Survey of Loss Reserving Actuaries Report

CAS Committee on Reserves

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Effective January 1, 1998, the NAIC adopted a change in how loss adjustment expense (LAE) is split into categories within Schedule P of the property and casualty statutory Annual Statement. The purpose of the Survey of Loss Reserving Actuaries was to solicit input from loss reserve practitioners on how these changes impacted loss reserving since 1998, and how they may impact future years and other aspects of actuarial work. The following are the key findings of the survey:

- Nearly two-thirds (63.5%) of the respondents reported that they were company reserving actuaries, while one-quarter (25.7%) reported that they were consulting reserving actuaries.

- When asked to describe how their company classified ALAE vs. ULAE prior to the change on January 1, 1998, nearly six in ten (58.1%) respondents reported using claim specific / non-claim specific as their criteria.

- When asked to describe the major expense reclassification for their company, over one-half (56.8%) of the respondents reported that External Claim Adjusters were reclassified from ALAE to A&O.

- Over three-fourths (82.4%) of the respondents reported that they implemented changes with the 1998 Annual Statement.

- Over half (55.4%) of the respondents reported that their company selected the Calendar Year (all accident years for calendar year 1998 and beyond) method to implement the new LAE split.

- When asked what they used to classify expenses, over one-half (54.1%) reported using an Expense Tracking System, while nearly a one-quarter (23.0%) used Formula Allocations.

- A majority (55.4%) of the respondents reported that their company is currently maintaining internal expense reporting under the former categorization while adopting the new categorization for statutory reporting.

- Over half (58.1%) of the respondents reported that their company was not using the new expense categorization for any purposes other than Annual Statement reporting.

- When respondents were asked to indicate areas they believed that further research was needed regarding the impact of the new LAE categories, the most popular responses were Reinsurance Contracts (18.9%) and Ratemaking Practices (13.5%).

SURVEY METHODOLOGY

Designing the Questionnaire

A four-page, 17-item self-administered questionnaire (see Appendix) was developed by the CAS Committee on Reserves and approved by the CAS Executive Council.

Conducting the Survey

A total of 3,239 questionnaires were mailed to Fellows and Associates of the CAS the week of March 1, 2000. In addition, the survey could be completed online through the CAS Web Site. Respondents were asked to complete the survey by May 1, 2000.

Data Analysis

A total of 74 (2.3%) completed questionnaires were returned to the CAS Office. Close to a third (29.7%) of the surveys were completed electronically. Responses to survey questions were compiled, coded, and entered into a database. The responses were then analyzed using a statistical analysis software package (SPSS).

Responses to Open-ended Questions

The survey contained several open-ended questions that asked respondents to write-in their responses. Where responses to open-ended questions are summarized in the report, a number precedes each response. This identification number represents the specific survey on which the comments were written. This allows those reading the report to track the written comments of a particular respondent, if desired.

RESULTS

Question 1:
Please indicate your type of employment.

Response	Frequency	Percent
Company Reserving Actuary	47	63.5
Consulting Reserving Actuary	19	25.7
Insurance Department Actuary	0	0.0
Other	6	8.1
Blank	2	2.7
Total	74	100.0

Nearly two-thirds (63.5%) of the respondents reported that they were company reserving actuaries, while one-quarter (25.7%) reported that they were consulting reserving actuaries.

Written responses to "Other":
-Company reserve management
– Company Life/Health Actuary
– Accountant
– Accountant
– CFO
– CFO

Question 2:
Prior to the change on January 1, 1998, how did your company classify ALAE vs. ULAE? You may want to refer to the background information provided at the front of the survey.

Response	Frequency	Percent
Claim Specific / Non-claim specific	43	58.1
External versus Internal	10	13.5
Combination of A and B	17	23.0
Neither	1	1.4
Blank	3	4.1
Total	74	100.0

When asked to describe how their company classified ALAE vs. ULAE prior to the change on January 1, 1998, nearly six in ten (58.1%) respondents reported using claim specific / non-claim specific as their criteria.

Written comments to Question 2:
– External versus Internal, but all legal rep has been outside and no independent claims adjustments are used.

Question 3:
Which choice would most closely approximate the major expense reclassification for your company?

	Prior to January 1, 1998	After January 1, 1998
1. Internal Defense Costs	ULAE	DCC
2. External Claim Adjusters	ALAE	A&O

Response	Frequency	Percent
#1	11	14.9
#2	42	56.8
No material changes	10	13.5
Other	8	10.8
Blank	3	4.1
Total	74	100.0

When asked to describe the major expense reclassification for their company, a majority (56.8%) of the respondents reported that External Claim Adjusters were reclassified from ALAE to A&O.

Written responses to "Other":
- #1 expected to be greater ultimate impact, #2 greater paid-to-date.
- Clients are confused. Data is contaminated.
- Coverage defense costs from general or ALAE to ULAE.
- External Defense Costs.
- Both 1 and 2.
- I don't think the choices are listed properly.
- The change was not adopted.
- Both 1 and 2.

Question 4:
Did your company implement these changes in their 1998 Annual Statement?

Response	Frequency	Percent
Yes	61	82.4
No	9	12.2
Do not know	0	0.0
Blank	4	5.4
Total	74	100.0

Over three-fourths (82.4%) of the respondents reported that they implemented changes with the 1998 Annual Statement.

Written comments to Question 4:
- One of our companies assumed there was no limit.
- Yes, but not very accurately.
- Also, reserve adjustments at 12/31/97 in anticipation of changes.
- Yes, for reserves only. Paid reclassified beginning 1999.

Question 5:
Which method did your company select to implement the new LAE split?

Response	Frequency	Percent
Accident Year (Accident year 1998 and beyond)	25	33.8
Calendar Year (All accident years for calendar year 1998 and beyond)	41	55.4
Do not know	3	4.1
Blank	5	6.8
Total	74	100.0

Over half (55.4%) of the respondents reported that their company selected the Calendar Year (all accident years for calendar year 1998 and beyond) method to implement the new LAE split.

Question 6:
Which of the following were used to classify expenses?

Response	Frequency	Percent
Expense Tracking System	40	54.1
Formula Allocations	17	23.0
Special "time/expense" studies	12	16.2
Other	11	14.9
Do not know	11	14.9

When respondents were asked what they used to classify expenses, over one-half (54.1%) reported using an Expense Tracking System, while nearly a one-quarter (23.0%) used Formula Allocations.

Written responses to "Other":
– Outside Adjuster expenses are reported as A&O, the only change. No special efforts are required as this data is claim specific and identified by a unique code.
– Used expense tracking system for paid expenses and formula allocations for expense reserves.
– All external expenses are assigned a new statistical code which indicates if the expense is DCC or A&O.
– Questionnaire to MGA's.
– Special coding for payments to external adjusters.
– Clients and auditors selected criteria.
– Systems in place reflected ISO stat plan definitions of ALAE to ULAE.
– Adjusters, in-house legal.
– Bulk reclass of internal legal operation.
– Reports from TPA.
– By claim (external).
– Coded in the claims system.

Question 7:

If your company used formula allocations to reclassify expenses, what allocation base was used?

Responses:
- Claim counts.
- To split ALAE reserves into DCC and A&O, I reviewed historical paid ALAE split into DCC and A&O to develop a percentage split for each line and AY. All of our ULAE is A&O.
- Several.
- Expense reserves were allocated based on expense payments.
- Claim counts, paid external AE, paid loss.
- Paid expenses.
- Formula allocations only used for reserves. A % of ALAE reserves classified as A&O. The % varied by accident year (maturity of accident year).
- Square 1 = outage, headcount, etc.
- Premium and Loss dollar allocations.
- Result of Time Expense Study.
- Salary.
- ALAE payments.
- Expense tracking system for one of our companies was used to prorate for our other company.
- Claim counts, claim dollars.

Question 8:
Is your company currently maintaining internal expense reporting under the former categorization while adopting the new categorization for statutory reporting?

Response	Frequency	Percent
Yes	41	55.4
No	21	28.4
Do not know	6	8.1
Blank	6	8.1
Total	74	100.0

A majority (55.4%) of the respondents reported that their company is currently maintaining internal expense reporting under the former categorization while adopting the new categorization for statutory reporting.

Written comments for question 8:
- Aware of new categorization and will incorporate if we use services that make a difference.
- No, however, during much of 1999 company retained old definitions.
- Yes, for some purposes.
- Some companies do, others do not.

Question 9:

Is your company using the new expense categorization for any purposes other than Annual Statement reporting?

Response	Frequency	Percent
Yes	17	23.0
No	43	58.1
Do not know	7	9.5
Blank	7	9.5
Total	74	100.0

Over half (58.1%) of the respondents reported that their company was not using the new expense categorization for any purposes other than Annual Statement reporting.

Written responses to "If Yes, Explain":
- Only one they use.
- Budget, expense tracking, management reports, tax reports.
- Internal expense reporting.
- Using same categorization for internal reporting.
- Internal reporting.
- Excess profits reports.
- Internal reserve studies are done and communicated using the former categorization. Internal profit and loss statements are done using the new categorization.
- We do track components of ALAE payments for internal reasons but we reserve ALAE by total ALAE.
- Functional categorization always used for reserve, expense analysis.
- All internal statistics and financial reporting.
- Internal reporting, LAE reserve calculation.
- Internal reporting.
- Loss & LAE sensitive rating plans.
- Internal reporting.
- Internal reporting.
- All financial reporting (internal and external).

Question 10:
Explain how your companies accomplished a reclassification of expenses from categories where claim detail was not maintained (for example, internal defense attorney costs, formerly categorized as ULAE) to categories such as DCC, where at least some detail (i.e. accident year) would be required.

- Didn't reclassify paid expenses. Applied definition on CY basis.
- This was not a major issue. The main change was for external adjusters, moving from ALAE to A&O.
- Recoding of expense activity through ledger coordinated from claim payment system.

Question 10 (cont.):

Explain how your companies accomplished a reclassification of expenses from categories where claim detail was not maintained (for example, internal defense attorney costs, formerly categorized as ULAE) to categories such as DCC, where at least some detail (i.e. accident year) would be required.

– We didn't have internal expenses that would be classified as DCC. If we did, it would be assigned based on WTS.

– Claims staff estimated their time between the categories DCC and A&O – not revisited in 1999. Loss payments used to allocate between accident years.

– Internal defense attorney costs were negligible so no reallocation done.

– Estimate Total Paid ULE/DCC as a % of Total Paid ULE using Salaries plus Overhead. Allocate Paid ULE/DCC to Line of Business using judgment %'s. Allocate Paid ULE/DCC to Acc Year using Calendar Year Closed Claim Costs + Open Counts.

– N/A. Claim detail was already being captured for internal defense attorney.

– Did not apply for my company.

– Nothing changed except column headings in 1999. The company's operations are such that nothing needs to be shifted.

– Detail on internal DCC was always maintained so shifting was easy.

– Internal expense code was available.

– Nothing to reclassify.

– We obtained as much detail as possible and used interviewing of claims personnel and gut feeling to make projections.

– Varies. On one extreme a company may decide that expenses go in the same categories as before. On the other hand, a company may decide that DCCP amounts to no more than attorney fees.

– My company has no internal legal staff.

– For internal defense costs, tracking of costs to the claim level was instituted in 1997 for calendar year 1997 expenses. Since we have a high volume of such costs, the 18 months of data available by 6/30/98 gave us adequate information to use techniques based on incremental development.

– Most likely by claim distribution.

– Wild guessing. Make data look like what it should look like or what they want it to look like.

– Since we have insignificant internal expenses that could be characterized as DCC, we are calling all internal expenses A&O. We are continuing to use the old ULAE accident year allocation rule of 45/5.

– Assumes reinsurance. Contracts written since 1/1/96 for ALAE (DCC) as one component of LAE, all other expenses defined as an other component.

Question 10 (cont.):

Explain how your companies accomplished a reclassification of expenses from categories where claim detail was not maintained (for example, internal defense attorney costs, formerly categorized as ULAE) to categories such as DCC, where at least some detail (i.e. accident year) would be required.

– For treaty reinsurance, an arbitrary formula reallocation was used, varying by subject treaty. The treaties follow the old definition!! For MGA's, we surveyed them. If they responded, we used what they gave us. For those who didn't respond, we prorated following the pattern of those who did.

– We did not encounter this situation. All of our expenses that were reclassified had coding on them that allowed us to accomplish the reclassification.

– ALAE reserves were reclassed as O&A based on ALAE payments being reclassed as O&A. ALAE reserves are not kept at a detailed level, but ALAE payments are. We then allocated these reclassed ALAE reserves to AY using judgment.

– Used department-specific expenses, allocated bases on claim counts, price losses, and price external LAE, as appropriate.

– A constant average cost per claim was applied to each claim handled by internal defense units. (This was not a large expense item at my company).

– No internal defense costs.

– No material change.

– Clients used a variety of arbitrary criteria. Few clients fully comprehend the revision. Virtually all view the revision as a regulatory item which does not impact management information.

– For these three relatively small companies, old ULAE is still A&O so there was NO reclassification from ULAE to DCC.

– We don't have the detail, so we just use allocation procedures to put the new DCC dollars somewhere. There is nothing in the regulation that says what type of detail you have to maintain on the new expenses.

– Since no actual data was available, expenses were booked to Personal Auto Bodily Injury. Amounts were considered immaterial.

– Claim detail was generally always maintained.

– Not sure.

– No internal defense attorney costs.

– This particular company is unusual and doesn't involve 3rd party litigation.

– Detail was maintained.

– Our company did not need to make any changes to comply with the new categories.

– Rudimentary formula allocations (guesses).

– We had all needed detail.

– We calculate ULAE reserves under the old definition by coverage and accident year, then estimate the percentage attributable to internal defense attorney costs, based on input/claims data from our Law Department. These percentages are mainly based on actuarial judgment.

Question 10 (cont.):
Explain how your companies accomplished a reclassification of expenses from categories where claim detail was not maintained (for example, internal defense attorney costs, formerly categorized as ULAE) to categories such as DCC, where at least some detail (i.e. accident year) would be required.

- No internal attorneys.

- Internal legal per-hour rates and internal medical cost containment per-transaction rates were determined. Costs are assigned to individual claims based on these rates.

- Since 1989, the company has utilized both time tracking and flat fee accounting methods to charge claims files for internal defense costs. The company historically carries a claim level code to identify external adjuster expense which is easily classified as adjuster expense on Schedule "P".

- I do not know. Generally, I accept a company/client's data as valid if the results look reasonable.

- We first allocated the calendar year internal defense costs into DCC. The calendar year payments were spread to accident years using a claim count process involving numbers of claim payments and numbers of open claims. Reserves were computed using runoffs of claim counts.

- We spread the reclass based on the "old" ALAE data still captured by our systems.

- A reclassification of expenses between categories would not have a significant impact given our volume of expenses in current classification we use.

- Claim detail was maintained prior to this change on expenses that were reclassified, therefore the reclassification was not difficult.

- Expense tracking system.

- Did not affect us.

- We do not have internal defense attorneys.

- Estimation based on discussions with claims management.

- Didn't need to. Internal litigation was coded to claim files.

- The change was not adopted.

- The company uses no internal defense attorneys, and so this major change item did not apply. Payments to independent adjusters are given a unique transaction code, and so were easily recategorized. Other items were immaterial.

- Primarily moved independent adjusters fees to A&O.

Question 11:
On a calendar year basis, the new categorizations apply to the incremental calendar year change across all accident years beginning January 1, 1998. From a Schedule P standpoint, this means for accident years 1997 and prior, the 12/31/98 evaluation of ALAE (i.e. the current column) and all future evaluations (or columns) will reflect a mixed definition. Accident year 1998 and future accident years will be under the new DCC definition. On an accident year basis, the new categorizations will apply to only accident year 1998 and future accident years. Prior accident years will continue to run-off under the old definition of ALAE.

What are the reserving challenges of dealing with this and what solutions have you found? How have you changed your reserving practices?

– CY Basis: Compare total LAE projections - new vs. old definition - to benchmarks that have not changed (premium, loss reserves, paid LAE, etc.). We've found that % of total LAE which is A&O is greater than that which was ULAE. We apply "pd to pd" method to determine A&O/Loss ratio as the basis of projecting A&O reserves. We have tried to establish "pd to pd" DCC/Loss factors as well.

– The company has maintained internal expense reports that utilize the old ALAE/ULAE segregation. They will continue to do this until sufficient experience has been gathered using the new categories.

– Company reserves per LAE are not overly significant.

– The only challenge is the need to refine our database and make a few special calculations. Just a nuisance.

– Where expense was shifted to A&O have moved it back to DCC to be consistent with former ALAE definition. Have still used ratio for A&O based on ULAE.

– Internal reserving continues to use ALAE & ULAE. Opining actuary uses ALAE & ULAE. For Schedule P analysis, we had accounting staff restate 1998 & 1999 accident years in terms of ALAE & ULAE.

– Biggest change is outside adjusters but reserves for outside adjusters have been estimated independent of other ALAE reserves for many years. Definition change was easy to handle from a reserving perspective.

– Significant judgments required in the selection of projection factors. We calculate total LAE reserve needs using historical triangle of ULE & ALE (DCC + A/O) and make sure that the judgment calls we're making for DCC and A/O individually, yield an overall LAE reserve similar to what we develop in total.

– Internally, we have not changed our reserving practices and still review ALAE and ULAE reserves separately. There is just an extra step required to split ALAE into DCC and A&O for statutory reporting.

– Under the circumstances described, nothing different needs to be done.

– Need to track development separately. Will use combined LAE as well.

– Reserving practices not changed. Still analyze ALAE separately from ULAE. The differences between ALAE & DCC and ULAE and A&O are dealt with in the data reconciliation of the actuarial report.

Question 11 (cont.):
What are the reserving challenges of dealing with this and what solutions have you found? How have you changed your reserving practices?

– Duplication of history in internal statistics and Schedule P data. Worked on breaking out these adjustments.

– For older years we did not have the detail to construct expense triangles under the new definition therefore we had to combine all expenses to form a LAE triangle to determine expense development.

– We used the old ALAE/ULAE definition to group data for reserving purposes then reallocated the bulk reserve for annual statement purposes according to the new categorization.

– N/A for this client. In general, though, I would probably propose a mapping of ULAE into accidents and build a hypothetical "DCC" triangle.

– We continue to capture the old definition of ALAE & ULAE to estimate reserves. We then allocate to the DCC and A&O based on an allocation system using internal expense code data.

– We applied the change on an accident year basis as this seemed cleaner to me. The challenges are from lack a historical data under the new definition. Also, reinsurance contracts have not changed the definition so detail must be kept in both fashions.

– The challenge is to find for each company individually procedures and methods which give reasonable results. Reasonability is about all one can probably hope for, at least for a while. With respect to DCCP, if one is using paid to paid factors by accident year which are developed to their ultimate values and multiplied by estimates of ultimate claims, it is possible to presume that the pattern of development will be the same with the new data as for the old except for the discontinuity as of January 1, 1998. Calculations can then be based upon this method being careful in the application of the ultimate losses to take account of the fact that payments prior to January 1, 1998 are of a different nature than those thereafter. With respect to AOP, if calendar year paid to paid ratios are utilized, it makes sense to examine the data separately for calendar years prior to 1998 and years 1998 and later.

– Looking at historical triangles will obviously be skewed (since we took the calendar year approach). Since my company has no internal legal staff handling DCC, that poses no problem, but independent adjuster costs are shifting from ULAE to DCC.

– We are able to keep separate the data for internal defense costs, external adjuster costs, and other ALAE costs. Currently we estimate "old ALAE definition" amounts, then subtract estimated external adjuster costs and add estimated internal defense costs. During a transition period, which will vary by line of business, this additional analysis will be required. Once we have adequate "new definition" data, we can revert to a simpler analysis.

– If they do it by calendar year basis your prior data will not be consistent w/ current year data thus leaving tests like the IRIS Ratios w/ no value on an Accident Year basis. I think we avoid the above problem.

– Easy for those who don't change. We will let you know when they move to new definitions. On CY basis, restating screws up triangles.

Question 11 (cont.):
What are the reserving challenges of dealing with this and what solutions have you found? How have you changed your reserving practices?

– Won't run-off calendar year 98 and subsequent be under the new DCC definition? Our reserving practices have not changed at all. We are still developing our ALAE/external and ULAE/internal reserves the same way we have in the past. What has changed is that we now have to allocate our developed ALAE/external reserve to the new DCC and A&O categories. We are allocating to these categories based on paid DCC and A&O expenses collected for calendar year 98 and subsequent. We consider all ULAE/internal reserves to be A&O. We are also collecting and building historical triangles of external DCC and A&O paid expenses for AY 1998 and subsequent. As soon as sufficient history is available we will use triangular analysis to develop our external DCC and A&O reserves.

– Expenses defined by reinsurance contracts.

– The challenge of Accident Year (selected) is to keep the pre-1988 Accident years on the old basis. The challenge for Treaties is to get anything like the new definitions into the contracts. There is also the problem of availability of UW years on some treaties.

– Internally, we have recast our triangles to be consistent with the current definitions.

– The definitional change only affects our statutory reports; internal reserving data was left unchanged. Therefore, our reserving practices haven't changed.

– Lack of data for internal DCC on a historical basis. Use of new definitions (for data-gathering and reserve analysis only) for all accident years.

– Currently, we continue to project ultimates using data under the former categorization, and then allocate the resulting IBNR needs to the new categories for AYs 1998 and subsequent. In the future, we will likely try to obtain restated (according to the new categorization) historical data to directly project the new category amounts for AYs 1998 and subsequent.

– The biggest issue is separating the A&O component of ALAE reserves. We can separate the historical payments of ALAE by component. We looked at historical A&O payments as % of total ALAE payments by accident year at different evaluation points (12, 24, 36 uses, etc.) From that, we could derive the % of total bulk ALAE reserves for A&O by accident years at different evaluation points.

– No material difference.

– Have focused on total L & LAE reserve. Further, several clients advise that claim service contracts, with third parties, obviate the need for A&O reserves or A&O payments.

– Most coverage defense issues relate to mass torts, which are concentrated in the "prior" AY. Also, AY triangle analysis typically is not performed for mass tort business, and these expenses were always analyzed separately, anyway, hence no new challenges, no new issues.

Question 11 (cont.):
What are the reserving challenges of dealing with this and what solutions have you found? How have you changed your reserving practices?

– For these three relatively small companies 1) The shift to DCC and A&O was implemented piecemeal throughout AY 1998 so even AY 1998 is a mixture of old and new. Only AY 1999 has pure DCC and A&O available. There won't be any DCC and A&O patterns for a few years yet. 2) For AY 1997 and prior, no company chose or could restate history. So there are no historical DCC or A&O patterns. 3) Since the three companies have to maintain old ALAE and ULAE for reinsurance purposes, they are tracking ALAE by DCC and A&O components. 4) The reserving practices have changed as follows: The preliminary reserving methodology continues to address ALAE and ULAE like before. Then ALAE is allocated to DCC and A&O based upon payments made since 7/98 by LOB/AY categories. ULAE is all assigned to A&O.

– There are no reserving challenges for us, except for doing the final allocation for annual statement purposes. There is no reason for us to throw out our historical data or historical way of setting reserves just because of this change. It is our opinion that we have to establish the right overall level of reserves. Which category they ultimately end in is immaterial.

– We analyze our ALE and ULE reserves separately using an accident year change in Paid ALE to Incurred L/R estimate for ALE and a calendar year Paid to Paid and Paid to Paid plus O/S as an estimate of the relationship of the ULE O/S to Loss O/S for ULE. In all but one Reserve Analysis there appeared to be no distortion in the rate of ALE to ULE. In the one we used the latest year diagonal which effectively eliminated the distortion. We will probably change to a Paid to Paid method and analyze the reserve in total.

– We kept enough detail on ALAE: Internal vs External & ULAE: Internal vs External so that the change over was not cumbersome.

– We reserve at the old level, and the financial area reallocates the result to the new classifications.

– No change to reserving practices except to recognize lower DCC costs in the calculations.

– This company had minimal ALAE under the old definition and it was more appropriate to redefine all years to a consistent basis using the new definitions.

– Instead of attempting to restate history, reserving is being done based on the old ALAE/ULAE definitions.

– Since the company's expense classifications have historically been consistent with the new categories, we did not need to do anything different.

– We use the old ALAE/ULAE and internal reports for LAE reserve adequacy testing. Reconciliations to the annual statement for actuarial reports is ugly. I still haven't run across a case where old ALAE+ULAE = new DCC + A&O.

– We are analyzing using the "old" definition and then re-allocating the final reserve.

– None, we maintained ALAE and ULAE definitions for reserving and make an adjustment to reflect the change in Schedule P.

– Internally, we have maintained the old definitions, so we have not changed our basic reserving practices. Our challenge is in estimating how much "old definition" ULAE to move to DCC for statutory purposes. Our system can capture ALAE (old definition) moving to A&O, so that hasn't been as difficult.

Question 11 (cont.):
What are the reserving challenges of dealing with this and what solutions have you found? How have you changed your reserving practices?

– Biggest impact was on auto physical damage. This line is so short tailed that I simply applied a little actuarial judgment.

– 1) Initially evaluate ALAE & ULAE with data segregated under the old definition. 2) Estimate independent adjuster expense reserves separately using development patterns for that expense. 3) Transfer indicated independent adjuster reserve from ALAE to ULAE. (Internal legal and medical cost containment reserves are not material for us).

– The DCC reserving changes are not a problem for us since we have accounted for internal defense cost as such since 1989. The change for IA's is not a problem because of short tail nature of that expense.

– We use data summarized by the old definition to determine required LAE reserves.

– Most client/companies have tracked data under both definitions. (In most cases, the recoverability of loss adjustment data is based on the pre-1998 definition, meaning they have to capture the data anyway). For those that don't, I can develop ratios regarding category shift from averages of other clients. Given the data in both formats, I have not found it necessary to change my reserving practices. The "mixed definition" is problematic, because the column will be mislabeled through the 2008 Annual Statement.

– We ignore previous ALAE and ULAE payments. Our methods rely on recent calendar years only and use claim counts to spread the calendar year LAE payments and claim count runoff patterns to get LAE reserves by accident year.

– No change to reserving practices. I don't pay any attention to the #s shown in the statement. I can continue to compare long term ratios based on the old definitions.

– Our reserving practices have historically been based on Bulk IBNR and ultimate losses including loss adjustment expenses; accordingly, we follow the same reserving practices given the minimal impact the changes would have on the financial presentation.

– Our Company handled the new categorizations on a calendar year basis. Our reserving practice has not changed; we simply added another level of detail to our analysis when evaluating our reserves.

– I asked all companies to give me the LAE under the old definition so that projections are possible. Without this, I don't have any way of doing it.

– Use outside actuary. No major problems noted.

– We continue our reserving practices based on old definitions and allocations.

– We were able to restate our ALAE triangles (not Schedule P data) and ULAE formula to be on the new definition.

– The change was not adopted.

– At this time we are evaluating expense reserves based on data accumulated per the prior definitions. The estimated reserve is then allocated using claim counts and claim $ according to the new definitions.

Question 11 (cont.):
What are the reserving challenges of dealing with this and what solutions have you found? How have you changed your reserving practices?

- The company has no internal defense attorneys, and so no recategorization took place. Independent adjuster costs are minimal (less than 0.5% of all loss adjustment expense). The amounts involved for the company are insignificant. No attempt has been made to change reserving practices.

- I have attempted to get my clients to break out the portion of A&O expenses that reflect "old" ALAE, i.e., expenses that can be allocated to an accident year. We analyze these expenses as in the past. The remainder, or "old" ULAE, is then analyzed separately as in the past.

- We analyze and select ALAE reserves based on the old definition as a starting point. We then have outside adjuster expense factors (which vary by line and acc year) which are applied to the old definition ALAE reserves to determine the outside adjuster expense reserve portion. These outside adjuster reserves are then subtracted from the old definition ALAE reserves and added to the old definition ULAE reserves. Since we do not use any in-house attorneys, there were no issues for us with the definition change as it related to this piece. The outside adjuster expense factors are analyzed and selected annually using paid outside adjuster expense triangles.

Question 12:
In your opinion, what impact will the categorization change have on industry Schedule P data as individual companies make different choices on how they will handle the change?

- Only has integrity in the aggregate (DCC + A&O combined). Should expand Parts 2-4 to include both DCC and A&O.

- Industry Schedule P data for all companies combined will be distorted by the change and by different ways of handling the change. Could impact companies that use industry data for benchmarking.

- I envision no major benefit to anyone. ALAE was always assigned to an AY. Internal expenses were assigned by allocation. I see no change occurring, just column change.

- Less expense under DCC than ALAE. More expense under A&O than ULAE.

- A big mess.

- Will only be able to analyze total LAE expenses and reserves for accident years prior to 1998.

- I expect that the allocations which companies will be doing in the future to get to DCC + A/O splits will yield every bit as much inconsistency from company to company as the old ALE and ULE split did.

- Minimal impact.

- Little to none.

- It will be different but not necessarily more consistent. My clients emphasize LAE to reduce losses to varying degrees.

- Industry Schedule P data will be a mish-mash of various company definitions.

- Large companies with internal legal staffs will have reclassification going both ways. Small companies probably will have reclassification going only one way.

Question 12 (cont.):

In your opinion, what impact will the categorization change have on industry Schedule P data as individual companies make different choices on how they will handle the change?

– I feel it gives us an inconsistent look when comparing companies. It would be more accurate to classify all expenses as LAE. Then we would have an accurate comparison of expenses.

– Allocation methods may vary widely. I could understand the inclusion of ALAE in Schedule P triangles. I am not sure how to interpret the inclusion of cost containment.

– We will not be able to trust the Schedule P data for years prior to 1998. While it may not have a huge impact for personal lines, I would be worried about some of the other liability and company lines because of the potential for long ALAE.

- I don't think it will improve reliability.

– You will not be able to use industry data as readily as in the past. Should have had all companies handle the change the same way.

– I am not optimistic that the data will be any more homogeneous between companies using the new definitions than it was using the old ones. The Schedule P data will be of much less value for a number of years than it has been in the past. It is not clear it will be more valuable at any time in the future because of this change than it has in the past.

– Should make for a clearer comparison of defense costs among various companies.

– The inconsistency will obviously cause Schedule P distortions.

– Industry conglomerate data could be rendered useless for 10 years especially for small companies who employ outside adjusters.

– It will defeat the whole purpose of having a standardized format for Schedule P. There should not be different choices on handling the change. For 10 years –> data=garbage. Especially bad for small companies, lots of outside adjusters.

– Schedule P data will be distorted. The reliability of any triangular analysis based on Schedule P data during the 10-year phase in period must be questioned.

– Schedule P has not been useful for reserve testing due to limit differences, reinsurance changes, statutory coverage differences for multistate writers. Schedule P combines various coverages that should be reserved separately.

– I will mainly follow combined as I cannot trust separations (especially pre-AY 1998).

– This change was not all that material. Given the limitations of Schedule P for reserve analysis, I don't think this will materially affect the quality of any industry analysis that uses Schedule P.

– ALAE and ULAE (or DCC and O&A) ratios will be inconsistent across companies if Schedule P is relied on for comparisons. This could lead to market analysts making incorrect conclusions. Also, Schedule P, Part 2 (Runoff) could be distorted since only DCC is included but O&A is not.

– No consistent basis across industry. Also depends on prior treatment of internal DCC.

– The data will be more volatile.

– It will take 10 years before any form of consistency is gained.

Question 12 (cont.):

In your opinion, what impact will the categorization change have on industry Schedule P data as individual companies make different choices on how they will handle the change?

– Increased emphasis on aggregate LAE data; reserve developments are now "minimums"; reinsurance treaty definitions may not follow annual statement.

– Most commercial lines companies were reporting expenses for the liability lines using the ISO stat plan, which used a functional definition for ALAE. Hence these companies were completing the annual statement consistent with new definition, inconsistent with old. Little impact expected for commercial lines. Most companies not using the ISO stat plan were personal lines NAII members, so personal lines industry data may be impacted (e.g. Our Company piece probably impacted).

– 1) Parts 2 and 3 are useless and will be for a number of years; 2) Part 1 is useless for DCC and A&O, and will be for a number of years. Only combined DCC+A&O (old LAE) has some usefulness; 3) Regulators aren't going to have any useful industry loss expense data for a few years.

– Overall it won't have any impact to us. Industry Schedule P data was of limited use to us before, and this will only make it worse. The regulation doesn't force companies to change to claims practices, so it is just a reporting issue. Any actuary with common sense knows not to place a lot of faith in data that comes from another company that doesn't operate the same way you do.

– This change in practice makes absolutely no sense whatsoever. I have been told that the reason for the change is that ALE is not comparable between companies (some companies utilize outside adjusters more than others). Well, companies are different and though old rule measured that difference, the proper place to break out legal and adjusting was in Part 4 (A/S) expense class. Break out line veto, direct legal and direct adjusters.

– Depends how much past practices would conflict with present practices on a company by company basis.

– It will make P a mixed bag with respect to LAE.

– In the long run, it is an improvement, but more dependence will be placed on evaluating the combined LAE as a cross check of reasonableness for the next few years.

– More inconsistencies will exist now than prior to the change.

– I expect some inconsistency for a few years until definitions are refined and companies fully adapt to the reclassification.

– Schedule P data is less useful, both in looking at the industry and at individual companies.

– The industry Schedule P will continue to be ambiguous. But, in the future the standardization will be beneficial.

– Impossible to tell – some companies have ULAE going into DCC and others have ULAE going into A&O. Could be a wash, probably is not.

– Industry Schedule P data will be even more difficult to decipher than ever before—I get the impression that most industry analysts don't have any idea how to interpret the impact. We'll need several full years of data under the new definitions to have any idea what the impact is.

– No opinion.

Question 12 (cont.):

In your opinion, what impact will the categorization change have on industry Schedule P data as individual companies make different choices on how they will handle the change?

– Some distortion on aggregate industry ULAE & ALAE development patterns. Uncertainty about appropriate adjustments due to variety of company treatments.

– Company comparisons will be more meaningful.

– It will make Schedule P even less useful than it already is.

– I have always believed that industry data must be handled cautiously – for reasons such as this.

– Can't use Schedule P to determine the adequacy of LAE reserves.

– Should be better once everybody implements it. But the next couple of years will be a transition period.

– Anyone using Schedule P will now have to ask questions regarding different assumptions that companies make than they did before. There is still consistency from company to company as to what is allocated between categories.

– As a result of the categorization changes, the impact to Schedule P will be that the data provided in the "Defense and Cost Containment" and "Adjusting and Other Payments" categories will lose its creditability. However, the overall impact would be minimal since these costs would be included in the total losses and loss expense.

– If more companies within the industry choose the calendar year method, the industry will produce a more favorable loss development on accident year 1997 and prior.

– At my personal lines only company, the shift was very insignificant.

– Schedule P is worthless for any comparison.

– I prefer the old split of internal versus external expenses. This new definition only makes Schedule P less useful.

– Incurred development (Part 2) will differ in its meaning by company so industry aggregate will be a mixed bag. This is because Part 2 (as well as Parts 3 and 4) only considers loss & DCC. I would suggest changing these parts to include DCC and A&O for AY 1998.

– Will probably be less useful for a period of time until companies have been on the new definition for several years. See #16 for additional comments.

– There will be less consistency in industry data going forward. It was my understanding that the primary reason that this change was adopted was to allow improved direct comparisons between companies. I do not support that reason as being more important than ratemaking, pricing, reserving, underwriting and reinsurance reasons for continuing allocating as many claim-specific dollars as possible to individual claims. Regulations should benefit policyholders and not simply add to the expense dollars policyholders should pay. One additional reason this change was not implemented here is that I/T resources were not available to do this work at a time when they were already overburdened doing Y2K remediation work. See further comments in response to number 15.

– Schedule P data will be a mixture of categorizations. Looking at expense data will be difficult and less meaningful for several years.

Question 12 (cont.):
In your opinion, what impact will the categorization change have on industry Schedule P data as individual companies make different choices on how they will handle the change?

– We do not see this as a significant issue. A review of the annual statement for different companies shows that companies have historically varied substantially when completing the annual statement. Thus, the history is hardly consistent prior to this change. We hope that more uniformity will result in the future because of this change.

– Data will be less reliable, less useful since companies will be inconsistent. Also, no one will be able to figure out how to analyze A&O category.

– Since each company will handle this differently, it may make it difficult to compare DCC and A/O results across companies.

Question 13:
How will users of Schedule P adjust for possible distortions in the data?

– Lots of uncertainty. Use interrogations to ascertain how company has implemented the new definition.

– It may be possible to make broad assumptions concerning what portion of ALAE is now recorded as A&O, etc. A statistical study could be undertaken.

– View change with possible factors to reflect distortions.

– They probably will make no adjustment.

– Restate in terms of ALAE & ULAE. Add ALAE/ULAE and DCC/A&O together prior to analysis.

– Will have to rely on accident years 1998 and subsequent to estimate the distribution of LAE for accident years prior to 1998.

– Ignore DCC and A/O and rely on total LAE.

– They probably won't adjust.

– Don't know, but it's not anywhere near or significant a "distortion" as that of shifting policy limit, attachment points, and "ultimate net loss" – type arrangement.

– I think most will treat ALAE w/ DCC and ULAE w/ A&O.

– How can they? Schedule P has become even more useless.

– Add everything together to get proper view.

– They will have to look at the combined DCC and A&O to get an accurate view of expenses.

– May need to combine ALAE & ULAE for several years. Could use individual company info but must find out what each company did.

– Combine all LAE.

– No need for adjustment.

– Without knowledge of company specific changes it will be extremely difficult to utilize Schedule P.

– The same way you raise teenagers -- any way you can.

– I have not given this much thought since we do not use Schedule P much.

Question 13 (cont.):
How will users of Schedule P adjust for possible distortions in the data?

– Analysts could use loss data only or loss & LAE data but loss & ALAE data will be screwed.

– Not use Schedule P! Not believe the data if they do use it. Combine the prices – current & historical and compare total to total. Look at losses alone.

– Not sure.

– Not use Schedule P. Ask for actuarial report.

– Combine ULAE and ALAE (or A&O & DCC) or even combine Loss and all LAE. (I don't trust case ALAE either, even as the old definition).

– I think they should simply acknowledge that there might be some small distortion and proceed.

– When possible, look at Loss & LAE instead of just Loss & DCC or O&A separately.

– Don't know; perhaps they will focus on Loss + Total LAE data, or just Loss Only data.

– I would look at total Loss and total LAE and not bother with the components. Not sure whey the switch was necessary.

– Increased focus on aggregate LAE data, if informed. Won't justify, if uninformed.

– Who uses Schedule P data? No impact on commercial lines in general, so no adjustment needed. State Farm and other big NAII members probably don't use Schedule P, so no harm, no foul. Small personal lines companies that have no other reserving data, or rely (unadvisably) on industry Schedule P data may be impacted. Not obvious for me (who is not impacted) why the impact can't be treated like a distortion from a cat.

– 1) Can't adjust on an industry basis with any assurance; 2) On company by company basis, it will depend upon the company reclassification approach and any supporting data. So there are no generalities.

– Who knows. Given the low intelligence level of the people who pushed for this change, who can guess what they will do. Since fewer people will be able to use the data, it probably doesn't matter what they do. And since I won't use their analyses, I don't care what they do.

– They can't. Schedule P has been rendered useless for separate analysis of ALE and ULE reserves.

– I'm not sure there is a clear-cut way to adjust for these types of distortions.

– Not sure.

– It may require using calendar year ratios on the last year or two or using combined LAE for calculations.

– Look at LAE in total and not the subsets.

– One simple method would be to compare historical expense/indemnity prior to the change and after the change. Apply a factor to adjust all years to a common standard.

– Like always, they will make the most of available information, with necessary qualifications.

Question 13 (cont.):
How will users of Schedule P adjust for possible distortions in the data?

– Use other sources of company data as/if they become available. Adjust individual companies to the industry average -- which is contrary to the purpose of looking at an individual company.

– Unknown.

– On a company basis, you need a disclosure in Schedule P Interrogations of some sort. Without a disclosure, it would be impossible to adjust for it. Trying to look at total LAE is not, in my opinion, an adequate approach. On an industry-wide basis -- impossible w/o more info.

– Ignore 1998/1999 Schedule P's for the development of ULAE/ALAE ratios. We've already seen this with a 1998 financial exam -- the auditors ignored the 1998 Schedule P and used 1997 P's to develop ULAE ratios. We were told that this was how they were handling the problem.

– No opinion.

– Combine ALAE & ULAE for analyses purposes.

– Users will require additional data from the company to evaluate adjustments by expense type and line of business.

- ????

– (I assume this question refers to individual Schedule P and not industry Schedule P). There is never a good substitute for knowing the company under evaluation, and having access to key personnel who can interpret the data for you as you analyze. If I were to analyze a company's Schedule P without that company's knowledge, I would likely combine both categories of expenses and evaluated them as a whole.

– Each company will have to be dealt with on its own merits.

– Will either have to use total LAE (many actuaries have been doing this anyway with industry data) or pick certain companies you know have implemented the new guidelines properly.

– Depends on the company being analyzed. As far as trying to review industry totals is concerned, I would think that only total LAE could be reviewed with any confidence.

– Users will adjust for the possible distortions in the data by applying more weight to the total losses and loss expenses and to adjust the individual analyses based on the data.

– They will have to include activity on Adjusting and Other Expenses when evaluating the loss data.

– I don't know how anyone can.

– I thing w/o providing detail of data under the old method, distortions will be impossible to quantify.

– They probably won't and may reach distorted conclusions.

– Do not know.

Question 13 (cont.):
How will users of Schedule P adjust for possible distortions in the data?

– This is a good question. Historically, Parts 2 and 3 have been prepared on a loss plus allocated basis given the fact that, by their very nature, unallocated loss adjustment expenses could only be assigned by accident year on a judgment basis. I am not clear what is expected to show up in Parts 2 and 3 now. To the extent any ULAE-type losses get into Part 2, loss development measures will be distorted. To the extent they get into Part 3, paid loss development patterns will be distorted. Who knows how users will adjust for these distortions, or if they even can.

– Look at all LAE combined. There still may be distortions because the distribution of expenses to accident year may have changed with the change in categorization.

– We do not use Schedule P very often. We assume that we would examine Schedule P in order to determine whether an apparent shift exists around calendar year 1998. If so, we would restate older years on a basis consistent with the most recent years.

– See #11. However, this cannot be done on industry data. No one will have a clue what's in accident years 1997 and prior.

– So far, outside users of Schedule P data do not seem concerned enough to adjust for the distortion created by implementing this change on a calendar year basis. No one has asked us to provide information to help them adjust the data.

Question 14:
As a result of the revised expense categories, Schedule P data subsequent to January 1, 1998 is on a different basis than that of prior years. What impact has this had on reports, for example IRIS tests, that are based on Schedule P data?

– IRIS tests involving ALAE are impacted (Ratio 10 & 11). IRIS tests 10 & 11 probably understated.

– Not a significant issue for my company since expenses are a relatively small portion of loss and expense.

– Minor impact.

– No idea.

– Probably very little.

– No apparent impacts.

– False indications of downward development in ALAE for accident years prior to 1998.

– For a company which has more $'s shift from ALE to A/O than from ULE to DCC and implemented the change on a calendar year basis, IRIS ratios are easier to pass at 12/31/98 and 12/31/99. This is because there are 12/31/97 reserves for ALE (now A/O) which will not have any subsequent payments in Schedule P Part 2.

– Minimal impact.

– No perceptible difference.

– Depends on how big the change was and what LOB. For many lines, LAE is smaller portion. Also, total LAE should not be affected.

Question 14 (cont.):
As a result of the revised expense categories, Schedule P data subsequent to January 1, 1998 is on a different basis than that of prior years. What impact has this had on reports, for example IRIS tests, that are based on Schedule P data?

– More leeway in reserve developments because most adjustments went from ALAE to ULAE for my company.

– I would imagine that the shifts of dollars into DCC was bigger than the shift of dollars out of ALAE. Resulting one to two year development is probably worse than otherwise.

– None really since our company implemented on an accident year basis. It would cause either redundancies or deficiencies to show up if implemented on a CY basis depending on the amount of outside adjusting or internal defense utilized.

– Varies by company. There may be an effect which is not all that significant. Both theoretical research - i.e., examining scenarios to better understand the effects - and compilation of actual results will be helpful. The latter will be particularly useful. As to area, reinsurance and ratemaking may be the most significant for some time to come. Retrospectively rated policies will be a sensitive area worth attention.

– For our company, impact was not a serious issue.

– If companies adopt the definition on a CY basis, the test can be useless since reserve development can't be calculated on a consistent basis.

– It makes them wrong. They are screwed up and I think not very useful.

– IRIS tests 9, 10, and 11 are distorted. The distortions will be favorable for us since by definition, DCC is a smaller reserve than ALAE. The distortions should go away next year.

– Probably show deficiencies as ALAE will be smaller than previous year.

– Probably not a big enough difference to matter. Fairer anyway as previously staff versus adjuster companies were treated differently.

– Small.

– For our company, the impact has not been significant.

– No material impact.

– Don't know.

– Haven't thought through that. Our IRIS tests not an issue.

– No material impact.

– IRIS ratios 9, 10 & 11 are now minimum development because some expenses are A&O and A&O does not wind up in "development" columns of Schedule P.

– No impact on IRIS for most commercial lines companies. No impact expected for Schedule P - Part 1. No impact for ISO stat plan companies. Not obvious that issue is big enough for those impacted (personal lines, non ISO companies).

– It didn't trigger unacceptable IRIS test values for my companies.

– It hasn't had an impact yet.

– I guess this would be a reasonable topic for *Proceedings* or *Forum* Paper.

– For us, it did not produce any exceptional IRIS values.

Question 14 (cont.):
As a result of the revised expense categories, Schedule P data subsequent to January 1, 1998 is on a different basis than that of prior years. What impact has this had on reports, for example IRIS tests, that are based on Schedule P data?

– Not sure.

– There is an effect for this company but it is minor.

– None for this company.

– Appears to be minimal for our companies.

– None for this company.

– It didn't ruin any of our IRIS ratios. The main problem we've had is reconciling our work (old LAE definitions) to the annual statements.

– Unknown.

– No material impact.

– I haven't noticed any impact on our reports. One area that has impacted us -- statutory reporting other than Schedule P, for example, NJ Excess Profits. These reports are supposed to tie to the Annual Statement, yet they include historical loss development factors as part of the calculation. This is a problem -- using "old definition" Loss and ALAE historical LDF's and applying them to "new definition" Loss & ALAE. We've kept this report on the "old definition" basis, subject to DOI approval. I'm sure there are other examples of this.

– If appropriately reserved at 12/31/97, there would be some distortion in one-and-two year developments at 12/31/97 and two-year development at 12/31/98. Independent adjuster expense has a short tail, so it should not have a large impact. There could be more distortion for companies that use internal legal staffs extensively for defense of claims.

– For our company, the impact has been immaterial.

– For our company it lowered the development of prior accident years because we implemented it on a calendar year basis.

– IRIS tests 9, 10 and 11 become meaningless. For small companies, such as most of my clients, this generally works in their favor -- as dollars were reserved, or under-reserved, and paid as ULAE (or A&O), beyond the scope of the Schedule P - Part 2 test. Generally, I do not go through any exercise to determine if a favorable Schedule P value would have become unfavorable with an adjustment.

– Not sure.

– None.

– The revised basis of Schedule P has had a nominal impact to our reports such as the IRIS test, etc.

– This will artificially improve the 1 and 2 year reserve development ratios.

– There is an obvious impact on the loss development tests.

– There are clear distortions without any attempt as an industry to quantify the problem.

– Good question. If I have time, I'll look into that.

– Probably minor impacts.

Question 14 (cont.):
As a result of the revised expense categories, Schedule P data subsequent to January 1, 1998 is on a different basis than that of prior years. What impact has this had on reports, for example IRIS tests, that are based on Schedule P data?

– I can only speculate what affect the distortions referenced in item 13 will have on various reports and tests.

– We have observed no impact at our company because the amounts are so small (in our case).

– Development will be distorted, depending on how companies implement the change.

Question 15:
Please indicate if you believe that further research is needed regarding the impact of the new LAE categories in the following areas.

Response	Frequency	Percent
a) Federal Income Taxes	7	9.5
b) Commission Agreements	4	5.4
c) Case Reserving Practices	6	8.1
d) Retrospectively-rated Policies	6	8.1
e) Ratemaking Practices	10	13.5
f) Reinsurance Contracts	14	18.9

When respondents were asked to indicate areas they believed that further research was needed regarding the impact of the new LAE categories, the most popular responses were reinsurance contracts (18.9%) and ratemaking practices (13.5%).

If you have experience with the change in any of the following areas, the Committee would appreciate your input.

– I think a Practice Note would be helpful for reserving.

– Yes, future information should be developed to ascertain possible distortions.

– I believe there has not been any impact as we treat the change as regulatory reporting required only.

– Our reinsurance contracts continue to require ALAE & ULAE. Ratemaking continues to use ALAE & ULAE.

– Can be confusion/problems because at least some reinsurance have not changed the definition of ALAE in their contracts.

– No further research.

– (Reinsurance Contracts) Many cover L & ALAE, no Loss & DCC!

– (Case Reserving Practices) Currently we are using old categories and old methods, and perhaps that is the best way to continue until someone comes up with a better method.

– (Reinsurance Contracts) Reinsurance contracts are always ambiguous on the treatment of LAE. I would say that very little effect will be felt.

Question 15 (cont.):
Please indicate if you believe that further research is needed regarding the impact of the new LAE categories. If you have experience with the change in any of the following areas, the Committee would appreciate your input.

– No thoughts, since not impacted.

– (Retrospectively-rated Policies and Ratemaking Practices) Information about actual ractices and effects will be helpful.

– No. I try not to use Schedule P for reserve testing.

– (Case Reserving Practices) In the real world, claims personnel will move to new definitions at different speeds within (same) and among (a lot) companies. (Reinsurance Contracts) If a reinsurance contract says it will pay for outside adjusters (as most do) there is no way they will report only DCC until contract terms and pricing (for outside adjuster companies) are changed.

– Another area needing research -- Excess Profits Reports.

– I would hope reinsurance contracts don't change. As a company our desire long-term is to meet both definitions A&O vs DCC and ALAE & ULAE. There is value to both.

– Let's bring Schedule P to actual dollars like rest of statement. Let's require/request full and complete claim count information in the process of these other modifications. Ten year Schedule P data for all lines.

– This is a broad question. Further research seems to always be needed, and refinements are nearly always possible.

– (Ratemaking Practices and Reinsurance Contracts) My experience is they seem to reflect "old definitions" not new.

– We don't see any need for research on above.

– (Reinsurance Contracts) Evaluation of new reinsurance contracts is impossible since you can't distinguish from Schedule P which expenses will be subject to the contracts.

– (All checked) Probably all of these areas. But since my company is NOT changing our internal reporting, I do not see an immediate impact other than statutory reporting.

– I believe that policyholders are best served when as many loss adjustment expense dollars as possible are assigned to specific claims -- whether those claims are in litigation or not. From a ratemaking perspective, class relativity factors, territorial rates, and state indications will be based primarily on claim-specific expenses. From an underwriting perspective, underwriting decisions (including pricing retrospectively-rated policies) will be made based on primarily claim-specific expenses. Reinsurance payments will be made based on primarily claim-specific expenses. To the extent contingent commissions are paid based on loss experience including LAE, they will be based on primarily claim-specific expenses. The more that is directly allocated to individual claims, the better. The argument that a company can keep two sets of books (one set for the above business reasons and another for the regulators) is ludicrous – it ignores the fact that policyholders would have to bear the cost of a second set of books.

– (Federal Income Taxes and Reinsurance Contracts) Most reinsurance contracts make reference to loss and "allocated adjustment expense." From the reinsurer's perspective, being claim-specific is more important than the DCC and A&O definition.

Question 15 (cont.):
Please indicate if you believe that further research is needed regarding the impact of the new LAE categories. If you have experience with the change in any of the following areas, the Committee would appreciate your input.

– We do not foresee any significant change for our company. The changes appear to be rather straightforward for companies with larger amounts.

– Loss Reserving -- Significant impact on doing loss reserve analysis.

Question 16:
Other comments, suggestions, or issues affecting your work due to these changes.

– NAIC should require restatement of all AY's to the new definition on a historical basis, even if allocation and estimates are necessary.

– This change seemed unnecessary. In general, loss adjustment expenses are smaller than pure loss costs, so why the separation into two categories? Just have one category – LAE.

– I believe the transition problems created by this change outweigh any potential benefit from the change.

– I think the change has created additional confusion. Schedule P can no longer be used to obtain ALAE and ULAE separately and there is increasing need to complete reconciliation from internal data to Schedule P data.

– The advantages of any such change as this should clearly outweigh the disadvantages. We are not convinced that criteria has been met.

– When changing a standard of practice only one option should be afforded else you leave yourself open to being inconsistent.

– Make changes standardized, shouldn't be choices as to how to report data. The whole point of an annual statement format is so everyone's data is in the same format. You can pick up any statement and understand the numbers.

– It is an awful experience and Schedule P is not currently a satisfying product worthy of our pride (in my opinion).

– The new definitions also moved legal expense incurred on declaratory judgment (DJ) actions from ALE to A&O. This was a significant rebucketing for environmental and asbestos expenses.

– Seems like a lot of work is required to satisfy this definitional change. I'm not sure the benefit outweighs the extra work.

– Difficulty of explaining to non-actuaries why change in definition causes change in companies reserve.

– The DCC includes cost containment expenses. I am surprised they are not in A&O. Don't adjusters try to contain costs? In any event, cost containment should be defined with some examples given.

– We will have to continue to use the "old" ALAE and ULAE approach with allocation to DCC and A&O for a few more years. Then DCC and A&O patterns might be useful in their own right.

Question 16 (cont.):
Other comments, suggestions, or issues affecting your work due to these changes.

– This was a stupid change, and I am sure glad that the CAS pushed for it It would be nice to see the CAS try to explain to our accountants and claims people the benefit of this extra work. In case you hadn't notice, Schedule P is perceived to be for actuaries use only. Any changes to it are deemed to be at our request. The question is why we haven't justified making this change. As stated above, this change makes industry Schedule P less useful.

– See number 14

– In my opinion, this change was poorly thought-out and serves no purpose at all. I am unaware of any beneficial purpose that will ultimately be served.

– I think it's crazy to have four categories: Losses, DCC, A&O and General expenses – especially since DCC and A&O include overhead. Simpler would be two categories: losses (including direct loss expenses) and expenses.

– I think the whole change was pointless.

– This resulted in a greatly increased amount of work on my part and on company personnel parts for no discernable benefit. It also caused great confusion as there is no clear definitions of what is A&O and what is DCC.

– It causes headaches for me regarding statutory reporting but since my company management has decided against making internal reporting changes the burden of the change pretty much falls on me.

– It is possible that companies that have to reclassify internal litigation expenses will find their reserves less adequate and companies reclassifying adjuster expenses will find their reserves more adequate.

– New definitions such as these, where limited historical information is available, present real reserving challenges. 'The information systems challenges were also significant given the change was made in the midst of Y2K preparation.

– What is the impact on statistical reporting? Will there be further changes in that area or will it continue to use the ALAE and ULAE categories?

– It has made loss reserve analysis significantly more difficult. I do not see any benefits whatsoever to the changes. Only problems.

Question 17:
Please let us know how the CAS Committee on Reserves may provide assistance to you as a loss reserve practitioner.

– Practice Note on reserving for these changes.

– Information about actual practices and effects will be helpful.

– By providing practical suggestions on how to deal with this issue.

– Eliminate Schedule P, Parts 2, 3, etc. It is too simple minded to be of any use in financial analysis. Only the actuarial report is useful.

– Guidelines for the allocations absent sound data!! Help!!

Question 17 (cont.):
Please let us know how the CAS Committee on Reserves may provide assistance to you as a loss reserve practitioner.

– Encourage the NAIC to not change definitions going forward.

– Any info on how former ALAE reclassed as O&A might develop over time (to assist in AY splits) would be helpful.

– Possible studies of how hypothetical shifts impact reserves.

– Sessions at CAS meetings or the CLRS covering reserve projection techniques to account for/recognize the change in categorization.

– Sessions at CLRS on how to address changes short-term and long-term. What are acceptable/reasonable approaches when historical triangles do not have separate components.

– What should reinsurance companies do with former ALAE reported to them by clients. Should they ask for it to be split between DCC and A&O?

– Lobby for Schedule P to be actual dollars – no 000 omitted. Lobby for better claim count data. Lobby for 10-year Schedule P data for all lines.

– These issues were analyzed by a multi-disciplinary task force on the issue years ago. (I can't remember the exact time, but our 2nd to last meeting finished hours before the World Trade Center bombing). Many of the same issues, and new ones, were raised several years ago during NAIC CATF discussions. Where were you then? Why the fuss now? You need to keep more up-to-speed of NAIC happenings. You should monitor COPLFR issues for items to work on.

– Provide information about methodologies for DCC and A&O used and seem to work for companies that were able to change past history (if there are any such companies). That will give us a starting point for figuring out how and when to adjust methodologies for companies that were unable to reclassify history.

– Encourage the NAIC to return to the definitions of ALE and ULE that make sense. Separate legal and adjusting as an expense category.

– Develop guidelines for A&O expense allocation and reserving.

– Best choice is to go back to old definition. Second choice is to have 4 LAE categories – allocated DCC, unallocated DCC, allocated A&O, and unallocated A&O. This would allow using LAE under either old or new definitions.

– Reverse the decision to change the definition.

– I would be interested in how other reserving actuaries are handling it and any recommended changes in methodology.

– Please publish the results of this survey.

Additional Written Comments

– The answers provided are for a small regional mutual company that uses some outside adjusters and does not have inside legal staff for claims litigation. This description represents over 50% of my consulting practice. These clients tend to have unsophisticated expense allocation systems and have tended to implement this change on a calendar year basis.

– I do reserving work with many small companies and the LAE issue has been and remains a hot – and sore – subject. This decision has resulted in much confusion and many hours of work for no obvious benefit. There is no more uniformity of reporting now than there was before; maybe even less so. I distributed copies of the survey to the companies on my mailing list (not all clients) and asked them to return either to me, to you directly, or to complete it online. I don't know how may responded to you online, but I am including 3 responses that I received as well as my own. If I can be of help, I am willing to discuss this issue with the committee.

– My responses represent approximately 15-20 companies I work with.

APPENDIX

Part I

(1) Please indicate your type of employment:

a. _____ Company Reserving Actuary
b. _____ Consulting Reserving Actuary
c. _____ Insurance Department Actuary
d. _____ Other__________________

(2) Prior to the change on January 1, 1998, how did your company classify ALAE vs. ULAE? You may want to refer to the background information provided at the front of the survey.

a. _____ Claim Specific / Non-claim Specific
b. _____ External versus Internal
c. _____ Combination of A and B
d. _____ Neither

(3) Which choice would most closely approximate the major expense reclassification for your company?

	Prior to January 1, 1998	After January 1, 1998
1. Internal Defense Costs	ULAE	DCC
2. External Claim Adjusters	ALAE	A&O

a. _____ #1
b. _____ #2
c. _____ No material changes
d. _____ Other____

(4) Did your company implement these changes in their 1998 Annual Statement?

a. _____ Yes
b. _____ No
c. _____ Do not know

(5) Which method did your company select to implement the new LAE split?

a. _____ Accident Year (Accident year 1998 and beyond)
b. _____ Calendar Year (All accident years for calendar year 1998 and beyond)
c. _____ Do not know

(6) Which of the following were used to classify expenses?

a. _____ Expense Tracking System
b. _____ Formula Allocations
c. _____ Special "time/expense" studies
d. _____ Other _________________________
e. _____ Do not know

(7) If your company used formula allocations to reclassify expenses, what allocation base was used?

a. ____

(8) Is your company currently maintaining internal expense reporting under the former categorization while adopting the new categorization for statutory reporting?

a. _____ Yes
b. _____ No
c. _____ Do not know

(9) Is your company using the new expense categorization for any purposes other than Annual Statement reporting?

a. _____ Yes; Explain__________________________
b. _____ No
c. _____ Do not know

Part II - Please use additional paper if necessary.

(10) Explain how your companies accomplished a reclassification of expenses from categories where claim detail was not maintained (for example, internal defense attorney costs, formerly categorized as ULAE) to categories such as DCC, where at least some detail (i.e. accident year) would be required.

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(11) On a calendar year basis, the new categorizations apply to the incremental calendar year change across all accident years beginning January 1, 1998. From a Schedule P standpoint, this means for accident years 1997 and prior, the 12/31/98 evaluation of ALAE (i.e. the current column) and all future evaluations (or columns) will reflect a mixed definition. Accident year 1998 and future accident years will be under the new DCC definition. On an accident year basis, the new categorizations will apply to only accident year 1998 and future accident years. Prior accident years will continue to run-off under the old definition of ALAE.

What are the reserving challenges of dealing with this and what solutions have you found? How have you changed your reserving practices?

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(12) In your opinion, what impact will the categorization change have on industry Schedule P data as individual companies make different choices on how they will handle the change?

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(13) How will users of Schedule P adjust for possible distortions in the data?

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(14) As a result of the revised expense categories, Schedule P data subsequent to January 1, 1998 is on a different basis than that of prior years. What impact has this had on reports, for example IRIS tests, that are based on Schedule P data?

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(15) Please indicate if you believe that further research is needed regarding the impact of the new LAE categories in the following areas. If you have experience with the change in any of the following areas, the Committee would appreciate your input.

_____ Federal Income Taxes	_____ Retrospectively-rated Policies
_____ Commission Agreements	_____ Ratemaking Practices
_____ Case Reserving Practices	_____ Reinsurance Contracts

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(16) Other comments, suggestions, or issues affecting your work due to these changes.

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(17) Please let us know how the CAS Committee on Reserves may provide assistance to you as a loss reserve practitioner.

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Optional

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Name

____
Title

____
Company

____
Address

____

____
Phone

____
Fax

____
E-mail

Please return this survey by May 1, 2000 to:

Casualty Actuarial Society
Attn: Committee on Reserves
1100 North Glebe Road, Suite 600
Arlington, VA 22201