



AMERICAN ACADEMY *of* ACTUARIES

May 8, 2009

Mr. John Purple, Chairperson
Casualty Actuarial and Statistical Task Force
National Association of Insurance Commissioners

Via email: Kris DeFrain, Director, Actuarial and Statistical Services
kdefrain@naic.org

Re: *Exposure Draft - P&C Opinions and Premium Deficiency Reserves*

Dear Mr. Purple:

The Committee on Property Liability Financial Reporting (COPLFR) of the American Academy of Actuaries¹ appreciates this opportunity to comment on a proposal by the Casualty Actuarial and Statistical Task Force (CASTF) of the National Association of Insurance Commissioners (NAIC) to include a requirement in the 2010 Annual Statement Instructions for appointed actuaries to express an opinion in the Statement of Actuarial Opinion on premium deficiency reserves (PDR).

The PDR proposal potentially would have a significant impact on practicing actuaries. In this response letter, we are providing a list of our preliminary views, and issues that we have identified for further consideration by the CASTF. We may update our response letter before the NAIC Summer 2009 National Meeting in June.

The proposed changes should not be adopted as described in the PDR proposal. This conclusion is based on the following considerations:

- The evaluation of the need for a PDR involves accounting policy decisions, including matters around investment income (e.g., whether or not investment income is considered, the interest rate, the methodology) and grouping of business, as well as the estimation of items that are not typically estimated by actuaries (e.g., expectations of future policy maintenance expense). In practice, the evaluation and estimation of the PDR tends to be a collaborative effort between actuaries and accountants. The actuaries' role might be limited to the projection of future losses (and premiums, as applicable). Accordingly, the NAIC should consider explaining in the instructions that the actuaries' role is limited to the evaluation of future premiums and losses.

¹ The American Academy of Actuaries is a 16,000-member professional association whose mission is to serve the public on behalf of the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

- In cases where a PDR exists, it may be appropriate in principle to include these amounts within the scope of the actuary’s opinion. However, because the existence of a PDR is very unusual, most actuaries have limited experience performing such projections, and we are not aware that common practice among actuaries currently exists. Therefore, opining actuaries would benefit from guidance in this area.
- In cases where no PDR exists, we have concerns that the benefits to the regulator of inclusion in the opinion may not be commensurate with the time the opining actuary would spend and/or the cost to the companies. For short-duration contracts, it is very uncommon for property/casualty insurance companies to have a PDR. Nevertheless, while actuaries do incorporate pricing adequacy in their analysis supporting their loss reserve opinion, the actuary may be obligated to support his/her opinion with a greater evaluation of current pricing adequacy than would otherwise be needed for a loss reserve opinion. This additional work would divert actuarial resources, just when such resources are most scarce, from work that would likely be more relevant.

There might be alternatives to requiring a “zero PDR” opinion. One possibility might be to require one on an as-needed basis as deemed necessary by the state regulator, such as for low risk-based capital circumstances or for lines of business that are in a severe downturn in the underwriting cycle. Another alternative might be to make the PDR opinion due subsequent to the loss reserve opinion (for example, July 1). These alternatives are meant to be illustrative, and we are not endorsing or recommending either of these possibilities.

- As an alternative to adding PDR, and/or the reasonableness of no PDR, to the opinion, given the infrequency of a PDR, the NAIC may want to consider having such items addressed through disclosure within the opinion rather than as an item being subject to the opinion.
- The statutory accounting guidance within Statement of Statutory Accounting Principles (SSAP) No. 65 for unearned premium for policies with coverage periods equal to or in excess of thirteen months (long-duration contracts) already subjects these amounts to an opinion. We understand that the PDR proposal would address contracts with coverage periods less than 13 months (short-duration contracts), as well as mortgage guaranty and financial guaranty contracts, which are outside the scope of SSAP 65. Since the statutory accounting for short-duration contracts differs significantly from mortgage guaranty and financial guaranty contracts, the NAIC should consider providing separate guidance for these contracts with regard to how PDR is considered within the opinion. The NAIC also should consider explaining in the instructions that the PDR requirement does not apply to long-duration contracts, as defined in Paragraph 23 of SSAP 65.
- With regard to the suggested changes to the 2010 Annual Statement Instructions in the PDR proposal, we have several observations:
 - On Page 4, the sentence, “The appropriateness of a non-zero premium deficiency reserve should also be included in the opinion” should be written as, “the appropriateness of not having a premium deficiency reserve should also be included in the opinion,” as this is more consistent with our understanding of the intent of the proposal.

- If an opinion on PDR is required, there should be a line on Exhibit A of the opinion specific to PDR.
- There should be specific guidance in the Annual Statement Instructions as to whether PDR could or should be combined with other reserve items for purposes of the opinion and its related disclosures.
- The NAIC should consider tracking the runoff of a PDR over time as reserves develop, perhaps in the Notes to the Financial Statements.

We very much appreciate the opportunity to respond to this proposal. We believe that the implementation of this proposal could be viewed as a significant increase in opining actuaries' obligations, and therefore, COPLFR is likely to have an extensive role providing guidance to casualty actuaries on this topic. We believe there is great value in NAIC and COPLFR working together towards an optimal solution.

Sincerely,

Marc F. Oberholtzer
Chairperson, COPLFR
American Academy of Actuaries