



	Risk of Material Adverse Deviation - A Regulator Viewpoint
	Melissa L. Greiner Property Casualty Actuary Pennsylvania Insurance Department CLRS – September 20, 2010

	Materiality and Risk of Material Adverse Deviation
	What more can we possibly talk about?  2

	Topics Covered
	<ul style="list-style-type: none">* Defining RMAD* Regulators view of RMAD* Commonly cited risks* Opinion and AOS Statistics  3

	First, a few Definitions
	<ul style="list-style-type: none"> * NAIC – National Association of Insurance Commissioners * COPLFR - Committee on Property Liability Financial Reporting, subgroup of the American Academy of Actuaries * Practice Note - Annual publication provided by COPLFR on Statements of Actuarial Opinion on Property and Casualty Loss Reserves <p style="text-align: right;">4</p>

	Topics Covered
	<ul style="list-style-type: none"> * Defining RMAD * Regulators view of RMAD * Commonly cited risks * Opinion and AOS Statistics <p style="text-align: right;">5</p>

	Definitions
	<ul style="list-style-type: none"> * Risk – the degree or probability of a loss * Material – important or pertinent * Adverse Deviation – amount of reserves (measured \$ or %) that increase or develop over time. <p style="text-align: right;">6</p>

	<h2 style="text-align: center;">Guidance on Materiality tends to be General</h2>
	<ul style="list-style-type: none"> * ASOP 36 <ul style="list-style-type: none"> – Uses phrases similar to “..likely to have a material effect” – There is no definition of material * NAIC APP Manual, Preamble, Paragraph VI, <ul style="list-style-type: none"> – “is the item large enough for users of the information to be influenced by it?” * SEC Staff Accounting Bulletin No. 99 <ul style="list-style-type: none"> – Similar to above, but more earnings focused – Both “quantitative” and “qualitative” factors should be considered. <p style="text-align: right;">7</p>

	<h2 style="text-align: center;">Risk of Material Adverse Deviation – Defined</h2>
	<ul style="list-style-type: none"> * ASOP 36 <ul style="list-style-type: none"> – The most important ASOP related to the Statutory Opinion. – Effective since 2001 – Paragraph 3.3.3 requires disclosure, <i>“When the actuary reasonably believes that there are significant risks and uncertainties that could result in material adverse deviation.”</i> <p style="text-align: right;">8</p>

	<h2 style="text-align: center;">Topics Covered</h2>
	<ul style="list-style-type: none"> * Defining RMAD * Regulators view of RMAD * Commonly cited risks * Opinion and AOS Statistics <p style="text-align: right;">9</p>

	<h2 style="margin: 0;">Why is RMAD Important for Opinion Writers ?</h2>
	<p>The NAIC <i>Annual Statement Instructions</i> require the Appointed Actuary to:</p> <ul style="list-style-type: none"> * Identify the materiality standard and the basis for establishing this standard. * Explicitly state whether or not there are significant risks and uncertainties that could result in MAD. <ul style="list-style-type: none"> - Is there Risk, Yes or No? - Additional answer in Exhibit B, Item 6. * Provide discussion of RMAD in the Relevant Comments section * If Yes to RMAD, describe major factors that could result in MAD. <p style="text-align: right; margin: 0;">10</p>

	<h2 style="margin: 0;">Regulator View of Opinion</h2>
	<ul style="list-style-type: none"> * Solvency of our insurers is the regulator's primary focus and concern. * Regulators are the PRIMARY users and intended audience of Opinions. * There are other users of Opinions. <p style="text-align: right; margin: 0;">11</p>

	<h2 style="margin: 0;">Regulator View</h2>
	<ul style="list-style-type: none"> * While all regulators have the same goal of protecting consumers and focusing on insurer solvency, each has his/her own perception of Materiality... * Does this element of perception make Appointed Actuaries less likely to conclude Yes? <p style="text-align: right; margin: 0;">12</p>

Regulators that review Opinions include:

- * Actuaries
 - Duties vary by state
- * Financial Examiners
 - Onsite auditing staff
- * Financial Analysts
 - Desk audits of insurer financial statements



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Regulator View of RMAD


- * My view as an actuarial regulator may differ from non-actuarial regulators.
- * Informal survey of financial examiners and financial analysts:
 - For RMAD, does an Actuary's Yes conclusion mean something different to you than a No conclusion?
 - If so, please explain.
- * Responses were quite varied in their perception of RMAD

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Regulator View of RMAD - Examples

- * "I am definitely more on the alert when a company has such a risk. If a qualified professional with inside knowledge of a company states there is a MAD risk, I believe I should pay attention to his assertion and act accordingly."
- * "I would put more emphasis in determining if the company's surplus can weather such a change in reserves."

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Regulator View of RMAD - Examples	
<ul style="list-style-type: none"> * "I assume in order for an actuary to conclude yes to this question, that there must be some reasonable chance for it to occur, but to what level and degree, I am not sure." * " 'No' means the actuary is confident or incompetent; 'Yes' means the actuary is leery of something or just in CYA mode." 	
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Regulator View of RMAD - Examples	
<ul style="list-style-type: none"> * "So while yes or no are not explicit factors used in assigning priority, either one could be used as part of an argument to support a higher or lower priority than the explicit criteria." * "To me, a yes or no response needs to be put into context." 	
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Regulator View of RMAD - Examples	
<ul style="list-style-type: none"> * "I would probably expect most, if not all opinions, to contain a 'yes' answer, because I think that most, if not all companies, face the risk of adverse development." * "Without identifying the risks considered, either answer could be misleading." * "The big problem or worry comes when there is no supporting paragraph or explanation that can alleviate an examiners fears or (hopefully) natural skepticism." 	
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	<h2 style="margin: 0;">Regulator View - Takeaway</h2>
	<ul style="list-style-type: none"> * COPFLR Practice Note* says, "The disclosure of a significant risk of MAD generally can be viewed as a disclosure and not as a qualification." * Accompanying disclosure is a critical component of risk evaluation. <p style="font-size: small; margin-top: 10px;">* Reference: 2009 Version, Appendix 2 - FAQ, Discussion 7</p> <p style="text-align: right; font-size: x-small;">19</p>

	<h2 style="margin: 0;">Regulator View - Takeaway</h2>
	<ul style="list-style-type: none"> * Individual perception may always have some influence on the response to a particular situation. * Proper way to evaluate RMAD: <ul style="list-style-type: none"> - Not as standalone disclosure - Consider with other relevant comment and explanation * Regulators of all types generally understand its context <p style="text-align: right; font-size: x-small;">20</p>

	<h2 style="margin: 0;">Topics Covered</h2>
	<ul style="list-style-type: none"> * Defining RMAD * Regulators view of RMAD * Commonly cited risks * Opinion and AOS Statistics <p style="text-align: right; font-size: x-small;">21</p>

	<h2 style="text-align: center;">Commonly Cited Risks</h2>
	<ul style="list-style-type: none"> * Reserve risk always has some level of inherent uncertainty. * Regulators get most value from Company specific risks. <ul style="list-style-type: none"> – Already have knowledge about a company's business profile. – Broad, general statements do not apply. * COPLFR Practice Note provides some good suggestions <p style="text-align: right; font-size: small;">22</p>


	<h2 style="text-align: center;">Commonly Cited Risks</h2>
	<ul style="list-style-type: none"> * What do Appointed Actuaries say in Opinions when there is a Risk of MAD? <div style="text-align: center;">  </div> <p style="text-align: right; font-size: small;">23</p>

	<h2 style="text-align: center;">Commonly Cited Risks</h2>
	<ul style="list-style-type: none"> * Line of Business Risk <ul style="list-style-type: none"> – “Long tailed nature of coverages written” – “Long time period associated with closing Workers Compensation claims” – “Company writes significant volume of long-tailed, low-frequency, high-severity classes of business including Excess Casualty” <p style="text-align: right; font-size: small;">24</p>

	Commonly Cited Risks
	<ul style="list-style-type: none"> * Asbestos, Environmental, Mass Tort Claims <ul style="list-style-type: none"> – “Significant exposure to A&E claims” – “Exposure to asbestos, environmental and other mass tort liabilities” * Rapid Growth <ul style="list-style-type: none"> – “Significant growth in direct writings” – “Increase in gross and net earned premium for 2006 to 2008”
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	Commonly Cited Risks
	<ul style="list-style-type: none"> * Changes in Claims... <ul style="list-style-type: none"> – “Changes in claims reserving practices for certain classes” – “Noticed a trend of changes in key diagnostics”
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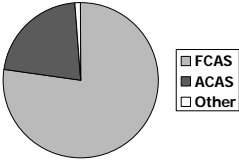
	Commonly Cited Risks
	<ul style="list-style-type: none"> * New Company or Limited History <ul style="list-style-type: none"> – “Company commenced operations in 2004, so has limited historical data on which to project” – “Small volume of company data” – “Newness of company’s operations” – “Heavy reliance on use of judgment and external industry data creates an additional risk”
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	Opinion & AOS Statistics
	<ul style="list-style-type: none"> * Who Signs Opinions? * Type of Opinion * Is there RMAD? * Point, Range or Both? * Position of Carried Reserves to Appointed Actuary Estimate

	Who Signs Opinions?
	<ul style="list-style-type: none"> * About 10% of CAS membership signs Opinions * For year ending 2009, about 2,550 Opinions issued by 492 actuaries. * Large handful of actuaries preparing a high number of Opinions

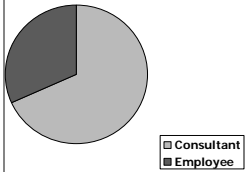
Who Signs Opinions?



- Actuarial Credential
- * Fellows 78%
 - * Associates 22%
 - * Other includes AAA members and non actuaries, approved by a few states

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Who Signs Opinions?



- Employment Status
- * Consultants 68%
 - * Employees 32%
 - * Does the employment relationship influence RMAD conclusion?

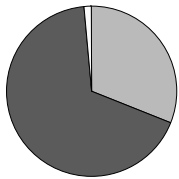
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Type of Opinion

- Of the five recognized Opinion types:
- * 98.8% Reasonable
 - * Not much change from prior years
 - Slightly more Excessive Opinions
 - Regulator(s) for companies receiving Inadequate Opinions very actively involved.

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Is there RMAD?

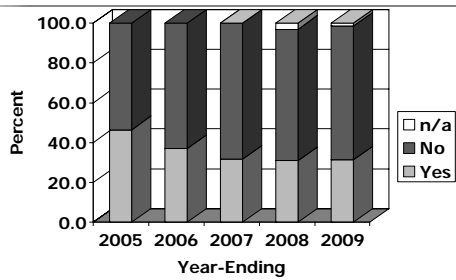


Of valid responses from NAIC database:

- * 31.2% Yes
- * 67.4% No
- * 1.4% n/a
- * Steady ratio over time.

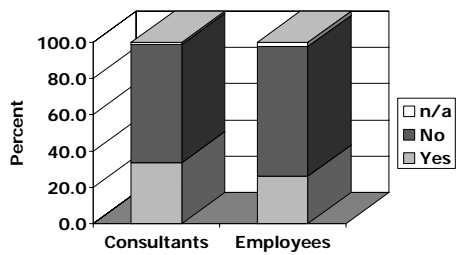
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Is there RMAD?



* 2005 and 2006 from multi-state sample; subsequent years from NAIC database 35

Is there RMAD? Varying by Employment



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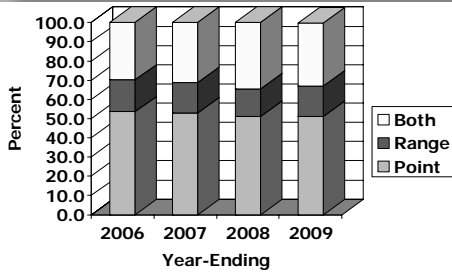
Point, Range or Both?

Point	51%
Range	16%
Both	33%

- * Again, not much change since prior year
- * Source: Multi-state sample of about 790 companies from six states

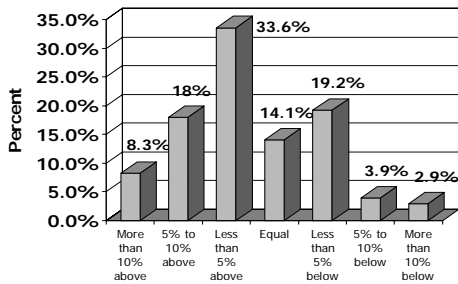
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Point, Range or Both?



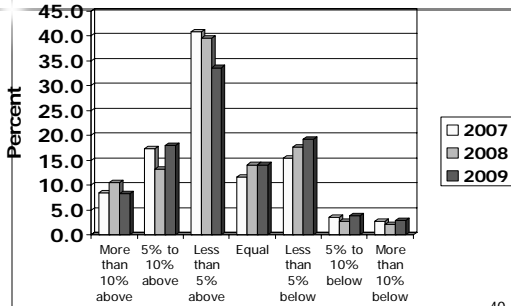
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Carried vs Actuarial Estimate Year End 2009



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Carried vs Actuarial Estimate Years Ending 2007 - 2009



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Final Points on RMAD

- * The Opinion's intended audience is the domestic regulator, whose focus is insurer solvency.
- * RMAD should be applicable and specific to the insurer.
- * RMAD should be evaluated with other relevant comments and related disclosures.

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Points for Appointed Actuaries to Consider

- * Is my explanation of relevant comments sufficient?
- * Can I provide an explanation of items considered and relevant discussion even if I conclude "No" to RMAD?
- * Are there points within my range that could cause a material misstatement of reserves or cause a financial reporting ratio to be triggered?

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