

Peer Review

Presentation to 2013 Casualty Loss Reserve Seminar

September 16, 2013

Commitment Beyond Numbers



Joseph A. Herbers, ACAS, MAAA, CERA
Managing Principal

Background on Joe Herbers

- Former COPLFR Member for 14 years, Past Chair
 - Faculty for AAA Seminar on Effective P/C Loss Reserve Opinions
 - Practice Note, Law Manual and Model Audit Rule Subcommittees
- Former member of CPC & FRC of AAA
- Write over 100 reserve analysis reports every year
- Reports are reviewed by internal peer reviewer, auditors, regulators, reinsurers, brokers, etc.
- Involved in audit support work reviewing other actuaries' reports

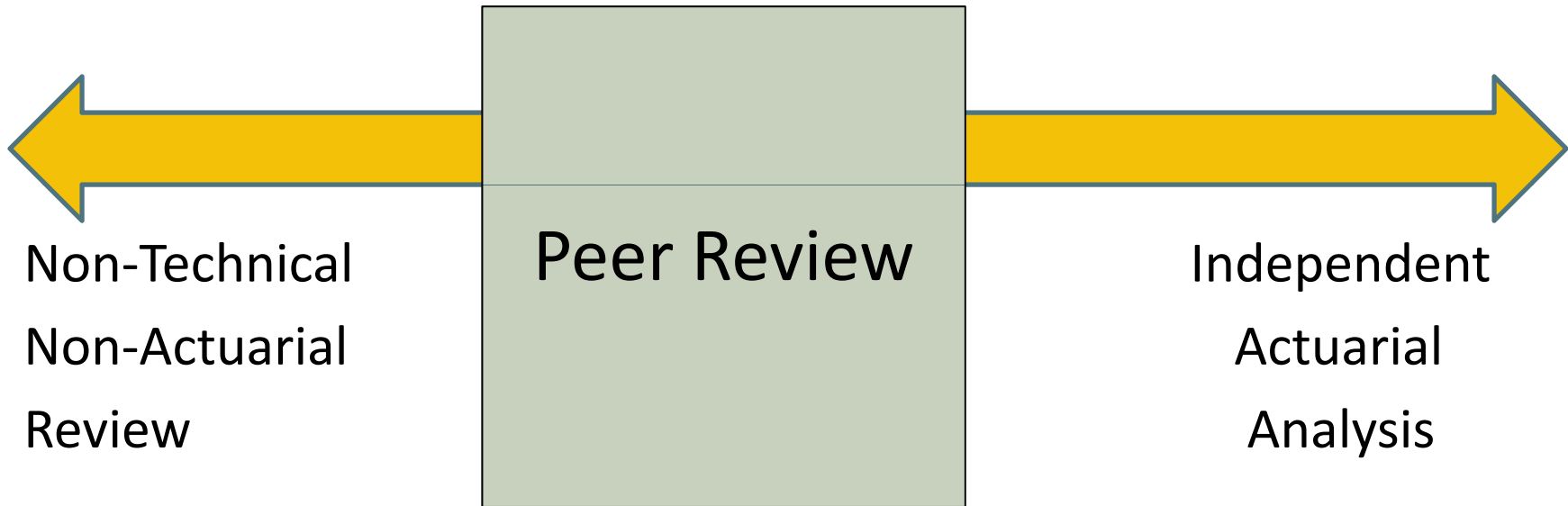
Perspectives on Actuarial Work Products

- Regulators - Rate Filings, Financial Exams, Captive Applications, ORSA Models
- Auditors – SAOs, Self-Insured Reserves, ORSA Models, Risk Transfer
- Reinsurers – Pricing Models, Captive Funding , Risk Transfer
- Competitors – SAOs, Rate Filings, Valuations
- Fronting/Excess Carriers – Reserves/Collateral, Program Business “Books”
- Internal Audit/Board of Directors – Independence

Two Extremes

Simple

Complex



Non-Technical
Non-Actuarial
Review

Peer Review

Independent
Actuarial
Analysis

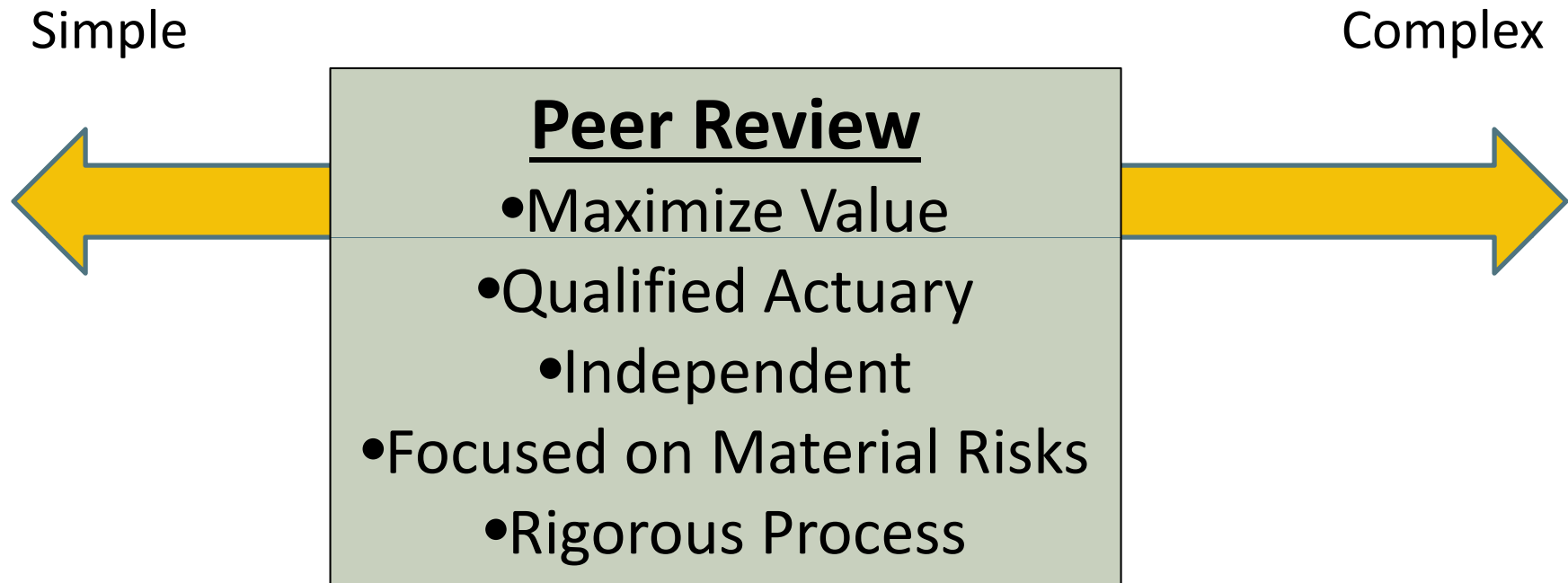
Non-Actuary “Read-Through” - Weaknesses

- Typically not trained actuaries
- Often only cursory reviews
- May have preconceived notions
- Independence from auditor, regulator, or original “principal”, etc.
- Potential inability to deal with complex, intricate or subtle actuarial issues/flaws

Second Independent Actuarial Analysis - Weaknesses

- Time Constraints?
- Expense (especially on smaller programs)
- Incremental Value Worth Cost?
- Hard to fully incorporate unique issues/operational changes as thoroughly as original work product within constraints
- Much of the time, the actuarial work product is fine and the second analysis is largely unnecessary

Two Extremes



Guidance – ASOP 41, Section 3.3.3

“(A)n actuarial report should identify the data, assumptions, and methods used by the actuary with sufficient clarity that another actuary qualified in the same practice area could make an objective appraisal of the reasonableness of the actuary’s work as presented in the actuary’s report.”

Note: Section 3.1 “The requirements of this standard should be applied to the cumulative communications with respect to each specific engagement ...”

Code of Conduct – Precept 4

- **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.**

Resources - 2005 AAA Discussion Paper

AMERICAN ACADEMY OF ACTUARIES

Council on Professionalism

PEER REVIEW

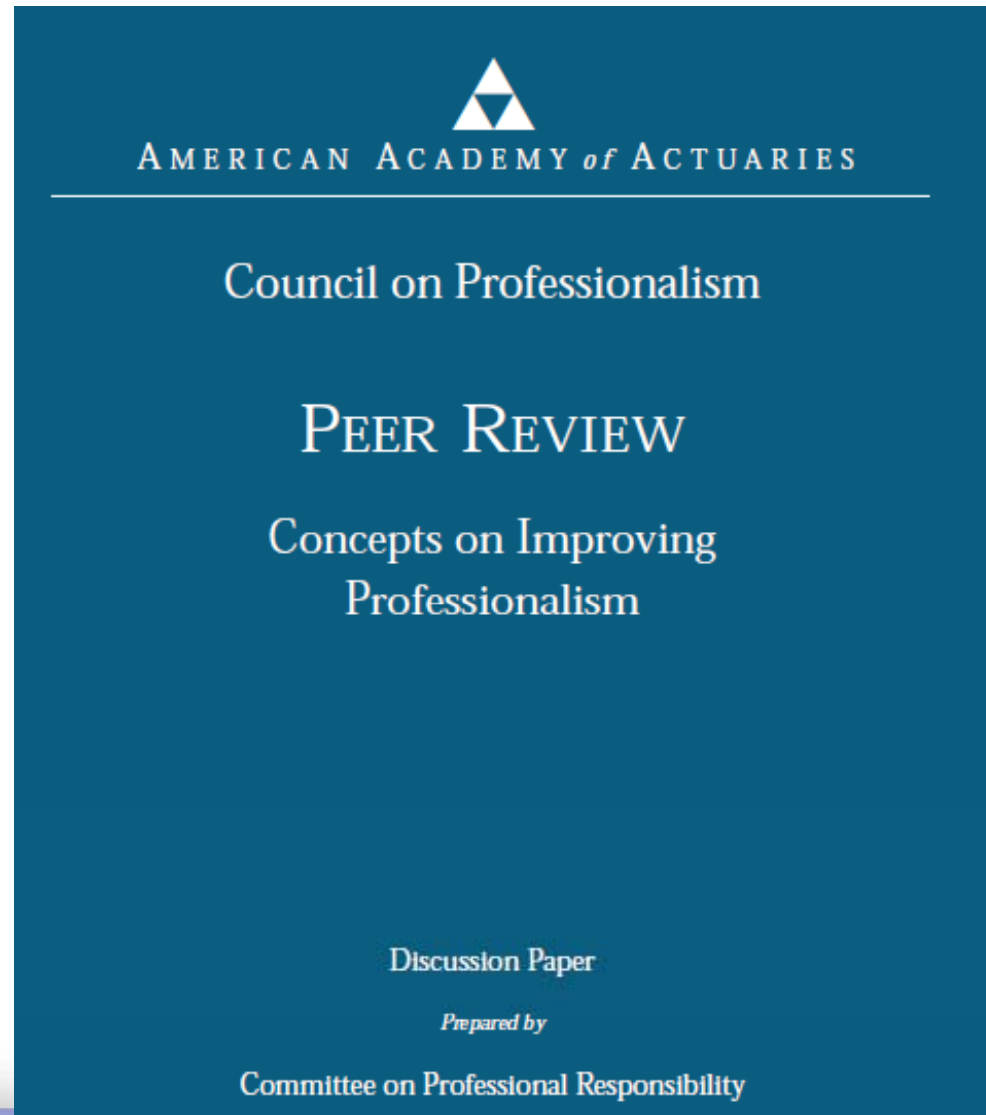
Concepts on Professionalism

Discussion Paper

Prepared by

Committee on Professional Responsibility

1999 AAA Council on Professionalism Paper



Guidance – ASOP 41, Section 3.3.3

“(A)n actuarial report should identify the data, assumptions, and methods used by the actuary with sufficient clarity that another actuary qualified in the same practice area could make an objective appraisal of the reasonableness of the actuary’s work as presented in the actuary’s report.”

Note: Section 3.1 “The requirements of this standard should be applied to the cumulative communications with respect to each specific engagement ...”

Form, Content, Professionalism

ASOP 41 - Actuarial Communications - Supplemental Peer Review Checklist

Company: _____

Yes	No	n/a		ASOP 41 Reference
<u>Requirements for Actuarial Communications:</u>				
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Form & Content are Appropriate for Intended Use	3.1.1
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Clarity of Report for Intended Users	3.1.2
<u>Actuarial Report:</u>				
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Actuarial Findings Clearly Stated	3.2
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Disclose Methods, Procedures, Assumptions and Data Sources	3.2
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Allow Another Qualified Actuary Objectively Appraise for Reasonableness	3.2
<u>Specific Circumstances:</u>				
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Do circumstances exist that constrain including content?	3.3
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	If so, have circumstances been identified and supported	3.3
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Explanation of Material Differences from Prior Report	3.5

ASOP 41 - Actuarial Communications - Supplemental Peer Review Checklist

Company: _____

Yes	No	n/a	<u>Communications & Disclosures:</u>	<u>ASOP 41 Reference</u>
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Identification of Responsible Actuary	4.1.1
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Identification of Actuarial Documents (Date/Subject in Cover Letter)	4.1.2
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Identification of Intended Users (Distribution & Use section)	4.1.3a
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Scope/Purpose of Engagement	4.1.3b
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Acknowledgement of Qualification	4.1.3c
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Cautions Regarding Risk or Uncertainty	3.4.1 & 4.1.3d
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Limitations on Use/Applicability of Actuarial Findings	4.1.3e
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Conflict of Interest	3.4.2 & 4.1.3f
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Reliance on Other Sources for Data/Information	3.4.3 & 4.1.3g
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Data/Information Date Identified	3.4.5 & 4.1.3h
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Subsequent Events Identified	3.4.6 & 4.1.3i
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Disclose Assumptions/Methods Prescribed by Law	4.2
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Disclose Responsibility for Assumptions/Methods	3.4.4 & 4.3
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Deviation from Standard	4.4

NOTE: ANY DEVIATION FROM STANDARD MUST BE DISCLOSED

Components of Peer Review - Form

- Is the client identified?
- Is the actuary responsible for the report identified?
- Is the project scope clearly defined?
- Is the work product clear?
- Are the text and tables well organized?
- Is the report complete?

Peer Review – Form Problems

- Not current with recent standards/practice note
 - Incomplete reports/Exhibits only
 - Benchmarks, methods or assumptions not documented
 - Exhibits not footnoted, can't follow data
 - Hundreds of pages of (often useless) exhibits
-
- ASOPs 41 and 43 really help
 - Problems with Form are often about protecting the actuary and the “principal”
 - Form problems are often precursors to content ones

Components of Peer Review - Contents

- Are assumptions/methods specified?
- Are the assumptions and methods reasonable for the assignment?
- Are the data sources appropriate?
- Are the calculations correct?
- Are the findings reasonable and adequately supported by the analysis?
- Are any reliances and limitations appropriate and clearly delineated?
- Is the potential variability of results adequately discussed?

Peer Review – Content Problems

- Inappropriate Benchmarks (e.g. loss costs, LDFs)
- Inappropriate Methods/Assumptions (e.g. Lognormal CVs)
- Incorrect Interpretation of Coverage (e.g. PCFs)
- Unrealistic Results (e.g. Collateral Reserves $>$ SIR, $75\% <$ Central)
- Lack of Adequate Support (Filings, Captive Applications)
- Improper Recognition of Operational Changes
- Insufficient Data/Credibility
- Data Reconciliation Problems
- Unique Risks – Extended Warranty, Credit
- Unique Reserving Issues
 - Death, Disability & Retirement Extended Reporting
 - Premium Deficiency Reserves
 - Long Duration Contracts

ASOP 43 - Unpaid Claim Estimates - Supplemental Peer Review Checklist

Company: _____

Reference

Yes
 No
 n/a

ASOP 43
Section

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Principal is identified			2.9
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Intended purpose or use is identified			3.1, 4.1
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Are multiple purposes or uses intended?			3.1
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	- If yes, were potential conflicts and adjustments considered?			3.1
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Acknowledge any data, staff or time constraints			3.2, 4.1
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Type of measure is disclosed and described			3.3 a , 4.1 c
			<input type="checkbox"/> Actuarial Central Estimate	<input type="checkbox"/> Discounted?		
			<input type="checkbox"/> Range	<input type="checkbox"/> Interest Rate		
			<u> If a range, disclose basis </u>			4.2 a
			<input type="checkbox"/> Other	<input type="checkbox"/> Risk Margin		
			<input type="checkbox"/> Gross			3.3 b
			<input type="checkbox"/> Net of specified recoverables			
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	- If yes, is collectibility risk considered?			3.3 c
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Type of unpaid claim expense covered in estimate is identified			3.3 d

ASOP 43 - Unpaid Claim Estimates - Supplemental Peer Review Checklist

Company: _____

Reference

Yes	No	n/a		ASOP 43 Section
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Claims to be covered by unpaid claim estimate are adequately described	3.3 e
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Risks posing a material effect disclosed	3.4
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Methods or models are appropriate and clearly documented	3.6.1
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	If only one method is used for a material component, disclosure and discussion of rationale for such is included	3.6.1
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Assumptions are appropriate, unbiased and documented	3.6.2
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	If estimates were calculated using principal's (client) assumptions, disclosure is made.	3.6.2
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Sensitivity to alternate assumptions considered and disclosed if material	3.6.2, 4.1 f
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Relevant known external factors are appropriately considered	3.6.6
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Significant changes in conditions considered	3.6.7
		<input type="checkbox"/>	Reliance on management representations?	
		<input type="checkbox"/>	Were representations reasonable?	

ASOP 43 - Unpaid Claim Estimates - Supplemental Peer Review Checklist

Company: _____

Reference

Yes
 No
 n/a

ASOP 43
Section

Elements of uncertainty considered _____ 3.6.8

If uncertainty is measured, consideration given to independence or correlation
between components of reserve estimates. _____ 3.6.8

Relevant dates are clearly disclosed _____ 4.1 d
 Accounting date
 Valuation date
 Review date

Specific significant risks and uncertainties, if any, disclosed _____ 4.1 e

If an updated analysis, changes in methods and assumptions having a material
impact are disclosed. _____ 4.2 b

Deviation from ASOP 43 disclosed _____ 4.4
 NOTE: ANY DEVIATION FROM STANDARD MUST BE DISCLOSED

Components of Peer Review - Professionalism

- Standards of Practice
- Statements of Principals
- Statements of Actuarial Opinion on Property and Casualty Loss Reserves
- Governing Laws and Regulations
- Applicable Accounting Standards

Peer Review – Professionalism Issues

- Inconsistent with state law (e.g. IL SRP, credit)
- Inconsistent with accounting standards (e.g. PDR, GASB 10 and 30)
- Inconsistent with Practice Note (e.g. DD&R, long duration contracts, reinsurance collectibility)
- Inconsistent with state law (e.g. DC captives) or other domicile (e.g. Bermuda)
- Many professionalism issues lead to material content issues or disclosure issues for interested parties

Dealing With Problems

- **Communicate** (May lead to a revision of the original report or your understanding)
- Limited Analysis – Is the issue material?
- Document
- Take the “High Road”
 - ASOP 21. Responding to or Assisting Auditors or Examiners in Connection with Financial Statements for All Practice Areas
 - PRECEPT 10. An Actuary shall perform Actuarial Services with courtesy and professional respect and shall cooperate with others in the **Principal's interest**.
 - ANNOTATION 10-1. Differences of opinion among actuaries may arise, particularly in choices of assumptions and methods. Discussions of such differences between an Actuary and another actuary, or in observations made by an Actuary to a Principal on the work of another actuary, should be conducted objectively and with courtesy and respect.

Thank You for Your Attention

Joseph A. Herbers, ACAS, MAAA, CERA

309.807.2310

jherbers@pinnacleactuaries.com

