


The Actuary's Role in a Risk Focused Statutory Examination

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Outline for our Discussion

- Inspiration (for the paper)
- Background on risk focused statutory exams
- Key observations for examination actuaries
- Key observations for company actuaries




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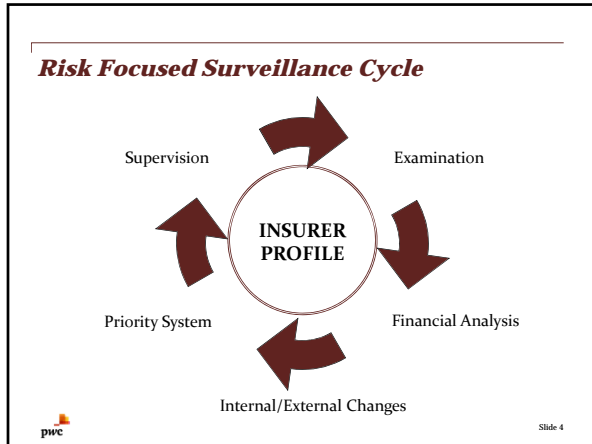
Inspiration

The risk-focused exam was intended to change the way insurance departments examined insurance companies...

So what changed?



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- Purposes**
- Detect financial trouble (or potential risks)
 - Assess controls and risk management process
 - Assess residual risk
 - Establish, or revise company priority score
 - Regulatory action
- pwc
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- Seven Phases of the Examination**
- 1 - Understand the company and functional activities
 - 2 - Identify and assess inherent risk in activities
 - 3 - Evaluate the controls and risk mitigation strategies
 - 4 - Determine the residual risk
 - 5 - Establish/conduct examination procedures
 - 6 - Update prioritization and supervisory plan
 - 7 - Draft examination report and management letter based upon findings
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NAIC Branded Risks

- Credit
- Market
- **Reserving**
- **Pricing/Underwriting** – Predictive Models, Mods
- **Liquidity** – Cash flow, Reinsurance, Concentration of Risk
- Operational
- Legal
- Strategic
- Reputational

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What assertions are evaluated?

- Valuation
- Completeness
- Accuracy
- Cutoff
- Obligation/Ownership
- Compliance
- Existence

Sounds a lot like Sarbanes-Oxley controls testing!
....but includes operational risk and prospective risk.


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Performing The Risk Assessment

- Inherent Risk = $f(x)$ (Likelihood and Impact)
- Mitigating Controls: Strong, Moderate or Weak

Residual Risk = Inherent Risk vs Mitigating Controls

Inherent Risk	Strong Risk Controls	Moderate Risk Controls	Weak Risk Controls
High	Moderate or High	Moderate or High	High
Moderate	Low or Moderate	Moderate	Moderate
Low	Low	Low	Low

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Performing the Risk Assessment by LOB

Appendix B

Line of Business	Differences with Auditor Estimates			Runoff Change in Estimate	R = Auditor Reviewed	Examination Team Risk Assessment					Phase Five Test Plan	
	\$ Diff. to Booked	% Diff. to Booked	% Diff. to ACE			MBE Difference	Risks 3.1, 3.2, 4.2, 4.3, 4.4, Audit vs ACE	Inherent Variability	Risk 4.6	Overall Residual Risk		
DIRECT												
TOTAL LOSS	(40,601)	-8.6%	-2.9%	16,301	R	High	Moderate	Moderate	High	Moderate		
PPA BI/AM Liability	(37,100)	-10.8%	-3.5%		R	High	Moderate	Moderate	High	High	Ind	
PPA Prop. Dam. Liab.	(950)	-4.2%	-3.6%		R	Low	Moderate	Low	Moderate	Low Mod.	Peer	
PPA PIP/NP Liability	(1,500)	-8.7%	-2.9%		R	High	Moderate	Moderate	High	Moderate	Ind	
:												
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- ### Observations for Actuaries Working on an Examinations
1. Incorporate a "risk-focused" approach when developing the Phase 5 testing plan for loss reserves.
 2. It may be difficult to tie the for 5 testing plan to the risk assessment. The risk assessment usually relates to the process and controls to establish the loss reserves, but the risk inherent in the estimates varies by line of business (or reserve segment).
 3. Efficiencies from a risk-focused testing approach for loss reserves may allow the actuary to provide the examiner in charge with insight on other areas of risks.
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- ### Actuarial Participation in Other Risk Areas
- #### Underwriting Risk
1. Company's use of predictive modeling
 2. Consistency with the assumptions used for pricing and reserving
 3. Monitoring and measuring flexible pricing changes
 4. Excessive growth, high risk or unprofitable business segments
- #### Liquidity Risk
1. Reinsurance program – retained limits and design
 2. Cat modeling and monitoring concentration of risk
 3. ERM risk tolerances
 4. Cash flow testing
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Observations for Company Actuaries

1. Preparation for the Phase 1 interviews: It is not just the quality of your actuarial review and the reasonability of your estimates, the documentation and effectiveness of your controls reduces testing.
2. Highlight controls that are "built-in" to the actuarial review process:
 - Data Reconciliations and triangle testing for consistency
 - Use of multiple actuarial methods
 - Claim diagnostics
 - Runoff or prior estimates and/or Actual vs Expected
 - Robust peer reviews with documentation
 - Board presentations
3. Leverage the auditor's (or other) actuarial testing.
4. Document management's rationale for booking different reserves.



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Discussion

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