach are based on the anticipated return from a selected portfolio of assets. The actuary should consider to the extent appropriate the relationships between the book and market values of assets, between the anticipated portfolio rates of return and market rates of return, and between the maturities of the assets and the estimated timing of future payments on unpaid claims. The portfolio rates of return should be net of investment expenses.
- c. Discount Rates Requested by Another Party—The actuary is responsible for the discount rates employed in preparing the actuarial findings unless the actuary appropriately discloses otherwise. The actuary should be guided by section 3.4.4 of ASOP No. 41, when using discount rates requested by another party.

3.4.2 Effect of Income Taxes—The actuary should consider whether the discount rates should be consistent with investment returns before or after the payment of income taxes.

3.5 Ranges—The actuary should consider the uncertainty in the discounted unpaid claim estimate when determining a range of estimates. The actuary should recognize that the uncertainty inherent in discounted unpaid claim estimates generally is different than the uncertainty inherent in undiscounted unpaid claim estimates.

Section 4. Communications and Disclosures

4.1 Actuarial Communication—When issuing an actuarial communication subject to this standard, the actuary should consider the intended purpose or use of the discounted unpaid claim estimate and refer to ASOP Nos. 23 and 41 for additional guidance on disclosure.

In addition, consistent with the intended purpose or use, the actuary should disclose the following in an appropriate actuarial communication:

- a. the assumptions as to selected discount rates and the basis for those assumptions, including the effect of income taxes, as described in section 3.4;
- b. to the extent practical, the difference between the undiscounted unpaid claim

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estimate and the discounted unpaid claim estimate;

- c. whether the discounted unpaid claim estimate includes a risk margin, and if so, the basis for the risk margin (for example, stated percentile of distribution or stated percentage load above expected);
- d. significant limitations, if any, that constrained the actuary's discounted unpaid claim estimate analysis such that, in the actuary's professional judgment, there is a significant risk that a more in-depth analysis would produce a materially different result;
- e. the following dates: (1) the accounting date of the discounted unpaid claim estimate, which is the date used to separate paid versus unpaid claim amounts; (2) the valuation date of the discounted unpaid claim estimate, which is the date through which transactions are included in the data used in the discounted unpaid claim estimate analysis; and (3) the review date of the discounted unpaid claim estimate, which is the cutoff date for including information known to the actuary in the discounted unpaid claim estimate analysis, if appropriate;
- f. specific significant risks and uncertainties, if any, with regard to actual timing of future payments;
- g. significant events, assumptions, or reliances, if any, underlying the discounted unpaid claim estimate that, in the actuary's professional judgment, have a material effect on the discounted unpaid claim estimate, including assumptions regarding the accounting basis or application of an accounting rule;
- h. the disclosure in ASOP No. 41, section 4.2, if any material assumption or method was prescribed by applicable law (statutes, regulations, and other legally binding authority);
- i. the disclosure in ASOP No. 41, section 4.3, if the actuary states reliance on other sources and thereby disclaims responsibility for any material assumption or method selected by a party other than the actuary; and
- j. the disclosure in ASOP No. 41, section 4.4, if, in the actuary's professional judgment, the actuary otherwise deviated materially from the guidance of this ASOP.

4.2 Additional Disclosures—In certain cases, consistent with the intended purpose or use, the actuary may need to make the following disclosures in addition to those in section 4.1:

- a. When the actuary specifies a range of estimates, the actuary should disclose the basis of the range provided.

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- b. When the unpaid claim estimate is an update of a previous estimate, the actuary should disclose changes in assumptions, procedures, methods or models that the actuary believes to have a material impact on the discounted unpaid claim estimate and the reasons for such changes to the extent known by the actuary. This standard does not require the actuary to measure or quantify the impact of such changes.

Appendix 1

Background and Current Practices

Note: This appendix is provided for informational purposes, but is not part of the standard of practice.

Background

In 1992, the ASB issued ASOP No. 20, *Discounting of Property and Casualty Loss and Loss Adjustment Expense Reserves*. Prior to that, there was no standard of practice concerning discounting of property and casualty loss and loss adjustment expense reserves. Since the issuance of ASOP No. 20, the ASB has issued ASOP No. 36, *Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves* and, ASOP No. 43, *Property/Casualty Unpaid Claim Estimates*. This revision provides more consistency with the language in these two ASOPs, and is more relevant now with the increased use of discounting related to fair value calculations.

The appropriateness of discounting unpaid claim estimates in various financial reporting contexts is a controversial topic. Traditionally, property and casualty unpaid claim estimates have not been discounted except in certain narrowly defined circumstances. However, the issue of discounting reserves has been discussed for many years. For example, the issue appeared in the 1927 *Proceedings of the Casualty Actuarial Society*, in an article by Benedict D. Flynn. In 1986, the U.S. Congress passed legislation prescribing discounting procedures for income-tax purposes. In the past, most state insurance departments prohibited discounting; some departments have permitted discounting for some lines of business. The National Association of Insurance Commissioners has consistently been opposed to discounting except in certain specific circumstances. The accounting profession is studying the issue as it relates to financial reporting.

Historically, the issue of reserve discounting has been closely related to the issue of risk margins. Undiscounted reserves are often considered to contain a needed implicit risk margin in the difference between undiscounted reserves and discounted reserves. If discounted reserves were incorporated into financial statements, many would argue that an explicit risk margin would become necessary. Suggestions for the treatment of that risk margin include treatment as a liability item, a segregated surplus item, or an off-balance-sheet item.

The discounting of unpaid claim estimates and risk margins are both important elements in estimating the fair value of unpaid claim estimates, yet neither is explicitly included in most current financial reporting. Much of the rationale for unpaid claim estimate discounting is related to the issue of fair value; however, some believe that discounted unpaid claim estimates without risk margin may be a poorer estimate of fair value than undiscounted unpaid claim estimates.

Unpaid claim estimate discounting calculations are commonly performed in conjunction with

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valuations of insurance companies for purposes such as acquisition or merger, or with transfers of portfolios or unpaid claims. In these instances and for other reasons, there are increasing numbers of circumstances where actuaries are asked to determine or evaluate discounted unpaid claim estimates.

Current Practices

Actuaries are currently guided by the existing ASOP No. 20. Other ASOPs issued by the Actuarial Standards Board pertaining to discounting of unpaid loss and loss adjustment expense estimates include ASOP No. 23, *Data Quality*; ASOP No. 36; ASOP No. 41, *Actuarial Communications*; and ASOP No. 43. In addition, disclosures related to discounting are required by the National Association of Insurance Commissioners, and guidance may be forthcoming as part of new International Financial Reporting Standards that are currently under development.

Numerous educational papers are in the public domain that are relevant to the topic of discounting and risk loads, including those published by the Casualty Actuarial Society. While these may provide useful educational guidance to practicing actuaries, these are not actuarial standards and are not binding.

Appendix 2

Comments on the Exposure Draft and Responses

The exposure draft of this ASOP, *Discounting of Property/Casualty Unpaid Claim Estimates*, was issued in December 2010 with a comment deadline of May 1, 2011. Five comment letters were received, one of which was submitted on behalf of multiple commentators. For purposes of this appendix, the term “commentator” may refer to more than one person associated with a particular comment letter. All comments were carefully considered and the Casualty Committee and ASB reviewed (and modified, where appropriate) the proposed changes.

Summarized below are the significant issues and questions contained in the comment letters and the responses.

The term “reviewers” in appendix 2 includes the Casualty Committee and the ASB. Also, unless otherwise noted, the section numbers and titles used in appendix 2 refer to those in this revised standard.

| SECTION 1. PURPOSE, SCOPE, CROSS REFERENCES, AND EFFECTIVE DATE | |
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| Section 1.2, Scope | |
| Comment | One commentator suggested that the standard be modified to apply broadly to loss sensitive estimates, such as retrospective premiums or the payment of claims-related assessments. |
| Response | The reviewers note the focus of this standard was on discounting unpaid claim estimates and, therefore, section 1.2 reiterates similar exclusions found in section 1.2 of ASOP No. 43, <i>Property/Casualty Unpaid Claim Estimates</i> , which does not apply to loss sensitive estimates. |
| SECTION 2. DEFINITIONS | |
| Comment | One commentator noted that the terms “payments” and “future payments” were used throughout the document and suggested that the terms be defined to include the inflow of recoveries in order for it to be clear that potential inflows should be considered. |
| Response | Section 1.2 identifies that this standard applies to estimates of gross amounts before recoverables (such as deductibles, ceded reinsurance, and salvage and subrogation), estimates of amounts after such recoverables, and estimates of amounts of such recoverables. As such, the reviewers believe that it is clear that payments and future payments should consider potential inflows and outflows depending on the context. |
| Comment | One commentator suggested that a definition for discount rate be added to the standard. |
| Response | The reviewers do not believe that a definition is necessary because it is sufficiently described in sections 2.4 and 3.4. |
| Section 2.1, Book Value | |
| Comment | One commentator suggested that the definition of book value be removed because the term is not used in the standard. |
| Response | The reviewers note the definition is referenced in section 3.4.1(b) and thus made no change. |

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| Section 2.3, Investment Risk | |
| Comment | Several commentators suggested expanding the list of examples of investment risk to include market risk and reinvestment risk. |
| Response | The reviewers believe that the definition is sufficiently clear without the need for examples. The examples given previously with credit risk and liquidity risk, and their associated definitions were removed in order to avoid the misunderstanding that they were an exhaustive list. |
| SECTION 3. ANALYSIS OF ISSUES AND RECOMMENDED PRACTICES | |
| Section 3.1, Appropriateness in Context | |
| Comment | Several commentators suggested that there may be circumstances where the actuary may use more than one methodology when performing the discounting calculation. For example, multiple methods may be used to determine a reasonable range of discounted unpaid claim estimates. |
| Response | The reviewers believe that actuaries generally use only one methodology when discounting unpaid claim estimates; however, the reviewers acknowledge that an actuary may want to use more than one methodology in some circumstances. The reviewers believe that use of more than one methodology in this context would be characterized as “a methodology” and hence no change was made. |
| Section 3.3, Payment Timing for Discounting | |
| Comment | Commentators interpreted the wording of section 3.3 to imply that an actuary must explicitly project the timing of future payments and that an implicit assumption regarding the timing might be a violation of the standard. |
| Response | The reviewers acknowledge that the timing of future payments might be estimated implicitly and rephrased this paragraph to avoid confusion. |
| Section 3.4, Discount Rates | |
| Comment | One commentator suggested that the term “discount rate” was incorrect and this standard should use “interest rate” in its place. |
| Response | The reviewers disagree. The term discount rate was chosen to be consistent with other standards of practice as well as other practice areas. |
| Comment | One commentator interpreted the approaches in section 3.4.1 to be a complete and exhaustive list and asked if that is what was intended. |
| Response | The approaches are not intended to be an exhaustive list. This section was rephrased to indicate that there may be other approaches. |
| Comment | One commentator suggested that some liability cash flows may extend beyond the normal range of asset maturity dates and that this standard provides no guidance in these situations. |
| Response | The reviewers believe techniques to address this situation, such as extrapolation, are consistent with the guidance in sections 3.4.1(a) and 3.4.1(b), and made no change. |
| Comment | One commentator requested that reference be made to U.S. Treasuries when discussing the use of a risk-free rate for the discount rate. |
| Response | The reviewers do not believe that sovereign debt or any other asset can be unequivocally defined as having low investment risk even though U.S. Treasuries have been historically viewed as low-risk. The reviewers believe that the risk-free approach in section 3.4.1(a) provides sufficient guidance for the actuary when approximating a |

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| | risk-free interest rate. |
| Comment | One commentator suggested that a discount rate might be based on a benchmark portfolio of assets and questioned whether or not this was accepted practice according to the standard. |
| Response | The reviewers note that section 3.4.1(b) does not prescribe whether the portfolio of assets is derived from actual assets or a benchmark. The use of either type of asset will depend on the context as mentioned in section 3.4.1. |
| Comment | Several commentators objected to the phrase that it is “generally expected” that the actuary is responsible for the discount rates employed in preparing the actuarial findings and suggested section 3.4.1(c) be rephrased accordingly. |
| Response | The reviewers agree and rephrased section 3.4.1(c). |
| Section 3.5, Ranges | |
| Comment | One commentator noted that there are many types of ranges, such as a range of best estimates or a range of possible outcomes, and this section was not clear which type of range was being referenced. |
| Response | The reviewers changed the word “range” to “range of estimates” in this section. The type of range used will depend on the context and, according to section 4.2(a), the actuary should disclose the basis of the range, if one is provided. |
| Section 3.6, Risk Margins [Exposure Draft] | |
| Comment | One commentator disagreed that an undiscounted unpaid claim estimate contains a margin. |
| Response | This section was removed and a sentence was added to section 1.2, which states: “This standard does not address the appropriateness of including a risk margin in specific contexts.” |
| SECTION 4. COMMUNICATIONS AND DISCLOSURES | |
| Section 4.1, Actuarial Communication | |
| Comment | One commentator suggested that the amount of the risk margin should be disclosed to the extent practical. |
| Response | The reviewers believe that in certain cases it may be difficult to quantify the amount of a risk margin and language requiring disclosure of the amount “to the extent practical” could place an undue burden on the actuary. |
| Comment | One commentator suggested deleting sections (d), (e), and (g) because they are duplicative with other standards. |
| Response | The reviewers acknowledge that the wording is similar to ASOP No. 43 but these sections are used in this standard to address the context of discounted unpaid claims estimates. |
| Comment | One commentator suggested that in some cases an estimate is discounted to a different date that may not coincide with the accounting date and suggested that section 4.1(e) include the concept of a separate “discount to” date. |
| Response | The reviewers agree that there may be circumstances where the estimate is discounted to a date different from the accounting date and believe this standard does not prevent the actuary from using and disclosing the different date. In addition, section 4.1(g) would require the disclosure of a different “discount to” date by virtue of it being a significant assumption underlying the discounted unpaid claim estimate. |