


Actuarial Standards of Practice
Recent activity and highlights

A presentation to SCCAC
by Dave Otto
December 1, 2011

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Description

- This session will be devoted to professionalism topics relating to property and casualty actuaries. It will cover the structure of our professional and ethical standards and will summarize key provisions in many of the standards which we use on a regular basis.
- This session will also highlight recent changes to the standards and will identify efforts that are ongoing.

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Agenda

- Why should we be concerned about professionalism?
- Why am I here?
- Understanding intent of our standards
- Focus with particular standards
 - Universal standards
 - Updated deviation language
 - Reserving standards
 - Ratemaking standards
 - Where no standard exists
 - Efforts in the pipeline
- Questions

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Why Should We Be Concerned?

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Why is Your Professionalism Important?

- It's required
- As a member of the CAS you are bound to:
 - Code of Professional Conduct
 - Actuarial Standards of Practice
 - Statements of Principles
 - Qualification Standards
 - Continuing Education Requirements
- For student actuaries, you are bound to:
 - Code of Professional Ethics for Candidates

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Sources of Concern

<p>Legal</p> <ul style="list-style-type: none"> • Who? <ul style="list-style-type: none"> • Investors/Policyholders of Insurance Companies • Company Management • Regulatory Authorities • Federal/State Courts • Securities And Exchange Commission • Justice Department • What is at risk? <ul style="list-style-type: none"> • Criminal = Prison • Civil = Money • Current Employment • Reputation • More Money – defense + settle • Time 	<p>Professional</p> <ul style="list-style-type: none"> • Who? <ul style="list-style-type: none"> • ABCD – investigates • CAS – determines punishment • What is at risk? <ul style="list-style-type: none"> • Credentials = PV Future Earnings • Reputation • Money – defense • Time
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Why Am I Here?

[Redacted content]

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Relevant Background

- CAS Committee on Professionalism Education (2000-2006)
- AAA Casualty Committee of the Actuarial Standards Board (2000-Present)
- Critical Review of the US Actuarial Profession (CRUSAP) Task Force Advisory Panel Member (2005-2007)
- Speaker on Professionalism Topics at Actuarial Seminars (9 times)
- Expert Witness in over 30 separate cases

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Caveats

- There is no guarantee that doing anything in this session will alleviate the risk of litigation or some other form of professional discipline. One must recognize one's own specific circumstances and act accordingly.
- I am not speaking on behalf of:
 - Towers Watson
 - CAS
 - ASB
 - AAA
 - Or any committee, person, place or thing
- This presentation was designed to be thought-provoking and may not necessarily represent my personal opinions
- It is your responsibility to know all of the standards and to properly interpret them and exercise your own professional judgment as you see fit.

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Understanding the Intent of our Standards

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Center of Our Professionalism

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Understanding How to Interpret the Standards

Before we dig into the standards, it is important to understand how to interpret the language within them

CIA: Spirit and Intent

- “Comparison of the standards of practice with the Income Tax Act is apt. In reading the Income Tax Act, a taxpayer’s objective may well be to *avoid* the Act’s spirit and intent. The “rules of the game” permit the taxpayer to do so within limits.” [CIA Discussion Draft, 1991]
 - Tax avoidance versus evasion
 - Speed “limits” – Ever drive slower? –Implied 5mph cushion?
 - Clinton perjury accusation – denied “sexual relations” with Lewinsky
- “In reading the standards of practice, the actuary’s objective is to *identify and comply* with their spirit and intent.” [CIA Discussion Draft, 1991]
 - How and Why?

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Identifying the Spirit and Intent: Look To The First Rule

- CAS Precept 1 / CIA Rule 1:
 - An Actuary/Member shall act honestly, with integrity and competence, and in a manner to fulfill the profession's responsibility to the public and to uphold the reputation of the actuarial profession.
- Candidate Code of Ethics Rule 1 [Introduced January 2008]:
 - An Actuarial Candidate shall act honestly, with integrity and competence, to uphold the reputation of the actuarial profession.
 - Rule 1 is to the other rules as the Golden Rule is to the Ten Commandments. It is fundamental. [CIA Discussion Draft, 1991]
 - A strained interpretation of a rule or recommendation is inappropriate. [CIA Discussion Draft, 1991]

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13

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Identifying the Spirit and Intent: Sample language

“Should”

- Simply a recommendation or a command?
- “You should clean your room” vs. “You must clean your room”
- ASOP 41 Documentation
 - “The actuary *should* create records and other appropriate documentation supporting an actuarial communication...”

“Consider”

- Technically defines a thought-process but leaves open how you deal with it
- “I considered it and decided not to do anything about it.”
- ASOP 23 Data
 - “If similar work has been previously performed for the same or recent periods, the actuary should *consider* reviewing the current data for consistency with the data used in the prior analysis.”

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Identifying the Spirit and Intent: Sample language

“Judgment”

- Another thought-process prevalent in our work
- Good or bad judgment? Appropriate, objective, unbiased, supported, guess?
- Arrogance within profession, much like medical profession, that hard-earned credentials are a license to exercise judgment however you see fit and shouldn't be questioned
- ASOP 43 Methods and Models
 - “The actuary should consider methods or models for estimating unpaid claims that, in the actuary's professional *judgment*, are appropriate.”

“Reasonable”

- Dictionary: not exceeding the limit prescribed by reason
- In the spectrum of assumptions/outcomes, where does reasonable line up with probable and possible? Lots of wiggle room?
- SOP Loss Reserving Principle 1
 - “An actuarially sound loss reserve for a defined group of claims as of a given valuation date is a provision, based on estimates derived from *reasonable* assumptions and appropriate actuarial methods...”

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Code of Professional Conduct

14 Precepts with Annotations

- Key Sections:

<ul style="list-style-type: none"> • Professional Integrity • Qualification Standards • Standards of Practice • Communication and Disclosure • Conflict of Interest • Control of Work Product 	<ul style="list-style-type: none"> • Confidentiality • Courtesy and Cooperation • Advertising • Titles and Designations • Violations of the Code
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Precept 3: “An Actuary shall ensure that Actuarial Services performed by or under the direction of the Actuary satisfy applicable standards of practice.”

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Focus on Standards of Practice

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Focus on Actuarial Standards of Practice

1. Identify a standard
2. Brief overall description
3. Highlight key component
4. Examples of why it is important

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**Actuarial Standards of Practice
"Universal" Standards**

ASOP's #9, #41 and #23

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ASOP #9: Documentation and Disclosure

Repealed March 2011

- Applied only to P&C Ratemaking, Reserving and Valuations
- ASOP 41 (2002) applies to all U.S. actuaries in all areas of practice
- Provisions in ASOP 9 believed to be adequately covered in ASOP 41, other ASOP's and the Code of Professional Conduct

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ASOP #9: Documentation and Disclosure

Key Provisions Were: Section 5.2 Extent of Documentation

- "Documentation should be sufficient for another actuary practicing in the same field to evaluate the work."
 - Addressed in ASOP 41

- "Any material changes in sources of data, assumptions, or methods from the last analysis should be documented. The actuary should explain the reason(s) for and describe the impact of the changes."
 - Addressed in ASOP 43 (reserving), ASOP 36 (opinions) and ASOP 13 (trending)

ASOP #9: Documentation and Disclosure

Key Provision:
Appendix 1

Sections of ASOP No. 9	Reference to ASOP No. 41, other ASOPs or the Code of Professional Conduct
Section 2	Definitions
2.1	Actuarial Report
2.2	Actuarial Work Product
2.3	Required Actuarial Documentation
2.4	Statement of Actuarial Opinion
2.5	Statement of Actuarial Review
Section 3	Background and Historical Issues
Section 4	Current Practices and Alternatives
Section 5	Analysis of Issues and Recommended Practices
5.1	Introduction
5.2	Extent of Documentation
5.3	Prevention of Misuse
5.4	Disclosure of Conflict with Professional Judgment and Advocacy
5.5	Availability of Documentation
5.6	Conflicting Interests
5.7	Signature on Work Product
5.8	Reliance on Another
5.9	Waiver of Fee
6.1	Deviation from Standard

ASOP #41: Actuarial Communications

- Covers communication by an Actuary to its employer or client
- The form can be written, electronic or oral
- The communication should be clear and appropriate to the particular circumstances and intended audience, timely following completion of analysis, and identify all responsible actuaries/sources

ASOP #41: Actuarial Communications

Key Provision #1: Section 3.2 Actuarial Report

- "In the actuarial report, the actuary should state the actuarial findings, and identify the methods, procedures, and data used by the actuary with sufficient clarity that another actuary qualified in the same practice area could make an objective appraisal of the reasonableness of the actuary's work as presented in the actuarial report."

Why?

- To remember what you did
- To remove doubt that you didn't do something else
 - If no evidence, someone else could make it look like you were sloppy or ignorant in light of what could have been known
- Lack of documentation used to try to shift the burden of proof
- To identify source of direction and information (everyone will turn on you)

ASOP #41: Actuarial Communications

Key Provision #2 (new in 2010): Section 3.4.4 Responsibility for Assumptions and Methods

- "An actuarial communication should identify the party responsible for each material assumption and method."
- "Where the communication is silent about such responsibility, the actuary who issued the communication will be assumed to have taken responsibility for that assumption or method."
- The actuary's obligation when identifying the other party...depends on how the assumption or method was selected:
 - If specified by law:
 - disclose applicable law
 - identify the assumptions or methods prescribed by the law
 - Identify that report was prepared in accordance with the law

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ASOP #41: Actuarial Communications

Key Provision #2 (new in 2010): Continued

- The actuary's obligation when identifying the other party...depends on how the assumption or method was selected:
 - If selected by another party, the actuary has three choices:
 1. If you believe it is reasonable for the assignment, then no obligation
 2. If you believe it is unreasonable, then must say so + identify assumption, party and reason they set it
 3. If unable to judge reasonableness because not qualified to judge or need to perform substantial amount of work, then must say so + identify assumption, party and reason they set it
- This raises the bar with respect to reliance on another's work
 - Example shown later with respect to ASOP 20 - Discounting

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ASOP #23: Data Quality

Gives guidance to the actuary in the following:

- Selecting the data that underlie the actuarial work product
- Relying on data supplied by others
- Reviewing data
- Using data
- Making appropriate disclosures with regard to data quality

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ASOP #23: Data Quality

Key Provision: Section 3.5 Review of Data

- "...The actuary should review the data for reasonableness and consistency..."
- What does reasonableness and consistency mean?
 - "This standard does not require the actuary to audit data." [Section 1.2]
 - "The actuary should review the data...for the purpose of identifying data values that are materially questionable or materially inconsistent" [Section 3.5b]
 - "If similar work has been previously performed...consider reviewing the current data for consistency with the data used in the prior analysis" [Section 3.5c]
 - "...particular attention to internal and external consistency" [Section 3.2b(2)]

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ASOP #23: Reasonableness and Consistency

Why?

- Garbage in – Garbage out
 - Often difficult to isolate the impact of a single issue since everything is intertwined
 - Lawyers will make a mountain out of a mole hill
- Key to note that actuaries often require data in formats unfamiliar or unique to other departments
 - Potential for misunderstanding between data provider and analyst
 - Sense checks
 - Comparison to previous work
 - Rough reconciliation to another source (financials)
 - Common mistake is actuaries tend to focus on the trees but never see the forest
 - Do the results from a big picture standpoint make sense?

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Actuarial Standards of Practice Updated Deviation Language

Effective May 1, 2011

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Updated Deviation Language

Deviation language has varied over the years. As a result, the ASB adopted new language to be used in all ASOP's, which refers back to the new ASOP 41

- In addition to disclosures pertinent to the particular ASOP, Section 4 of each standard will also include
 1. The disclosure in ASOP 41, Section 4.2, if any material assumption or method was prescribed by law (statutes, regulations, and other legally binding authority); [identify law, assumptions prescribed by law and confirm that prepared in accordance with law]
 2. The disclosure in ASOP 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 [identify party, assumptions selected by party and reason party, rather than actuary, set the assumption]
 3. The disclosure in ASOP 41, Section 4.4, if, in the actuary's professional judgment, the actuary otherwise deviated materially from the guidance of this ASOP. [provide a statement in communication with respect to nature, rationale, and effect of deviation]

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Actuarial Standards of Practice Reserving Standards

ASOP's #20, #36 and #43

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ASOP#43: Property/Casualty Unpaid Claim Estimates
 Adopted in 2007

Terms:

- Unpaid claim estimate
 - Avoided the term "reserve" because it implies an amount booked in a financial statement
- Actuarial central estimate
 - Expected value over range of reasonable outcomes
 - "Best estimate" not used because identifies quality but not objectivity
- Does not apply to estimates developed during the ratemaking process
 - The "reserving" component within a ratemaking context is not perceived to be as complete and rigorous as a sole reserving exercise so some language may be onerous
 - Does NOT excuse a ratemaking actuary from abiding by common-sense practices

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ASOP#43: Property/Casualty Unpaid Claim Estimates

Key Provisions: Section 3.6.2 Assumptions

- "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."
 - Narrows the use of the term "reasonable assumptions"
 - Applies to all assumptions – conflicts with practice of having some assumptions that may be high and some assumptions that may be low


Section 3.7.1 Reasonableness

- "The actuary should assess the reasonableness of the unpaid claim estimate, using appropriate indicators or tests that, in the actuary's professional judgment, provide a validation that the unpaid claim estimate is reasonable."
 - Does the bottom line estimate make sense?
 - Loss ratio?
 - Claim severity?
 - Relationship to prior years and premium growth?

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ASOP#36: Statements of Actuarial Opinion (SAOs)

- What Came First: The Chicken or the Egg?



- With respect to ASOP's, unfortunately, the wrong one came first
 - ASOP 36 adopted in 2000
 - Provided guidance to actuaries when issuing SAO's
 - Also provided basic "reserving" guidance
 - ASOP 43 adopted in 2007
 - Provided guidance to actuaries regarding the estimation of unpaid claims, both when in support of SAO's and in other circumstances
 - ASOP 36 revised in 2010
 - Eliminated redundant guidance with ASOP 43
 - Focus solely on nuances unique to "Opinions"

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ASOP#36: Statements of Actuarial Opinion (SAOs)

Key Provision:

- No quick tips
- AAA Practice Note on Statements of Actuarial Opinion is a great source for guidance
 - Complexity of modern Statutory Opinions means you need to spend a great deal of time combing through the entire standard, guidance, and regs

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ASOP#20: Discounting of Property and Casualty Loss and Loss Adjustment Expense Reserves

Originally adopted in 1992. Complete rewrite in 2011

- The introduction of the standard on discounting was a contentious issue
 - Belief that full-value reserves are often considered to contain a needed implicit risk margin
 - As a result, elements of conservatism guidance crept into the standard through the use implicit and explicit risk margins
 - “The actuary should be aware of the historical relationship between reserve discounting and risk margins and include appropriate risk margins”
 - “The actuary may reduce the selected interest rate as a means of incorporating a risk margin”
 - “Implicit risk margins may be introduced at one or more steps in the discounting process, including the estimation of the full-value reserve and the selection of the payment pattern...”
- In addition, no corresponding disclosure of the margins were required

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ASOP#20: Discounting of Property and Casualty Loss and Loss Adjustment Expense Reserves

Key Provisions: Section 3.3.1 Assumptions

- “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.”
 - Eliminates conservatism approach from old version
 - Same language as ASOP 43

Section 4.1c Communications

- “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.”
 - Depending on the context, margins may be appropriate and this standard requires disclosure if margins are present.
 - Not required to quantify because may be undue burden and concern it would raise the bar.

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38

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ASOP#20: Discounting of Property and Casualty Loss and Loss Adjustment Expense Reserves

- Original version also gave actuaries a pass on the interest rate
 - Selected Rates Supplied By Another: “In certain contexts, the actuary may provide a discounted reserve estimate without providing an opinion on the appropriateness of the selected interest rates.”
 - No longer the case with ASOP 41

Key Provision: Section 3.4.1c 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 ... ASOP41...”
 - If selected by another party, the actuary has three choices:
 1. If you believe it is reasonable for the assignment, then no obligation
 2. If you believe it is unreasonable, then must say so + identify assumption, party and reason they set it
 3. If unable to judge reasonableness because not qualified to judge or need to perform substantial amount of work, then must say so + identify assumption, party and reason they set it

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Actuarial Standards of Practice Ratemaking Standards

ASOP's # 13, #25, #29, #30 and #39

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ASOP#13: Trending Procedures in Property/Casualty Insurance

Originally adopted in 1990, with recent revisions in 2009

Key Provision: Section 3.2 Historical Insurance and Non-Insurance Data

- "When selecting data, the actuary should consider...the effect of known biases or distortions on the data relied upon."
 - Impact of catastrophe influences
 - Seasonality
 - Coverage changes
 - Nonrecurring events
 - Claim practices
 - Distributional changes in deductibles, types of risks and policy limits
- Almost all data can be shown to be biased in some way – especially in hindsight
- Selection of trend may require a rigorous approach

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ASOP#25: Credibility Procedures Applicable to Accident and Health, Group Term Life, and Property/Casualty Coverages

Adopted in 1996

Key Provision: Section 3.3 Choice of Related Experience

- "The actuary should use care in selecting the related experience that is to be blended with the subject experience. Such related experience should have frequency, severity or other determinable characteristics that may reasonably be expected to be similar to the subject experience. If the proposed related experience does not or cannot be adjusted to meet such criteria, it should not be used."
- Key is "reasonably expected to be similar." May be worthwhile to document expectation because easy for a lawyer to inappropriately use hindsight to argue otherwise.

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42

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ASOP#29: Expense Provisions in Property/Casualty Insurance Ratemaking

Adopted in 1997

Key Provision: Section 3.2 Determining Expense Provisions

- "Expense provisions should reflect the conditions expected during the time these policies or coverages are expected to be in effect and should include all expenses expected to be incurred in connection with the transfer of risk."
 - Similar language to the Statements of Principles
- The actuary after filing a rate increase is questioned that the reinsurance provision indicated in the filing did not reconcile to the rate the company paid to its reinsurer.

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ASOP#30: Treatment of Profit and Contingency Provisions and the Cost of Capital in Property/Casualty Insurance Ratemaking

Adopted in 1997

Key Provision: Section 3.1 Estimating the Cost of Capital and Underwriting Profit Provision

- "For historical and practical reasons, this standard separately discusses the underwriting profit provision, investment income from insurance operations, and investment income on capital. The actuary should keep in mind that evaluation of whether the cost of capital is appropriately recognized does not necessarily require these distinctions."
- Many models/techniques exist and results may vary significantly. Defending ones own model might require a response to alternative reasonable models that produce different results.
- Also need to be careful when changing the model from one analysis to the next.

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ASOP#39: Treatment of Catastrophe Losses in Property/Casualty Insurance Ratemaking

Adopted in 2000

Key Provision: Section 3.3.2

- "The actuary should be satisfied that the resulting ratemaking procedures appropriately reflect the expected frequency and severity distribution of catastrophes, as well as anticipated class, coverage, geographic and other relevant exposure distributions."
- Catastrophes have produced record levels of damage. Companies have withdrawn from some markets and others were unable to fulfill their total obligations. Again legal remedies are often sought, if malpractice could have or seemed to have caused the problem.

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What about when there is a lack of guidance?

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When No Standard Applies

- Consider standards that are relevant
 - Loss reserving within a ratemaking context – ASOP#43
- Consider guidance from other organizations
 - CAS/CIA
 - ABCD
- Consider Rule 1 of the Code
 - An Actuary/Member shall act honestly, with integrity and competence, and in a manner to fulfill the profession's responsibility to the public and to uphold the reputation of the actuarial profession.

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What Efforts Are Currently in the Pipeline?

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Efforts in the Pipeline

- Statements of Principles
 - Promulgated by the CAS
 - Effort to revise – task forces are being assembled
- Ratemaking Standard(s)
 - Formal request by CAS to create a standard on ratemaking
 - Currently, ratemaking concepts are covered under various ASOP's: 12, 13, 23, 25, 29, 30, 38, 39.
 - Comparison to "Considerations" in SOP indicate there may be areas of practice needing guidance: loss development, exposure bases, individual risk rating...
 - Antitrust concern that guidance on ratemaking may be perceived as setting prices
 - Crucial to distinguish the difference in estimating the cost of insurance and establishing a corresponding price.
 - Similar in concept to unpaid claim estimates and reserves.
 - Also a request by ASB to consider applying ASOP 43 to ratemaking, which is under review

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50

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