



CS-18: THE ACTUARIAL ROLE IN THE AUDIT

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Common questions regarding audits

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- What is the focus of an underwriting audit? Why audit?
 - What is an underwriting audit like?
 - What are the roles/responsibilities of those on the audit team?
 - What is the benefit of sending an actuary on the audit?
 - As an actuary, what should you do to prepare for an audit?
 - What is done with the results of the audit? What is the impact on the pricing?

Agenda



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Overview of an underwriting audit



Overview of an underwriting audit



Why audit?

- Primary focus: To confirm that client is operating consistent with expectations

As Ronald Reagan once said . . . “Trust, but verify”

- Make recommendations (via wrap up) to improve client underwriting/pricing process
- To gain insight into nuances of client-specific data that cannot be gleaned from submission
- Strengthen relationship with client by adding value/providing service



A better understanding of the client’s operations and pricing should translate into better reinsurance pricing assumptions

Overview of an underwriting audit

The actuary's role at the underwriting audit:

- Gain a better understanding of the client, target business, and exposures
- Meet with client actuary
 - May glean information that an underwriter may not have gotten and that is not in reinsurance submission
 - Review rate monitoring process
 - Review pricing tools and price adequacy
 - Review loss development and portfolio changes that will impact pricing
 - Review historical results
- Member of the underwriting file review team

Overview of an underwriting audit

What is an underwriting audit like?

Typical schedule (over 1 to 2 days):

1. Overview meeting
2. Possible meeting with client's actuary
3. Underwriting file review
4. Lunch or dinner with client
5. Wrap up

Overview of an underwriting audit

1. Overview meeting:

- There may be other reinsurers present
- Good chance to meet/judge client management and line underwriters
- Client usually provides overview of their book of business/market
- Good chance to ask open-ended questions
 - What has changed since last year?
- Be prepared with good questions – clients appreciate it when you do your homework (Do not interrogate client, though!)
- Get their view of market trends and competitors
- What are they targeting, where are they pulling back?

Overview of an underwriting audit



2. Meeting with client actuary:

- A separate meeting with actuary can be extremely beneficial
- Gain better understanding of actuarial organization and involvement within client company
 - How does the client actuary view his/her role?
 - What is their role relative to account pricing, model development, reserving, rate monitoring?
- Get a walk-through of the client's pricing model(s) and/or the pricing of one or two accounts.
 - This can help when reviewing actual files to make sure application of tool is consistent with expectations.

Overview of an underwriting audit



2. Meeting with client actuary:

- Review the rate monitoring process
 - Discuss how much of the business is captured in the rate monitor
 - Which elements are not captured in the report (new vs. renewal, high excess or accounts with layer changes, minimum premium accounts, etc.)
 - Provide possible suggestions on how to capture missing elements and/or get actuary's view as to impact of missing elements
- Discuss any changes that may impact loss development or prospective portfolio
- To the extent the client is comfortable, discuss prospective ELR and rate change assumptions.
- Build a relationship with client's actuary

Overview of an underwriting audit



3. Underwriting file review:

- File information and analysis
- Risk assessment
- Pricing
- Documentation
- Compliance

Overview of an underwriting audit



3. Underwriting file review:

File information and analysis:

- Completed application, loss history, loss control reports, MVR's, financials, etc. present in file
- Indications that the above have been reviewed
- Some files contain prior year pricing information; if not, a comparison to the prior year's file may be appropriate (check rating parameters, risk classification, etc.)

Overview of an underwriting audit



3. Underwriting file review:

Risk assessment:

- Quality review and understanding of policyholder operations and exposures
- Review of historical losses
- Follow up on loss control recommendations
- Proper use of limits and SIRs
- Coverage: Were the policy form, exclusions, and endorsements appropriate?

Overview of an underwriting audit



3. Underwriting file review:

Pricing:

- Was the risk properly classified and rated?
- Does exposure base seem reasonable?
- Are the pricing tools used appropriate for the risk?
- Use of schedule rating reasonable or just a means to back into needed rate?
- Comparison to prior year's pricing and capture of rate change
- Is pricing consistent across audit file sample?

Overview of an underwriting audit



3. Underwriting file review:

Documentation:

- Is file neat and organized?
- Can the pricing process be traced?
- Did the underwriter clearly summarize the reasons for writing the risk?

Overview of an underwriting audit



3. Underwriting file review:

Compliance:

- Is the risk within the underwriting guidelines?
- Was the risk appropriately referred and approved?
- Does the risk fit with the company's strategy and capabilities?

Overview of an underwriting audit



5. Wrap-up:

- Once files are reviewed and results compiled, the reinsurer may offer guidance to the client.
- What adverse patterns did the audit reveal and what steps can improve the process?
- What positive patterns were revealed that should be reinforced?
- What controls can the reinsurer recommend to help the client improve its risk selection and/or pricing process going forward?

Overview of an underwriting audit



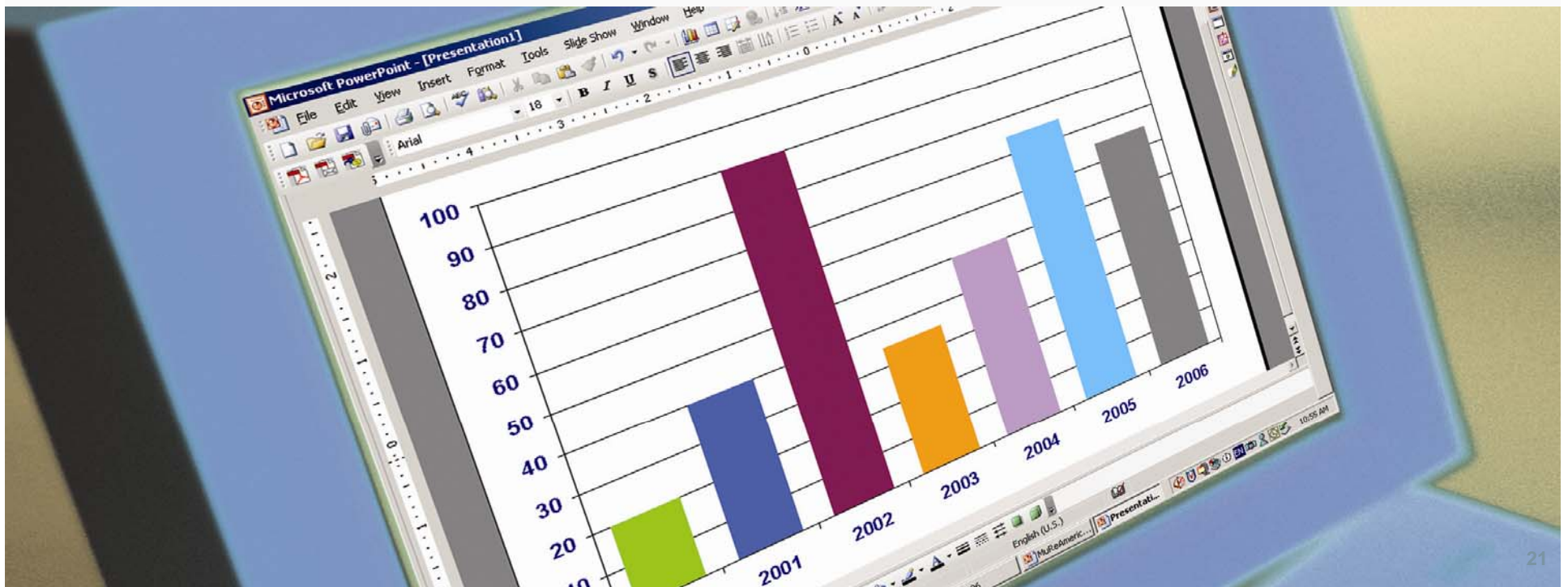
Audit challenges:

- Short timeframe
- Required social time (lunch, dinner, etc.)
- Regular job doesn't go away
- Other auditors in conference room can be a distraction
- Each file takes a while to review
- Relationship considerations



Preparation is key to successful audit!

Preparing for the audit



Preparing for an audit

-
- Coordinate and prepare with other disciplines (underwriting, client management, claims, etc.) in advance:
 - Know your objectives and audience
 - If possible, try to arrange a separate meeting with the client's actuary during the audit
 - Review external information sources (know your client):
 - Company's website
 - A.M. Best report
 - Google the company for recent news articles
 - Review Annual Statements and Schedule P

Preparing for an audit

-
- Review the reinsurance submission, if available; otherwise, review the prior year's submission or rate study:
 - Identify any additional data needs or questions relating to the data
 - Identify areas where assumptions were made in prior year's rate study that require clarification

 - Review internal reports and analyses:
 - Prior underwriting audit and claims audit reports
 - Review historical results on all business ceded by client

Preparing for an audit



Things to bring with you to the audit:

- An agenda containing the list of questions you would like to have addressed
- The current or prior year's submission, depending on availability
- Your laptop, possibly loaded with a worksheet to capture data from underwriting files



Post audit / Impact on pricing



Post audit / Impact on pricing



Post-audit activities:

- Write a brief memo highlighting your findings from the audit, including notes from discussions with the client's actuary.
- This memo should be provided to the underwriter and kept in the pricing file.
- Reflect information learned at the audit in your pricing.

Impact on pricing:

- Case study and examples

Post Audit / Impact on pricing

Examples of audit impact on pricing:

1. Rate monitoring/On-leveling:

- Client rate monitor looks sophisticated but only captures small % of book.
 - Adjustment made for new business and for impact of layer shift
- Umbrella rate monitoring often falls short –
 - Client rates umbrella based off of modified underlying premium and underlying premium is 30% of what it was 5 years ago – most of umbrella policies are now at minimum as a result.
 - Year-over-year deviations in 1st mil factor (client uses range) not captured as rate change; only umbrella schedule credits monitored
- File review revealed classification shifting at renewal

Post Audit / Impact on pricing

Examples of audit impact on pricing:

2. Claims handling/reserving:

- Changes in adjuster loads due to staffing issues lead to slower development patterns than seen historically.
- Client settlement behavior/initiatives impacting excess development. Data provided by client demonstrated speed up of large claim closure rate due to settlements.
- Based on changes in claims handling procedures, exposure to ECO/XPL claims should be reduced relative to historical results.
- Paid-to-incurred ratios show increasing trend over last couple of calendar years due to change in reserving.

Post Audit / Impact on pricing

Examples of audit impact on pricing:

3. Portfolio changes:

- Client writing “start-up” program business. Client’s actuary provided MGA’s historical data that he reviewed, allowing an experience rating.
- Client is shifting average limit and attachment point, affecting the usefulness of historical experience rating.
- Client’s mix of business will change prospectively, which has a direct impact on expected loss ratio. Reviewed experience by segment and adjusted treaty structure as a result.
- Client exiting specific state(s). Client’s actuary provided data to remove exited states’ historical premiums and losses from experience.



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