



Actuarial Standards of Practice

Recent activity and highlights

**A presentation to SCCAC
by Dave Otto**

December 4, 2014

Description

This session will be devoted to professionalism topics relating to property and casualty actuaries. It will cover the structure of our professional and ethical standards and will highlight recent changes to the standards and will identify efforts that are ongoing.

Relevant Background

- CAS Committee on Professionalism Education (2000-2006)
- AAA Casualty Committee of the Actuarial Standards Board (2000-Present)
 - Currently Chairperson (2013 – present)
- Critical Review of the US Actuarial Profession (CRUSAP) Task Force Advisory Panel Member (2005-2007)
- Frequent Speaker on Professionalism Topics at Actuarial Seminars
- Expert Witness in over 30 separate cases

Caveats

- There is no guarantee that doing anything in this session will alleviate the risk of litigation or some other form of professional discipline. One must recognize one's own specific circumstances and act accordingly
- I am not speaking on behalf of:
 - Towers Watson
 - CAS
 - ASB
 - AAA
 - Or any committee, person, place or thing
- This presentation was designed to be thought-provoking and may not necessarily represent my personal opinions
- It is your responsibility to know all of the standards and to properly interpret them and exercise your own professional judgment as you see fit

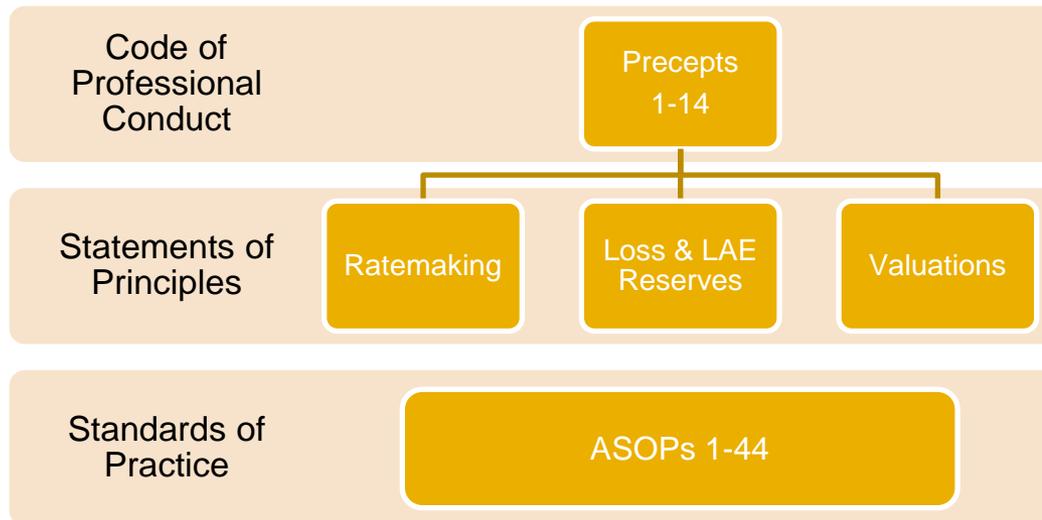
Agenda

- Tying together the Code, Statements of Principles and Standards of Practice
- Recent changes to Actuarial Standards of Practice
 - ASOP1 – Introductory Actuarial Standards of Practice (March 2013)
 - Updated Deviation Guidance (May 2011)
 - Exposure Draft on Property/Casualty Ratemaking (comment deadline January 31, 2015)
 - Modeling Standards
 - ASOP38 Revision – Catastrophe Modeling (all practice areas)
 - Modeling (exposure draft)
- Questions throughout

Overview

Overview of Actuarial Professionalism

- **Code:** Each US-based actuarial organization requires its members, through its Code of Professional Conduct (Code), to satisfy applicable ASOPs when rendering actuarial services in the United States
- **Principles:** The CAS Board of Directors has established Principles which provide the foundation for the development of actuarial procedures and standards of practice
- **Standards:** The ASB is vested by the US-based actuarial organizations with the responsibility for promulgating actuarial standards of practice (ASOPs) for actuaries rendering actuarial services in the United States



Code of Professional Conduct

14 Precepts with Annotations

- Key Sections:

- Professional Integrity
- Qualification Standards
- Standards of Practice
- Communication and Disclosure
- Conflict of Interest
- Control of Work Product
- Confidentiality
- Courtesy and Cooperation
- Advertising
- Titles and Designations
- Violations of the Code

Fundamental Precepts

- Precept 1:
 - An Actuary/Member shall act honestly, with integrity and competence, and in a manner to fulfill the profession's responsibility to the public and to uphold the reputation of the actuarial profession
- Candidate Code of Ethics Rule 1: [Introduced January 2008]
 - An Actuarial Candidate shall act honestly, with integrity and competence, to uphold the reputation of the actuarial profession
- Precept 3: “An Actuary shall ensure that Actuarial Services performed by or under the direction of the Actuary satisfy applicable standards of practice”

CAS Statements of Principles

- Principles provide the foundation for the development of actuarial procedures and standards of practice
- Currently 3 Statements of Principles
 - Loss and Loss Adjustment Expense Reserves
 - Insurance Ratemaking
 - Valuations
- Example Principle: A rate is an estimate of the expected value of future costs
- In addition to identifying the core principles, these documents have historically included additional information that could be interpreted as guidance (i.e. standard of practice)
 - Examples: Ratemaking principles contain a section titled “Considerations” that provides information about topics such as the use of trend
 - Recent push by the CAS to remove guidance from Principles

Actuarial Standards of Practice (ASOPs)

- Currently 44 ASOPs (ASOPs 9, 14, 16, 31 repealed)
- Development of ASOPs led by five ASB Committees
 - Pension
 - Life
 - Health
 - Casualty
 - ERM
 - General
- Relevant P&C new additions/changes
 - ASOP1 – General
 - Updated Deviation Language
 - Exposure Draft on Ratemaking – Casualty
 - ASOP38 Revision – General
 - Exposure Draft on Modeling - General

Relevant Changes to Standards of Practice

ASOP1 - Introductory Actuarial Standards of Practice

Adopted March 2013

ASOP1: Introductory Actuarial Standards of Practice

- Applies to all actuarial practices
- Defines the purpose of ASOPs
- Attempts to clarify the meaning of commonly used terms throughout the ASOPs

ASOP1: Purpose of ASOPs

- 3.1.2 ASOPs are not intended to shift the burden of proof or the burden of production during litigation and deviation from one or more provisions of an ASOP should not, in and of itself, be presumed to be malpractice
 - ASOPs intended for use by actuaries with the necessary education and experience to understand and apply them
- 3.1.4 ASOPs are principles-based
 - do not attempt to dictate every step and decision
 - Not narrowly prescriptive and do not dictate a single approach

ASOPs provide the actuary with an analytical framework for exercising professional judgment

 - Actuaries can reasonably reach different conclusions when faced with the same facts

ASOP1: Purpose of ASOPs

- 3.1.5 Where requirements of law conflict with the guidance of an ASOP, the requirements of law shall govern
- 3.1.6 ASOPs are binding upon actuaries
 - Failure to comply results in a breach of the Code and the profession's counseling and discipline process (4.1)
 - Not necessarily implying malpractice (3.1.2)

Other actuarial literature is not binding

- Practice notes published by the Academy
- Research papers, journal articles, textbooks, presentations at meetings
- 4.5 ASOPs make specific provision for the actuary to deviate when required or when deems it appropriate
 - Not a breach of an ASOP if the actuary if the actuary does so as described in the ASOP and in ASOP41

Actuarial Standards of Practice Updated Deviation Language

Effective May 1, 2011

Updated Deviation Language

Deviation language has varied over the years. As a result, the ASB adopted new language to be used in all ASOP's, which refers back to the new ASOP41

- In addition to disclosures pertinent to the particular ASOP, Section 4 of each standard will also include
 1. The disclosure in ASOP41, Section 4.2, if any material assumption or method was prescribed by law (statutes, regulations, and other legally binding authority); [identify law, assumptions prescribed by law and confirm that prepared in accordance with law]
 2. The disclosure in ASOP41, Section 4.3, if the actuary states reliance on other sources and thereby disclaims responsibility for any material assumption or method selected by a party other than the actuary [identify party, assumptions selected by party and reason party, rather than actuary, set the assumption]
 3. The disclosure in ASOP41, Section 4.4, if, in the actuary's professional judgment, the actuary otherwise deviated materially from the guidance of this ASOP. [provide a statement in communication with respect to nature, rationale, and effect of deviation]

Back to ASOP1

ASOP1: Terms of Construction

- Must – ASB does not anticipate that the actuary will have a reasonable alternative but to follow a course of action
 - Failure to follow constitutes a deviation (directed to ASOP41 for disclosure)
- Should – Indicates what is normally the appropriate practice for an actuary to follow
 - Failure to follow constitutes a deviation (directed to ASOP41 for disclosure)
- Should Consider – Used to suggest potential courses of action
 - If in actuary's professional judgment an action is not appropriate, then failure to take the action is not a deviation from guidance (no ASOP41 disclosure)
- May – The course of action described is one that would be reasonable in many circumstances
 - Often used when providing examples
 - Not intended to imply that it is reasonable in all circumstances nor that alternative courses of action are impermissible

ASOP1: Terms of Construction Continued

- Actuarial Services
- Actuarial Soundness
- Deviation
- Known
- Materiality
- Practical / Practicable
- Principal
- Professional Judgment
- Reasonable
- Reliance
- Significance / Significant

ASOP1: Impact on Pre-Existing ASOPs

- Unfortunately, ASOP1 was created after many ASOPs were drafted so a study was performed to determine if any inconsistencies or ambiguities exist with new guidance
 - Casualty Committee reviewed P&C ASOPs and concluded:
 - Category 1: ASOP43 should be revised in order to align with ASOP1 (assembling task force)
 - Category 2: Language in these ASOPs could be improved but did not warrant a change solely to reflect ASOP1
 - ASOP13 (Trending)
 - ASOP20 (Discounting)
 - ASOP29 (Expense Provisions)
 - ASOP30 (Profit and Contingencies)
 - ASOP36 (Opinions)
 - ASOP39 (Catastrophe Provisions)
 - General Committee - ASOP23 (Data Quality) is slated for update in 2015 for updated language

Draft ASOP on Property/Casualty Ratemaking

Comment Deadline January 31, 2015

CAS Statement of Principles

- Current Statements of Principles
 - Reserving (1988)
 - Ratemaking (1988)
 - Valuations (1989)
- CAS Board is in the process of updating these documents
 - Material change: Desire to remove language that can be interpreted as “guidance” and would better be put into an ASOP
 - SOPs supposed to provide the foundation for ASOPs

Reserving Statement of Principles

- Definitions
- Principles
 1. Actuarially sound **loss** reserve...derived from reasonable assumptions and appropriate actuarial methods...
 2. Actuarially sound **LAE** reserve...derived from reasonable assumptions and appropriate actuarial methods...
 3. Uncertainty inherent in estimation implies that a range of reserves can be actuarially sound...
 4. The most appropriate reserve within a range depends on the relative likelihood of estimates within the range and the financial reporting context...
- Considerations
 - Data organization
 - Homogeneity
 - Credibility

Reserving Statement of Principles

- Considerations continued
 - Data availability
 - Data should meet requirements for the proper evaluation of reserves...
 - Emergence patterns
 - Settlement patterns
 - Development patterns
 - The pattern of development on known claims should be carefully reviewed...
 - Frequency and severity
 - Reopened claims potential
 - Claims-made
 - Aggregate limits
 - Salvage and subrogation
 - Generally accepted accounting principles
 - Reinsurance

Reserving Statement of Principles

- Considerations continued
 - Portfolio transfers
 - Pools and associations
 - Operational changes
 - Changes in contracts
 - External influences
 - Discounting
 - Provision for uncertainty
 - Reasonableness
 - Incurred losses implied by the reserves should be measured for reasonableness against relevant indicators...No material departure from expected results should be accepted without attempting to find an explanation for the variation.
 - Loss-related balance sheet items
 - Loss reserving methods
 - Ordinarily the actuary will examine the indications of more than one method...

Reserving Statement of Principles

- 2013 – Draft SOP on Ratemaking
 - Definitions (one page)
 - Principles (four paragraphs)
 - “actuarially sound” removed
 - “unpaid claims” like ASOP43 instead of “reserve”
 - Conclusion
- Considerations removed completely
 - It is believed that ASOP43 (2007) and ASOP36 (2000) do not conflict and cover what was addressed in the Considerations
- Final?

Ratemaking Statement of Principles

- Definitions
- Principles
 1. A rate is an estimate of the expected value of future costs
 2. A rate provides for all costs associated with the transfer of risk
 3. A rate provides for the costs associated with an individual risk transfer
 4. A rate is reasonable, and not excessive, inadequate, or unfairly discriminatory if it is an actuarially sound estimate of the expected value of all future costs associated with an individual risk transfer
- Considerations
 - Much like the Reserving SOP, considerations within this SOP have an element of guidance

Ratemaking Statement of Principles

- Considerations

- At the request of the CAS Board, the Casualty Committee performed a review of the considerations to determine if they were adequately covered by existing ASOPs
 - **Exposure Unit – N/A**
 - Data/Organization of data – ASOP23
 - Homogeneity/Credibility – ASOP25
 - **Loss development – N/A**
 - Trends – ASOP13
 - Catastrophes – ASOP38, 39
 - Policy provision – Various
 - Reinsurance – Various
 - Operational changes – ASOPs 12, 13, 29
 - Other influences – ASOPs 12, 13, 29
 - Classification plan – ASOP12

Ratemaking Statement of Principles

- Considerations

- At the request of the CAS Board, the Casualty Committee performed a review of the considerations to determine if they were adequately covered by existing ASOPs
 - **Individual risk rating – N/A**
 - Risk – ASOP30
 - Investment and other income – ASOP30
 - Actuarial judgment – Various
 - In summary, the gaps identified were loss development, exposure unit and individual risk rating
 - CAS Board requested the ASB to develop a standard on Ratemaking:
 1. Address the gaps
 2. Provide a single source of reference for ratemaking guidance
- Hence the creation of the ASOP on Ratemaking

Exposure Draft – Property/Casualty Ratemaking

- Released in conjunction with the release of the Discussion Draft of the Statement of Principles regarding Ratemaking
- SOP removes Considerations
 - Definitions
 - Principles
 - Conclusion
- ASOP
 - Intended to cover gaps
 - References ASOPs that relate to ratemaking
 - Reserving/Unpaid Claims vs Ratemaking/Price
 - This standard is limited to the estimation of **future costs** and does not address other considerations that may affect the **price** charged to a policyholder, such as marketing goals, competition, and legal restrictions
 - Comments due January 31, 2015

Valuations Statement of Principles

- Not aware of any issues or review underway

Modeling ASOPs

General Committee of the ASB

Modeling ASOPs

- Currently ASOP38 – Using models outside the actuary’s expertise (Property and Casualty)
 - Life practice desired to develop a standard on models
 - ASB Desire to expand to all practice areas
 - Had a cat-modeling flavor (RMS, AIR, EQECAT)
 - Sent to General Committee for consideration
 - Create an ASOP on Catastrophes (all practice areas) – New ASOP38
 - Create an ASOP on Modeling (all practice areas)

Modeling ASOPs

- ASOP on Catastrophes (all practice areas) – New ASOP38
 - Appropriate reliance on experts
 - Understanding of the catastrophe model
 - Appropriateness of the model for the project's objective
 - Appropriate validation
 - Use of the model and its results
- ASOP on Modeling (all practice areas)
 - Application of ASOP guidance
 - Model reliance
 - Models developed by others
 - Responsibility of the actuary

Modeling ASOPs

- ASOP on Modeling (all practice areas)
 - Model meeting the intended purpose
 - Designing, building or developing the model
 - Selecting or using the model
 - Modifying the model
 - Understanding the model
 - Model structure
 - Inputs to the model
 - Assumptions and parameters
 - Mitigation of model risk
 - Validation, checking and analysis
 - Appropriate governance and controls

Modeling ASOPs

- ASOP on Modeling (all practice areas)
 - Presentation of results
 - Explanation of model in report
 - Reconciliation
 - Description of judgment
 - Terms from applicable law
- Where do things stand?
 - ASOP38 Catastrophes
 - ASOP Modeling

Thank You



Dave Otto

12235 El Camino Real, Suite 150
San Diego, California 92130

Ph: (858) 793-1425

Dave.otto@towerswatson.com