The Appointed Actuary System

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Written by Dennis B. Funa

The Actuarial Society of the Philippines (ASP) through its Professional Standards and Review Council (PSRC) has proposed to the Insurance Commission the adoption of the Appointed Actuary System "as a means to strengthen corporate governance and protect policyholder interest." In their proposal, the Appointed Actuary shall prepare an annual Appointed Actuary Report (AAR) for the company's board of directors, senior management, and the Insurance Commission. The AAR, as proposed, shall include, among others, a commentary on "assets backing liabilities", "returns on reserve investment funds compared to assumptions", "commentary on product pricing", a "summary of existing reinsurance arrangements", and a discussion on the "solvency position and risk-based capital".

An Appointed Actuary is appointed directly by the board of directors of an insurance company and is charged with documenting the liability reserve of an insurer. They are engaged by the insurer "to ensure compliance with all required reserve statutes." They are not appointed by management to avoid management pressures. They are autonomous from the company. To ensure this autonomy, notice must first be sent to the regulator in case of resignation or termination of the actuary and must state therein the reasons for such resignation or termination.

They play "an important role within insurers by providing independent advice to boards and senior management on the key financial risks facing an insurer." Thus, the Appointed Actuary plays a key role in the protection of policyholder interests. Its main purpose "is to ensure that the board (of directors) has unfettered access to expert and impartial actuarial advice and review, to assist with the sound and prudent management of an insurer and that the insurer gives adequate consideration to the protection of policyholder interests." It is accountable to both the company management and the insurance regulator. He must also have access to the auditors of the company.

The functions of the Appointed Actuary have expanded over the years to include giving an opinion on the over-all financial position of the company. Far from just monitoring the reserves, the Appointed Actuary vouches for the solvency of the insurer. In so doing, the actuary considers several factors, such as: premium rates, nature of the contracts in force, investments and investment policies, marketing plans, level of expenses, the company's free reserves, reinsurance arrangements, vulnerability to fluctuations, allocation of profits to policyholders and shareholders, and tax position of the company. Hence, the appointed actuary must have access to information on all these matters.

The regulator can rely, to a certain degree, on this actuarial report. The regulator can be unburdened from going into the details of sufficiency of premium rates, policy conditions and reserving standards. In a way, the regulator will have to rely on the professionalism of the appointed actuary.

Following the crisis in the savings and loan industry and the occasional insolvency of a number of insurance companies in the U.S., NAIC adopted a new valuation law in 1990 and in it introduced a new concept called the Appointed Actuary. The standard valuation law requires an annual opinion by a qualified actuary, usually three months after the end of the financial year. The opinion would include a statement on reserves computed in accordance with accepted actuarial standards. The Appointed Actuary became responsible "for ensuring that all benefits provided by insurance contracts have adequate reserves."

To explain the concept of loss reserves, we quote the *Encyclopaedia of Actuarial Science*: "Because of the long-term nature of most life insurance policies, the estimation of the period profit of a mutual life insurance company involves more than counting the cash in the vault. The estimation requires a valuation of contingent liabilities involving future benefit payments less future premium payments, which may not be realized as cash payments for many years. The resulting estimate of the value of future liabilities must be subtracted from an estimate of the value of assets." In other words, the actuary makes a statement on the unpaid claims liability.

Loss reserves is the largest liability of insurers. The Appointed Actuary is tasked "to provide an actuarial valuation of loss reserves." It is the accuracy of this loss reserves and other policy liabilities (*i.e.*, the unearned premium reserve) that is the duty of the Appointed Actuary (reserve opinion).

Thus, the Appointed Actuary System introduced the practice of using actuaries as "Instruments of Regulation".

The United Kingdom has had an Appointed Actuary System for life insurance companies since 1974. It was introduced by a 1973 Act of Parliament "to continuously monitor the financial position of the assigned insurance company." The system also exists in such countries as the U.S., Australia, Canada, Italy, and Ireland. In Asia, it is practiced in Hong Kong, Vietnam, Malaysia, Singapore, Indonesia and Thailand. In the 1992 Annual Statement Instructions issued by NAIC, the annual Statement shall include a "Statement of Actuarial Opinion" giving the opinion of the actuary to the Board of Directors relating to loss reserves for P&C insurance companies. There is also such requirement in the Life Standard Valuation Law. Notably, in the U.K. and Canadian set-up, appointed actuaries have the added responsibility to "blow the whistle" on companies.

While the Appointed Actuary is being compensated by the company, he has the professional duty and obligation to advise the company that a particular course of action is not sound and to report such matter to the regulator. He does not become an executive of the company, and his access to the board of directors must not be hampered.

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Dennis B. Funa (dennisfuna@yahoo.com) is the current Insurance Commissioner. He was appointed by President Rodrigo R. Duterte as the new Insurance Commissioner in December 2016.