



**2007 CAS Spring Meeting
Session #C12**

**Loss Reserve Ranges in Practice
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Analyzing and Communicating Loss Reserve Uncertainty

- Some interested parties are asking very logical questions in order to understand the potential variability of loss reserves
- These questions present some very difficult challenges for actuaries.

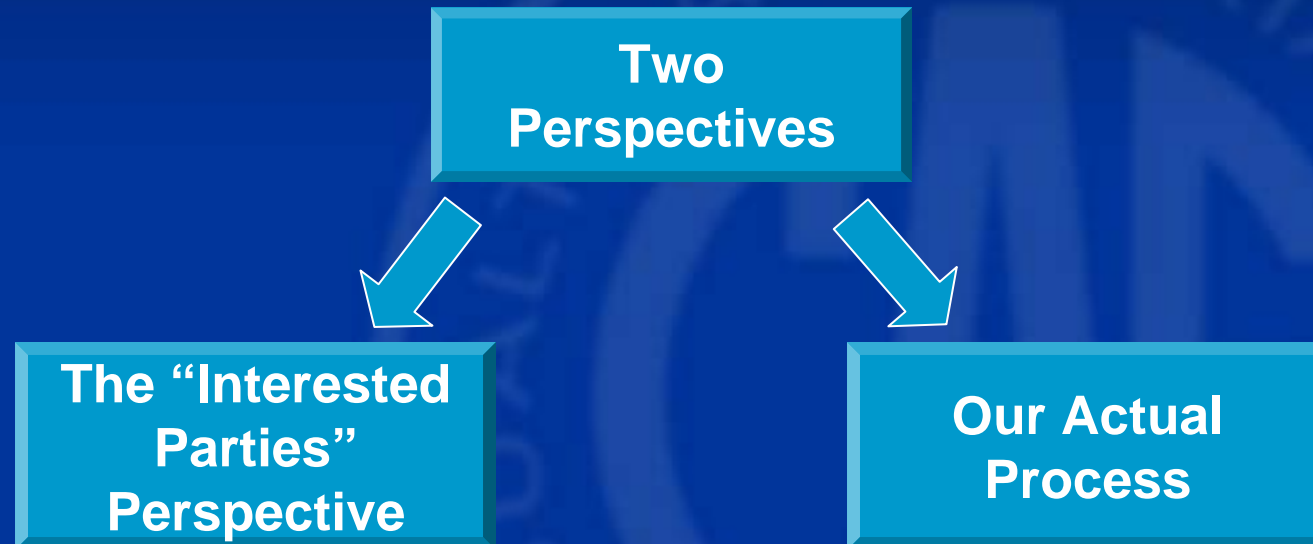


Analyzing and Communicating Loss Reserve Uncertainty

- Interested parties want to know how management selected the aggregate reserve figure on the balance sheet.
- Why is management's selection more appropriate than any other selection?
- If management's selection differs from the actuary's selection, why did management choose a different number?



Selecting the Point Estimate, Low Estimate and High Estimate





Selecting the Point Estimate, Low Estimate and High Estimate

The “Interested Parties” Perspective

The actuary
selects a low
estimate

The actuary
selects a high
estimate

Management
selects a point
estimate



Selecting the Point Estimate, Low Estimate and High Estimate

Our Actual Process

There may be thousands of point estimates in each reserve review.

The actuary selects a point estimate for each reserve group for each experience period



The actuary sums the point estimates for each reserve group for each experience period



Management selects a point estimate

Interested parties want to know how management chose the point estimate.



Example: Number of Point Estimates Selected by the Actuary

Lines of Insurance: Private Passenger Auto

Coverage Groups: BI, PIP, Med Pay, UM/UIM, PD, Collision, Comprehensive

Experience Periods: Qtrly Accdt Periods for 10 years

Loss Groups: Loss, ALAE

Reserve Methods: 4 Standard Methods

There is uncertainty in the selection of each of the 2,240 point estimates.

$$1 \times 7 \times 40 \times 2 \times 4 = 2,240$$



Expectations for Reserve Disclosure

- Interested parties want to know how management selected the point estimate.
 - They want to understand the process.
 - They would like details
 - This entails quite a lengthy response
 - The actuarial point estimates
 - The actuarial methods



Expectations for Reserve Disclosure

- Interested parties want to know the key assumptions influencing the selection of the point estimate.
 - They would like a specific list of key assumptions.
 - They want to know of any changes in the key assumptions.



Expectations for Reserve Disclosure

- **Key Assumptions**
 - **Claims Handling**
 - **Underwriting**
 - **Mix of Business**
 - **Legal/Regulatory Environment**
 - **etc**



Expectations for Reserve Disclosure

- Interested parties want to know if there were changes in the key assumptions since the last reporting date that influenced the selection of the current point estimates?



Examples of Changes in Key Assumptions

- “The Company increased its utilization of alternative dispute resolution processes, such as mediation and arbitration, to facilitate settlements to reduce defense and legal costs.”



Examples of Changes in Key Assumptions

- “The Company increased its in-house legal expertise to better manage the litigation processes and expenses.”



Examples of Changes in Key Assumptions

- “The Company increased its emphasis on attempting to settle third-party claims earlier in the claim process.”



Examples of Changes in Key Assumptions

- “The Company has been aggressively re-underwriting its book of business.”



Examples of Changes in Key Assumptions

- “The Company placed emphasis on removing highly volatile, unprofitable, and undesirable risks from its book of business.”



Examples of Changes in Key Assumptions

- “Improvements in the quality of the book reduced the number and severity of claims in more recent quarters.”



Expectations for Reserve Disclosure

- Describe the new events that occurred that led to the change in the key assumptions.
 - Explain what led to the utilization of alternative dispute resolution processes.
 - Explain what led to the increase in in-house legal expertise.
 - Explain what led to the increased emphasis on attempting to settle third-party claims earlier in the claim process.”



Expectations for Reserve Disclosure

- Explain why you recognized the change in key assumptions in this period rather than prior periods.
 - The interested parties want to know why the change is impacting the current operating results.



Expectations for Reserve Disclosure

- Quantify the impact of the changes in the key assumptions.
 - How do we explain which specific change or combination of changes that led us to select one reserve amount over another for each reserve methodology for each line for each reserve group for each experience period, etc?