



Casualty Actuarial Society

• **DISCUSSION DRAFT** •

**Statement of Principles
Regarding Property and Casualty
Loss and Loss Adjustment Expense Reserves**

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Developed by the
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Statement of Principles Regarding Property and Casualty Loss and Loss Adjustment Expense Reserves

INTRODUCTION

The purpose of this statement is to identify and describe principles for the evaluation, review and estimation of property and casualty loss and loss adjustment expense reserves (collectively referred to herein as “loss reserves”). Loss reserves are utilized for a variety of purposes, including financial reporting, valuation, commutation and ratemaking. This statement consists of four parts:

- I. Definitions
- II. Context
- III. Principles
- IV. Applications

I. DEFINITIONS

Insurer: For the purpose of this statement, an insurer is any risk bearer for property and casualty exposures, whether an insurance or reinsurance company, self-insured entity or other.

Loss: The costs related to a claim or a group of claims generally are categorized as either losses or loss adjustment expenses. Losses are the amounts incurred to indemnify or compensate claimants, policyholders, and other risk-bearers for their damages, such as economic losses (e.g., wages, medical bills and rehabilitation expenses) and non-economic losses (e.g., pain and suffering). Loss adjustment expenses are the related amounts incurred to investigate, manage, and settle claims and include such items as fees for attorneys, investigators, appraisers and expert witnesses, and the salaries and overhead expenses of claims personnel. Any subsequent use of the term “loss” in this statement refers to losses and/or loss adjustment expenses. Accordingly, this statement applies to reserves for losses, reserves for loss adjustment expenses and reserves for both losses and loss adjustment expenses.

Loss Reserve: A loss reserve is an estimate of the unpaid amounts required to settle a defined group of claims as of a particular accounting date.

Defined Group of Claims: It is important to clearly define the group of claims to which the loss reserve applies. Typically, a group of claims is defined by the type of exposure (e.g., workers compensation, general liability or automobile liability) and an applicable exposure period (e.g., calendar or fiscal years, quarters, or months) which may be based on the accident, injury, or occurrence date (the date on which an event occurred that gives rise to a claim), the report date (the date on which a claim was reported to the insurer), the policy date (the date on which exposure began) or the underwriting date (the date on which the treaty, policy or other contract was underwritten). In defining a group of claims, other criteria may apply in addition to or instead of those described as typical.

Accounting Date: The accounting date defines the boundary between paid losses and the unpaid losses. The loss reserve is an estimate of those payments that occur subsequent to the accounting date.

Valuation Date: The valuation date is the date through which transactions are included in the data used in the evaluation of the loss reserve, regardless of when the analysis is performed.

Review Date: While the accumulation of transactions included in the database is cut off as of the valuation date, others types of information affecting the loss reserve (such as changes in statutes, court decisions, and the status of the insurer) may become available between the valuation date and the date on which the evaluation, review or estimation of the loss reserve is completed. The review date is the date through which such additional information is incorporated into the loss reserve.

Dates Generally: The various dates defined in this statement are important to fully describe a loss reserve. Frequently, the accounting date, the valuation date, the review date, and the date used to define a group of claims are identical. For example, during January, 2005, one may be evaluating the liability for all claims with occurrence dates through December 31, 2004 (the defined group of claims), as of December 31, 2004 (the accounting date), using data valued as of December 31, 2004 (the valuation date), and other relevant information as of December 31, 2004 (the review date). However, it is not uncommon for the accounting date, the valuation date and the date used to define the group of claims to occur in any order. The review date must necessarily occur on or subsequent to the valuation date.

Final Settlement: Final settlement is the ultimate disposition, by any means, of a claim such that there will be no further payments, recoveries, or activities related to such claim.

II. CONTEXT

The context in which loss reserves are presented may indicate elements to be reflected in the loss reserves. Depending on the context:

1. loss reserves may reflect the effects of ceded reinsurance or other ceded exposures, anticipated salvage and subrogation, policyholder deductibles, self-insured retentions, excess insurance, coinsurance, coordination of benefits, second injury funds, and other collateral sources;
2. loss reserves may be stated at nominal value (i.e., estimated without consideration of investment income to be earned) or at present value in consideration of anticipated investment income;
3. loss reserves may contain a provision to reflect uncertainty; and
4. loss reserves may reflect the status of the insurer or reflect the arrangement under which claims are to be settled. For example, loss reserves may reflect whether an insurer is an on-going concern, in bankruptcy or insolvent, in rehabilitation or liquidation, in run-off, in arbitration or is settling claims under an arrangement that otherwise impacts the cost of settlement.

III. PRINCIPLES

1. **Actuarially Reasonable Loss Reserve:** An actuarially reasonable loss reserve for a defined group of claims is an estimate, derived from reasonable assumptions and appropriate methods, using data as of a given valuation date and other relevant information as of a given review date, of the unpaid amounts required to settle all such claims, whether reported or not, as of a particular accounting date.
2. **Probability Distribution Representation:** The unpaid amounts required to settle a defined group of claims can be represented as a probability distribution for which neither the form nor the parameters are necessarily known.

3. **Inherent Uncertainty:** The unpaid amounts required to settle a defined group of claims are dependent upon events subsequent to the valuation date and therefore, any loss reserve is inherently uncertain. The uncertainty in the loss reserve increases as the dispersion of the corresponding probability distribution increases. Data limitations may also add to the uncertainty in the loss reserve.
4. **Range of Reserves:** The uncertainty in the estimate of the unpaid amounts required to settle a defined group of claims implies that a range of loss reserves can be actuarially reasonable.
5. **Estimated Versus Actual Payments:** The estimated future payments implied by an actuarially reasonable loss reserve likely will differ from the actual future payments required to settle a defined group of claims since the actual future payments can be known with certainty only when all such claims have reached final settlement.
6. **Relevant Variables and Circumstances:** Actuarially reasonable loss reserves depend upon a number of relevant variables and circumstances including data and information regarding underwriting, claims handling, data processing and accounting as well as the economic, business, legal, political, and social environments as of the valuation and review dates. At different valuation or review dates, those variables and circumstances may have changed. As such, an actuarially reasonable loss reserve as of a particular accounting date, valuation date, and review date may differ from an actuarially reasonable loss reserve as of the same accounting date and a different valuation or review date.
7. **Selection of Loss Reserve:** The selection of a loss reserve from within a range of actuarially reasonable loss reserves depends upon the relative likelihood of the estimates and the context in which the loss reserve is to be presented.

IV. APPLICATIONS

Loss Reserving Methods: Detailed discussion of the technology and applicability of current loss reserving practices is beyond the scope of this statement. Selection of appropriate methods is the responsibility of the individual(s) evaluating, reviewing or estimating the loss reserves.

Standards of Practice: This statement provides principles of loss reserving. Relevant Standards of Practice address the application of these principles.