

ASOP 36 and 43

Clearer Guidance to Actuaries Performing Services Related to
Developing Unpaid Claim Estimates and Issuing SAOs

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Presenters

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Agenda

- ASOP 43 – Property/Casualty Unpaid Claim Estimates
- ASOP 36 – Statement of Actuarial Opinion Regarding Property/Casualty Loss and LAE Reserves

ASOP 43 and the Statutory Opinion



ASOP 36 vs. ASOP 43

- ASOP 36 talks about how to form an opinion on a given value, and what to say about it
 - Is the carried reserve reasonable?
- ASOP 43 talks about how to do the estimation work to come up with a value.
 - How to get a reasonable estimate
- So in a typical situation, an ASOP 43-compliant analysis will precede application of ASOP 36.



Today's discussion

- This discussion of ASOP 43 will focus on preparing an ASOP 43 analysis that will support an ASOP 36 opinion
 - Either prepared by the same actuary
 - Or used by the opining actuary in forming his/her opinion



Analysis of Issues and Recommended Practice Outline

- Purpose or Use
- Constraints
- Scope
- Understanding of the Nature of Claims
- Unpaid Claim Estimate Analysis
 - Methods
 - Assumptions
 - Data
 - Recoverables (incl. collectability, gross vs. net)
 - External conditions, changing conditions
 - Uncertainty
- Unpaid Claim Estimate
 - Reasonableness tests
 - Presentation



Purpose or Use

“The actuary should identify the intended purpose or use of the unpaid claim estimate”

- One possible purpose is to allow you to opine on the carried reserve
 - Other possibilities exist
 - **Establishing the number that will be carried**
 - **Part of Merger & Acquisition work**
 - **Commutation analysis, and so on**
- The Statutory carried reserve is “management’s best estimate”
 - How are you going to produce a report that allows the opining actuary to evaluate that – what is your intended measure?
 - Expected Value or Actuarial Central Estimate?
 - With or without a risk margin? Do you need to consider GAAP as well as SAP?
 - Do you need to consider discounting?



Handling of Constraints

- Sometimes constraints exist in the performance of an actuarial analysis, such as those due to limited data, staff or time. Where the actuary believes that such constraints create a significant risk that a more in-depth analysis would produce a materially different result, the actuary should notify the principal of that risk and communicate the constraints of the analysis to the principal
 - If the constraints are extreme – such as in the case of a very new company – you may not be able to produce an analysis that supports an opinion (ASOP 36’s “no opinion” opinion)



Scope of the Estimate

“The actuary should determine the scope of the unpaid claims estimate.”

- Gross or net
- Collectability risk
- Unpaid claim adjustment expenses
- Cohorts of claims
- Other items needed to sufficiently describe scope
- *Your analysis should match the scope to the opinion scope*



Methods and Models

Actuary should select specific methods and/or models, modify or develop new ones based on relevant issues:

- Intended purpose, nature and scope
- Nature of claims, exposures
- Development characteristics
- Characteristics of available data and applicability to available data
- Validity of assumptions underlying each method or model



Methods and Models

- A number of methods may be available - selection based on facts & circumstances
- Different components of the estimate may require different methods
- **actuary should use multiple applicable methods to estimate unpaid loss for a particular component, unless**
 - Reliance on a single estimate reasonable in actuary's judgment
 - Disclose rationale for the decision in the actuarial communication
- Don't have to use same method as in the past
- Evaluate the appropriateness of chosen method(s) even if same method as in the past

Assumptions

- Assumptions may be implicit or explicit
- Consider reasonableness of assumptions underlying method
- **Assumptions should have no deliberate or conscious bias to underestimation or overestimation (whatever the intended measure of the estimate).**
 - Bias with regard to an expected value estimate would not necessarily be bias with regard to a measure intended to be higher or lower than an expected value estimate
- Assumptions should not be internally inconsistent
- Consider sensitivity of estimate to reasonable alternative assumptions (If very sensitive, understand why, communicate)
- ASOP 43 says that it's okay to use assumptions dictated to you, subject to appropriate disclosure
 - But if you do, can you then form an opinion?



Data, Recoverables, etc.

- Actuary directed to ASOP 23 – Data Quality
- Actuary should consider if material recoverables/offsets exist
 - unless outside the scope
- Gross vs. Ceded vs. Net
 - Consider facts and circumstances when choosing which components to estimate



External conditions, Changing conditions

- Consider external conditions that may have a material effect, to the extent they are generally known to the actuary and amenable to estimation
- Consider significant changing conditions likely to be insufficiently reflected in the data or assumptions



Uncertainty

- Actuarial estimates are inherently uncertain
- Actuary is not required to measure uncertainty
- If uncertainty is in the scope – ASOP provides guidance
- Although you don't have to measure uncertainty
 - ASOP 36 requires that you determine if there is a significant RMAD
 - So some evaluation of the RMAD should be included in your 43 analysis – can be quantitative or qualitative



Reasonableness

Do a reasonableness test on the estimate against relevant indicators – a priori reasonable assumptions do not always yield reasonable estimates

“The actuary should assess the reasonableness of the unpaid claim estimate, using appropriate indicators or tests that, in the actuary’s professional judgment, provide a validation that the unpaid claim estimate is reasonable.”

“When the actuary’s unpaid claim estimate comprises multiple components, the actuary should consider whether, in the actuary’s professional judgment, the estimates of the multiple components are reasonably consistent.”



Unpaid Claim Estimate Presentation

- Actuary should consider the intended purpose or use of the unpaid claim estimate when deciding how to present the unpaid claim estimate
 - How the opining actuary got to the conclusion in the opinion (ASOP 36) should be *very* clear in the underlying report (ASOP 43)
- Multiple possible presentations (not an exhaustive list):
 - Point estimate
 - Range of estimates
 - Point estimate + margin for adverse deviation
 - Probability distribution
 - But note that a probability distribution of outcomes is *not* a probability distribution of reasonable estimates
- If the carried reserve is not the same as the point estimate in the ASOP 43 report
 - What makes the carried reasonable?



Communications & Disclosures

- General Guidance:
ASOP 41 Actuarial Communications
 - Principal & Scope, Form & Content, Timing, etc.
 - An actuarial report *is* required
 - Documentation should be sufficient for another actuary practicing in the same field to evaluate the work
- *ASOP 23 Data Quality*



Communications & Disclosures Specific to the Proposed Standard

- Clearly convey the intended purpose or use
 - More than one intended use?
 - Any compromises in order to produce a single work product for multiple intended uses?
- Any resource constraint issues?
- Clearly define the scope of the estimate



Dates Associated with the Estimate

- Actuarial communication should include
 - Accounting date
 - Valuation date
- Review date may have to be included in certain circumstances

As an example, “This unpaid claim estimate as of December 31, 2005 was based on data evaluated as of November 30, 2005 and additional information provided to me through January 17, 2006”



Communications & Disclosures

Uncertainty

- The actuarial communication should include discussion of the uncertainties in the estimated claim liability
- This discussion should include both the uncertainty in the estimate and the uncertainty of actual results varying from the estimate



Significant Events & Assumptions

- Include explicit discussion of any significant assumptions or events underlying the estimate that may not be obvious to the intended audience, including significant assumptions regarding the accounting basis or application of an accounting rule
- Where the final work product reflects a material assumption or methodology that differs from what the actuary believes to be reasonable
 - Disclose the dependency of the final result and
 - Disclose the source



Ranges

- What is the range intended to convey?
- For example:
 - a range of estimates of the actuarial central estimate;
 - This is the range contemplated in ASOP 36
 - a range representing a confidence interval within the range of outcomes produced by a particular model or models;
 - a range representing a confidence interval reflecting both process and parameter risk;
 - some other clearly defined range



Material Changes

- If the analysis is an update, disclose any material changes in assumptions
- Disclose the reasons for the change
- Not required to quantify the effect

ASOP 36 – Current version

Major Points

- Scope
- Types of Opinions
- “Reasonable estimate”, “Reasonable Range”
- Second Opinions / Reliance on Others
- Material Risk of Adverse Deviation
- Disclosures
- Other – including sources of future changes



ASOP 36 - Scope

- Opinions required by law/regulation
OR
- Labeled as “Statement of Actuarial Opinion”
- Loss & LAE reserves only

ASOP 36 – Types of Opinions

Five types of opinions

- Reasonable provision
- Deficient / Inadequate
- Excessive / Redundant
- Qualified – “all but”
 - quantified “but” – except for line A with \$X reserve
 - unquantified “but” – except for item B that is buried in C
- No Opinion – due to deficiency/limitation in data, analysis, assumptions, information ...

ASOP 36 – “Reasonable”

- Reasonable provision =
 Within a range of reasonable reserve estimates
- Range of reasonable estimates =
 “a range of estimates that could be produced by appropriate actuarial methods or alternative sets of assumptions that the actuary judges to be reasonable.”
- Range of reasonable estimates \neq
 range of all possible outcomes

“In evaluating the reasonableness of reserves, the actuary should consider one or more expected value estimates of the reserves ...”

ASOP 36 – Second Opinions, Reliance on Others

Allows for Second Opinions, defined as
“review of the work of another actuary [with the] opinion given based on that review”

Also allows for:

- “Reliance on Others for Supporting Analysis”
 - Without claiming responsibility for their work
 - With claiming responsibility for their work
- “Reliance on Opinions of Other Actuaries”



ASOP 36 – Reliance on Others’ Opinions

“Reliance on Opinions of Other Actuaries”

- Can only do so if consistent with intended use of that other opinion.
- Allowed to claim no responsibility for that other opinion.
- Where sometimes used:
 - Large health insurance reserves for P&C company
 - Assumed reserves from residual market pool
e.g., WC, Auto



ASOP 36 – Material Adverse Deviation

“Consider the implications of uncertainty”

Required explanatory paragraph disclosure

“if the actuary reasonably believes that there are significant risks and uncertainties that could result in material adverse deviation”

- Include amount considered material
- Describe major sources of risk / uncertainty.

ASOP 36 – Required Disclosures

- Say “statement of actuarial opinion” in the title
- State when relying on the work of others, and not taking responsibility for it.
- If reserves being opined upon (are):
 - Gross or net (or both)
 - Discounted
 - Include a Risk Margin
 - If deficient, by (at least) how much
 - If excessive, by (at least) how much

ASOP 36 – Required Disclosures (2)

If opining actuary used different:

- assumptions
- procedures
- methods

from a prior opinion, and change was believed to be material to the results, then disclose the change.

Not required to quantify the impact.



ASOP 36 – Other items

Educational material on

- Analyzing reserves
- Sources of uncertainty
- Dealing with data

Risk margins –

“The actuary may include risk margins in a range of reasonable estimates, but is not required to do so”

Scope excludes:

- Non loss & lae items
- Asset Adequacy analysis
- Risk Transfer analysis

ASOP 36 – Exposure Draft

Major Issues

- **Overlap with ASOP 43**
- **Scope confusion – “Statement of Actuarial Opinion”**
- **More clarity on the subject of the opinion**
- **Second Opinions / Reliance on others**
- **Format Revisions**



ASOP 36 – Exposure Draft changes vs. current ASOP 36

Overlap with ASOP 43

- **Remove the overlap –
e.g., guidance on how to produce an estimate**

Scope confusion – “Statement of Actuarial Opinion” Change

**“identified as Statement of Actuarial Opinion”
to
“identified as [SAO] in compliance with this [std]”**

ASOP 36 – Exposure Draft Changes (2)

More clarity on what's being opined upon

Explicitly requires disclosure of:

- Purpose, intended use
- Intended measure
- Gross vs. net
- How are recoverables handled regarding collectability
- Treatment of LAE.
- Lines of business, etc.



ASOP 36 – Exposure Draft Changes (3)

No longer references “Second Opinions”

No longer allows for reliance on others’ analysis without claiming responsibility for it.

Reliance on others without responsibility only possible for others’ reserve opinions

e.g., Others’ opinions on residual market pool



ASOP 36 – Exposure Draft Changes (4) - formatting

Educational material removed

Material was valuable, but counter to ASB format

All required disclosures moved to section 4

All required analysis moved to section 3

Section 3 restructured to follow sequential flow of the work

ASOP 36 – Comments on Exposure Draft

Caveat – will only discuss major conceptual items potentially causing changes, and those less apt to result in changes.

*None of this has yet been approved by the ASB.
Redrafting of exposure draft is at subcommittee level.*



ASOP 36 – Comments on Exposure Draft (2)

Q1 - Intended measure – unclear.

A1 - Possible response – replace with “accounting basis for the reserve” being opined upon

Q2 – Reliance on others ...

A2 – Possible response – actuary always responsible for entire opinion. If you rely on other’s opinion for a portion, the result is a qualified opinion.



ASOP 36 – Comments on Exposure Draft (3)

Q3 – General scope issues – make ASOP 36 more consistent with statutory opinion.

A3 - Possible response – Scope of ASOP 36 is broader, needs to allow for opinions on trusts, self-insured accounts, M&A work, etc.

Q4 – Risk margins – Always allow, always require

A4 – Possible response – Opining is on a pre-existing amount. Opining Actuary is restricted to the accounting basis (and accounting policy) underlying that amount. May not “hold the option” as to risk margin.



ASOP 36 – Comments on Exposure Draft (4)

Q5 – Retain educational language.

A5 - Possible response – The ASB made a decision as to what will and will not be in ASOPs. They decided that basic education does not belong in standards.

Q6 – Effective date – not too close to year-end.

A6 – Possible response – subcommittee acknowledges the concern and will pass it along.

Questions from the Audience?