



**Casualty Actuarial Workbench:
Regulation of the PDR
and other Recent Initiatives**

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**Presented to: Southern California Casualty
Actuarial Club**

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What Is The PDR?

Premium Deficiency Reserve

- Long-standing GAAP requirement (FAS 60)
- Statutory requirement since Codification (SSAP 53 - 2001)
- Founded on evaluation of rate adequacy (for short-term contracts)
- Squarely within the actuarial purview



PDR – “The Dream”

- Part of Unearned Premium Reserve
- Provides for liability shortfall when rates inadequate
- Improves consistency between Premium liabilities and Loss liabilities
- Can also serve as a metric to alert principals to inadequate rates



PDR - The Current Statutory Requirement

- Credit is allowed for
 - Prepaid, pre-booked expenses (acquisition costs)
 - Investment Income (for better estimate of economic liability)
- To be evaluated “in a manner consistent with how policies are marketed, serviced, and measured.” [SSAP 53]
- Only zero or positive PDRs are to be booked
- Profitable lines may not offset PDR for unprofitable lines



PDR – Current Landscape

- As part of unearned premium, is now outside scope of reserve opinions
- No requirement currently for any actuarial review
- Many practitioners have given little thought to how it should be estimated
- Someone has to check the box that says it was reviewed



So Who Evaluates It These Days?

One Guess...



So Who Evaluates It These Days?

The Accountants



PDR – “The Reality”

- Very few companies carry a PDR
- Some estimates place actuarial involvement at 10%
- Accountants tend to focus on the fact that the reserve usually does not appear material
- Analysis is superficial, involving underwriting input and target loss ratios
- Very coarse breakdown of lines (e.g. “all commercial” / “all personal”) results in offset of profits and losses



CASTF (NAIC) Comes On The Scene

- Proposal for a PDR Opinion was exposed in early 2009
- Year-end 2010 currently proposed date of implementation
- Data gathering /comment gathering
- In the first round, several letters were submitted



CASTF's Basic Proposal

- All companies subject to opinion requirement
- Separate opinion contained within loss reserve opinion
- SSAP 53 left as is – reserve requirement has not changed
- Actuarial opinion on the reasonableness of the established reserve
 - Increases transparency of the reserve
 - Requires one person (an actuary) to take ownership of the estimate, evaluated in isolation



Since I Am At The Podium, I Will Tell You What I Think

- Supported this concept in 2008 before CASTF took it up [*Actuarial Review*, August 08]
- Broadly, this is an excellent proposal
- All insurers should get such an opinion covering all their lines
- Industry needs more transparent underwriting
- Help temper the pricing/profitability cycle
- No one better qualified than actuaries



Is This About Reserves/Solvency?

- Only partly. This proposal will improve the reserving of companies in this area
- Equally or more important: PDR provides actuarial insight into rate adequacy



How Could The Proposal Be Fine Tuned?

- Let the pricing actuary sign the PDR opinion
- Take it out of the time frame of the year-end crunch
- Provide guidance on how finely the lines of business need to be examined
- Specify that reasonableness of reserve is independent of the materiality of the reserve or its size relative to surplus or to other company reserves



COPLFR's (AAA's) Comments

- Actuaries don't routinely do these types of analyses so we have limited experience and established practice
- There is little existing guidance so we need to be told how to make this estimate
- We need accountants' help to estimate this, especially in areas like investment income and underwriting expenses
- The effort involved is disproportionate to the benefit since PDRs are infrequent and small
- If companies are carrying zero PDR, why do an expensive analysis to prove what we already know?



Translation: “We Don’t Wanna”

- Actuaries are experts at rates. We can and should do this
- We don’t have to pass the buck to the accountants. We can sign the opinion, and get help on areas of doubt
- We don’t know if “zero” is the right number until the analysis is completed
- Even when the reserve is immaterial it provides valuable insight on rate adequacy
- The actuarial report will provide detail for drilling down line by line



What Do The Companies Have To Hide?

- If they are monitoring profitability, why would a PDR be difficult?
- If they are monitoring rate levels, why aren't actuaries already involved?
- If the reserve requirement exists, and they are complying already, why can't they get an actuary to sign off on it?
- Aren't the stakeholders entitled to full disclosure?



Precedent – Reserve Opinions

- There was a similar controversy in the early 90's
- Many actuaries objected to this obligation
- Accountants waiting in the wings, happy to take it
- The industry is much better off now with the heightened, more robust oversight
- So is the profession – greater demand, greater use of actuaries
- Requirement was later extended to monoline insurance, with identical reaction: resistance, then acceptance; broader use of actuaries resulting in better reserving



Next Steps

- Follow up comments solicited (due tomorrow. I sent mine)
- National Meeting of NAIC in Minneapolis
 - CASTF to discuss PDR on June 14
- A subgroup of CASTF has been appointed to revise the proposal
 - Opinion-free “safe harbor” proposed for companies with zero PDR (bad idea)
 - Logistical details like timing of opinion to be addressed
 - Other issues like detailed practice guidance are on the table
- The 2010 implementation could slip
- Significant interest among members of CASTF, due to widespread perception among regulators that this is necessary



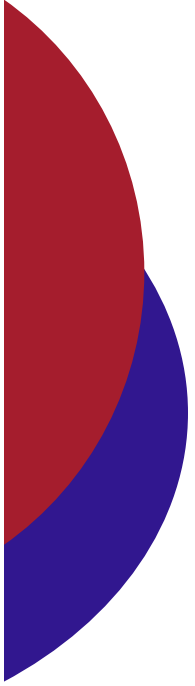
To Follow the Debate (& Other CASTF Issues)

- See materials posted at
www.naic.org/committees_c_castf.htm
- Become an Interested Party to receive CASTF email notices
Send request to kdefrain@naic.org
- Participate in CASTF teleconferences
(public is welcome)



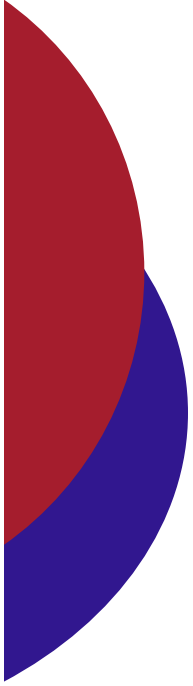
A Little Bit of Pontificating (Me Again)

- CAS wants to do ERM
- PDR is a risk factor that falls within our core skills AND is ERM
- Underwriting risk is a critical ERM risk
- You can't do ERM without incurring costs and sometimes giving companies bad news
- Head-in-the-sand approach to risk is antithetical to a profession serious about becoming go-to risk analysts!



Questions?

Discussion?



Next Topic

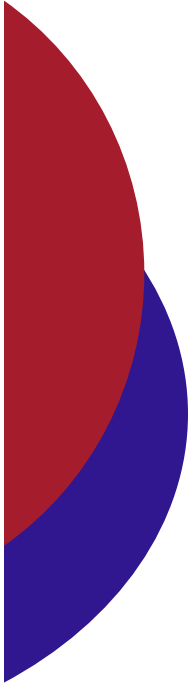
Update on Continuing Education



Current CE for U.S. Actuaries

AAA Qualification Standard (2008)

- 30 hours CE (major expansion)
- Only applicable to those providing “actuarial opinions”
- Only applicable in U.S.
- Great improvement but still not universal to all CAS members



The International Problem

- The Qualification Standard only applies in the U.S. because the AAA is a national body
- Other countries set their own standards
- A few countries (e.g. Bermuda) have no CE standard to speak of



The “Scope of Practice” Problem

The AAA (and the CAS in its initial exposure draft) use a laborious definition of actuarial opinion:

“Actuaries who issue Statements of Actuarial Opinion when rendering Actuarial Services in the United States are required ... to satisfy these Qualification Standards ...

“For purposes of the Qualification Standards, a **‘Statement of Actuarial Opinion’** (SAO) is an opinion expressed by an actuary in the course of performing Actuarial Services and intended by that actuary to be relied upon by the person or organization to which the opinion is addressed. ‘Actuarial Services’ are defined in the *Code of Professional Conduct* as ‘Professional services provided to a Principal (client or employer) by an individual acting in the capacity of an actuary. Such services include the rendering of advice, recommendations, findings, or opinions based upon actuarial considerations.’”



The Initial Response of the CAS CE Task Force (2008)

- CAS Policy exposure draft – strictly dealt with the extraterritorial issue
- Left untouched the scope of practice issue
- Those not providing opinions remained exempt



Why Not Go the Rest of the Way?

- The Exposure Draft will not impact U.S. practitioners
- Everyone providing actuarial services needs continuing ed
- The reputation of the profession is impacted by this issue
- The CAS is lagging most other societies significantly



CE for Other U.S. Societies

Have trumped AAA with universal requirements

- SOA: every actuary who does not meet requirement must disclose; evidence of non-compliance also available in online Directory; requires more organized activity
- CCA: 30 hours per year required to retain membership
- EA's: long-standing universal requirement (12 hours)
- ASPPA: average annual requirement of 20 hours to retain credential



CE for Societies Internationally

- Faculty & Institute (UK): 15 hours per year (universal)
- Institute-Australia: 40 hours per year (universal)
- CIA (Canada): 50 hours per year (universal, including CAS members!)
- Mexico: 40 hours per year (with exams required as certification!)



Subsequent Events

- Many comments were received by the Task Force
- Second draft of Policy extends 30 hours of CE per year to all members (with very limited exceptions)
- Definition of Actuarial Opinion is deleted, just like the SOA did in their new policy
- Task Force was dismissed with thanks but the Board is not done yet...



Where is CE Going Next?

- Board ratified the approach but had some concerns with the details
- Appointing an EC sub-group to refine the draft and decide whether re-exposure is necessary
 - I tend to think it will need to be re-exposed
- A number of issues will need to be clarified
 - Nature/scope of exemptions from CE
 - Method of requalification of those whose CE lapses (either through error, or due to exemption)
 - Method of monitoring/enforcement/discipline (if any)



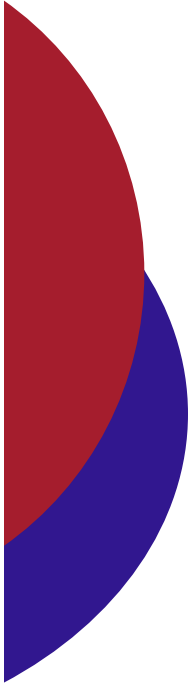
With More Requirements the CAS Provides More Opportunities

- CAS aggressively expanding both traditional and low-cost CE offerings
- Webinars, webcasts, on-line archives
- *Variance*
- Not *all* CE opportunities cost \$1000's
- Result will be a better prepared, better educated profession



Why Does CE Matter?

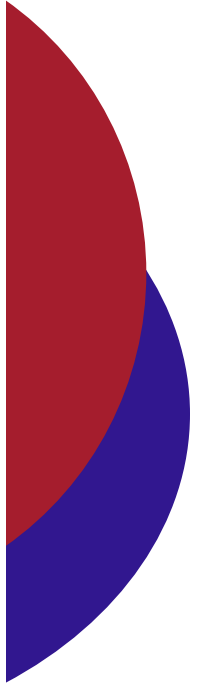
- CRUSAP
- Morris Report
- Standard & Poor's
- Centennial Goal
- Reputation of the Profession
- Preparedness for the Future



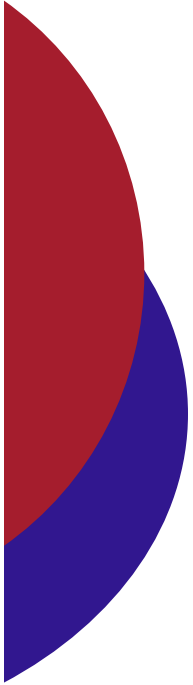
Discussion?

Questions?

Other Issues?



Thank You!



Ken Quintilian, FCAS, MAAA, is currently Vice President Administration of the CAS, and Vice President & Chief Actuary at Medical Liability Mutual Insurance Company.

The opinions expressed in this presentation are his own and do not reflect positions of the CAS or of his employer.



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