

# SUBPOENAED! HOW NOT TO HANDLE A DEPOSITION

*Friday, September 7, 2012: 10:00 a.m.*

## **Mock Deposition Background story**

Young Chap, FCAS, has been employed by Confident Underwriters, Inc. for the past four years. He was appointed by the Confident Underwriters Board to sign their Statement of Actuarial Opinion in 2008. Young earned the FCAS designation in 2007 and has 12 years experience in the insurance industry. Young Chap is the first in-house credentialed actuary employed by Confident Underwriters.

Confident Underwriters, founded in 1983, writes commercial accounts comprised of GL, Property, Auto and Workers Comp. In 2007, a new marketing initiative was launched to increase market share in all of Confident Underwriters' core states. With confident predictions that the soft market would end in the near future, this initiative would position the company well to reap the rewards when the market hardened and would help to lower the company's expense ratio which had been increasing steadily. The combination of soft market pressures and the desire of the company management to grow its market share caused a migration into higher hazard groups. In addition, the company's portfolio was subject to downward pricing pressures, with the average rate level per exposure dropping as much as 30%-40% in some classes of business. Confident Underwriters' surplus was under some strain from this growth, but management could see no other way to raise capital, so Confident Underwriters boldly selected the strategy to seek organic growth from profits on new business.

Confident Underwriters does not have an in-house claims department, but rather uses a Third Party Administrator (TPA) to adjust its claims. In 2008, on an expense saving initiative, Confident Underwriters contracted with a new TPA to begin handling all new and existing claims. Case reserve procedures differed between the prior TPA and the new TPA, but no evaluation of the differences were made by the company. Higher than estimated losses emerged in 2010 on the 2008 and 2009 accident years increasing the loss ratios on these accident years by as much as 20 points beyond the year-end 2009 actuarial projection. Further adverse development emerged in 2011, causing Young Chap to recommend quite significant strengthening of the bulk reserves. Young concluded the booked loss reserves at the end of 2010 were materially understated. The combined effect of the 2011 loss emergence on older accident years and Young's recommended increase in the bulk reserves based on his third quarter 2011 reserve review amounted to 40% of surplus.

If management had booked these reserve increases, Confident Underwriters' surplus would have dropped below the Regulatory Action Level capital requirement, triggering an audit by the State of Caution Insurance Department. Therefore Confident Underwriters management booked reserves 20% below Young Chap's Actuarial Central Estimate, near the bottom of Young's range. Nevertheless, despite the reserve development problems, TPA case reserve questions, price decreases, reserves booked low in the range and weak surplus, Young Chap produced a "reasonable" opinion and did not note any Significant Risks of Material Adverse Development in the comments section of his opinion.

The auditors relied on the "reasonable" opinion and management certifications, and issued an unqualified audit opinion. They never asked Young for any work papers, nor indeed contacted him at all.

Unfortunately for Confident Underwriters, the State of Caution examiners and actuaries were neither blind nor stupid. They took one look at Schedule "P" and the Actuarial Opinion Summary and called for an immediate special examination, including an independent actuarial review. After the review and the examination showed that even Young Chap's Actuarial Central Estimate was weak, they put Confident Underwriters into receivership last month. They then stopped all new writings and renewals, and sued Management and the auditors. Young Chap was offered as a company witness and is being deposed Friday, September 7 in Denver.