



Lights! Camera! Professionalism!

2014 CAS Casualty Loss
Reserving Seminar
Committee On Professionalism Education



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.**





Disclosures

Legal Disclosure

The views expressed by the panelists are their own and may not necessarily reflect those of their respective employers.

Non-Legal Disclosure

This session discusses professionalism “gray areas.” It is not our intent to give you “answers”, but instead to have open discussions on these situations. If you need additional guidance, please consult the ABCD.





Agenda

- Professional Guidance
- Skit
- Small Group Discussion
- Large Group Discussion
- Takeaways





Professionalism Skit: Non-Practicing Actuary

Committee on Professionalism
Education



Professional Guidance

- Precept 1 of the Code of Conduct: “An Actuary shall act honestly, with integrity and competence, and in a manner to fulfill the profession's responsibility to the public and to uphold the reputation of the actuarial profession.”



Professional Guidance

- Statement of Principles Regarding P&C Loss and Loss Adjustment Reserves

Section II. Principles

- 1. An actuarially sound loss reserve is a provision, based on estimates derived from *reasonable assumptions* and appropriate actuarial methods for the unpaid amount required to settle all claims, whether reported or not, for which liability exists on a particular accounting date.
- 3. The uncertainty inherent in the estimation of required provisions for unpaid losses or loss adjustment expenses implies that a range of reserves can be actuarially sound. The true value of the liability for losses or loss adjustment expenses at any accounting date can be known only when all attendant claims have been settled.



Professional Guidance

- Statement of Principles Regarding P&C Loss and Loss Adjustment Reserves

- III Considerations: Understanding the trends and changes affecting the data base is a prerequisite to the application of actuarially sound reserving methods. A knowledge of changes in underwriting, claims handling, data processing and accounting, as well as changes in the legal and social environment, affecting the experience is essential to the accurate interpretation and evaluation of observed data and the choice of reserving methods.



Professional Guidance

● ASOP 1: Introductory ASOP

Section 4. Compliance with ASOPs

- 4.1 ASOPs are binding upon actuaries. Failure to comply with an applicable ASOP results in a breach of the Code. Such breaches subject the actuary to the profession's counseling and discipline processes.
- 4.2 Actuaries should take a good faith approach in complying with ASOPs, exercising good judgment and professional integrity. It is not appropriate for users of ASOPs to make a strained interpretation of the provisions of an ASOP.



Professional Guidance

- ASOP 41: Actuarial Communications

- Section 3.5 Explanation of Material Differences—If a later actuarial communication produced by the same actuary, which opines on the same issue, includes materially different results or expresses a different opinion from the former communication, then the later communication should make it clear that the earlier results or opinion are no longer valid and explain why they have changed. If the later communication is oral, the actuary should follow-up with a document that clarifies the reason(s) for the changes.



Professional Guidance

- ASOP 21: Responding to or Assisting Auditors or Examiners in Connection with Financial Statements for All Practice Areas
 - Section 2.5 Responding Actuary – An actuary expressly designated by an entity to respond to the auditor or examiner with respect to specified elements of the entity’s financial statement that are based on actuarial considerations. An entity may expressly designate one or more actuaries as responding actuaries for a particular audit or examination.



Professional Guidance

- ASOP 21: Responding to or Assisting Auditors or Examiners

Section 3.1 Responsibilities of the Responding Actuary

- 3.1.1 Data, Assumptions, and Methods – The responding actuary should be prepared to discuss with the auditor or examiner the following items, based on existing documentation, underlying those elements of the financial statement for which the actuary is the responding actuary:
 - a. the data used;
 - b. the source of prescribed assumptions, if any;
 - c. the methods used; and
 - d. the basis for assumptions that are not prescribed assumptions.



Professional Guidance

- ASOP 36: Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves
 - Section 3.7 Reserve Evaluation—The actuary should consider a reserve to be reasonable if it is within a range of estimates that could be produced by an unpaid claim estimate analysis that is, in the actuary’s professional judgment, consistent with both ASOP No. 43, Property/Casualty Unpaid Claim Estimates, and the identified stated basis of reserve presentation.



Professional Guidance

- ASOP 36: Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves
 - Section 3.7 Reserve Evaluation, Con't – The actuary should consider the relevant characteristics of the entity's exposures to the extent that they are likely to have a material effect on the results of the actuary's reserve evaluation.



Professional Guidance

- ASOP 43: Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves
 - Section 3.6.2 Assumptions—The actuary should consider the reasonableness of the assumptions underlying each method or model used....The actuary should consider the sensitivity of the unpaid claim estimates to reasonable alternative assumptions.



Skit Background

- Robin Actuary is the reserving actuary for ABC Insurance Co.
- Robin was promoted to this position three years ago when the former reserving actuary, Dallas Finance, was promoted to CFO at ABC.
- Dallas is a non-practicing actuary. Robin has been signing the reserves for the past three years.



Skit Background

- The external auditors have asked Robin to analyze the tail selection for the workers compensation line of business.
- ABC has an old (30 years) Worker's Compensation (WC) book, but they no longer actively write WC. Their WC premium is about \$5M per year, which is about 10% of what they wrote five years ago.



Skit Background

- Robin puts a team of claims adjusters, actuarial analysts and a consultant to review old WC claim files.
- At the end of the project, Robin presents the results to Dallas.





Lights, Camera, Action!



General Questions

- Can Robin use last year's tail factor and “move” towards the newly calculated factor?
- Can she ask the external auditors for additional back up? (Why did the auditors ask for a review of the tail factor?)
- Can Robin sign the reserves without the \$250M IBNR?
- What are Dallas' responsibilities given the fact that he signed reserves using the wrong assumption for years?



Alternate Endings

- Alternative 1 – Robin should move towards the new tail.
- Alternative 2 – Robin should not sign off on the reserves unless additional reserves are added.
- Alternative 3 – Robin should call the ABCD for more guidance.





Professionalism Skit: The Growing Book

Committee on Professionalism
Education



Professional Guidance

- Precept 1 of the Code of Conduct: “An Actuary shall act honestly, with integrity and competence, and in a manner to fulfill the profession's responsibility to the public and to uphold the reputation of the actuarial profession.”



Professional Guidance

- Precept 4 of the Code of Conduct: Communications and Disclosure “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.



Professional Guidance

● ASOP 41: Actuarial Communications

- 3.1 Requirements for Actuarial Communications—The performance of a specific actuarial engagement or assignment typically requires significant and ongoing communications between the actuary and the intended users regarding the following:
 - the scope of the requested work;
 - the methods, procedures, assumptions, data, and other information required to complete the work; and
 - the development of the communication of the actuarial findings.





Professional Guidance

- ASOP 41: Actuarial Communications
 - 3.1 Requirements for Actuarial Communications
 - 3.1.1 Form and Content—The actuary should take appropriate steps to ensure that the form and content of each actuarial communication are appropriate to the particular circumstances, taking into account the intended users.



Professional Guidance

- ASOP 41: Actuarial Communications
 - 3.4 Disclosures Within an Actuarial Report—
Consideration of the items to be disclosed is an important part of the preparation of any actuarial communication.
 - 3.4.1 Uncertainty or Risk—The actuary should consider what cautions regarding possible uncertainty or risk in any results should be included in the actuarial report.



Professional Guidance

- ASOP 36: Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves
 - Section 3.6 Materiality—The actuary should evaluate materiality based on the actuary’s professional judgment, any applicable materiality guidelines or standards, and the intended purpose for which the actuary is preparing the statement of actuarial opinion.
 - The actuary should consider the intended users in choosing the materiality standard.



Professional Guidance

- **ASOP 36: Statements of Actuarial Opinion**
 - Section 3.11 Statements of Actuarial Opinion— The statement of actuarial opinion should be one of the following types:
 - Reasonable
 - Deficient or Inadequate
 - Redundant or Excessive
 - Qualified Opinion
 - No Opinion



Professional Guidance

- ASOP 36: Statements of Actuarial Opinion
 - Section 3.11, d. Qualified Opinion—Reserves for a certain item or items within the scope of the opinion are in question because they cannot be reasonably estimated or the actuary is unable to issue an opinion on the reserves for those items.
 - The actuary is not required to issue a qualified opinion if the actuary reasonably believes that the item or items in question are not likely to be material.



Skit Background

- Pat is a consulting actuary with over 25 years of experience.
- Pat has been the appointed actuary for Growth Is Our Middle Name (Growth) insurance company for the past 10 years.
- Growth is a specialty insurance company writing mainly professional liability for accountants, actuaries, architects, engineers, and lawyers.



Skit Background

- Growth has been expanding its business gradually over the past few years.
- Pat is assisted on the assignment by Alex, an actuarial analyst who has been also been on the project for 10 years.
- Pat and Alex have a close working relationship with Chris, the CFO of Growth.





Lights, Camera, Action!





General Questions

- Are there any professionalism gray areas presented in this skit?
- Questions to Consider:
 - The Materiality of the D&O Reserves
 - How the report was communicated
 - Issues with the intended user



Alternate Endings

- Alternative 1 – Pat and Alex were justified in their actions.
- Alternative 2 – Pat and Alex could have communicated the issues better, but the opinion outcome remains the same.
- Alternative 3 – Pat and Alex should have gone back and considered Chris' claims that the D&O were not material.





Professionalism Skit: The Bermuda Captive

Committee on Professionalism
Education



Professional Guidance

- Precept 1 of the Code of Conduct: “An Actuary shall act honestly, with integrity and competence, and in a manner to fulfill the profession's responsibility to the public and to uphold the reputation of the actuarial profession.”



Professional Guidance

- Precept 7 of the Code of Conduct: Conflict of Interest

- An Actuary shall not knowingly perform Actuarial Services involving an actual or potential conflict of interest unless:

- (a) the Actuary's ability to act fairly is unimpaired;

- (b) there has been disclosure of the conflict to all present and known prospective Principals whose interests would be affected by the conflict; and

- (c) all such Principals have expressly agreed to the performance of the Actuarial Services by the Actuary.



Professional Guidance

- Precept 8 of the Code of Conduct: Control of Work Product
 - An Actuary who performs Actuarial Services shall take reasonable steps to ensure that such services are not used to mislead other parties.
 - 8-1. Recognize the risks of misquotation, misinterpretation, or other misuse of the Actuarial Communication and take reasonable steps to present it clearly and fairly



Professional Guidance

- Precept 10 of the Code of Conduct: Courtesy and Cooperation
 - An Actuary shall perform Actuarial Services with courtesy and professional respect and shall cooperate with others in the Principal's interest.
 - 10-2. A Principal has an indisputable right to choose a professional advisor. An Actuary may provide service to any Principal who requests it, even though such Principal is being or has been served by another actuary in the same matter.
 - 10-5. When a Principal has given consent for a new or additional actuary to consult with an Actuary with respect to a matter for which the Actuary is providing or has provided Actuarial Services, the Actuary shall cooperate in furnishing relevant information, subject to receiving reasonable compensation for the work required to assemble and transmit pertinent data and documents.



Professional Guidance

- Statement of Principles Regarding P&C Loss and Loss Adjustment Reserves

Section II. Principles

- 1. An actuarially sound loss reserve is a provision, based on estimates derived from *reasonable assumptions* and appropriate actuarial methods for the unpaid amount required to settle all claims, whether reported or not, for which liability exists on a particular accounting date.
- 3. The uncertainty inherent in the estimation of required provisions for unpaid losses or loss adjustment expenses implies that a range of reserves can be actuarially sound. The true value of the liability for losses or loss adjustment expenses at any accounting date can be known only when all attendant claims have been settled.



Professional Guidance

- Statement of Principles Regarding P&C Loss and Loss Adjustment Reserves

- III Considerations: Development Patterns

The pattern of development on known claims should be carefully reviewed. An insurer's claims procedures will affect the manner in which the case reserves develop for any group of claims, and changes in claims practices may affect the consistency of historical

- III Considerations: Portfolio Transfers, Commutations, and Structured Settlements

Portfolio transfers, commutations, and structured settlements generally recognize the time value of money. Such transactions should be evaluated for their impact on the loss reserves and the development patterns.



Professional Guidance

- ASOP 23: Data Quality

Section 3. Analysis of Issues and Recommended Practices

- 3.4 Reliance on Other Information Relevant to the Use of Data

In many situations, the actuary is provided with other information relevant to the appropriate use of data, such as contract provisions, plan documents, and reinsurance treaties. The validity and comprehensiveness of such information are the responsibility of those who supply such information. The actuary may rely on such information supplied by another, unless it is or becomes apparent to the actuary during the time of the assignment that the information contains material errors or is otherwise unreliable. The actuary should disclose reliance on information provided by another in an appropriate actuarial communication.



Professional Guidance

- ASOP 21: Responding to or Assisting Auditors or Examiners

Section 3.1 Responsibilities of the Responding Actuary

- 3.1.1 Data, Assumptions, and Methods – The responding actuary should be prepared to discuss with the auditor or examiner the following items, based on existing documentation, underlying those elements of the financial statement for which the actuary is the responding actuary:
 - a. the data used;
 - b. the source of prescribed assumptions, if any;
 - c. the methods used; and
 - d. the basis for assumptions that are not prescribed assumptions.



Professional Guidance

- ASOP 36: Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves
 - Section 3.7 Reserve Evaluation—The actuary should consider a reserve to be reasonable if it is within a range of estimates that could be produced by an unpaid claim estimate analysis that is, in the actuary’s professional judgment, consistent with both ASOP No. 43, Property/Casualty Unpaid Claim Estimates, and the identified stated basis of reserve presentation.



Professional Guidance

- ASOP 36: Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves

- 3.7.2 Evaluation Based on Actuary's Use of Another's Unpaid Claims Estimate Analysis or Opinion

In the course of conducting a reserve evaluation, the actuary may make use of another's supporting analyses or opinions. The actuary should understand the intended purpose of the analyses or opinions, and assess whether the analyses or opinions are consistent with the stated basis of presentation of the reserves. (See section 4.2(f) for related disclosure requirements.)

The actuary should only make use of another's analyses or opinions when, in the actuary's professional judgment, it is reasonable to do so.



Professional Guidance

- ASOP 36: Section 3.7.2 Con't

- In making this determination, the actuary should consider the following:

- a. the amount of the reserves covered by another's analyses or opinions in comparison to the total reserves subject to the actuary's opinion;
- b. the nature of the exposure and coverage;
- c. the way in which reasonably likely variations in estimates covered by another's analyses or opinions may affect the actuary's opinion on the total reserves subject to the actuary's opinion; and
- d. the credentials of the individual(s) that prepared the analyses or opinions.



Professional Guidance

- ASOP 36: Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves
 - 3.8 Prior Opinion—If the actuary prepared the most recent prior opinion, or if the actuary is able to review the prior opinion actuary's work, then the actuary should determine whether the current assumptions, procedures, or methods differ from those employed in providing the most recent prior opinion prepared in accordance with this standard. If the current assumptions, procedures, or methods differ from those employed in the prior opinion, the actuary should consider whether the changes are likely to have had a material effect on the actuary's unpaid claim estimate. (See section 4.2(a) for related disclosure requirements.)



Professional Guidance

- ASOP 41: Actuarial Communications

- Section 3.5 Explanation of Material Differences—If a later actuarial communication produced by the same actuary, which opines on the same issue, includes materially different results or expresses a different opinion from the former communication, then the later communication should make it clear that the earlier results or opinion are no longer valid and explain why they have changed. If the later communication is oral, the actuary should follow-up with a document that clarifies the reason(s) for the changes.



Professional Guidance

● ASOP 41: Actuarial Communications

- 3.7 Responsibility to Other Users—An actuarial document may be used in a way that may influence persons who are not intended users. The actuary should recognize the risks of misquotation, misinterpretation, or other misuse of such a document and should take reasonable steps to ensure that the actuarial document is clear and presented fairly. To help prevent misuse, the actuary may include language in the actuarial document that limits its distribution to other users (for example, by stating that it may only be provided to such parties in its entirety or only with the actuary’s consent).
- Nothing in this standard creates an obligation for the actuary to communicate with any person other than the intended users.



Product Background

- Tax advantages created in an insurance company moves a portion of its business to an offshore reinsurance company by ceding premium and losses through intercompany reinsurance agreements.
- Bermuda is a popular offshore domicile for insurance and reinsurance companies (tax advantages and favorable regulatory environment.)
- These arrangements are more typical of large self-insured organizations through captive insurance companies, but there can be similar advantages for an insurance company doing something similar.
- Companies in Bermuda are regulated by the Bermuda Monetary Authority (BMA) and are not regulated by the NAIC.



Product Background

- A loss portfolio transfer is where the obligations as well as the day to day management of a group of claims are transferred to an assuming company.
- The transaction usually involves a one-time purchase amount of funds to be transferred from the ceding company (seller) to the assuming company (buyer) which results in the ceding company liabilities to be reduced for these claims.
- By doing so the ceding company relieves itself of the long term nature of the claims and is said to release surplus.



Skit Background

- Sidney, an FCAS, works for a major accounting firm which formerly audited Los Patos Insurance Company (Patos), a workers compensation writer in the state of California.
- Patos expanded too rapidly in what turned out to be a soft market, was determined to be technically insolvent by year end 2012, and went into a state receivership shortly thereafter.
- The runoff of Patos was sold to Rubbish Holdings Corporation (Rubbish) during 2013 in the form of a loss portfolio transfer. Rubbish is audited by another accounting firm.



Skit Background

- Patos operated a subsidiary reinsurance company domiciled in Bermuda called Pond Re, and assumed business from Patos through intercompany reinsurance contracts.
- Pond Re was not part of the loss portfolio transfer with Rubbish -- and therefore is still under the control of the state of California insurance regulators as part of the receivership -- and is now a ceding reinsurer for Rubbish's assumed liabilities.



Skit Background

- Pond Re is a fully solvent entity and requires a Bermuda statutory audit as of year ending 2013 as well as a Bermuda Loss Reserve Specialist Opinion (LRSO).
- Sidney's accounting firm was contracted to perform the statutory audit and to issue the LRSO for Pond Re.
- Sidney agreed to do the reserve analysis and be the appointed Loss Reserve Specialist for Pond Re without knowing any of the background of the company.



Skit Background

- Ryan, an FCAS with many years of reserving experience, performed the actuarial review of Patos's loss reserves for year end 2012 as part of the independent audit and signed the NAIC opinion.
- Sidney and Ryan are colleagues in different offices and Sidney was not a part of the team of actuaries who reviewed the loss reserves for Patos.





Lights, Camera, Action!



General Questions

- Does Ryan have a valid reason to refuse to do the 2013 work for Pond Re?
- If justified, does Ryan have a duty to share his/her findings and workpapers from a prior review with Sidney?
- Sidney suspects that the CA regulators are going to use the analysis as an independent estimate for a commutation price between Rubbish and Pond Re, effectively allowing the regulators to terminate the captive and release the capital to the other debtors. How can Sidney protect his/her work so it is not used out of context?
- Will the data from the now unrelated cedant, Rubbish Holdings, be sufficient to form an opinion on the ceded portion of the reserves?

