

**Comments on the effect of Revisions to the  
Actuarial Opinion and Memorandum Regulation**

Presented to the National Association of Insurance Commissioners'  
Life and Health Actuarial Task Force

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## Overview

The American Academy of Actuaries' (Academy) Life Practice Council was asked to comment on the effect of the revisions to the Actuarial Opinion and Memorandum Regulation (AOMR) being adopted by the Statutory Accounting Principles Working Group to be part of codification at the September 2002 National Association of Insurance Commissioners (NAIC) meeting.

To summarize: the NAIC's Life and Health Actuarial Task Force (LHATF) passed revisions to the AOMR (revised AOMR) in March of 2001. Among the revisions were the following:

- 1) It requires actuarial opinions, which are based on asset adequacy analysis for all but a few companies.
- 2) It requires a Regulatory Asset Adequacy Issues Summary to be prepared.
- 3) It allows Commissioners to accept opinions based on other states' laws.
- 4) It includes updated requirements for documentation of the various assumptions, economic scenarios, and product features incorporated into the asset adequacy analysis.

The Life Practice Council's Valuation Subcommittee supports the revisions to the AOMR. Actuarial Standards of Practice (ASOP) 7 and 22 were revised to support the changes to the AOMR. These revisions have been adopted by the Actuarial Standard Board and are effective for year-end 2002.

No state has yet to adopt the revised AOMR, although we understand a number of them plan to do so in 2003.

The problem is that, if the revised AOMR has been adopted into codification, what are the rules that companies should follow at year-end 2002 if they are not otherwise required to file an actuarial opinion supported by asset adequacy analysis (i.e., if they are filing the old "Section 7" opinion)? Are companies required to perform asset adequacy analysis for year-end 2002? Are they required to disclose the impact of asset adequacy analysis in a footnote in the annual statement?

## **The Codification Rules**

The following explains what codification rules could impact this discussion:

In the Preamble to the Accounting Practices and Procedures (AP&P) manual, which contains the codification rules:

· Paragraph 4 states that the AP&P manual is intended to establish a comprehensive basis of accounting if not in conflict with state statutes and / or regulations.

· Paragraph 49 indicates that the provisions of the AP&P manual need not be applied to immaterial items.

In Statement of Statutory Accounting Principles (SSAP) Number 1 on Disclosure of Accounting Policies, Risks & Uncertainties, and Other Disclosures, Paragraph 7 indicates that if a reporting entity employs accounting practices that depart from the NAIC accounting practices and procedures, disclosure of the following information about those accounting practices that affect statutory surplus or risk based capital shall be made:

- a. A description of the accounting practice;
- b. A statement that the accounting practice differs from NAIC statutory accounting practices and procedures; and
- c. The monetary effect on net income and statutory surplus of using an accounting practice which differs from NAIC statutory accounting practices and procedures.

The last paragraph in each of the SSAPs on reserves, SSAP 51 (life contracts), 52 (deposit contracts), and 54 (health contracts), states that: “This statement is effective for years beginning in 2001. Contracts issued prior to January 1, 2001 shall be accounted for based on the laws and regulations of the domiciliary state.”

## **What States are Affected by the Codification Change Regarding the AOMR**

A number of states adopted a specific version of the Accounting Practices and Procedures Manual. For those states, which adopted a manual earlier than the September 2002 version, the codification changes made in September will not have an impact. For those states that adopted a rule that provides that all domestic insurers shall employ the most current version of the AP&P manual, this could have an impact. States where this can have an impact include California, Ohio, Massachusetts and New York.

## Why there is a Potential Problem

As stated above, codification rules only apply when they are not in conflict with state laws. All states have a form of the "old" AOMR. Therefore, the addition of the revised AOMR to codification should not impact the form of actuarial opinion companies submit to states. However, because SSAP Number 1 requires the disclosure of differences between reserves held and reserves required by applying codification standards, asset adequacy analysis may be required for companies that are not otherwise required to perform such analysis. This is due to the fact that these companies may not be able to disclose the differences unless the asset adequacy analysis is performed.

Note that if companies are required to perform asset adequacy analysis by SSAP Number 1, there is no requirement in SSAP Number 1 for the actuary to submit an opinion to states based on that analysis.

## Potential Solutions to the AOMR Codification Issue

There are several possible solutions to the AOMR/codification issue:

- 1) **Perform Asset Adequacy Analysis Effective Year-End 2002:** Asset adequacy analysis will be required if states adopt the revised AOMR in 2003. Some suggest that companies start doing the analysis in 2002. Asset adequacy analysis does not necessarily involve cash flow testing – ASOP 7 and 22 discuss acceptable alternatives. Companies generally do some sort of analysis to track the profitability of their business, and much of this analysis could be used for the asset adequacy work. A con to this approach is timing and expenses (and the surprise of not knowing you were going to have the expense).
- 2) **If a Company can Determine that the Business is Immaterial, Nothing Needs to be Done For Year-End 2002:** The codification rules only apply to business issued in 2001 and later. As mentioned above, in the AP&P manual preamble, paragraph 49, it states that codification rules need not be applied to immaterial items. For some companies, the issues of 2001 and later may make up an immaterial amount of business, so not taking any action would not be in conflict with codification. No disclosure would be necessary.
- 3) **Do Nothing, and Disclose that Reserves that were not Based on Asset Adequacy Analysis in the Annual Statement:** The disclosure that the reserves were not based on asset adequacy analysis is consistent with the required disclosures, assuming that asset adequacy analysis can have a material impact on results. In addition, the AP&P manual states that how the numerical effect of the actual accounting practices versus the codification levels be disclosed, so this would not be consistent with all the codification rules. What would happen to a company that made such a disclosure, would be up to the auditors and state regulators. A con to this approach is that this may be unacceptable to auditors or state regulators.

4) **Have This Issue be Determined on a State-By-State Basis:** At least one state is considering requiring asset adequacy analysis for year-end 2002 from all companies over a certain size, e.g., \$100 million. Another state is considering making an individual determination on a company-by-company basis, as to who would have to do cash flow testing. Any deviation from the precise requirements of codification could be viewed by the states as a “permitted practice”. Technically, this would still require that the amount of the difference be disclosed in the annual statement, so one would still have the issue of what would be acceptable to an auditor if this was the alternative chosen by a state.

## **Other Issues**

**Regulatory Asset Adequacy Issues Summary:** The Regulatory Asset Adequacy Issues Summary may be viewed as part of the codification rules adopted, since all the changes to the AOMR were incorporated in Appendix A-822 of the codification rules. It would be useful for the affected states to determine if this is indeed a requirement for all companies for year-end 2002. Note, some states, notably California and Illinois, already require a summary similar to that required in the revisions to the AOMR.

**Commissioners Accepting Opinions Based on Other States Laws:** It does not appear that any state has yet made a determination that opinions based on state of domicile be accepted. Therefore, for year-end 2002, each actuary’s opinion remains subject to knowing and signing to the fact that the reserves in the aggregate meet the requirements of the state of filing.

**Changes to the Asset Adequacy Testing:** Many of the changes to the asset adequacy analysis requirements, e.g., having the actuary determine the scenarios necessary to reasonably test their company’s business, have been incorporated into the ASOPs, which are effective at year-end 2002. Therefore, these requirements will be in place for this year-end.

## **Summary**

There are alternatives to what should be done for Section 7 companies for year-end 2002. In addition, there is an open question as to whether the Regulatory Asset Adequacy Issues Summary would be required in any state.

The American Academy of Actuaries would like to inform their members as soon as possible so that its members will be responsive to regulatory requirements.

If you have any question on this report, please contact Donna Claire at (631) 269-1501.