AMERICAN ACADEMY of ACTUARIES

February 3, 2011

Via email
Richard Marcks, Chair
Casualty Actuarial and Statistical Task Force (CASTF)
National Association of Insurance Commissioners
2301 McGee Street Suite 800
Kansas City, MO 64108

Re: Improvements to Statements of Actuarial Opinion and the Actuarial Opinion Summary

Dear Rich:

As you may recall, the Casualty Actuarial Society (CAS) released the Report of its Task Force for Enhancing the Reputation of Casualty Actuaries (Task Force) in March 2008 and asked the CAS Executive Council to consider and implement its recommendations. In October 2009, the CAS Vice-President for Marketing & Communications, Patricia A. Teufel, notified the American Academy of Actuaries'[1] Casualty Practice Council that the CAS Board of Directors had approved its Executive Council's action plan for the recommendations. Several of those recommendations were referred to the Committee on Property and Liability Financial Reporting (COPLFR) of the American Academy of Actuaries.

In a February 24, 2010 letter, COPLFR communicated with the CASTF concerning several specific recommendations of the Task Force that involved interaction between CASTF and COPLFR. The following provides a summary of related activities undertaken by COPLFR in 2010 and commentary on the specific areas of the CAS recommendations identified in our previous communication as relevant to COPLFR.

1) ***Work on enhancements to the Statements of Actuarial Opinion (SAO) to ensure that SAOs and related reports are responsive to the needs of their users.***

As you may recall, the CASTF provided information concerning regulator feedback on 2009 SAOs. COPLFR addressed much of that feedback in a concurrent session at the September 2010 Casualty Loss Reserve Seminar in Orlando and, to a lesser extent, during presentations at the Academy's Seminar on Effective Loss Reserve Opinions in Chicago on November 17-18, 2010.

COPLFR recognizes regulators' desire for a more robust Schedule P reconciliation on the part of practitioners and fully supports the provision of higher levels of detail than an "all

[1] The American Academy of Actuaries ("Academy") is a 17,000-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.

lines, all accident years combined" reconciliation. At the same time, COPLFR is aware of two fundamental problems faced every year by actuaries trying to comply with the Annual Statement Instructions regarding Schedule P reconciliation.

The first of these problems is the mismatch between policy (underwriting) year versus accident year. There is a potential for a discrepancy in a Schedule P reconciliation if/when the actuary uses data on a basis other than by accident year. These mismatches by year should, however, offset and result in a balance by line of business and overall.

The second (and more prevalent) issue relates to those situations in which an SAO is prepared using data valued before December 31, accompanied by a roll-forward calculation. It is challenging to reconcile year-end data with actuarial data valued at an earlier point in time. This practice is prevalent out of necessity, given the timing associated with year-end SAOs.

While not raised by regulators, the issue of peer review is another matter that merits exploration by COPLFR as a potential tool to ensure that SAOs and supporting reports are responsive to the needs of regulators. COPLFR members discussed the relative pros and cons of recommending mandated professional peer review but reached no consensus. Fairly large issues come into play, including, but not limited to, client confidentiality (especially for sole practitioners), added costs, and added time constraints involved in getting such a review completed in a timely fashion.

Regarding the issue of better documentation of initial expected loss ratios (IELRs), COPLFR's recently-issued Model Audit Rule Practice Note discussed the importance of the IELR on page 15. Additionally, CAS's Working Group on Bornhuetter-Ferguson Initial Expected Losses Ratios, under the leadership of Lynne Bloom, is producing a paper on this topic. Three members of COPLFR are also members of that Working Party. Our committee looks forward to reviewing the recommendations in that upcoming paper.

2) ***Solicit feedback from regulators as to what has been learned over time from their past reviews of filed SAO and Actuarial Opinion Summary (AOS) documents.***

   COPLFR solicited this feedback from regulators at the March 2010 meeting of the CASTF; that meeting resulted in the observations and conclusions addressed above.

3) ***Consider expanding the number of evaluation points in the AOS, and include the one-year development to surplus ratio.***

   COPLFR is not opposed to expanding the number of evaluation points in the AOS but is wary of the possibility of misleading new AOS content that could be prompted by changes in circumstances like:

   a. Change of Appointed Actuary;
   b. Change from a point estimate approach to a range approach, or vice versa;
   c. Change in company management and/or reserving philosophy;

d. Impact of acquisitions, divestitures, commutations, novations, pooling;
e. Impact of significant changes in the underlying mix of business written; and
f. Direct v. net, that is, would the regulatory focus be on net only?

One question is whether regulators would like to see actual temporal changes or historical AOS amounts that are restated given the actuary's most current evaluation. If regulators wish to see the latter, COPLFR would have many more questions and concerns about the presentation and narrative accompanying the changes.

Similarly, COPLFR has discussed whether the AOS was the proper venue for discussion of temporal changes or whether such a discussion belonged in the actuarial report in support of the SAO and AOS instead. No consensus was reached on this question.

4) ***Incorporate temporal changes in reserve position within the AOS.***

This change would likely add value to the AOS and help regulators "triage" companies in their jurisdiction for early review. However, as mentioned above, COPLFR anticipates it would have questions and concerns about the specifics of this new requirement. For that reason, COPLFR may comment further on any specific proposal concerning temporal changes.

5) ***Consider requiring additional explanatory information when temporal differences in reserve estimates exceed a predetermined threshold, relative to given benchmarks.***

The questions raised in #3 above also apply to this recommendation. Further, given the time constraints of the AOS and regulators' ability to request the workpapers of an Appointed Actuary, COPLFR is uncertain as to whether the AOS is the proper venue for such an analysis of temporal differences.

If you have any questions about these issues, please feel free to contact me through Lauren Pachman, the Academy's casualty policy analyst, at pachman@actuary.org.

Sincerely,

Joseph A. Herbers, ACAS, MAAA
Chair, Committee on Property and Liability Financial Reporting

cc (via email): Lynne Bloom