

MEMORANDUM

TO: Actuarial Standards Board (ASB)

FROM: Gordon Hay, FCAS, MAAA, CPCU
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Nebraska Department of Insurance

DATE: 2/9/2018

SUBJ: *Capital Adequacy Assessment for Insurers – Second Exposure Draft
Comment Deadline March 1, 2018*

My comments arise from my role as the P&C actuary on a team that reviews ORSA Summaries submitted to the Nebraska Department of Insurance. These comments are my own, and do not necessarily reflect the views of the Department.

Further, I realize that the Committee asked for responses to five questions, but my comments are not anticipated by those particular questions.

As a regulatory actuary and an ORSA Summary reviewer, I help a team evaluate the degree to which a filed report includes everything that's relevant and required, and I also help identify opportunities to encourage maturation in the filer's ERM/ORSA processes.

I have no objection to the ASOP Scope including provision of actuarial services in reviewing capital adequacy assessments prepared and presented by others. If that is the intent, the Committee should clarify its Scope statement:

Section 1.2: Scope includes "review" of a capital adequacy assessment. I see an undesirable ambiguity. "Review" may mean the capital adequacy assessment is reviewed annually, just like companies have actuaries who periodically review rates or reserves. Under this meaning, the reviewer, designer and performer are the same person or team. Alternatively, "review" could mean developing an independent response to a capital adequacy assessment presentation. The presentation is created after the assessment is completed and summarized. Such reviewers may be actuaries (who would be subject to the ASOP).

I will proceed as if the second definition is intended, and under that assumption I notice anomalies.

Guidance in Sections 3.1 through 3.6 and 3.8 is combined for actuaries who design, perform and review capital adequacy assessments. This is fine under the first definition, but not under the second. With regard to the ASOP as it affects reviewers who are separate from the designers and performers, my key questions are

- What would a reviewing actuary DO to comply with the ASOP (as drafted)?
- Is that an appropriate set of activities for a reviewing actuary?

Reviewers' interests differ from preparers' interests, reflecting reviewers' roles as peers, auditors, regulators, executives, boards of directors, rating agency analysts reviewing company submissions or anyone reviewing ratings proposed or issued by AM Bests, Moody's or S&P. We will see actuaries, non-

actuaries and mixed teams, reviewing work from others who are actuaries, non-actuaries and mixed teams.

Section-by Section notes follow, with emphasis on the reviewing actuary's expected actions:

Section 3.1 and 3.2: the actuary should reflect impact (list) and consider (list). The reviewer's actual opportunity is to understand disclosures from the preparer (designer/performer). As an ORSA Summary reviewer, I don't replicate and improve, nor do I analyze independently. I don't have a context or generate a work product that would "reflect impact." If I "consider" am I going to document thoughts? As a reviewer, I may be expected to evaluate whether there's evidence in the presentation that the preparer appropriately reflected impact or considered the items on the lists.

Section 3.3: the actuary should review the selected valuation bases for assets and liabilities to determine whether they are consistent with and appropriate for the intended use of the capital adequacy assessment. When doing so, the actuary should consider (list). "Valuation basis" is well understood among pension and maybe life actuaries, but without a definition, I have no context for it in casualty actuarial practice. As a P&C actuary, I don't even know what is expected of the preparer. As a reviewing actuary, I probably should assess whether the whole package of economic and other assumptions in the presentation is consistent with the intended use of the capital adequacy assessment.

Section 3.4: When the actuary assists in the ... review of the appropriateness or applicability of risk capital target(s) or risk capital threshold(s), the actuary should take into account the following (on a historical, current, and prospective basis, as appropriate) (another list). How does a reviewer "take into account" a list that the preparer (if an actuary) has also been required to "take into account?" I could try to understand the presentation and ask questions where things seem missing or unclear, but I may have nothing to say if someone asks me "As a reviewer, how did you take XXXX into account?" But as a reviewer, I may be required to opine whether the risk capital target(s) or threshold(s) are reasonable and applicable, or better, whether the presentation includes appropriate justification or thought processes for such target(s) or threshold(s).

Section 3.5: When the actuary assists in the ... review of the appropriateness or applicability of risk capital target(s) or risk capital threshold(s), the actuary should consider (another list). As reviewer, if I "consider" am I going to document thoughts? As a reviewer, I may be required to judge whether the risk capital target(s) or threshold(s) are reasonable and applicable, or better, judge the justification or thought processes in the presentation for any such target(s) or threshold(s).

Section 3.6 (Types of Tests listed) and Section 3.7 (list of considerations when incorporating management actions), do NOT mention the reviewer. As a reviewing actuary, Section 3.6 is exactly where the State wants my advice regarding which tests are appropriate and whether the calculations are accurate. If management actions are asserted to have a material mitigating effect, I would probably be asked to focus on quality and quantification of those assertions.

Section 3.8: When the actuary is ... reviewing a capital adequacy assessment of an insurer that individually or as part of a group operates in more than one jurisdiction, the actuary should reflect the impact of (a list). As an ORSA Summary reviewer, I don't replicate and improve, nor do I analyze independently. I don't have a context in which to "reflect impact." I may be required as a reviewer to

evaluate whether there's evidence in the presentation that the preparer appropriately "reflected impact" of items on the list.

Section 3.9: When the actuary is ... reviewing a capital adequacy assessment of an insurer that is part of a group, the actuary should consider the following, if applicable (a list). As reviewer, if I "consider" am I going to document thoughts? I am more likely as a reviewer to evaluate evidence in the presentation that the preparer appropriately considered the items on the list.

So, if "review" in the Scope paragraph includes review by regulatory or other actuaries, the ASOP (as drafted) would require reviewers to DO intangible things that mimic what builders, updaters and presenters should do, but omits what productive reviewers do.

If the second definition of "review" is intended, the ASOP should include guidance specifically for actuaries as reviewers. I see none, but maybe a Section 3.11 could be written to capture the minimum actions we expect from actuarial reviewers, using notes from above as a starting point?

3.11 Review of Capital Adequacy Assessments designed and/or performed by others

- a. If the assignment is to review a capital adequacy assessment prepared by others, an actuary may be expected to evaluate evidence in the presentation that the preparer(s) appropriately reflected impact or otherwise considered the items listed in Sections 3.1, 3.2, 3.8 and 3.9 above.
- b. An actuary reviewing a capital adequacy assessment should assess whether the whole package of economic and other assumptions disclosed in the presentation is consistent with the intended use of the capital adequacy assessment.
- c. An actuary reviewing a capital adequacy assessment may be expected to opine on the reasonableness and/or applicability of risk capital target(s) or threshold(s) in the presentation.
- d. An actuary reviewing a capital adequacy assessment should evaluate whether the presentation includes appropriate justification or thought processes for any risk capital target(s) or threshold(s).
- e. An actuary reviewing a capital adequacy assessment should evaluate whether the tests presented are appropriate and sufficient for the intended use of the capital adequacy assessment, and should confirm whether the test calculations are accurate.
- f. If the presentation and/or conclusions of a capital adequacy assessment are materially dependent on mitigating effects of management actions, an actuary reviewing that capital adequacy assessment should evaluate whether qualitative and quantitative evidence provided in the presentation adequately supports the assumed mitigation effects.

The essence of my comment is to differentiate guidance for reviewers from guidance for preparers and presenters of capital adequacy assessments.

Also exposed by the International Association of Actuaries (IAA) for comment is ISAP6, which includes Scope language to include reviewers:

“This ISAP applies to actuaries when performing actuarial services with responsibility for, or significant involvement in, the development, implementation, maintenance or review of some or all of the components of ERM programs, including ORSA, that are within the scope of regulations consistent with ICP 8 and ICP 16. This ISAP applies to an actuary only to the extent of the actuary’s responsibility and involvement.”

I think, standing alone, the use of “review” is similarly ambiguous in the ISAP6 Scope paragraph. However, Unlike the ASOP, care has been taken in subsequent sections of ISAP6 to specify reviewers’ obligations. Reviewers are implicitly included in Sections 2.1 and 2.2 which apply to all, and explicitly included in Section 2.4 (Enterprise Level Risk Management) and Section 2.5 (ORSA). Section 2.4 subsections are 2.4.1 (aggregate risk assessment), 2.4.2 (developing, maintaining or reviewing an ERM Framework) and 2.4.3 (additional factors if an insurer is part of a group). Reviewers are not included in Section 2.3 (risk identification, assessment and management for an ERM program).

Therefore, I am commenting on the ASOP Second Exposure, but will not comment on ISAP6.

Thank you for your attention.

A handwritten signature in black ink, appearing to read 'Gordon Hay', written over a horizontal line.

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