DISCUSSION BY L. H. LONGLEY-COOK

The accuracy of loss reserves is of great importance at the present time and company actuaries are giving more and more attention to the many problems involved in the proper determination of reserves, particularly for liability losses. It seems well to stress that reserves are definitely in the field of actuarial rather than accounting work because, as with ratemaking, we are concerned with analyzing past events so that we may determine from them what is likely to occur in the future. So long as losses are adequately reserved, there is little danger, except as a result of fraud, of the insolvency of an insurance company and the consequent suffering of claimants who are unable to collect under the policies the companies have issued.

Rightly, many regulatory officials are giving more attention to the adequacy of the reserves of companies in this age of inadequate and even non-existent profit margins, and at least one state is asking that the adequacy of loss reserves shall be certified by a qualified actuary. Unfortunately, the property-liability insurance companies are under considerable pressure to reduce the margins in their reserves to such narrow limits that there is no proper protection against the variations between estimates and final results which are inevitable in all actuarial forecasts. These pressures come from two sources. The first is the Internal Revenue Service who in their drive to collect the maximum income tax do not appear to appreciate fully the need for safety margin in reserves. The second source is a recent development. Attorneys representing the American Trial Lawyers Association have been opposing properly indicated rate increases with many unsupportable claims, among them the claim that companies overestimate their unpaid losses so as to obtain more than adequate rate increases. These outside pressures, combined with the understandable desire of underwriters and management to show profitable results in a time when many lines have been unprofitable, have inevitably led to the careful review by many companies of their reserves and, as a result, the safety margins in reserves are, I believe, smaller than they were in the past. If this view is accepted, the 1965 results of many companies were less favorable than the published figures.

The paper presented this spring by Mr. Balcarek is particularly welcome because our recent *Proceedings* contain so little discussion of this important topic. The lesson to be learned from this paper is that haphazard variation in the adequacy of reserves from year to year can very seriously affect the underwriting results of a company and, hence, completely wrong underwriting and production plans for the future can easily result from lack of proper attention to reserves. On the other hand, except in the case of rapid production growth, reasonable safety margins in reserves will not have much effect on underwriting results if the margins are consistently maintained.

In planning a reserve system for liability insurance, there seem to be two basic rules which I have never seen written down, although they have been repeated to me by my elders on numerous occasions. The first is that individual underwriters must not set their own reserves, particularly the incurred but not reported reserves and special reserves, since there may be too much temptation to lower reserving standards to compensate for a bad underwriting year. This follows from the general premise that if you are to be judged by your performance, it must be measured objectively. In the same way, a student cannot grade his own answers to essay type examinations. The second is that while individual claim adjusters must be corrected if they consistently set excessive or inadequate reserves, the results of loss development studies used to determine the overall adequacy of company case reserves must never be divulged to claim adjusters as this will lead inevitably to changes in individual case reserving practices. Such changes will exaggerate the previous indications when future tests are made and can lead to a snowballing result. It will take months before any great reliance can be placed on the reserve tests.

I, myself, incline to loss deficiency reserve technique described in Mr. Tapley's paper of 1956* rather than the more usual practice of modifying the incurred but not reported reserves for the over or understatement of case reserves. I believe that with a computer and more sophisticated techniques, excellent and consistent reserves can be developed; but whatever reserving method is used, reserve developments must be continuously and most carefully studied if satisfactory results are to be achieved.

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* *PCAS, Vol. XLIII,* p. 166.