

EXAM 6 – UNITED STATES, FALL 2015

23. (4 points)

A new Appointed Actuary was appointed for this year's Statement of Actuarial Opinion (SAO).

Consider the following information for the insurance company (all figures in millions of dollars):

Surplus	\$11.0
Carried Net Loss & LAE Reserves	\$14.6
Range of Reasonable Net Loss & LAE estimate	\$14.4 - \$15.7
Authorized Control Level	\$5.0
Surplus required to maintain current financial strength rating	\$9.9

- IRIS ratios 11, 12 and 13 are within the range of usual values.
- The report of the prior Appointed Actuary was unavailable for review.

a. (2 points)

Propose and calculate four materiality standards that may be considered for purposes of preparing the SAO. Use a different metric for each standard.

b. (0.5 point)

Justify the selection of one materiality standard from part a. above to be considered when evaluating whether there is a risk of material adverse deviation.

c. (1 point)

The Appointed Actuary has selected a materiality standard of \$0.9 million. Describe two reasons why the Appointed Actuary might conclude that a risk of material adverse deviation exists.

d. (0.5 point)

Describe the disclosures with respect to methods and assumptions that should be included in the RELEVANT COMMENTS section of the SAO.

SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 23	
TOTAL POINT VALUE: 4	LEARNING OBJECTIVE: D1
SAMPLE ANSWERS	
Part a: 2 points	
<ul style="list-style-type: none"> • % of surplus, e.g. 10% of \$11M = \$1.1M • % of recorded reserve, e.g. 10% of \$14.6M = \$1.46M • The amount of adverse deviation in reserves that would cause surplus to drop to next RBC action level (CAL); e.g. \$11M - 2*\$5M = \$1M • The amount of adverse deviation in reserves that would cause surplus to drop below amount required to maintain current financial strength rating; e.g. \$11M - \$9.9M = \$1.1M 	
Part b: 0.5 point	
<ul style="list-style-type: none"> • The materiality standard should address solvency concerns as the intended users of the SAO are regulators. • Given above, and to be conservative, the lowest of the standards presented in part a would be a suitable choice. 	
Part c: 1 point	
<ul style="list-style-type: none"> • If 10% of recorded reserve is greater than Adjusted Capital less CAL, then the NAIC Financial Analysis Handbook suggests that there is a presumption of a risk of material adverse deviation. <ul style="list-style-type: none"> ○ $10\% \times \\$14.6M = \\$1.46M > \\$11M - 2 \times \\$5.0M$ • If the recorded reserve plus the materiality standard is less than the high end of the actuary's range of reasonable reserve estimates, then there is a presumption of a risk of material adverse deviation. <ul style="list-style-type: none"> ○ $\\$14.6M + \\$0.9M = \\$15.5M < \\$15.7M$ 	
Part d: 0.5 point	
<ul style="list-style-type: none"> • The prior actuary's report is unavailable for review. • Because the prior actuary's report is unavailable, the opining actuary is unable to determine if there are changes in assumptions and/or methodology that are material. 	
EXAMINER'S REPORT	
<p>Candidates were expected to know the requirements surrounding the issuance of Statements of Actuarial Opinion, e.g. different materiality standards, justifying a chosen materiality standard, assessing possible factors that would suggest a risk of material adverse deviation exists, and describing appropriate disclosures that should be included in the SAO when the prior actuary's report is unavailable for review.</p>	
Part a	
<p>Common errors included:</p> <ul style="list-style-type: none"> • 0.2M = distance to low end of the actuary's range • 1.3M = width of actuary's range • Any percentage of premium • Percent of actuary's estimate rather than the carried reserve • Amount to reduce surplus to ACL rather than CAL, the next RBC level below current 	
Part b	
<p>This part asked the candidates to justify their selection of a materiality standard from those they</p>	

SAMPLE ANSWERS AND EXAMINER'S REPORT

listed in part a. Most candidates were able to state a reasonable explanation for their choice (e.g. amount that would cause RBC to fall to next action level) but did not provide a rationale for why this was of suitable choice (i.e. because intended users of the SAO are regulators who are primarily concerned with solvency).

Part c

This part asked the candidates to describe two reasons why the appointed actuary might conclude that a risk of material deviation exists. Most candidates were able to identify the position of the recorded reserve relative to the actuary's range as a reason to conclude a RMAD exists. However, very few identified that the Company would also fail the NAIC check-list test and thereby raise regulatory scrutiny regarding the type of RMAD disclosure.

Common errors included:

- recorded reserve is "close" to the low end of the actuary's range;
- reference to the fact that the prior actuary's report was not available;
- reference to possible general exposure factors such as asbestos & environmental exposures or catastrophic losses that may contribute to higher than normal uncertainty in estimating loss reserves. Given the facts that were provided, both of the numerical tests would suggest that a RMAD be included in the SAO, so it is unnecessary to assume that other hypothetical risk factors exist to conclude that a RMAD disclosure should be given.

Part d

This part asked the candidates to describe the appropriate disclosures regarding methods & assumptions that should be included in the Relevant Comments section of the SAO. Most candidates were able to correct identify that because the prior actuary's report was unavailable, the current actuary should disclose that he/she was unable to determine if there were any changes in assumptions and/or methodology.

Common errors included:

- failing to recognize that the prior actuary's report was unavailable
- providing a list of other disclosures required, not just those pertaining to changes in methods and assumptions, e.g. RMAD
- referring to how the materiality standard was determined