

EXAM 6 – UNITED STATES, FALL 2012

25. (2.5 points)

An actuary analyzed the loss and loss adjustment expense (L&LAE) reserves as of December 31, 2011, for an insurance company. The insurance company management has decided to book a net reserve amount of \$117 million and a gross reserve amount of \$195 million. Given the following information:

- i. The actuary reviewed the reserves both gross and net of reinsurance.
- ii. The actuary's actuarial central estimate of the net L&LAE reserves is \$125 million. The actuary believes a range of reasonable net L&LAE reserves is \$115 million to \$165 million.
- iii. Discussions with company management indicate that there are no expected problems with collectability for reinsurance.
- iv. There is a pending lawsuit against one of the company's general liability insureds for \$10 million that is not reflected in the company's reserve or the actuary's estimate. The event triggering the lawsuit occurred in 2010 and there is a significant probability that the company will lose this lawsuit.
- v. There is a pending lawsuit against one of the company's general liability insureds for \$17,000 that is not reflected in the company's reserve or the actuary's estimate. The event triggering the lawsuit occurred in 2009 and there is a significant probability that the company will lose this lawsuit.

Identify whether or not the actuary should disclose each of the items above in the Statement of Actuarial Opinion for this company and briefly discuss the reason.

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25) Sample Answer

Answer 1

- 1) Yes, Actuary must state scope of what opinion covers
- 2) No, Actuary does not disclose his range/point estimate in his opinion (unless there is an inadequate or excessive provision). Actuary is opining on whether held reserves are reasonable.
- 3) Yes, as gross and net reserves are being opinioned on, Actuary should state his assumptions in regard to reinsurance collectability. This should cover Sch F, ratings of counterparties, conversations with mgmt... under relevant comments in the Reinsurance section.
- 4) Yes. This is $10/177 = 8.5\%$ of carried loss reserves. This is a significant amount and should meet the material adverse deviation standard.
- 5) No, this amount is not material

Answer 2

- 1) This would be disclosed in the opinion section within the scope of SAO, where the actuary describes what was reviewed and what opinion is held about what was reviewed.
- 2) This would not be disclosed. The actuary would never disclose their results in an SAO, except when discussing the amount by which the company is redundant or excessive, but since the company is within their range, none is required.
- 3) This would be disclosed in the relevant comments – Reinsurance Section that the actuary held discussions with management since the amount ceded is material and that no collectability issues are known.
- 4) This would be disclosed in the Relevant Comments - Risk of material adverse deviation section. The \$10M is material since the actuaries range including the law suit would be \$125M to 175M causing the company's reserves to be deficient.
- 5) This would not be disclosed since it would not be material (opposite of iv). The revised range including the lawsuit would be \$115.017M to \$165.017M not affecting the reasonable opinion.

Answer 3

Net 117, gross 195

- i) Yes, in exhibit A. Must disclose an opinion as well
- ii) Do not disclose range or central estimate. Disclose that the reserves make a reasonable provision for all unpaid loss and loss expense obligations

iii) Needs to disclose relevant comments on reinsurance. --talks with management on uncollectibility should be disclosed.

iv) Assuming the estimates in ii are true, \$10 has a material effect and should be disclosed. Also disclose materiality standard (here being $(125-115)/125 = 8\%$ of reserves), disclose how the standard was derived, disclose any risk of material adverse deviation and the factors that cause MAD

v) Not material; does not need to form an opinion or comment in relevant comments. Don't disclose.

Answer 4

i) The actuary would state this in the scope paragraph. There isn't need for additional disclosure beyond the scope paragraph, but they need & want to let the regulators know they looked at it.

ii) In the opinion paragraph, they would state that there is a reasonable provision for loss & LAE reserves. No need to disclose their amount, however, this is stated in the AOS. This is because the companies held reserves is within the actuaries range of estimates.

iii) This would be disclosed in the relevant comments. Reinsurance is a major concern so regulators want to know there are any issues.

iv) This needs to be disclosed because this is a type I subsequent event there is a significant chance that there will be additional losses of \$10M that they will realize. This is 8.5% of held reserves, so this is a material amount.

v) they would not have to disclose this because it is a small amount (0.01%) of held reserves and is immaterial,

Answer 5

i.) yes; part of scope (ASOP 36, COPLFR)

ii.) no; these items are part of AOS

iii.) Yes; collectability is part of relevant comments and actuary consults management, financial ratings and schedule F

iv.) Yes; (risk of material adverse deviation); it's a type I subsequent event and $117+10=127$ is within actuary's reasonable range

v.) no, not material.

Examiner's Report

In part i., a common mistake was that the candidate would answer that yes, one must comment on the reserves gross and net, but would not answer why. We were looking for “required in scope paragraph”, but often did not receive that.

In part iii, many candidates answered that yes, must comment if there are no expected problems with collectability, but the most common mistake was that the candidates neglected to mention that comment is only needed if material.

By and large, there were not frequent mistakes for the other parts.