



AMERICAN ACADEMY *of* ACTUARIES

September 13, 1998

Mr. Richard J. Roth, Jr.
Chief Property/Casualty Actuary
California Department of Insurance
300 South Spring Street
Los Angeles, CA 90013

Re: Statement of Actuarial Opinion with respect to Unearned Premium Reserves

Dear Mr. Roth:

As requested at the June 1998 meeting of the Casualty Actuarial Task Force (CATF), the Committee on Property and Liability Financial Reporting (COPLFR) has discussed the proposal to expand the scope of the statement of actuarial opinion to include the unearned premium reserve. We offer the following observations:

- For most property and casualty insurers, the vast majority of the unearned premium reserve is appropriately calculated on a pro rata basis. The proposal recognizes this fact and would allow the actuary to rely on the calculations of others for such blocks of business. Requiring an actuarial opinion where no actuarial analysis is needed adds additional expense without benefiting solvency regulation.
- The CATF was concerned specifically that actuaries review the Death, Disability and Retirement (DDR) reserve that is sometimes included in the Unearned Premium Reserve. Within the context of an actuarial opinion on the entire Unearned Premium Reserve, the DDR reserve would be immaterial for many, if not almost all, companies for which such reserves are required. The goal of requiring actuarial attention on the DDR reserve would not be served.
- Accordingly, COPLFR recommends that the scope of the statement of actuarial opinion (SAO) **NOT** be expanded at this time to include the entire unearned premium reserve. Instead, we recommend that the Annual Statement Instructions be amended, if necessary, to clarify that the actuary should consider the DDR reserve when rendering the actuary's statement of actuarial opinion.
- During the discussion, it was noted that the forthcoming codification of statutory accounting provides for a Premium Deficiency Reserve (PDR), as currently exists under GAAP accounting. The requirement for such a reserve raises the question of whether the unearned

premium reserve, calculated on a pro rata basis, constitutes a reasonable provision for that liability. We note that the adequacy of the unearned premium reserve will be a less significant issue on a codified statutory basis than on a GAAP basis, since codified statutory accounting still does not permit recognition of a deferred acquisition cost (DAC) asset.

COPLFR believes that the implications of the PDR merit further discussion in the context of the implementation of codification and in responding to the CATF proposal to expand the statement of actuarial opinion to include the unearned premium reserve. Accordingly, we have established a working group to consider this issue and develop recommendations that we will be prepared to present to the CATF at its March 1999 meeting. We note that an opinion on the unearned premium reserve will require the actuarial profession to address several new issues, including appropriate guidance on what constitutes a reasonable provision for that liability. For instance, many insurers' unearned premium reserves are likely to be considered substantially redundant on an actuarial basis, since the DAC asset will not have been allowed on a codified statutory basis. How should such redundancies, in conjunction with varying loss and loss expense reserve scenarios, affect an actuary's overall reserve opinion? Further, it should be noted that the proposal to expand the statement of actuarial opinion to include unearned premium reserves would require that the actuary afford significantly greater attention to pricing considerations than is currently required.

We are glad to have this opportunity to provide our analysis and recommendations to you, and we will be available to respond to any questions you may have.

Very truly yours,

Patricia A. Teufel, FCAS, MAAA
Chair
Committee on Property and Liability Financial Reporting

Cc: Eric Nordman, NAIC SSO Staff
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