

Using Your Professionalism GPS to Navigate the Actuarial World

Casualty Loss Reserve Seminar
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Actuarial Navigation

Where do you turn when you are faced with an ethical "traffic jam" and need to navigate away from it?



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Increased Scrutiny of Actuaries since 2003

- Standard and Poor's (2003)
 - "Insurance Actuaries: A Crisis of Credibility"
 - Blamed actuaries for reserve shortfalls in early 2000s
 - #1 Casualty Actuarial story for 2003 (CAS)
- Morris Review (UK, 2004-05)
 - Insolvency of Equitable Life (UK)
 - Led to oversight by Financial Reporting Council

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Increased Scrutiny of Actuaries since 2003

- ☞ AIG/Gen Re Sham Reinsurance (4/1/08)
 - ☞ Convictions of actuaries Ron Ferguson and Chris Garand
 - ☞ Sentenced in spring 2009, appeals pending
- ☞ NY Times article (5/21/08)
 - ☞ "Actuaries Scrutinized on Pensions"
 - ☞ Issues with public pension funding in NY, AK, San Diego CA, Milwaukee County WI, and Evanston IL

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GPS Tools for the Actuary



- ☞ Code of Professional Conduct
- ☞ Actuarial Standards of Practice
 - ☞ Applicability Guidelines
- ☞ CAS Statement of Principles
 - ☞ Foundational Statements

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Survey Question

- ☞ When was the last time you referred to the Code of Professional Conduct?
 - a) In the past year, to answer a work-related question.
 - b) In the past year, to meet continuing education requirements.
 - c) Between 1 and 2 years ago, for any reason
 - d) More than two years ago, or don't remember.

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Case Studies



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Case Studies Overview

- Cases are designed so there are no right or wrong answers and reflect “real life predicaments”
- Structure of this session
 - After reading the case together, will ask for a show of hands for what solution you would choose
 - Will ask one volunteer for each option answered to explain why they chose that course of action
 - Discuss some relevant Code and ASOPs
- Disclaimers:
 - Exercise is for education purposes only.
 - Opinions expressed do not represent the opinion of the respective employers or the Casualty Actuarial Society.
 - No authoritative guidance should be expected of the moderator or panelists.

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Case Study #1 – “Ranges”

You are the chief actuary for your company and develop a reserve estimate for December 31, 2008 using reasonable methods and assumptions. The opening actuary produces a range using reasonable assumptions and your estimate is materially above the opening 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. (Assume you have already discussed the difference with the opening actuary)

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Case #1 Course of Action

What Would You Do?

- (a) Stick to your reserve recommendation and document your results regardless of what the company books.
- (b) Lower your range to meet the opining actuary's range.
- (c) You are confident that your estimates are correct so, the opining actuary's must be wrong. You call the ABCD on the opining actuary.
- (d) None of the above.

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Professional Integrity

PRECEPT 1:

An Actuary shall act honestly, with integrity and competence, and in a manner to fulfill the profession's responsibility to the public and to uphold the reputation of the actuarial profession.



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Communications and Disclosure

PRECEPT 4:

An Actuary who issues an Actuarial Communication shall take appropriate steps to ensure that the Actuarial Communication is clear and appropriate to the circumstances and its intended audience and satisfies applicable standards of practice.



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ASOP#41: Actuarial Communications

- ☞ All types of Actuarial work – not just P&C
- ☞ Written, Electronic, or Oral Communications
- ☞ Provides guidance for the appropriate form and content that should be included - depending on circumstances and audience
- ☞ Discusses timelines and reliance on others

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ASOP #9: Documentation and Disclosure in P&C Ratemaking, Reserving & Valuations

- ☞ Repeal currently pending
- ☞ Replaced by ASOP #41
 - ☞ "Actuarial Communications"
- ☞ Scope – limited to practices related to the 3 Statement of Principles documents
- ☞ Included as appendices

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Case Study #2 – "Triangle Error"

Your systems vice president recently informed you that there was an error in the loss triangles provided for your loss reserve analysis as of March 31. You run a quick test with the new data and believe it will produce reserve estimates materially higher than your previous best estimate. However, because of recently passed tort reform, you expect your loss experience will improve throughout the year and that the difference will become immaterial by year end. Your CEO shares your expectations about the improved experience and insists you postpone incorporating the new data until the next quarter as your company has already booked your original estimate and rebooking the new reserves would cause a delay in the company's earnings release.

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Case #4 Course of Action

What Would You Do?

- (a) Update your analysis and provide a new estimate to the CEO to ensure your work is not misused.
- (b) Agree with your CEO and incorporate the new data in your next reserving study, arguing your range is wider than normal due to the passage of tort reform.
- (c) Report your CEO to the appropriate authorities
- (d) Seek guidance from the ABCD.

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Control of Work Product

PRECEPT 8:



An Actuary who performs Actuarial Services shall take reasonable steps to ensure that such services are not used to mislead other parties.

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ASOP#23: Data Quality

- ☞ Guidance for the following
 - ☞ Selecting data that underlie the work product
 - ☞ Relying on data supplied by others
 - ☞ Reviewing data
 - ☞ Using data
 - ☞ Making appropriate disclosures regarding data quality
- ☞ All practice areas – not just P&C
- ☞ Does not require data audit

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Case Study#3 – “Draft Report”

A consulting actuary has delivered a draft report to its client/principal. During a subsequent discussion of the results, the actuary and the Controller talk about the potential surplus impact of a possible strategic course of action. After this conversation the consulting actuary does a thorough proforma analysis and provides a final report in which the results vary from the draft report discussions due to some changes in assumptions as provided by the CEO and CFO. The Controller has already implemented some of the originally discussed strategy and is now complaining to the CEO and CFO that the actuary misled him and has produced faulty work. What should the actuary do?

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Case #3 Course of Action

What Would You Do?

- (a) Meet with the CEO and CFO to discuss the misinterpretation of your work product and verify that your final work product fulfills the work contract.
- (b) Meet with the Controller to discuss the changes and why your earlier conversation should not have been relied upon.
- (c) Do nothing.
- (d) None of the above.

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Communications and Disclosure

PRECEPT 5:

An Actuary who issues an Actuarial Communication shall, as appropriate, identify the Principal(s) for whom the Actuarial Communication is issued and describe the capacity in which the Actuary serves.

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Case Study #4 – “Insolvent Target”

You are a partner of a consulting firm that has been hired to assist in the review of a potential acquisition. After completing your analysis, you discover that the target is materially under-reserved. The target received an unqualified Statement of Actuarial Opinion from another consulting actuary. As a result of your work, the acquiring company walks away from the target. (You signed a confidentiality agreement with the acquiring company prior to being engaged on the assignment.)

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Case #4 Course of Action

What Would You Do?

- (a) The client walked away, so you feel your duty to your Principal ends with the engagement.
- (b) You notify the insurance commissioner in the target company's state of domicile of the reserve deficiency.
- (c) Seek counseling from the ABCD.

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Confidentiality

PRECEPT 9:

An Actuary shall not disclose to another party any Confidential Information unless authorized to do so by the Principal or required to do so by Law.



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Case Study #5 – “Auditor’s Actuary”

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?

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Case #5 Course of Action

What Do You Say?

- a) Yes, the auditor’s actuary has a responsibility to the public and to the profession to be honest. There was an attempt to communicate with the other actuary but because it could not be resolved, the auditor’s actuary had to notify the company and regulators.
- b) No, the auditor’s actuary should have cooperated with the other actuary in the interest of the Principal. Further the auditor’s actuary disclosed Confidential Information to the regulators.
- c) Maybe, it depends on a number of other factors not described in the case.

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Courtesy and Cooperation



PRECEPT 10:

An Actuary shall perform Actuarial Services with courtesy and professional respect and shall cooperate with others in the Principal’s interest.

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Case Study#6 – “Material Reserves”

You are the chief actuary for a large commercial lines insurance company. It is year-end 2008, and the losses from the soft-market years of 2003-2006 are starting to materialize, but due to the slow emergence patterns of much of the business, your reserve indications have a +/- 10% range. However, due to the reserve charge your company took the prior year due to catastrophes, even a +5% deviation from the point estimate will dangerously deplete the company surplus. What do you do?

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Case #6 Course of Action

What Would You Do?

- (a) Continue with your recommendation to book the best estimate but do not reveal your range. There is far too much uncertainty in the range to truly rely on your current estimates.
- (b) Clearly communicate to management the uncertainty underlying your projections and let management decide what reserve to book.
- (c) None of the above.

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Violations of the Code of Professional Conduct

PRECEPT 13:

An Actuary with knowledge of an apparent, unresolved, material violation of the Code by another Actuary should consider discussing the situation with the other Actuary and attempt to resolve the apparent violation. If such discussion is not attempted or is not successful, the Actuary shall disclose such violation to the appropriate counseling and discipline body of the profession, except where the disclosure would be contrary to Law or would divulge Confidential Information.

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Canadian Rules of Professional Conduct

- ⇒ The Rules of Professional Conduct in Canada require that certain procedures **must** be followed when a member is aware of a violation of the Rules.
 - ⇒ Affirmative responsibility to act to correct violation
 - ⇒ No confidentiality agreement or employment protections exist



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ASOP#43: Property/Casualty Unpaid Claim Estimates

- ⇒ Specifically targets unpaid claim estimates
 - ⇒ CAS Statement of Principles being revised to exclude guidance language more appropriate for an ASOP
 - ⇒ Applies to all classes of entities (e.g., self-insureds, reinsurers, insurers and governmental agencies)
 - ⇒ Defines the difference between claim estimates and reserves

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ASOP#43: Property/Casualty Unpaid Claim Estimates (Cont'd)

- ⇒ Must specify the purpose of the estimates
- ⇒ Must communicate constraints on analysis
 - ⇒ Limited or no data
 - ⇒ Limited time or resources
- ⇒ Must identify the scope of the estimate
 - ⇒ Central estimate, high, low, median, etc. ("best estimate" or "actuarial estimate" are not sufficient)
 - ⇒ Is the estimate appropriate for the intended purpose
 - ⇒ Specify other attributes of the estimate (e.g., discounted, net or gross of recoveries and reinsurance)
- ⇒ Materiality

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ASOP#36: Statements of Opinion P/C
Loss and LAE Reserves

- Guidance for *written* statements of opinion
- Applies to insurance cos, reinsurance cos and other P/C Risk Financing systems
 - Such as Self-Insurance
- Applies to practices that relate to the principles presented in the Reserving Statement of Principles Document

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Other Code of Conduct Precepts

- #2 – Qualification Standards
- #3 – Standards of Practice
- #6 – Communications and Disclosure (compensation disclosure)
- #7 – Conflict of Interest
- #11 – Advertising
- #12 – Titles and Designations
- #14 – Cooperation with ABCD

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Other ASOPs not mentioned

- #20 Discounting Reserves
- #38 Using Models outside your area of expertise
- #25 Credibility
- #17 Expert Testimony

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Applicability Guidelines

- ☞ ASOPs that apply to all practice areas
 - ☞ 23 Data Quality, 41 Communications, 9 Documentation & Disclosure
- ☞ Reserving ASOPs
 - ☞ 20, 36, 43
- ☞ Ratemaking ASOPs
 - ☞ 13, 29, 30, 39
- ☞ Other Key ASOPs
 - ☞ 12, 17, 25, 38

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Common Allegations Received by ABCD

Alleged Violation	Number Disposed or in Process (2005)	Number Disposed or in Process (2006)	Number Disposed or in Process (2007)	Precept
Failure to act with integrity	19	18	11	1
Calculation or data errors	7	2	2	1
Failure to perform services with competence	3	3	5	1
Other errors in work	3	3	2	1
Work fails to satisfy ASOP	3	3	7	3
Improper reserve estimate for insurer	3	0	0	3
Use of unreasonable assumptions	3	1	1	3
Failure to cooperate with other actuary	3	3	3	10

Source: ABCD 2005, 2006 and 2007 Annual Reports

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Questions?

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