

# CAS: Enhancing the Reputation of Casualty Actuaries



GIRO Convention  
October 2007

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## Background

- November 2003 Standard & Poors article
  - “Actuaries are signing off on reserves that turn out to be wildly inaccurate. It’s an abysmal track record.”
  - “....whether through knavery or naivete....”
- 2003 CAS leadership survey “Top Story”
- September 2004 board retreat to discuss issue
- Task Force on Actuarial Credibility formed
  - To identify, prioritize, and investigate the feasibility of possible strategies for enhancing the perceived credibility of the actuarial profession, and to develop action plans for implementing strategies considered to have the greatest potential for high impact.
  - CAS Board accepted Task Force Report at its Spring 2005 meeting

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## Task Force Recommendations

- A. Enhance transparency of the actuary’s conclusions by identifying differences between the “best estimates” of management and the actuary.
- B. Enhance the public’s understanding of actuarial estimates and to refine actuarial methodologies.
- C. To improve the transparency of actuarial estimates by providing the changes from one reporting period to the next within the actuarial report.
- D. To enhance the quality of corporate governance for property/casualty insurers by educating audit committees and/or boards of directors on the roles and responsibility of the appointed actuary.
- E. To enhance self-governance of the actuarial profession with respect to reserve opinions by requiring the appointed actuary to provide an explanatory document with the ABCD whenever the change in the actuary’s reserve estimate over a defined period of time exceeds certain predetermined thresholds.
- F. Incorporate the actuarial statement with the Jurat page of each property/casualty insurance company’s Annual Statement.

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## Said Another Way....

- Qualification
- Personal Accountability
- Research
- Education
- Governance
- Communication

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## Qualification

- Ensuring that actuaries have the necessary education and training to perform the requested services
- Action: American Academy adopted revised Qualifications Standards, effective January 1, 2008

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## Personal Accountability

- Public disclosure of actuary's point estimate reserve the most highly contested of any of the recommendations
- Acknowledged and applauded by certain rating agency representatives
- However, many actuaries who were actively involved in financial reporting disagreed with the recommendation. There were concerns that:
  - Inherent uncertainty in the reserve estimates would not be fully understood; Users of actuarial opinions would believe there was more certainty in the reserve estimates than actually exists
  - "Dueling" estimates would place actuaries in an adversarial role with their principal(s); there would be undue emphasis on resolving the differences between the two estimates (the actuary's best estimate and management's recorded reserves)

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## What HAS Happened?

- Membership Polled on Reputation Risk as well as Task Force Recommendations
  - MAP survey conducted – Q2 2005
  - Survey of Opinion Writers – Q4 2005
- NAIC Casualty Actuarial Task Force considered recommendation – Q3 2005
  - Deferred action
  - Preferred rather to evaluate the quality of information provided in the Actuarial Opinion Summary for regulatory purposes
  - Potential conflict exists between regulatory and other interests, when disclosure is public
- Actuarial Standards Board asked Casualty Committee to consider recommended changes – Q4 2005
  - Casualty Committee noted strong disagreement among actuaries
  - Tabled consideration

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## What HAS happened?

- Actuarial Opinion Summary provides useful and timely information to regulators
  - Confidential document, due March 15
  - Disclosure of point estimate and/or range
  - Extended discussion of issues affecting the reserves, in situations where there is chronic adverse reserve development
  - Information could be aggregated for analysis
- Regulatory Guidance Brief provides clear direction to the appointed actuary on what items should be considered and how

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## Research

- Why Do Companies Fail? Or Have Large Reserve Changes?
  - Committees of both CAS and American Academy researched
  - Observations
    - Small number of companies explain total industry reserve development, although the companies change from year to year
    - High concentration of public companies and companies that write long-tailed lines of business in that group
    - Initial mis-pricing of business a significant contributor
- Refining/advancing actuarial methodologies to quantify reserve uncertainty
  - CAS Working Parties
    - Bornhuetter-Ferguson Initial Expected Loss Ratio
    - Tail Factors
  - COTOR Challenge
  - Strong collaboration among actuarial associations globally

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## Possible New Ground

- Using predictive modeling to link economic conditions to reserve estimates
  - Likely will better reflect the inherent process and parameter risks
  - Example: GIROC research on development patterns within underwriting cycle
- Develop approaches for reconciling conflicts in estimates
  - Applicable both to mean estimates and to estimates of the distribution
  - Greater transparency of assumptions/judgments

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## Education – Of Actuaries

- American Academy's seminar on Effective P/C Reserve Opinions
  - Offered annually since 2005 – consistently SRO
  - “Boot Camp” designed to provide appointed actuaries with an overview of current requirements
  - Provides a forum for discussing how to deal with difficult situations
- Educational sessions on modeling reserve variability
  - Prototype program offered at CAS Spring Meeting 2005
    - Focused on the more common stochastic methodologies
    - Overview of Mack, Bootstrapping and others
  - Limited Attendance seminar offered 2006 & 2007
  - Call Paper Program – CLRS 2006

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## Education – Of Our Publics

- Efforts to date have focused on:
- Agree upon common language to discuss variability
  - Terms such as likely, unlikely, remote, etc. are easier to understand
  - GIROC has provided a great lead here
- Work toward developing standard methodologies for assessing uncertainty
  - Describe those approaches in plain English
  - Agree on common language to describe how we assessed uncertainty, again in plain English
- Use of examples

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## Governance – Within the Profession

- Several New Actuarial Standards of Practice
  - ASOP 36: Statement of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves (Adopted 2000)
  - ASOP 43: Property/Casualty Unpaid Claim Estimates (Effective September 2007)
  - ASOP 42: Actuarial Communications (Effective March 2002)
- Critical Assessment of Counseling and Discipline
  - Actuaries' knowledge and use of ABCD lacking
    - Broad education initiative
    - Particularly on counseling and requests for guidance
  - CRUSAP: Organizational Changes Recommended

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## Broader Governance Initiative

- American Academy recently issued “Actuarial Considerations for Audit Committees and Boards”
  - What should be expected of the Appointed Actuary?
  - Understanding actuarial workproduct
- Regulators (NAIC) discussed the advisability of requiring that the appointed actuary's report be made “in person”, with no consensus
- Formal survey of actuarial opinion users under consideration

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## Communication

- A Real Challenge
- Terms are not well-defined
  - Different actuaries use the same words to mean different things.
  - Current accounting literature is ambiguous as to ultimate objective for financial reporting purposes
- For many actuaries, English is a second language
  - CEO Surveys confirm effective communication as an issue
  - Risk and uncertainty ARE difficult concepts to communicate
  - Reluctance of many actuaries to engage in “dialogue”
- Training: “If it's offered, they will come” – but we don't

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## In Summary

- No “Silver Bullet”
- Many actions “in the works”
- All US organizations representing casualty actuaries involved in implementation effort
- For CAS, reputation risk incorporated into our Enterprise Risk Management initiatives
- Softening market conditions heighten risk, particularly if pricing actions are not effectively monitored and incorporated into the reserve estimates

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