


Risk Focused Exams How Can We Help You? The Big Picture & *The Details*

Karen Adams, ACAS, P&C Actuary
Arizona Department of Insurance

Robert Walling, FCAS, Principal
Pinnacle Actuarial Resources

M. Wendy Germani, FCAS, Consultant

Antitrust Notice

- ▶ The Casualty Actuarial Society is committed to adhering strictly to the letter and spirit of the antitrust laws. Seminars conducted under the auspices of the CAS are designed solely to provide a forum for the expression of various points of view on topics described in the programs or agendas for such meetings.
 - ▶ Under no circumstances shall CAS seminars be used as a means for competing companies or firms to reach any understanding – expressed or implied – that restricts competition or in any way impairs the ability of members to exercise independent business judgment regarding matters affecting competition.
 - ▶ It is the responsibility of all seminar participants to be aware of antitrust regulations, to prevent any written or verbal discussions that appear to violate these laws, and to adhere in every respect to the CAS antitrust compliance policy.
- 

Applicability

- ▶ **This discussion can benefit actuaries performing any or all of the following in support of an insurance company operation:**
 - Consulting Actuary providing exam services
 - Appointed Actuary
 - Chief Actuary
 - Company actuary in following activities:
 - Reserving
 - ERM or Predictive Modeling
 - Insurance Department actuary
 - Actuarial student of any level

The Big Picture

- Take Advantage of Audits
- Take Advantage of SOX/MAR
- Focus on Risk

Insurance
Departments

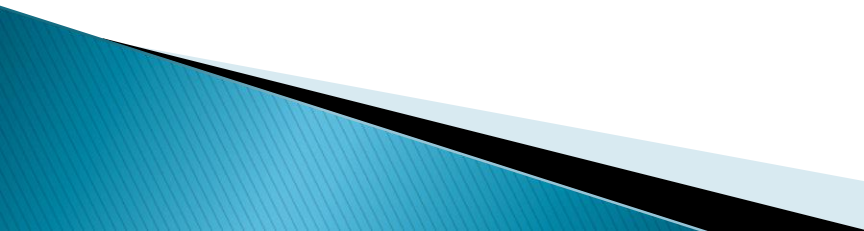
Consulting
Actuaries

Company
/Group

Explanation

- ▶ SOX – Sarbanes Oxley – Enacted in 2002, Applies to all Publicly Traded US Companies.
 - Establish & Evaluate Financial Reporting Controls
 - Requires Attestation from Outside Auditor's
- ▶ MAR – Model Audit Rule– Effective 2010, Applies to companies w \$1,000,000 WP in domestic state.
 - Requires independent audit of internal financial controls
 - WP requirement might vary from state to state

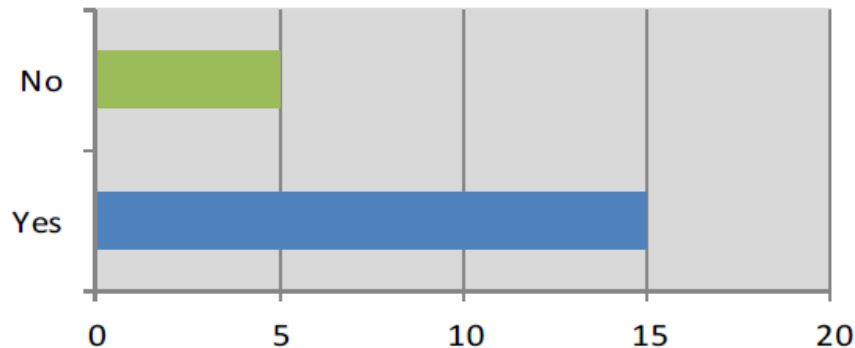
The Big Picture Idea

- ▶ Tailor the Exam to the Company
 - ▶ Be More Effective
 - ▶ Be More Efficient
 - ▶ Spend More Time on Areas of Risk
 - ▶ Spend Less Time Where Co Demonstrates Risk Control–Reliability
- 

Has the Idea Worked?

- Industry Comment Feb. 2012: Depends on Examiner's Expertise

2. Do you believe that examiners have gained a better understanding of your organization and its risks through the risk focused examination process? Please explain.

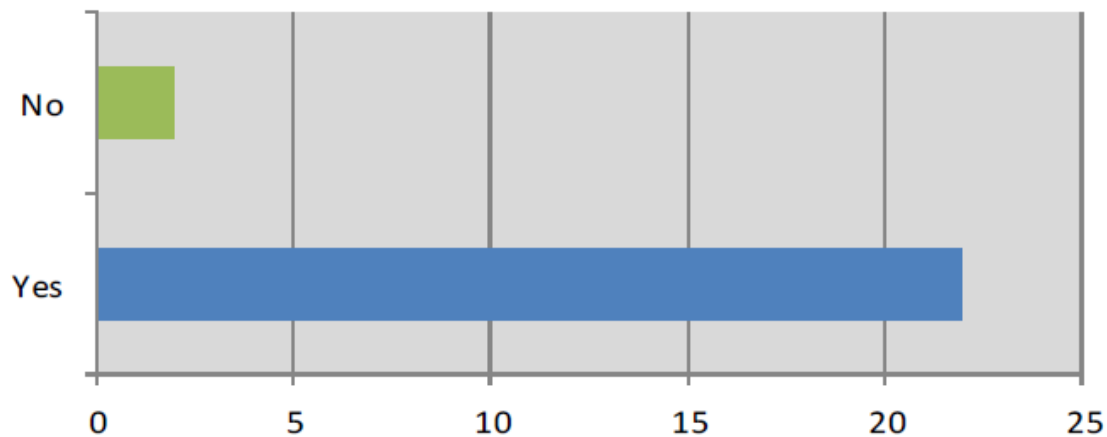


- Source NAIC – Risk Focused Surveillance Working Group Survey

Has the Idea Worked?

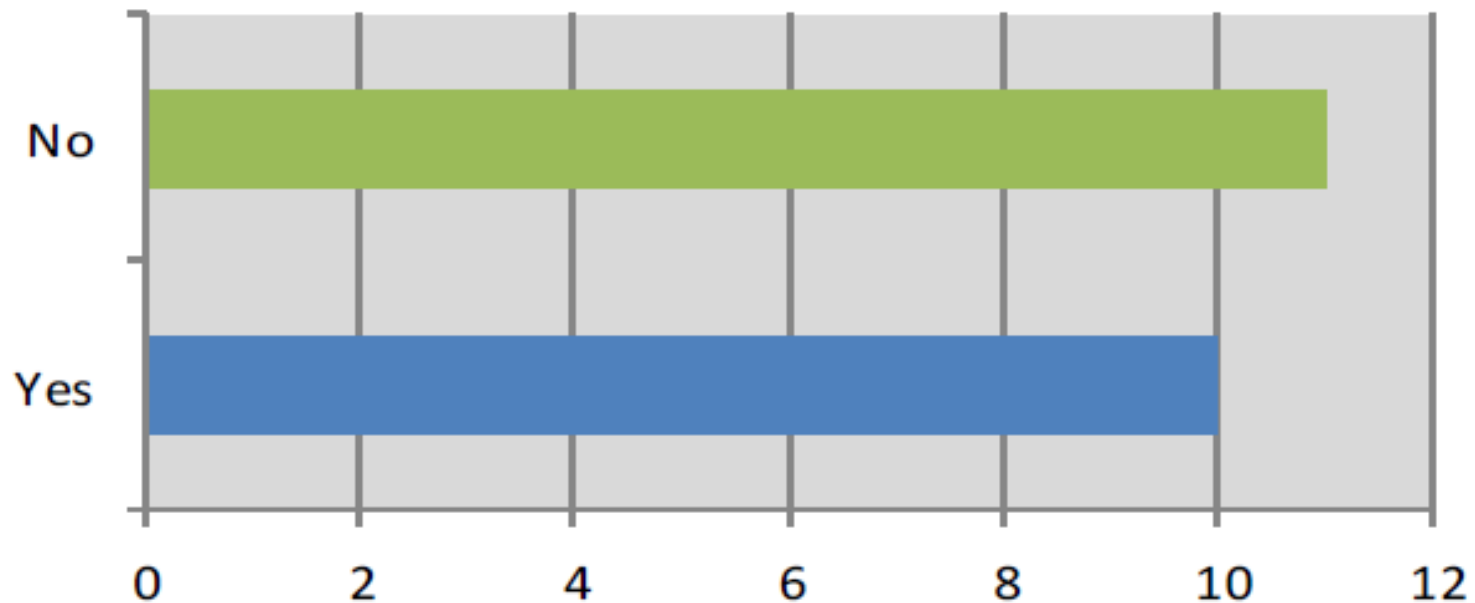
- Oversight by the EIC and Coordination are Important at effective use of specialists

9. Do you believe the "specialists" (actuarial, information technology controls review, investments, reinsurance) review during an examination is in line with the new risk-focused approach? If not, please explain.

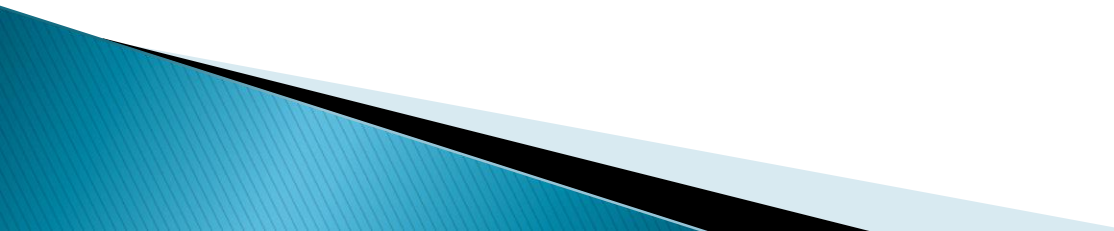


Has the Idea Worked?

- Do You Believe that Examiner's Focus Resources on More Risky Areas?
- As of Feb 12,2012

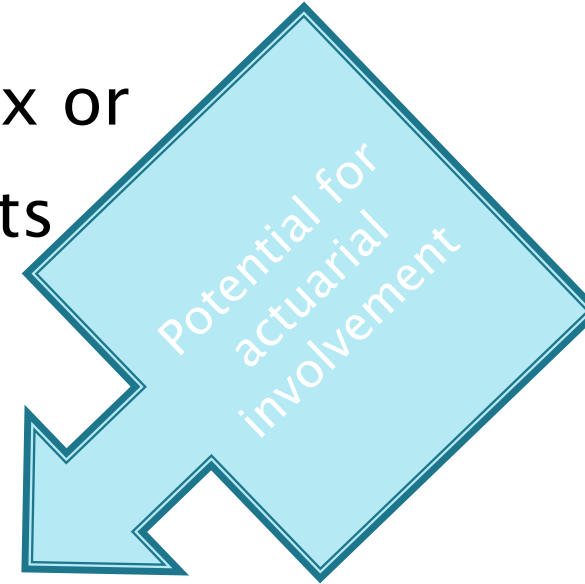


Critical Risk Categories

- 1) New in 2014 Exams
 - 2) Funnel Resource to High Risk Areas and away from lower risk areas
 - 3) Critical Risks must be addressed
 - 4) Non-critical risks addressed at EIC (Examiner in Charge) discretion
- 

Critical Risk Categories

- 1) Valuation/ Impairment of Complex or Subjectively Valued Invested Assets
- 2) Liquidity
- 3) Investment Portfolio
- 4) Reinsurance Program
- 5) Reinsurance Reporting and Collectability



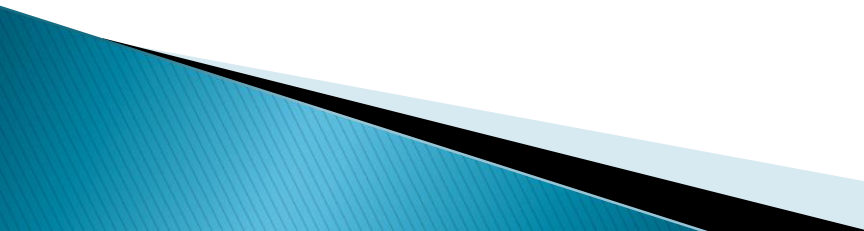
The Big Picture – Phases

- ➔ (1) & (2) understanding the Co. and identifying areas of risk (Interviews, review work papers)
- ➔ (3) Documenting controls
 - ▶ (4) Determining residual risk,
- ➔ (5) Test high & moderate residual Risk
 - ▶ (6) & (7) Updating supervisory plan, and drafting the examination

The Big Picture

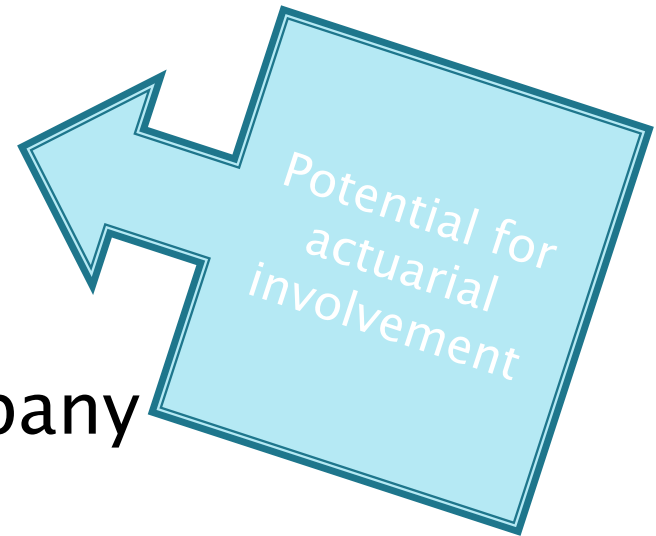
- ▶ Which of these is Something Your Company (or a Company you opine for) must Manage?
 - a) Pricing
 - b) Adverse Selection
 - c) Underwriting
 - d) Catastrophes
 - e) Reserving
 - f) Reinsurance
 - g) Changing Regulatory Environment – ACA
 - f) Insurance Fraud
 - g) Judicial Environment
- 

The Big Picture

- ▶ Risks Exist For All Insurance Companies
 - ▶ The RF-Exam Investigates and Documents How the Company Mitigates the Risk
 - Now
 - Prospectively
 - ▶ The RF-Exam Checks Controls for Effectiveness (& Documentation)
 - ▶ The RF-Exam Tests Balance Sheet Items not Mitigated Sufficiently
- 

Critical Risk Categories

- 6) Underwriting and Pricing
- 7) Reserve Data
- 8) Reserve Adequacy
- 9) Related Party/Holding Company
- 10) Capital Management



The Details – Controls

- ▶ A “control” is under the jurisdiction and direction of company management.
- ▶ A “Control” reduces risk
- ▶ NAIC Guidelines Require Documentation

The Details – Def. of Controls

- ▶ Systematic measures (such as reviews, checks instituted by an organization to:
 - ▶ 1) Conduct its business in an orderly and efficient manner;
 - ▶ 2) Safeguard its assets and resources;
 - ▶ 3) Deter and detect errors, fraud, and theft;
 - ▶ 4) Ensure accuracy and completeness of its accounting data;
 - ▶ 5) Produce reliable and timely financial and management information; and
 - ▶ 6) Ensure adherence to its policies and plans.

The Details – PHASE 3 VS. PHASE 5

- ▶ ▪ Phase 3 – Identify and Evaluate Controls
- ▶ ▪ Phase 5 – Conduct Detail Testing Procedures

- ▶ Initial Risk
- ▶ – Effectiveness of Controls
- ▶ +/- Exam Team Judgment

Residual Risk & Need for Further testing

The Details – Control Examples

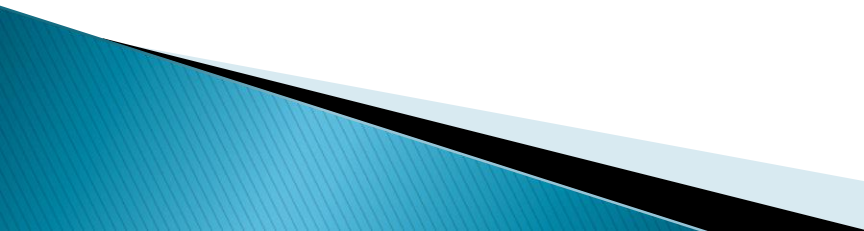
Written Company Policy : Book Opining
Actuary's Central Estimate

Company Procedure: Actuarial Report
presented to Board and Discussed in Detail and
Documented

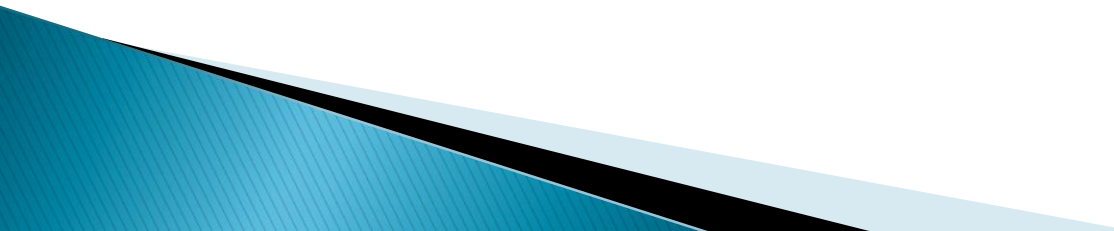
Company Choice: External Peer review by well
respected firm conducted bi-annually. Results
are discussed & incorporated.



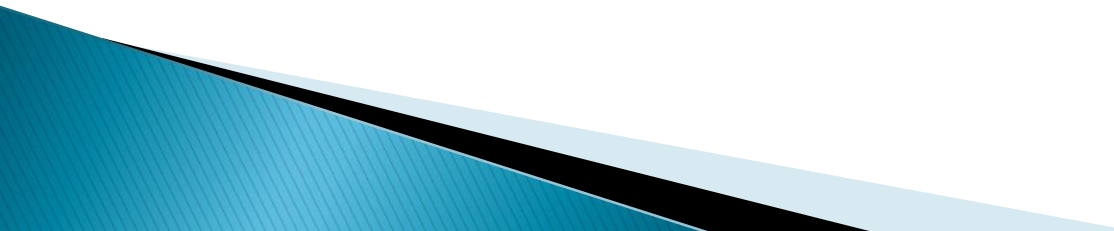
The Details – Controls

- ▶ Which of these is a control?
 - a. The company has always hired an FCAS.
 - b. The Department of Insurance enforces specific UEPR calculations.
 - c. It is obvious that our reserves are redundant.
 - d. Case reserves are reviewed by the opening actuary for changes in case reserve adequacy.
 - e. Consistency within Annual Statement is enforced by the NAIC.
- 

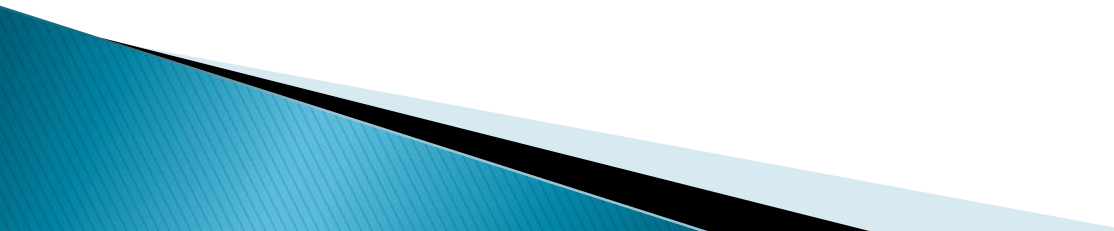
The Actuaries – Company Actuary

- ▶ Document – Pricing, Underwriting
 - ▶ Document – Data checking
 - ▶ Document – Board Meeting minutes
 - ▶ Document – Controls, Testing
 - Document – Reviews, Reconciliations
- 

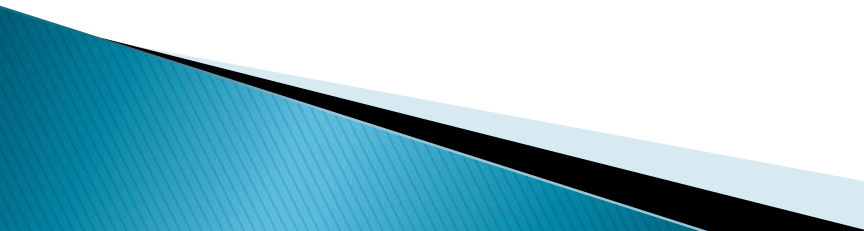
The Actuaries – Regulatory Actuaries

- ▶ **Department Actuaries**
 - ▶ **Consulting Actuaries**
 - ▶ **Both – Working Closely Together**
 - ▶ **Varies by State and Exam**
- 

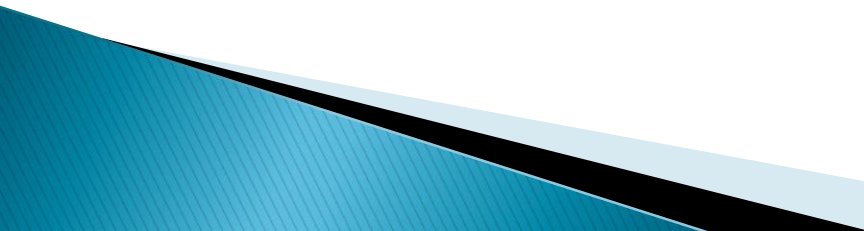
Regulatory Actuary – Issues

- ▶ Budgeting and Timing must be Flexible
 - Some states budget by phase
 - ▶ Each State Will be different
 - ▶ Roles of Consulting and Department Actuaries are Evolving
- 

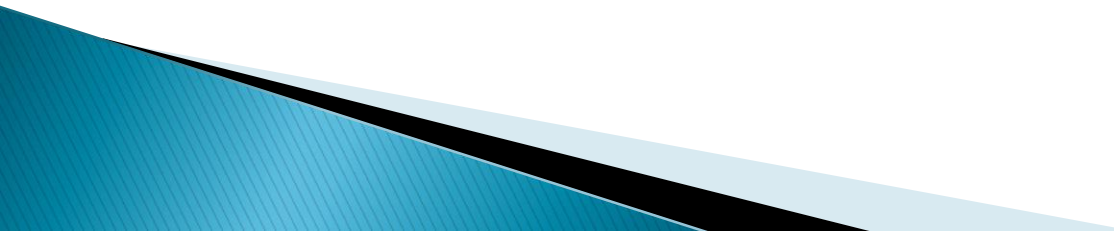
Consulting Actuary – Challenge

- ▶ My actuarial firm has been asked to submit a bid for the examination of Longtail Ins. Co. as of 12/31/20XX
 - ▶ I have the annual statement, the opinion, and the 2nd quarter statement
 - ▶ The 2nd quarter statement shows case reserves increased dramatically, and IBNR taken down dramatically.
 - ▶ What Should I put in my bid?
 - ▶ Should I ask for more Information?
- 

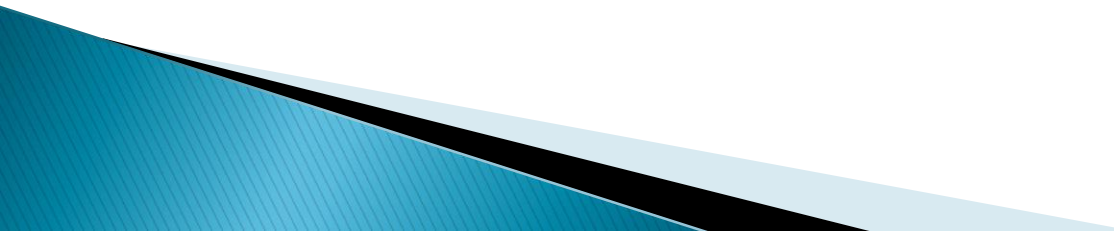
Regulatory Actuary – Challenge

- ▶ We need to contract with an actuarial Firm for a Risk Focused Exam
 - ▶ We think that the exam will be straight forward with regard to the actuarial analysis
 - ▶ Once before, the actuarial team uncovered some unknown issues, but it is unlikely that will happen this time.
- 

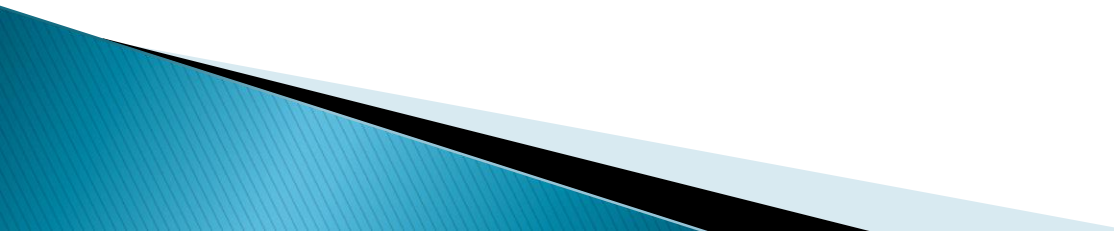
Regulatory Actuaries Should Expect

- ▶ To be involved at the onset
 - ▶ Offer guidance to non-actuaries on sources of risk.
 - ▶ Provide advice/brainstorming on potential risks. What makes this company different?
 - ▶ Understand the steps in the risk focused process
- 


Regulatory Actuaries Should Expect

- ▶ Work closely with the EIC (Examiner in Charge)
 - ▶ Document and Communicate
 - ▶ Review the opening actuary's actuarial Report or (less likely)
 - ▶ Perform an independent reserve analysis
- 

Regulatory Actuaries Might Be

- ▶ Leading Interviews
 - ▶ Involved in Interviews with Company Executives
 - ▶ Documenting Controls and Tests
 - ▶ Determining Residual Risk
 - ▶ Filling Out Risk Matrices
 - ▶ Expected to have knowledge of Team Mate
 - The NAIC exam documentation software
- 

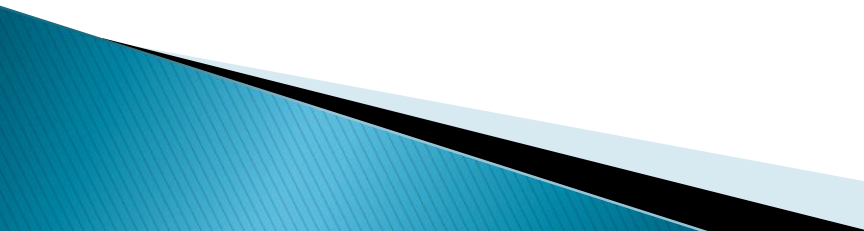
Regulatory Actuaries Should Expect

- ▶ The Examiner-in-Charge (EIC) to take the lead in Communication and Coordination with respect to a risk focused examination
 - ▶ To be proactive with Communication
 - ▶ Be involved in Periodic meetings and/or status reports between EIC and Actuary.
 - ▶ Expect the unexpected
- 

Company-Opining Actuaries Should Expect

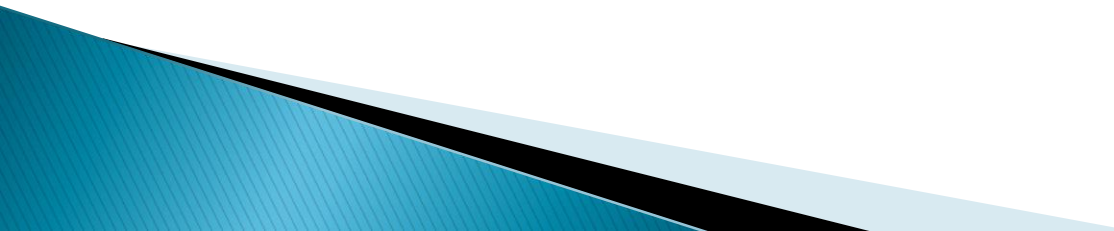
- ▶ To be asked questions about risk and how your company manages risk
- ▶ How do you communicate reserve values to the Board of Directors?
- ▶ To provide documents to state examiners for review and inspection.
 - Actuarial reports
 - Pricing history

Appointed Actuaries Should Expect

- ▶ Actuarial Opinions, Summaries and Reports will be thoroughly reviewed by regulators
 - ▶ The Opinion and Actuarial Report must be presented to the Board of Directors, or Audit Committee for their review and consideration.
 - ▶ “A well prepared and documented Actuarial Report that is consistent with the spirit of ASOP 9 can provide a foundation for efficient reserve evaluation within a statutory examination.”
- 

The Challenge – Consulting Actuary & Co Actuary

“The reserving assumptions and methodologies used by the insurer are not appropriate for the lines of business written.”

- ▶ How will the regulatory actuary determine the answer to this question?
 - ▶ What questions will the regulatory actuary ask?
 - ▶ How will the company actuary answer them?
- 

The Challenge to Consulting Actuary

- ▶ The State Insurance Department examiner is still asking me to provide an independent analysis of the Company's carried loss reserves, including a full actuarial report. What should I do?

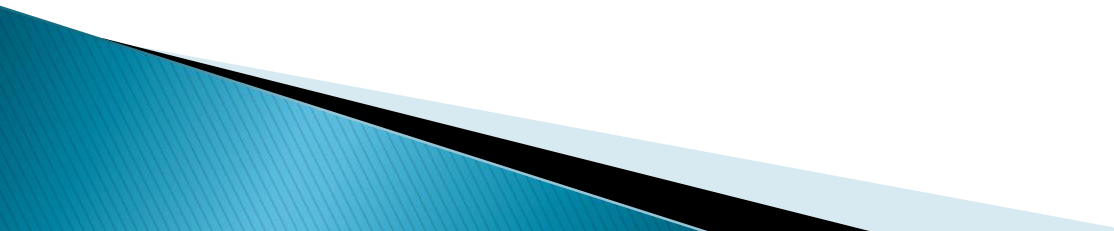
The Challenge to Consulting Actuary

- ▶ The State Insurance Department examiner is has asked me to review the opining actuary's report.
- ▶ The premiums are used as the exposure base, but
 - The premiums have not been adjusted for rate changes
 - The premiums are not consistent with other information I have received.
- ▶ The company has been expanding rapidly in a litigious state & the actuary does not split the data by state.
- ▶ The actuary relies heavily of the Freq Severity method and company claim triangles, but there may be issues with the data.

The Challenge – Consulting Actuary

- ▶ The State Insurance Department examiner is asking me to assist in the inherent risk assessment process and writing risk statements. What are risk statements and how do I do that?

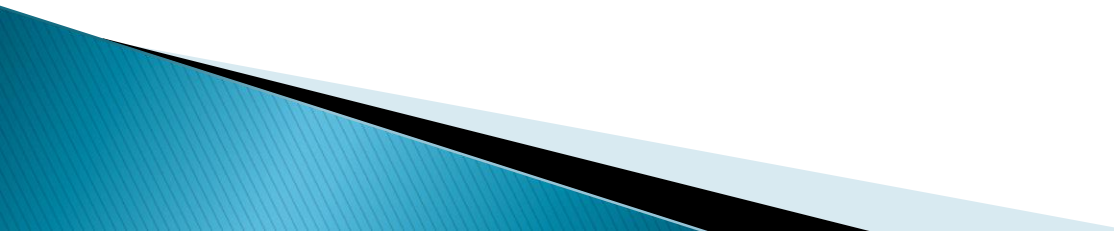
The Challenge – Company Actuary

- ▶ Every year my company hires an outside actuarial firm to write the Statutory Opinion filed with the Annual Statement. Why do the state examiners still want to talk to me and my staff? We are already busy trying to keep up with management's demands for our time.
- 

The Challenge – Consulting Actuary

- ▶ The State Insurance Department examiner has asked for my thoughts on the company's controls about their reserving process. I don't remember control testing being addressed on any of my actuarial exams. What does he mean?

The Challenge –Appointed Actuary

- ▶ As Appointed Actuary for my client, I always conclude that reserves are reasonable and there is no risk of material adverse deviation. The Company's carried reserves are always within my range of estimates, so why do the state examiners want to talk with me?
- 

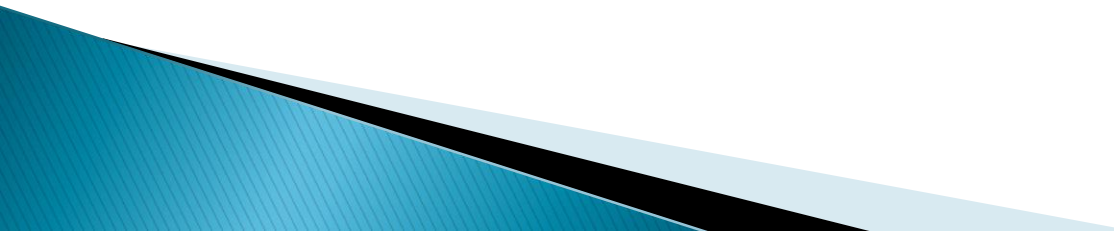
The Challenge – Consulting Actuary

- ▶ The State Insurance Department examiner is asking me for my Residual Risk Assessment. What does that mean and how do I determine the answer?

The Challenge – Consulting Actuary

- ▶ The State Insurance Department examiner is telling me that the residual risk for the reserves process is moderate and he needs help with substantive testing. What kind of actuarial analysis is acceptable?

Other Considerations

- ▶ Holding Company Act / Form F
 - ▶ ORSA (Own Risk Solvency Assessment)
 - ▶ International Operations
 - ▶ Supervisory Colleges
 - ▶ Model Audit Rule
 - ▶ FIO – IASA
- 

ORSA – Own Risk and Solvency Assessment

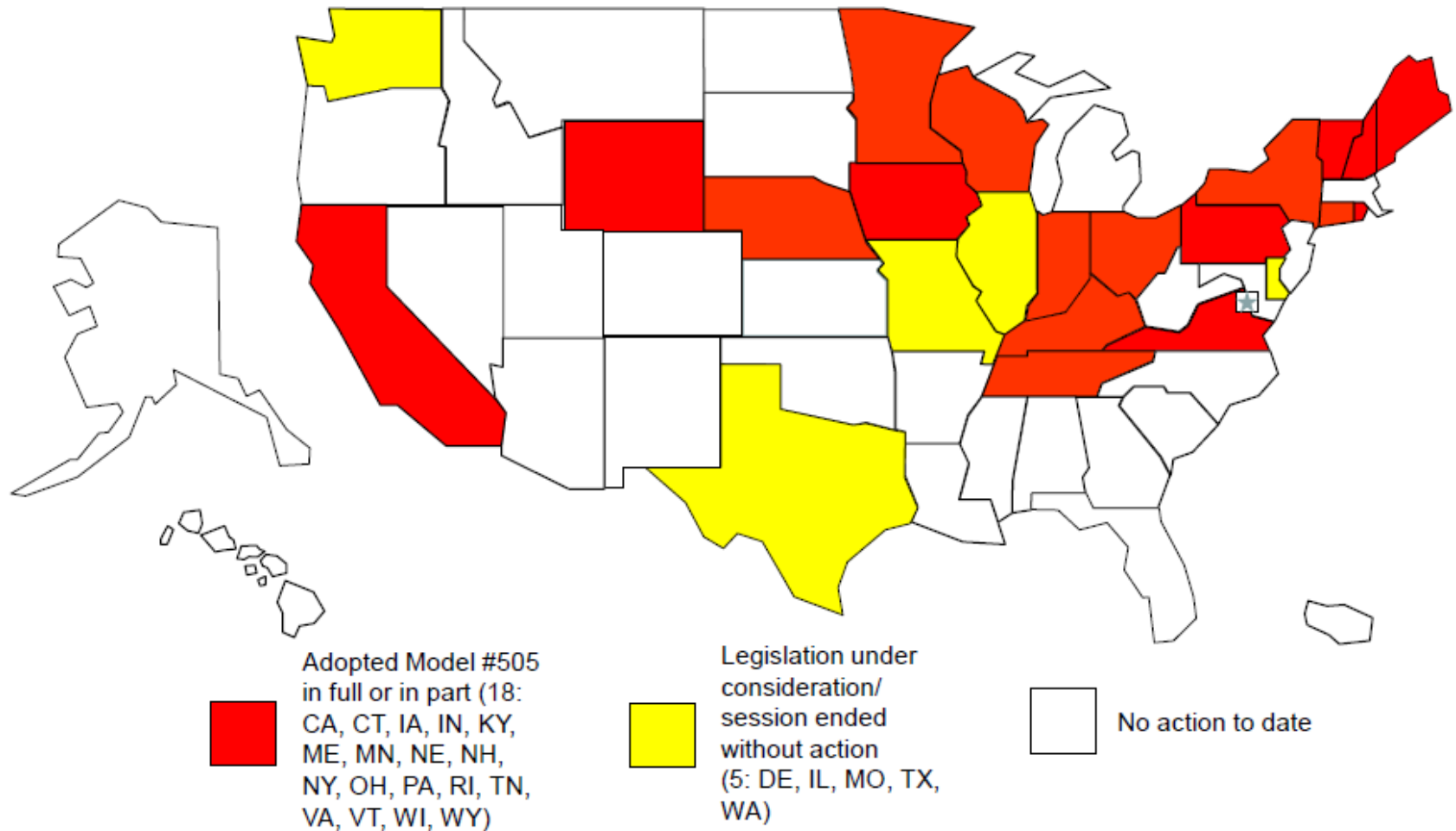
- ▶ Applies to
 - A) Individual Companies with Revenue of \$500M or more
 - B) Groups with Revenue of \$1 B or more.

Purpose 1: Foster Good ERM practices

Purpose 2: Provide a group level view

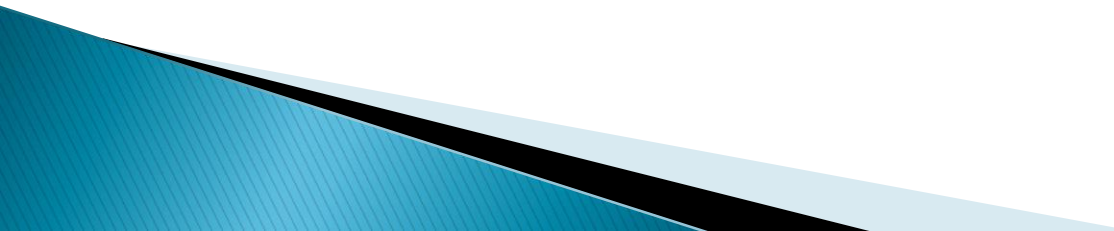
It is not clear at this time how the ORSA will be used in an Risk Focused Exam.

Implementation of Model Act #505
Risk Management and Own Risk and Solvency Assessment Model Act
[status as of July 15, 2014]



This map represents state action or pending state action addressing the topic of the model. This map does not reflect a determination as to whether the pending or enacted legislation contains all elements of the model.

ORSA – Own Risk and Solvency Assessment

- ▶ **Section 1** – Description of the Insurer's Risk Management Framework
 - ▶ **Section 2** – Insurer's Assessment of Risk Exposure
 - ▶ **Section 3** – Group Assessment of Risk Capital and Prospective Solvency Assessment
- 

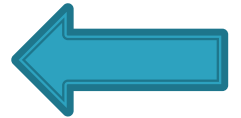
ORSA – Applicable ASOPs

- ▶ ERM ASOPs
- ▶ 46. Risk Evaluation in Enterprise Risk Management (Doc. No. 165; September 2012)
- ▶ 47. Risk Treatment in Enterprise Risk Management (Doc. No. 169; December 2012)

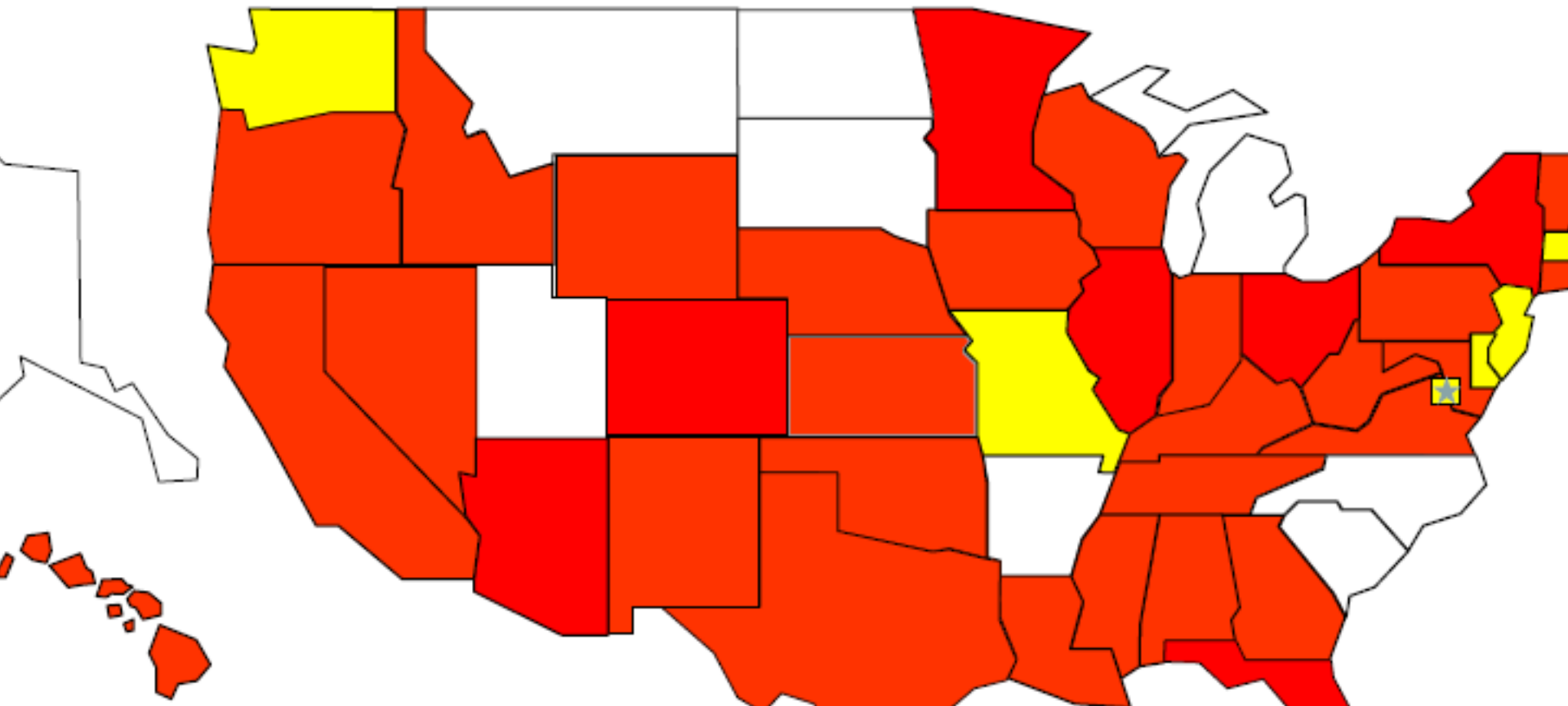
Many of the other ASOPs apply as well. Some of the more obvious are Communication & Disclosure, Modeling, Data Quality, Trending, Credibility, Unpaid Claim Estimates

Holding Company Act

- ▶ Form A Statement Regarding M&A with a Domestic Insurer
- ▶ Form B Insurance Holding Company System Annual Registration Statement
- ▶ Form C Summary of Changes
- ▶ Form D Prior Notice of a Transaction
- ▶ Form E Pre-Acquisition Notification Form
- ▶ Form F Enterprise Risk Report



[status as of July 15, 2014]



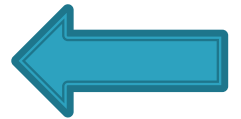
Adopted Model #440
in full or in part (37:
AL, AZ, CA, CO, CT,
FL, GA, HI, ID, IA, IL,
IN, KS, KY, LA, ME,
MD, MN, MS, NE, NM,
NV, NH, NY, OH, OK,
OR, PA, PR, RI, TN,

Legislation under
consideration/
session ended
without action (6:
DE, DC, MA, MO,
NJ, WA)


No action to date

HCA – Form B

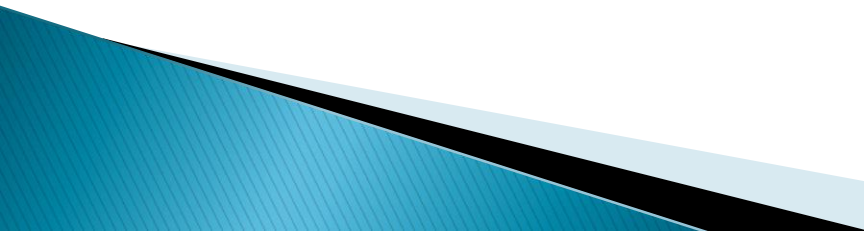
- ▶ Organizational Structure
- ▶ Nature and function of all entities, including
 - Non-Insurance affiliates
 - Non-US entities
- ▶ Reinsurance
- ▶ Dividends
- ▶ Other : Loans, Guarantees, Litigation



HCA – Form F – Enterprise Risk

- ▶ Material developments regarding strategy, internal audit findings, compliance or risk management
 - ▶ Acquisition or disposal of insurance entities and reallocating of existing financial or insurance entities •
 - ▶ Any changes of shareholders of the insurance holding company system exceeding ten percent (10%) or more of voting securities;
- 

HCA – Form F – Enterprise Risk

- ▶ Annual confidential supplement identifying material risks within the insurance holding company system that could pose financial and/or reputational contagion to the insurer
 - ▶ •Applies to all holding companies—no size distinction
 - ▶ •Note that Form F filing will be unique to each insurer
- 

Reference– Exhibit DD p1

▶ **EXHIBIT DD**

▶ **CRITICAL RISK CATEGORIES**

- ▶ One of the goals of a risk-focused examination is to focus on the most critical financial solvency risks facing an insurer. To assist the examination team in meeting this goal, a list of critical risk categories has been developed for consideration in reviewing the adequacy of risk statements developed for each examination. The initial identification of risks in Phase 2 should utilize the understanding of the company gained in Phase 1 as well as a consideration of branded risk categories, exam assertions, etc. The critical risk categories can then be used at the end of Phase 2 to ensure that the risks identified through this process cover some of the most commonly identified solvency risks identified by insurance regulators. The expectation is that each critical risk category will be addressed by at least one risk statement on a key activity matrix (or Exhibit V). Alternately, if the exam team determines that a particular category is not applicable or critical to the company being examined, an explanation may be provided within the Examination Planning Memorandum.
- ▶ The critical risk categories take into consideration both financial reporting and other than financial reporting risks, which categories would be common to most insurers and the typical impact of a risk category on the current and prospective financial solvency of an insurer. Additional risks beyond the critical risk categories are expected to be identified and reviewed through the examination process at the discretion of each examination team as described in Section 2 of the Handbook.
- ▶ To demonstrate that the examination has covered each of the relevant critical risk categories, the template below should be completed to demonstrate where in the exam file each critical risk area is addressed. This may be accomplished by providing reference to each individual risk statement that addresses each critical risk category. In situations where a particular critical risk category is not addressed by at least one risk statement, the exam team should provide reference to an explanation provided within the Examination Planning Memorandum.

Reference– Exhibit DD p2

Critical Risk Category Reporting Template

Risk Category	Description	Where Addressed
Valuation/ Impairment of Complex or Subjectively Valued Invested Assets	This category encompasses the valuation of particularly complex or subjectively valued investment holdings significant to the insurer, including assets that are hard-to-value, high-risk and/or subject to significant price variation, with a focus on current valuation. The likelihood of security impairment and determination of whether those impairments are other than temporary would also be an area to consider.	<i>Example Comment: See Risks 2.1 and 3.1 on the Investments Matrix</i>
Liquidity Considerations	This category encompasses the ability of the insurance company to meet current contractual obligations, which could include liquidating assets or obtaining adequate funding without incurring unacceptable losses. This category is most relevant for near-term cash flow needs that could impact the insurer (1-2 years).	<i>Example Comment: This critical risk category was not deemed relevant. See a discussion in the EPM at A.5.3.</i>
Appropriateness of Investment Portfolio and Strategy	This category encompasses whether the insurer's investment portfolio and strategy are appropriately structured to support its ongoing business plan. Considerations may include elements of the ongoing investment strategy such as asset diversification, quality, maturities, and risk/reward considerations, which could impact the insurer's vulnerability to future market fluctuations and impairments. For long-term lines of business in particular, these considerations would address asset adequacy testing/liability matching.	<i>Example Comment: See Risks 5 and 6 on Exhibit V at A.7.3.</i>

Reference– Exhibit DD p3

<p>Appropriateness/Adequacy of Reinsurance Program</p>	<p>This category encompasses the overall reinsurance strategy of the insurer, whether the strategy is appropriate to support its ongoing business plan and whether adequate coverage is in place to address the insurer's risk exposures (e.g. catastrophe risks, morbidity risk, etc.). Considerations may include the quality of reinsurance counterparties, types of coverage in place, associated limits, net retentions, concentration of reinsurance cessions, coverage periods, terms, affiliated agreements, etc.</p>	
<p>Reinsurance Reporting and Collectibility</p>	<p>This category encompasses whether all reinsurance amounts are properly accounted for and reported by the insurer. Considerations may include the existence and valuation (including collectibility) of reinsurance recoverable amounts and reserve credits. In addition, proper accounting and reporting/disclosure for risk transfer issues may be considered.</p>	
<p>Underwriting and Pricing Strategy/Quality</p>	<p>This category encompasses whether the insurer has appropriate underwriting, pricing and marketing practices (including premiums management) to meet its financial solvency needs. Considerations may include whether the insurer has established and implemented appropriate risk exposure limits and underwriting guidelines, whether the insurer is establishing adequate rates for the risks assumed under its policies and expense structure, and whether these strategies and practices are consistently applied across the insurer's distribution channels.</p>	
<p>Reserve Data</p>	<p>This category encompasses whether selected elements of the underlying data utilized by the actuary in reserve calculations are complete and accurate. Considerations may include claim or in-force data depending on the lines of business and reserving methodologies utilized by the insurer.</p>	
<p>Reserve Adequacy</p>	<p>This category encompasses the overall accuracy and adequacy of the reported reserves. Considerations may include the assumptions and methodologies used as well as the accuracy of reserve calculations. This category may apply to various forms of significant reserves carried by an insurer including life reserves, IBNR reserves, case reserves, LAE reserves, policy reserves, premium deficiency reserves, etc.</p>	
<p>Related Party/Holding Company Considerations</p>	<p>This category encompasses transactions and agreements arising from relationships with affiliates that affect the insurer's ongoing solvency position. Considerations may include inequitable contract provisions, the impact of guarantees, contagion risks extending from holding company operations, inter company tax issues, etc.</p>	