



AMERICAN ACADEMY *of* ACTUARIES

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April 8, 2003

Mr. John Purple, FCAS, MAAA  
Chairperson, Casualty Actuarial Task Force (CATF)  
National Association of Insurance Commissioners (NAIC)  
P. O. 816  
Hartford, CT 06142-0816

Dear Mr. Purple:

The Committee on Property and Liability Financial Reporting (COPLFR) of the American Academy of Actuaries<sup>1</sup> is pleased to provide initial comments concerning the draft Annual Statement Instructions for implementing the proposed Model Law on Property and Casualty Actuarial Opinions.

While we believe we understand the goals of most items of the draft instructions, we do have some questions in several areas.

We have several concerns regarding the new instructions that indicate an incoming actuary must “consult the previous appointed actuary to determine whether reason exists to decline the appointment.” First, the suggested consultation appears to be an action by the regulator to get the incoming actuary to investigate possible inappropriate actions by the company. We believe that only the regulator has standing to perform such investigatory tasks. By frankly discussing internal company problems with a non-regulatory third party, the outgoing actuary may be at risk of violating confidentiality agreements company and/or triggering libel or slander accusations, particularly if the actuary is discussing feelings or suspicions that the actuary is unable to prove substantive. Should the actuary provide a more limited consultation, he or she puts him/herself at risk of charges of failure to disclose based on a very vague standard.

Second, we are not clear as to the expected timing of any consultations. Informal discussions had indicated that the expectation was that the consultations would occur after the new actuary had been appointed. However, having an actuary sign a contract to provide an opinion and then break that contract would appear awkward, at best, and could involve breach of contract litigation issues at worst. On the other hand, having these consultations take place before the incoming actuary accepts the appointed actuary position, presents the kind of confidentiality and slander/libel issues noted above with multiple actuaries considering the appointment.

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<sup>1</sup> The American Academy of Actuaries is the public policy organization for actuaries practicing in all specialties within the United States. A major purpose of the Academy is to act as the public information organization for the profession. The Academy is non-partisan and assists the public policy process through the presentation of clear and objective actuarial analysis. The Academy regularly prepares testimony for Congress, provides information to federal elected officials, comments on proposed federal regulations, and works closely with state officials on issues related to insurance. The Academy also develops and upholds actuarial standards of conduct, qualification and practice, and the Code of Professional Conduct for all actuaries practicing in the United States.

We would suggest an alternative wording such as the incoming actuary “should follow the Code of Professional Conduct and endeavor to consult with” the outgoing actuary. Alternatively, we would suggest considering a procedure paralleling that outlined in Section 6 of the NAIC’s instructions for Annual Audited Financial Reports, which outlines procedures to be followed when auditors are replaced. This procedure place the burden of explanation on the company at the time of replacement, and offers a chance for the outgoing actuary to comment on the company’s explanation.

We are pleased to see that the draft continues to offer the option of providing either a point estimate or a range in the Actuarial Opinion Summary. We continue to believe that provision of either a range or point estimate should be sufficient to allow the regulator to gauge, by the regulator’s own standards, whether a company’s reserve position is reasonable. Creating additional work in instances where both a range and a point estimate are not generally derived does not appear to yield a commensurate benefit.

We would request that the wording in the instructions refer to the actuary’s “point estimate” rather than the actuary’s “best estimate”. We believe that the “best estimate” terminology tends imply that the actuary is capable of providing some sort of pinpoint estimate of the reserve need, which we do not believe adequately portrays the uncertainty in most actuarial reserve estimates.

We believe we understand the intent of the three items in section C. However, we believe wording for each needs to be refined.

- Instructions should be specific as to whether discussion is required of net reserves, gross reserves, or both.
- Regarding Item 1, the instruction does not indicate whether the base for the 5% calculations is surplus or reserves. If the base is reserves whether the one year, two year, or some other duration test should be used to gauge the 5% adverse development cited. Nor does it explicitly state the test is on the Schedule P Summary calendar year reserve, although we assume this may be what is the intent. The Schedule P Summary, however, reflects only net reserves. This item also asks the actuary to essentially predict the future. A more reasonably answerable question would be to ask the actuary to comment on the reasons for past reserve shortfalls and on what management has done that may impact future adverse development.
- Regarding Item 2, we would stress that discussion of differences between the actuary’s range and/or point estimate and the company’s recorded reserve should be confined to instances where the differences are of some magnitude. It may, in fact, be desirable to discuss explicit criteria. Given the tolerances that must realistically be put around the appointed actuary’s estimates, the timing of the actuarial analysis and the need for most companies to have mechanical methods to efficiently spread reserves to a wide variety of categories (e.g., state, annual statement line, profit center), there is little likelihood that the actuary’s estimates will align exactly with what the company has booked. Nor would it seem productive to pressure companies to make relatively small year-end adjustments in reserves in the midst of Annual Statement production.

We would also note that it remains management’s responsibility to record its best estimate and the burden logically should be on management to explain why, if it records an estimate

significantly different from the appointed actuary's, why management's best estimate is a better choice. It is the actuary's responsibility to opine on whether the reserves recorded are reasonable. While the actuary may be able to comment on some known differences in assumptions in setting reserves, it does not appear reasonable to put the actuary in the position of explaining some other party's decision. It may be advisable to ask the actuary instead to explain why the actuary came to the conclusion that management's best estimate is reasonable even though it differs significantly enough from the actuary's to comment on.

- We believe it should be made clear, regarding item 3, that the actuary may or may not have some general information about points more or less likely to occur in any reasonable range. However, it is unreasonable to presuppose knowledge of the probabilities of any point or group of points, given the nature of reserve estimates.

COPLFR is also in the process of consulting the American Academy of Actuaries' chief counsel concerning both the wording of the Model Law and the draft instructions and will provide separate input regarding those conclusions as soon as possible.

We welcome the opportunity to work with the CATF to develop instructions to implement the proposed Model Law. We believe this should be the beginning of an extended dialogue to ensure that implementation of the new Model Law results both in providing regulators with significant additional data which they can depend upon to assist them in allocating their actuarial and solvency resources and in requirements that opining actuaries can reasonably and meaningfully fulfill.

Sincerely,

Andrea Sweeny, FCAS, MAAA, FCA, Chairperson  
Committee on Property and Liability Reporting.