Using Your Professionalism GPS to Navigate the Underwriting Cycle

In Focus: The Underwriting Cycle Seminar
October 5, 2009

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Panelists: Terry Klodnicki,. Jennifer Vincent

Actuarial Navigation

- Where do you turn when you are faced with an ethical "traffic jam" and need to navigate away from it?

Increased Scrutiny of Actuaries Since 2003

- Standard and Poor's (2003)
  - "Insurance Actuaries: A Crisis of Credibility"
  - Blamed actuaries for reserve shortfalls in early 2000s
  - #1 Casualty Actuarial story for 2003 (CAS)
- Morris Review (UK, 2004-05)
  - Insolvency of Equitable Life (UK)
  - Led to oversight by Financial Reporting Council

Increased Scrutiny of Actuaries Since 2003

- AIG/Gen Re Sham Reinsurance (4/1/08)
  - Convictions of actuaries Ron Ferguson and Chris Garand
  - Sentenced in spring 2009, appeals pending
- NY Times article (5/21/08)
  - "Actuaries Scrutinized on Pensions"
  - Issues with public pension funding in NY, AK, San Diego CA, Milwaukee County WI, and Evanston IL

GPS Tools for the Actuary

- Code of Professional Conduct
- Actuarial Standards of Practice
  - Applicability Guidelines
- CAS Statement of Principles
  - Foundational Statements TBD

3 Keys to Navigating the Cycle

- Continue to communicate and document findings to avoid misinterpretation
  - Code Precept #4 – Actuarial Communication should be "clear and appropriate to the circumstances and satisfy applicable standards"
  - Code Precept #8 – "shall take reasonable steps to ensure…services are not used to mislead other parties."

3 Keys to Navigating the Cycle

- Follow the standards regardless of the business climate
  - Code Precept #3 – "shall ensure that Actuarial Services…satisfy applicable standards of practice"
- Remind your management/client that you have a duty not only to your Principal but also to the public and the profession (Code Precept #1)

CASE STUDIES

Case Studies Overview

- "Real life" predicaments
- Structure of session
  - Read the case together.
  - Seek ethical solutions from the audience
  - Discuss relevant Code and ASOPs
- Disclaimers:
  - Exercise is for education purposes only.
  - Opinions expressed do not represent the opinion of the respective employers or the Casualty Actuarial Society.
  - No authoritative guidance should be expected of the moderator or panelists.

Case Study #1 – "Soft Market Grower"

As the chief actuary for your state's insurance department, you are reviewing a filing requesting a 30% decrease for a large commercial lines insurer. Despite the soft market, the company has generated unprecedented growth, primarily due to its cutthroat pricing. The company argues it needs the additional 30% to remain competitive, but your analysis shows the decrease is not justified.

The Insurance Commissioner tells you to approve the decrease because it results in lower premiums to her constituents. You argue that approving their request will not only be destructive to the market, it could also ultimately bankrupt the company if left to grow at inadequate rates. In the end, she insists you approve the 30% rate decrease. What do you do?

Professional Integrity

- PRECEPT 1:

  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.

Principles of Ratemaking

Principle 4:

A rate is reasonable and not excessive, inadequate, or unfairly discriminatory if it is an actuarially sound estimate of the expected value of all future costs associated with an individual risk transfer.

Case Study#2 – "Material Reserves"

You are the chief actuary for a large commercial lines insurance company. It is year-end 2011, and the losses from the soft-market years of 2006-2010 are starting to materialize, but due to the slow emergence patterns of much of the business, your reserve indications have a +/- 10% range. However, due to the reserve charge your company took the prior year due to catastrophes, even a +5% deviation from the point estimate will dangerously deplete the company surplus. What do you do?

ASOP#41: Actuarial Communications

- All types of Actuarial work – not just P&C
- Written, Electronic, or Oral Communications
- Provides guidance for the appropriate form and content that should be included - depending on circumstances and audience
- Discusses timelines and reliance on others

ASOP #9: Documentation and Disclosure in P&C Ratemaking, Reserving & Valuations

- Repeal currently pending
- Replaced by ASOP #41
  - "Actuarial Communications"
- Scope – limited to practices related to the 3 Statement of Principles documents
- Included as appendices

Reserving ASOPs

- #43 – Property & Casualty Unpaid Claim Estimates
  - Our newest ASOP
- #36 – Statements of Opinion – P&C Loss & LAE Reserves
  - Written Opinions
  - Associated with Reserving Principles

Principles of Reserving

Principle 4:

The most appropriate reserve within a range of actuarially sound estimates depends on both the relative likelihood of estimates within the range and the financial reporting context in which the reserve will be presented.

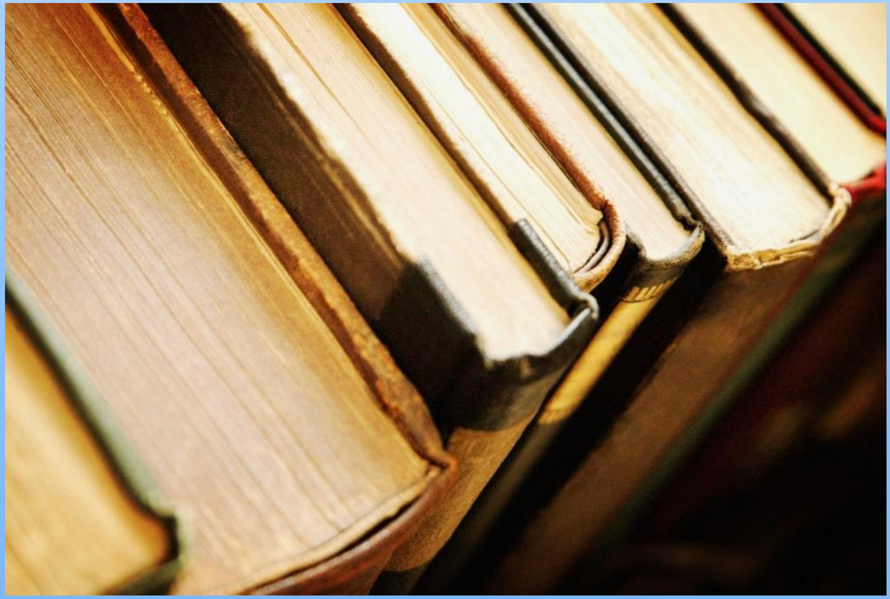
Case Study#3 – "New Product"

You have been the VP of underwriting for the large accounts market for the last three years. The actuary supporting your market along with the marketing department have developed a new product with forms, rates and a 5-year pro-forma of the expected results of this new product on the market's financial statements. You have reviewed the work and believe there are some flaws in the pricing and financial modeling. Instead of generating a profit in year 1, the new product will not generate a profit until year 5, if at all. What do you do?

Standards of Practice

- PRECEPT 3:

  An Actuary shall ensure that Actuarial Services performed by or under the direction of the Actuary <u>satisfy applicable standards of practice</u>.



Ratemaking ASOPs

- #12 Risk Classification
- #13 Trending in P/C Ratemaking
- #29 Expense Provisions
- #30 Profit & Contingency Provision
- #39 Treatment of Catastrophe Losses in P/C Ratemaking

Courtesy and Cooperation

- PRECEPT 10:

  An Actuary shall perform Actuarial Services with courtesy and professional respect and shall cooperate with others in the Principal's interest.

Case Study #4 – "Triangle Error"

Your systems vice president recently informed you that there was an error in the loss triangles provided for your loss reserve analysis as of March 31. The company has already booked your best estimate based on the erroneous data, and you believe the correct data would result in materially higher reserves.

However, last year your company implemented large price increases and re-underwrote its business following a prolonged soft market. You anticipate the improving results will render the reserve shortfall immaterial by year end. Because of this, your CEO insists you postpone correcting your analysis until next quarter to avoid having to delay the company's earnings release. What do you do?

Control of Work Product

- PRECEPT 8:

  An Actuary who performs Actuarial Services shall take reasonable steps to ensure that such services are not used to mislead other parties.

ASOP#23: Data Quality

- Guidance for the following
  - Selecting data that underlie the work product
  - Relying on data supplied by others
  - Reviewing data
  - Using data
  - Making appropriate disclosures regarding data quality
- All practice areas – not just P&C
- Does not require data audit

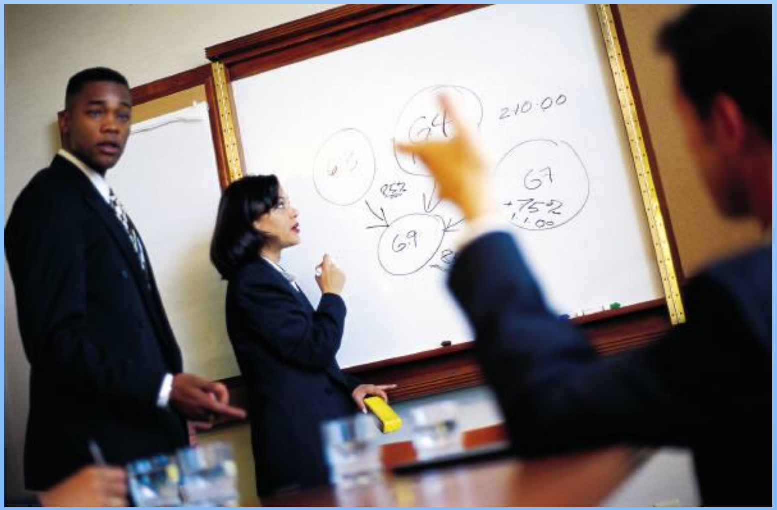
Case Study#5 – "Draft Report"

A consulting actuary has delivered a draft report to its client/principal. During a subsequent discussion of the results, the actuary and the Controller talk about the potential surplus impact of a possible strategic course of action. After this conversation the consulting actuary does a thorough pro-forma analysis and provides a final report in which the results vary from the draft report discussions due to some changes in assumptions as provided by the CEO and CFO. The Controller has already implemented some of the originally discussed strategy and is now complaining to the CEO and CFO that the actuary misled him and has produced faulty work. What should the actuary do?

Communications and Disclosure

- 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.



Communications and Disclosure

- PRECEPT 5:

  An Actuary who issues an Actuarial Communication shall, as appropriate, identify the Principal(s) for whom the Actuarial Communication is issued and describe the capacity in which the Actuary serves.

Case Study #6 – "Insolvent Target"

You are a partner of a consulting firm that has been hired to assist in the review of a potential acquisition. After completing your analysis, you discover that the target is materially under-reserved (due to a prolonged soft market). The target received an unqualified Statement of Actuarial Opinion from another consulting actuary. As a result of your work, the acquiring company walks away from the target. (You signed a confidentiality agreement with the acquiring company prior to being engaged on the assignment.)

Confidentiality

- PRECEPT 9:

  An Actuary shall not disclose to another party any Confidential Information unless authorized to do so by the Principal or required to do so by Law.

Violations of the Code of Professional Conduct

- PRECEPT 13:

  An Actuary with knowledge of an apparent, unresolved, material violation of the Code by another Actuary should consider discussing the situation with the other Actuary and attempt to resolve the apparent violation. If such discussion is not attempted or is not successful, the Actuary shall disclose such violation to the appropriate counseling and discipline body of the profession, except where the disclosure would be contrary to Law or would divulge Confidential Information.

Canadian Rules of Professional Conduct

- The Rules of Professional Conduct in Canada require that certain procedures must be followed when a member is aware of a violation of the Rules.
  - Affirmative responsibility to act to correct violation
  - No confidentiality agreement or employment protections exist

Violations of the Code of Professional Conduct

- PRECEPT 14:

  An Actuary shall respond promptly, truthfully, and fully to any request for information by, and cooperate fully with, an appropriate counseling and disciplinary body of the profession in connection with any disciplinary, counseling or other proceeding of such body relating to the Code. The Actuary's responsibility to respond shall be subject to applicable restrictions on Confidential Information and those imposed by Law.

Other Code of Conduct Precepts

- #2 – Qualification Standards
- #6 – Communications and Disclosure (compensation disclosure)
- #7 – Conflict of Interest
- #11 – Advertising
- #12 – Titles and Designations

Other ASOPs Not Mentioned

- #20 Discounting Reserves
- #38 Using Models outside your area of expertise
- #25 Credibility
- #17 Expert Testimony

Applicability Guidelines

- ASOPs that apply to all practice areas
  - 23 Data Quality, 41 Communications,
  - 9 Documentation & Disclosure
- Reserving ASOPs
  - 20, 36, 43
- Ratemaking ASOPs
  - 13, 29, 30, 39
- Other Key ASOPs
  - 12, 17, 25, 38

Common Allegations Received by ABCD

Alleged Violation	Number Disposed or in Process (2005)	Number Disposed or in Process (2006)	Number Disposed or in Process (2007)	Precept
Failure to act with integrity	19	18	11	1
Calculation or data errors	7	2	2	1
Failure to perform services with competence	3	3	5	1
Other errors in work	3	3	2	1
Work fails to satisfy ASOP	3	3	7	3
Improper reserve estimate for insurer	3	0	1	3
Use of unreasonable assumptions	3	1	1	3
Failure to cooperate with other actuary	3	3	3	10
Inadequate actuarial communication	2	1	3	4

Source: *ABCD 2005-07 Annual Reports*

Now It's Your Turn…

Any Situations Involving a "Friend of Yours"?