

# Regulatory Perspectives on the Actuarial Meaning of Insurance

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CAS Annual Meeting  
November 7, 2022

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## Why does the regulatory perspective on insurance matter?

- Vermont Department of Regulation:
  - The ongoing work of the department on behalf of Vermonters helps consumers access financial and insurance-related services with confidence that:
    - Consumers are treated fairly, according to the terms of contracts and laws.
    - Regulated companies, institutions, and individuals operate within the law.
    - Regulated entities operate in a financially sound manner, and remain able to deliver on consumers' earnings, benefits, claims, or other services.
    - Costs and services are reasonable for the marketplace.

  
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## The Role of the Regulatory Actuary

- Provide opinion regarding the actuarially reasonableness of rates/premiums
  - Not redundant, but also not excessive
- Opine on the appropriateness of the initial capital
- Comment on the coverages, retentions and premium volume
- Comment on the overall structure of the program:
  - Flow of Funds
  - Relevant aspects of the proposed insurance program (i.e.: validity for type, form, risk transfer);
- The adequacy of reinsurance including the amount and type of reinsurance needed and risk transfer considerations.



[www.vermontbusinessregistry.com/bidAttachments/56028/CaptivesRFP-Services-12-17-21-finalforposting.pdf](http://www.vermontbusinessregistry.com/bidAttachments/56028/CaptivesRFP-Services-12-17-21-finalforposting.pdf),

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## The “Avrahami Checklist”

- Insurable Risk
- Risk Transfer
- Risk Distribution
- Commonly Accepted Notions of Insurance
  - Actuarially Determined Premiums
  - Market Comparable Coverages/Premiums
  - Capitalization
  - Formed for a Non-Tax Reason
  - Non-circular Flow of Funds
  - Entity Faces Actual and Insurable Risk
  - Policies were Arms Length Contracts
  - Regulatory Controls and Minimum Statutory Requirements
  - Pay Claims



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## Insurable Risk

- **Regulatory Questions:**

- Is this a standard industry coverage or coverage form?
- Does it transfer both timing and economic risk?
- Are claims values estimable?
- Are there obvious moral or morale hazards?
- Are there significant loss limiting features?
- Is the exposure insurance risk or business risk?



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## Risk Transfer

- **Regulatory Questions:**

- Is there a significant chance of a material loss?
  - What does the adverse scenario of the pro forma financials indicate?
- Does the program satisfy the self-evident rules?
  - Accounting and actuarial guidance
- For reinsurance programs, has an Expected Reinsurance Deficit (ERD) been calculated?



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## Risk Distribution

### • Regulatory Questions:

- Does the program satisfy existing safe harbors?
  - Brother-Sister
  - Group Captive
  - Unrelated Risk
- Does the program have significant concentrations of risk?
- Are there a statistically significant number of independent exposure units?
  - Has an Expected Adverse Deviation (EAD) analysis been done?
- If there is a reinsurance facility, has it undergone regulatory review and been approved as a reinsurer?



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## Common Notions

### • Regulatory Questions:

- Does the proposed captive behave like an insurance company in the generally accepted sense?
  - Subject to the scale and complexity of the company
- What is the non-tax business purpose?
  - Is it first and foremost and insurance company?
- If there is a reinsurance pool, how/when do funds transfer?
- Are the risks actual and insurable?
  - Claims history and/or enterprise risk management process
- Were the coverage forms and premiums developed at arms length?
- Is the capitalization appropriate relative to the
  - Probable Maximum Loss
  - Premium
  - Loss Reserves?



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## Common Notions - Claims

### • Regulatory Questions:

- Is there a formal claims process?
- Is coverage determined by an independent third party?
- Are there claims?
- Are any claims denied?
- Are there any events that should have resulted in claims not submitted?



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## Common Notions - Premiums

### • Regulatory Questions:

- How were the premiums determined?
  - Experience
  - Commercial Rate Filings
  - Current Commercial Premiums
  - Rate on Line
- Are the premiums “market comparable?”
  - Compare “differences in conditions” (DIC) premiums to underlying coverage
  - Compare to filed and approved commercial rate filings for comparable coverages
    - Filed and approved means that they were determined to be actuarially reasonable
  - How are differences between commercial carriers and captive expenses reflected?
  - Is the coverage even available in the commercial market?
    - Only in the excess and surplus lines (E&S) market?



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**Thank You!**

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