Putting the Powdered Sugar on the Beignet – Best Practices and Hot Topics for a Health Valuation Actuary

SOUTHEASTERN ACTUARIES CONFERENCE

ACTUARIES' CLUB OF THE SOUTHWEST

2022 Joint Annual Meeting

NOVEMBER 17, 2022

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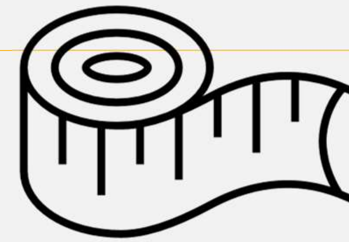
Lewis & Ellis, Inc. – Senior Vice President & Principal

BECOMING AN APPOINTED ACTUARY

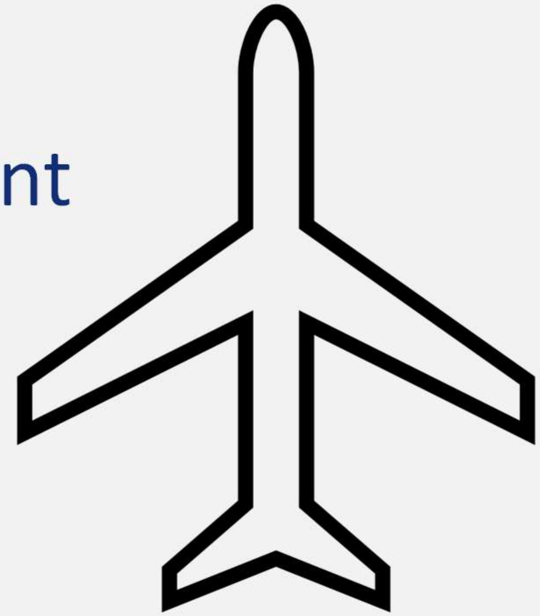
HOW DO YOU KNOW IF YOU ARE QUALIFIED TO SIGN?



- Review the U.S. Qualifications Standards
- “Look in the mirror test”
- Internal documentation of qualification standards and CE credits is necessary upon request by AAA, ABCD, auditors, etc.
- State regulations may require further attestation of no adverse professional disciplinary actions, fraud, etc. in the prior 3-5 years

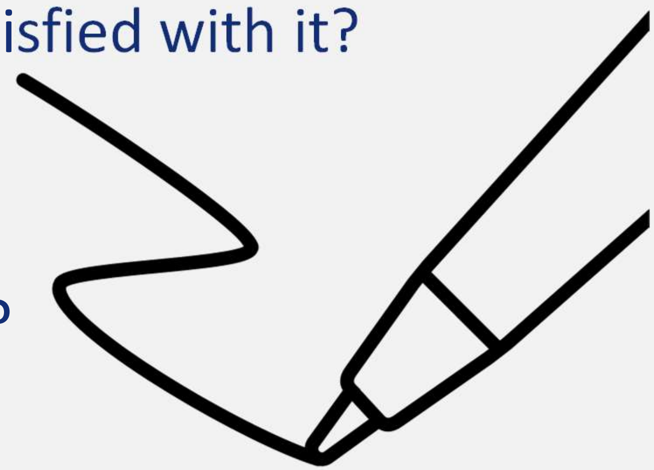
WAYS YOU CAN CONFIDENTLY ANSWER "YES!"

- Mentors
- Assist with SAO preparation
- Be the source for a reliance statement
- Check all the USQS boxes



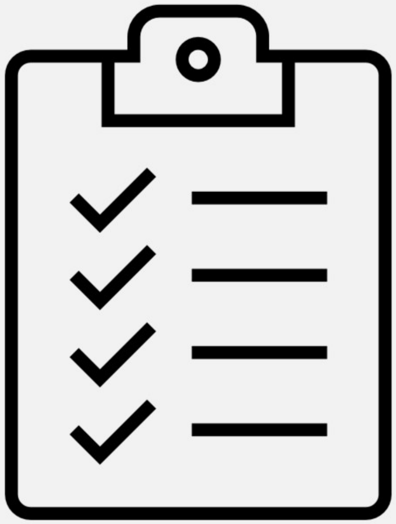
SIGNING YOUR FIRST SAO/AM

- What was done in prior years?
  - Is it appropriate and replicable?
  - Was the board / management / regulator satisfied with it?
  - Would you be proud of it?
- Balancing demands of the job
  - Good vs “amazing” SAO/AM: does it matter?
- You are signing
  - It’s great to get others’ perspectives, but ultimately you are responsible for the SAO



IT'S A REWARDING ROLE, BUT THERE ARE WAYS TO MAKE IT EASIER ON YOURSELF AS APPOINTED ACTUARY…

- Use your team, you're not alone…but you alone are signing
- Get exposure to SAO/AMs early in your career
- Understand the AM expectations well before December 31 / May 1
- Experience + Context + Expectations = "Yes, I'm definitely qualified to sign!"



ACTUARIAL MEMORANDUM & REGULATORY ISSUES

NAIC ANNUAL STATEMENT INSTRUCTIONS – ACT MEMO

- **Instruction Limitations:**
  - Instructions are general in nature.
  - Not detailed enough to ensure consistency across actuaries.
  - Focus of the instructions is Unpaid Claims Liabilities
  - They do not adequately address all actuarial liabilities and assets that could be included in the SAO.
  - Actuaries must determine what should be included in the Actuarial Memorandum.

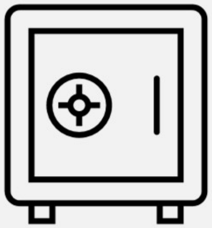
- **The Actuarial Memorandum should contain BOTH narrative and technical components.**
  - Narrative Component - Intended for non-actuaries, such as company management, the Board, and regulators with non-technical backgrounds
  - Technical Component - Intended for health actuaries, and regulators with more technical and/or financial backgrounds.

ACT MEMO - MISPERCEPTIONS

- **The Memo is for the Board of Directors only.**
  - The Memo is a regulatory requirement that provides information for the regulator to evaluate insurance companies' financials.
  - It is an actuarial communication, subject to ASOP #41, Actuarial Communications.
  - The appointed actuary may choose to prepare a separate report to the BOD/Audit Committee in a format that specifically serves the needs of that audience.
- **The Regulator Does Not Really Use the Actuarial Memorandum**
  - Misperception that regulators only look at the Memo every three to five years, during the financial examination. Many regulators request every year since the analysis performed in determining the actuarial items are detailed.

ACT MEMO - MISPERCEPTIONS

- **The Memo might disclose confidential or proprietary information**
  - The NAIC instructions state that the Memo is expected to be held confidential.



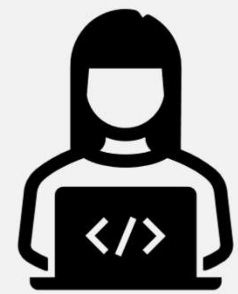
- **The Appointed Actuary is not responsible for information provided by another Actuary**
  - Misperception is that if some of the information included in the actuarial opinion is provided by another actuary, the appointed actuary does not need to review it.

NARRATIVE COMPONENT

- Per ASI, “should provide ***sufficient*** detail to clearly explain to company management, the regulator, or other authority the findings, recommendations and conclusions, as well as their ***significance***.”
- **Sufficient –** Includes a qualitative aspect to it requiring judgment by the actuary.
- **Significance –** Might take into consideration:
  - The magnitude of an actual recorded amount.
  - Potential for significant variability in the amount.
  - Complexity with determining any amount.
  - Importance to financial position.

NARRATIVE COMPONENT

- **Findings should be explained for each of the Scope items of the Opinion.**
  - Could be necessary to explain an amount of $0, e.g. PDRs
  - Explain a zero or non-zero that is not obvious to the intended audience.
  - Noting materiality of changes could be beneficial and notable in the Scope/Significance section.
- **Might consider including a detailed explanation of any estimate:**
  - That requires substantial judgment.
  - That is difficult to estimate.
  - For which the probable variance in the actual outcome versus the estimate has significant implications on reported income or company solvency/surplus.



TECHNICAL COMPONENT

- Per ASI, "should provide ***sufficient*** documentation and disclosure for another actuary practicing in the same field to evaluate the work. This technical component ***must*** show the analysis from the ***basic data***, (e.g., claim lags) to the conclusions."
- **Sufficient –** Could mean that after reading the Act Memo, the reviewer has no more questions and the Act Memo has made it clear how the appointed actuary has come to his or her conclusions.
- **Significance –** Interpretation might be required. However, the language states an expectation that significant detail will be provided with regard to the basic data, along with how that data is used in drawing conclusions in order to allow for another actuary practicing in the same field to evaluate the work. (could provide both PDFs and XLS files)

OPINION SECTION - CONSIDERATIONS

- Usual for the actuary to discuss the process leading to the conclusion that the amounts being opined upon (including any $0 items) are reasonable, and when viewed in aggregate, are good and sufficient.
- Might include support, such as an exhibit with best estimates and booked amounts to demonstrate the overall provision for adverse deviation, or margin, across the amounts opined upon, or a volatility analysis.
- Might describe the thought process behind the good and sufficient conclusion, including discussion of what the range of the assets and liabilities could be under moderately adverse conditions, including a discussion of any interactions.
- The actuary should provide enough details to convince the reviewer that it is a reasonable conclusion that the amounts booked will be sufficient under moderately adverse conditions.

RELEVANT COMMENTS

- Could be necessary to explain an amount of $0, e.g., PDRs
- Explain a zero or non-zero that is not obvious to the intended audience.
- Clearly state items cause the opinion to be qualified.
- Reasons for not following prescribed language
- Language required by state law or regulation.
- Description of any material changes in methodology.
- Description of major uncertainties (e.g., risk adjustment)
- Factors that had a significant impact on your opinion.
- Significant data issues.
- Address topics of regulatory importance.
- Subsequent events

PROVISIONS FOR ADVERSE DEVIATION (MARGIN)

ASOP #5: 3.3.1d Provision for Adverse Deviation

- "Recognizing that the estimation of liabilities for incurred but unpaid health and disability claims involves an estimate of the true obligations that will emerge, the actuary should consider what explicit provision for adverse deviation, if any, might be appropriately included. If a provision for adverse deviation is included, the unpaid claims liability should be appropriate, in the actuary's judgment, for the intended use."

ASOP 28: 3.7 Liability and Asset Valuation

- "When the actuary opines that the liabilities make ***good and sufficient*** provision, the actuary should include a provision for adverse deviation. The provision should result in amounts that, in the actuary's professional judgment, are sufficient to cover obligations under ***moderately adverse*** conditions."

ASOP 28: 3.9 Adverse Deviation

- "In general, when establishing a provision for adverse deviation, the provision should increase as the level of uncertainty increases."

ASOP 28: 3.11.a Unqualified Opinion

- "The actuary should be satisfied that the liabilities, assets, and related items opined on make reasonable provision to cover obligations under moderately adverse conditions."

WHAT IS AN APPROPRIATE MARGIN?

- **Issues of excessive margin**
  - Timing of excessive/adequate margin
- **Implicit versus explicit margin**
  - Does your method (without margin) always produce excessive margin?
- **How was margin determined?**
  - Is there an official margin policy? Who sets the margin? How was it established? Different by LOB?
- **Has the level of uncertainty increased or decreased?**
- **Are there company-specific or external factors that may require an "extraordinary" margin to be applied?**

MARGIN – HINDSIGHT TESTING

- Compare the Claims Unpaid to periodically revised estimates with additional runout and to the actual runout over several years and determine whether there is a pattern of overstating or understating the liability.
- A consistent pattern of significant overstatement or understatement could indicate that the underlying assumptions or methods (including margin) needs to be reviewed and potentially revised.
- Consider use results from monthly IBNR calculations.

PREMIUM DEFICIENCY RESERVES (PDRS)

SSAP #54: Section 19 Additional Reserves

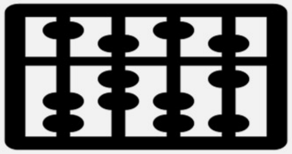
- "When the expected claims payments or incurred costs, claim adjustment expenses and administration costs exceed the premiums to be collected for the remainder of a contract period … For purposes of determining if a premium deficiency exists, contracts shall be grouped in a manner consistent with how policies are marketed, serviced and measured…Deficiencies shall not be offset by anticipated profits in other policy groupings. Such accruals shall be made for any loss contracts, even if the contract period has not yet started."

ASOP #42: Section 3.5

- "…the actuary should use ***reasonable*** assumptions that are appropriate for the intended purpose, and also reasonable in the aggregate."
- Blocks of Business—"…a manner consistent with applicable financial reporting requirements…The actuary may need to estimate a premium deficiency reserve for a block of business where a premium deficiency exists ***even if the contract period has not started.***"

PDRS - CONSIDERATIONS

- Can be a complex actuarial estimate that involves a significant amount of actuarial judgment to determine the appropriate actuarial assumptions, methods, and reasonableness of results.



- Analysis should be done to determine if it is necessary to establish a PDR.
- Should provide detailed information relating to the PDR calculation, including a statement of the amount of the PDR calculated by the actuary, even if it is $0.

PDRS - CONSIDERATIONS

Calculation Methodology

- Describe the overall approach used to determine the PDR.
- Note special circumstances that warrant specific considerations, e.g. a new carrier or a significant new block.

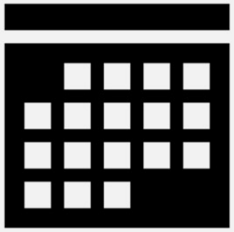
Grouping Methodology

- Describe the groupings used for both the analysis and reporting.
- Basis and reasoning for the groupings, e.g. credibility.
- Explain any changes since prior PDR.

PDRS - CONSIDERATIONS

The Projection Period

- Include rationale for the choice of the projection period.
- Explain any changes versus prior PDR.
- It is important to discuss the inclusion or exclusion of cash flows from policies effective after the valuation date but contracted on or before the "as of" date.
  - SSAP #54, Section 18
  - ASOP #42, Section 3.5



PDRS – HINDSIGHT TESTING

- Compare the PDR to the net underwriting losses on page 4, line 24 for the year following the valuation date.
- A consistent discrepancy between the PDR and the net underwriting gain or loss for the following year can indicate that the assumptions and/or methods might need to be revised.

RELIANCES

- "My examination included such ***review*** of the actuarial assumptions and actuarial methods and of the underlying basic liability records and such ***tests*** of the actuarial calculations ***as I considered necessary***. I also reconciled the underlying basic liability records to the Underwriting and Investment Exhibit, Part 2B of the company's current annual statement."
- "In forming my opinion on [specify types of reserves] I relied upon data prepared by [name and title of company officer certifying liability records or other data] as certified in the attached statements. I ***evaluated*** that data for reasonableness and consistency. I also reconciled that data to the Underwriting and Investment Exhibit, Part 2B of the company's current annual statement. In other respects, my examination included ***review*** of the actuarial assumptions and actuarial methods used and ***tests*** of the calculations ***I considered necessary***."

Thank You!

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