

Appendix 2

Comments on the Second Exposure Draft and Responses

The second exposure draft of this ASOP, *Property/Casualty Unpaid Claim Estimates*, was issued in February 2007 with a comment deadline of May 1, 2007. Nine comment letters were received, some of which were submitted on behalf of multiple commentators, such as by firms or committees. For purposes of this appendix, the term “commentator” may refer to more than one person associated with a particular comment letter. The Subcommittee on Reserving carefully considered all comments received 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 subcommittee, the Casualty Committee, and the ASB. Also, unless otherwise noted, the section numbers and titles used in appendix 4 refer to those in the second exposure draft.

GENERAL COMMENTS	
Comment	Two commentators requested that the standard comment on what would constitute reasonable review of a previous estimate. Specifically, they were concerned with actuaries reviewing an earlier estimate with the benefit of hindsight, particularly in a litigation situation.
Response	A sentence has been added to section 3.7.1, Reasonableness, to address this issue.
SECTION 1. PURPOSE, SCOPE, CROSS REFERENCES, AND EFFECTIVE DATE	
Section 1.2, Scope	
Comment	One commentator suggested a clarification to section 1.2, inserting the words “or will have occurred” immediately after the words “for events that have already occurred.”
Response	The reviewers agree and made the change.
Comment	One commentator was concerned that the development of unpaid claim estimates for ratemaking purposes would benefit from much of what is in this standard, despite the ratemaking scope exclusion in this standard. The recommendation was to retain the ratemaking exclusion in this standard but to then begin work on a revision that would remove such an exclusion.
Response	The reviewers agree with retaining the ratemaking scope exclusion for this standard but believe the ratemaking situation is outside their current charge.

Comment	One commentator suggested adding the words “specific types of” before the word “recoverables” in the first paragraph of section 1.2, as otherwise it might imply that all types of recoverables are being discussed.
Response	The reviewers disagree with the suggestion, as the intent is to potentially include all types of recoverables related to unpaid claims, relying on the actuary in section 3.3, Scope of the Unpaid Claim Estimate, to identify the particular recoverables (if any) applicable to the given purpose or use of the unpaid claim estimate(s) being developed. The reviewers made no change.
Comment	Two commentators were concerned that some may be confused by the use of the term “unpaid claim estimates” rather than “reserves.”
Response	The reviewers added a paragraph to section 1.2 for clarity.
Comment	One commentator was concerned that the scope exclusion for items that “may be a function of unpaid claim estimates” would inadvertently exclude recoverables that are included in unpaid claims.
Response	The reviewers believe that the standard is sufficiently clear (as reflected in the first paragraph, last sentence of section 1.2) that such recoverables are covered by the standard.
Comment	One commentator suggested adding “pricing” and “premiums” to the list of items that are a function of unpaid claim estimates or claim outcomes but not included in this standard’s scope.
Response	The reviewers do not feel this is necessary, as ratemaking is already excluded in the section’s first paragraph, and this list is not meant to be all inclusive.
Comment	Two commentators expressed concern that health insurance written by companies filing property/casualty annual statements may be included in the scope. One of these commentators recommended addressing this by explicitly excluding health insurance from the scope. The other commentator recommended that there was no need for a separate property casualty standard on unpaid claim estimates, as the property/casualty perspective could probably be addressed in the current ASOP No. 5, <i>Incurred Health and Disability Claims</i> . The latter commentator also suggested a definition of “property/casualty” be provided if a separate property/casualty standard was to be adopted.
Response	The reviewers agree that such confusion may exist, and added a paragraph to section 1.2, Scope.
Comment	One commentator stated the end of section 1.2 dealing with conflict with applicable law, etc. is not necessary, and that the term “provision” (found in section 1.3, Cross References) is also used in some jurisdictions in place of policy or loss reserves.
Response	The reviewers disagree as this wording is standard for all ASOPs and made no change.

SECTION 2. DEFINITIONS

Section 2.1, Actuarial Central Estimate	
Comment	One commentator objected to the term “actuarial central estimate,” due to the concern that it would be a truncated mean in most situations, biased low relative to the expected value, and recommended that if absolutely needed in the standard that it be relabeled without the word “actuarial” as part of the label.
Response	The reviewers disagree with the deletion of the term “actuarial” and made no change. Refer to appendix 3.
Comment	One commentator was concerned that the use of the term “expected value” in the definition of “actuarial central estimate” would imply a statistical mean. The commentator suggested changing “expected value” to “central tendency...such as an average or an expected value.”
Response	The reviewers considered similar wording in the drafting process and made no change. Refer to appendix 3.
Comment	One commentator suggested that different terms be used to describe the results from methods vs. models. Specifically, the commentator suggested the term “actuarial central estimate” be limited to describing a result from a method, while the term “actuarial distribution estimate” or some other term be used to describe the results of a model.
Response	The reviewers believe the standard allows the actuary to describe the results using whatever term the actuary sees fit to use (the term “actuarial central estimate” is provided as just one of many possible terms that can be used) and made no change.
Section 2.3, Coverage	
Comment	One commentator was concerned that the definition of “coverage” did not include self-insured first party claims.
Response	The reviewers could not envision a situation where a “liability” or claim would exist with regard to first party self-insured losses. Rather, this was viewed as more of a reduction in asset value. As such, the reviewers did not agree with the need to address self-insured first party claims and made no change.
Section 2.5, Method and 2.6, Model	
Comment	One commentator stated, “There are definite differences between ‘methods’ and ‘models’ that are much more substantial and fundamental than” what is in the proposed standard. The commentator suggested that more complete definitions be taken from the CAS Working Party paper on reserve variability.
Response	The definitions in the standard are abbreviated versions of what is in the referenced Working Party paper. The reviewers believe that further elaboration is unnecessary, although reference to various CAS publications has been added to appendix 1.
Section 2.7. Model Risk	
Comment	One commentator believed that combining reference to methods and models in the definition of “model risk” in section 2.7 caused grammatical problems. The suggested fix was to create a new term, “method risk,” which would also lead to a slight change in paragraph 3.6.8, Uncertainty.
Response	The reviewers believe that common usage is to include what was described as “method risk” in the category of “model risk.” Hence, a change was made to the definition, but a separate term (and definition) for “method risk” was not added.

Section 2.8, Parameter Risk	
Comment	One commentator objected to the reference to “methods” in the definition of “parameter” risk, due to a belief that “since a ‘method’ does not have an underlying distribution there are no parameters to estimate.”
Response	The reviewers believe that this is within the purview of common usage of the terms “methods” and “parameters,” and made no change.
Comment	One commentator suggested adding a definition of “parameter” for consistency purposes.
Response	The reviewers believe that such a definition is unnecessary and made no change.
Section 2.11, Unpaid Claim Estimates	
Comment	One commentator suggested modifying this definition (and the unpaid claim estimate analysis definition) to clarify that unpaid claim estimates are synonymous with loss reserve estimates or unpaid claim liability estimates in financial reporting contexts.
Response	The reviewers added language to section 1.2, Scope, for clarity.
SECTION 3. ANALYSIS OF ISSUES AND RECOMMENDED PRACTICES	
Section 3.1, Purpose or Use of the Unpaid Claim Estimate	
Comment	One commentator agreed with the use of the term “unpaid claim estimate” rather than “reserve” to avoid the financial reporting context, but believed that reference to the “intended purpose” of the estimate forced the discussion back solely to reserves and financial reporting. The suggested fix was to remove any discussion of “intended purpose” in the standard, and focus solely on estimating the distribution of possible future outcomes in the standard. (This concern also led to minor changes suggested in section 1.2, Scope.)
Response	The reviewers disagree that the only “intended purposes” would be those relating to financial reporting. Other “intended purposes” (some of which are listed in section 3.1) include merger/acquisition-related valuations, scenario analyses for risk management purposes, valuations as part of commutation discussions, etc. The reviewers made no change.
Comment	The last sentence of this section states “the actuary...should consider adjustments to accommodate the multiple purposes to the extent...it is appropriate and practical” to do so. One commentator asked if the intent was for the actuary to adjust the estimate or to provide different estimates for each purpose/use.
Response	The reviewers discussed different possible approaches to addressing this situation and decided that the standard should be silent on whether to produce multiple estimates, produce a single estimate that attempts to accommodate both purposes (assuming that this is possible), or some other option. Instead, the standard requires the actuary to consider some adjustment and leaves it up to the actuary’s professional judgment as to whether or what kind of adjustment to make. The reviewers made no change.

Section 3.2, Constraints on the Unpaid Claim Estimate Analysis	
Comment	One commentator suggested replacing “staff” with “resources” in this section as to be more general.
Response	The reviewers agree and changed the language.
Comment	One commentator suggested replacing “result” with “estimate” in this section so that it is more consistent with the rest of the ASOP.
Response	The reviewers disagree. As worded, “result” could incorporate other parts of the analysis beyond the estimate, such as analysis of uncertainty (if included in the assignment’s scope). The reviewers made no change.
Comment	Where there is a significant risk of the type described in this section, one commentator recommended that this situation be a required disclosure.
Response	The reviewers disagree noting that required disclosure is already addressed in section 4.1(b) and made no change.
Section 3.3, Scope of the Unpaid Claim Estimate	
Comment	One commentator was concerned that the wording in 3.3(a)(1) may cause actuaries to limit themselves to only the alternatives listed. Alternate wording was suggested.
Response	The reviewers agree and changed the wording in response.
Comment	One commentator suggested an editorial change for section 3.3(c), whereby “is to be considered” would be changed to “is considered.”
Response	The reviewers disagree with the suggestion, as section 3.3 addresses identification of the scope of the work in advance of the actual analysis. Hence, “is to be” is more appropriate than “is” in this context. The reviewers made no change.
Comment	One commentator suggested replacing the phrase “any other items” in section 3.3(f) with “other items” or “any other significant items,” due to a concern that the current wording would be too all inclusive and could result in excessive procedures.
Response	The reviewers disagree, as the reference at the end of the paragraph (“needed to describe the scope sufficiently”) already addresses the stated concern, and made no change.
Comment	One commentator suggested replacing “material to the actuary” with “material to the estimate” in section 3.5, Nature of Unpaid Claims, first paragraph.
Response	The reviewers agree and made the change.
Section 3.6, Unpaid Claim Estimate Analysis	
Comment	One commentator was concerned with the possible ambiguity with the term “factors” in this paragraph.
Response	The reviewers believe that this possible ambiguity is sufficiently addressed by the discussion in section 3.6.

Comment	One commentator suggested that additional guidance on unpaid claim adjustment expenses be provided for situations involving prepaid expenses and third party administrators (TPAs).
Response	The standard already includes claim adjustment expenses in its scope, as “unpaid claims” is defined in section 1.1, Purpose, as including the related claim adjustment expenses. The reviewers also believe that prepayments to TPAs for the expense of adjusting claims is a specific situation and, as such, is too detailed for the general guidance in this standard. The reviewers made no change.
Section 3.6.1, Methods and Models	
Comment	One commentator stated that “we should be doing all we can to foster the rigorous use of stochastic models in favor of traditional deterministic methods” and objected to the use of “methods” and “models” as essentially interchangeable terms.
Response	The reviewers consider judgment to be a major component of the application of both methods and models. As such, the reviewers do not consider one to be clearly superior to the other in all situations. The reviewers made no change.
Comment	In section 3.6.1, in the phrase that says, “For example, different coverages within a line of business may require different methods,” one commentator questioned whether the word “require” was appropriate.
Response	The reviewers believe that the word “require” is appropriate in this context, given that it is used in the context of an example and not in providing a direct requirement. The reviewers made no change.
Comment	One commentator suggested wording with regard to required disclosure if multiple methods were not used for “any component.” The suggestion limited the disclosure to only material components. The same commentator also asked for clarification of the term “component.”
Response	The reviewers reworded the section to clarify that the requirement only existed for material components. The suggested clarification of the term “component” was not adopted, as the reviewers felt that it would lead to a list of component examples that would never be complete for all applications.
Section 3.6.3, Data	
Comment	One commentator suggested adding guidance that “additional liabilities may be necessary if the data does not balance to recorded claim expenses, i.e., if there is a timing difference between when a claim is shown as paid in the actuarial data and when it is recorded by the principal.”
Response	The reviewers believe that this is a specific situation and is covered by the general guidance in section 3.6.1(c). The reviewers made no change.
Section 3.6.6, External Conditions	
Comment	One commentator suggested that section 3.6.6, External Conditions, focused on past or current conditions, while section 3.6.7, Changing Conditions, focused on current or future conditions, and that these time horizons might be clarified in the standard.
Response	The reviewers do not agree that the time horizons in the two sections are constrained as suggested by the commentator and made no change.

Section 3.6.7, Changing Conditions	
Comment	Two commentators suggested that the actuary should be required to evaluate the reasonableness of management’s representations (as referred to in section 3.6.7) under certain circumstances. One of these commentators stated the reference to “reasonable representations” in section 3.6.7 already implies the actuary is required to perform such an evaluation but suggested the standard state this requirement explicitly.
Response	The reviewers disagreed that the standard should require an actuary to perform an evaluation affirming the reasonableness of management’s representations and have revised the language to indicate the actuary may rely upon their representations unless, in the actuary’s professional judgment, they appear to be unreasonable.
Section 3.6.8, Uncertainty	
Comment	One commentator suggested that examples of uncertainty measures be provided.
Response	The reviewers did not believe that such a list was necessary and made no change.
Comment	One commentator suggested that the original reference to the covariance of multiple component’s estimates implied particular statistical tests or relationships that may not be amenable to testing. Replacement wording was suggested.
Response	The reviewers acknowledge the concern and developed new wording that addressed the concern expressed.
Comment	One commentator stated that since the concept of a risk margin is implied by this section, this section should discuss risk margins explicitly.
Response	The reviewers disagree that discussion of uncertainty requires discussion of a risk margin and made no change.
Section 3.7.1, Reasonableness	
Comment	One commentator asked if the actuary should also be assessing the reasonableness of the estimate relative to its intended purpose.
Response	The reviewers believe that the required disclosures in section 4.1, Actuarial Communications, and ASOP No. 41, <i>Actuarial Communications</i> , sufficiently address the commentator’s concerns and made no change.

Section 3.7.2, Multiple Components	
Comment	One commentator stated, "I am not certain how 'estimates of the multiple components' can be consistent. I can see how the assumptions used can be consistent, the methods can be consistent, or they can be consistently developed." As a result, the commentator suggested that this section be clarified.
Response	The reviewers believe that the correct focus is on consistency of the estimates of the multiple components as stated. It is not always apparent whether or not the assumptions and/or models/methods underlying the estimates are consistent until the results of those assumptions/models/methods are evaluated. For example, an estimate of gross claim liabilities and a separate estimate of net claim liabilities may each seem to be reasonable when evaluated individually based on the underlying assumptions/models/methods used in their estimation, but the resulting relationship between gross and net estimates may be found to be unreasonable, indicating that the estimates were not reasonably consistent. The reviewers made no change.
Section 3.7.3, Presentation	
Comment	One commentator recommended that the standard require that the methods and/or models be appropriate to the intended purpose of the estimate, and that this is more important than requiring such of the estimate presentation.
Response	The wording in section 3.6.1, Methods and Models, already addresses this issue and no change was made.
Section 4. Communications and Disclosures	
Section 4.1, Actuarial Communications	
Comment	One commentator noted that the definition of "valuation date" found in section 4.1(d) differed from that found in ASOP No. 41, <i>Actuarial Communications</i> , "the date as of which the liabilities are determined."
Response	The reviewers believe that the definition in section 4.1(d) of this standard conforms with standard usage of the term among casualty actuaries and made no change.
Comment	One commentator suggested further elaborating on this disclosure requirement by requiring "specific comments regarding the major factors or particular conditions applicable to the unpaid claim estimate." Otherwise, the commentator was concerned that this would result in too many boilerplate disclosures about the risk.
Response	The reviewers acknowledge the concern and addressed it by adding the word "specific" before "significant" in section 4.1(e).
Section 4.2, Additional Disclosures	
Comment	Where the unpaid claim estimate is an update of a previous estimate, one commentator suggested requiring that the amount of change in estimate be disclosed, with reasons provided whenever the change was significant and the reasons for the change were known.
Response	The reviewers did not agree and made no change.

Appendix

Appendix 1—Background

Comment	One commentator suggested a change to appendix 1 regarding the proposed revision to the CAS <i>Statement of Principles Regarding Property and Casualty Loss and Loss Adjustment Expense Reserves</i> . The commentator recommended that the wording be changed from “focus more narrowly on principles” to “focus more broadly on principles.”
Response	The reviewers disagree, as the proposed revision would remove various sections in the current Principles statement, including extensive discussion on Considerations, and made no change.