Title of Exposure Draft: ASOP 30 – Profit Margins and Contingency Provisions in Property/Casualty Risk Transfer and Risk Retention

Comment Deadline: November 1, 2024

Instructions: Please review the exposure draft, and give the ASB the benefit or your recommendations by completing this comment template. Please fill out the tables within the section below, adding rows as necessary. Sample for completing the template provided at the following link: http://www.actuarialstandardsboard.org/email/2020/ASB-Comment-Template-Sample.docx

Each completed comment template received by the comment deadline will receive consideration by the drafting committee and the ASB. The ASB accepts comments by email. Please send to comments@actuary.org and include the phrase 'ASB COMMENTS' in the subject line. Please note: Any email not containing this exact phrase in the subject line will be deleted by our system's spam filter.

The ASB posts all signed comments received to its website to encourage transparency and dialogue. Comments received after the deadline may not be considered. Anonymous comments will not be considered by the ASB nor posted to the website. Comments will be posted in the order that they are received. The ASB disclaims any responsibility for the content of the comments, which are solely the responsibility of those who submit them.

I. Identification:

Casualty Practice Council
Amy Angell, MAAA, FCAS Vice President, Casualty, American Academy of Actuaries, on behalf of the Casualty Practice Council

II. ASB Questions (If Any). Responses to any transmittal memorandum questions should be entered below.

Question No.	Commentator Response
1.	No, the distinctions and relationships between contingency provision and risk margin are not clear. We suggest revisions to the definitions in our specific recommendations below, to make these distinctions clearer.
2.	No, the difference between modeled expected losses and actual expected losses is not clear. We suggest alternative wording in our specific recommendations to section 2.2 below.
3.	Yes, the level seems to be appropriate.

III. Specific Recommendations:

Section # (e.g. 3.2.a)	Commentator Recommendation (Please provide recommended wording for any suggested changes)	Commentator Rationale (Support for the recommendation)
2.1 Capital	Recommended edited definition: **"The amount of liquid assets or funds dedicated to satisfying the payment obligations from a defined set of liabilities arising from risk transfer or risk retention. In the case of risk transfer, capital may also be referred to as capital and surplus, or as policyholder's surplus."**	The exposure draft refers to the "payment of obligations" … in excess of the funds backing the liabilities." However, few insurers actually hold segregated funds to back the liabilities. Also, the term "capital" can have different meanings for an insurer versus a company in another industry or organization, such as a governmental entity. The key attributes are missing from the current proposed definitions, i.e., assets (1) which are liquid and (2) which are dedicated to satisfying the liabilities.

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2.2 Contingency Provision	Recommended edited definition: "A provision for the expected differences, **if any**, between the ~~actuary's modeled expected losses~~ **future cost estimates** derived from the actuary's model(s) and the ~~actual~~ **actuary's selected future cost estimates** ~~expected losses~~ **based on judgment and experience** that cannot be eliminated by changes in other components used in the ~~of the ratemaking~~ **future cost estimation** process."	The term, "actual" expected losses, is inaccurate terminology because actuaries tend to think of "actual" losses as the real experience emerges. The adjective "actual" indicates after something is known. "Expected" connotes before something is known. The edit should strike "expected" and simply state "actual losses." Explaining a contingency provision as a component of expected losses is very confusing and seems illogical. The essence of the contingency provision is that there are limitations or deficiencies in the estimation process "which cannot be eliminated by changes in the other components …." Thus, actual losses (or other net cash outflows) are more likely than not to exceed the expected losses (or other net cash outflows) produced by the expected loss models. This provision is intended to compensate for such deficiencies but is not intended to produce a net profit across a large number of transactions or an extended period of time. Reference to "ratemaking process" is problematic, as the term is used by actuaries in regard to specific regulatory "rate" filings for insurers. It would be better to refer to the process of "future cost estimation."
2.5 Profit Margin	Recommend re-titling as "**Profit Provision"** and using the term "profit provision" in place of "profit margin" through the ASOP. Recommended edited definition: **"A provision included in the future cost estimate to provide for profit.** ~~The difference between all expected cash inflows and all expected cash outflows in the future cost estimate of the risk transfer or risk retention~~. The profit **provision** ~~margin~~ is also equal to the underwriting profit provision, plus the provision for investment income, **minus** ~~less~~ expected income taxes, plus any risk margins in the future cost estimate. ~~Profit margin is also known as total return.~~"	A profit margin typically refers to the final profit that results after a particular financial transaction executes. However, in this ASOP, this item is a component or provision that is included in the future cost estimates to provide for an expected profit amount.
3.1 Overview	Replace: "Profit margins, contingency provisions, and the cost of capital are used by actuaries when developing or reviewing future cost estimates for property/casualty risk transfer or risk retention." With:	Profit and contingency provisions are not always included, and in fact, are frequently not included, when developing future cost estimates for risk retention. The language in the exposure draft suggests that the actuary should include such provisions in all future cost estimates.

	"Profit margins, contingency provisions, and the cost of capital **may be** used by actuaries when developing or reviewing future cost estimates for property/casualty risk transfer or risk retention."	
3.3 Profit Margin	Recommend re-titling as "**Profit Provision"** and using the term "profit provision" in place of "profit margin" through the ASOP. Recommended edits: "The actuary should include an appropriate profit **provision** ~~margin~~ in **a** ~~the~~ future cost estimate associated with ~~the risk retention or~~ risk transfer. **For risk retention, the actuary should consider whether it is appropriate to include a profit provision consistent with the intended purpose and use of the actuary's future cost estimates.**" Consistent with the edit recommendations, it is recommended that term margin be replaced with **provision** in sections 3.3.1, 3.3.2, 3.3.3 3.3.4, 3.3.5, 3.3.6, and 3.3.7.	The term "profit margin" in general business usage typically refers to the after-the-fact profit that remains after a financial transaction or event takes place. However, in this ASOP, the component referred to is really a before-the-fact provision added or included in the future cost estimate. In addition, a future cost estimate for risk retention may not include a profit provision.
3.3.1 (d)	Edits Recommended d. the amount of capital **supporting the transaction,** whether available, allocated, or notional;	Provides additional clarification.

IV. General Recommendations (If Any):

Commentator Recommendation (Identify relevant sections when possible)	Commentator Rationale (Support for the recommendation)
The current standard refers to the profit and contingency provisions, as well as the underwriting profit provision. This use of terminology should be retained.	
Revert to the prior term "profit provision" in the title as well as throughout the ASOP instead of the term "profit margin."	As previously indicated, the term "profit margin" in general business usage typically refers to the after-the-fact profit that remains after a financial transaction or event takes place. However, in this ASOP, the component referred to is really a before-the-fact provision added or included in the future cost estimate.

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Provide more guidance as to how the actuary should determine the appropriate cost of capital to be used.	There is very little helpful guidance provided around determining the appropriate cost of capital to be considered when selecting the profit provision.
Acknowledge that profit margins (or some components thereof) and contingency provisions may not apply to risk retention.	Profit provisions and cost of capital may not be explicit considerations in risk retention.

V. Signature:

Commentator Signature	Date
Amy Angell, MAAA, FCAS Vice President, Casualty, American Academy of Actuaries, on behalf of the Casualty Practice Council	November 6, 2024