New Actuarial Standard about Capital Adequacy

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Capital adequacy assessments and pools

**Current Practices**
- Dozens of “capital adequacy assessment” approaches
- Same pool could be viewed as funded excessively or inadequate
- Poor financial decisions legitimized
- Not a healthy situation given importance of pools to local government
- But no approach is out of compliance as no standard has existed

**Future**
- New actuarial standard will lead to a more standardized approach and considerations
- Pool “capital adequacy assessment” - either comply or not
- Standard is for the “assessment”, not the level of “capital”
- Process leads to informed decision making
- Common vocabulary – comparisons and perspective
What is involved in an actuarial capital adequacy assessment?

### Capital Model

#### Quantitative
- Unpaid Claim uncertainty
- Projected Loss uncertainty
- Investment Mix
- Correlation
- Retention
- Operational Environment
- Other Risk Drivers

#### Qualitative

**Pool Funding Goals**
- Expressed in quantifiable terms

**Risk Tolerance**
- What failure rate is acceptable?

**Purpose of Capital**
- Solvency?
- Rate Stability?

**Other Sources of Capital**
- Tolerance for large rate changes or cash calls?
**Shift in focus from unpaid claim estimate to net position**

Best Practices/Regulation currently focus on unpaid claim estimate
- Actuarial opinion/certification
- Commonly misunderstood

But financial viability dependent on funding adequacy – net position
- Ability to withstand financial stresses
Results from early adopters

- More risk than previously considered
- Longer-term strategic planning
- More sophisticated decisions on rate levels, retention, investment policy, etc.
- Framework to measure financial health – boards have a valid perspective
**Pool regulation impact?**

| Regulation results from problems                          | • There have been pool failures  
|                                                          | • Pool failure creates a problem for the members |
| Forms of regulation                                       | • Inform stakeholders of risk       
|                                                          | • Mandate certain minimum thresholds |
| National regulation unrealistic                           | • Insurance regulation done on a state by state basis |
|                                                          | • Individual state regulators may utilize this standard |
|                                                          | • Other states often copy           |
But pools are different from insurance companies and each pool is unique?

1. There is not a goal to make money for investors
2. Oversight is done by Board of Directors made up of members
3. Members have voting privileges
4. Policies and business practices are focused on serving the members
5. Lower cost structure
Key takeaways

Standard is prescribing what needs to be taken into account in a capital adequacy assessment – not how much a pool needs to fund.

How a pool handles financial stresses – capital strategy – is a foundational issue.

Operational sophistication will improve leading to more efficient structures and rate stability to the members.

Board governance will be enhanced.

Public entity pools were mentioned in an actuarial standard of practice – adds legitimacy to the pooling industry.