A Range of Opinion Topics

CLRS 2013
Nicole Elliott, TX Dept of Insurance
Mary D. Miller, Risk & Regulatory Consultants, LLC
Lisa Slotznick, PricewaterhouseCoopers
Wendy Germani, AACG LLC

1

Agenda: Topics for Discussion

- Are you qualified to sign an Opinion?
- By and Beyond the Numbers:
  - Who signs Opinions?
  - Measures of Reserve Adequacy
  - Ranges
  - Does your opinion have an RMAD?
- What are the new Actuarial Report requirements?
- What is the "Practice Note" and how to use it?
- If the Opinion is not "reasonable", what happened?
- Dates, Dates, Dates
- Changes to the Opinion Instructions

2

Am I Qualified?

- Precept 2 of the Code of Professional Conduct
  - "An Actuary shall perform Actuarial Services **only when the Actuary is qualified to do so** on the basis of basic and continuing education and experience, and only when the Actuary satisfies applicable qualification standards." (emphasis added)
  - "It is the professional responsibility of an Actuary to **observe applicable qualification standards** that have been promulgated by a Recognized Actuarial Organization for the jurisdictions in which the Actuary renders Actuarial Services and to keep current regarding changes in these standards." (emphasis added) (Annotation 2-1)

3

An Overview of Qualifications

US Qualification Standards

	Education	Experience	Law	Continuing Education	AND	One of the Following:		
General	MAAA, Fellow or Associate of SOA or CAS or fully qualified member of another IAA-member organization	3 years responsible actuarial experience	Be knowledgeable of the Law applicable to the SAO	30 hours of relevant education		Fellow completing the specialty track in the relevant area	Fellow with one year experience in the relevant area	Minimum 3 years experience in the relevant area
Specific	Complete relevant exams OR demonstrate responsible work and/or self study in the relevant subjects	3 years responsible experience relevant to the subject		15 hours (of the 30) directly related to the subject				

NAIC Requirements

Qualification	Specialization
Meet the US Qualification Standards (General & Specific)	CAS Member in good standing or MAAA approved by Casualty Practice Council

4

Am I Qualified? Case Study

- Karen is an ACAS, MAAA
- She has been employed in an insurer' s actuarial department for 10 years
- During the last five, she has been in charge of reserving for extended warranty coverages, working closely with the insurer's Chief Actuary

Am I Qualified? Case Study cont.

- Karen has been asked to take on appointed actuary responsibilities for a few subsidiaries of her employer, a large insurance group
- The subsidiaries specialize in extended warranty; all operate exclusively in the US
- NAIC SAO opinions apply to the state of domicile
- Karen has asserted that she meets continuing education requirements

Case Study: Is Karen Qualified?

US Qualification Standards

	Education	Experience	Law	Continuing Education	AND	One of the Following:		
General	MAAA, Fellow or Associate of SOA or CAS or fully qualified member of another IAA-member organization YES	3 years responsible actuarial experience YES	Be knowledgeable of the Law applicable to the SAO YES	30 hours of relevant experience YES		Fellow completing the specialty track in the relevant area NO	Fellow with one year experience in the relevant area NO	Minimum 3 years experience in the relevant area YES
Specific	Complete relevant exams OR demonstrate responsible work and/or self study in the relevant subjects MAYBE	3 years responsible experience relevant to the subject YES		15 hours (of the 30) directly related to the subject MAYBE				

NAIC Requirements

Qualification	Specialization
Meet the US Qualification Standards (General & Specific) MAYBE	CAS Member in good standing or MAAA approved by Casualty Practice Council YES

Case Study Summary
Is Karen Qualified?

- Karen meets the General Qualification Standard
- With respect to the Specific Qualification Standard:
  - Karen has successfully completed exams covering several of the subjects identified, but
  - If she became an associate in 2011 or later, she has not yet passed the exams covering premium liabilities and reinsurance
  - In order to satisfy the Specific Qualification Standard, she will need to obtain a signed statement from a qualified actuary
  - Karen should also make sure that she has at least 15 hours of continuing education directly relevant to the SAO

By the Numbers: Opinion Signers

- About 8 percent of CAS members sign statutory opinions*
- About 2,525 statutory opinions were issued for year-end 2012*
- About 480 actuaries issued opinions*
  - 64 percent are consultants**
  - 77 percent are Fellows**
- 99 percent are Reasonable opinions*

*based on 2012 data

**based on 2010 data

Source: NAIC filings

9

Top Opinion Signers

- Top 20 opiners (4 percent of opiners):
  - Issued 651 opinions (approx. one-fourth of opinions)
  - Issued between 21 and 69 opinions each (33 avg)
- 34 actuaries (7 percent of opiners)
  - Issued 889 opinions (approx. one-third of opinions)
  - Signed 15 or more
- 138 actuaries (29 percent of opiners) signed *only* one opinion
- Stats have been about the same for the past few years

Source: 2012 NAIC filings

10

Measures of Reserve Adequacy

- Where do you think companies carry reserves in relation to the actuary's estimates?
- Has this changed over time?
- Reserve IRIS ratios – one year development – how has this ratio changed over time?

11

Carried Reserves vs. Actuary's Point Estimate or Midpoint of Range

Gross	2008	2009	2010	2011	2012
Below actuary's estimate	30%	28%	26%	26%	25%
Equal to	14%	17%	19%	20%	18%
Above	56%	56%	56%	54%	57%
Within +/- 5%	71%	71%	74%	73%	74%
Net	**2008**	**2009**	**2010**	**2011**	**2012**
Below actuary's estimate	23%	24%	25%	22%	23%
Equal to	13%	14%	17%	19%	16%
Above	64%	62%	58%	59%	61%
Within +/- 5%	71%	69%	69%	73%	71%

Excludes companies that carry zero reserves
Source: AOS data collected for companies domiciled in NY, PA, TX, IL, OH

12

IRIS Ratio 11 Avg Reserve Development

- Average IRIS ratio #11 value is minimal to slightly favorable over the past five years, when outliers and zero-net companies are removed
- IRIS ratio 11 greater than 5% in at least three of the last five years, requiring disclosure in the Actuarial Opinion Summary:
  - 2012 – 147 companies
  - 2011 – 132 companies

13 Source: statutory filings

Ranges – Beyond the Numbers

- Is a range required?
- How are ranges developed?
- What do regulators see – Types of Ranges
- What are you or your firm doing?
- How do you communicate your range?

14

Background on Ranges

ASOP No. 43, Section 4.2a: "In the case when the actuary specifies a range of estimates, the actuary should disclose the basis of the range provided, for example, a range of estimates of the intended measure (each of such estimates considered to be a reasonable estimate on a stand-alone basis); a range representing a confidence interval within the range of outcomes produced by a particular model or models; or a range representing a confidence interval reflecting certain risks, such as process risk and parameter risk." (emphasis added)

15

Some commonly used approaches

1. Flat percentage adjustment
2. Function of results from different methods
3. Low and high reasonable assumption sets
4. Mack method
5. Bootstrap chain ladder

16

Range Related Communication

- Clear Disclosures
  - Type of range
  - What does the range represent (all outcomes, probable outcomes, expected outcomes)
  - What happens when the outcome in the future might be outside the range
  - Common misinterpretations

17

Point, Range, or Both – Net basis

	2008	2009	2010	2011	2012
Point	48%	47%	49%	50%	46%
Range	15%	16%	14%	8%	6%
Both	37%	37%	36%	42%	48%

Excludes companies that carry zero reserves
Source: AOS data collected for companies domiciled in NY, PA, TX, IL, OH (630 companies out of 2,525, or 25% of filings)

18

Background on RMAD

- The opinion on the reasonableness of the reserves does not tell the whole story
  - Reserves can be reasonable, and the company can be in trouble
  - Reasonable does not:
    - Mean "prudent," "proper," "adequate," or other terms
      - These terms do not appear in ASOP 36 nor the NAIC Instructions. However, some states refer to these types of terms. Check the Academy's P/C Loss Reserve Law Manual for state-by-state details
    - Depend on the solvency of the company
- The RMAD—and other disclosures—should be written to help describe the most important things that could go wrong or to disclose that no significant risks are believed to exist

19

Separate the evaluation of what is material from what is a significant risk

- Materiality
  - How much adverse deviation would matter
  - Regardless of whether there are risks that are significantly likely to produce that much adverse deviation
- Significant risks and uncertainties
  - Must consider the uncertainty in the loss reserves
  - Must consider the materiality standard
- Important to treat these as separate decisions

20

Materiality

- Materiality used in more instances than risk of material adverse deviation
  - When is it acceptable to list items as unreviewed?
  - From preamble to SSAPs: "Is the item large enough for users of the information to be influenced by it?"
  - Other examples of materiality from preamble:
    - Breach of covenant or regulatory requirement
    - Turn a profit into a loss
    - Reverse an earnings trend
    - Trigger a risk-based capital event
    - Small amounts arising from abnormal or unusual transactions or events

21

Materiality—Discussion Topics from Preamble and Appendix 7 of 2012 Practice Note

- Relative rather than absolute size determines materiality in a given situation
- Amount of deviation considered immaterial may increase as attainable degree of precision decreases
- Essence of materiality—Omission or misstatement of an item is material if the magnitude is such that the judgment of a reasonable person relying on the financial statement would have been changed by the inclusion of the correct item
- Would the item under consideration affect the opining actuary's judgment as to whether the loss and loss expense reserves make a reasonable provision for the liabilities of the entity?

22

Risk factors

- Ceded reserves greater than 50 percent of surplus
- Cessions to weakly rated reinsurers and/or reinsurance in dispute of more than 25 percent of the materiality standard
- Difficult exposures that are more than 25 percent of total reserves, separately or in combination
- High concentration in volatile lines of business
- Rapid expansion, changes in claims operations
- New company, sparse data, reliance on benchmark data
- Historical record of adverse development
- Low or negative surplus
- Carried reserves at the low end of the range
- Highly leveraged companies

A possible approach is to evaluate the relevant risk factors

- How likely they are to cause adverse development
  - Is the likelihood "greater than remote"?
- Materiality
  - If the development occurs, would it cause sufficient adverse deviation to pass the materiality threshold?
- Combinations
  - Are there several risk factors that alone are not significant but that can combine to be significant?
- These are not absolute rules
  - Significant judgment is required

Is there RMAD?

	2008	2009	2010	2011	2012
N/A	3%	3%	3%	4%	3%
No	66%	68%	69%	68%	69%
Yes	32%	29%	28%	29%	28%

Source: NAIC filings

25

2012 Instructions: Actuarial Report

- **Actuary's Relationship to Management** including role in advising board or management NEW 2012
- **Comparison of Results by Data Groupings** used in actuarial analysis to carried amounts. REVISED 2012
- **Reconciliation Exhibit** including map of the data used by the actuary, consistent with the liability groupings used in the actuarial analysis, to the Schedule P line of business reporting REVISED 2012
- **Change in Actuary's Estimates Exhibit** showing the change in the actuary's estimates from the prior report, including extended discussion in the text of factors underlying any material changes NEW 2012

26

Relationship to Management

Samples of new required disclosure from the 2011 Practice Note:

- *I am the Chief Actuary of the Company and provide the Statement of Actuarial Opinion on the Company's carried reserves based on my internal analysis of the Company's unpaid claim liabilities. The results of my analysis were presented to Management on MM/DD/YY and to the Board of Directors of this Company on MM/DD/YY. The booked reserves for these liabilities were established consistent with the final results of my analysis.*
- *The Company relied on an internal actuarial analysis prepared by Actuary XYZ in establishing its booked reserves. I have been hired as an independent consulting actuary to provide a Statement of Opinion on the Company's booked reserves as of year-end 2011. In establishing my opinion, I independently reviewed the Company's internal analysis. I did not perform a separate, independent analysis and did not explicitly advise the Company management in establishing their booked reserves.*

See 2012 Practice Note for more general information to consider

27

Reconciliation

- Instructions used to say: *Documentation of the required reconciliation from the data used for analysis to the Annual Statement Schedule P*
- Now says: *An exhibit that reconciles and maps the data used by the Actuary, consistent with the segmentation of exposure or liability groupings used in their analysis, to the Annual Statement Schedule P line of business reporting*
- Attempts to clarify what is meant by "required reconciliation"
- Key word is "maps"
- Reduces questions regarding data integrity and completeness

28

Changes in Estimates: "Report Card"

- Requirement: *Exhibit showing the change in the actuary's estimates from the prior report, including extended discussion of factors underlying any material changes*
- Show changes on a net basis but include the changes on a gross basis , if relevant
- Material total changes should be discussed; however, also include explanation for any significant fluctuations among accident years or segments
- The actuary should judge at what level of aggregation the comparisons are meaningful in order to explain any shift in results, perceived or otherwise.
- This exhibit is for the change in the actuary's estimates, not the carried reserves

29

Practice Note and COPLFR

- COPLFR: Committee on Property & Liability Financial Reporting
  - Responsible for updating the Practice Note each year
- Practice Note: Statements of Actuarial Opinion on Property & Casualty Loss Reserves
  - The purpose is to provide information to actuaries on current or emerging practices in which their peers are engaged
  - It is intended to assist actuaries by describing practices that COPLFR believes will be commonly employed in issuing statements of actuarial opinion in compliance with the NAIC Property and Casualty Annual Statement Instructions

30

What the Practice Note "is" and "is not"

- The Practice Note "is"…
  - A supplement to available actuarial and regulatory guidance, such as:
    - Actuarial Standards of Practice from the ASB
    - Property Casualty Annual Statement Instructions from the NAIC
    - U.S. Qualification Standards from the Academy
  - A description of practices that COPLFR members believe to be commonly employed
  - Meant to provide information to actuaries on current or emerging practices
  - An evolving document, responding to changes in regulation and practice

31

What the Practice Note "is" and "is not"

- The Practice Note "is not"….
  - An interpretation of actuarial standards
  - Binding on actuaries
  - An exhaustive description of all common practices
  - A source for regulatory requirements in a specific state or jurisdiction

32

How do I get the Practice Note?

- Available FREE on the Academy's website
- A peek inside…
  - Follows the NAIC Instructions with detailed discussion of each section, including the Actuarial Opinion Summary
  - Appendixes cover: Actual copies of the NAIC Opinion Instructions!, Evaluation and Reconciliation of Data, Frequently Asked Questions, Guidance for Pools & Associations, Misc Illustrative Wordings in Common Use, Intercompany Pooling, Unearned Premium for Long Duration Contracts, Regulatory Guidance, Data Testing Requirements, An Overview for Audit Committee Members of P/C Insurers: Effective Use of Actuarial Expertise

33

Not Reasonable - the 1%

- Deficient (3)
- Excessive (9)
- Qualified (4)
- No Opinion (8)
- Is management happy?

Source: 2012 NAIC filings

34

Dates, Dates, Dates

- **Accounting Date** - The stated cutoff date for reflecting events and recording amounts as paid or unpaid in a financial statement or accounting system.

  The accounting date is sometimes referred to as the "as of date." Typically, for a Statement of Actuarial Opinion will be December 31, 20XX.
- **Valuation Date** - The date through which transactions are included in the data used in the unpaid claim estimate analysis. Typically, for a Statement of Actuarial Opinion will be December 31, 20XX.
- **Review Date** - The date (subsequent to the valuation date) through which material through which transactions are included in the data

35

Changes to NAIC Instructions

- None for 2013
- Planned for 2014
- Any suggestions?

36