



AMERICAN ACADEMY *of* ACTUARIES

September 1, 2006

The Honorable Susan F. Cogswell, Chair
Casualty Actuarial Task Force
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108

Attn: Ms. Kris DeFrain, FCAS

Re: Schedule P Interrogatory Changes – ERE Reserve Disclosures

Dear Commissioner Cogswell:

The American Academy of Actuaries'¹ Medical Malpractice Subcommittee is pleased to submit the following comments regarding the National Association of Insurance Commissioners' (NAIC) Casualty Actuarial Task Force (CATF) Extended Loss Subgroup's recently proposed replacement for Schedule P Interrogatory #1. As the subcommittee understands it, the eleven proposed Death, Disability, or Retirement (DDR) interrogatory questions, as suggested in the draft exposed on August 8, 2006, are intended to replace the single interrogatory question on the topic currently found in the Annual Statement blank.

The Subcommittee appreciates the efforts of the CATF in enhancing the current Extended Reporting Endorsements (ERE) reserve disclosure. We understand that CATF's eleven proposed questions are aimed at helping regulators identify situations where they may need to request additional information or review the assumptions underlying the DDR reserve calculated in the actuary's DDR work papers and actuarial report. However, the Subcommittee questions the need for the changes to the current interrogatory proposed in the August 8, 2006 draft. It seems the attention being afforded this issue is disproportional to the typically small size of the DDR reserve in comparison to the much larger loss reserve and unearned premium reserve carried by most medical malpractice insurers. If the intent is in any way to evaluate the reserve, the Subcommittee agrees that the current question on this topic, Schedule P Interrogatory #1, does not gather enough information to reliably benchmark the adequacy of the carried reserve. On the other

¹ The American Academy of Actuaries is a national organization formed in 1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession.

hand, the Subcommittee also observes that the proposed questions in the exposure draft go beyond the level needed to accomplish the degree of oversight that is typically envisioned in the Annual Statement for a reserve of this magnitude.

Furthermore, the goal of this series of questions is not clear, since the assumptions and methodology needed to actuarially estimate such a reserve go well beyond the information that can be reasonably included in the Annual Statement. In fact, the requested data is not always available, and the reporting companies frequently do not use it in estimating their reserves.

We feel that appropriate questions would clarify the nature of the reserves and their amounts and help regulators track the reserves through the annual statement. However, it is not realistic to use these interrogatories to provide a reviewer with sufficient information to estimate the reserves or to make a well-informed judgment about their reasonableness. Such judgments require too much data. In connection with companies' year-end actuarial estimates of reserves, companies usually retain detailed work papers supporting the calculation of these reserves. The most appropriate way to gather and examine such extensive and detailed data is by reviewing these work papers and actuarial reports.

We understand that one concern is the existence of discrepancies between the current interrogatory and other items in the Annual Statement. One suggestion that might address this is to create a table of these pertinent items and require an explanation of any discrepancies that exist between them.

The remaining comments will be directed to each individual interrogatory.

1.01 Currently, the proposal only requires a detailed response to the eleven interrogatories if the company is carrying a non-zero medical malpractice DDR reserve on the Annual Statement, but the Subcommittee feels that companies with zero DDR reserve should also answer the interrogatories. Due to the nature of the DDR reserve, its estimated value can vary quite widely. The estimated DDR reserve can be zero, even when the company expects to issue "free" tails in the future. We suggest this question be broadened to ask, "*Does your company issue Medical Malpractice Claims Made insurance policies that provide tail benefits to qualifying insureds (for example, in the event of Death, Disability, or Retirement) at a reduced charge or no additional cost? If the answer is 'no' to this question, leave questions 1.02 through 1.11 blank.*"

Some companies issue free or reduced price tails for reasons other than the death, disability, or retirement of one of their insureds. These should be anticipated and reserved for as well as the DDR, and the above wording is intended to encompass such policies. We recommend that the NOTE before question 1.01 likewise be reworded to indicate that the Interrogatory is focused not solely on "DDR reserves," per se, but on any reserve for yet-to-be-issued "prepaid tails," regardless of the reason for their issuance.

1.04 We suggest this question be expanded to clarify where the reserve is reported if the answer to this question is “no,” or if the reserve is carried as a loss reserve. Is it included in Schedule P? Is it in row 1 of the Liability page, or is it included as a write-in? Because of the variety of possible answers to this question, a “text-response line” for a response might be more informative.

1.01 through 1.04 otherwise seem like reasonable questions that could be included on the Schedule P Interrogatory Page. We feel that questions 1.05 through 1.11, on the other hand, are potentially burdensome to compile and sensitive to disclose. We are not sure how they contribute to the goal of transparency in the reserving methodology. We think they should not be adopted for use in the Annual Statement.

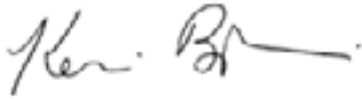
1.05-1.06 Policy count information can vary considerably in meaning and is not easily ascertained from accounting records. Free tail premiums, if available, could reflect the general magnitude of the exposure for these tails, once issued. However, it is our belief that these premiums may not be calculated by most companies and recorded in the occurrence premiums in the Annual Statement.

1.07-1.08 These “free tail” eligibility criteria are two specific coverage items related to this very small segment of the total claims-made policy. They are not key factors of the reserve and are insufficient to accurately estimate the “adequate reserve.” There are numerous other criteria, such as whether an insured gets vesting credit for years spent as a claims-made insured at another carrier. “Consecutive years insured” often varies based on age at retirement. Furthermore, trend, discount, exposure, and especially policy lapse rates must be considered. The only practical way to examine all these assumptions and calculations is to review the full actuarial report or work papers for the reserve. As a general rule, such reports or work papers should exist for any company that answered “yes” to Item 1.01. We question the benefit of singling out these small policy provisions while many other provisions and assumptions are much more material.

1.09-1.11 These questions seem out of place in an Annual Statement, which is focused on reserves and current financial condition, not prospective rate levels. The questions are vague, and multi-state, multi-product carriers may find the questions difficult to monitor and accurately respond to. Although we do not fully understand the intent of these questions (e.g., collecting the provision included in the rates to compare to the assumptions used in the DDR reserve calculation, company comparisons, trend analysis, etc.), their answers are not always readily discernable from an approved rate filing. More than any of the other questions, we feel that these questions add little value to the disclosure and should be deleted.

Thank you for the opportunity to comment on the proposed interrogatories. Please do not hesitate to contact me or Lauren Pachman, the Academy's Casualty Policy Analyst, at 202-223-8196, if you have any questions or would like additional information.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Kevin Bingham".

Kevin Bingham, ACAS, MAAA
Chair, Medical Malpractice Subcommittee
American Academy of Actuaries

cc: Lauren Pachman, AAA