# Year-end Appointed Actuary Report – Discussing Your Results with Management and the Board

*Case Studies on Hardest Discussions*

November 2020

# CAS Antitrust Notice

- The Casualty Actuarial Society (CAS) 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.

# Agenda

- Introduction of panelists
- Case studies
- Changes to NAIC Statement of Actuarial Opinion (SAO) requirements
- Resources

# Panelists

- Robert Wolf
  - Vice President & Chief Actuary at Stone Trust Insurance/ Wintaii Group
  - Member of CAS Annual Meeting Planning Committee
  - Twice a Former Member of the CAS Board of Directors
- Miriam Fisk
  - P&C Actuary at Texas Department of Insurance
  - Vice chair of AOWG
- Kathleen ("Kathy") C. Odomirok
  - Principal at EY
  - Chair of COPLFR
  - Lead author of the main textbook for CAS Exam 6
  - Member of the CAS Board of Directors

# Ground Rules

- Open forum on SAO issues
  - Focus on the NAIC P/C Opinion
- Panelists provide perspectives from:
  - Chief Actuary/Company management
  - Consulting Actuary
  - Regulator
- Your perspectives

# Case Studies

# Case study #1:
# *What should be included in Qualification Documentation?*

# Poll Question #1:
# What would you include in your qualification documentation? (select all that apply)

- Explanation of the requirement for the Appointed Actuary to provide qualification documentation to the Board of Directors
- General statements about meeting the definition of ‘Qualified Actuary’
- Specific statement about whether or not you have credit or are substituting experience/continuing education for CAS Exam 6U (as an FCAS or ACAS) and CAS Exam 7 (as an ACAS)
- Paragraph(s) describing your actuarial work experience
- Attached resume
- Different statements for each specific company, about how your experience is relevant to the company’s structure, lines of business, or special circumstances
- Attached continuing education log
- “Additional information is available upon request.”

# What should be included?

## NAIC SAO Instructions:

The Appointed Actuary shall provide to the Board of Directors qualification documentation on occasion of their appointment, and on an annual basis thereafter, directly or through company management. The documentation should include **brief biographical information** and a **description of how the definition of "Qualified Actuary" is met or expected to be met** (in the case of continuing education) for that year. The documentation should describe the Appointed Actuary's **responsible experience relevant to the subject of the Actuarial Opinion**. The Board of Directors shall document the company's review of those materials and any other information they may deem relevant, including information that may be requested directly from the Appointed Actuary. The qualification documentation shall be considered workpapers and be available for inspection upon regulator request or during a financial examination.

**(emphasis added)**

# Regulatory Guidance

NAIC Actuarial Opinion Working Group's Regulatory Guidance (adopted 10/30/2020):

> As a general principle, Appointed Actuaries should provide **enough detail** within the documentation **to demonstrate that they satisfy each component of the 'Qualified Actuary' definition**. In crafting the qualification documentation it may be helpful to think about **what is important for the Board of Directors to know** about their Appointed Actuary's qualifications, and to remember that documentation should be **relevant to the subject of the Actuarial Opinion being issued**.

**(emphasis added)**

# Definition of "Qualified Actuary"

## NAIC SAO Instructions:

"Qualified Actuary" is a person who:

(i) Meets the **basic education, experience and continuing education** requirements of the Specific Qualification Standard for Statements of Actuarial Opinion, NAIC Property and Casualty Annual Statement, as set forth in the Qualification Standards for Actuaries Issuing Statements of Actuarial Opinion in the United States (U.S. Qualifications Standards), promulgated by the American Academy of Actuaries (Academy);

(ii) Has obtained and maintains an **Accepted Actuarial Designation**; and

(iii) Is a **member of a professional actuarial association** that requires adherence to the same Code of Professional Conduct promulgated by the Academy, requires adherence to the U.S. Qualification Standards, and participates in the Actuarial Board for Counseling and Discipline when its members are practicing in the U.S.

**(emphasis added)**

# “Accepted Actuarial Designation”

3 options:

- FCAS with credit for CAS Exam 6 (US)
- ACAS with credit for CAS Exam 6 (US) and CAS Exam 7
- FSA by completing the general insurance track, including credit for SOA Financial and Regulatory Environment Exam (US) exam and SOA Advanced Topics in General Insurance Exam

# What if I don’t have credit for certain exams?

NAIC SAO Instructions:

“An FCAS or ACAS earned prior to 2021 who did not pass CAS Exam 6 (US) or an allowable exam substitution, may substitute experience and/or continuing education for CAS Exam 6 (US) **provided the Appointed Actuary explains in his/her qualification documentation how knowledge of U.S. financial reporting and regulation was obtained**.”

“An ACAS earned prior to 2021 who did not pass CAS Exam 7 or an allowable exam substitution, may substitute experience and/or continuing education for CAS Exam 7 **provided the Appointed Actuary explains in his/her qualification documentation how knowledge of the additional reserving topics in CAS Exam 7 (Section A) in the May 2019 syllabus was obtained**.”

**(emphasis added)**

# Relevant Experience

AOWG Regulatory Guidance:

- To describe the Appointed Actuary's responsible experience relevant to the subject of the Actuarial Opinion, information **may include specific actuarial experiences relevant to the company's structure (e.g., insurer, reinsurer, RRG), lines of business, or special circumstances**.
- Experiences **may include education (through organized activities or readings)** about specific types of company structures, lines of business, or special circumstances.

**(emphasis added)**

# Continuing Education

## AOWG Regulatory Guidance:

c) "Continuing education: met (or expected to be met) through a combination of **[industry conferences; seminars (both in-person and webinar); online courses; committee work; self-study; etc.]**, on topics including ________ (provide a **brief overview of the CE topics**. For example, 'trends in workers' compensation' or 'standards of actuarial practice on reserving.'). A detailed log of my continuing education credit hours is available upon request."

- Section 3.3 of the Specific Qualification Standards for Statements of Actuarial Opinion, NAIC Property and Casualty Annual Statement requires the Appointed Actuary to earn 15 hours of CE on **topics mentioned in Section 3.1.1.2**. The Appointed Actuary should **consider providing expanded detail on the completion (or planned completion) of these hours** in the CE documentation.

**(emphasis added)**

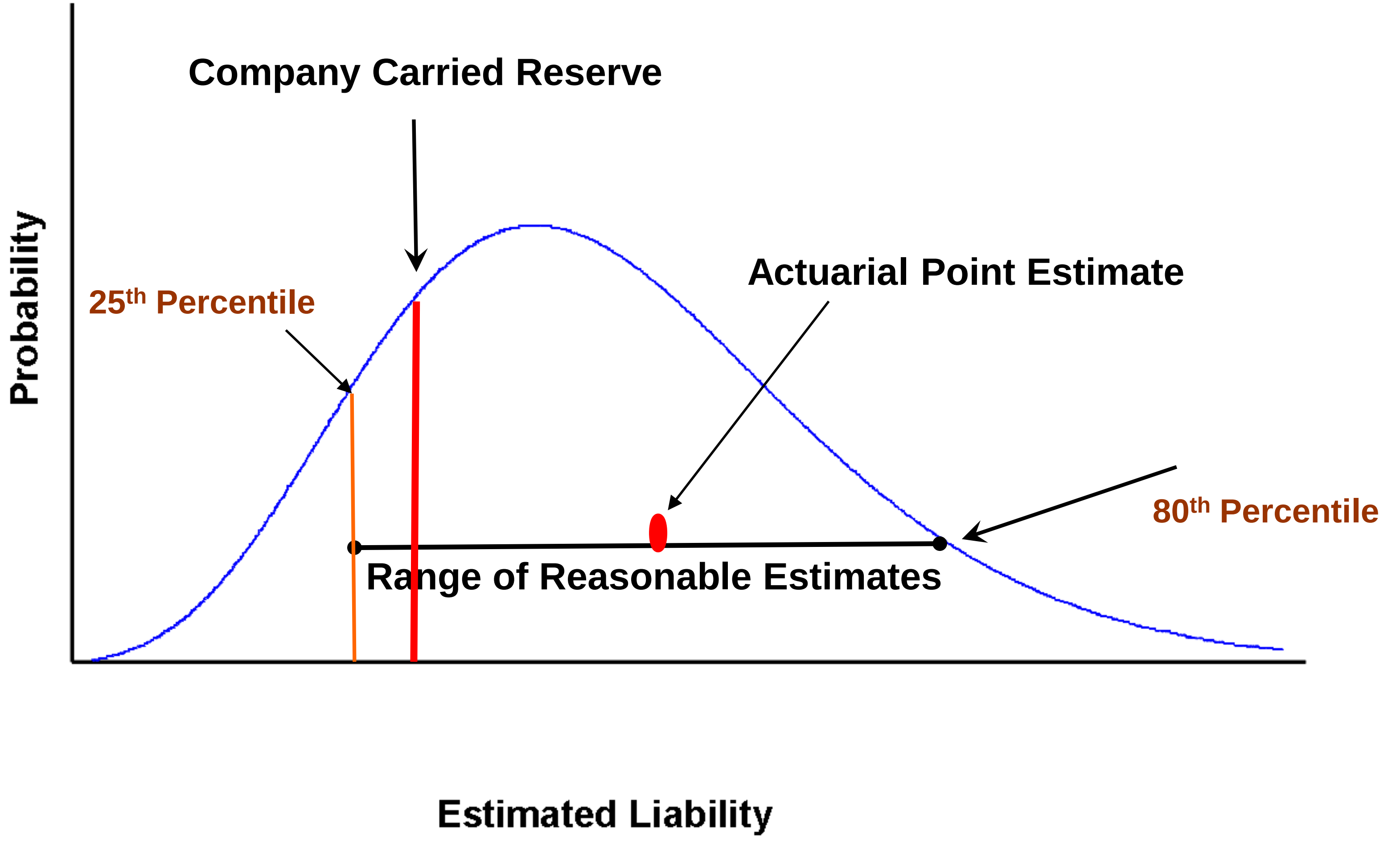
# Case study #2:

## *What is a reserve range?*

# Case Study #2:
# You are reviewing the reserves below

The Appointed Actuary…….

- …discloses that carried reserves are reasonable;
- …provides a range of reasonable estimates per the AOS



# Case Study #2 Poll Question: What type of Opinion would you provide?

A. “Reasonable” Opinion
B. “Inadequate” Opinion
C. “Excessive” Opinion”
D. “Qualified” Opinion
E. “No” Opinion

# Types of Ranges

**Two types of ranges:**
**Range of all possible outcomes**

**Range of reasonable estimates**

**Sometimes, both are referred to as "ranges," but they have very different meanings**

**A range of possible outcomes is not the same as a range of reasonable estimates!**

**The type of range will vary depending on its intended purpose or use**

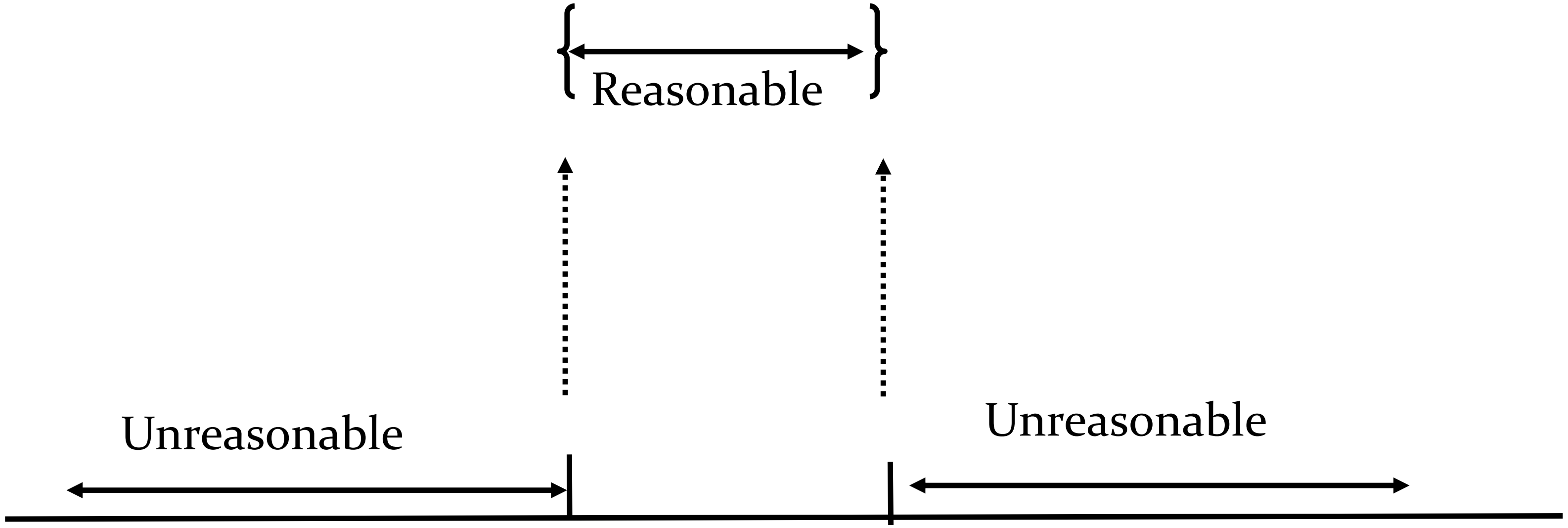
# Focus of Statement of Actuarial Opinion

## Estimating a range of <u>reasonable actuarial central estimates (ACE)</u>

- Expected value over the range of reasonably possible outcomes (ASOP No. 43)
- Defined by a set of Low and High estimates; each a reasonable estimate of the ACE
- A “Range” is not the same as a “Distribution”
- *A Range of Reasonable Estimates* is a range of estimates that could be produced by appropriate actuarial methods or alternative sets of assumptions that the actuary judges to be reasonable.

# What is a Reasonable Range?

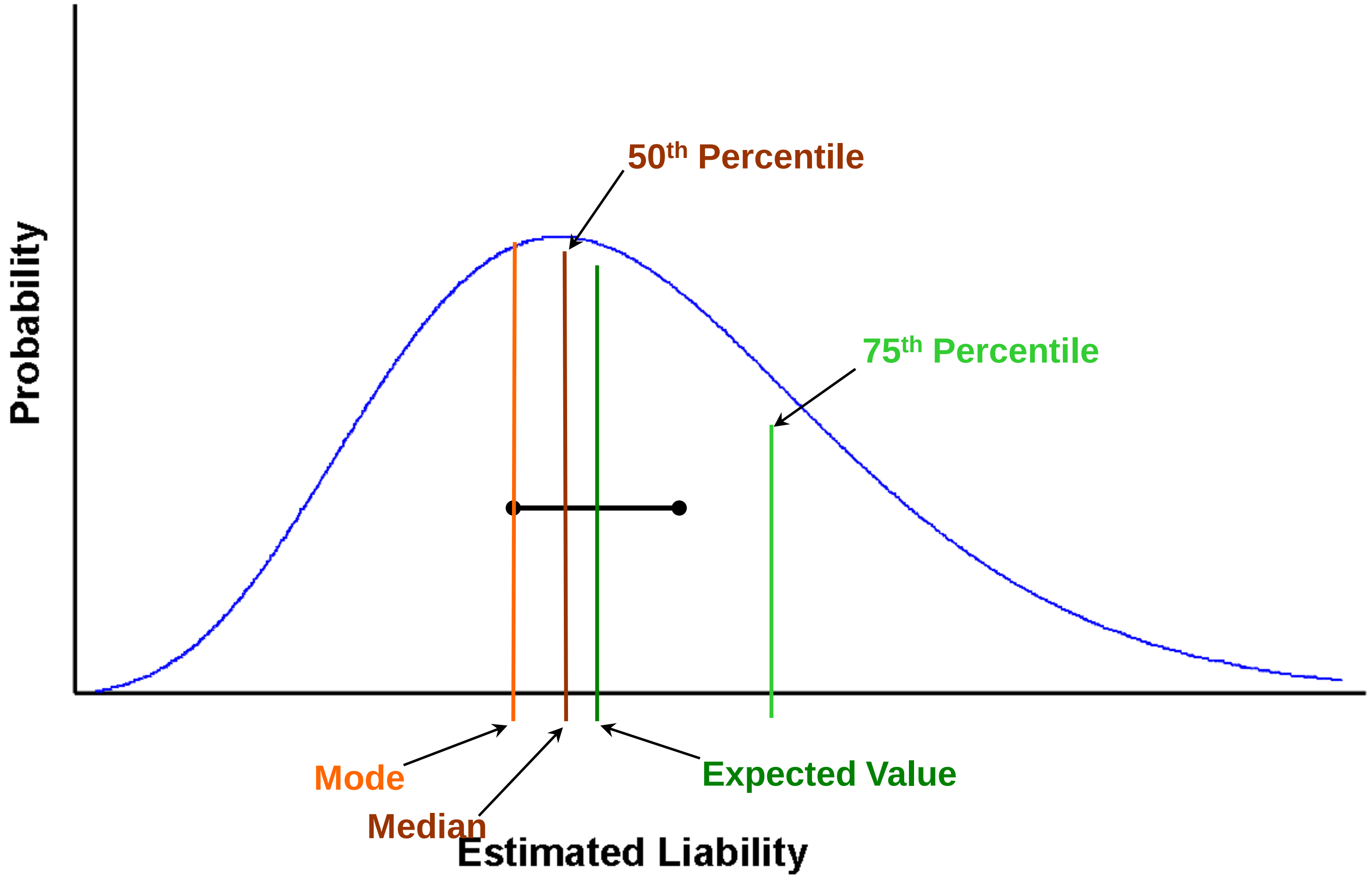
That which is **Not Unreasonable (☺)**



# Reserve Distribution

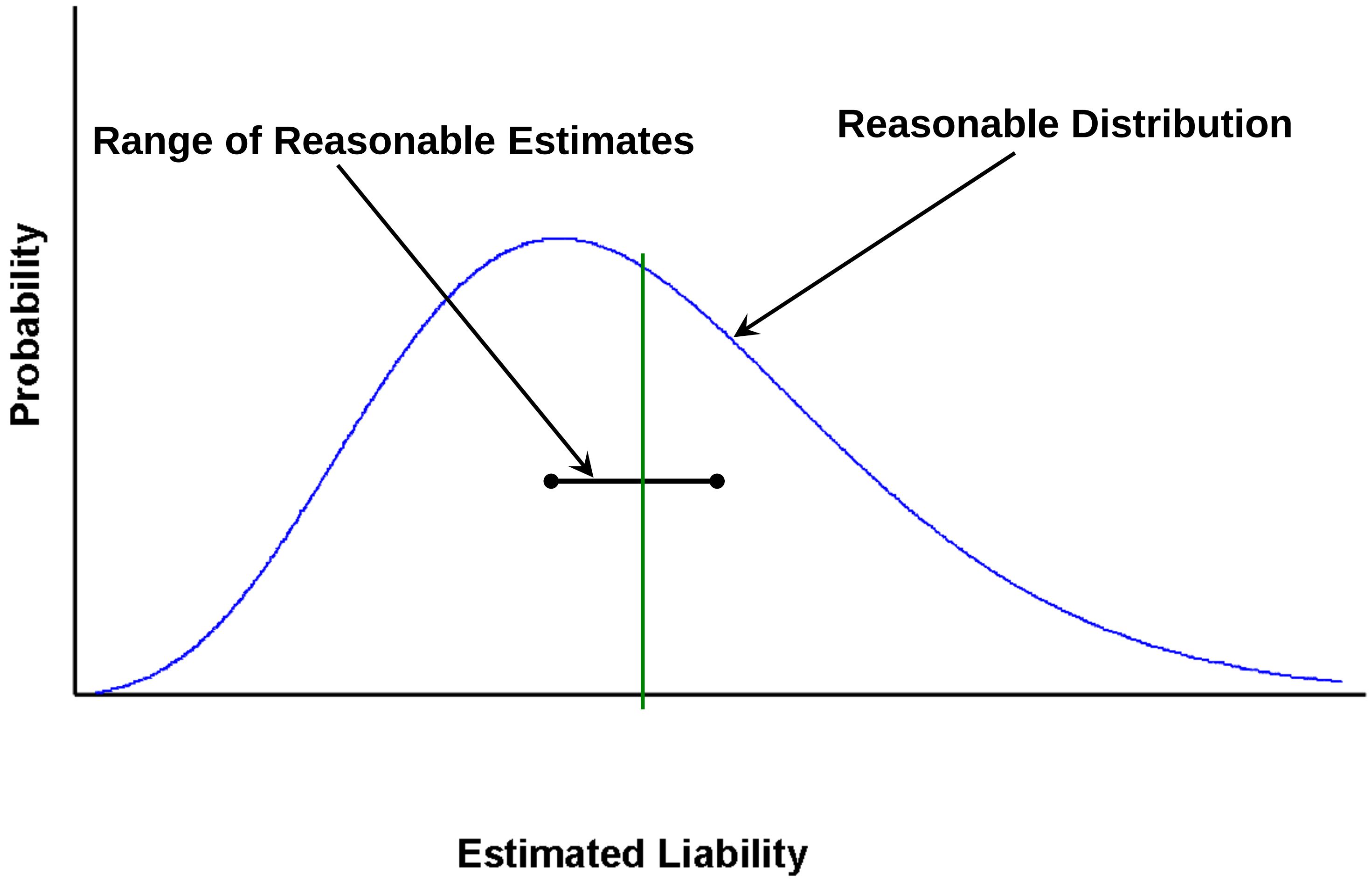
- Provides information about "all" possible outcomes.

- Context for defining a variety of other measures (e.g., risk margin, materiality, risk based capital, RMAD etc.)



# Absolute Range vs Reasonable Range?

Confusing to our audience

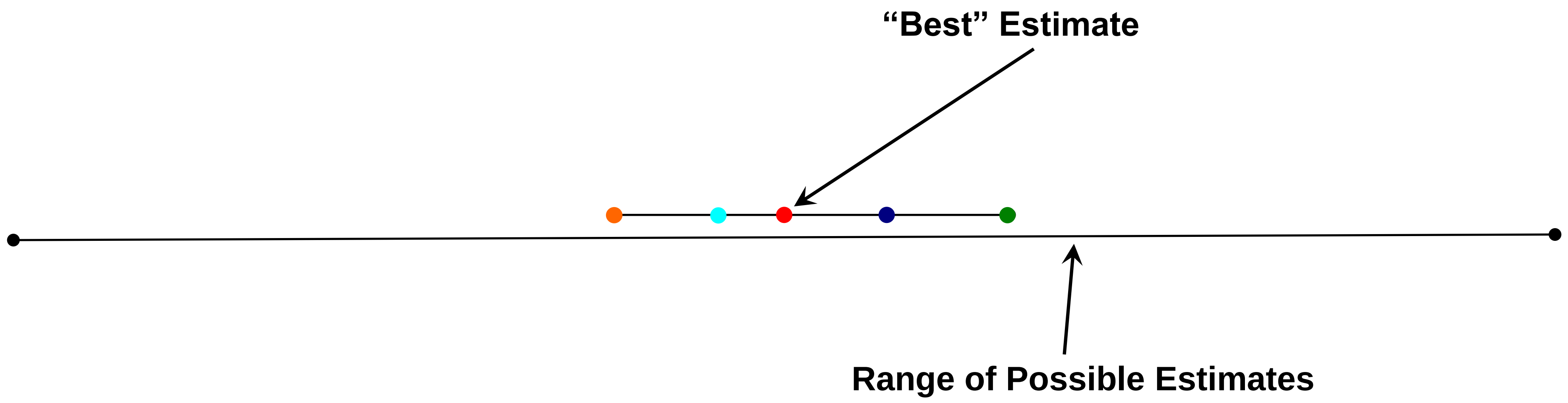


# Intended Purpose - Examples

| Range of Reasonable Estimates | Range of Possible Outcomes |
|---|---|
| • Reports supporting the SAO | • Capital Modeling |
| • Internal communications | • Enterprise Risk Management |
| • Audits and statutory exams | • Strategic Planning |
| • Materiality Standard | |
| • M&A | |

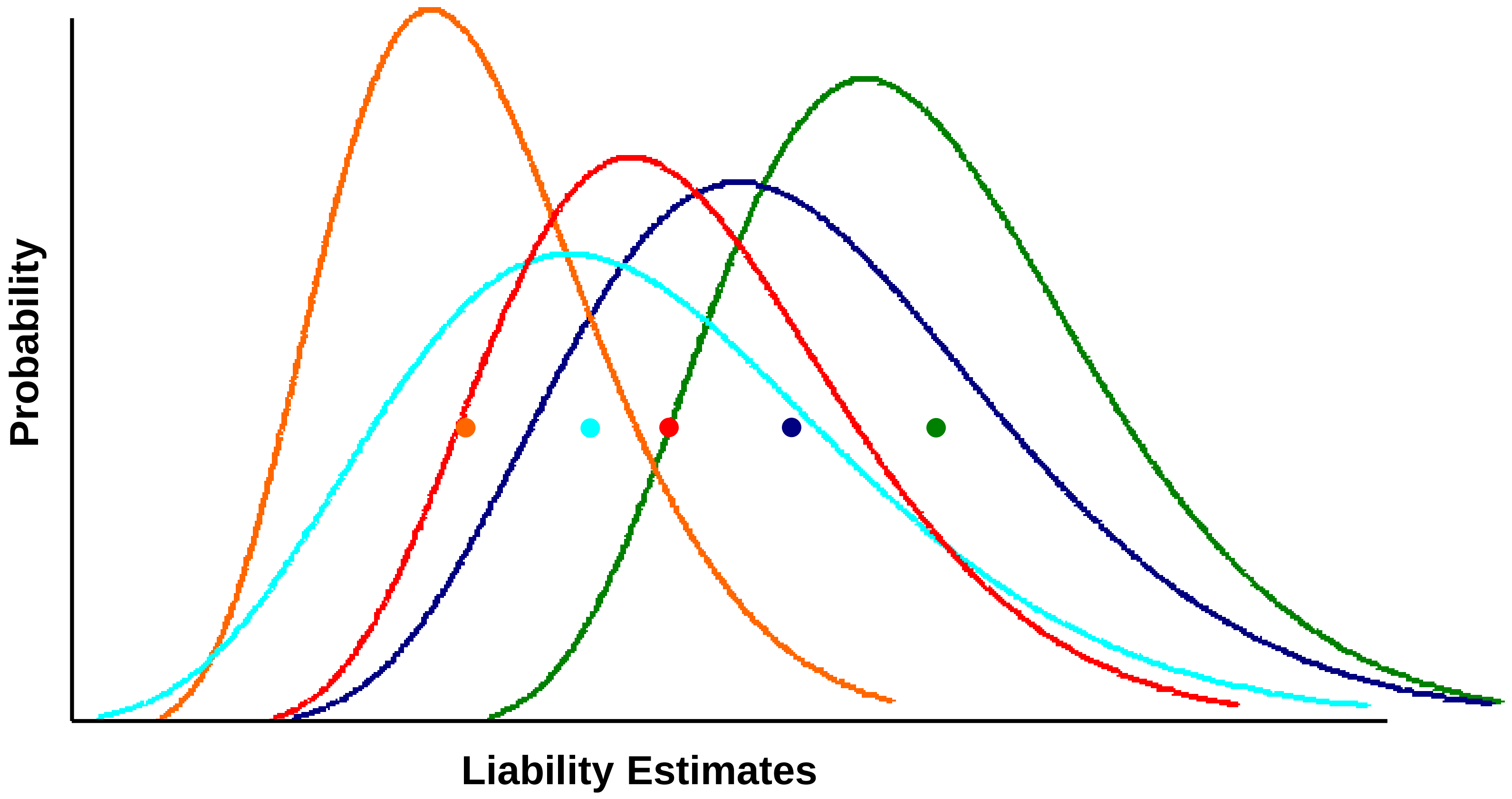
# Range of Reasonable Estimates

You have several estimates from a variety of methods



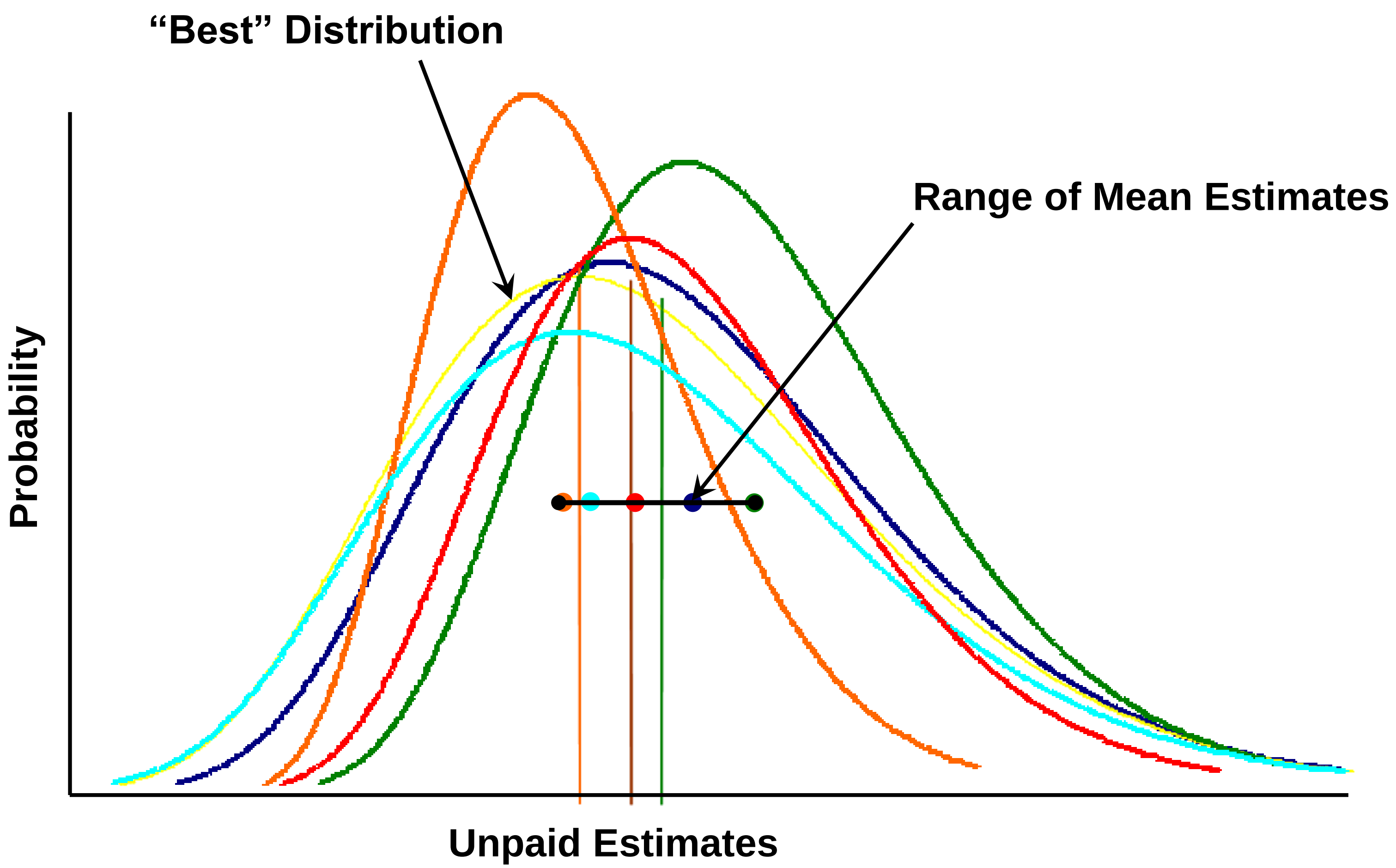
# Multiple Distributions

There are many distributions to consider depending on the assumptions of the methods employed



# Assessing Assumptions of Your Methods

Can be a countercheck of validating assumptions underlying your overall distribution and assumptions underlying your reserve methods



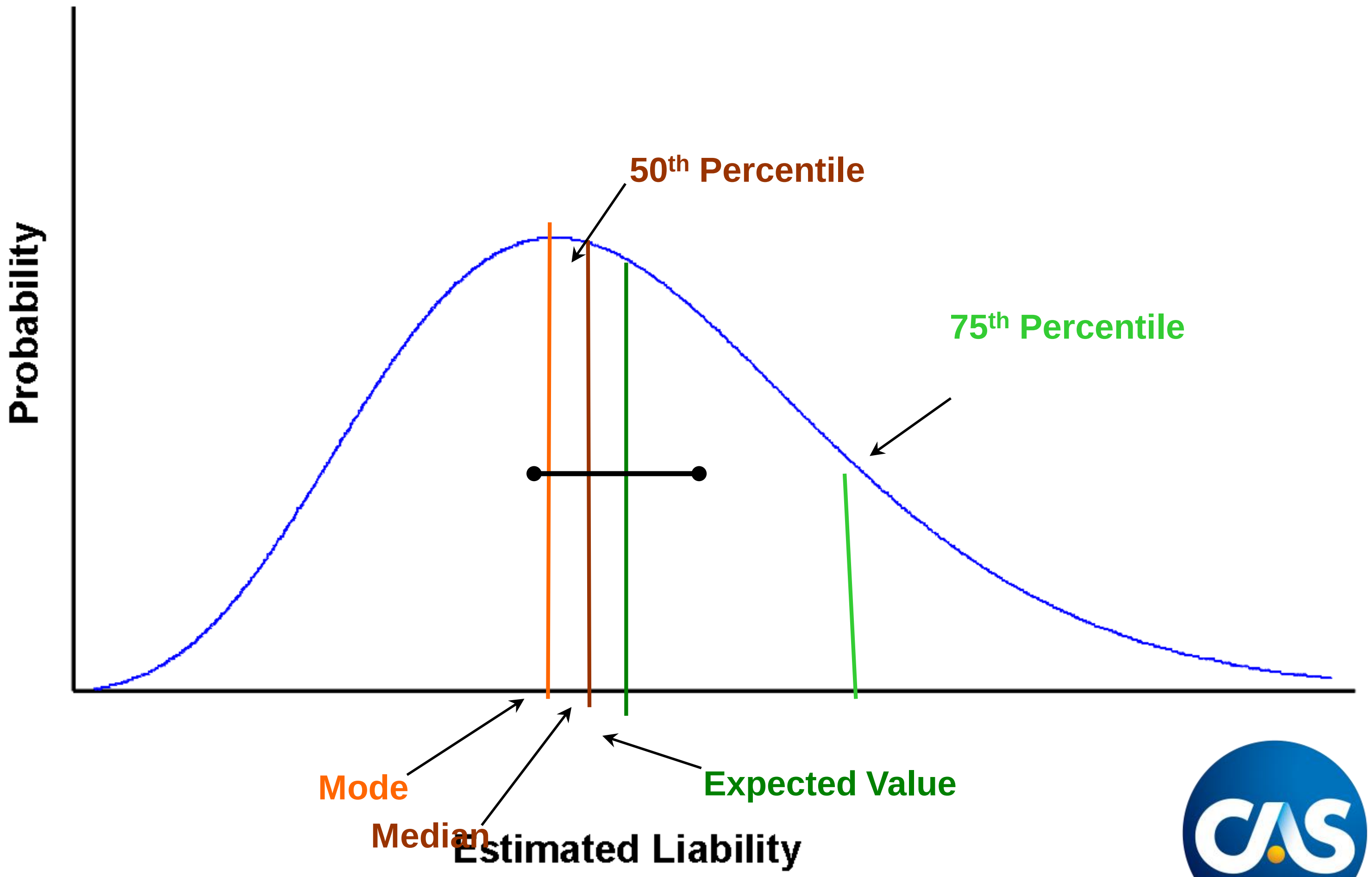
# Considerations

*A range of reasonable actuarial central estimates considers primarily **parameter** and **model** risk, not **process** risk*

- **Process Risk: the randomness of future outcomes** *given a known distribution of possible outcomes*
- **Parameter Risk: the potential error in the estimated parameters** used to describe the distribution of possible outcomes, *assuming the process generating the outcomes is known*
- **Model Risk: the chance that the model ("process") used** to estimate the distribution of possible outcomes is incorrect or incomplete

# Situations

- What is an “Unreasonable Carried Reserve”
- What is an “Excessive” Carried Reserve?
- If Carried Reserves are at the 85th percentile, are they excessive?
- If Carried Reserves are at the 45th percentile, are they unreasonable?
- Is a Reasonable Range encompassing the 25th percentile and the 90th percentile truly a reasonable range?



# Case study #3:
# *Is my Opinion a Qualified Opinion?*

# Case Study #3 Poll Question: When is a Qualified Opinion required?

A. When I cannot reach a conclusion due to deficiencies or limitations in the data, analyses, assumptions ore related information

B. When there are significant risks that could result in material adverse deviation

C. When I am unable to assess the reasonableness of the reserves for a certain item or items if material

D. When I am unable to assess the reasonableness of the reserves for a certain item or items, regardless of materiality of the item(s)

E. When I include relevant comments and/or disclosures

# Is my Opinion a Qualified Opinion?

Situation:

- A significant portion of the Company's recorded reserves emanate from business assumed from underwriting pools for which management has recorded the amount reported by the pools
- There is no Actuarial Report or analysis available that supports the amount recorded by the Company, so the Company's Appointed Actuary is unable to "make use of the work" of another

# What is a Qualified Opinion?

NAIC SAO Instructions:

Qualified Opinion: **When, in the Appointed Actuary's opinion, the reserves for a certain item or items are in question because they cannot be reasonably estimated or the Appointed Actuary is unable to render an opinion on those items**, the Appointed Actuary should issue a qualified Statement of Actuarial Opinion. The Appointed Actuary should disclose the item (or items) to which the qualification relates, the reason(s) for the qualification and the amounts for such item(s), if disclosed by the Company. Such a qualified opinion should state whether the carried reserve amount makes a reasonable provision for the liabilities associated with the specified reserves, except for the item (or items) to which the qualification relates. The Appointed Actuary is **not required to issue a qualified opinion if the Appointed Actuary reasonably believes that the item (or items) in question are not likely to be material**.

**(emphasis added)**

# How would the Appointed Actuary address?

- First, determine whether the item (or items) in question material to the overall balance
- Option 1: If the Appointed Actuary determines that such reserves are immaterial or that potential variability in the item(s) would not affect the actuary's conclusion on the reasonableness of the total reserves
    - No need to qualify the opinion, but should have supporting documentation in the underlying workpapers of the conclusion regarding materiality of the item(s)
- Option 2: If the reserves for such item(s) are deemed to be material or variability in the item(s) could impact the actuary's conclusion, perform a "review"
    - Consider making use of the work of another, if such work is available
        - If the Appointed Actuary makes use of the work of another, the *Instructions* say that the Appointed Actuary must provide the following information in the Opinion:
            - The person's name;
            - The person's affiliation;
            - The person's credential(s), if the person is an actuary; and
            - A description of the type of analysis performed, if the person is not an actuary
        - ASOP No. 36 says that the actuary should disclose whether he or she reviewed the other's underlying analysis and, if so, the extent of the review
            - The NAIC AOWG Regulatory Guidance encourages the Appointed Actuary to consider discussing his or her conclusions from the review
    - Consider performing an independent evaluation of the reserves for the item(s) in question so that a conclusion can be reached as to the reasonableness of the reserve for the item(s) in question

  If reserves for the item(s) are deemed reasonable, no need to Qualify the opinion
- Option 3: If the reserves for a certain item(s) are material or variability in the item(s) could impact the actuary's conclusion, but they cannot be reasonably estimated or the Appointed Actuary is unable to render an opinion on those items
    - Exclude reserves for the item(s) and issue a Qualified Opinion

# Case study #4:
# *Are there any risk factors?*

# Does this company have any risk factors?

- Company has written business for 4 years, writing only 1 line of business (homeowners) in 2 states
- Gross and net written premium increased:
  - 700% in the $2^{nd}$ year
  - 100% in the $3^{rd}$ year
  - 50% in the $4^{th}$ year
- Carried reserves have been within 2% of the Appointed Actuary's point estimate each year
- Actual net loss & DCCE reserve development has been consistently slightly favorable each year
- Consistent strong surplus position relative to RBC, reserves, and premium

# Case Study #4 Poll Question: Would you list any risk factors in your Opinion for this company?

A. Yes

B. No

# Company-Specific Risk Factor Requirements

NAIC SAO Instructions:

- "The Appointed Actuary should include an explanatory paragraph to **describe the major factors, combination of factors or particular conditions** underlying the risks and uncertainties the Appointed Actuary considers relevant. The explanatory paragraph **should not include general, broad statements about risks and uncertainties due to economic changes, judicial decisions, regulatory actions, political or social forces, etc., nor is the Appointed Actuary required to include an exhaustive list of all potential sources of risks and uncertainties.**"
- "The Actuarial Report must also include:...

  E. **Extended comments** on trends that indicate the **presence or absence** of risks and uncertainties that could result in material adverse deviation."

**(emphasis added)**

# Regulatory Guidance on Risk Factors

AOWG Regulatory Guidance:

- "No company-specific risk factors – The Appointed Actuary is asked to discuss company-specific risk factors **regardless of the RMAD conclusion**. **If the Appointed Actuary does not believe that there are any company-specific risk factors, the Appointed Actuary should state that.**"
- "Mitigating factors – Regulators generally expect Appointed Actuaries to comment on significant company-specific risk factors that exist **prior to the company's application of controls or use of mitigation techniques**. The company's risk management behaviors may, however, affect the Appointed Actuary's RMAD conclusion."

**(emphasis added)**

# Additional Considerations

- Gross vs. Net
  - The AOWG Regulatory Guidance discusses the potential for an Appointed Actuary to reach different gross and net conclusions on the type of opinion, materiality standard, and RMAD
  - Should this concept extend to the company-specific risk factors?
- "General, broad statements" vs. company-specific factors
- COVID-19

# Case study #5:
# *RMAD misconceptions*

# Case Study #5 Poll Question: Which of the following are true? (select all that apply)

A. No RMAD is required when the Company's net recorded reserve for loss and loss adjustment expenses (LAE) lies within the upper bound of the Appointed Actuary's range

B. No RMAD is required if Company management does not believe there are significant risks that could result in material adverse deviation

C. Presence of RMAD results in an adverse or qualified opinion

D. If a Company is exposed to significant risks, but no one risk could result in material adverse deviation on its own, then a RMAD is not required

E. RMAD considerations only apply to loss and LAE reserves on a net of reinsurance basis and not on a gross of reinsurance basis

F. RMAD should likely exist when the sum of the materiality standard plus the carried reserves is within the range of reasonable estimates

G. The Appointed Actuary did not compute a range therefore there cannot be a RMAD

H. A RMAD is always required when there are significant risks that could result in material adverse deviation when considered in combination

I. Mitigating factors may affect the Appointed Actuary's RMAD conclusion

J. A RMAD may be self-evident if the Company has consistently observed adverse development

# Misconception or reality #1: No RMAD is required when the Company's reserve lies within the upper bound of the range

- This is FALSE
- Even if the recorded reserve lies within the upper bound of the Appointed Actuary's range (i.e., above the midpoint), the distance between the recorded reserve and upper bound could exceed the Appointed Actuary's materiality standard
- Further, regardless of the quantitative test, the Company may be exposed to significant risks that could result in material adverse deviation (qualitative test)

# Misconception or reality #2: No RMAD is required if Company management does not believe there is a RMAD (or doesn't want one)

- This is FALSE
- It is the Appointed Actuary's Opinion and the Appointed Actuary has an obligation to evaluate and conclude whether there are significant risks that could result in material adverse deviation

# Misconception or reality #3: Presence of RMAD results in an adverse or qualified opinion

- This is FALSE
- The Appointed Actuary may conclude that the recorded reserves are reasonable without qualification despite the RMAD conclusion
- Statements regarding Company risk factors and RMAD are disclosures required in the RELEVANT COMMENTS section

# Misconception or reality #4: RMAD is only required when individual risks could result in material adverse deviation on their own (stand-alone basis)

- This is FALSE
- According to the Instructions, the Appointed Actuary should address the items individually and in combination when commenting on a material impact

# Misconception or reality #5: RMAD considerations only apply to net reserves

- This is FALSE
- According to the Instructions, consideration should be made as to whether the REQUIRED COMMENTS (including risk factors and RMAD) would differ on gross of reinsurance basis; if so disclosure and commentary is required
- According to the NAIC SAO Instructions, "Exhibit B should be completed for Net dollar amounts included in the SCOPE. If an answer would be different for Direct and Assumed amounts, identify and discuss the difference within RELEVANT COMMENTS."

# Misconception or reality #6: RMAD should likely exist when materiality standard + carried reserves is within the Appointed Actuary's reasonable range

- This is TRUE
- In this situation the Appointed Actuary believes that it is reasonable to expect the Company's recorded reserves will develop by a material amount

# Misconception or reality #7: No range, no RMAD

- This is FALSE
- The Appointed Actuary is not required to provide a range
- According to Section 3.7 of ASOP No. 36, Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves:

  "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."

# Misconception or reality #8: A RMAD is always required when there are significant risks that could result in material adverse deviation

- This is TRUE
- This is the exact question that the Appointed Actuary is required to respond to in item 6 of Exhibit B of the Statement of Actuarial Opinion:

  "Are there significant risks that could result in Material Adverse Deviation?"

# Misconception or reality #9: Mitigating factors may affect the Appointed Actuary's RMAD conclusion

- This is TRUE
- This comes from the NAIC AOWG Regulatory Guidance which says:

  "Mitigating factors – Regulators generally expect Appointed Actuaries to comment on significant company-specific risk factors that exist prior to the company's application of controls or use of mitigation techniques. The company's risk management behaviors may, however, affect the Appointed Actuary's RMAD conclusion."
- Consideration should be made as to whether a RMAD exists before (or regardless of) the mitigating factor(s)
  - An example might be the existence of a retroactive reinsurance agreement that is not taken into account; according to SSAP No. 62R:

    "The ceding entity shall record, without recognition of the retroactive reinsurance, loss and loss expense reserves on a gross basis on the balance sheet and in all schedules and exhibits"

# Misconception or reality #10: A RMAD may be self-evident if the Company has consistently observed adverse development

- This is TRUE
- If a review of the Five Year Historical Data Exhibit shows that the Company has exhibited consistent adverse development, the Appointed Actuary may want to consider whether a RMAD is essentially self-evident
- Consistent adverse development is also a sign that the methods and/or assumptions may not be representative of the underlying experience and therefore the Appointed Actuary may want to reconsider
- Regardless, the Appointed Actuary should be able to explain why such development is not expected to continue based on the current methods, assumptions and estimates

# Changes to the NAIC SAO Instructions in 2020

# Changes to the NAIC SAO Instructions

- SAO 2020 requirements
- Continuing Education (CE) requirements for Appointed Actuaries
  - CAS actuaries can attest to having met the CE requirements for issuing Actuarial Opinions on the CAS website, as they do for CE
    - Required for 2021 attestations
      - Meet USQS – "I have complied by US Qualification Standard"
      - Meet USQS and NAIC – "I have complied – NAIC Statement of Actuarial Opinion by US Qualifications"
  - CE requirements did not change
  - Documentation of 2020 CE (2021 attestations) need to include additional documentation of NAIC CE categories
    - Particular format of reporting is not currently mandated, although a template has been released by the CAS and SOA
    - CAS to provide summary statistics on type of CE to NAIC

<u>If subject to the *U.S. Qualification Standards*, the Appointed Actuary shall annually attest to having met the continuing education requirements under Section 3 of the *U.S. Qualification Standards* for issuing Actuarial Opinions. As agreed with the actuarial organizations, the Casualty Actuarial Society (CAS) and Society of Actuaries (SOA) will determine the process for receiving the attestations for their respective members and make available the attestations to the public. An Appointed Actuary subject to the *U.S. Qualification Standards* and not a member of the CAS or SOA shall select one of the above organizations to submit their attestation.</u>

<u>In accordance with the CAS and SOA's continuing education review procedures, an Appointed Actuary who is subject to the *U.S. Qualification Standards* and selected for review shall submit a log of their continuing education in a form determined by the CAS and SOA. The log shall include categorization of continuing education approved for use by the Casualty Actuarial and Statistical Task Force. As agreed with the actuarial organizations, the CAS and SOA will provide an annual consolidated report to the NAIC identifying the types and subject matter of continuing education being obtained by Appointed Actuaries. An Appointed Actuary subject to the *U.S. Qualification Standards* and not a member of the CAS or SOA shall follow the review procedures for the organization in which they submitted their attestation.</u>

*NAIC SAO 2020 Instructions*
*As adopted on May 28, 2020*

# Changes to NAIC Regulatory Guidance

- 2020 Regulatory Guidance issued by the NAIC Actuarial Opinion Working Group (AOWG)
  - Provides expectation that the Opinion and Actuarial Report address COVID-19

> COVID-19 and subsequent economic events have had a significant impact on 2020 accident year insurance liabilities for some lines of business. Furthermore, the effects of COVID-19 could extend to other aspects of the company's operations and the claims process. The Appointed Actuary should consider the direct impacts to loss and unearned premium reserves, claims patterns and loss trends, collectability of reinsurance and/or premiums, exposure, etc., as well as indirect impacts such as claims handling delays and procedural changes resulting from public health orders. It is important for the Appointed Actuary to understand the company's treatment of any changes stemming from COVID-19, for example premium refunds or rate reductions, in the annual financial statement. The impact of such financial reporting on assumptions and methods used in the actuarial analysis should be discussed within the Actuarial Report.
>
> If the impact on reserves is significant, the actuary should make relevant comments on COVID-19 impacts and discuss the corresponding actuarial assumptions in the Statement of Actuarial Opinion. Otherwise, Appointed Actuaries are still strongly encouraged to mention their review of COVID-19 effects on the company in the Statement of Actuarial Opinion, to demonstrate that it has not been overlooked or disregarded.

*NAIC AOWG 2020 Regulatory Guidance*
*As adopted on October 30, 2020*

# Resources

# Resources

- NAIC Annual Statement Instructions
- Domiciliary regulator
- Department of Insurance websites
- COPLFR Practice Note & COVID FAQs
- AAA Law Manual
- Financial Analysis Handbook – P/C SAO Checklist
  - www.naic.org/prod_serv/FAH-ZU-16-01.pdf
  - www.naic.org/prod_serv/FAH-ZU-16-02.pdf
- AOWG Regulatory Guidance
- COPLFR Opinion Writer's Seminar
- Statements of Statutory Accounting Principles (SSAPs)
- ASOPs
- CAS sessions, other professional meetings
- CAS & AAA publications
- Publicly-available SAOs (A.M. Best's, SNL, internet search)
- COPLFR members

# Thank You!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