

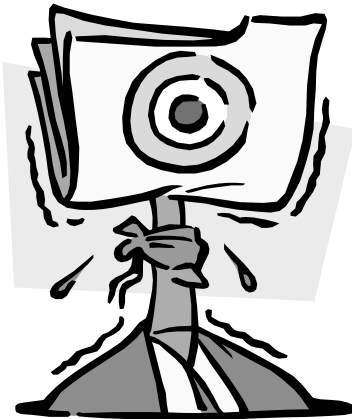
Session 99: Do The Right Thing!

Charles Cook,
Consulting Actuary, MBA Inc.

Michael Toothman,
Actuarial and Risk Consulting Services

Chet Szczepanski,
Donegal Insurance Group

Critical Focus Points



- Statements of Actuarial Opinion
 - Narrowly defined
 - Broadly defined
- Estimates of Critical Financial Values
- Other

Conflicting Perspectives

- Board of Directors
- Management
- Shareholders
- Retained 'Independent' Actuary
- Professional Peers
- Regulator
- Consumer
- Public
- Courts
- Other



Sources of Guidance



- Code of Conduct
- Qualification Standards
- Actuarial Standards of Practice
 - 43. Property/Casualty Unpaid Claim Estimates (Doc. No. 106; June 2007)
 - Other ASOP's
- Principles
- Peers
- Ethical Principles
- Common Sense!

How to Navigate Through Such Troubled Waters?

Case Studies



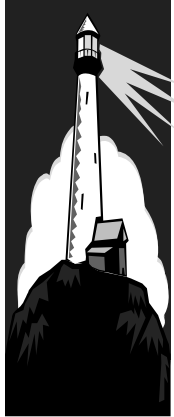
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Example #1: SITUATION

- Inquiry from Actuary A for a large audit firm
- Inquiry concerns Client Actuary B
- B issued a report saying reserves should be \$X, which company booked
- A has determined that B believes \$X is not correct but that reserves should be \$Y (Y materially different from X) and company intends to correct over several accounting periods.
- A believes B has “crossed the line”. What should A do?

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Example #1: CONSIDERATIONS/ADVICE

- A's responsibility under Precept 13
- B's Behavior
 - Possible violations of Precepts 1 & 8, maybe Precept 3, possibly others
- ABCD Process: A's Options

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Example #2: SITUATION

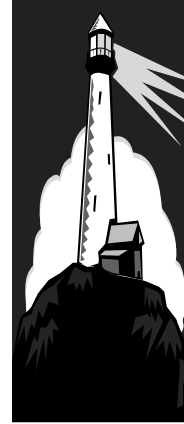
- Subject Actuary (SA) is actuary for an insurer which is being sold
- Sales agreement calls for a "true-up" of balance sheet within 90 days after effective date of sale
- SA established reserves recorded on the balance sheet at effective date of sale
- Subsequent to effective date, SA became aware of 4 potentially large claims
 - Two were reported just before effective date
 - Third occurred before effective date but was reported afterwards
 - Fourth occurred just after effective date



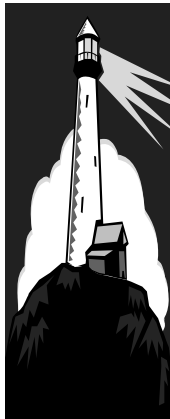
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Example #2: SITUATION (Cont.)

- All were unusual and potentially severe claims that would have a material impact on SA's reserve estimate.
- SA feels a duty to both the seller (his former employer) and the buyer (his new employer).
- What should SA do?



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Example #2 CONSIDERATIONS/ADVICE

- SA should reread the Code and the applicable Standards with this situation particularly in mind.
- SA should set the reserves as if he were being paid equally by both parties.
- SA should disclose the unusual circumstances to both parties.
- If SA feels he should add an additional risk margin to his reserves due to the increased uncertainty caused by these claims, he should identify that risk margin separately.
- Basically, follow Precepts 1 and 4.

Case Studies



Example #3: SITUATION

- Subject Actuary (SA) has been consultant for privately-held insurer for several years and has issued a Statement of Actuarial Opinion each year.
- Management has at all times wished to be “quite prudent” in its reserving. SA’s reports have therefore shown “best estimates” that in truth have been based on “conservative” assumptions. Management and Board members have at all times been aware of and indeed desired this “bias”.

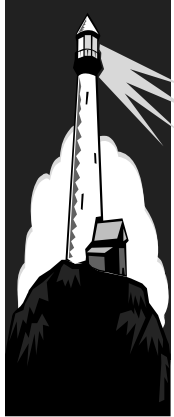
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Example #3: SITUATION (Cont.)

- Majority owner now wishes to buy out the interests of the minority owners. All parties therefore now desire a “true” estimate of the reserves.
- Impact of change from “conservative” assumptions to “realistic” assumptions may be material to the balance sheet and is certainly material to the income statement for the year of the change.
- What should SA do?

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Example #3 CONSIDERATIONS/ADVICE

- Precepts 1, 4 and 8
- Deficiencies in SA's past actions
- ASOP 36
- Ways to improve SA's work in the future in similar situations

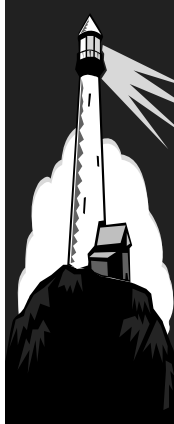
Case Studies -- Example 4: A Tale of 6 Actuaries in 4 Acts



Example #4: Scene 1

- ❖ *Young Pricing Actuary* is employed by Huge Insurance Group. He is assigned to Workers Insurance Company to set their prices.
- ❖ Workers Insurance is 90% Workers Comp and 90% in solid state – it is a leading WC market in that state.
- ❖ When he develops his losses to ultimate, he notices that his reserves for the three years he uses for prices are all far larger than the reserves on the statutory Annual Statement of Workers Insurance Company.

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- ❖ *Young Pricing Actuary* has no responsibility whatsoever for loss reserves.
- ❖ They are set somewhere in the Corporate Actuarial department of Huge Insurance Group in the Head Office.
- ❖ He doesn't even know who is responsible.
- ❖ What should *Young Pricing Actuary* do?

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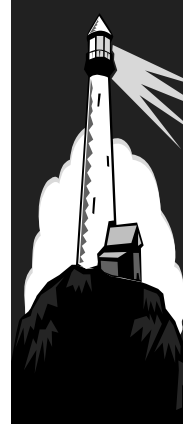
Example #4: Scene 2

- It is several years later. Workers Insurance Company is consistently profitable (because *Young Pricing Actuary* has used his own reserves) but looks outrageously profitable because HQ continues to post severely inadequate reserves in the Annual Statement.
- Huge Insurance Group has decided to sell Workers Insurance Company.
- Healthco is interested in buying it – they are 95% health insurance, 85% in solid state – it looks like a good match.



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- **Healthco's health actuaries** like the match, but wisely recommend that Healthco Management hire **Comp Consulting Actuary** to do due diligence on the WC business – it is not Health + disability.
- As soon as **Comp Consulting Actuary** starts his due diligence he is shocked to find reserves that seem to be low by \$hundreds of millions. More than a year of revenues! More than 70% of Surplus!
- He goes straight to **Young Pricing Actuary**.
- What should **Young Pricing Actuary** do?
- What should **Comp Consulting Actuary** do next?



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Example #4: Scene 3

- Young Pricing Actuary** in practice confirmed **Comp Consulting Actuary's** findings
- Comp Consulting Actuary** in practice requested a meeting between the investment bankers, Healthco Management, Huge Insurance Group, and the consultants.
- The leading representative for Huge Insurance Group happens to be **Big Exec Actuary**.
- When the situation is described to him, what does **Big Exec Actuary** do?

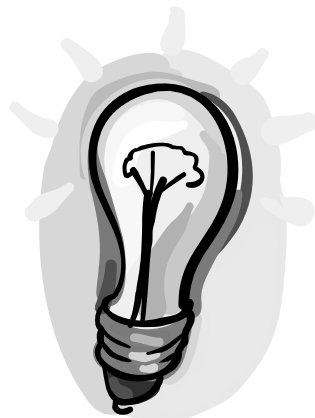
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Example #4: Scene 4

- ⌘ The worst fears about the reserves were confirmed.
- ⌘ But the profitability for each of the past five years was also confirmed.
- ⌘ What does *Comp Consulting Actuary* do?
- ⌘ What do *Healthco's Health Actuaries* recommend to management?



In Conclusion



- Common themes
- Take 'aways'
- Must do's
- Must don'ts
- Questions?