

CHANGES TO THE ASOPS

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Today's Agenda

- Introduction to the Actuarial Standards Board
- ASOP 1
 - ▣ Introduction to ASOP 1
 - ▣ Where does ASOP 1 fit in?
 - ▣ Substance of ASOP 1
 - ▣ Intersection with ASOP 41
 - ▣ Conclusion
- ASOP 25 (Second Exposure Draft)
- Questions/Comments

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Actuarial Standards Board

The Actuarial Standards Board

- The Actuarial Standards Board is an autonomous board created under the Academy Bylaws
- The ASB promulgates, revises or amends, and repeals Actuarial Standards of Practice (ASOPs)
- ASOPs provide guidance to credentialed actuaries who render actuarial services in the USA
- The ASB is composed of nine members serving 3-year terms; broadly representative of all areas of actuarial practice; appointed by the presidents and president-elects of the five US-based actuarial organizations

Operating Committees of the ASB

- Casualty
- General
- Health
- Life
- Pension
- ERM

The ASB Process

1. The Board assigns tasks to the committees
2. The committees discuss and prepare exposure drafts
3. The Board & Legal Counsel review and return for revision (maybe several times) or approve
4. The members comment on the exposure draft
5. The committee discusses *every* comment and revises or responds
6. Return to steps 3 to 5: maybe another exposure draft and/or a revision by the ASB
7. Eventually issued as final and given an effective date

Introduction to the New ASOP 1

- A revision to the former introduction to the ASOPs
- Sets the stage for all other ASOPs
- Improves and streamlines wording, as compared to the prior introduction
- Adds important new definitions
- Reinforces the mandatory nature of the guidance by making an ASOP rather than an introduction

- ASOP 1 is effective for all actuarial services performed on or after **June 1, 2013** that means ***NOW***

The Code of Professional Conduct

- The Code is the foundation of actuarial professionalism for U.S. credentialed actuaries:
 - It applies to all actuarial members of the Academy, ASSPA, CAS, CCA and SOA
- The Code provides basic definitions such as “Actuarial Communications” and “Actuarial services”
- The Code contains 14 Precepts; Precept 3 states “An Actuary shall ensure that Actuarial Services performed by or under the direction of the Actuary satisfy applicable standards of practice”
- *This means the ASOPS are mandatory for you all*

What are ASOPs?

Where do they come from?

- The Actuarial Standards Board is charged by all five U.S.-Based actuarial organizations with establishing and revising (or repealing) ASOPs in the U.S.
- The goal is to define an “appropriate” level of practice
- ASOPs are ***binding*** authoritative guidance for actuaries
- ASOPs are part of the actuary’s work considerations
- ASOPs provide a basic framework intended to accommodate considerations such as law and regulations, professional considerations, evolving actuarial practice, and professional judgment
- They are neither a cook-book nor a straight-jacket

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ASOP 1: Introductory Actuarial Standard of Practice

How does ASOP 1 fit in?

- Provides Guidance to actuaries on how to read and interpret the other actuarial standards of practice
- Key terms used in the other ASOPs are defined or discussed in ASOP No. 1
- ASOP 1 defines the purpose and format of all ASOPs
- Discusses how ASOPs are binding on actuaries
- Its appendices provide useful background information

Substance of ASOP 1

□ **Section 1 – Overview**

- “Sets forth principles that have been broadly applicable to the work of the ASB since its inception”
- Carries the same weight and authority as other ASOPs
- Applies to all ASOPs and all practice areas

Substance of ASOP 1

- **Section 2 – Definitions, Discussions, and Related Guidance: “Must” and “Should”**
 - Subtle but important distinction
 - **Must** = ASB does not envision any scenario where there would be a reasonable alternative
 - **Should** = what is normally the appropriate practice to follow
 - **“Should consider”**
 - In all of these, even “must”, the actuary is allowed to deviate, *if the actuary follows ASOP 41*

Substance of ASOP 1

- **Section 2 -- Definitions, Discussions, and Related Guidance: Actuarial Soundness**
 - Ambiguous term with multiple definitions
 - See the Academy Actuarial Soundness Task Force Paper (published May 2012)
 - (it is available on the Academy website under files/publications)
 - The actuary should define the meaning of actuarially sound *in the context he/she is using it*

Substance of ASOP 1

- **Section 2 -- Definitions, Discussions, and Related Guidance: Materiality**
 - “... its omission or misstatement could influence a decision of an intended user”
 - Purposes of the work and how it will be used
 - Professional judgment
 - Applicable law, standards, or guidelines
 - *ASOPs need not be applied to immaterial items*
 - See Academy’s Discussion Paper on Materiality (published June 2006)

Substance of ASOP 1

- **Section 2 -- Definitions, Discussions, and Related Guidance: Practical or Practicable**
 - “... all possible steps need not always be taken ...”
 - “... a course of action that is likely to yield an appropriate result ...”
 - “... without being unnecessarily time-consuming, elaborate, or costly ...”
 - “... relative to the principal’s needs”

Substance of ASOP 1

- **Section 3 – Purpose and Format of the ASOPs**
 - Identify what “should be considered, done, documented, and disclosed” when rendering actuarial services
 - Intended for use by actuaries who are qualified to do so under Precept 2 of the Code of Professional Conduct (and under the U.S. Qualification Standards)
 - ASOPs don’t cover everything; use professional judgment in new or non-routine situations
 - ASOPs are principles-based: not a how-to manual
 - Analytical framework; allows for professional judgment
 - Reasonable differences in conclusions are possible

Substance of ASOP 1

□ Section 3 – Purpose and Format of the ASOPs

- Law supersedes ASOPs and may result in a deviation
- ASOPs are binding; other actuarial literature is not
- Practice notes, research papers, study notes, text books and journals, etc. may be helpful, but they do not establish actuarial standards of practice and are not binding
- New/revised ASOPs become binding on and after their respective effective dates
- Common format assists in readability and consistency
 - The common format is three parts: transmittal memo, the standard, and appendices: ***only the standard itself is binding***

Substance of ASOP 1

□ Section 4 – Compliance

- Use “good faith” approach: reasonable professional judgment / professional integrity (Precept 1 of the Code) – strained interpretations are not appropriate
- Responsible for determining which ASOPs apply
 - *Consider reviewing the Applicability Guidelines*
- If it is necessary to deviate from the guidance in an ASOP, it is not a breach if disclosed as described in the ASOP
 - *Put your reasons in the file, in writing, at the time you do it, so you can produce it if challenged*

Substance of ASOP 1

□ Section 4 – Compliance

- Failure to comply could be a material violation of Precept 3 of the Code, and also violate Precept 1
- Such failures could result in your being reported to the ABCD and potential discipline (which may include suspension of your credentials or expulsion)
- Such failures could also result in a lawsuit for your errors and omissions (malpractice); the opposing attorney will use the ASOPs as evidence of your errors or omissions
- If ASOPs conflict, consider a Request for Guidance from the ABCD and use good professional judgment

Substance of ASOP 1

- Appendices – Description and Purpose
 - Appendix 1 provides background and additional information
 - Much of this is taken from the original introduction
 - Not guidance, but still useful information
 - Covers the following:
 - ✓ Clarification of language
 - ✓ Role and scope of ASOPs
 - ✓ Development of ASOPs
 - ✓ Organization of ASOPs
 - Appendix 2 discusses the comments on the exposure draft

Intersection with ASOP 41

- **Like all the ASOPs, ASOP 41 is enhanced and clarified by reading ASOP 1**
 - ASOP 41, particularly Section 4.4 “Deviation from the Guidance of an ASOP” discusses disclosing deviations
 - ASOP No. 1, like ASOP 41, deals with broad issues affecting all areas of actuarial practice
 - Discussions of “must”, “should”, “deviation”, “professional judgment” and other terms, along with other provisions such as Section 4 Compliance with ASOPs, help to clarify ASOP 41:
 - ✓ What constitutes deviation from the guidance
 - ✓ When and how do the disclosure requirements apply
 - ✓ What are “Specific Circumstances”

Conclusion

- **ASOP No. 1 provides real Guidance**
 - It is applicable to all actuarial work
 - It will help put the role of the other ASOPs into the context of your daily work
 - It will help you read and use all the other ASOPs
- Read ASOP No. 1 and become familiar with it
- Remember that reading an ASOP, and commenting on an exposure draft, both count as professionalism CE
- **So does participating in this session**

The New ASOP No. 1

QUESTIONS



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ASOP 25: Credibility Procedures

ASOP 25: A Historical Perspective

- Originally adopted, effective March 1, 1997
 - ▣ Applicable to accident & health, group term life, property/casualty coverage and other forms of non-life coverages
- Updated in May 1, 2011
 - ▣ Deviation language modified to be consistent with other ASOPs
- **Second Exposure Draft of Proposed Revision Pending (Comment Period ends September 30, 2013)**
 - ▣ Significant change in scope proposed – would apply to all practice areas
 - ▣ First exposure draft issued in September 2012, with a comment deadline of December 31, 2012

A Caution

- The proposed revision was developed by a Credibility Task Force of the General Committee of the Actuarial Standards Board
- While the Actuarial Standards Board and the General Committee of the ASB to which the Task Force reports have several casualty representatives, the Credibility Task Force had only one CAS member.

Proposed Scope for ASOP 25

- Standard applies when providing actuarial services in the following situations:
 - ▣ When the actuary is required by applicable law to evaluate credibility
 - ▣ When the actuary chooses to evaluate the credibility of subject experience, or states in any related actuarial communication that credibility has been evaluated in accordance with this ASOP
 - ▣ When the actuary is blending or considering blending subject experience with other experience
 - ▣ When the actuary represents the data being used as statistically or mathematically credible.

What Changed from 1st Exposure ?

- Scope of the standard clarified
- Definition of “credibility procedure” added
- Purpose and use of credibility procedures clarified, in particular regarding the continued need for professional judgment
- “Method(s)” and “methodology(ies)” replaced with “procedures”

Definitions

- **ADDED**
- Credibility Procedure – a process that involves:
 - ▣ The evaluation of subject experience for potential use in setting assumptions without reference to other data; or
 - ▣ The identification of relevant experience and the selection and implementation of a method for blending the relevant experience with the subject experience
- **MODIFIED (Used to be Related Experience)**
- Relevant Experience – Sets of data, that include data other than the subject experience, that, in the actuary's judgment, are predictive of the parameter under study (including but not limited to loss ratios, claims, mortality, payment patterns, persistency, or experiences). Relevant experience may include subject experience as a subset.

Definitions (Continued)

- **NO CHANGE** Credibility – a measure of the predictive value in a given application that the actuary attaches to a particular set of data (predictive is used here in the statistical sense and not in the sense of predicting the future)
- **NO CHANGE** Full Credibility – the level at which the subject experience is assigned full predictive value, often based on a selected confidence interval

Purpose & Use of Credibility Procedures

- Purposes are:
 - ▣ To evaluate subject experience for potential use in setting assumptions without reference to other data; and
 - ▣ To improve the estimate of expected values.
- Credibility procedures may be used for
 - ▣ Pricing
 - ▣ Ratemaking
 - ▣ Prospective experience rating
 - ▣ Assumption setting for valuation and modeling

Does ASOP 25 apply in reserving situations?

Selection of Credibility Procedure

- Use an appropriate credibility procedure
 - ▣ The procedure selected or developed may be different for different practice areas and application
 - ▣ Additional review may be necessary to satisfy applicable law
 - ▣ Actuary should consider the predictive value of more recent experience as compared to experience for earlier time periods
- In selecting or developing a credibility procedure, consider:
 - ▣ Whether the procedure is expected to produce reasonable results
 - ▣ Whether the procedure is appropriate for the intended use and purpose; and
 - ▣ Whether the procedure is practical to implement when taking into consideration both the cost and benefit of employing the procedure

Selection of Relevant Experience

- The actuary should use care in selecting the relevant experience
- Relevant experience should have characteristics similar to the subject experience (frequency, severity or other determinable risk characteristics)
 - ▣ If the subject experience is a material part of the relevant experience, use of that experience may not be appropriate
 - ▣ Predictive value can sometimes be enhanced by separate treatment of homogenous segments
- In some instances, no relevant experience is available
 - ▣ In this situation, actuary should exercise professional judgment, considering available subject experience.

Professional Judgment

- Use of credibility procedures is not always a precise mathematical procedure; the actuary should exercise professional judgment
- In some situations, an acceptable procedure for blending the subject experience with the relevant experience may be based on the actuary assigning full, partial or zero credibility to the subject experience without using a rigorous mathematical model

Disclosure

- Whenever appropriate in the actuary's professional judgment, disclose:
 - ▣ The credibility procedures used, and
 - ▣ Any material changes from prior credibility procedures
- Consider disclosures required in ASOP No. 41
 - ▣ If any material assumption or method was prescribed by law
 - ▣ If the actuary states reliance on other sources and thereby disclaims responsibility for any material assumption or method selected by another
 - ▣ If the actuary has otherwise deviated materially from the guidance of the ASOP

Background (Not binding)

- A variety of approaches are used in credibility procedures
 - Classical credibility procedures
 - Empirical credibility procedures
 - Bayesian credibility procedures
 - Procedures involving Generalized Linear Models
(NEW)

Conclusion

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- ASOP 25 is relevant to most actuarial work
- The Comment Period(s) allow you to weigh in on the Standards of Practice
- Make sure to comment before September 30, 2013
- The Committee discusses **EVERY** comment and revises or responds

ASOP 25 (Second Exposure Draft)

QUESTIONS

