ACTUARIAL STANDARDS BOARD

● EXPOSURE DRAFT ●

Proposed Revision of
Actuarial Standard
of Practice
No. 29

Expense Provisions for Future Cost Estimates for Prospective Property/Casualty Risk Transfer and Risk Retention

Comment Deadline:
May 31, 2022

Developed by the
Task Force to Revise ASOP No. 29 of the
Casualty Committee of the
Actuarial Standards Board

Approved by the
Actuarial Standards Board
December 2021

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APPENDIX

December 2021

TO: Members of Actuarial Organizations Governed by the Standards of Practice of the Actuarial Standards Board and Other Persons Interested in Expense Provisions for Future Cost Estimates for Prospective Property/Casualty Risk Transfer and Risk Retention

FROM: Actuarial Standards Board (ASB)

SUBJ: Proposed Revision of Actuarial Standard of Practice No. 29

This document contains the proposed revision of actuarial standard of practice (ASOP) No. 29, *Expense Provisions for Future Cost Estimates for Prospective Property/Casualty Risk Transfer and Risk Retention*. Please review this exposure draft and give the ASB the benefit of your comments and suggestions. Each written comment letter or email received by the comment deadline will receive consideration by the drafting committee and the ASB.

The ASB appreciates comments and suggestions on all areas of this proposed standard. The ASB requests comments be provided using the Comments Template that can be found here and submitted electronically to comments@actuary.org. Include the phrase "ASOP No. 29 COMMENTS" in the subject line of your message. Also, please indicate in the template whether your comments are being submitted on your own behalf or on behalf of a company or organization.

The ASB posts all signed comments received on 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 on 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.

For more information on the exposure process, please see the ASB Procedures Manual.

Deadline for receipt of comments: **May 31, 2022**

History of the Standard

This standard originally was developed by the Subcommittee on Ratemaking of the ASB's Casualty Committee. At that time, the Casualty Actuarial Society's May 1988 *Statement of Principles Regarding Property and Casualty Insurance Ratemaking* identified and described principles applicable to the determination and review of property/casualty insurance rates. Those principles were limited to that portion of the ratemaking process involving the estimation of costs associated with the transfer of risk. For most lines of business, the expense provision is a significant portion of the rate. For some lines of business, the expense provision can actually exceed the loss provision. For this reason, it was necessary to have a standard of practice to provide guidance to actuaries when determining expense provisions.

In 2020, the ASB's Casualty Committee reviewed the standard and identified several obsolete references, which necessitated this revision.

This revision uses the phrase "risk transfer or risk retention" throughout the text, with the exception of the title. This differs from the phrase "risk transfer and risk retention" that is used in ASOP No. 53, *Estimating Future Costs for Prospective Property/Casualty Risk Retention and Risk Transfer*. These phrases have the same intention and should not be interpreted to have any different meaning. Both of these standards apply to actuaries performing work that pertains to either risk transfer or risk retention, or both as part of the same work product. The ASB has concluded that the word "or" is more appropriate.

Notable Changes from the Existing ASOP

Notable changes made to the existing ASOP are summarized below. Notable changes do not include changes made to improve readability, clarity, or consistency.

1. Changed the scope to apply to risk transfer and risk retention consistent with ASOP No. 53, *Estimating Future Costs for Prospective Property/Casualty Risk Transfer and Risk Retention*.

2. Clarified the scope to include applicability to reviewing actuaries.

3. Added a reference to ASOP No. 53 in section 1.2.

4. Added definitions of expense provision, risk retention, and risk transfer.

5. Changed "rates" to "future cost estimates" throughout the ASOP.

6. Replaced the reference to New York State insurance law with a reference in section 3.1 to the pertinent requirements for defining the types of expenses prescribed in applicable law and, if applicable, the *Instructions for Uniform Classification of Expenses* published by the National Association of Insurance Commissioners (NAIC).

7. Added a reference to appropriate methods, models, and assumptions for developing the expense provisions during the period for which the future costs are being estimated, as well as references to ASOP Nos. 53 and 56, *Modeling*, in section 3.2.

8. Removed the reference to the CAS *Statement of Principles Regarding Property/Casualty Ratemaking* in section 3.5.

9. Added new sections on reliance in sections 3.8, 3.9, and 3.10, and included references to ASOP Nos. 23, *Data Quality*, and 41, *Actuarial Communications*, in section 3.8.

10. Added a new section on the preparation and retention of documentation in section 3.

11. Expanded the list of required disclosures in section 4.

12. Added a new section regarding the disclosure of confidential information in section 4.

13. Deleted the reference to repealed ASOP No. 9, *Documentation and Disclosure in Property/Casualty Insurance Ratemaking, Loss Reserving, and Valuations,* in section 4.

Request for Comments

The ASB appreciates comments and suggestions on all areas of this proposed standard submitted through the Comments Template. Rationale and recommended wording for any suggested changes would be helpful.

The ASB voted in December 2021 to approve this exposure draft.

The Actuarial Standards Board (ASB) sets standards for appropriate actuarial practice in the United States through the development and promulgation of Actuarial Standards of Practice (ASOPs). These ASOPs describe the procedures an actuary should follow when performing actuarial services and identify what the actuary should disclose when communicating the results of those services.

PROPOSED REVISION OF
ACTUARIAL STANDARD OF PRACTICE NO. 29

EXPENSE PROVISIONS FOR FUTURE COST ESTIMATES FOR PROSPECTIVE PROPERTY/CASUALTY RISK TRANSFER AND RISK RETENTION

STANDARD OF PRACTICE

Section 1. Purpose, Scope, Cross References, and Effective Date

1.1 Purpose—This actuarial standard of practice (ASOP or standard) provides guidance to actuaries when performing actuarial services with respect to developing or reviewing **expense provisions** for future cost estimates for prospective property/casualty **risk transfer** or **risk retention**.

1.2 Scope—This standard of practice applies to actuaries when developing or reviewing **expense provisions** for future cost estimates for prospective property/casualty **risk transfer** or **risk retention**. This includes **expense provisions** developed or reviewed for insurance, reinsurance, self-insurance, loss portfolio transfers, or any other mechanisms for prospective property/casualty **risk transfer** or **risk retention**. If the actuary's actuarial services involve reviewing **expense provisions** developed by another party, the actuary should use the guidance in this ASOP to the extent practicable.

The actuary also should refer to ASOP No. 53, *Estimating Future Costs for Prospective Property/Casualty Risk Transfer and Risk Retention*, when developing or reviewing **expense provisions** for prospective property/casualty **risk transfer** or **risk retention**.

If the actuary determines that the guidance in this ASOP conflicts with ASOP No. 53 or a cross-practice ASOP (applies to all practice areas), this ASOP governs.

If a conflict exists between this standard and applicable law (statutes, regulations, and other legally binding authority), the actuary should comply with applicable law. If the actuary departs from the guidance set forth in this standard in order to comply with applicable law, or for any other reason the actuary deems appropriate, the actuary should refer to section 4.

1.3 Cross References—When this standard refers to the provisions of other documents, the reference includes the referenced documents as they may be amended or restated in the future, and any successor to them, by whatever name called. If any amended or restated document differs materially from the originally referenced document, the actuary should consider the guidance in this standard to the extent it is applicable and appropriate.

1.4 Effective Date—This standard is effective for work performed on or after four months after adoption by the Actuarial Standards Board.

Section 2. Definitions

The terms below are defined for use in this actuarial standard of practice and appear in bold throughout the ASOP.

2.1 Commission and Brokerage Fees—Compensation associated with the acquisition of business paid to agents, brokers, or other parties, including ceding insurance companies.

2.2 Expense Provision—Future cost estimate for prospective property/casualty **risk transfer** or **risk retention** other than losses, the provision for profit and contingencies, investment expenses, and federal and foreign income taxes.

2.3 General Administrative Expenses—Operational and administrative expenses (other than investment expenses) not specifically defined elsewhere in this section.

2.4 Loss Adjustment Expenses—The costs of administering, determining coverage for, settling, or defending claims even if it is ultimately determined that the claim is invalid. It is also known as "claim adjustment expense."

2.5 Other Acquisition Expenses—Costs, other than **commission and brokerage fees**, associated with the acquisition of business.

2.6 Policyholder Dividends—Nonguaranteed returns of premium or distributions of surplus.

2.7 Residual Market Provision—A provision for the entity's costs that represents its share of residual market profits or losses.

2.8 Risk Retention—A risk-management and risk-control strategy for the assessment, management, or financing of retained risk associated with the specific coverage. Examples of **risk retention** include self-insurance and certain types of single parent captives.

2.9 Risk Transfer—A risk-management and risk-control strategy, involving legally binding agreements, that shifts responsibility from one party to another or indemnifies one party by another party for the financial obligations associated with the coverage. Examples of **risk transfer** include insurance, reinsurance, and loss portfolio transfers.

2.10 Statutory Assessment Provision—A provision for the entity's costs stemming from any mandated assessment.

2.11 Taxes, Licenses, and Fees—Taxes, license costs, and miscellaneous fees except federal and foreign income taxes.

Section 3. Analysis of Issues and Recommended Practices

3.1 Categorizing Expenses—The actuary should consider categorizing the **expense provisions** by type of expense. Common expense categories include but are not limited to **commission and brokerage fees**, **general administrative expenses**, **loss adjustment expenses**, **other acquisition expenses**, **policyholder dividends**, **residual market provision**, **statutory assessment provision**, and **taxes, licenses, and fees**. When categorizing the expenses, the actuary should be familiar with the pertinent requirements for defining the types of expenses prescribed in applicable law and, if applicable, the *Instructions for Uniform Classification of Expenses* published by the National Association of Insurance Commissioners (NAIC). The actuary also should be familiar with the entity's own methods of classifying and assigning expenses.

3.2 Developing Expense Provisions—When developing **expense provisions**, the actuary should develop **expense provisions** that are appropriate for the policies to be written or coverages provided during the period for which the future costs are being estimated, that reflect the environment expected to exist in the period for which the future costs are being estimated, and that include all expenses expected to be incurred in connection with the transfer or retention of risk other than losses, the provision for profit and contingencies, investment expenses, and federal and foreign income taxes.

The actuary should select appropriate methods, models, and assumptions for developing the **expense provisions** during the period for which the future costs are being estimated. When developing or reviewing **expense provisions** for prospective property/casualty **risk transfer** or **risk retention**, the actuary also should refer to ASOP No. 53 and ASOP No. 56, *Modeling*.

The actuary should consider developing **expense provisions** for expenses that do not vary in direct proportion to premium on a basis that is not directly proportional to premium, such as per policy, per coverage, a percentage of claim losses, per unit of exposure, or some other manner that is consistent with how they are incurred.

The actuary may use studies or professional judgment to support such estimates.

3.3 Start-Up Costs—The actuary may amortize start-up or development costs using an appropriate amortization period.

3.4 Expense Trending—When using trending procedures in determining **expense provisions**, the actuary should be guided by ASOP No. 13, *Trending Procedures in Property/Casualty Insurance Ratemaking*. The actuary should consider reflecting any trends in expense levels that vary from trends in losses and exposure bases.

3.5 Policyholder Dividends—If the actuary determines that **policyholder dividends** are a reasonably expected expense, the actuary should consider including the expected amount of **policyholder dividends** in the **expense provision**. When determining an **expense provision** for **policyholder dividends**, the actuary should take into account the company's dividend payment history, its current dividend policy or practice, whether dividends are related to loss experience, the capitalization of the company, and other considerations affecting the payment of dividends.

3.6 Residual Market and Statutory Assessment Provisions—The actuary should include a **residual market provision** or a **statutory assessment provision**, or both, if applicable. If the residual market expenses or statutory assessments are assessed retrospectively, the actuary should consider including a provision to recover any previously unassessed costs or to account for any prior excess collections.

3.7 Provision for the Cost of Reinsurance— If the actuary includes the cost of reinsurance as an **expense provision**, the actuary should take into account the amount to be paid to the reinsurer, ceding commissions or allowances, expected reinsurance recoveries, and other relevant information specifically relating to cost, such as a retrospective profit-sharing agreement or reinstatement premiums between the reinsured and the reinsurer.

3.8 Reliance on Data or Other Information Supplied by Others—When relying on data or other information supplied by others, the actuary should refer to ASOP No. 23, *Data Quality*, and ASOP No. 41, *Actuarial Communications*, for guidance.

3.9 Reliance on Assumptions or Methods Selected by Another Party—When relying on assumptions or methods selected by another party, the actuary should refer to ASOP No. 41 for guidance. The actuary should disclose the extent of any such reliance.

3.10 Reliance on Another Actuary—The actuary may rely on another actuary who has developed a portion of the **expense provision**. However, the relying actuary should be reasonably satisfied that the other actuary is qualified to perform such work, the supporting analysis was performed in accordance with applicable ASOPs, and the analysis is appropriate for the project's objective. The actuary should disclose the extent of any such reliance.

3.11 Conflict with Applicable Law—When legislative or regulatory rules disallow or limit certain categories of expenses in **expense provisions**, the actuary should develop the **expense provision** in accordance with the law and disclose any material difference from the actuarially determined **expense provisions**.

3.12 Documentation—The actuary should prepare and retain documentation to support compliance with the requirements of section 3 and the disclosure requirements of section 4. The actuary should prepare such documentation in a form such that another actuary qualified in the same practice area could assess the reasonableness of the actuary's work. The degree of such documentation should be based on the professional judgment of the actuary and may vary with the complexity and purpose of the actuarial services. In addition, the actuary should refer to ASOP No. 41 for guidance related to the retention of file material other than that which is to be disclosed under section 4.

Section 4. Communications and Disclosures

4.1 Required Disclosures in an Actuarial Report—When issuing an actuarial report to which this standard applies, the actuary should refer to ASOP Nos. 13, 23, 41, 53, and 56. In addition, the actuary should disclose the following in such actuarial reports:

a. the individual expense items included in the **expense provisions**, if developed by type of expense (see section 3.1);

b. the methods, models, and material assumptions used in developing the **expense provisions** (see section 3.2);

c. any amortized start-up costs (see section 3.3);

d. any trending assumptions (see section 3.4);

e. any provisions for **policyholder dividends** (see section 3.5);

f. any **residual market provisions** and **statutory assessment provisions** (see section 3.6);

g. any provision for reinsurance (see section 3.7);

h. the extent of any reliance on data or other information supplied by others (see section 3.8);

i. the extent of any reliance on assumptions or methods selected by another party (see section 3.9);

j. the extent of any reliance on another actuary (see section 3.10); and

k. any material difference between the **expense provisions** developed in accordance with the law and the actuarially determined **expense provisions** (see section 3.11).

4.2 Additional Disclosures in an Actuarial Report—The actuary also should include disclosures in accordance with ASOP No. 41 in an actuarial report for the following circumstances:

a. if any material assumption or method was prescribed by applicable law;

b. if the actuary states reliance on other sources and thereby disclaims responsibility for any material assumption or method selected by a party other than the actuary; and

c. if in the actuary's professional judgment, the actuary has deviated materially from the guidance of this ASOP.

4.3 Confidential Information—Nothing in this ASOP is intended to require the actuary to disclose confidential information.

Appendix

Background and Current Practices

Note: This appendix is provided for informational purposes and is not part of the standard of practice.

Background

Prior to the relatively high inflation of the 1970s, a predominant ratemaking technique involved including expenses, other than loss adjustment expenses, as a percentage of premium. In doing so, it was assumed that the expense portion of the future cost estimate was subject to the same trend (usually very low) to which the loss and loss adjustment expense portions were subjected. However, higher levels of inflation had a rather significant impact on the expected change in the various elements of the future cost estimate. By the 1970s, the assumption that the trend in expenses would approximate the trend in losses was being questioned. Although the actuarially determined loss trend may have been applied to the loss and loss adjustment expenses as usual, a separate analysis and trend may have been necessary to properly reflect the anticipated change in certain other expenses.

Recognition of the impact of inflation on expenses that were not varying with premium lead to the following additional considerations:

> Expense Flattening—Expense flattening techniques assign expenses to policies or other units of exposure rather than in proportion to premium or losses. Thus, expense flattening is a procedure sometimes used to determine that portion of the future cost estimate that does not vary in direct proportion to premium or losses.
>
> Expense Trending—Expense trending reflects how changes over time affect expenses. Over the years, separate trending of expenses has become a more common technique. However, including expenses as a proportion of premium is still used.

Although the property/casualty actuarial literature is relatively sparse on the topic of expense provisions, techniques for separately trending losses and expenses and alternatives to premium-related expense provisions have been included in such literature. Also included are discussions about the inappropriateness, in some cases, of assuming proportional expenses for administrative ease when, in fact, some expense categories do not vary in direct proportion to premium.

Over time, various regulations have required expense limitations by either limiting or disallowing certain expenses or by requiring expense flattening of various types.

Current Practices

Practice has not changed significantly since ASOP No. 29 and the NAIC's *Instructions for Uniform Classification of Expenses* were first introduced in 1997 and 1998, respectively. The NAIC codified the reporting of expenses in the early 2000s.