

Comment #10 – 12/23/13 – 9:39 a.m.

The following are my comments on the ASOP 38 exposure draft.

ANSWERS TO SPECIFIC QUESTIONS ASKED:

Q1. ... Is the inclusion of these other perils sufficiently clear and appropriate?

A1. Yes

Q2. ... Is the scope of the ASOP and definition of catastrophe model sufficiently clear?

A2. Yes

Q3. ... does not apply when the actuary is only designing, building, modifying, or developing a catastrophe model (or a portion of a catastrophe model). Is this sufficiently clear and appropriate?

A3. Yes

Q4. The proposed ASOP now applies to all practice areas. Is that clear and appropriate?

A4. It is clear, but I don't think it is appropriate (although I can only speak from the P&C practice area and not other practice areas). Guidance is useful if it helps an actuary in their actuarial practice. The broader the scope of the guidance the less useful it may be. In particular, there are certain considerations that should apply to modeling earthquake risks (such as understanding the soil characteristics of the region exposed to seismic activity) or that should apply to hurricane risks (such as distance from the coast and soil saturation) that can't be covered in a more generic standard. As such, I see generic standards as less useful to the profession. I believe that at a minimum they need to be supplemented with sections devoted to certain applications, if not handled through separate practice-specific standards.

Q5. The proposed ASOP is intended to maintain the same level and quality of guidance as the current ASOP No. 38 in regards to property/casualty actuarial work involving the use of catastrophe models. Does the proposed ASOP meet that intent?

A5. Apparently so, but I wonder whether practice has varied enough since the original ASOP 38 to point out potential problems. My particular concern is that certain components of the actuarial workproduct are subject to specialization done by central areas within a larger company, with this extent of reliance on others not sufficiently reflected in actuarial standards such as ASOP 38. For example, a large company writing property insurance in many different jurisdictions may rely on a single area specializing in cat modeling for its cat exposure analysis, and another specialized area developing their target profit load (based on an IRR model, capital allocations, etc.) for the rate filing, with the actuary working on the particular rate filing for a certain jurisdiction focusing on the non-cat loss costs for the filing. That actuary would accept the cat load and the profit load from the specialized areas, and incorporate them into that actuary's rate filing. Yet this ASOP (both current and proposed) assume that said actuary has reviewed both the profit load and cat load assumptions. In reality, nearly all such workproducts are essentially joint workproducts. (If a rate hearing was called, the company filing the rate would have their profit load expert testify to the profit load portion of the filing and their cat model expert testify to the cat load portion, not the actuary producing the specific state rate filing.)

This ASOP tries to address this at the end of Section 3 with paragraph 3.7 (Reliance on Another Actuary) – but the application of this paragraph with all the earlier paragraphs is unclear. In addition, that topic should be near the front of section 3 and not the end of section 3.

This is probably an issue for multiple ASOPs, hence there should be a study of how “reliance on others” is handled by the ASOPs now versus how it might be handled.

Q6. Is the proposed standard sufficiently flexible to allow for new developments in practice?

A6. No, as it does not sufficiently handle the issue of reliance on others (for specialized component of a workproduct). See the answer to Q5 above.

OTHER COMMENTS, IN ORDER OF THE RELEVANT ASOP PARAGRAPH.

1.2 Scope

The inclusion of reference to “ASOP No. XX, Modeling” is inappropriate as it does not define the scope of this ASOP. It is also premature to include in proposed language any reference to a standard that does not yet exist, as it presumes a decision has already been made on such a standard.

3.1 Introduction

This language presumes that the user of a cat model is always in charge of which cat model to use or whether to use a cat model. Instead this ASOP needs to allow for the use of a cat model at the directive of the principal. For example, a large property insurer may have many different people involved in pricing and ratemaking, but the insurer can't afford to allow each one the option as to which cat model run and use for the pricing/ratemaking cat load. What should the responsibility be for the actuary using the cat model in such a situation where they have no choice in what is used but instead rely on others within the company.

3.3.1 Model Components

The standard requires the actuary to identify the fields of expertise were used in developing or updating the model. This probably needs to be softened somewhat to the “general” fields of expertise, as there may be some special areas of expertise within seismology or geology or meteorology that may be relevant to this question but are beyond the needs of an actuary using a generic well-accepted third party vendor model (such as AIR, RMS or Eqecat). The requirement for familiarity with “the level of independent expert review and testing” also seems excessive for someone using a well-accepted third party vendor model for a rate filing.

3.3.2 User Input

Where the ASOP says that “the actuary should evaluate the reasonableness of the user input”, can the actuary rely upon an in-house expert for this? This may be a specialized function within a larger company. The same issue applies to 3.4.a with regard to “Applicability of Historical Data”.

3.7 Reliance on Another Actuary

This paragraph needs to be near the beginning of section 3, with clarity as to how it affects the other requirements of Section 3. In the current form it is unclear how and the extent to which it affects the earlier requirements under this ASOP.

4.3 Documentation

This paragraph says “The documentation should demonstrate how the actuary has met the requirements of sections 3.1–3.7 above.” While a carryover from the current ASOP 38, it is unclear why this is needed here and is not an issue for every actuarial workproduct under any ASOP. Why is it necessary to document as part of the workproduct compliance with this ASOP, while with others it may only be necessary to be readily to prove compliance (via an audit trail or in some other fashion)?

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