
Professionalism and the Practicing Actuary: *Do You Know the Rules of the Road?*

Casualty Loss Reserve Seminar

September 11-12, 2006

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Panelists: Terry Klodnicki, ACAS, MAAA
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Not Following Rules of the Road

- What would you do if your driving privileges were suspended?
 - ❑ Rely on family members and friends to drive you around
 - ❑ Take public transportation
 - ❑ Bike, walk, roller blade



Not Following “Actuarial” Rules

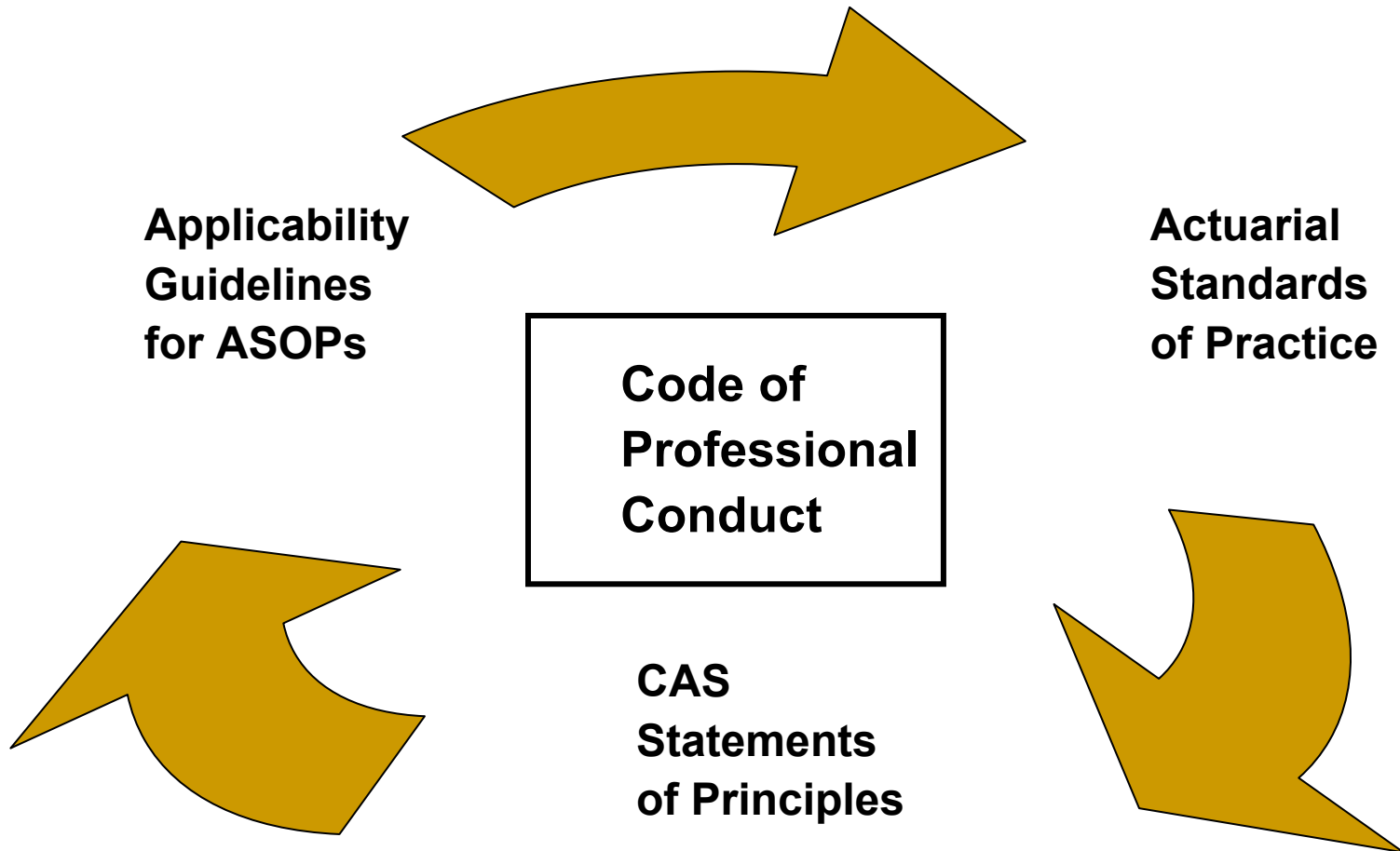


- Possible outcomes
 - You’ll get pulled over by the “police” (ABCD).
 - You’ll get into an accident (actuarial litigation)
- Implications of losing your actuarial “license”
 - Potential lawsuit
 - Damaged reputation
 - Lost wages/work
 - Find alternative career

Increased Scrutiny of Actuaries

- Morris Review (2004-05)
 - Investigation by Sir Derek Morris into the actuarial profession
 - Result of Lord Penrose's concerns with the actuarial profession in connection with the Equitable Life insolvency
- “To date, at least fifty [legal] actions have been filed against actuaries, with over 70% coming in the last decade.” *Mealey's Litigation Report, August 2002.*
- ABCD received 15 cases regarding conduct and practice in 2005.
- Recent high-profile insurance failures:
 - Reliance, Legion, Unicover
 - PIE, Fremont

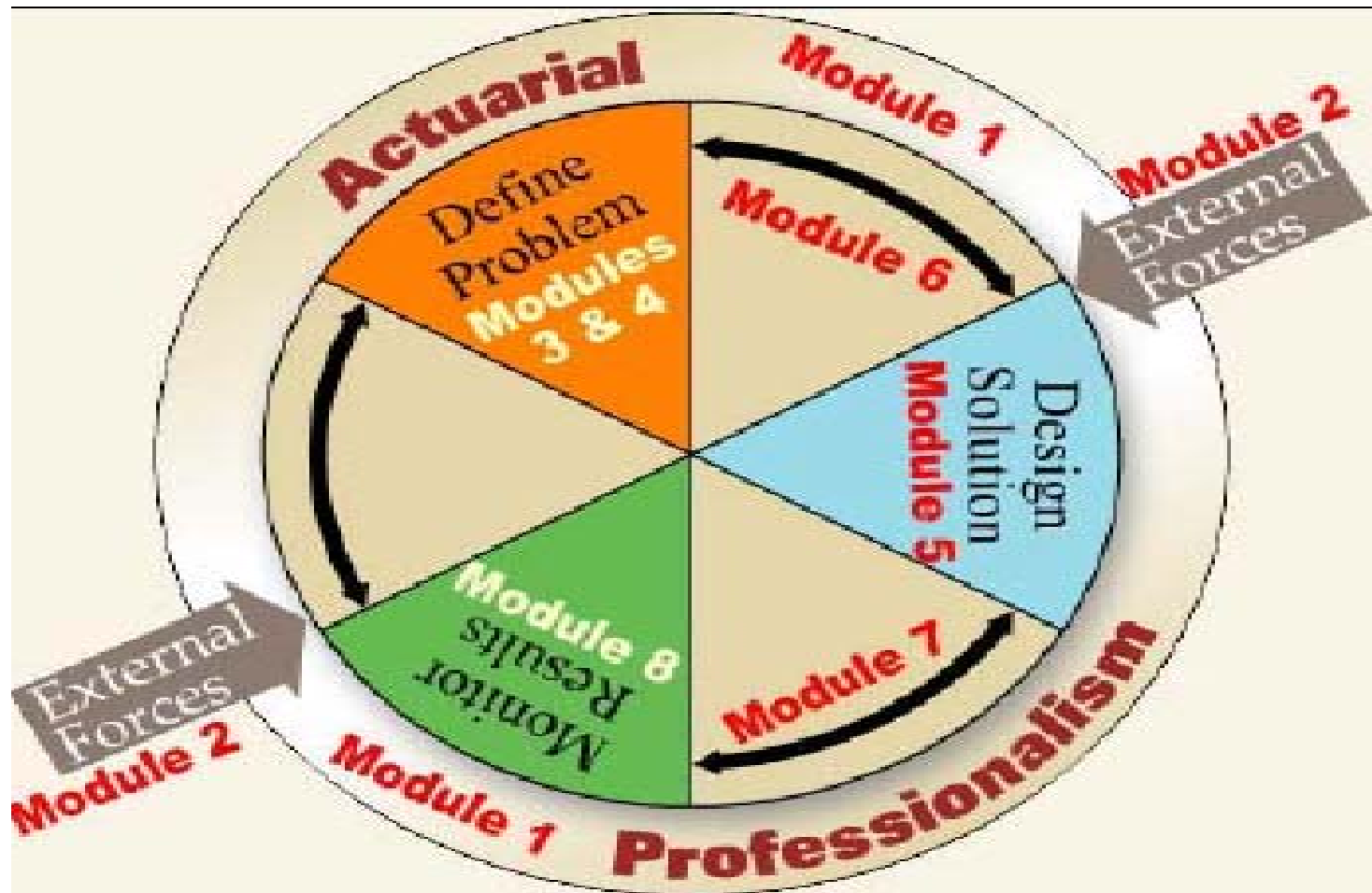
Rules of the “Actuarial” Road



Professionalism is Embedded in the Purposes of the CAS

- To advance the body of knowledge in actuarial science applications other than life insurance,
- To establish and maintain standards of qualification for membership,
- **To promote and maintain high standards of conduct and competence for its members,**
- To increase awareness of actuarial science.

The SOA Actuarial Control Cycle



Source: Society of Actuaries Web Conference on Education Redesign, 12/6/2005

Code of Professional Conduct

Code of Professional Conduct

- 14 precepts with annotations
- Key sections:
 - Professional integrity
 - Qualification standards
 - Standards of practice
 - Communication and disclosure
 - Conflict of interest
 - Control of work product
 - Confidentiality
 - Courtesy and Cooperation
 - Advertising
 - Titles and Designations
 - Violations of the Code of Professional Conduct
- Separate handout includes the entire Code

Common Allegations Received by ABCD

Alleged Violation	Number Disposed or in Process (2005)	Precept
Failure to act with integrity	19	1
Calculation or data errors	7	1
Failure to perform services with competence	3	1
Other errors in work	3	1
Work fails to satisfy ASOP	3	3
Improper reserve estimate for insurer	3	3
Use of unreasonable assumptions	3	3
Failure to cooperate with other actuary	3	10

Source: *ABCD 2005 Annual Report*, 3/9/2006

A Word about the ABCD

- The **A**ctuarial **B**oard for **C**ounseling and **D**iscipline “considers complaints and questions concerning possible violations of the Code...”
- It also “responds to inquiries by actuaries concerning their professional conduct and, when requested to do so, provides guidance in professional matters.”
 - *2002 Academy Yearbook*

Actuarial Standards of Practice

Use of Applicability Guidelines

- Excellent reference along with the list of Actuarial Standards of Practice
- To encourage professionalism of actuaries
- Non-authoritative guidance
- Example – Preparing a reserve estimate for Schedule P:
 - Should follow ASOPs 9, 20, 21, 23, 28, and 41
 - If issuing an actuarial opinion, need to also consider ASOPs 13 and 36.

Actuarial Standard of Practice #41: *Actuarial Communications*

ASOP #41: Actuarial Communications

- Covers communication by an Actuary to a Principal
 - Actuary defined by Code of Conduct
 - Principal is Actuary's client or employer
- Form can be written, electronic, or oral
 - Oral should not conflict with written or electronic
 - "Significant" actuarial findings should be written or electronic
 - Incorporate "significant" findings in report

ASOP #41: Actuarial Communications (Cont'd)

- Clear and appropriate for circumstances and intended audience
- Should be timely following completion of analysis
- Should identify all responsible actuaries
- Must state reliance on other sources

ASOP #41: Actuarial Communications (Cont'd)

- Cumulative Communications
 - Standard applies to all cumulative communications between Actuary and Principal, not individual communications
- Internal communications excluded, unless designated as actuarial communications

ASOP #41: Actuarial Communications (Cont'd)

- Communications not limited to Prescribed Statements of Actuarial Opinion (PSAOs)
 - Regulatory bodies may call the specific actuarial communications a PSAO.
- Connection with ASOP#9
 - ASOP#9 only covers casualty actuarial communication, ASOP#41 applies to all types of actuaries

Actuarial Standard of Practice #23: *Data Quality*

ASOP#23: Data Quality

- New standard effective 7/1/2006
- Guidance for selecting, reviewing, and using data
- Covers reliance on data supplied by others
- Disclosures regarding data quality are discussed

ASOP#23: Data Quality (Cont'd)

- Does NOT require the actuary to:
 - Determine whether data has been falsified
 - Compile data differently for sole purpose of searching for questionable or inconsistent data
 - Audit data
- Applies even when not issuing Prescribed Statement of Actuarial Opinion (PSAO)

ASOP#23: Data Quality (Cont'd)

- Review of data
 - Consider other checking, auditing already performed
 - Determine definition of each data element
 - Identify questionable data elements
 - Review data from previous project
- Should document process for reviewing data and identify material defects or adjustments/modifications made
- Follow ASOP#41 regarding communication of data review
- Should decline project if data determined to be sufficiently inadequate

Actuarial Standard of Practice
#36: *Statements of Actuarial
Opinion*

ASOP#36: Statements of Actuarial Opinion (SAOs)

- Applies only to WRITTEN statements required by law and/or identified as an SAO by the actuary.
- Types of SAOs
 - Reasonable Provision
 - Deficient or Inadequate Provision
 - Redundant or Excessive Provision
 - Qualified Opinion
 - No Opinion

ASOP#36: Statements of Actuarial Opinion (SAOs) (Cont'd)

- Reasonable Opinion
 - Stated Reserve within Actuary's Range
- Qualified Opinion
 - Cannot estimate reserve for certain items
- No Opinion
 - Actuary cannot reach a conclusion

ASOP#36: Statements of Actuarial Opinion (SAOs) (Cont'd)

- **Material Adverse Deviation**
 - Actuary believes risks and uncertainties exist that could result in material deviation
 - Must disclose amount of adverse deviation judged to be material
 - Description of conditions that could result in adverse deviation
- **Materiality typically defined as a % of surplus, reserves, or net income**

ASOP#36: Statements of Actuarial Opinion (SAOs) (Cont'd)

- Other provisions of standard
 - Considerations in reserve analysis
 - Understanding significance and collectibility of ceded reinsurance
 - Second opinions (reviewing SAO)
- Key items requiring disclosure
 - Reliance on work of others
 - Changes in Actuary's assumptions, procedures, or methods
 - Amount needed to increase or decrease carried reserve if outside actuary's range

Other ASOPs Applicable to Reserving

Other ASOPs

- ASOP#17 – Expert Testimony
 - Allows for differences of opinion between actuaries
 - Must disclose conflicts of interest
 - Must satisfy qualifications standards of PSAOs to give expert testimony
- ASOP#20 – Discounting Reserves
 - Determining timing of payments and appropriate discount rate

Other ASOPs (Cont'd)

- **ASOP#25 – Credibility**
 - Selecting credibility procedures and choice of credibility complement (related experience)

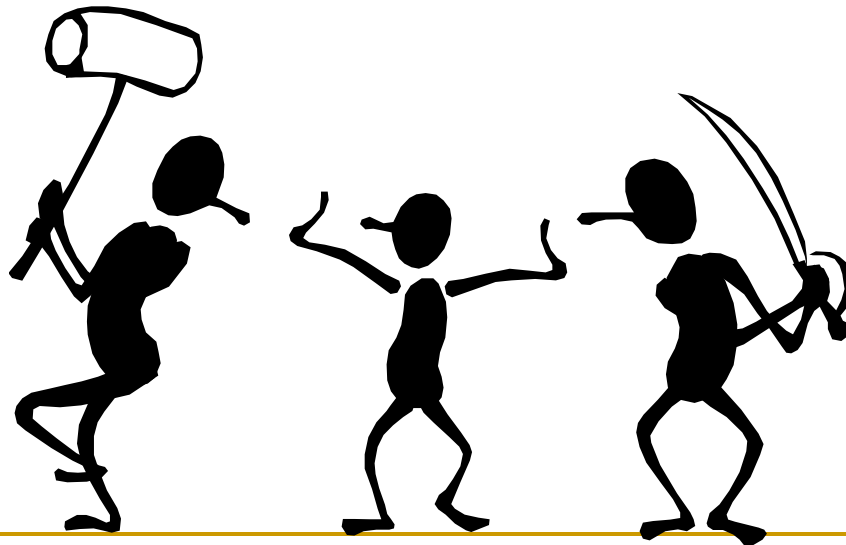
- **ASOP#38 – Using Models Outside Area of Expertise**
 - Understanding and determining appropriateness of model.

ASOP Exposure Draft on P/C Loss and LAE Claim Estimates

- Rationale for development
 - No current ASOP for reserving
 - CAS Statement of Principles being revised to exclude guidance language more appropriate for an ASOP
- First exposure draft released in February
- Comment period closed June 30
- Stay tuned!

“SNAPPERS”

(Audience Participation Requested)



Snappers Overview

- Snappers = Real Life Predicament
 - What should you do?
 - By-the-book actuary = Follow the Code!
 - Businessman actuary = Get the job done!
- Ground Rules
 - Role-Playing – We are not expressing our own personal views or those of our employers.
 - Audience Participation – Snappers are designed to spark discussion.

Snapper # 1

You are the chief actuary for your company and develop a reserve estimate for December 31, 2005 using reasonable methods and assumptions. The opining actuary produces a range using reasonable assumptions and your estimate is well above the opining actuary's range. Traditionally your company has booked your best estimate but now insists that you lower your estimate to within the range, which is outside your reasonable range. What do you do?

Snapper # 2

You are the reserving actuary for a personal auto liability carrier in California. You traditionally have performed your reserve analysis separately for urban and rural drivers. As a result of new legislation, your company has filed new rates based on driving record instead of zip code. You expect premiums to fall in the urban areas and as a result you have raised your expected loss ratios in urban areas. An urban-area branch manager whose bonus is tied to his branch's profitability disagrees and has convinced your boss that you are overreacting to the change. Your boss requires you to lower your expected loss ratio for his branch. What do you do?

Snapper # 3

A **consulting actuary** is hired to review a company's loss reserves and subsequently issues an unqualified Statement of Actuarial Opinion. The actuary for the company's audit firm estimates a deficiency in the reserves when she performs her review, and as a result the auditor will not sign off on the company's financial statement.

Discussions between the two actuaries become heated. Eventually, the actuary for the audit firm issues a statement to the company, as well as to the regulators criticizing the consulting actuary's analysis.

Is the approach used by the actuary for the audit firm appropriate?

Snapper # 4

You are the 1st FCAS employed by a small monoline writer of Auto Extended Warranty coverage, where loss experience is almost non-existent for the 1st 36 months. The consulting actuary who performed the reserve review in the past set ultimate loss ratios high enough to yield an underwriting loss, although the underwriters are convinced the book is profitable. (CY results for this growing line support the UWs' view.) The portfolio underwent major re-underwriting 3 years ago, invalidating nearly all useable history. What is your course of action?

- (By the way, as part of senior management, you participate in the corporate profit-sharing plan.)

Snapper # 5

You are the consulting actuary hired to review a company's reserves for environmental liability. You present your estimate and range to the company. They subsequently inform you that another analysis has been done by a firm using a proprietary exposure-based model. The other actuary is reluctant to share with you the assumptions within the model for fear that you would replicate them and jeopardize their competitive advantage. However, the company has insisted that the two of you reconcile your estimates and provide a final recommendation. What do you do?

Snapper # 6

Your systems vice president recently informed you that there was an error in the loss triangles provided for your loss analysis as of March 31, 2006. Although the company has already booked your reserve estimate, you re-estimate the March 31 reserves with the corrected data and it produced reserve estimates that are 7% higher than your previous best estimate. Because of recently passed tort reform, you expect your loss experience will improve throughout 2006 and that the difference will become immaterial by the end of 2006. Your CEO shares your expectations about the improved experience and wants you to amortize the difference throughout 2006. What do you do?

Snapper # 7

You are an actuary and have been engaged by a company to review the reserves for a potential acquisition. You perform your own independent study and, after signing a confidentiality agreement, also received copies of the last two actuarial studies performed on the target company. Your reserve estimate is significantly higher than the target's carried reserves. You reviewed the target's actuarial studies and found a flaw in the methodology that, if corrected, would cause the target to become insolvent. You attempt to contact the target company's actuary to make sure you are interpreting the results correctly and he has not returned your calls. What do you do?

Now... It's Your Turn

Any situations involving “a friend of yours?”

Limited Attendance Seminar on Professionalism

- The CAS is sponsoring a limited attendance seminar on professionalism.
- First session to be held Sunday at the annual meeting in San Francisco.
- Scaled down version (4 hours) of current Course on Professionalism for candidates.
- **Free** to attend if you are attending the annual meeting.
- Intended for “experienced” members who want a refresher on professionalism topics.
- Details to come later – watch your email!

Thanks for Your Participation!
