



AMERICAN ACADEMY *of* ACTUARIES

September 30, 1999

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

Re: Possible Statement of Opinion with Respect to Unearned Premium Reserves

Dear Mr. Roth:

The Casualty Actuarial Task Force (CATF) of the National Association of Insurance Commissioners has been discussing the possibility of adding the Premium Deficiency Reserve (PDR) being introduced in 2001 with Codification to the Statement of Actuarial Opinion.

At the CATF's request, the Committee on Property and Liability Financial Reporting (COPLFR) has continued a dialog with the CATF subgroup appointed to review this possibility. Our goal has been to work toward clarifying issues and reaching concurrence on the principles involved if the CATF concludes that a Statement of Actuarial Opinion on the premium deficiency reserve is desirable. Michael Lamb of Oregon, who leads the CATF subgroup, provided you with a summary of his group's conclusions to date in his letter dated September 28, 1999. He has graciously provided COPLFR a copy of this letter. Based our continuing dialog, we are in very large measure in concurrence with the principles outlined in Mr. Lamb's letter. Specifically regarding:

Discounting

The CATF subgroup concludes that investment income should not be considered in the PDR calculation. As reflected in our March 5, 1999 letter to the CATF, we concur that, for purposes of consistency in statutory reporting, the calculation of the PDR should logically not reflect the effects of investment income. We would reiterate, however, that this is likely to have a significant impact on some insurance company balance sheets. This impact is also likely to vary substantially by company, with companies writing longer tailed lines generally having a larger effect. Members of the CATF subgroup have suggested approaching the EX4 Codification Working Group concerning the expected surplus impact of the PDR. Mr. Lamb notes that current blank proposals include the PDR as a write in item only on Page 3 of the Annual Statement, implying the Codification Work Group does not regard this as a potentially significant liability. We would concur that approaching the Codification Working Group on this subject is a very sensible idea.

Grouping of Contracts

The subgroup also suggests discussing removing the prohibition against offsets between groupings of contracts in calculating the PDR contained in SSAP #53 with the Codification

Working Group. As also noted in our March 5 letter, COPLFR concurs that removing this wording would be a desirable result.

Mandatory Reserves

The CATF subgroup has suggested that if an actuary considers mandated reserves, such as those for financial guarantee or title insurance, in evaluating the reasonableness of the PDR, the actuary should note this in the Statement of Actuarial Opinion. This seems to be a practical, straightforward solution to what is likely to be a relatively infrequent issue.

DD&R and Long Duration Reserves

The subgroup believes that these two items should be considered separately from the PDR. COPLFR would agree that they are specialized calculations. We see no immediate problems to listing them in the SCOPE paragraph of the Statement of Actuarial Opinion, although the list of potential items included in this paragraph is now getting quite long and diverse and will become longer with the PDR. We note that the opinion paragraph expresses a judgement on the reserves cited in the scope paragraph in the aggregate.

Policies for Which No Premium Has Been Billed

The CATF subgroup believes the PDR calculation should apply once a contract is accepted by an insurer. While we expect some workable implementation guidelines can be established regarding what contracts are subject to the PDR, we believe we need to work through some specific examples to insure that whatever philosophy is adopted reflects information currently maintained by insurance companies and reflects logical and consistent accounting principles. This is also an area where consultation with the Codification Working Group may be useful. The issue which gave rise to the wording the CATF subgroup references in SSAP #54 may now have disappeared.

We have welcomed the opportunity to provide our thoughts to the CATF subgroup and look forward to continuing our discussions.

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Very truly yours,

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