

## INTRODUCTION (1989)

The Institute of Actuaries has prepared and published this Claims Reserving Manual in the hope that it will help both actuaries and others interested in claims reserving practices.

### Background

The reserve for outstanding and IBNR claims is an important item in the financial statement of a general insurance company, and actuaries are now being used increasingly to help set the amounts or comment on their adequacy.

An informal survey of the traditional methods in use in the UK market showed, not unexpectedly, a large variety of relatively simple methods, with a common theme based on the "chain ladder" or "link ratio" approach. There was also considerable ambiguity in the terminology used. A need was identified for a comprehensive claims reserving manual which would describe and classify many of the methods which are found to be in use, and set out clear definitions and assumptions.

### Contents

The Manual is structured in short sections, to provide easy access to the numerous topics. Volume 1 begins with the insurance background, material on the basic purposes of claims reserving, the types of data available, and the internal and external influences which it is important to consider in setting reserves. This volume then goes on to give an extensive and structured review of the methods available and commonly in use at the present time. There are detailed comments on the assumptions involved, the dependence on the data, and the different approaches available.

Volume 1 deals with arithmetic or deterministic methods. Volume 2 includes more advanced methods involving probabilistic and statistical concepts. The test for the inclusion of a method in Volume 2 is that it has been used by a practitioner with responsibility for advising on the setting of reserves, or commenting on their adequacy, and that he or she finds it helpful. The fact that a method may contain weaknesses from a theoretical statistical viewpoint may be commented upon, but will not prevent its publication.

The standpoint of the Manual is that claims reserving is a practical subject which requires informed judgement. The advantage of a method should be that it helps to interpret the data and apply such judgement.

## **The readership**

Volume 1 of the Manual is intended to be understandable to all who are involved in the process of claims reserving — insurers, actuaries, accountants, or consultants — whatever the level of their technical knowledge. To this end it presents reserving through a series of detailed arithmetical examples with careful definition of the market terminology.

Volume 2 is for practitioners with some familiarity with more advanced statistical ideas, but the aim of the presentations and examples is to give all the readers of Volume 1 an intuitive understanding of the methods by way of a summary overview.

The change in approach from Volume 1 is established by an opening article in Volume 2 which looks briefly at chain ladder methods from a statistical point of view.

## **Notation**

Although Volume 1 avoids any specialised mathematics it is useful to describe each method by a symbolic shorthand which is devised in the context of each method as it is developed. A comprehensive system of notation covering all methods would have been cumbersome and incomprehensibly complex. However the symbols used conform to a general structure which is set out in the Glossary of Notation which appears at the end of Volume 1. Each of the more advanced methods described in Volume 2 requires its own specific mathematical notation.

## **Format**

The Manual is loose-leaf, for ease of updating and inclusion of additional material. It is expected that the first update will be one year after first publication.

## **General comment**

The Manual describes methods; it does not discuss the suitability of any method, nor the level of caution at which a reserve should be set, for any specific purpose such as tax or solvency. Hence the essential inter-relationship between assets and liabilities is ignored except for a short section on discounting. Within the chosen limited framework, intimately related actuarial subjects such as allocation of capital, return on capital, premium rates, investment strategy and release of profit are completely ignored, and the reader must make due allowance for this.

Throughout the Manual the phrase "claims reserve" has been used. In certain situations accounting terminology will use the phrase "claims provision" to mean the same thing.

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