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Regulatory Issues for Small Insurance Companies A Review of the June 4, 2013 Webinar

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Jerry Enoch moderated a session with presenters Mark Birdsall, Mike Boerner and Perry Kupferman, regulatory actuaries with Kansas, Texas, and California, respectively. The webinar, which was co-sponsored by the Smaller Insurance Company Section and the American Academy of Actuaries (AAA), was well attended and received high review marks from the audience.

While also addressing product filing issues, Own Risk and Solvency Assessment (ORSA) and AG38 issues, most of the discussion involved general appointed actuary filings and future principle-based valuation issues.

I was reminded of the Internal Revenue Service (IRS) advice on how to get your refund quickly. Sign the return. Check your addition. Include the appropriate forms, etc. This clearly applies to policy form filings. In like fashion, the actuarial opinion, Regulatory Asset Adequacy Issues Summary, and the supporting actuarial memorandum are each subject to a review process in each state. If you want a smooth process, do the simple stuff as the IRS recommends. Domestic companies usually go through a finer filter than non-domestics. Companies with a problem history tend to get priority and increased scrutiny. The priority order is set by financial examiners. The actuarial items in the *Financial Analysis Handbook* are probably reviewed.

While there is not uniformity, participants got a sense of what probably occurs. Returning to the IRS analogy, the regulatory actuary will review the actuary's appointment, credentials and continuing education status. He will look for variation from standard language. He will see if the asset adequacy methods used (or not used) make sense for the respective blocks of business. Are the assets used appropriate? Are assumptions reasonable? Reserve and other figures will be checked with the annual statement. Are ending and interim negative results reasonably explained or

adequately reserved? Does the data support the conclusion? Is the reserve level justified? Concerns are discussed with the financial analyst and with the home state regulator for non-domestics. The appointed actuary will be contacted with questions. Are meaningful risks to the company disclosed and discussed?

This was not a theoretical discussion but a practical guide to finishing the work product. Properly finishing and documenting these obvious tasks will save the regulator and the appointed actuary time and improve their relationship. That relationship was the subject of further discussion. The regulator seeks an open environment with clear and concise communication. One regulator described the three types of response he gets to questions. Most appointed actuaries give him more information than he requests or needs. A significant number are minimalists who respond only to questions asked. A small number do not answer the questions asked and are uncooperative. It was suggested that consultants were more likely to resist providing needed information. ["Ouch!" says your consulting actuary reviewer.] The regulators appreciate a non-adversarial, collegial relationship. They appreciate good documentation.

The AAA has an AOMR Communication Group that brings company actuaries together with regulatory actuaries to find ways to improve communications to make the process easier for everyone. The group is developing a best practices guide. Contact Tom Campbell if you wish to be involved.

Risk-based examinations were discussed. This is expected to be an evolving process as experience is gained. Some companies examined felt it was everything from the older examinations plus much more. Eventually, it might save effort by focusing on areas of greater risk. The actuary will be interviewed during the audit. He or she should be ready to explain reserve and product development processes as

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well as reinsurance. Any unusual features of products or experience trends are likely topics. It will expedite the audit if any internal audit data is provided to the examiners. A description of actuarial controls should be available. Regulators prefer to deal directly with the company actuary rather than to have a non-actuary point of contact.

It was suggested that we small company actuaries work with the National Association of Insurance Commissioners (NAIC) to improve various regulatory processes. The industry input to various committees and task forces typically comes from larger companies. The meetings are usually phone conferences and, usually, all are welcome.

ORSA was discussed. It will not initially be required of smaller companies. However, if it is as successful as its proponents expect, it will be applied to smaller companies in the future. It is a structure for getting the companies and regulators focused on risk analysis and mitigation. It will integrate reserve and risk-based capital (RBC) documentation under the ORSA. It will assist the regulators in quantifying industry risks. OK, this session was not entirely practical.

A good but brief overview of principle-based reserves (PBR) was provided. Small company actuaries are particularly interested in the exclusion tests. The three types of reserves (net premium, deterministic and stochastic) and

the exclusion tests (stochastic and deterministic) that might exempt a block of business from one of the reserve calculations were described. One of the stochastic exclusion tests requires a certification, at least every three years, that the block does not have material interest rate risk or asset return volatility risk. Further small company issues such as simplifications, approximations and efficient modeling techniques allowed in VM-20 were noted. There are also exemptions for experience reporting. Clearly the concern of small companies about the expense of doing PBR has been acknowledged. The political prospects for VM-20 were described. Although it could become law Jan. 1, 2015, companies can defer implementation for three years. There is ongoing work in many areas of PBR and participation was again encouraged. (By the time this is published the section will have had an August webinar on the topic of PBR and smaller companies.)

All of the speakers encouraged company actuaries to communicate with them. Regulators need understanding, and that can often develop most easily through telephone discussions. It should be recognized that regulatory actuaries are usually generalists. Consequently, we shouldn't expect an off-the-cuff response to a complex technical question; but they still want to work with us. Scheduling calls in advance and specifying the topic will improve the communication. ●



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