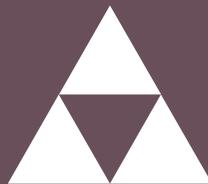


A PUBLIC POLICY PRACTICE NOTE

# Statements of Actuarial Opinion on Property and Casualty Loss Reserves

*December 31, 2010*

American Academy of Actuaries  
Committee on Property and Liability Financial Reporting



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AMERICAN ACADEMY *of* ACTUARIES

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Developed by the  
Committee on Property and Liability Financial Reporting  
of the American Academy of Actuaries



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AMERICAN ACADEMY *of* ACTUARIES

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The American Academy of Actuaries is a professional association with over 17,000 members, whose mission is to assist public policymakers 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.

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December 2010

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## A PUBLIC POLICY PRACTICE NOTE

### **Practice Note on Statements of Actuarial Opinion on P&C Loss Reserves as of Dec. 31, 2010**

#### **Developed by the Committee on Property and Liability Financial Reporting of the American Academy of Actuaries**

### **Introduction**

This practice note was prepared by the Committee on Property and Liability Financial Reporting (COPLFR) of the American Academy of Actuaries (Academy). The purpose of this practice note is to provide information to actuaries on current or emerging practices in which their peers are engaged. It is intended to supplement the available actuarial literature, especially where the practices addressed are subject to evolving technology, recently adopted external requirements, or advances in actuarial science or other applicable disciplines (e.g., economics, statistics, or enterprise risk management). It is not an interpretation of actuarial standards of practice, nor is it meant to be a codification of generally accepted actuarial practice. Actuaries are not in any way bound to comply with this practice note or to conform their work to the practices described herein.

This practice note is intended to assist actuaries by describing practices that COPLFR believes will be commonly employed in issuing statements of actuarial opinion on loss and loss expense reserves in compliance with the Property and Casualty Annual Statement Instructions for 2010 issued by the National Association of Insurance Commissioners (NAIC). Actuaries may also find this information useful in preparing statements of actuarial opinion for other audiences or regulators. However, approaches other than the ones described within this practice note may also be in common use. The information contained herein is not binding on any actuary and is not a definitive statement of what constitutes generally accepted practice in this area. All boldface materials preceding each discussion section are NAIC materials and are reproduced with its permission. Further replication or distribution of NAIC materials without the written consent of the NAIC is strictly prohibited.

Actuaries are reminded that Actuarial Standard of Practice (ASOP) No. 36, *Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves*, applies to the material covered by this practice note. That standard is binding on all actuaries opining on P&C loss reserves. Proposed revisions of ASOP No. 36 have been exposed for comment by the Actuarial Standards Board (ASB). As a result, final revisions to ASOP No. 36 are currently pending. In the event of a conflict between this practice note and the final revisions to ASOP No. 36, the reader should follow the final revisions to ASOP No. 36.

In addition, ASOP No. 43, *Property/Casualty Unpaid Claim Estimates*, became effective in June 2007. While ASOP No. 43 may not result in substantial changes in process or documentation, this standard contains binding guidance on many important aspects of the loss reserve estimation

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process. Defining the intended measure of the actuary's estimate, actuarial considerations when relying on management representations, and how correlation among lines is considered when aggregating reserve estimates are just a few items for which ASOP No. 43 provides binding guidance. Actuaries are encouraged to carefully review and understand the requirements of ASOP No. 43 and document their work product to a degree that supports compliance with this ASOP.

Actuaries will also find guidance in ASOP No. 9, *Documentation and Disclosure in Property and Casualty Insurance Ratemaking, Loss Reserving, and Valuations* (repeal pending); ASOP No. 23, *Data Quality*; and ASOP No. 41, *Actuarial Communications*. Two proposed revisions of ASOP No. 41 have been exposed for comment by the ASB. As a result, final revisions to ASOP No. 41 are currently pending. In the event of a conflict between this practice note and the final revisions to ASOP No. 41, the reader should follow the final revisions to ASOP No. 41. Additionally, ASOP No. 9 is currently pending repeal by the ASB, contingent on the final revisions to ASOP No. 41.

Actuaries are also reminded that the Academy's Committee on Qualifications promulgated amended U.S. Qualification Standards (including Continuing Education Requirements) for Actuaries Issuing Statements of Actuarial Opinion in the United States, which became effective Jan. 1, 2008. That document supersedes in its entirety the Qualification Standards for Prescribed Statements of Actuarial Opinion Including Continuing Education Requirements, which became effective April 15, 2001. This practice note refers to a Statement of Actuarial Opinion as contemplated by the amended Qualification Standards, and the actuary must meet the qualifications, continuing education, and other requirements contained therein.

Individual states may have requirements that modify or supplement the NAIC Annual Statement Instructions. NAIC codification became effective in 2001. Individual states may not have implemented all aspects of codification. The actuary may wish to refer to the Academy's most recent *Property/Casualty Loss Reserve Law Manual* for guidance on these points.

In the Annual Statement Instructions and in this practice note, the term "loss reserves" includes loss adjustment expense reserves unless specified otherwise. This follows NAIC instruction terminology.

COPLFR appreciates the comments it has received since the issuance of the 2009 practice note and has incorporated a number of suggestions in this update. COPLFR also welcomes any suggested improvements for future updates of this practice note. Suggestions may be sent to Joseph Herbers, chairperson of COPLFR for 2010-2011, through Lauren Pachman, the Academy's casualty policy analyst.

## Organization

In the following pages, the NAIC Annual Statement Instructions related to the Statement of Actuarial Opinion (SAO) are presented first in bold print, section by section. Next, where COPLFR thought it appropriate, a description of possible practice related to the particular section

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of the Instructions follows. Finally, illustrative wording is presented in italics if applicable. The illustrative wording is meant to cover a variety of common situations but does not cover all possible circumstances and may be altered as the actuary deems necessary or appropriate. The actuary is not expected to make unaltered use of the illustrative language. On the contrary, the individual actuary is responsible for assuring that the language used in the SAO accurately represents the actuary's opinion of the given situation. The actuary should not use the illustrative wording provided herein as a substitute for language that is more appropriate in a given situation.

### Changes from the 2009 Practice Note

Substantive changes from the 2009 note are indicated by gray or colored highlighting of the changed text.

1. In the 2008 Annual Statement, the Schedule P Interrogatory 1 was revised in several ways. One of the changes limited the scope of this interrogatory to the total claims-made extended loss and expense reserve for Medical Professional Liability only (i.e., Other Liability and Products Liability were eliminated). However, no corresponding changes were made to Disclosure 12 in Exhibit B of the Statement of Actuarial Opinion.

Effective for 2010 Statements of Actuarial Opinion, Exhibit B, the parenthetical reference to Schedule P Interrogatories for Disclosure 12 has changed. The modification has the effect of requiring Exhibit B to include extended loss and expense reserves for all P&C lines of business (for example, Lawyers' Professional Liability). Therefore, the amount shown in Exhibit B, Disclosure 12 must be at least as much as the amount in Interrogatory 1.

Discussion and illustrative wording regarding extended reporting reserves have been added on pages 27-28.

2. Note 30 to the Financial Statements was revised for the 2010 Annual Statement with respect to premium deficiency reserves. In addition to disclosing the carried liability amount, the changes now require the company to disclose the date of the most recent evaluation of the premium deficiency reserve liability. There is now also a requirement to disclose whether anticipated investment income was considered in that evaluation.

This change is mentioned in this Practice Note for informational purposes only. There is no requirement for the Appointed Actuary to include the premium deficiency reserve in the scope of the Statement of Actuarial Opinion. Of course, the Appointed Actuary always has the option of including any premium deficiency reserve within his or her Opinion. In this situation, the premium deficiency reserve amount would be shown in Exhibit A, scope item 9 – "Other Premium Reserve items on which the Appointed Actuary is expressing an Opinion."

3. Changes were made to Statement of Statutory Accounting Principles (SSAP) No. 62 – Property and Casualty Reinsurance (now referred to as SSAP No. 62R), effective January 1, 2010, which could impact the work an actuary does in preparing a Statement of Actuarial Opinion. Particularly, certain property and casualty run-off agreements with non-affiliates are

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now treated as exceptions to deposit accounting. This change is mentioned in this Practice Note for informational purposes only.

4. Appendix 3 (NAIC Guidance for Actuarial Opinions for Pools and Associations) has been revised by the Casualty Actuarial and Statistical Task Force (CASTF) of the NAIC to reflect the current structure of SAO exhibits A and B.

5. The CASTF has provided updated regulatory guidance for 2010 Statements of Actuarial Opinion (Appendix 9a). The changes from the 2009 guidance focus on: (a) proper documentation of Schedule P reconciliations and (b) identification of the person upon whom the appointed actuary relied on for preparation of the data used.

6. A new appendix, Appendix 12, has been added to include the Academy publication *An Overview for Audit Committee Members of P/C Insurers: Effective Use of Actuarial Expertise*.

## Advance Notification of Future Changes

The format of the 2011 SAO will remain substantially unchanged from the 2010 format.

## Electronic Filing

The NAIC central office requires that an electronic version of the SAO be filed with the electronic version of the Annual Statement that is filed with the central office. Most annual statement electronic preparation software packages produce the required files. Scanned signatures, conforming signatures (e.g., /s/ Pat Actuary), and unsigned opinions are all commonly used alternatives for the electronic version of the SAO.

The version of the SAO to be filed with the NAIC electronically must be submitted in “unsecure” format to allow the NAIC to search the document and then establish a consistent level of security prior to public release. When sending an SAO directly to a state insurance regulator, secure files are allowed.

## **Statements of Actuarial Opinion on P&C Loss Reserves as of Dec. 31, 2010**

1. There is to be included or attached to Page 1 of the Annual Statement, the statement of a Qualified Actuary, entitled “Statement of Actuarial Opinion,” setting forth his or her opinion relating to reserves specified in the SCOPE paragraph. The Actuarial Opinion, both the narrative and required Exhibits, shall be in the format of and contain the information required by this Section of the *Annual Statement Instructions Property and Casualty*.

The Qualified Actuary must be appointed by the Board of Directors, or its equivalent, or by a committee of the Board, by December 31 of the calendar year for which the opinion is rendered. Upon initial appointment (or “retention”), the Company shall notify the domiciliary commissioner within five business days of the appointment with the following information:

- a. Name and title (and, in the case of a consulting actuary, the name of the firm).
- b. Manner of appointment of the Appointed Actuary (e.g., who made the appointment and when).
- c. A statement that the person meets the requirements of a qualified actuary.

Once this notification is furnished, no further notice is required with respect to this person unless the actuary ceases to be appointed or retained or ceases to meet the requirements of a qualified actuary.

If an actuary who was the Appointed Actuary for the immediately preceding filed Actuarial Opinion is replaced by an action of the Board of Directors, the insurer shall within five (5) business days notify the Insurance Department of the state of domicile of this event. The insurer shall also furnish the domiciliary Commissioner with a separate letter within ten (10) business days of the above notification stating whether in the twenty four (24) months preceding such event there were any disagreements with the former Appointed Actuary regarding the content of the opinion on matters of the risk of material adverse deviation, required disclosures, scopes, procedure, or data quality. The disagreements required to be reported in response to this paragraph include both those resolved to the former actuary’s satisfaction and those not resolved to the former actuary’s satisfaction. The insurer shall also in writing request such former actuary to furnish a letter addressed to the insurer stating whether the actuary agrees with the statements contained in the insurer’s letter and, if not, stating the reasons for which he does not agree; and the insurer shall furnish such responsive letter from the former actuary to the domiciliary Commissioner together with its own.

The Appointed Actuary must report to the Board of Directors or the Audit Committee each year on the items within the scope of the Actuarial Opinion. The Actuarial Opinion and the Actuarial Report must be made available to the Board of Directors. The minutes of the Board of Directors should indicate that the Appointed Actuary has presented such information to the Board of Directors or the Audit Committee and that the Actuarial Opinion and Actuarial Report were made available. A separate Actuarial Opinion is required for each company filing an Annual Statement. When there is an affiliated company pooling arrangement, one

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**Actuarial Report for the aggregate pool is sufficient, but there must be addendums to the Actuarial Report to cover non-pooled reserves for individual companies.**

**The Statement of Actuarial Opinion and the supporting Actuarial Report and Workpapers, should be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including but not limited to ASOPs [9](#), [23](#), and [36](#), as promulgated by the Actuarial Standards Board, and Statements of Principles adopted by the Casualty Actuarial Society.**

## DISCUSSION – THE APPOINTED ACTUARY:

The Instructions require the appointed actuary to be a Qualified Actuary as defined in Section 1.A. of the Instructions. Therefore, the appointed actuary must be an individual, not a firm. The appointed actuary is permitted to state reliance on other qualified actuaries as appropriate for review of some portions of the reserves. The actuary may be appointed for one or more subsequent year-ends at the same time. If, for example, one actuary is appointed in November 2009 for the December 2009 opinion, without mention of subsequent year-ends, and a different actuary is appointed in November 2010 for the December 2010 opinion, notification to the commissioner is required by the Instructions.

The report to the board of directors may be an oral report, the full actuarial report defined in Section 1.A. of the Instructions, or a summary of the actuarial report (e.g., an executive summary). It is generally appropriate for the report to include discussion of each item in the SCOPE, OPINION, and RELEVANT COMMENT sections of the SAO (Sections 4 through 6, and Exhibits A and B of the Instructions) and to convey clearly the findings given in the SAO. The report usually provides more discussion than the SAO itself. An oral report may be desirable (although it is not required) to give the board an opportunity to ask questions of the appointed actuary and to help improve the board's understanding of the reserves and their importance. Appendix 9a includes the regulators' discussion of this presentation.

Since a SAO is required for each company in a group, a report is presented to the board of each company. However, the reports for two or more companies may be combined into a single report.

## ILLUSTRATIVE WORDING:

No wording is needed except to show the date of appointment by the board (or equivalent authority) as noted in Section 1 of the Instructions.

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**1A. Definitions**

**“Qualified Actuary” is a person who is either:**

- i. A member in good standing of the Casualty Actuarial Society, or**
- ii. A member in good standing of the American Academy of Actuaries who has been approved as qualified for signing casualty loss reserve opinions by the Casualty Practice Council of the American Academy of Actuaries.**

**“Insurer” means an insurer authorized to write property and/or casualty insurance under the laws of any state and who files on the Property and Casualty Blank.**

**“Actuarial Report” means a document or other presentation, prepared as a formal means of conveying the actuary’s professional conclusions and recommendations, of recording and communicating the methods and procedures, of assuring that the parties addressed are aware of the significance of the actuary’s opinion or findings and that documents the analysis underlying the opinion. The expected content of the report is further described in paragraph 7.**

**“Long Duration Contracts” refers to contracts, excluding financial guaranty contracts, mortgage guaranty contracts and surety contracts, that fulfill both of the following conditions: (1) the contract term is greater than or equal to thirteen months and (2) the insurer can neither cancel nor increase the premium during the contract term.**

**DISCUSSION – ACTUARIAL REPORT:**

The above definition of “actuarial report” is similar to the definition contained in [ASOP No. 9<sup>1</sup>](#), *Documentation and Disclosure in Property and Casualty Insurance Ratemaking, Loss Reserving, and Valuations*. The requirements for the actuarial report are further defined in Section 7.

**1B. Exemptions**

**An insurer who intends to file for one of the exemptions under this Section must submit a letter of intent to its domiciliary commissioner no later than December 1 of the calendar year for which the exemption is to be claimed. The commissioner may deny the exemption prior to December 31 of the same year if he or she deems the exemption inappropriate.**

**A copy of the approved exemption must be filed with the Annual Statement in all jurisdictions in which the company is authorized.**

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<sup>1</sup> The repeal of ASOP No. 9 is pending.

**Exemption for Small Companies**

An insurer that has less than \$1,000,000 total direct plus assumed written premiums during a calendar year, and less than \$1,000,000 total direct plus assumed loss and loss adjustment expense reserves at year-end, in lieu of the Actuarial Opinion required for the calendar year, may submit an affidavit under oath of an officer of the insurer that specifies the amounts of direct plus assumed written premiums and direct plus assumed loss and loss adjustment reserves.

**Exemption for Insurers under Supervision or Conservatorship**

Unless ordered by the domiciliary commissioner, an insurer that is under supervision or conservatorship pursuant to statutory provision is exempt from the filing requirements contained herein.

**Exemption for Nature of Business**

An insurer otherwise subject to the requirement and not eligible for an exemption as enumerated above may apply to its domiciliary commissioner for an exemption based on the nature of business written.

**Financial Hardship Exemption**

An insurer otherwise subject to this requirement and not eligible for an exemption as enumerated above may apply to the commissioner for a financial hardship exemption. Financial hardship is presumed to exist if the projected reasonable cost of the Actuarial Opinion would exceed the lesser of:

- (i) One percent of the insurer's capital and surplus reflected in the insurer's latest quarterly statement for the calendar year for that the exemption is sought; or
- (ii) Three percent of the insurer's direct plus assumed premiums written during the calendar year for which the exemption is sought as projected from the insurer's latest quarterly statements filed with its domiciliary commissioner.

**1C. Special Requirements for Pooled Companies**

The following paragraphs apply to companies that are members of an intercompany pooling arrangement whereby there is one lead company that has 100% of the pooled business and all other companies have a 0% share of the pool (no reported Schedule P data).

All companies in the pool shall submit a 'pooled opinion' that includes a description of the pool, identification of the lead company, and a listing of all companies in the pool. The

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**IRIS ratios, risk of material adverse deviation discussion, and other relevant comments shall relate to the pooled risks and to the surplus of the lead company.**

**Exhibits A and B for each company in the pool should represent the company's share of the pool and should reconcile to the financial statement for each company. For non-lead companies, the responses in Exhibit B to question 5 should be \$0 and to question 6 should be "not applicable". Also for the non-lead companies, Exhibits A and B of the lead company should be attached as an addendum to the PDF file and/or hard copy being filed (but would not be reported by the non-lead company in their data capture).**

## DISCUSSION – INTERCOMPANY POOLING ARRANGEMENTS

Section 1C applies only to situations in which, under an intercompany pooling agreement, the lead company retains 100 percent of the pooled reserves, and the other pool participants each retain 0 percent. In these situations, the actuary is directed to prepare an SAO on the pool. That SAO is to be filed with the Annual Statements of each of the pooled companies. Exhibits A and B for each company reflect values specific to the individual company, and Exhibits A and B of the pool are to be filed as an addendum to the SAOs of the 0 percent companies. This special requirement does not appear to apply to any other intercompany pooling arrangements. Note the distinction between pooling to a 100 percent lead company with no retrocession and ceding 100 percent via a quota share reinsurance agreement. Any reinsurance agreement with affiliates must be approved by the regulator as either an intercompany pooling arrangement or a quota share reinsurance agreement. The financial reporting depends on the approved filing, regardless of how a company views the contract.

One of the following situations may present itself to the opining actuary:

- 1. An intercompany pooling agreement applies, the lead company retains 100 percent of the pooled business, and the other pool participants each retain 0 percent. Schedule P for the lead company will contain the total gross and net reserves for the pool. The gross and net reserves in Schedule P for the other companies will be zero. Paragraph 1C of the Opinion Instructions and paragraph 6 of the Actuarial Opinion Summary (AOS) Instructions apply.*
- 2. An intercompany pooling agreement applies, more than one pool participant retains a share of the pooled business, and other pool participants each retain 0 percent. Schedule P for the each company that retains a non-zero share of the pooled business will show its share of the gross and net reserves. The gross and net reserves in Schedule P for the other companies will be zero. However, since more than one company retains a share of the business, paragraph 1C of the Opinion Instructions and paragraph 6 of the AOS Instructions do not apply.*
- 3. A reinsurance agreement applies, and the company (or companies) cedes 100 percent of its reserves under a quota share reinsurance agreement. Schedule P for the company (or companies) ceding 100 percent of its reserves shows gross reserves but zero net reserves. Paragraph 1C of the SAO Instructions and paragraph 6 of the AOS Instructions do not apply.*

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If questions exist as to whether Section 1C applies, refer to the Financial Statement Note entitled, "Intercompany Pooling Arrangements," read the contract itself, and/or contact your state regulator. Refer to Appendix 6 for more information.

2. **The Statement of Actuarial Opinion must consist of an IDENTIFICATION paragraph identifying the Appointed Actuary; a SCOPE paragraph identifying the subjects on which an opinion is to be expressed and describing the scope of the actuary's work; an OPINION paragraph expressing his or her opinion with respect to such subjects; and one or more additional RELEVANT COMMENTS paragraphs. These four Sections must be clearly designated.**
3. **The IDENTIFICATION paragraph should specifically indicate the Appointed Actuary's relationship to the company, qualifications for acting as appointed actuary, date of appointment, and specify that the appointment was made by the Board of Directors, or its equivalent, or by a committee of the Board.**

**A member of the American Academy of Actuaries qualifying under paragraph 1. A. (ii) must attach, each year, a copy of the approval letter from the Academy.**

**These Instructions require that a "qualified actuary" prepare the Opinion. Nevertheless, if a person who does not meet the definition of a "qualified actuary" has been approved by the insurance regulatory official of the domiciliary state, the company must attach, each year, a letter from that official stating that the individual meets the state's requirements for rendering the Opinion.**

#### **DISCUSSION – QUALIFIED ACTUARY:**

In addition to the qualifications outlined in the Instructions, the Appointed Actuary is expected to have satisfied the Qualification Standards promulgated by the Committee on Qualifications of the American Academy of Actuaries (regardless of whether the actuary is a member of the Academy). Specifically, for an NAIC SAO, the actuary must have completed continuing education outlined in Section 3, the Specific Qualification Standards, of the Qualification Standards.

4. **The SCOPE paragraph should contain a sentence such as the following:**

**"I have examined the actuarial assumptions and methods used in determining reserves listed in Exhibit A, as shown in the Annual Statement of the Company as prepared for filing with state regulatory officials, as of December 31, 20\_\_."**

**Exhibit A should list those items and amounts with respect to which the Appointed Actuary is expressing an opinion.**

**The Appointed Actuary should state that the items in the SCOPE, on which he or she is expressing an opinion, reflect the Loss Reserve Disclosure items (8 thru 13) in Exhibit B.**

**The SCOPE paragraph should include a paragraph such as the following regarding the data used by the Appointed Actuary in forming the opinion:**

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**“In forming my opinion on the loss and loss adjustment expense reserves, I relied upon data prepared by \_\_\_\_\_ (name, affiliation and relation to Company). I evaluated that data for reasonableness and consistency. I also reconciled that data to Schedule P – Part 1 of the company’s current Annual Statement. In other respects, my examination included such review of the actuarial assumptions and methods used and such tests of the calculations as I considered necessary.”**

## DISCUSSION – DATA:

The actuary is required to disclose the name and affiliation of the person(s) responsible for the data used by the actuary in his/her analysis. It is expected that one or two senior people will usually be named in the opinion. It is possible for the appointed actuary to also be the person responsible for the data.

Detailed descriptions of possible practice concerning the evaluation and reconciliation of data are provided in Appendix 1. Further information regarding data-testing requirements and the interaction between the actuary and the company’s external auditor is provided in Appendix 11.

## DISCUSSION – METHODOLOGY:

If the opining actuary reviewed the assumptions and methods used in setting the reserves, the above wording is generally appropriate, absent any extenuating circumstances that may warrant the use of alternative language.

Certain states **may** interpret these Instructions literally and expect the actuary to have examined the company’s methodology for determining its reserves. The actuary needs to be familiar with the interpretation of the company’s domiciliary state and may need to perform additional work to comply with that state’s interpretation.

## ILLUSTRATIVE WORDING – METHODOLOGY:

If the opining actuary instead performs an independent analysis of the reserves, then wording similar to the illustrative language below may be appropriate in place of the first sentence shown in the Instructions (above), absent any extenuating circumstances that may warrant the use of alternative language:

*I have examined the reserves listed in Exhibit A, as shown in the Annual Statement of the company as prepared for filing with state regulatory officials, as of December 31, 20\_\_.*

If the opining actuary did not review the methods and assumptions used in determining the reserves but performed independent tests to evaluate the reserves, wording similar to the following may be appropriate in place of the last sentence above:

*In other respects, my examination included the use of such actuarial assumptions and methods and such tests of the calculations as I considered necessary.*

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If there is some segment of the associated reserve amounts for which the actuary is not giving an opinion, such qualification may be stated here. This would be a qualified opinion in accordance with ASOP No. 36<sup>2</sup>, which requires the actuary to indicate the segment of business and the associated reserve amounts. The actuary is referred to Appendix 2 for a detailed discussion of what constitutes a qualified opinion.

5. **The OPINION paragraph should include a sentence that at least covers the points listed in the following illustration:**

**“In my opinion, the amounts carried in Exhibit A on account of the items identified:**

- A. **Meet the requirements of the insurance laws of (state of domicile).**
- B. **Are computed in accordance with accepted actuarial standards and principles.**
- C. **Make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its contracts and agreements.”**

**If the Scope includes material Unearned Premium Reserves for Long Duration Contracts, the Opinion should cover the following illustration:**

- D. **“Make a reasonable provision for the unearned premium reserves for long duration contracts of the Company under the terms of its contracts and agreements.”**

**If there is any aggregation or combination of items in Exhibit A, the opinion language should clearly identify the combined items.**

**Insurance laws and regulations shall at all times take precedence over the actuarial standards and principles.**

**If the actuary has relied on the Actuarial Opinion of another actuary (such as for pools and associations, for a subsidiary, or for special lines of business), the other actuary must be identified by name and affiliation within the OPINION paragraph.**

**A statement of actuarial opinion should be made in accordance with one of the following sections (a-e). The actuary must explicitly identify in Exhibit B which category applies.**

- a. **Determination of Reasonable Provision. When the stated reserve amount is within the actuary’s range of reasonable reserve estimates, the actuary should issue a statement of actuarial opinion that the stated reserve amount makes a reasonable provision for the liabilities associated with the specified reserves.**
- b. **Determination of Deficient or Inadequate Provision. When the stated reserve amount is less than the minimum amount that the actuary believes**

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<sup>2</sup> ASOP No. 36 is currently undergoing revisions.

is reasonable, the actuary should issue a statement of actuarial opinion that the stated reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves.

- c. **Determination of Redundant or Excessive Provision.** When the stated reserve amount is greater than the maximum amount that the actuary believes is reasonable, the actuary should issue a statement of actuarial opinion that the stated reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves.
- d. **Qualified Opinion.** When, in the actuary's opinion, the reserves for a certain item or items are in question because they cannot be reasonably estimated or the actuary is unable to render an opinion on those items, the actuary should issue a qualified statement of actuarial opinion. Such a qualified opinion should state whether the stated reserve amount makes a reasonable provision for the liabilities associated with the specified reserves, *except for* the item, or items, to which the qualification relates. The actuary is not required to issue a qualified opinion if the actuary reasonably believes that the item or items in question are not likely to be material.
- e. **No Opinion.** The actuary's ability to give an opinion is dependent upon data, analyses, assumptions, and related information that are sufficient to support a conclusion. If the actuary cannot reach a conclusion due to deficiencies or limitations in the data, analyses, assumptions, or related information, then the actuary may issue a statement of no opinion. A statement of no opinion should include a description of the reasons why no opinion could be given.

## DISCUSSION – THE OPINION:

In accordance with [ASOP No. 36<sup>3</sup>](#), the actuary will state whether the opinion is for losses and loss-adjustment expenses combined or separately.

[ASOP No. 36<sup>4</sup>](#) states that a reserve makes a reasonable provision if it is within the actuary's range of reasonable reserve estimates. This standard defines the range of reasonable estimates as a range of estimates that could be produced by appropriate actuarial methods or alternative sets of assumptions that the actuary judges to be reasonable. Note that the range of reasonable estimates is narrower, perhaps considerably, than the range of possible outcomes of the ultimate settlement value of the reserve.

[ASOP No. 36<sup>5</sup>](#) contains specific disclosure requirements for deficient or inadequate opinions, redundant or excessive opinions, qualified opinions, and situations in which no opinion can be formed. Appendix 2 contains further relevant information.

If the actuary reaches different conclusions regarding the SCOPE items, e.g., the determination of a reasonable provision for net reserves versus a determination of a redundant provision for gross reserves

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<sup>3</sup> ASOP No. 36 is currently undergoing revisions.

<sup>4</sup> Ibid.

<sup>5</sup> ASOP No. 36 is currently undergoing revisions.

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(direct plus assumed reserves), then the opinion would usually include language that explicitly conveys the intended category of opinion for each of the SCOPE items.

When the reserve estimate is subject to an exceptionally high degree of variability, or when a reasonable fluctuation in reserve can have a material effect on surplus, the actuary may choose to discuss this in the opinion. This situation may arise from the relationship of reserves to surplus, the relationship of the range of reasonable estimates to surplus, or others. The actuary may choose to state the reason for the potential variability. [ASOP No. 36](#)<sup>6</sup> requires this disclosure when the actuary reasonably believes that there are significant risks or uncertainties that could result in material adverse deviation.

In determining whether the reserves make a reasonable provision for all unpaid loss and loss expense obligations, the actuary can refer to [ASOP No. 36](#)<sup>7</sup> and find further information in the principles contained in the *CAS Statement of Principles Regarding Property and Casualty Loss and Loss Adjustment Expense Reserves*, contained in an appendix to [ASOP No. 9](#)<sup>8</sup>.

In situations in which the actuary does an independent analysis of the reserves, the opinion statement in 5(B) may read “are consistent with reserves computed....”

If the SCOPE includes material unearned premium reserves for extended losses and expenses, as a write-in item in the Exhibit A SCOPE, line 9, the actuary may wish to add an additional statement in the OPINION paragraph, item “D” (or “E,” if appropriate), such as:

*“In my opinion, the amounts carried in Exhibit A on account of the items identified:*

*D.(or E.) “Make a reasonable provision for the unearned premium reserves for extended losses and expenses of the company under the terms of its contracts and agreements.”*

The opinion statement in 5(D), as noted in the Instructions or as suggested above, is usually appropriate when the actuary is opining on unearned premiums for extended loss and expense reserves, as separately identified in Exhibit A: SCOPE.

Management is required to record its best estimate of reserves by line of business and in total in the statutory accounts. The actuary may wish to consider that management’s obligations in this regard may be different than the actuary’s. The actuary is required in Sections 5(B) and 5(C) to opine on the reasonableness of the reserves in the aggregate.

Section 5(A) requires an opinion that the reserves meet the requirements of the [insurance laws of the state of domicile](#). In most jurisdictions, these laws may be interpreted to include statutory accounting requirements. Thus, to comply with insurance law, reserves ordinarily represent management’s best estimate. The actuary may wish to ascertain from management that the recorded reserves are its best estimate by line of business and in total.

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<sup>6</sup> Ibid.

<sup>7</sup> Ibid.

<sup>8</sup> The repeal of ASOP No. 9 is pending.

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Section 5 also requires that, if an actuary has relied on the actuarial opinion of another actuary, he or she must provide that other actuary's name and affiliation in the opinion. [ASOP No. 36<sup>9</sup>](#) further outlines the actuary's responsibilities when relying on the opinions of other actuaries.

## DISCUSSION – DEFICIENT OR REDUNDANT PROVISION:

Note that [ASOP No. 36<sup>10</sup>](#) requires disclosure of the amount by which the inadequate reserve differs from the minimum amount the actuary believes is reasonable, or that redundant reserves exceed the maximum amount the actuary believes is reasonable.

## ILLUSTRATIVE WORDING – DEFICIENT OR REDUNDANT PROVISION:

The actuary may choose to use wording similar to the following:

*The provision for unpaid losses and loss expenses is \$X less than (greater than) the minimum (maximum) amount I consider necessary to be within the range of reasonable estimates.*

**6. The Appointed Actuary must provide RELEVANT COMMENT paragraphs to address the following topics of regulatory importance.**

**a. Risk of Material Adverse Deviation.**

**The Appointed Actuary must provide specific RELEVANT COMMENT paragraphs to address the risk of material adverse deviation. The actuary must identify the materiality standard and the basis for establishing this standard. The materiality standard must be disclosed in \$US in Exhibit B: Disclosures. The actuary should explicitly state whether or not he or she reasonably believes that there are significant risks and uncertainties that could result in material adverse deviation. If such risk exists, the actuary should include an explanatory paragraph to describe the major factors, combination of factors, or particular conditions underlying the risks and uncertainties that the actuary reasonably believes could result in material adverse deviation. The explanatory paragraph should not include general, broad statements about risks and uncertainties due to economic changes, judicial decisions, regulatory actions, political or social forces, etc., nor is the actuary required to include an exhaustive list of all potential sources of risks and uncertainties.**

**b. Other Disclosures in Exhibit B**  
**RELEVANT COMMENT paragraphs should describe the significance of each of the remaining Disclosure items in Exhibit B. The actuary should address the items individually and in combination when commenting on a material impact.**

**c. Reinsurance**

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<sup>9</sup> ASOP No. 36 is currently undergoing revisions.

<sup>10</sup> Ibid.

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**RELEVANT COMMENT** paragraphs should address retroactive reinsurance, financial reinsurance and reinsurance collectibility. Before commenting on reinsurance collectibility, the actuary should solicit information from management on any actual collectibility problems, review ratings given to reinsurers by a recognized rating service, and examine Schedule F for the current year for indications of regulatory action or reinsurance recoverable on paid losses over 90 days past due. The comment should also reflect any other information the actuary has received from management or that is publicly available about the capability or willingness of reinsurers to pay claims. The actuary's comments do not imply an opinion on the financial condition of any reinsurer.

Retroactive reinsurance refers to agreements referenced in SSAP No. **62R**, Property and Casualty Reinsurance, of the NAIC *Accounting Practices and Procedures Manual* (SSAP No. **62R**).

Financial reinsurance refers to contracts referenced in SSAP No. **62R**, of the NAIC *Accounting Practices and Procedures Manual* in which credit is not allowed for the ceding insurer because the arrangements do not include a transfer of both timing and underwriting risk that the reinsurer undertakes in fact to indemnify the ceding insurer against loss or liability by reason of the original insurance.

**d. IRIS Ratios**

If the company reserves will create exceptional values using the NAIC IRIS Tests for One-Year Reserve Development to Surplus, Two-Year Reserve Development to Surplus and Estimated Current Reserve Deficiency to Surplus, the actuary must include **RELEVANT COMMENT** on the factors that led to the unusual value(s).

**e. Methods and Assumptions**

If there has been any significant change in the actuarial assumptions and/or methods from those previously employed, that change should be described in a **RELEVANT COMMENT** paragraph.

**DISCUSSION – RISK OF MATERIAL ADVERSE DEVIATION:**

ASOP No. 36<sup>11</sup> requires an additional explanatory paragraph when the actuary reasonably believes that there are significant risks or uncertainties that could result in material adverse deviation. This paragraph would contain the following:

- a) The amount of adverse deviation that the actuary judges to be material with respect to the SAO;
- b) A description of the major factors or particular conditions underlying the risks or uncertainties that the actuary believes could result in material adverse deviation.

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<sup>11</sup> ASOP No. 36 is currently undergoing revisions.

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The NAIC Instructions go further than ASOP No. 36<sup>12</sup>, requiring the actuary to explicitly state whether he or she reasonably believes that there are significant risks or uncertainties that could result in material adverse deviation. Further, the actuary is required to disclose the materiality standard in Exhibit B and discuss the basis for establishing this materiality standard in a RELEVANT COMMENT paragraph.

The actuary may wish to consider the interplay between this NAIC requirement and the ASOP No. 36<sup>13</sup> disclosure. In addition, the actuary may wish to review the regulatory guidance on this subject, which is included in Appendix 9a.

### **The Materiality Standard**

The actuary is required by the Instructions to comment on the basis of the materiality standard. Examples of considerations in the choice of a materiality standard are:

- Percentage of surplus
- Percentage of reserves
- The amount of adverse deviation that would cause a drop in financial strength ratings
- The amount of adverse deviation that would cause surplus to fall below minimum capital requirements
- The amount of deviation that would cause RBC to fall to the next action level
- Multiples of net retained risk
- Reinsurance considerations, such as levels of ceded reserves compared to surplus or concerns about solvency or collectibility of reinsurance
- The upper limit of a company's reinsurance protection on reserve development, if any

Other standards may be acceptable as well. No matter how the materiality standard is determined, the actuary ordinarily will want to consider why that standard is appropriate for the company under review.

### **Risk of Material Adverse Deviation**

The Instructions require the actuary to explicitly state whether he or she reasonably believes that there are significant risks or uncertainties that could result in material adverse deviation. Because of the nature of the NAIC's request regarding discussion of the risk of material adverse deviation, each individual situation will call for its own wording. Possible wording for this section may be structured in the following way:

*I have identified the major risk factors for this company as \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_. The existence of these risk factors leads me to conclude that there is a risk of material adverse deviation for this company. These risk factors are described in more detail in the following paragraph and in the report supporting this opinion. The absence of other risk factors from this listing does not imply that additional factors will not be identified in the future as having had a significant influence on the company's reserves.*

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<sup>12</sup> Ibid.

<sup>13</sup> Ibid.

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When considering the inclusion of risk disclosures in a RELEVANT COMMENTS paragraph, the actuary usually considers the likelihood of the event occurring. COPLFR has prepared a list of possible risk factors; these are not meant to be all-inclusive and certainly are not meant to apply to every company. For example, one would not expect to see discussion of the risk of asbestos and environmental losses from a personal-lines company. The list below is meant to provide some suggestions for the types of risk factors and underlying loss exposures for which comment may be appropriate:

Asbestos and environmental losses

Construction defect; including so-called “Chinese drywall” exposure

Catastrophic weather events

Exposure related to mortgage defaults

High excess layers

Large deductible workers’ compensation claims

Medical professional liability legislative issues

New products or new markets

Rapid growth in one or more lines of business or segments

Lack of data or unexpected and unexplained changes in data

Operational changes that are not objectively quantified

Sudden unexplained changes in frequency or severity of reported data for a line of business or segment

If the actuary determines that there are significant risks or uncertainties that could result in material adverse deviation, then an explanatory paragraph ordinarily would be included in the SAO. That paragraph typically would describe the major factors or conditions underlying the risks or uncertainties that the actuary reasonably believes could contribute to material adverse deviation. The actuary should refer to the sections of ASOP No. 36<sup>14</sup> that deal with Significant Risks and Uncertainties (section 3.3.3) and Materiality (section 3.4) for further guidance about the explanatory paragraph. The regulators further expect the actuarial report to address the risk factors identified in the SAO, with descriptions of alternate outcomes that could result in adverse development in excess of the materiality threshold.

Note that, in the Regulatory Guidance document (Appendix 9a), the actuary is encouraged to comment on the risks and other factors considered, even when no risk of material adverse deviation is judged to exist. If there is a significant risk which may or may not rise to the level of materiality, it may be prudent to comment.

### DISCUSSION – ADDITIONAL RELEVANT COMMENTS:

The actuary typically would also describe the significance of each remaining disclosure item in Exhibit B.

Further, the Annual Statement Instructions require that RELEVANT COMMENT paragraphs address retroactive reinsurance/financial reinsurance and reinsurance collectibility, regardless of its effect or lack of effect on the subject company.

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<sup>14</sup> ASOP No. 36 is currently undergoing revisions.

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Commentary is also required to explain any exceptional values using the IRIS Tests for One-Year Reserve Development to Surplus, Two-Year Reserve Development to Surplus, and/or Estimated Current Reserve Deficiency to Surplus.

If there have been any significant changes in actuarial assumptions and/or methods from those previously employed, those are normally described in a RELEVANT COMMENT paragraph.

**DISCUSSION: CHANGE IN METHODS AND ASSUMPTIONS:**

The NAIC requirement is similar to the [ASOP No. 36](#)<sup>15</sup> required disclosure of changes in the opining actuary's assumptions, procedures, or methods if the actuary believes that such changes are likely to have a material effect on reserves. The actuary is only obliged to comment on changes that are, in the actuary's professional judgment, material.

Pursuant to [ASOP No. 36](#)<sup>16</sup>, neither the use of assumptions, procedures, or methods for new reserve segments that differ from those used previously, nor periodic updating of experience data, factors, or weights appear to constitute a change in assumptions, procedures, or methods for these purposes.

When an opining actuary is changing assumptions and/or methods from the prior year, and the impact of the change is not known, the conservative approach is to disclose the change. It is advisable in most instances to describe briefly the change itself and the reason for it.

If there is a change in appointed actuary, the newly appointed actuary is not expected to calculate the year-end reserve indication using a predecessor's methodology. Given each actuary's varying comfort level with different techniques, and the use of custom reserve review packages by various reserve practitioners, it is impractical to expect an actuary to always copy a predecessor's methodology. However, the newly appointed actuary may choose to become familiar with his or her predecessor's basic methodology and conclusions. If the predecessor's methods are materially different from those of the newly appointed actuary, he or she may choose to note the difference(s) in the SAO. [ASOP No. 36](#)<sup>17</sup> requires disclosure of instances in which the actuary is unable to review the prior actuary's work.

**ILLUSTRATIVE WORDING: CHANGE IN METHODS AND ASSUMPTIONS:**

The actuary may choose to use wording similar to the following:

1. Material change due to distortions affecting old method

*A material change in actuarial methods was made in the analysis supporting this opinion. The change entailed using a reported loss development procedure in place of the paid loss development procedure used last year. This change was necessitated by the implementation of a new claim payment system, distorting the paid data but leaving unchanged the case incurred.*

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<sup>15</sup> ASOP No. 36 is currently undergoing revisions.

<sup>16</sup> Ibid.

<sup>17</sup> Ibid.

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2. Change made, materiality unknown

*A change in actuarial methods was made in the supporting reserve analysis (versus the prior year). The materiality of this change could not be determined. The change, developing auto liability losses with bodily injury and property damage combined rather than separated, was necessitated due to the implementation of a new claim system. The new system did not contain the data in the same detail as was available last year.*

3. Material change, old method found to be less accurate

*A material change in actuarial assumptions was made in the analysis supporting this opinion. The prior analysis used a method for determining a tail factor that now appears to be inappropriate. Instead, the new method used produces a tail more in line with historical claim development.*

## DISCUSSION – OTHER DISCLOSURES IN EXHIBIT B – DISCOUNTING AND SALVAGE/SUBROGATION:

Actuarial opinions are normally prepared on the same basis with regard to discounting and anticipated salvage and subrogation as the disclosed basis for the carried loss reserves.

The amount of discount is required by the Instructions to be disclosed separately for tabular and non-tabular reserves. The amount of non-tabular discount, if any, is disclosed in Schedule P, Part 1 and in the Notes to the Financial Statements.

If the actuary is providing a SAO for discounted loss and loss adjustment expense reserves, the actuary can find guidance in ASOP No. 36<sup>18</sup> and ASOP No. 20, *Discounting of Property and Casualty Loss and Loss Adjustment Expense Reserves*. The actuary should also check the insurance laws of the state of domicile to make sure that discounting is allowed.

The actuary may wish to consider whether the derivation of incurred but not reported (IBNR) implicitly includes anticipated salvage and subrogation. This may occur when the company records reserves gross as to anticipated salvage and subrogation, but the underlying data is net as to salvage and subrogation received.

## DISCUSSION – OTHER DISCLOSURES IN EXHIBIT B – POOLS AND ASSOCIATIONS:

Some key considerations for the SAO concerning company practice will generally be:

1. Are pool reserves material?

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<sup>18</sup> ASOP No. 36 is currently undergoing revisions.

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2. Does the company book what the pool reports with no independent analysis, perform independent actuarial analysis and in some instances adjust the pool's reported reserves, rely on the pool actuary's opinion, or some combination of the above?
3. If there is a lag in the booking of pool losses, does the company accrue for this or not? Are premiums treated similarly? Are these items material?

Appendix 3 contains further guidance, including guidelines from the CASTF of the NAIC regarding actuarial opinions for pools and associations.

### ILLUSTRATIVE WORDING-POOLS AND ASSOCIATIONS:

The actuary may choose to use wording similar to the following:

1. Material reserves; adjustment for booking lag

*The company participates in a number of voluntary and involuntary pooling arrangements. The booked reserves and earned premiums for some pools reflect losses incurred and premiums earned by the pools through various dates prior to year-end. Company practice is to record the loss and loss adjustment expense reserves reported to it by the pools with accrual for any reporting lag.*

2. Material reserves; independent review of significant pools or reliance on pool actuarial opinion; balance of non-reviewed reserves immaterial; adjustment for lag

*The company participates in a number of voluntary and involuntary pooling arrangements. Company practice is to review independently the reserves for the larger pools, which account for \$ABC of pool reserves. Based on this review, the company has increased the reserves reported by these pools by \_\_\_ percent. The company has relied on actuarial opinions prepared by actuaries on behalf of the pool for other larger pools, which account for \$DEF of pool reserves. The remaining non-reviewed pool reserve (\$JKL) is immaterial. Aggregate reserves held for all pools are \$XYZ. Company practice is to accrue for the reporting lag for these pools.*

3. Immaterial pool exposure

*The company participates in a small number of voluntary and involuntary pools. Company practice is to record the loss and loss adjustment reserves reported to it by the pools. Reserve exposure with respect to pools is considered immaterial.*

4. No adjustment for booking lag

*Company practice is to record the loss and loss adjustment reserves reported to it by the pools. Any adjustment to these reserves for reporting lag is considered immaterial.*

## DISCUSSION – OTHER DISCLOSURES IN EXHIBIT B – MASS TORT EXPOSURE:

Many mass tort events have significant uncertainties associated with reserve estimation. Recent advances in actuarial methodologies have assisted in the quantification of some such incidents; however, there may be some cases in which the actuary may believe that the reserve is not actuarially estimable, and this may create a qualified opinion as defined in [ASOP No. 36<sup>19</sup>](#). The examples that follow involve environmental and asbestos liability, specific types of mass tort exposure. However, this discussion may aid an actuary dealing with other mass tort situations as well.

In most cases, one of the following situations will present itself to the opining actuary:

1. The company has not provided coverage that could reasonably be expected to produce material levels of asbestos and/or environmental liability claims activity.
2. The company has provided coverage that can reasonably be expected to produce material levels of asbestos and/or environmental liability claims activity.

The actuary might make a determination that these exposures could result in either a scope limitation (which may be appropriate if the actuary does not consider this liability to be actuarially estimable), no limitation, or an adverse opinion (which may be appropriate if the actuary believes that a reasonable estimate of this liability can be made, but that the booked reserve for this liability is not reasonable, and this results in an inadequate *overall* reserve). The decision to issue an adverse opinion is typically based upon *overall* reserve adequacy, not just reserve adequacy for this or any other isolated reserve segment. (Note: The company is required to disclose asbestos and environmental reserves in the Notes to the Financial Statements.) A scope limitation may not be required if the actuary reasonably believes that the potential amounts are not material. A scope limitation is usually a qualified opinion under [ASOP No. 36<sup>20</sup>](#).

For situation (2) above, the actuary may choose to review the company's disclosure in the Notes to the Financial Statements, as well as, for publicly held companies, the form 10K (SEC document) and, possibly, annual statement notes and 10Ks of similar companies. The actuary may choose to consider commenting on the following issues:

1. Whether there appears to be a material exposure
2. The aggregate dollar amount of reserves held for this exposure
3. The significant variability and uncertainty inherent in any estimate of these liabilities

Additionally, the actuary may choose to comment on some of the following related items:

- a. Whether the actuary believes that the ultimate liability is actuarially estimable
- b. The difficulties attendant in providing an actuarial estimate of these liabilities

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<sup>19</sup> ASOP No. 36 is currently undergoing revisions.

<sup>20</sup> ASOP No. 36 is currently undergoing revisions.

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- c. Whether these liabilities are being handled by a dedicated experienced claim/legal unit
- d. Any other factors the actuary may have considered in forming his or her opinion

For situation (1) above, the actuary may choose to make a brief disclosure indicating that there appears to be no material exposure based upon the coverages written and that there has been little or no reported activity to date.

**ILLUSTRATIVE WORDING – ASBESTOS AND ENVIRONMENTAL LIABILITY:**

The actuary may choose to use wording similar to the following:

Situation (1):

*I have reviewed the company's exposure to asbestos and environmental claims. In my opinion, there is a remote chance of material liability, since reported claim activity levels are minimal, and the company writes only personal automobile business.*

Situation (2):

*I have reviewed the company's exposure to asbestos and environmental claims, and I have concluded that this exposure is material.*

Samples of possible additional wording follow.

Sample 1

*The company currently holds \$XYZ million of reserves for losses and loss adjustment for asbestos and environmental claims. Estimation of ultimate liabilities for these claims is unusually difficult due to outstanding issues such as the existence of coverage, definition of an occurrence, determination of ultimate damages, and allocation of such damages to financially responsible parties. Therefore, any estimation of these liabilities is subject to significantly greater than normal variation and uncertainty.*

Sample 2

*The company currently holds \$XYZ million of reserves for losses and loss adjustment expenses for asbestos and environmental claims. This reserve estimate is based upon consideration of the current state of the applicable law and coverage litigation. In my opinion, actuarial estimates of these ultimate liabilities are subject to greater inherent uncertainty than is typical of the remainder of the company's reserves. Reasons for this increased uncertainty include significant unresolved legal issues, including the existence of coverage, the definition of an occurrence, general risks inherent in major litigation, expanded theories of liability, and future legal decisions affecting coverage.*

## DISCUSSION – OTHER DISCLOSURES IN EXHIBIT B – THE TOTAL CLAIMS MADE EXTENDED LOSS AND EXPENSE RESERVE:

The scope of the actuary's opinion includes the amount of extended loss and expense reserves reported in Exhibit B, Disclosure 12. If such amounts are material in relation to the aggregate of the loss and loss adjustment expense reserves, the actuary may wish to consider the use of estimation techniques appropriate for this reserve.

For purposes of the Opinion, the provision for extended loss and expense reserve is that for which no premium has been explicitly paid (although there may be implicit premium) and for which no policy has yet been issued. This equates to Death, Disability, or Retirement (DDR) provisions in Claims-Made insurance policies. References to "activated tail" and "paid tail" relate to "triggered" or "issued" policies, and, therefore, any related loss reserves are not considered to be "extended loss and expense reserves."

Schedule P, Interrogatory No. 1 relates to yet-to-be issued Extended Reporting Endorsements (ERE) arising from DDR provisions in Medical Professional Liability Claims-Made insurance policies. The DDR reserves for lines of business other than Medical Professional Liability (for example, Lawyers' Professional Liability), if any, are not disclosed in Interrogatory No. 1. However, Exhibit B, Disclosure 12 should include all of the company's extended loss and expense reserves, not just the Medical Professional Liability portion of these reserves.

For example, the amount of total DDR reserves included in the company's net loss and loss expense reserves would be included as "extended loss and expense reserve" in Exhibit B, Disclosure 12.1. Note that the amount shown in Disclosure 12.1 should be greater than or equal to the loss and loss expense reserve amount shown in Schedule P, Interrogatory 1.6. Alternatively, DDR provisions reported as unearned premium reserves would be included in Exhibit B, Disclosure 12.2. Note that the amount disclosed in Disclosure 12.2 should be greater than or equal to the unearned premium reserve amount shown in Schedule P, Interrogatory 1.2.

## ILLUSTRATIVE WORDING – THE TOTAL CLAIMS MADE EXTENDED LOSS AND EXPENSE RESERVE:

If there are contracts of this type, the actuary may choose to use wording similar to the following:

*The company writes extended loss and expense contracts on claims-made professional liability policies, which provide automatic extended reporting coverage in the event of death, disability, or retirement. The company's accrual for this liability is included in its unearned premium reserves and is shown in Item 9 on Exhibit A.*

## DISCUSSION – RETROACTIVE REINSURANCE/FINANCIAL REINSURANCE:

Comment on this item is always required by the Annual Statement Instructions.

The Instructions require that any write-in assumed reserves on the Liabilities, Surplus and Other Funds page of the company's Annual Statement be listed in Exhibit A: SCOPE.

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The actuary may wish to review the Annual Statement General Interrogatories, Part 2, No. 7 and No. 9, which disclose certain aspects of the company's use of ceded reinsurance. Any positive response to Interrogatory No. 9 will require the company to file a reinsurance summary supplement. In addition, the CEO and CFO must provide a reinsurance attestation with the Annual Statement.

For accounting purposes, the company is required to determine whether a particular contract constitutes retroactive reinsurance (loss portfolio transfer) or financial reinsurance. If the company accounted for any contract as retroactive reinsurance or financial reinsurance, it may be appropriate for the opining actuary to give it similar treatment in evaluating the reserves. It may also be appropriate for the opining actuary to indicate in the opinion whether any contract was accounted for in one of these ways and, if so, whether the actuary's evaluation of the reserves is consistent with that treatment.

The determination of whether a particular contract is retroactive reinsurance, financial reinsurance, or neither is sometimes a matter of judgment, and, customarily, that judgment is made by the company's accounting experts. The scope of the SAO does not appear to include an evaluation of risk transfer or an assessment of the appropriateness of the accounting treatment of the reinsurance contracts of a company.

The actuary may choose to be familiar with the important aspects of the reinsurance coverage but can rely on summaries of the reinsurance coverage prepared by others, rather than reading and evaluating each contract. However, if the actuary is aware of a determination that he or she believes to be clearly incorrect, the actuary ordinarily will indicate this in the SAO and describe his or her treatment of the contract(s) in question and the impact of this adjustment on the actuary's opinion.

The actuary should be aware that changes were made to SSAP No. 62R, effective January 1, 2010, that could impact the work an actuary does in preparing a Statement of Actuarial Opinion. Particularly, certain property and casualty run-off agreements with non-affiliates are now treated as exceptions to deposit accounting.

It typically is not necessary to identify specific reinsurers or contracts in the SAO.

### ILLUSTRATIVE WORDING – RETROACTIVE REINSURANCE/FINANCIAL REINSURANCE:

The actuary may choose to use wording similar to the following:

If there are no contracts of these types:

*Based on discussions with company management (or [identify other appropriate sources]) and its description of the company's ceded (and/or assumed) reinsurance, I am not aware of any reinsurance contract (having a material effect on the loss or loss expense reserves) that either has been or should have been accounted for as retroactive reinsurance or financial reinsurance.*

If a contract was appropriately accounted for as retroactive reinsurance (or as financial reinsurance):

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*One ceded reinsurance contract was accounted for by the company as retroactive reinsurance (or financial reinsurance). As a result, my evaluation of the net reserves was performed on a gross basis with regard to that contract. Based on discussions with company management [or identify appropriate sources] and its description of the company's ceded (and/or assumed) reinsurance, I am not aware of any other reinsurance contract (having a material effect on the loss or loss expense reserves) that either has been or should have been accounted for as retroactive reinsurance or financial reinsurance.*

## DISCUSSION – REINSURANCE:

If ceded reinsurance is not material relative to statutory net reserves and surplus, no further information typically needs to be given.

The actuary may choose to discuss the materiality of ceded amounts with troubled reinsurers (e.g., those in liquidation or rehabilitation) if the overall amount is material.

If any issues are raised by the above considerations, the actuary may choose to provide some discussion as to amounts already set up to cover this risk (e.g., uncollectible reinsurance reserve, Schedule F penalty). If the amounts already set up are deemed by the actuary to be inadequate, the actuary may choose to indicate how the shortfall is being treated in the reserve opinion. For example, is the shortage in these amounts being added to the otherwise indicated loss reserve? Is the reserve being evaluated net of the indicated and held amounts for reinsurance uncollectibility?

At various times, publicly-available information materially affects the perceived value of ceded reinsurance. The Instructions provide that the actuary's comments are to reflect any such information of which the actuary is aware. For example, the actuary would ordinarily comment on large cessions to a company recently placed under regulatory control, if the actuary has knowledge of such cessions.

In some cases, other parties may already perform the above analysis. When the opining actuary is relying on other parties for the reinsurance collectibility analysis, it is generally prudent to so state and to discuss the qualifications of these parties.

## ILLUSTRATIVE WORDING – REINSURANCE:

The actuary may choose to use wording similar to the following:

1. Immaterial ceded reinsurance levels

*Use of ceded reinsurance is minimal, resulting in an immaterial risk of reinsurance uncollectibility relative to surplus.*

2. Material amounts of ceded reinsurance, with none to troubled reinsurers

*Ceded loss reserves are all with residual market pools, with companies rated XX or better by A.M. Best Co. (or its substantive equivalent), or fully collateralized. Past uncollectibility levels and current amounts in dispute have been reviewed and found to be immaterial relative to*

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*surplus. Therefore, reinsurance collectibility does not appear to be an issue. (Note: Even though reinsurance is with strong reinsurers, it is possible that reinsurance credits are overstated. If such credits were overstated in the past, then this typically could be discovered by an analysis of past uncollectible levels or of amounts currently in dispute.)*

3. Inadequate reserves for collectibility problems

*My review of reinsurance-recoverable balances found \$XX million of loss and LAE reserves ceded to currently-insolvent reinsurers. Provisions for uncollectible reinsurance, including amounts shown on the Liabilities, Surplus and Other Funds page, Provision for reinsurance, only account for \$YY million of this amount, with no provision made for the remaining \$[XX-YY] million. In forming my opinion of the net reserves, I have recognized this \$[XX-YY] million as uncollectible.*

4. Miscellaneous – Public information

*The company has a high portion of its reinsurance recoverable with the XYZ Corporation, whose financial difficulties have been publicized. I have reviewed the company's exposure to this reinsurer, the ability to offset recoveries with amounts payable, and the company's reserves for uncollectible reinsurance and found... (Note: The actuary could go on to discuss a need to adjust the indicated net reserves, or state that the situation has been adequately addressed.)*

## DISCUSSION – IRIS RATIOS:

The actuary is required to provide commentary on the factors underlying exceptional values calculated under the NAIC IRIS Tests for One-Year Reserve Development to Surplus, Two-Year Reserve Development to Surplus, and Estimated Current Reserve Deficiency to Surplus. If one or more of these tests' calculations result in exceptional value(s), the actuary must include a RELEVANT COMMENT paragraph to explain in detail the primary reasons for the exceptional value(s). The actuary may want to consider potential responses in the AOS Section E for consistency with commentary in the SAO on IRIS test exceptional values.

An explanatory paragraph is not required unless the calculations of the IRIS tests create exceptional values. However, even when there are no exceptional values, the actuary may want to include wording indicating that he/she reviewed the calculations of the IRIS tests and noted no exceptional values.

## ILLUSTRATIVE WORDING – IRIS RATIOS:

The actuary may choose to use wording similar to the following:

*During the past year, the company strengthened net reserves for prior accident years by \$100,000,000. Most of the increase was for asbestos and environmental claims for accident years 1980 and prior. This extraordinary loss reserve strengthening caused exceptional values for the NAIC IRIS Tests regarding One Year Reserve Development to Surplus, Two Year Reserve Development to Surplus, and/or Estimated Current Reserve Deficiency to Surplus.*

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Or

*During the past year, the company booked significant amounts of additional premiums in long-tail lines from various loss-sensitive programs. These additional premiums caused an exceptional value for the IRIS test regarding Estimated Current Reserve Deficiency to Surplus. These lines have also shown some non-substantial upward reserve development.*

When the IRIS test calculations produce no exceptional values, the actuary may still choose to include an explanatory paragraph, with wording similar to the following:

*I have examined the NAIC IRIS tests for One-Year Reserve Development to Surplus, Two-Year Reserve Development to Surplus, and Estimated Current Reserve Deficiency to Surplus, and no exceptional values were observed.*

7. **The Actuarial Opinion must include assurance that an Actuarial Report and underlying actuarial workpapers supporting the actuarial opinion will be maintained at the company and available for regulatory examination for seven years. The Actuarial Report contains significant proprietary information. It is expected that the Report be held confidential and not intended for public inspection. The report must be available by May 1 of the year following the year-end for which the opinion was rendered or within two weeks after a request from an individual state commissioner.**

**The Actuarial Report should be consistent with the documentation and disclosure requirements of ASOP # 9. The Actuarial Report should contain both narrative and technical components. The narrative component should provide sufficient detail to clearly explain to company management, the regulator, or other authority the findings, recommendations and conclusions, as well as their significance. The technical component should provide sufficient documentation and disclosure for another actuary practicing in the same field to evaluate the work. This technical component must show the analysis from the basic data, e.g., loss triangles, to the conclusions.**

**The Report must also include:**

- **An exhibit which ties to the Annual Statement and compares the Actuary's conclusions to the carried amounts;**
- **Summary exhibit(s) of either the actuary's best estimate, range of reasonable estimates, or both, that led to the conclusion in the OPINION paragraph regarding the reasonableness of the provision for all unpaid loss and loss adjustment expense obligations;**
- **Documentation of the required reconciliation from the data used for analysis to the Annual Statement Schedule P;**
- **Extended comments on trends that indicate the presence or absence of risks and uncertainties that could result in material adverse deviation; and**
- **Extended comments on factors that led to unusual IRIS ratios for One-Year Reserve Development to Surplus, Two-Year Reserve Development to Surplus, or Estimated Current Reserve Deficiency to Surplus, and how these factors were addressed in prior and current analyses.**

## DISCUSSION – ACTUARIAL REPORT:

The above requirements for the Actuarial Report are much more specific than those contained in ASOP No. 9<sup>21</sup>, *Documentation and Disclosure in Property and Casualty Insurance Ratemaking, Loss Reserving, and Valuations*. Section 5.2 of ASOP No. 9<sup>22</sup> provides guidance as follows:

1. The documentation should be sufficient for another actuary practicing in the same field to evaluate the work.
2. The documentation should describe clearly the sources of data, material assumptions, and methods.
3. Any material changes in sources of data, assumptions, or methods from the last analysis should be documented. The actuary should explain the reason(s) for and describe the impact of the changes.

The NAIC Instructions require the actuarial report to show the analysis, from the basic data to the conclusions, and the Instructions require the actuarial report to contain all the items listed in Section 7. The Instructions also require that the actuarial report be available for review in a timely fashion. Additionally, they require that the reconciliation papers discussed in paragraph 4 become a part of the report or workpapers. The actuary may wish to consider both ASOP No. 9<sup>23</sup> and the regulatory guidance in Appendix 9a when developing the actuarial report.

The actuary usually includes within the actuarial report some detail on how the materiality threshold was chosen, including commentary on what items were considered in choosing the threshold. In addition, the actuarial report normally would include extended commentary on the risks considered in the actuary's determination of the existence of a risk of material adverse deviation.

The CASTF, through the Regulatory Guidance Brief, included as Appendix 9a of this Practice Note, also encourages the actuary to include in the actuarial report an exhibit that summarizes changes in the Appointed Actuary's estimates from the prior analysis, with extended discussion of significant factors underlying the changes.

- 8. The statement should conclude with the signature of the Appointed Actuary responsible for providing the Actuarial Opinion and the date when the opinion was rendered. The signature and date should appear in the following format:**

---

**Signature of actuary**  
**Printed name of actuary**  
**Address of actuary**  
**Telephone number of actuary**

---

<sup>21</sup> The repeal of ASOP No. 9 is pending.

<sup>21</sup> Ibid.

<sup>23</sup> Ibid.

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**Date opinion was rendered**

9. **The insurer required to furnish an actuarial opinion shall require its Appointed Actuary to notify its Board of Directors or its audit committee in writing within five (5) business days after any determination by the Appointed Actuary that the opinion submitted to the domiciliary Commissioner was in error as a result of reliance on data or other information (other than assumptions) that, as of the balance sheet date, was factually incorrect. The Opinion shall be considered to be in error if the Opinion would have not been issued or would have been materially altered had the correct data or other information been used. The Opinion shall not be considered to be in error if it would have been materially altered or not issued solely because of data or information concerning events subsequent to the balance sheet date or because actual results differ from those projected.**

**Notification shall be required for any such determination made between the issuance of the Opinion and the balance sheet date that the next Opinion will be issued. The notification should include a summary of such findings and an amended Opinion.**

**An insurer who is notified pursuant to the preceding paragraphs shall forward a copy of the summary and the amended Opinion to the domiciliary Commissioner within five (5) business days of receipt of such and shall provide the Appointed Actuary making the notification with a copy of the summary and amended Opinion being furnished to the domiciliary Commissioner. If the Appointed Actuary fails to receive such copy within the five (5) business day period referred to in the previous sentence, the Appointed Actuary shall notify the domiciliary Commissioner within the next five (5) business days that the submitted Opinion should no longer be relied upon or such other notification recommended by the actuary's attorney.**

**If the Appointed Actuary learns that the data or other information relied upon was factually incorrect, but cannot immediately determine what, if any, changes are needed in the Actuarial Opinion, the actuary and the company should undertake as quickly as is reasonably practical those procedures necessary for the actuary to make the determination discussed above. If the insurer does not provide the necessary data corrections and other support (including financial support) within ten (10) business days, the actuary should proceed with the notification discussed above.**

**No Appointed Actuary shall be liable in any manner to any person for any statement made in connection with the above paragraphs if such statement is made in a good faith effort to comply with the above paragraphs.**

**DISCUSSION – SECTIONS 8 AND 9:**

No specific description of possible practice is provided for Sections 8 and 9.

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**10. Data in Exhibits A and B are to be filed in both print and data capture format.**

**DISCUSSION – SECTION 10:**

In addition to filing the Annual Statement, the company is required to file certain information reported in the Annual Statement in electronic format. The information reported in Exhibit A: SCOPE and Exhibit B: DISCLOSURES of the SAO will be included in the company's electronic filing. Accordingly, the actuary is strongly encouraged to prepare Exhibits A and B in the exact format shown in the Annual Statement Instructions to facilitate the company's electronic capture of the data and information contained therein.

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**Exhibit A: SCOPE**

**DATA TO BE FILED IN BOTH PRINT AND DATA CAPTURE FORMATS**

<b><u>Loss Reserves:</u></b>	<b><u>Amount</u></b>
1. Reserve for Unpaid Losses (Liabilities, Surplus and Other Funds page, Col 1, Line 1)	\$ _____
2. Reserve for Unpaid Loss Adjustment Expenses (Liabilities, Surplus and Other Funds page, Col 1, Line 3)	\$ _____
3. Reserve of Unpaid Losses – Direct and Assumed (Should equal Schedule P, Part 1, Totals from Cols. 13 and 15, Line 12 * 1000)	\$ _____
4. Reserve for Unpaid Loss Adjustment Expenses – Direct and Assumed (Should equal Schedule P, Part 1, Totals from Cols. 17, 19 and 21, Line 12 * 1000)	\$ _____
5. The Page 3 write-in item reserve, “Retroactive Reinsurance Reserve Assumed”	\$ _____
6. Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion (list separately)	\$ _____
<b><u>Premium Reserves:</u></b>	
7. Reserve for Direct and Assumed Unearned Premiums for Long Duration Contracts	\$ _____
8. Reserve for Net Unearned Premiums for Long Duration Contracts	\$ _____
9. Other Premium Reserve items on which the Appointed Actuary is expressing an Opinion (list separately)	\$ _____

**DISCUSSION – EXHIBIT A: SCOPE**

Exhibit A contains all items 1 through 9. Every item in Exhibit A typically will contain a value, even if the company’s value for an individual item is \$0. Write-in lines are not to be inserted into Exhibit A. Also, if the actuary is including a value in items 6 and/or 9, then the opinion should include an explanation as to why that value is being included in the Exhibit A disclosure.

**DISCUSSION – RETROACTIVE REINSURANCE RESERVE:**

This is a contra-liability for the ceding company and a liability for the assuming company. SCOPE items 1, 2, 3, and 4 typically are not reduced by the retroactive reinsurance reserve ceded and thus are gross to these ceded reserves. SCOPE items 1, 2, 3, and 4 generally exclude retroactive reinsurance assumed, and such assumed reserves are recorded on a write-in line.

**DISCUSSION – PREMIUM RESERVES:**

Appendix 8 provides guidance on this requirement.

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**Exhibit B: DISCLOSURES**  
**DATA TO BE FILED IN BOTH PRINT AND DATA CAPTURE FORMATS**

**Note: Exhibit B should be completed for Net dollar amounts included in the SCOPE. If an answer would be different for Direct and Assumed amounts, identify and discuss the difference within RELEVANT COMMENTS.**

- |  |          |            |             |                                   |
|--|----------|------------|-------------|-----------------------------------|
|  |          | Last _____ | First _____ | Mid _____                         |
| 1. Name of the Appointed Actuary   |          |            |             |                                   |
| 2. The Appointed Actuary's Relationship to the Company.<br>Enter E or C based upon the following:<br>E if an Employee<br>C if a Consultant   |          |            |             | _____                             |
| 3. The Appointed Actuary is a Qualified Actuary based upon what qualification? Enter F, A, M, or O based upon the following:<br>F if a Fellow of the Casualty Actuarial Society (FCAS)<br>A if an Associate of the Casualty Actuarial Society (ACAS)<br>M if not a member of the Casualty Actuarial Society, but a Member of the American Academy of Actuaries (MAAA) approved by the Casualty Practice Council, as documented with the attached approval letter.<br>O for Other |          |            |             | _____                             |
| 4. Type of Opinion, as identified in the OPINION paragraph. Enter R, I, E, Q, or N based upon the following:<br>R if Reasonable<br>I if Inadequate or Deficient Provision<br>E if Excessive or Redundant Provision<br>Q if Qualified. Use Q when part of the OPINION is Qualified.<br>N if No Opinion  |          |            |             | _____                             |
| 5. Materiality Standard expressed in US dollars (Used to Answer Question #6)   | \$ _____ |            |             |                                   |
| 6. Is there a Significant Risk of Material Adverse Deviation?  |          |            |             | Yes [ ] No [ ] Not Applicable [ ] |
| 7. Statutory Surplus (Liabilities, Col 1, <b>Line 37</b> )   | \$ _____ |            |             |                                   |
| 8. Anticipated net salvage and subrogation included as a reduction to loss reserves as reported in Schedule P (should equal Part 1 Summary, Col 23, Line 12 * 1000)  | \$ _____ |            |             |                                   |
| 9. Discount included as a reduction to loss reserves and loss expense reserves as reported in Schedule P   |          |            |             |                                   |
| 9.1 Nontabular Discount [ <b>Notes, Line 32B23</b> , (Amounts 1, 2, 3 & 4)], Electronic Filing Cols 7, 8, 9, & 10,   | \$ _____ |            |             |                                   |
| 9.2 Tabular Discount [ <b>Notes, Line 32A23</b> (Amounts 1 & 2)], Electronic Filing Cols 7 & 8.  | \$ _____ |            |             |                                   |
| 10. The net reserves for losses and expenses for the company's share of voluntary and involuntary underwriting pools' and associations' unpaid losses and expenses that are included in reserves shown on the Liabilities, Surplus and Other Funds page, Losses and  | \$ _____ |            |             |                                   |

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**Loss Adjustment Expenses lines.**

- 11. The net reserves for losses and loss adjustment expenses that the company carries for the following liabilities included on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines. \***
- 11.1 Asbestos, as disclosed in the Notes to Financial Statements (Notes, Line 33A03D, ending net asbestos reserves for current year) Electronic Filing Col 11** \$ \_\_\_\_\_
- 11.2 Environmental, as disclosed in the Notes to Financial Statements (Notes, Line 33D03D, ending net environmental reserves for current year), Electronic Filing Col 11** \$ \_\_\_\_\_
- 12. The total claims made extended loss and expense reserve (Greater than or equal to Schedule P Interrogatories).**
- 12.1 Amount reported as loss reserves** \$ \_\_\_\_\_
- 12.2 Amount reported as unearned premium reserves** \$ \_\_\_\_\_
- 13. Other items on which the Appointed Actuary is providing Relevant Comment (list separately)** \$ \_\_\_\_\_

\* **The reserves disclosed in item 11 above should exclude amounts relating to contracts specifically written to cover asbestos and environmental exposures. Contracts specifically written to cover these exposures include Environmental Impairment Liability (post 1986), Asbestos Abatement, Pollution Legal Liability, Contractor's Pollution Liability, Consultant's Environmental Liability, and Pollution and Remediation Legal Liability.**

## DISCUSSION – DISCLOSURE ITEMS:

The actuary is strongly encouraged to prepare Exhibit B in the exact format shown in the Annual Statement Instructions with no items deleted and write-in lines not inserted.

The information obtained in items 1 through 4 and 6 normally is disclosed elsewhere in the SAO. It has been added to Exhibit B in order to facilitate the capture of certain information in the company's electronic data filing.

For item 6, the response "Not Applicable" is intended to be used only in the situation of a company with 0 percent participation under an intercompany pooling agreement in which the lead company retains 100 percent of the pooled reserves. In addition, as directed by Section 1C of the Instructions, Exhibits A and B should reflect values specific to the individual company, and Exhibits A and B of the pool should be filed as an addendum to the SAO of the 0 percent company.

Also note, as discussed in the CASTF's Regulatory Guidance Brief, included as Appendix 9a of this Practice Note, that the regulators expect the answer to item 6 to be consistent with the disclosure in the Relevant Comments of the SAO as to whether there are significant risks or uncertainties that could result in material adverse deviation.

If the actuary reaches different conclusions regarding net reserves versus gross reserves (direct plus assumed reserves), then item 4 in Exhibit B ordinarily would reflect the opinion category for net reserves.

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If the loss and/or loss expense reserves on the Liabilities, Surplus and Other Funds page, loss and loss adjustment expenses lines are discounted, then the underwriting and investment exhibit is completed net of discounting. Disclosures regarding discounting of tabular and non-tabular reserves are made in the Notes to the Financial Statements; additional disclosures regarding discounting of non-tabular reserves are made in Schedule P, Part 1. If loss and/or loss expense reserve discounting is handled through a separate contra-liability item on the Liabilities, Surplus and Other Funds page, the actuary may choose to reflect this discount in the reserves on which the opinion is given.

Disclosure 10 is the sum of voluntary and involuntary participation in underwriting pools and associations. A zero entry would be unusual for workers' compensation or automobile insurers. The actuary may choose to show the voluntary and involuntary participation separately in the body of the SAO.

Disclosure 10 normally would not include reinsurance assumed from a pool by a company that is not a participant in the pool but rather provides reinsurance protection for the pool's participants.

Exhibit B typically would contain information and amounts for all of items 1 through 13, even if the company's value for an individual item is \$0. Also, if the actuary is including a value in item 13, then the opinion would normally include, within a RELEVANT COMMENT paragraph, an explanation of why that value is being included in the Exhibit B disclosure.

## **Actuarial Opinion Summary as of Dec. 31, 2010**

The AOS is identified by the NAIC as a supplemental filing, separate from the Annual Statement and the SAO. Instructions for preparation of the AOS are provided separately from the SAO Instructions, to emphasize the supplemental nature of the AOS filing.

### **Actuarial Opinion Summary Supplement**

- 1. For all companies that are required by their domiciliary state to submit a confidential document entitled Actuarial Opinion Summary (AOS), such document shall be filed with the domiciliary state no later than March 15 (or by a later date otherwise specified by the domiciliary state). This AOS shall be submitted to a non-domiciliary state within fifteen days of request, but no earlier than March 15, provided that the requesting state can demonstrate, through the existence of law or some similar means, that they are able to preserve the confidentiality of the document.**
- 2. The AOS should be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including but not limited to ASOPs 9, 23, and 36, as promulgated by the Actuarial Standards Board, and Statements of Principles adopted by the Casualty Actuarial Society.**
- 3. Exemptions for filing the AOS are the same as those for filing the Statement of Actuarial Opinion.**
- 4. The AOS contains significant proprietary information. It is expected that the AOS be held confidential and is not intended for public inspection. The AOS should not be filed with the NAIC and should be kept separate from any copy of the Statement of Actuarial Opinion in order to maintain confidentiality of the AOS. The AOS can contain a statement that refers to the Statement of Actuarial Opinion and the date of that opinion.**

### **DISCUSSION – FILING THE AOS:**

The AOS is to be filed with the company's domiciliary state insurance department separately from the Annual Statement and the SAO. The AOS generally must be filed by March 15, unless the state's insurance department has specified a different date. **The actuary may want to refer to the Academy's Property/Casualty Loss Reserve Law Manual to find the state-specific due date.** A non-domiciliary state may also request the AOS, but only if that state can demonstrate its ability to preserve the confidentiality of the AOS, in accordance with item 1 of the foregoing NAIC Instructions. The AOS is not included with the company's Annual Statement and other documents filed directly with the NAIC.

The AOS is filed separately from the SAO, but the wording of the AOS may make reference to the SAO.

- 5. The AOS should be signed and dated by the Appointed Actuary who signed the Statement of Actuarial Opinion and should include at least the following:**

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- A. The Appointed Actuary's range of reasonable estimates for loss and loss adjustment expense reserves, net and gross of reinsurance; and/or**
- B. The Appointed Actuary's point estimates for loss and loss adjustment expense reserves, net and gross of reinsurance; and**
- C. The Company's recorded loss and loss adjustment expense reserves, net and gross of reinsurance; and**
- D. The difference between the company's carried reserves and the Appointed Actuary's point estimate and/or range of reasonable estimates, net and gross of reinsurance; and**
- E. Where there has been one-year adverse development in excess of 5% of surplus, as measured by Schedule P, Part 2 Summary, in at least three of the past five calendar years, include explicit description of the reserve elements or management decisions which were the major contributors.**

## DISCUSSION – ACTUARIAL OPINION SUMMARY:

The AOS requires the actuary to disclose, on a gross and net basis, the actuary's point estimate and/or the actuary's range, and compare this to the carried reserves. ASOP No. 36<sup>24</sup> states that a range of reasonable estimates is a range of estimates that could be produced by appropriate actuarial methods or alternative sets of assumptions that the actuary judges to be reasonable. The actuarial report normally includes detailed descriptions and calculations that support the point estimate and/or range of estimates.

If the actuary produces a range of estimates for a portion of total reserves and a point estimate for the remaining reserves, then the AOS usually includes both and shows how the point estimate and the range combine to form the actuary's opinion, which can be categorized as reasonable, deficient, redundant, qualified, or no opinion.

If the one-year development has been adverse by at least five percent in at least three of the last five calendar years, the AOS also requires explicit discussion of reserve elements and/or management decisions to which such adverse development can be attributed. Each year's one-year development, on a net basis, is compared to the prior period's surplus, and a ratio is developed. The one-year development test is the same calculation as that which underlies the IRIS ratio regarding One-Year Reserve Development to Surplus. The calculation of the company's one-year reserve development to surplus for each of the prior five years is disclosed in the five-year historical exhibit of the company's Annual Statement.

If the ratios for three (or more) of the years are five percent or greater, then the actuary is required by the AOS to comment. The actuary's comments typically explain in detail the cause(s) of the adverse development in those years. If fewer than three years fail the test, then the actuary is not required to comment but may wish to include a sentence like the following for clarity:

*The calculations of the one-year development test of the company's reserves yielded results in excess of five percent of surplus in only one of the last five years.*

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<sup>24</sup> ASOP No. 36 is currently undergoing revisions.

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Discussion of adverse development is usually intended to be more detailed than the discussions in the Statement of Actuarial Opinion of IRIS ratio failure.

For example, the illustrative language in the IRIS ratio section of this practice note is:

*During the past year, the company strengthened net reserves for prior accident years by \$100,000,000. Most of the increase was for asbestos and environmental claims for accident years 1980 and prior. This extraordinary loss reserve strengthening caused exceptional values for the NAIC IRIS Tests regarding One Year Reserve Development to Surplus, Two Year Reserve Development to Surplus, and/or Estimated Current Reserve Deficiency to Surplus.*

If, for example, strengthening for asbestos and environmental was one of the reasons for one-year development to exceed five percent in at least three of the last five calendar years with adverse development, then the actuary would usually consider language like the following, in addition to explanations of any other causes of adverse development for those years:

*During this past year, the company evaluated its asbestos exposures using a ground-up evaluation. The ground-up evaluation considered deteriorating trends in pre-packaged bankruptcies and in reinsurance collectibility. The evaluation included input from claims, legal, and actuarial personnel. The outcome of the evaluation was an increase in the amount of estimated net asbestos liability to the company, thereby resulting in a one-year development test of reserves that exceeds five percent of surplus.*

If the one-year development has been adverse by at least five percent in at least three of the last five calendar years, but the actuary has not issued the SAO in each of those five years, the actuary may wish to begin the required commentary with wording such as the following:

*The company had one-year adverse development in excess of five percent of surplus in at least three of the last five calendar years. I became the appointed actuary on [date] and have issued the Statement of Actuarial Opinion on the company's loss and loss adjustment expense reserves, beginning with year-end [year]. The company's management has represented to me that the one-year adverse development in prior years was due to . . .*

OR

*The company had one-year adverse development in excess of five percent of surplus in at least three of the last five calendar years. I became the appointed actuary on [date] and have issued the Statement of Actuarial Opinion on the company's loss and loss adjustment expense reserves, beginning with year-end [year]. I have reviewed the actuarial reports for the years prior to my appointment, and I have determined that the one-year adverse development in prior years was due to . . .*

### **Setting Up Actuarial Opinion Summary**

The AOS is due by March 15, and it is to be submitted by the company (see Appendix 6 for comments on intercompany pooling) separately from its Annual Statement and the SAO. Because it is sent

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separately from the opinion, the actuary may wish to consider including some basic information along with the AOS. Sample wording is presented below:

*Date: March 15, 2010*

*Actuarial Opinion Summary*

*Company: THE Insurance Company*  
*NAIC#: #####*  
*Appointed Actuary: Janet Actuary*

*I have signed the company's Statement of Actuarial Opinion on Feb. 22, 2010. These two documents are closely linked; the Actuarial Opinion Summary is an extension of the Statement of Actuarial Opinion. Therefore, all limitations, caveats, and reliances in the Statement of Actuarial Opinion should also be applied to the Actuarial Opinion Summary. Moreover, it is my understanding that, consistent with the Annual Statement Instructions, the Actuarial Opinion Summary will be kept confidential by state regulators and is not intended for public inspection, subject to applicable law.*

Note that the actuary is not required to submit a copy of the SAO with the AOS, since that opinion will have been submitted along with the company's Annual Statement.

Sample formats for the AOS are provided below. These sample formats are intended to be illustrative only, and they may not apply in every situation. The actuary is not required to adopt them.

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**SAMPLE FORMAT FOR AOS**

[Name] Insurance Company  
December 31, 2010

**Sample # 1:** If actuary provides range without point estimate:

	<u>Net Reserves</u>			<u>Gross Reserves</u>		
	<u>Low</u>	<u>Point</u>	<u>High</u>	<u>Low</u>	<u>Point</u>	<u>High</u>
A Actuary's range of estimates	9,000		11,000	10,000		12,000
B Actuary's point estimate		NA			NA	
C Company carried reserves		10,000			11,000	
D Difference between company carried and actuary's estimate	1,000		(1,000)	1,000		(1,000)

**Sample # 2:** If actuary provides point estimate without range:

	<u>Net Reserves</u>			<u>Gross Reserves</u>		
	<u>Low</u>	<u>Point</u>	<u>High</u>	<u>Low</u>	<u>Point</u>	<u>High</u>
A Actuary's range of estimates	NA		NA	NA		NA
B Actuary's point estimate		10,500			11,600	
C Company carried reserves		10,000			11,000	
D Difference between company carried and actuary's estimate		(500)			(600)	

**Sample # 3:** If actuary provides a qualified opinion – point estimate without a range:

	<u>Net Reserves</u>			<u>Gross Reserves</u>		
	<u>Low</u>	<u>Point</u>	<u>High</u>	<u>Low</u>	<u>Point</u>	<u>High</u>
A Actuary's range of estimates	NA		NA	NA		NA
B Actuary's point estimate		9,500			10,000	
C1 Company carried reserves - TOTAL		10,000			11,000	
C2 Company carried reserves - portion excluded by opinion		1,000			1,500	
C3 Company carried reserves covered by opinion		9,000			9,500	
D Difference between company carried and actuary's estimate (C3-B)		(500)			(500)	

E. *The company has not had one-year adverse development, as measured by Schedule P, Part 2 Summary, in excess of five percent of surplus in at least three of the last five calendar years.*

[Signature] \_\_\_\_\_

*Name of Actuary*

*Date*

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The following illustrative wording may be included within the AOS to note that the expectation is that the information provided is to be kept confidential.

*This Actuarial Opinion Summary was prepared solely for the company for filing with regulatory agencies and is not intended for any other purpose. Furthermore, it is my understanding that, consistent with the Annual Statement Supplemental Filing Instructions, the information provided in this Actuarial Opinion Summary will be kept confidential by those regulatory agencies and will not be made available for public inspection, subject to applicable law.*

- 6. The AOS for non-lead companies in a pool (as defined in paragraph 1c of the instructions for the Statement of Actuarial Opinion) shall include a statement that the company is a 0% pool participant. For the non-lead company, the information provided for paragraph 5 should be that of the lead company.**

**DISCUSSION – SECTION 6:**

Paragraph 6 applies only to companies that are 0 percent participants in an intercompany pooling agreement as defined in paragraph 1C of the Instructions for the SAO.

- 7. No Appointed Actuary shall be liable in any manner to any person for any statement made in connection with the above paragraphs if such statement is made in a good faith effort to comply with the above paragraphs.**

**DISCUSSION – SECTION 7:**

No specific description of possible practice is provided for Section 7 of the Instructions for the AOS.

## Appendix 1 Evaluation and Reconciliation of Data (Section 4 of Opinion Instructions)

### “I evaluated the data for reasonableness and consistency.”

This sentence normally means that the actuary reviewed the data triangles, etc., used in the course of forming the actuarial opinion and found no data points that were either outside the range of reasonable possibilities or internally inconsistent to a significant degree (or that appropriate adjustments have been reflected in the actuary’s analysis). The objective of the evaluation for reasonableness and consistency is to identify significant data errors that would ordinarily be observed by the actuary in the course of analyzing the reserves.

### NOTE:

ASOP No. 23, Data Quality, also provides guidance on this issue; the actuary is to comply with ASOP No. 23 when evaluating data.

For purposes of compliance with the NAIC Instructions, the following discussion is provided:

1. The key question in reviewing a specific, unusual data point is normally whether the data point is so unusual as to indicate a likely data error of significance to the actuary’s opinion on the reserves. Data points that could reasonably result from random variations in claim experience or from normal coding errors (e.g., a small downward development in the number of claims reported for a particular accident year and line of business) generally need not be questioned. (Note: The actuary may well inquire about the causes of unusual data points for purposes of evaluating the reserves but is not required to do so solely as a test of data accuracy if the data are within the range of reasonable possibilities.)
2. It is generally prudent to watch for inconsistencies in the data compilations used directly in the actuarial analysis. For example, if the actuary is using a paid-loss development method of estimating the outstanding losses, the actuary may choose to investigate any cumulative paid-loss amount that significantly exceeds subsequent cumulative paid-loss amounts for the same accident year and coverage (unless the actuary is aware of a valid reason for downward developments under the circumstances). However, if the estimation methods used by the actuary for that line of business do not involve review of paid-loss developments, they need not be reviewed solely to check for unreasonable or inconsistent data, even though paid losses may have been compiled in the process of putting together other data compilations that were used directly in the analysis.
3. If data initially appeared to be unreasonable or inconsistent, but were either explained or adjusted satisfactorily, the above sentence can be used without qualification in most instances.
4. If the actuary identified the data as being unreasonable or inconsistent to a significant degree (relative to the actuary’s opinion on the reserves), and the apparent data problem was not resolved satisfactorily, some possible alternatives are as follows:

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- a. Do not rely on the data in question: If, in the actuary's judgment, this causes a significant increase in the uncertainty inherent in the actuary's opinion on the reserves, then the situation would usually be described in the Statement of Actuarial Opinion and would usually be elaborated upon in the Actuarial Report, or
- b. Conclude that an actuarial opinion cannot be formed based on the available data.

**“I also reconciled the data to Schedule P, Part 1 of the company's current Annual Statement.”**

This sentence normally means the following:

- A. Each of the following types of data, if relied upon significantly in forming the actuarial opinion (on a net or a direct plus assumed basis), were reconciled to Schedule P, Parts 1, 1A, ..., 1R (referred to collectively as Schedule P below): paid losses, incurred (case basis) losses, paid defense and cost containment expenses, incurred (case basis) defense and cost containment expenses, paid adjusting and other expenses, salvage and subrogation received, and earned premiums,
- B. The reconciliation of paid data consisted of comparing either (a) cumulative paid amounts, or (b) current calendar-year paid amounts obtained from the actuarial data to the analogous data from Schedule P, Part 1; the reconciliation of case basis reserves consisted of comparing the current year-end case basis reserves from the actuarial analysis to Schedule P, Part 1; the comparisons were completed in detail by line of business and year in which losses were incurred, to the extent that such detail was relied upon significantly and is provided in Schedule P, and
- C. The differences, if any, were deemed by the actuary to be either insignificant or explainable by known causes that did not represent errors in the data relied upon by the actuary (e.g., the case basis reserves for loss adjustment expenses were based on formulas that differed between the two sources).

**DISCUSSION:**

1. The actuary may also use types of data that are not included in the above reconciliation (e.g., numbers of units of exposure, numbers of claims, policy limits distributions, and loss data for older years adjusted to reflect subsequent years' reinsurance retentions). Salvage and subrogation received would normally be reconciled if the losses are reviewed gross of salvage and subrogation and/or a separate analysis is performed for salvage and subrogation. Additionally, the actuary may consider reconciling claim counts, if the method of counting claims is consistent between the reserve analysis data and Schedule P (e.g., per claim vs. per occurrence).
2. If data used by the actuary are subdivided more finely than that in Schedule P (e.g., lines of business are subdivided, accident quarter detail is used, or the data are subdivided between pools and associations and other business), then the data relied upon can be aggregated to the level shown in Schedule P. Similarly, if the actuary chooses to combine some Schedule P lines

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of business for purposes of the actuarial study, then the Schedule P data can be aggregated as needed for comparison.

3. If the data used by the actuary are grouped in such a manner (e.g., by type of policyholder, with each type including subsets of two or more Schedule P lines of business) that both those data and the Schedule P data require aggregation before they can be compared, then they can be compared after minimal necessary aggregation. Alternatively, it may be possible to compile more finely detailed data that, when aggregated in different ways, reproduce both the data used by the actuary and the Schedule P data. A brief note indicating the inability to compare data directly (i.e., before some aggregation of both the data used by the actuary and Schedule P data) and the level at which the comparison was performed may be included in the Statement of Actuarial Opinion and may be elaborated upon in the Actuarial Report.
4. If adjustments were made to the data for purposes of the actuarial analysis (e.g., to put older years on a basis more similar to recent years or for purposes of projecting the recent years), the data before adjustment often can be compared against Schedule P.
5. If, as is common, the adjusting and other loss-expense data used by the actuary were grouped by payment year, not subdivided by accident year, then it typically would be appropriate for the latest calendar year's payments (not in detail by accident year) to be compared by line of business, allowing variations in line-of-business groupings as discussed above.
6. If any paid or case-incurred loss or loss-adjustment expense data that were relied upon significantly cannot be compared in detail by line of business and year for reasons other than those in notes (2) through (5) above (e.g., if the data used in the actuarial analysis were grouped by policy year), then this may be indicated in the Statement of Actuarial Opinion and may be elaborated upon in the Actuarial Report. If it is not possible to compare the data with Schedule P by year, the data may be compared with Schedule P on an all-years-combined basis. This may be appropriate for calendar-year paid losses, calendar-year defense and cost containment expenses, current year-end case basis loss reserves, and current year-end case basis defense and cost containment expense reserves.
7. If any loss or loss-adjustment expense data corresponding to the prior year's line of Schedule P were relied upon significantly, such data may be compared to Schedule P on an all-years-combined basis. This comparison may include calendar-year paid losses, calendar-year paid defense and cost containment expenses, current year-end case basis loss reserves, and current year-end case basis defense and cost containment expense reserves.
8. As with other aspects of the work underlying the Statement of Actuarial Opinion, the opining actuary may review the methodology used in the reconciliation and its results but need not have personally done or checked the calculations.
9. The actuary's analysis may be based primarily on data evaluated earlier than year-end (e.g., Oct. 31). If actual year-end data are not used as the base for projection of the outstanding amounts, then, in forming the opinion on year-end reserves, the actuary would typically compare the actual year-end data against expected year-end values based on the earlier evaluation. The actual year-end values would typically still be reconciled to Schedule P.

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10. The Actuarial Report ordinarily contains a description of the comparison performed and of any data that were relied upon significantly but could not be compared against Schedule P.
11. If, after attempting to resolve the differences, significant, unexplained differences remain between the data used by the actuary and those shown in Schedule P, the actuary may choose to do the following:
  - a. Confirm that the person(s) responsible for the data used by the actuary and the person(s) responsible for the data in Schedule P are aware of the differences. (They ordinarily will have learned of the differences in the course of the actuary's efforts to resolve them.)
  - b. Recommend that the company inform its outside auditors of the unexplained differences.
  - c. Discuss the situation in the Statement of Actuarial Opinion, and elaborate on it in the Actuarial Report.

## Appendix 2

### Frequently Asked Questions Regarding the Practice Note

#### QUESTION 1:

The term *material* is used several times in the practice note. How does an actuary assess materiality?

#### DISCUSSION 1:

In evaluating materiality, the opining actuary will be guided by [ASOP No. 36<sup>25</sup>](#) and may wish to consider issues like the level of carried reserves or the level of reported surplus. Given the wide variation in company financial structures and insurance risks, no simple rule of thumb regarding materiality is meaningful and appropriate in all circumstances. In the final analysis, materiality will depend upon the actuary's judgment.

Materiality is further discussed in Appendix 7.

#### QUESTION 2:

When is a carried reserve reasonable?

#### DISCUSSION 2:

[ASOP No. 36<sup>26</sup>](#) states that a reserve makes a reasonable provision if it is within the actuary's range of reasonable reserve estimates. This standard defines the range of reasonable estimates as a range of estimates that could be produced by appropriate actuarial methods or alternative sets of assumptions that the actuary judges to be reasonable.

Note that the range of reasonable estimates typically is narrower, perhaps considerably, than the range of possible outcomes of the ultimate settlement value of the reserve. A reserve booked at the low end of the range of possible outcomes would ordinarily not be within the range of reasonable estimates and so likely would not make a reasonable provision for all unpaid loss and loss expense obligations.

The actuary will be guided by [ASOP No. 36<sup>27</sup>](#).

#### QUESTION 3:

What if the net loss and loss-expense reserves and the direct-plus-assumed loss and loss-expense reserves make reasonable provisions for the unpaid loss and loss-expense obligations of the company, but some of the amounts booked for certain subsets of the carried reserves do not in isolation make reasonable provisions for the associated portions of the company's obligation?

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<sup>25</sup> ASOP No. 36 is currently undergoing revisions.

<sup>26</sup> Ibid.

<sup>27</sup> Ibid.

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**DISCUSSION 3:**

COPLFR believes that the determination of whether to issue an adverse opinion is based upon the overall evaluation of the loss and loss-expense reserves as disclosed in the SCOPE paragraph. For this purpose, it may not be relevant whether the actuary believes that each subset of the reserves makes reasonable provision for the associated obligations, as long as underestimates in one are offset by overestimates elsewhere.

However, the NAIC *Accounting Practices and Procedures Manual* requires management to book its best estimate by line of business as well as in total. The actuary may wish to ascertain that the reserves correspond to management's best estimate by line of business and in the aggregate.

**QUESTION 4:**

Why would someone issue a qualified opinion? How may an actuary choose to indicate that an opinion is qualified?

**DISCUSSION 4:**

According to [ASOP No. 36<sup>28</sup>](#), the actuary is to issue a qualified opinion when, in the actuary's opinion, the reserves for a certain item or items are in question because they cannot be reasonably estimated, or the actuary is unable to render an opinion on those items. He or she will disclose in the opinion the item or items to which the qualification relates, the reasons for the qualification, and the amounts for such items, if disclosed by the entity, that are included in the stated reserve amount. A qualified opinion normally will state whether the stated reserve amount makes a reasonable provision for the liabilities associated with the specified reserves, *except for* the item, or items, to which the qualification relates. Actuaries typically are careful to avoid language that may imply the opinion is qualified when in fact it is not. If the opinion is a qualified opinion, the actuary explicitly states in the opinion paragraph that it is a qualified opinion.

**QUESTION 5:**

How would an opining actuary treat a situation in which there is a portion of reserves for which he or she did not perform an independent analysis? Does this necessarily mean that the opinion is qualified? Are there situations in which an unqualified opinion may be offered even though the actuary did not review all the reserves? If so, where would this be disclosed in the opinion?

**DISCUSSION 5:**

Often, the phrase "independent analysis" is construed as a quantitative analysis. In addressing this question, it is important to distinguish between "quantitative analysis" and "review." In the course of a review of reserves, actuaries generally use quantitative methods to analyze most reserve segments. For certain segments, the actuary may, relying on professional judgment, conclude that the reserves for the segment are likely to be too small to be material to the total. This professional judgment would

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<sup>28</sup> ASOP No. 36 is currently undergoing revisions.

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typically reflect information such as the number of open claims, dollars of total case loss reserves, and types of policies written. The use of such professional judgment does not necessarily require a qualified opinion.

With this in mind, there are a number of possible situations that may arise, including:

Situation 1: An actuary reviews information regarding a portion of the company's business, concludes based on professional judgment that loss reserves for this portion are likely to be immaterial to the overall reserves, and decides not to perform a quantitative analysis of that business. The actuary may or may not disclose this in the opinion. The actuary may wish to address this professional judgment in the report supporting the opinion. In this instance, since loss reserves for that business are deemed immaterial, there is no need to qualify the opinion.

Situation 2: An actuary reviews a quantitative analysis performed by another party regarding a material portion of the company's business, concludes based on professional judgment that the analysis for this portion produces reasonable results, and decides not to perform an independent quantitative analysis of that business. The actuary may or may not disclose this in the opinion. The actuary may wish to address this professional judgment in the report supporting the opinion. In this instance, there is no need to qualify the opinion.

Situation 3: An actuary identifies a portion of the business that may be material to loss reserves, but there is insufficient information with which to perform a quantitative review or draw a conclusion about materiality. The actuary discloses this in the opinion and the supporting report. The opinion is qualified to exclude this portion of the business.

Situation 4: An actuary identifies a portion of the business that is certainly material to loss reserves, but there is insufficient information with which to perform a review. The actuary discloses this in the opinion and the supporting report. The opinion is qualified to exclude this portion of the business.

Situation 5: A portion of the business is deemed to be outside the scope of the actuary's review. For example, a different actuary reviews and opines on reserves for the accident and health line of business. The actuary discloses this in the opinion and supporting report. The opinion is qualified to exclude this portion of the business. If the actuary has information regarding the materiality of the business, it is typically helpful to disclose this information in the opinion.

Situation 6: On a portion of the business, the opining actuary has relied upon the opinion of another actuary to form his or her opinion. For example, this may occur with voluntary or involuntary pools. In this instance, the provisions of ASOP No. 36<sup>29</sup>, addressing reliance on the opinions of other actuaries, will guide the opining actuary. The actuary discloses the reliance in the opinion and supporting report. Such reliance does not necessarily require a qualified opinion.

### QUESTION 6:

How does the opining actuary usually treat pools when an opinion is provided by another actuary on behalf of the pool?

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<sup>29</sup> ASOP No. 36 is currently undergoing revisions.

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## DISCUSSION 6:

The actuary typically responds in one of four ways:

1. The actuary may conclude that such reserves are likely to be immaterial or that the potential variability of the pool's reserves would not affect the actuary's conclusion on the total reserve and would respond as in Situation 1 above.
2. The actuary may rely on the opinion of the pool actuary and disclose such reliance in accordance with ASOP No. 36<sup>30</sup> and the Instructions.

Neither (1) or (2) constitute a qualified opinion.

3. The actuary may conduct an independent analysis or review of the work of the pool actuary. In this situation, the actuary may wish to specifically note this in the opinion but does not appear to be required to do so. In this scenario, the actuary is taking responsibility for this segment of the analysis, and the analysis is usually documented in the supporting Actuarial Report.
4. The actuary may exclude these pools and issue a qualified opinion. This may have regulatory consequences.

## QUESTION 7:

What is a clean opinion?

## DISCUSSION 7:

ASOP No. 36<sup>31</sup> does not define a "clean opinion," and there is currently no widely accepted definition of this term. COPLFR believes that the five categories of opinion in ASOP No. 36<sup>32</sup> (reasonable, deficient, redundant, qualified, and no opinion) are usually sufficient and notes that the disclosure of a significant risk of material adverse deviation generally can be viewed as a disclosure and not as a qualification.

## QUESTION 8:

The NAIC Instructions for the annual audited financial report regarding the auditor's review of data used by the appointed actuary, require the auditor to "... obtain an understanding of the data identified by the appointed actuary as significant ..." to the decision regarding the reasonableness of reserves. Within this context, how would the actuary define the term "significant?"

## DISCUSSION 8:

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<sup>30</sup> ASOP No. 36 is currently undergoing revisions.

<sup>31</sup> Ibid.

<sup>32</sup> Ibid.

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Although the term “significant” is not defined within the data testing requirement, COPLFR suggests the following as an example of a definition for use in this instance: A data item or attribute would normally be considered to be “significant” to an analysis of loss reserves if, in the appointed actuary’s professional judgment, the correctness of the data item or attribute in the loss reserve analysis is likely to have a material effect on the opinion. Examples of a “material effect” might include a change in the type of opinion rendered (reasonable, qualified, redundant, deficient, or no opinion) or the presence or absence of a risk of material adverse deviation. *[Note: Actuaries are not required to use or practice consistent with this definition. It has not been adopted by the ASB and is not binding on any actuary.]*

### QUESTION 9:

What constitutes pre-paid loss adjustment expense as discussed in Interpretation 02-21, Appendix B of the NAIC *Accounting Practices and Procedures Manual*, and why does a company still need to record a liability for unpaid loss adjustment expenses if it has “pre-paid” such expenses?

### DISCUSSION 9:

Pre-paid loss adjustment expenses include amounts paid by an insurance company to another affiliated or unaffiliated party, such as a third party administrator (TPA), management company, or other entity, for future claim servicing costs on losses that have already occurred.

According to INT 02-21 in Appendix B of the NAIC *Accounting Practices and Procedures Manual*, the liability for unpaid loss adjustment expenses should be established regardless of any such pre-payments.

### QUESTION 10:

The reserves disclosed in the Schedule P Interrogatory 1 as yet-to-be issued ERE arising from DDR provisions in Medical Professional Liability Claims Made insurance policies, and disclosed in Exhibit B, item 12 as “extended loss and expense reserves,” are to be included in the SAO. Are reserves related to an activated free tail included in that extended loss and expense reserve? How about reserves related to un-activated free tail coverage or a paid tail policy? **What about lines of business other than Medical Professional Liability?**

### DISCUSSION 10:

The provision for “extended loss and expense reserve” is that for which no premium has been explicitly paid (although there may be implicit premium) and for which no policy has yet been issued. Within that context, the references to “activated tail” and “paid tail” relate to “triggered” or “issued” policies, and, therefore, any related loss reserves are no longer considered to be “extended loss and expense reserves.” Presuming that “un-activated free tail coverage” relates to prospectively guaranteed coverage, the provision for such prospectively guaranteed coverage, for Medical Professional Liability insureds, would be included in unearned premium reserve and disclosed as DDR reserve in Schedule P Interrogatory 1.2. **Although not reflected in Schedule P, Interrogatory 1.2, DDR reserves for lines of business other than Medical Professional Liability are also within the scope of the SAO. DDR reserves for all lines of business, therefore, should be included in Exhibit B, Disclosure 12.**

## Appendix 3

The Casualty Actuarial and Statistical Task Force of the NAIC has provided guidance for a required SAO for Pools and Associations. This guidance document is reproduced for the convenience of the reader.

September 2010

### NAIC Guidance for Actuarial Opinions for Pools and Associations

Prepared by the  
Casualty Actuarial & Statistical Task Force

A “Statement of Actuarial Opinion” (SAO) for Pools and Associations should be written in accordance with the NAIC Annual Statement Instructions Property and Casualty. The Casualty Actuarial & Statistical Task Force (CASTF) of the NAIC provides the following guidance to aid in writing a SAO for Pools and Associations. Note that the Actuarial Opinion Summary (AOS) does not apply to Pools and Associations.

The numbering in the following guidance corresponds to the numbering in the NAIC Annual Statement Instructions Property and Casualty.

1. The Board of Directors of the pool shall appoint a Qualified Actuary to write the SAO for the pool. The SAO shall be forwarded by the pool administrator to each pool member by January 31st of the succeeding year or as otherwise agreed by voluntary pool members.

#### 1.A. Definitions

Pool member means an insurer authorized to write property and/or casualty insurance under the laws of any state, unless otherwise defined in state law, and includes but is not limited to fire and marine companies, general casualty companies, local mutual aid societies, statewide mutual assessment companies, mutual insurance companies other than farm mutual insurance companies and county mutual insurance companies, Lloyd’s plans, reciprocal and interinsurance exchanges, captive insurance companies, risk retention groups, stipulated premium insurance companies, and nonprofit legal services corporations.

#### 4. SCOPE Paragraph

The net reserves included in the SCOPE paragraph are net of reinsurance, other than cessions used to distribute the losses to pool members.

The SCOPE paragraph should indicate the accounting basis on which the entity is providing its financial information, the valuation date of data used in support of the opinion, and whether this data has been adjusted to reflect expected values as of December 31 of the calendar year for

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which the SAO is provided. Alternatively, if data reported by the entity is on a lagged basis, the number of months by which data is lagged should be noted.

Exhibit A should be modified to provide only those items relevant to Pools and Associations.

**6. RELEVANT COMMENTS paragraphs**

The Appointed Actuary must provide RELEVANT COMMENT paragraphs to address issues such as collectibility of assessments, the mechanism for recovering any pool deficits, or the nature of member’s liability as part of the pool.

**b. Other Disclosures in Exhibit B**

Exhibit B should be modified to provide only those items relevant to Pools and Associations.

**d. IRIS Ratios**

In lieu of comments about IRIS ratios, if the entity’s current reserves indicate adverse development of greater than 20% on reserve valuations established at the same date one year and/or two years prior, the actuary must include RELEVANT COMMENT on the factors that led to the unusual value(s) along with explanation.

**Exhibits**

The exhibits required in the NAIC Annual Statement Instructions Property and Casualty should be modified to provide only those items relevant to Pools and Associations. The CASTF provides the following altered exhibits for reference.

**Exhibit A: SCOPE**

<u>Loss Reserves:</u>	<u>Amount</u>
1. Reserve for Unpaid Losses	\$ _____
2. Reserve for Unpaid Loss Adjustment Expenses	\$ _____
3. Reserve for Unpaid Losses – Direct and Assumed	\$ _____
4. Reserve for Unpaid Loss Adjustment Expenses – Direct and Assumed	\$ _____
5. The Page 3 write-in item reserve, “Retroactive Reinsurance Reserve Assumed”	\$ XXX
6. Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion (list separately)	\$ _____
<u>Premium Reserves:</u>	
7. Reserve for Direct and Assumed Unearned Premiums for Long Duration Contracts	\$ XXX
8. Reserve for Net Unearned Premiums for Long Duration Contracts	\$ XXX

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9. Other Premium Reserve items on which the Appointed Actuary is expressing an Opinion (list separately) \$ \_\_\_\_\_

**Exhibit B: DISCLOSURES**

1. Name of the Appointed Actuary Last \_\_\_\_\_ First \_\_\_\_\_ Mid \_\_\_\_\_

2. The Appointed Actuary's Relationship to the entity  
Enter E or C based upon the following:  
E if an Employee  
C if a Consultant \_\_\_\_\_

3. The Appointed Actuary is a Qualified Actuary based upon what qualification?  
Enter F, A, M, or O based upon the following:  
F if a Fellow of the Casualty Actuarial Society (FCAS)  
A if an Associate of the Casualty Actuarial Society (ACAS)  
M if not a member of the Casualty Actuarial Society, but a Member of the American Academy of Actuaries (MAAA) approved by the Casualty Practice Council, as documented with the attached approval letter.  
O for Other \_\_\_\_\_

4. Type of Opinion, as identified in the OPINION paragraph.  
Enter R, I, E, Q, or N based upon the following:  
R if Reasonable  
I if Inadequate or Deficient Provision  
E if Excessive or Redundant Provision  
Q if Qualified. Use Q when part of the OPINION is Qualified.  
N if No Opinion \_\_\_\_\_

5. Materiality Standard expressed in US dollars (Used to Answer Question #6) \$ \_\_\_\_\_

6. Is there a Significant Risk of Material Adverse Deviation? Yes [ ] No [ ] Not Applicable [ ]

7. Statutory Surplus \$ \_\_\_\_\_

8. Anticipated net salvage and subrogation included as a reduction to loss reserves \$ \_\_\_\_\_

9. Discount included as a reduction to loss reserves and loss expense reserves

9.1 Nontabular Discount \$ \_\_\_\_\_

9.2 Tabular Discount \$ \_\_\_\_\_

10. The net reserves for losses and expenses for the company's share of voluntary and involuntary underwriting pools' and associations' unpaid losses and expenses \$ XXX

11. The net reserves for losses and loss adjustment expenses that the company carries for the following liabilities\*

11.1 Asbestos, as disclosed in the Notes to Financial Statements \$ XXX

11.2 Environmental, as disclosed in the Notes to Financial Statements \$ XXX

12. The total claims made extended loss and expense reserve

12.1 Amount reported as loss reserves \$ XXX

12.2 Amount reported as unearned premium reserves \$ XXX

13. Other items on which the Appointed Actuary is providing Relevant Comment (list separately) \$ \_\_\_\_\_

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\* The reserves disclosed in item 11 above, should exclude amounts relating to contracts specifically written to cover asbestos and environmental exposures. Contracts specifically written to cover these exposures include Environmental Impairment Liability (post 1986), Asbestos Abatement, Pollution Legal Liability, Contractor's Pollution Liability, Consultant's Environmental Liability, and Pollution and Remediation Legal Liability.

## Appendix 4

### 2010 Title Insurance Company Annual Statement Instructions

#### ACTUARIAL OPINION

1. There is to be included or attached to Page 1 of the annual statement, the statement of a qualified actuary, entitled "Statement of Actuarial Opinion," setting forth his or her opinion relating to reserves specified in the SCOPE paragraph. The Actuarial Opinion, both the narrative and **required** exhibits, shall be in the format of and contain the information required by this Section.

The qualified actuary must be appointed by the Board of Directors or its equivalent, or by a committee of the Board, by December 31 of the calendar year for which the opinion is rendered. Upon initial appointment (or "retention"), the company shall notify the domiciliary commissioner within five business days of the appointment with the following information:

- a. name and title (and, in the case of a consulting actuary, the name of the firm).
- b. manner of appointment of the Appointed Actuary (i.e., who made the appointment and when).
- c. a statement that the person meets the requirements of a qualified actuary.

Once this notification is furnished, no further notice is required with respect to this person unless the actuary ceases to be appointed or retained or ceases to meet the requirements of a qualified actuary.

If an actuary who was the appointed actuary for the immediately preceding filed Actuarial Opinion is replaced by an action of the Board of Directors, the reporting entity shall within five (5) business days notify the insurance department of the state of domicile of this event. The insurer shall also furnish the domiciliary commissioner with a separate letter within ten (10) business days of the above notification stating whether in the twenty-four (24) months preceding such event there were any disagreements with the former appointed actuary regarding the content of the opinion on matters of the risk of material adverse deviation, required disclosures, scopes, procedure, or data quality. The disagreements required to be reported in response to this paragraph include both those resolved to the former actuary's satisfaction and those not resolved to the former actuary's satisfaction. The reporting entity shall also request in writing such former actuary to furnish a letter addressed to the entity stating whether the actuary agrees with the statements contained in the entity's letter and, if not, stating the reasons for which he does not agree; and the reporting entity shall furnish such responsive letter from the former actuary to the domiciliary commissioner together with its own.

The appointed actuary must report to the Board of Directors or the Audit Committee each year on the items within the scope of the Actuarial Opinion. The Actuarial Opinion and the Actuarial Report must be made available to the Board of Directors. The minutes of the Board of Directors should indicate that the appointed actuary has presented such information to the Board of Directors or the Audit Committee and that the Actuarial Opinion and the Actuarial Report were made available. A separate Actuarial Opinion is required for each company filing an Annual Statement. When there is an affiliated company pooling arrangement, one Actuarial Report for the aggregate pool is sufficient, but there must be addendums to the Actuarial Report to cover non-pooled reserves for individual companies.

The Statement of Actuarial Opinion and the supporting Actuarial Report and workpapers, should be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including but not limited to ASOPs 9, 23, and 36, as promulgated by the Actuarial Standards Board, and Statements of Principals adopted by the Casualty Actuarial Society.

#### 1A. Definitions

Qualified actuary is a person who is either:

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- (i) A member in good standing of the Casualty Actuarial Society, or
- (ii) A member in good standing of the American Academy of Actuaries who has been approved as qualified for signing casualty loss reserve opinions by the Casualty Practice Council of the American Academy of Actuaries

Insurer means a reporting entity authorized to write title insurance under the laws of any state and who files on the Title blank.

Actuarial Report means a document or other presentation, prepared as a formal means of conveying the actuary's professional conclusions and recommendations, of recording and communicating the methods and procedures, of assuring that the parties addressed are aware of the significance of the actuary's opinion or findings and that documents the analysis underlying the opinion. The expected content of the report is further described in paragraph 7.

### 1B. Exemptions

A reporting entity who intends to file for one of the exemptions under this section must submit a letter of intent to its domiciliary commissioner no later than December 1 of the calendar year for which the exemption is to be claimed. The commissioner may deny the exemption prior to December 31 of the same year if the exemption is deemed inappropriate.

A copy of the approved exemption must be filed with the annual statement in all jurisdictions in which the company is authorized.

#### Exemption For Small Companies

An insurer that has less than \$1,000,000 total direct plus assumed written premiums during a calendar year, and less than \$1,000,000 total direct plus assumed loss and loss adjustment expense reserves at year-end, in lieu of the Actuarial Opinion required for the calendar year, may submit an affidavit under oath of an officer of the insurer that specifies the amounts of direct plus assumed written premiums and direct plus assumed loss and loss adjustment reserves.

#### Exemption for Insurers under Supervision or Conservatorship

Unless ordered by the domiciliary commissioner, an insurer that is under supervision or conservatorship pursuant to statutory provision is exempt from the filing requirements contained herein.

#### Exemption for Nature of Business

An insurer otherwise subject to the requirement and not eligible for an exemption as enumerated above may apply to its domiciliary commissioner for an exemption based on the nature of business written.

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### Financial Hardship Exemption

An insurer otherwise subject to this requirement and not eligible for an exemption as enumerated above may apply to the commissioner for a financial hardship exemption.

Financial hardship is presumed to exist if the projected reasonable cost of the opinion would exceed the lesser of:

- (i) One percent of the insurer's capital and surplus reflected in the insurer's latest quarterly statement for the calendar year for which the exemption is sought; or
  - (ii) Three percent of the insurer's direct plus assumed premiums written during the calendar year for which the exemption is sought as projected from the insurer's latest quarterly statements filed with its domiciliary commissioner.
2. The Statement of Actuarial Opinion must consist of an IDENTIFICATION paragraph identifying the appointed actuary; a SCOPE paragraph identifying the subjects on which an opinion is to be expressed and describing the scope of the actuary's work; an OPINION paragraph expressing his or her opinion with respect to such subjects and one or more additional RELEVANT COMMENTS paragraphs. These four sections must be clearly designated.
  3. The identification paragraph should specifically indicate the appointed actuary's relationship to the company, qualifications for acting as appointed actuary, date of appointment, and specify that the appointment was made by the Board of Directors, or its equivalent, or by a committee of the Board.

A member of the American Academy of Actuaries qualifying under paragraph 1A(ii) must attach, each year, a copy of the approval letter from the Academy.

These instructions require that a qualified actuary prepare the Opinion. If a person who does not meet the definition of a qualified actuary has been approved by the insurance regulatory official of the domiciliary state, the company must attach, each year, a letter from that official stating that the individual meets the state's requirements for rendering the Opinion.

4. The scope paragraph should contain a sentence such as the following:

"I have examined the actuarial assumptions and methods used in determining reserves listed in Exhibit A, as shown in the Annual Statement of the Company as prepared for filing with state regulatory officials, as of December 31, 20\_\_."

Exhibit A should list those items and amounts with respect to which the appointed actuary is expressing an opinion.

The appointed actuary should state that the items in the scope paragraph, on which he or she is expressing an opinion, reflect the disclosure items (3 through 8) in Exhibit B.

The scope paragraph should include a paragraph such as the following regarding the data used by the appointed actuary in forming the opinion:

"In forming my opinion on the loss and loss adjustment expense reserves, I relied upon data prepared by (name, affiliation and relation to Company). I evaluated that data for reasonableness and consistency. I also reconciled that data to Schedule P, Parts 1 and 2 of the company's current annual statement. In other respects, my examination included such review of the actuarial assumptions and methods used and such tests of the calculations as I considered necessary."

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5. The opinion paragraph should include a sentence that at least covers the points listed in the following illustration:

“In my opinion, the amounts carried in Exhibit A on account of the items identified:

- A. Meet the requirements of the insurance laws of (state of domicile).
- B. Are computed in accordance with accepted actuarial standards and principles.
- C. Make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its contracts and agreements.”

If there is any aggregation or combination of items in Exhibit A, the opinion language should clearly identify the combined items.

Insurance laws and regulations shall at all times take precedence over the actuarial standards and principles.

If the actuary has relied on the Actuarial Opinion of another actuary (such as for pools and associations, for a subsidiary, or for special lines of business), the other actuary must be identified by name and affiliation within the opinion paragraph.

A Statement of Actuarial Opinion should be made in accordance with one of the following sections (a-e). The actuary must explicitly identify in Exhibit B which category applies.

- a. Determination of Reasonable Provision. When the stated reserve amount is within the actuary’s range of reasonable reserve estimates, the actuary should issue a statement of actuarial opinion that the stated reserve amount makes a reasonable provision for the liabilities associated with the specified reserves.
- b. Determination of Deficient or Inadequate Provision. When the stated reserve amount is less than the minimum amount that the actuary believes is reasonable, the actuary should issue a statement of actuarial opinion that the stated reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves.
- c. Determination of Redundant or Excessive Provision. When the stated reserve amount is greater than the maximum amount that the actuary believes is reasonable, the actuary should issue a statement of actuarial opinion that the stated reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves.
- d. Qualified Opinion. When, in the actuary’s opinion, the reserves for a certain item or items are in question because they cannot be reasonably estimated or the actuary is unable to render an opinion on those items, the actuary should issue a qualified statement of actuarial opinion. Such a qualified opinion should state whether the stated reserve amount makes a reasonable provision for the liabilities associated with the specified reserves, *except for* the item, or items, to which the qualification relates. The actuary is not required to issue a qualified opinion if the actuary reasonably believes that the item or items in question are not likely to be material.
- e. No Opinion. The actuary’s ability to give an opinion is dependent upon data, analyses, assumptions, and related information that are sufficient to support a conclusion. If the actuary cannot reach a conclusion due to deficiencies or limitations in the data, analyses, assumptions, or related information, then the actuary may issue a statement of no opinion. A statement of no opinion should include a description of the reasons why no opinion could be given.

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6. The appointed actuary must provide relevant comment paragraphs to address the following topics of regulatory importance.

a. Risk of Material Adverse Deviation.

The appointed actuary must provide specific relevant comment paragraphs to address the risk of material adverse deviation. The actuary must identify the materiality standard and the basis for establishing this standard with respect to the relevant characteristics of the company. The materiality standard must be disclosed in US dollars in Exhibit B: Disclosures. The actuary should explicitly state whether or not he or she reasonably believes that there are significant risks and uncertainties that could result in material adverse deviation. If such risk exists, the actuary should include an explanatory paragraph to describe the major factors, combination of factors, or particular conditions underlying the risks and uncertainties that the actuary reasonably believes could result in material adverse deviation. The explanatory paragraph should not include general, broad statements about risks and uncertainties due to economic changes, judicial decisions, regulatory actions, political or social forces, etc., nor is the actuary required to include an exhaustive list of all potential sources of risks and uncertainties.

b. Other Disclosures in Exhibit B

Relevant comment paragraphs should describe the significance of each of the remaining disclosure items in Exhibit B. The actuary should address the items individually and in combination when commenting on a material impact.

c. Reinsurance

Relevant comment paragraphs should address retroactive reinsurance, financial reinsurance and reinsurance collectibility. Before commenting on reinsurance collectibility, the actuary should solicit information from management on any actual collectibility problems, review ratings given to reinsurers by a recognized rating service, and examine Schedule F for the current year for indications of regulatory action or reinsurance recoverable on paid losses over 90 days past due. The comment should also reflect any other information the actuary has received from management or that is publicly available about the capability or willingness of reinsurers to pay claims. The actuary's comments do not imply an opinion on the financial condition of any reinsurer.

Retroactive reinsurance refers to agreements referenced in SSAP No. 62R, Property and Casualty Reinsurance, of the *Accounting Practices and Procedures Manual*.

Financial reinsurance refers to contracts referenced in SSAP No. 62R, Property and Liability Reinsurance, paragraph 34, of the *Accounting Practices and Procedures Manual* in which credit is not allowed for the ceding insurer because the arrangements do not include a transfer of both timing and underwriting risk that the reinsurer undertakes in fact to indemnify the ceding insurer against loss or liability by reason of the original insurance.

d. Methods and Assumptions

If there has been any significant change in the actuarial assumptions and/or methods from those previously employed, that change should be described in a relevant comment paragraph.

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7. The Actuarial Opinion must include assurance that an Actuarial Report and underlying actuarial workpapers supporting the actuarial opinion will be maintained at the company and available for examination for seven years. The Actuarial Report contains significant proprietary information. It is expected that the report be held confidential and not intended for public inspection. The report must be available by May 1 of the year following the year end for which the opinion was rendered or within two weeks after a request from an individual state commissioner.

The Actuarial Report should be consistent with the documentation and disclosure requirements of ASOP #9. The Actuarial Report should contain both narrative and technical components. The narrative component should provide sufficient detail to clearly explain to company management, the regulator, or other authority the findings, recommendations and conclusions, as well as their significance. The technical component should provide sufficient documentation and disclosure for another actuary practicing in the same field to evaluate the work. This technical component must show the analysis from the basic data, e.g., loss triangles, to the conclusions.

The Report must also include:

- An exhibit which ties to the Annual Statement and compares the Actuary's conclusions to the carried amounts;
  - Summary exhibit(s) of either the actuary's best estimate, range of reasonable estimates, or both, that led to the conclusion in the opinion paragraph regarding the reasonableness of the provision for all unpaid loss and loss adjustment expense obligations;
  - Documentation of the required reconciliation from the data used for analysis to the Annual Statement Schedule P;
  - Extended comments on trends that indicate the presence or absence of risks and uncertainties that could result in material adverse deviation; and
  - Documentation of interviews, questionnaires, correspondence or other meetings with company management or officers that influenced the actuary's conclusions, reliances or opinion.
8. The statement should conclude with the signature of the appointed actuary responsible for providing the Actuarial Opinion and the date when the opinion was rendered. The signature and date should appear in the following format:

---

Signature of actuary  
Printed name of actuary  
Address of actuary  
Telephone number of actuary  
Date opinion was rendered

9. The insurer required to furnish an actuarial opinion shall require its appointed actuary to notify its Board of Directors or its audit committee in writing within five (5) business days after any determination by the appointed actuary that the opinion submitted to the domiciliary Commissioner was in error as a result of reliance on data or other information (other than assumptions) that, as of the balance sheet date, was factually incorrect. The opinion shall be considered to be in error if the opinion would have not been issued or would have been materially altered had the correct data or other information been used. The opinion shall not be considered to be in error if it would have been materially altered or not issued solely because of data or information concerning events subsequent to the balance sheet date or because actual results differ from those projected.

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Notification shall be required for any such determination made between the issuance of the opinion and the balance sheet date for which the next opinion will be issued. The notification should include a summary of such findings and an amended opinion.

A reporting entity who is notified pursuant to the preceding paragraphs shall forward a copy of the summary and the amended opinion to the domiciliary commissioner within five (5) business days of receipt of such and shall provide the appointed actuary making the notification with a copy of the summary and amended opinion being furnished to the domiciliary commissioner. If the appointed actuary fails to receive such copy within the five (5) business day period referred to in the previous sentence, the appointed actuary shall notify the domiciliary commissioner within the next five (5) business days that the submitted opinion should no longer be relied upon or such other notification recommended by the actuary's attorney.

If the appointed actuary learns that the data or other information relied upon was factually incorrect, but cannot immediately determine what, if any, changes are needed in the Actuarial Opinion, the actuary and the company should undertake as quickly as is reasonably practical those procedures necessary for the actuary to make the determination discussed above. If the insurer does not provide the necessary data corrections and other support (including financial support) within ten (10) business days, the actuary should proceed with the notification discussed above.

10. Data in Exhibits A and B are to be filed in both print and data capture format.

No appointed actuary shall be liable in any manner to any person for any statement made in connection with the above paragraphs if such statement is made in a good faith effort to comply with the above paragraphs.

STATEMENT OF ACTUARIAL OPINION

**Exhibit A: SCOPE**

**DATA TO BE FILED IN BOTH PRINT AND DATA CAPTURE FORMAT**

LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES:	<u>Amount</u>
1. Reserve for Unpaid Losses and Loss Adjustment Expenses (Schedule P, Part 1, Total Column 24 or 35 if discounting is allowable under state law)	\$ _____
2. Other items on which the Appointed Actuary is expressing an Opinion (list separately)	\$ _____

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**Exhibit B: DISCLOSURES**  
DATA TO BE FILED IN BOTH PRINT AND DATA CAPTURE FORMAT

NOTE: Exhibit B should be completed for Net dollar amounts included in the SCOPE. If an answer would be different for Direct and Assumed amounts, identify and discuss the difference within RELEVANT COMMENTS.

	Last	First	Middle
1. Name of Appointed Actuary	_____	_____	_____
2. The Appointed Actuary's Relationship to the Company. Enter E or C based upon the following: E - If an Employee C - If a Consultant			_____
3. The Appointed Actuary is a Qualified Actuary based upon what qualification? Enter F, A, M, or O based upon the following: F - If a Fellow of the Casualty Actuarial Society (FCAS) A - If an Associate of the Casualty Actuarial Society (ACAS) M - If not a member of the Casualty Actuarial Society, but a Member of the American Academy of Actuaries (MAAA) approved by the Casualty Practice Council, as documented with the attached approval letter. O - For Other			_____
4. Type of Opinion, as identified in the OPINION paragraph. Enter R, I, E, Q, or N based upon the following: R - If Reasonable I - If Inadequate or Deficient Provision E - If Excessive or Redundant Provision Q - If Qualified. Use Q when part of the OPINION is Qualified. N - If No Opinion			_____
5. Materiality Standard expressed in US dollars (Used to answer question #6)	\$ _____		
6. Is there a Significant Risk of Material Adverse Deviation?			_____
7. Statutory Surplus	\$ _____		
8. Known claims reserve (Liability Page, Line 1)	\$ _____		
9. Statutory premium reserve (Liability Page, Line 2)	\$ _____		
10. Aggregate of other reserves required by law (Liability Page, Line 3)	\$ _____		
11. Supplemental reserve (Liability Page, Line 4)	\$ _____		
12. Anticipated net salvage and subrogation included as a reduction to loss reserves as reported in Schedule P	\$ _____		
13. Discount included as a reduction to loss reserves and loss expense reserves as reported in Schedule P	\$ _____		
14. Other items on which the Appointed Actuary is providing Relevant Comment (list separately)	\$ _____		

## A PUBLIC POLICY PRACTICE NOTE

### DISCUSSION – OPINION:

In Exhibit A: SCOPE, the Instructions require the actuary to express an opinion on a single reserve:

Reserve for Unpaid Losses and Unpaid Loss Adjustment Expenses (Schedule P, Part 1, Total Column 24 or 35 if discounting is allowable under state law)

The Schedule P reserve for unpaid losses and unpaid loss adjustment expenses is net of reinsurance. It includes a provision for known claims (both case-basis and “bulk” provisions for subsequent development on known claims), a provision for IBNR and ALAE, and a provision for unallocated loss adjustment expense.

The Schedule P reserves are not always the same as the liabilities shown on the Liabilities, Surplus and Other Funds page of the Annual Statement. The Liabilities, Surplus and Other Funds page shows the known claims reserve (line 1), but does not show IBNR and unallocated reserves. Instead, the balance sheet shows a statutory premium reserve (line 2), other reserves required by law (line 3), and a supplemental reserve (line 4). The Schedule P reserves may be lower than the balance sheet reserves. Those balance sheet reserve items are disclosed in Exhibit B: DISCLOSURES and therefore are included in the items on which the actuary is required to provide discussion in the RELEVANT COMMENTS section.

The reconciliation of the Schedule P reserves and the balance sheet reserves occurs in Part 2B of the Operations and Investment Exhibit of the Annual Statement. In row 10 of that exhibit, the total Schedule P reserves are compared to the total of the known claims reserve, statutory premium reserve, and other reserves required by law from the balance sheet to determine whether a supplemental reserve is required. If the Schedule P reserves are less than the total of those balance sheet reserves, then a \$0 supplemental reserve is recorded on the balance sheet. However, if the Schedule P reserves exceed the total balance sheet reserves, then a supplemental reserve equal to the excess of the Schedule P reserves over the total balance sheet reserves is recorded. In essence, the balance sheet reserves are the minimum of the Schedule P reserves and the total of the known claims reserve, the statutory premium reserve, and other reserves required by law.

Note that the Title Instructions do not require an opinion on unearned premium reserves on long-duration policies.

### DISCUSSION – SALVAGE & SUBROGATION:

The NAIC Instructions for Schedule P contain detailed rules for reflecting salvage and subrogation. To summarize, the Instructions do not permit paid losses and case-basis loss and loss-expense reserves to be reduced for anticipated salvage and subrogation, but IBNR reserves may contain a provision for expected future salvage and subrogation. The actuary may wish to verify that paid losses and case-basis reserves are gross of anticipated salvage and subrogation, for example, by questioning claims and/or financial personnel.

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## DISCUSSION – RECONCILIATION OF DATA:

The required statement regarding reconciliation of data, included in Section 4 of the Title Instructions, is similar to the requirement in the P&C Instructions, except that Part 2 is added to this sentence: *I also reconciled that data to Schedule P-Parts 1 and 2...*

Parts 1 and 2 of the Title Schedule P are similar in concept to the P&C blank. Both parts seek data on a policy-year basis. Part 1 shows written premium instead of earned premium. Part 2 requires 20 policy years and has the following data elements: paid loss and allocated loss expense, loss and ALAE case basis reserves, bulk reserves on known claims, and IBNR reserves.

Part 3, which contains data on a report-year basis, does not require reconciliation but can be used to evaluate the adequacy of known case reserves. However, the Appointed Actuary does not separately opine on the reasonableness of the known claims reserve, and there is no requirement for the actuary to evaluate the adequacy of the known claims reserve.

## DISCUSSION – RELEVANT COMMENTS:

The Title Opinion Instructions require specific relevant comment paragraphs to address the risk of material adverse deviation. The actuary must also identify the materiality standard and the basis for establishing this standard with respect to the relevant characteristics of the company. The actuary may wish to review discussion provided earlier in this practice note on the risk of material adverse deviation.

Since the reserves within the scope of the opinion (Exhibit A) are the total Schedule P reserves, it follows that the question of whether the actuary reasonably believes that there are significant risks or uncertainties that could result in material adverse deviation should also be based on the total Schedule P reserves. However, in determining what constitutes a “material” adverse deviation, the actuary may want to consider the relationship between the total Schedule P reserves and the balance sheet reserves and comment on it in the opinion. For example, if the Schedule P reserves are significantly less than the total of the known claims reserve, the statutory premium reserve, and other reserves required by law, then an adverse deviation in the Schedule P reserves may have no impact on the balance sheet reserves. On the other hand, if total Schedule P reserves are close to, or greater than, the balance sheet reserves, then a material adverse deviation in the Schedule P reserves could have a balance sheet impact.

The actuary may also want to consider the potential for material adverse deviation in the total Schedule P reserves arising out of the known claims reserve alone. As an illustration, even if total Schedule P reserves are significantly less than the total balance sheet reserves, an adverse deviation in the known claims reserve may have a balance sheet impact, and perhaps a material impact.

While the Title Insurance Company Annual Statement Instructions include a statement that “the explanatory paragraph should not include general, broad statements about risks and uncertainties due to economic changes, judicial decisions, regulatory actions, political or social forces, etc.”, it

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is generally recognized that title insurance companies face the same universal risk factors with respect to the impact of the economy and the nature of title insurance coverage. Therefore, the actuary may consider listing these risk factors in addition to other risk factors that are specific to the entity.

Relevant comment paragraphs are to address retroactive reinsurance, financial reinsurance, and reinsurance collectibility. Additionally, relevant comment paragraphs will describe the significance of each of the remaining disclosure items in Exhibit B. The actuary typically will address the items individually and in combination when commenting on a material impact.

### DISCUSSION – EXHIBITS A & B:

In addition to filing the Annual Statement, the company is required to file certain information, reported in the Annual Statement, in electronic format. The information reported in Exhibit A: SCOPE and Exhibit B: DISCLOSURES of the SAO is included in that electronic filing. Accordingly, the actuary is strongly encouraged to prepare Exhibits A and B in the exact format shown in the Annual Statement Instructions to facilitate the company's electronic capture of the data and information contained therein.

## Appendix 5

### Miscellaneous Illustrative Wordings in Common Use

*[These illustrative wordings, while intended to be of interest and assistance to the actuary, are not authoritative and are not intended to be binding. COPLFR believes these illustrative wordings reflect factors that many actuaries will take into account, but other approaches will, no doubt, be used as well.]*

Actuaries often include wording in their opinions to help the reader's understanding. This appendix contains some of the wordings that are believed to be in common use. However, the actuary is not required to use this language and is encouraged to use alternative language as appropriate.

**The actuary may wish to include language clarifying that certain items, such as assets, are not within the scope of the opinion:**

*My review was limited to the items noted in Exhibit A and did not include an analysis of any income statement or other balance sheet items. My opinion on the reserves is based on the assumption that all reserves are backed by valid assets, which have suitably scheduled maturities and/or adequate liquidity to meet cash flow requirements.*

**Actuaries have included language noting the inherent uncertainty of loss reserve projections. Several such examples are set forth below:**

*In evaluating whether the reserves make a reasonable provision for unpaid losses and loss adjustment expenses, it is necessary to project future loss and loss expense emergence and payments. Actual future losses and loss adjustment expenses will not develop exactly as projected and may, in fact, vary significantly from the projections.*

*Since loss reserves are subject to uncertainty with respect to future events, actual development may vary from the amount carried in the balance sheet. No warranty is expressed or implied that such variance will not occur.*

*It should be noted that reserve calculations deal with the inherent uncertainty of future contingent events. While I believe the reserves in Exhibit A represent a reasonable provision based on the appropriate application of actuarial techniques to the available data, there can be no guarantee that actual future payments will not differ from the reserve values stated in Exhibit A.*

**The actuary may wish to include language to better define what is contemplated by the reserves:**

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*My projections make no provision for the extraordinary future emergence of new classes or types of losses not sufficiently represented in the company's historical database or that are not yet quantifiable.*

**The actuary may wish to include language in those situations in which the opinion is for the total of loss and loss adjustment expense:**

*In my opinion, the amounts recorded in the Annual Statement for the sum of items 1 and 2 as well as the sum of items 3 and 4 in Exhibit A:*

- a. *Meet the requirements of the insurance laws...*

**Opinions have included language to indicate the intended audience:**

*This Statement of Opinion is solely for the use of, and is only to be relied upon by, the company and the state insurance department(s) with which it files its annual statement.*

**Opinions may include wording concerning special circumstances that may impact stressed companies:**

*In Month 200X, the company and all companies comprising the YYY Company Group were placed in Stress Situation A (e.g., placed under the control of the insurance department, placed in runoff, downgraded by a major rating agency, subject to a number of stories in the trade press regarding BBBB, etc.). As a result of these events, I have identified the following risk factors that may have a material impact on the variability of the company's reserves: 1. the company's ability to continue to write business, 2. the company's ability to collect reinsurance recoverables in the amount due and on a timely basis, and 3. the company's increased risk of a liquidity event.*

*To the extent that the company is in Stress Situation A, claims reporting, administration, and settlement abilities may be affected, which, in turn, could impact the reserve levels.*

*Historically, companies in Stress Situation A have experienced greater difficulties in collecting reinsurance recoverables. A variety of factors may contribute to this condition, including the company's ability to identify and report reinsurance recoverables, an increase in coverage disputes with reinsurers, and general slowdown of payments by reinsurers. The company cedes \$CCCC of loss and loss adjustment expense reserves to non-affiliated reinsurers in comparison to the company's surplus as regards to policyholders of \$DDDD. While the probability of failure to collect full amounts due from the reinsurers is unknown, it is more than remote.*

**In situations in which there is a lack of historical data (e.g., new companies, change in book of business for mature companies, or general lack of data), the actuary may find it useful to consider the following:**

1. Whether there are adequate data to evaluate the reserves

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2. If industry data or another company's data were used, whether there is reason to believe that these data are likely to be reasonably similar to the data patterns of the company for which the actuary is rendering an opinion
3. Whether to provide disclosures concerning the data used
4. Whether to provide disclosures concerning the resulting variability and uncertainty.

The actuary may choose to use wording similar to the following:

1. New company—opinion formed

*The ABC Insurance Co. commenced operations in 20XX. Certain critical assumptions on which the company relied to estimate reserves were based on external industry data sources. In my opinion, these data are relevant to the operations of the company. However, the uncertainty of projections is increased by the use of these external data.*

2. New company—no opinion formed

*The ABC Insurance Co. commenced operations in 20XX. Therefore, the company has only been in business for Y years and, as a result, does not, in my opinion, have sufficient historical experience upon which to base a reliable actuarial estimate of the loss and loss adjustment expense reserves as of Dec. 31, 20XX. I am not aware of appropriate external data upon which to base an estimate.*

## Appendix 6

### Intercompany Pooling

It is a common practice for affiliated companies within an insurance group to pool business through an intercompany pooling agreement. Typically, one company in the pool assumes business from the other companies in the pool and then cedes the combined business (including its own business) back to the other companies, according to the percentage of their participation in the pool. This has a number of advantages, including simplified preparation of Annual Statements for the affiliated companies.

The NAIC Annual Statement Instructions for Schedule P require that direct plus assumed and ceded business be reported on a pooled basis. For companies within a group that pool all of their business, after external reinsurance, Schedule P is therefore identical for each company on a gross, ceded, and net basis, except that each company's Schedule P reflects its participation percentage. For a comprehensive example of how this works, the actuary may refer to the NAIC Instructions for Schedule P.

Since Schedule P gross and ceded premiums and losses reflect intercompany pooling transactions, gross and ceded premiums and losses for a pooled company are different in Schedule P as compared to the Underwriting and Investment Exhibits of the Annual Statement. For these companies, ceded reserves in Schedule P are also different from ceded reserves in Schedule F.

The Instructions provide that any retroactive change in intercompany pooling requires a restatement of Schedule P to reflect the current pooling agreement. A retroactive change in intercompany pooling among companies 100 percent owned by a common parent, which results in no gain in surplus, is not accounted for as retroactive reinsurance (see SSAP No. 63 and the *NAIC Accounting Practices and Procedures Manual*).

There are a number of impacts from intercompany pooling on reserve analyses and actuarial opinions. These are discussed by Instruction section.

4. For business that is part of a pooling agreement, the NAIC permits reserve analyses to be performed on a pooled basis, both gross and net of reinsurance. The actuary may wish to comment on this along the following lines:

*The company is part of an intercompany pooling agreement with other affiliates of [name of group]. Premiums and losses are allocated to the company based on its assigned percentage of the total pool. Analysis of the reserve items identified in Exhibit A has been performed for all pool companies combined.*

or

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*The company is the lead company of the XXX Insurance Group pool. The majority of the business written by the XXX Insurance Group is ceded to company A, company B, and company C and then pooled with the other four pool members: company D, company E, company F, and company G. Loss and loss-expense reserves for the total pool were analyzed in the aggregate for all pool companies and allocated to the pool companies based on their pool percentages. Any favorable or adverse development will affect pool members in a manner commensurate with their pool participation.*

If all business in the affiliated companies is part of the pooling agreement, the reconciliation of data to Schedule P, Part 1 can also be performed on a pooled basis. The actuary may wish to comment on this along the following lines when discussing reconciliation:

*I also reconciled that data to a composite Schedule P – Part 1, comprising the total intercompany pool to which the company belongs.*

6. Intercompany pooling agreements may create substantial cessions on Schedule F between members of the pool.

*A change in pooling percentage can cause a company to fail IRIS Tests, particularly the Estimated Current Reserve Deficiency to Surplus.*

6. If the composition of the pool, or a company's share of the pool, changed materially during the current year, the actuary may wish to comment on this by describing the change.

**The Actuarial Opinion Summary and Intercompany Pooling:**

In cases of intercompany pooling, the actuary often performs his or her analysis and draws his or her conclusions on the basis of total reserves. This information is usually described within the opinion. Though it is not required, the actuary may wish to consider showing the point estimate and/or range of estimates and carried reserves for the total pool, in addition to the amounts for the individual company, within the AOS.

However, special considerations apply to non-lead companies under an intercompany pooling arrangement in which the lead company retains 100 percent of the pooled reserves. The AOS for those non-lead companies (0 percent pool participants) is to include a statement that the company is a 0 percent pool participant, and, for that non-lead company, the information provided for paragraph 5 is to be that of the lead company.

The following illustrative wording describes the situation in which the actuary is presenting the AOS information based on intercompany pooling:

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*The company is part of an intercompany pooling arrangement with other affiliates of [name of group]. Premiums and losses are allocated to the company based on its assigned percentage of the total pool. Analysis of the reserve items identified above has been performed for all pool companies combined. The actuary's point estimate is assigned to the company as disclosed in the Notes to Financial Statements. The company assumes a xx percent share of the net pooled business.*

## Appendix 7

# CAS VFIC Note on Materiality and ASOP No. 36: Considerations for the Practicing Actuary

### Introduction

This note has been prepared by the Valuation, Finance, and Investments Committee (VFIC) of the CAS as an aid to the actuary considering the concept of materiality contained in ASOP No. 36.

ASOP No. 36 requires the actuary to use the concept of materiality in a number of important ways, including:

- determination of whether or not to issue a qualified opinion,
- determination of the need for disclosure of significant risks and uncertainties,
- consideration of factors likely to affect the actuary's reserve analysis, and
- determination of the need for a number of other possible disclosures.

There is no formulaic approach to determining the standard of materiality the actuary should use for a given Statement of Actuarial Opinion (SAO). The ASOP instructs the actuary to evaluate materiality based on professional judgment, any applicable guidelines or standards, and the intended purpose of the SAO. VFIC intends this note to aid the actuary who must evaluate materiality in the course of preparing a SAO. Following this introduction are three sections:

1. **Materiality and ASOP No. 36:** Discusses the use of the concept of materiality in ASOP No. 36, highlighting its impact on decisions made by the actuary in the course of preparing a SAO.
2. **Materiality in Accounting Contexts:** Reviews the concept of materiality in accounting contexts, including both regulatory and Securities Exchange Commission (SEC) financial reporting. This discussion is not intended to be guidance for the actuary, since an actuary's issues and concerns are not in general the same as those of accountants. Instead, this review is provided to enrich the discussion of potential issues with regard to materiality.
3. **Materiality, Statements of Actuarial Opinion, and ASOP No. 36:** Discusses qualitative and quantitative concepts the actuary may wish to consider while coming to a professional judgment on materiality in the context of ASOP No. 36. Although certain quantitative measures can be suggested for consideration in certain circumstances, no formulaic approach to a quantitative materiality standard can be developed.

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Several caveats are in order at this point:

- **This note is intended only as an aid and does not supercede [sic] the actuary's professional judgment or the language of ASOP No. 36. Although the note has been prepared by knowledgeable members of VFIC, it has not received the professional review process required for establishment of actuarial standards. Accordingly, the note is not an authoritative document for actuaries and is not binding on any actuary. VFIC recommends that this note be read in conjunction with ASOP No. 36.**
- This note discusses concepts of materiality relevant to the SAOs that are the subject of ASOP No. 36. This note does not focus on considerations of materiality that may be required for other purposes, such as GAAP or Statutory financial statements. Although some of the general concepts of materiality that are discussed here are relevant in other contexts, key to the concept of materiality is consideration of the intended purpose of the analysis. Discussion of the intended uses of financial statements is beyond the scope of this document.
- ASOP No. 36 applies to any written SAO on loss and loss expense reserves. Many SAOs are prepared to be filed for regulatory purposes with an insurer's statutory annual financial statements. If the actuary is preparing an SAO for some other purpose, e.g., valuation of a company or of a book of business, then the actuary's materiality standards may differ from those relevant to the statutory SAO.

**2000 Valuation, Finance, and Investments Committee**

**Casualty Actuarial Society**

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## Materiality and ASOP No. 36

### **ASOP No. 36 applies to actuaries issuing written statements of actuarial opinion regarding property/casualty loss and loss adjustment expense reserves in the following situations**

- the opinion is provided to comply with requirements of law or regulation for a Statement of Actuarial Opinion; or
- the opinion is represented by the actuary as a Statement of Actuarial Opinion.

Further, if the actuary's statement includes opinions regarding amounts for items other than loss and loss adjustment expense reserves, ASOP No. 36 applies only to the portion of the Statement of Actuarial Opinion that relates to loss and loss adjustment expense reserves.

Whenever the actuary determines that a material condition exists, the actuary is required to make some response to the condition. The following lists sections of ASOP No. 36 that use the word "material." For convenience, the discussion below quotes some of the context showing how the term **material** (with added highlighting) is used in the section.

**Again, please note that VFIC has not reproduced ASOP No. 36 in this note. Actuaries should read that document in conjunction with this one.**

**Sections 3.3.2 d:** "The actuary is not required to issue a qualified opinion if the actuary reasonably believes that the item or items in question are not likely to be **material**."

**Section 3.3.3:** "When the actuary reasonably believes that there are significant risks and uncertainties that could result in **material** adverse deviation, the actuary should also include an explanatory paragraph in the Statement of Actuarial Opinion." This statement is further clarified. "The actuary is not required to include in the explanatory paragraph general, broad statements about risks and uncertainties due to economic changes, judicial decisions, regulatory actions, political or social forces, etc., nor is the actuary required to include an exhaustive list of all potential sources of risks and uncertainties."

**Section 3.4:** "... the actuary should consider the purposes and intended uses for which the actuary prepared the Statement of Actuarial Opinion. The actuary should evaluate **materiality** based on professional judgment, **materiality** guidelines or standards applicable to the Statement of Actuarial Opinion and the actuary's intended purpose for the Statement of Actuarial Opinion."

**Section 3.5:** "In addition to the reserve methods used, the actuary should consider the relevant past, present, or reasonably foreseeable future conditions that are likely to have a **material** effect on the results of the actuary's reserve analysis or on the risk and uncertainties arising from such conditions."

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Specific considerations listed in Section 3.5 are the following:

- Coverage Provisions - consider coverage changes, coverage disputes, or coverage litigation.
- Changing Conditions - consider changes in conditions particularly with regard to claims, losses, or exposures that are new or unusual.
- External Conditions - consider forces in the environment that are likely to have a *material* effect on the results of the actuary's reserve analysis. However, the actuary is not required to have detailed knowledge of all the economic changes, regulatory changes, judicial decisions, political or social forces, etc., that may affect the settlement values.
- Data - consider whether there are significant data problems or issues.
- Assumptions - consider the sensitivity of the reserve estimates to reasonable, alternative assumptions. When the use of reasonable, alternative assumptions would have a *material* effect the actuary should consider the implications regarding the risks and uncertainties associated with such an effect.
- Changes in Assumptions, Procedures or Methods - consider whether the change is likely to have a *material* effect on the results. The use of assumptions, procedures or methods for new reserve segments that differ from those used previously is not a change in assumptions, procedures, or methods. Similarly, when the determination of reserves is based on the periodic updating of experience data, factor, or weights, such periodic updating is not a change in assumptions, procedures or methods.

**Section 3.7.1 Collectibility:** "If the amount of ceded reinsurance reserves is *material*, the actuary should consider the collectibility of ceded reinsurance."

**Section 3.7.4 Risk Transfer Requirements:** "... the actuary should ascertain whether an adjustment to the reserves to meet such requirements is likely to have a *material* effect on the actuary's reserve analysis or on the risk and uncertainties associated with the reserves."

### **Section 4.5 Changes in Opining Actuary's Assumptions, Procedures, or Methods:**

"If a change occurs in the opining actuary's assumptions, procedures, or methods from those previously employed in providing an opinion on the entity's reserves, and if the actuary believes that the change is likely to have a *material* effect on the results of the actuary's reserve analysis, then the actuary should disclose the nature of the change. If the actuary can not make a judgment as to whether the change is likely to have a *material* effect on the results of the actuary's reserve analysis, the actuary should disclose that there has been a change in actuarial assumptions, procedures, or methods, the effect of which is unknown. No disclosure is required unless the actuary believes that the changes are likely to have a *material* effect on the results of the actuary's reserve analysis."

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Further, the Statement of Opinion should include the following disclosure(s):

**Section 4.6.a.:** “If there have been changes in accounting or processing procedures that significantly affect the consistency of the data used in the reserve analysis and that the actuary believes are likely to have a *material* effect on the results of the actuary’s reserve analysis, then the actuary should disclose the nature of such changes in accounting or processing procedures.”

**Section 4.6.c.:** “If the scope of the opinion includes consideration of regulatory or accounting requirements regarding risk transfer in reinsurance contracts and if an adjustment to the reserves to satisfy such requirements is likely to have a *material* effect on the results of the actuary’s reserve analysis, then the actuary should disclose the impact of the risk transfer requirements.”

**Section 4.6.g.:** “If the actuary reasonably believes that there are significant risks and uncertainties that could result in *material* adverse deviation, an explanatory paragraph (as described in section 3.3.3) should be included.”

**Section 4.6.h.:** “If the Statement of Actuarial Opinion relies on present values and if the actuary believes that such reliance is likely to have a *material* effect on the results of the actuary’s reserve analysis, the actuary should disclose that present values were used in forming the opinion....”

**Section 4.6.i.:** “If the Statement of Actuarial Opinion relies on risk margins and if the actuary believes that such reliance is likely to have a *material* effect on the results of the actuary’s reserve analysis, then....”

**Nota bene:** The use of *materially* in the following excerpt from ASOP No. 36 differs from those discussed above as it refers to the actuary’s procedures rather than to the results of the actuary’s analysis.

**Section 4.8.:** The “actuary must be prepared to justify the use of any procedures that depart *materially* from those set forth in this standard and must include, in any actuarial communication disclosing the results of the procedures...”

### Materiality in Accounting Contexts

**As of this writing, there is no ASOP specifically addressing materiality. Therefore, the primary guidance to the opining actuary is the language in ASOP No. 36. Secondly, the opining actuary may consider other documents (including this one) originating both inside and outside the actuarial profession. The NAIC in the preamble to its new Accounting Practices and Procedures Manual (Codification) and the SEC in its Staff Accounting Bulletin (SAB) No. 99 have addressed materiality. These documents discuss materiality from an accounting viewpoint. While neither document can be taken as an ASOP, the language itself may provide some understanding as to what constitutes materiality for certain parties interested in the opining actuary’s work (e.g., regulators and public auditors).**

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**A. NAIC *Accounting Practices and Procedures Manual***

The Codification defines a material omission or misstatement of an item in a statutory financial statement as having a magnitude such that it is probable that the judgment of a reasonable person relying upon the statutory financial statement would be changed or influenced by the inclusion or correction of the item.

In narrowing the definition, the following considerations are discussed:

- Some items are more important than others and require closer scrutiny. These include items which may put the insurer in danger of breach of covenant or regulatory requirement (such as a risk-based capital trigger), turn a loss into a profit, reverse a downward earning trend, or represent an unusual event.
- The relative size of the judgment item is usually more important than the absolute size. An example for this is a reserve amount that would significantly impact the earnings of a small company but barely impact the earnings of a large company.

The amount of the deviation of an item that is considered immaterial may increase if the attainable degree of precision decreases.

**B. SEC Staff Accounting Bulletin No. 99**

SAB No. 99 uses a similar definition of materiality and has many of the same considerations as does Codification, but it applies to financial statements filed with the SEC.

Of primary importance is that an item that is small in absolute magnitude may be important if its inclusion or modification would change someone's conclusion about the basic financial condition of the company. Numerous examples given in the document include, but are not limited to, masking a change in earnings or other trends, changing a loss into a gain or vice versa, hiding a failure to meet analysts' expectations, and affecting a portion of the business identified as having a key operational role.

But SAB No. 99 notes additional concerns beyond those it has in common with Codification. One issue is that the common practice of using quantitative thresholds as rules of thumb for materiality has no basis in law or accounting literature. Another is that the materiality of items should be considered both separately and in total. An example given considers materiality issues affecting revenues and expenses even though the difference in net income may net out to be small. Similarly, an item may be immaterial in the context of the current year financial statements only to cumulate with other items in the future to yield material differences.

Following are summarized concepts from SAB No. 99 concerning whether a particular set of circumstances is material.

- There should not be exclusive reliance on a percentage or numerical threshold to determine something is material or not.

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- The use of a percentage or numerical threshold may provide the basis for a preliminary assumption regarding materiality.
- A matter is material if there is a substantial likelihood that a reasonable person would consider it important.
- Both “quantitative” and “qualitative” factors should be considered in assessing an item’s materiality. Experienced human judgment is necessary and appropriate.

Following are qualitative considerations excerpted from SAB No. 99. Note that these items are not necessarily the appropriate items for considering materiality with regard to an SAO submitted to fulfill regulatory requirements. To quote:

“Among the considerations that may well render material a quantitatively small misstatement of a financial statement item are -

- whether the misstatement arises from an item capable of precise measurement or
- whether it arises from an estimate and, if so, the degree of imprecision inherent in the estimate
- whether the misstatement masks a change in earnings or other trends
- whether the misstatement hides a failure to meet analysts’ consensus expectations for the enterprise
- whether the misstatement changes a loss into income or vice versa
- whether the misstatement concerns a segment or other portion of the registrant’s business that has been identified as playing a significant role in the registrant’s operations or profitability
- whether the misstatement affects the registrant’s compliance with regulatory requirements
- whether the misstatement affects the registrant’s compliance with loan covenants or other contractual requirements
- whether the misstatement has the effect of increasing management’s compensation-for example, by satisfying requirements for the award of bonuses or other forms of incentive compensation
- whether the misstatement involves concealment of an unlawful transaction.”

Further, SAB No. 99 concludes that each misstatement should be considered both separately and in the aggregate.

### **Materiality, Statements of Actuarial Opinion, and ASOP No. 36**

VFIC intends that the prior section's review of materiality in an accounting context be regarded as suggestive of issues an actuary may consider in evaluating materiality in the context of ASOP No. 36. One common element between financial reporting and the SAO is that judgments regarding materiality involve both qualitative and quantitative considerations. As noted in Section 3.4 of ASOP No. 36:

“The actuary should evaluate materiality based on professional judgment, materiality guidelines or standards applicable to the Statement of Actuarial Opinion and the actuary's intended purpose for the Statement of Actuarial Opinion.”

Requiring the use of professional judgment and placing importance on intended purpose both emphasize the role of qualitative considerations in evaluating materiality.

Actuaries will naturally also focus on quantitative considerations related to judgments on materiality. No formula can be developed that will substitute for professional judgment by providing a materiality level for each situation. What can be done is to highlight some of the numerical considerations that may be relevant to the determination of materiality in some situations.

#### **A. SAOs Filed with Statutory Annual Statements**

Many SAOs are prepared to satisfy the regulatory requirement that such a statement be filed along with a company's Annual Statement. In that case, a key concern of the management and regulatory audiences for the SAO is company solvency. At least two qualitative issues suggest themselves for consideration in this context:

- Would the item under consideration affect the opining actuary's judgment as to whether the loss and loss expense reserves make a reasonable provision for the liabilities of the entity being opined on?
- Would the item under consideration affect the opinion reader's judgment concerning the impact of the loss and loss expense reserves on the solvency of the entity being opined on, even if the loss and loss expense reserves do make a reasonable provision for the liabilities of the entity being opined upon?

Following are possible quantitative measures that the actuary could consider in the initial phase of determining whether a particular item is material in the context of a SAO prepared for filing with regulators:

- Absolute magnitude of item that represents a correction or a different result if reviewing the work of others.
- Absolute magnitude of item for which data are not available or are incomplete.

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- Ratio of item to reserves or statutory surplus.
- Impact of item on IRIS ratios.
- Impact of item on risk-based capital results.

Likelihood or size of potential variation of ultimate actual result from current expectations.

**SAOs Prepared for Other Purposes**

If the SAO is prepared for a purpose other than that of reporting to regulators, other measures may be appropriate. As a qualitative consideration, the actuary may wish to consider the following issue:

- Would the item under consideration affect the opinion reader's judgment of the impact of loss and loss expense reserves relative to the purpose for which the SAO was obtained?

Here are some other quantitative measures that may be relevant in these contexts:

- Ratio of item to net income or net worth.
- Impact of item on earnings per share.

Evaluation of these quantitative measures to determine a materiality standard must be considered in conjunction with the purpose or intended use of the opinion, the specific circumstances of the entity being opined upon, and the actuary's professional judgment. Variations in a company's circumstances or in the purpose for which the opinion is sought can cause variations in materiality standards even for analyses of otherwise equivalent liabilities.

## Appendix 8

### Unearned Premium for Long Duration Contracts

Unearned premium reserves related to direct and assumed contracts with contract terms greater than 13 months and for which the insurer cannot cancel or increase the premium during their lives are covered by the Section 4 and Exhibit A: SCOPE (Items 7 and 8) requirements. The following specific contract types are excluded: financial guaranty, mortgage guaranty, and surety. While the primary focus of SCOPE Items 7 and 8 is extended warranty contracts, there are some companies writing other contracts with durations greater than 13 months with fixed premiums that the insurer cannot cancel, such as residual value contracts or directors' and officers' liability insurance. These may fall within the SCOPE of this section of the Instructions.

In 1995, the NAIC implemented an accounting rule establishing a methodology for determining a minimum level of unearned premium reserves for single or fixed premium policies with coverage periods of 13 months or greater. The accounting rule, revised in 1997, is found in the *NAIC Accounting Practices and Procedures Manual* and is reprinted in the Academy's *Property/Casualty Loss Reserve Law Manual*.

The rule applies to any reporting date prior to the expiration of the contracts. The rule for calculating the unearned premium reserve is composed of three tests to be applied individually by policy year for the three most recent policy years and in the aggregate for older policy years.

In assessing the various forms of disclosure and commentary, the actuary may wish to recognize any relevant amounts recorded as premium deficiency reserve.

#### OPINION LANGUAGE:

For Statements of Actuarial Opinion that cover the contracts described in this section, the actuary may choose to edit language throughout the opinion to keep it consistent with the fact that loss, loss adjustment, and unearned premium reserves are included. Some of the places in an opinion where an actuary typically uses the phrase "loss and loss adjustment expense" to refer to what is covered in the opinion are in the IDENTIFICATION paragraph, the SCOPE paragraph, the OPINION paragraph, the description of reconciliation issues, and the RELEVANT COMMENTS section. The actuary may choose to refer throughout the opinion to the unearned premium reserves by some description such as "the unearned premium reserves related to single or fixed premium policies with coverage periods of 13 months or greater which are non-cancelable and not subject to premium increase (excluding financial guaranty contracts, mortgage guaranty contracts, and surety contracts)" or may define it once along with an abbreviation such as "long duration unearned premium reserves."

The Section 4 and Exhibit A: SCOPE (Items 7 and 8) Instructions request disclosure of the unearned premium reserve on which the opinion is made. The following entries are to be included on Exhibit A: SCOPE:

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Premium Reserves:

- (7) *Reserve for Direct and Assumed Unearned Premium for Long Duration Contracts (subset of the Underwriting and Investment Exhibit Recapitulation of All Premiums, Total Reserve for Unearned Premiums)*
- (8) *Reserve for Net Unearned Premium for Long Duration Contracts (subset of the Liabilities, Surplus and Other Funds page, Unearned Premiums line)*
- (9) *Other Premium Reserve items on which the Appointed Actuary is expressing an opinion*

The following is illustrative language included in the NAIC Instructions for item (D) of the OPINION section of the Opinion:

- (D) *Make a reasonable provision for the unearned premium reserves for long duration contracts of the company under the terms of its contracts and agreements.*

Note that the NAIC Instructions require that, if there is any aggregation or combination of items in Exhibit A, the opinion language is to clearly identify the combined items.

The following items are generally considered in calculating the needed unearned premium reserves and applying the three stipulated tests for evaluating the adequacy of the unearned premium reserve for long duration contracts:

- a) *A provision for net investment income in the projected future losses and expenses under unexpired policies: \$\_\_\_\_\_*
- b) *A reduction in projected losses and expenses for:*
  - i) *subrogation and salvage: \$\_\_\_\_\_*
  - ii) *reinsurance: \$\_\_\_\_\_*
  - iii) *credits for deductibles and self-insured retentions: \$\_\_\_\_\_*
  - iv) *other statutory approved credits: \$\_\_\_\_\_*

The NAIC Instructions do not require disclosure of these amounts in the opinion. Descriptions of the review procedures performed, including application of the three tests and the associated assumptions as appropriate, are included in the Actuarial Report supporting the opinion.

**ILLUSTRATIVE WORDING:**

The company for which the opinion is being written may be in any of these three situations:

1. The company writes no long duration contracts,
2. The unearned premium reserve for long duration contracts is immaterial in relation to the aggregate of the loss, loss-adjustment expense, and long duration unearned premium reserves,

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3. The long duration unearned premium reserve is material in relation to the aggregate of the loss, loss-adjustment expense, and long duration unearned premium reserves.

**Situation 1** The company writes no long-duration contracts.

When the company writes no long duration contracts, the opining actuary may choose to use the opinion format that makes no allusion to the long duration unearned premium reserves in the SCOPE or OPINION sections. A brief disclosure in the RELEVANT COMMENTS Section of the opinion may be worded along the following lines:

*The company writes no policies or contracts related to single or fixed premium policies with coverage periods of 13 months or greater that are non-cancelable and not subject to premium increase (excluding financial guaranty contracts, mortgage guaranty contracts, and surety contracts).*

**Situation 2** The unearned premium reserve for long duration contracts is immaterial in relation to the aggregate of the loss, loss-adjustment expense, and long-duration unearned premium reserves.

When the company writes an amount of long duration contracts that develop an unearned premium reserve that is immaterial when combined with the loss and loss adjustment expense reserves, the opining actuary may make all of the disclosures described for the SCOPE and OPINION paragraphs. A brief disclosure in the RELEVANT COMMENTS section of the opinion may be worded along the following lines:

*Total net unearned premium for the company as recorded on the Liabilities, Surplus and Other Funds page, Unearned premiums line of the Annual Statement is \$\_\_\_\_\_. The unearned premium for long duration contracts, to which this opinion applies, is \_\_\_\_\_, representing \_\_\_percent of the total net unearned premium for the company. This component of the unearned premium is not material to the company.*

**Situation 3** The unearned premium reserve for long duration contracts is material in relation to the aggregate of the loss, loss-adjustment expense, and long-duration unearned premium reserves.

When the long-duration contract unearned premium reserve is material, the actuary may choose to apply language similar to the language described in the portion of this section labeled Opinion Language.

## Appendix 9a



### REGULATORY GUIDANCE On Property and Casualty Statutory Statements of Actuarial Opinion For the Year 2010

Prepared by the NAIC's  
Casualty Actuarial and Statistical (C) Task Force

#### Introduction

The Casualty Actuarial and Statistical (C) Task Force (CASTF) of the NAIC believes that the Statement of Actuarial Opinion (Opinion) is a valuable tool in serving the regulatory mission of protecting consumers. This Regulatory Guidance document supplements the NAIC's *Property and Casualty Annual Statement Instructions (Instructions)* in an effort to provide clarity and timely guidance to companies and Appointed Actuaries regarding regulatory expectations with respect to the Opinion.

An Appointed Actuary has a responsibility to know and understand both the *Instructions* and the expectations of regulators. One expectation of regulators clearly presented in the *Instructions* is that the Opinion and the supporting report and work papers should be consistent with appropriate Actuarial Standards of Practice (ASOP), including *but not limited to* ASOPs Nos. 9, 23, 36 and 43. While the Actuarial Standards Board may have been considering a repeal of ASOP No. 9, that action has been deferred. Many regulators oppose this repeal, viewing it as a clear reduction in the standards expected in an actuarial work product. Regardless of any action by the Actuarial Standards Board, regulators expect that all Opinions and the supporting Actuarial Reports continue to meet the standard of ASOP No. 9.

The CASTF consciously avoids illustrative language in the *Instructions* and encourages all actuaries to use whatever language they feel is appropriate to clearly convey their opinion *and* thought processes in reaching conclusions on a company with reference to specific characteristics of that company in both the Opinion and the supporting report.

#### Paragraph 1: Appointment, Definitions, Exemptions, and Special Requirements for Pooled Companies

Paragraph 1 is directed to company management and changed slightly in 2009 to clarify the interests of regulators when an initial actuarial appointment or change in Appointed Actuary is made. The CASTF expects that an actuary considering a new assignment is aware of the requirement and will request similar information from the company and the former Appointed Actuary in order to make an informed decision about accepting the assignment.

Both company management and a potential Appointed Actuary should be mindful of the following:

- **Timely feedback** — The CASTF encourages management to seek feedback from a “qualified actuary” *prior to* management's decision on establishing carried reserves. This allows management to make an informed decision with the benefit of actuarial analysis. It also helps to avoid a difficult situation in which management is committed to a decision that results in pressure on the actuary to “stretch” the range of reasonable reserve estimates.
- **Reporting to the Board or Audit Committee** — The actuary is required to report to the Board. This may be done in a form of the actuary's choosing. The CASTF strongly encourages the Appointed Actuary to present his or her analysis in person so that the risks and uncertainties that underlie the exposures and the significance of the actuary's findings can be adequately conveyed and discussed. As the actuarial profession makes advances in reserve methodology, such as stochastic simulation, a single deterministic indication would not be appropriate for many companies. While management is limited to single values on lines 1 and 3 of the Liability Page, the Board should be made aware of the actuary's opinion regarding the

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risk of material adverse deviation, the sources of that risk, and what amount of adverse deviation the actuary judges to be material.

Paragraphs 1A, 1B and 1C are unchanged for year-end 2010, but we include the following for your consideration.

### **Paragraph 1C: Special Requirements for Pooled Companies**

Paragraph 1C applies only to those situations where there is an intercompany pooling agreement in which the lead company retains 100% of the pooled reserves and the other members of the pool retain 0%. In this situation, the Schedule P of the 0% companies is blank, and rendering an Opinion on non-existent values is virtually useless to the regulator. For these situations only, the actuary is directed to prepare an Opinion on the Pool, which is to be filed with the Annual Statement of each of the pooled companies.

Exhibits A and B should reflect values specific to the individual company. Additionally, the actuary should prepare Exhibits A and B of the Pool to be filed as an addendum to the Opinions of the 0% companies. This will allow for proper data submission for each company in the Pool while accommodating the greatest distribution of the relevant values for the Pool. The *Instructions* include specific answers for the Exhibit B questions regarding materiality and the risk of material adverse deviation. Note the distinction between pooling with a 100% lead company with no retrocession and ceding 100% via a quota share agreement. These affiliate agreements must be approved by the regulator as either an intercompany pooling arrangement or a quota-share reinsurance agreement. The proper financial reporting is dependent on the approved filings, regardless of how company management regards their operating platform.

### **Paragraph 2: Structure of the Opinion**

Paragraph 2 is unchanged for 2010. It succinctly presents the four primary sections of the Opinion.

### **Paragraph 3: Identification**

Paragraph 3 is unchanged for 2010.

### **Paragraph 4: Scope**

Paragraph 4 is unchanged for 2010. Editorial changes relate to items in the exhibits. Exhibit A provides a clear picture of what items are to be opined on by the actuary. Guidance for Exhibit B disclosure items is discussed in Paragraph 6.

The CASTF calls attention to two continuing items of interest to regulators that pertain to the Scope of the Opinion:

1. **Exposure** — An Opinion on the reasonability of the carried reserves should reflect consideration and evaluation of more than just loss history. ASOP No. 36 §3.5.2 calls for the actuary to give attention to “exposures that are new or unusual and that are likely to be insufficiently reflected in the experience data or in the assumptions used to estimate loss and loss adjustment expense reserves.” The CAS Statement of Principles on Loss and Loss Adjustment Expense Reserves and other actuarial literature address the relevance of exposure to the reserve actuary’s work. The CASTF expects the actuary to probe and understand the exposure associated with the company for which the Opinion is issued. Areas of particular interest to regulators include:
  - Coverage for Service Contracts: Due to wide variation in state laws, this type of product may or may not be regulated or treated as insurance. Insurance may only come into play as excess coverage for contractual liability. The insurer and the Appointed Actuary often have no underlying data on loss experience absorbed by the policyholder. When losses break through the retention, they can be catastrophic for the insurer, particularly a specialty writer or a risk retention group with concentration in this exposure.

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- D&O and XS Coverages: For any coverage with extended emergence patterns, regulators expect that the actuary's analysis will demonstrate attention to factors that influence the underlying exposure and potential for claims subject to the coverage provided.
- Economic Conditions: A number of Opinions identify various economic conditions as risk factors. With the current strains on the economy—and housing markets in particular—regulators expect the Appointed Actuary of a company that faces such risks to attempt to quantify those risks in the analysis. Regulators find that mere disclaimers are insufficient. Actuaries should consider the potential for premium deficiencies, particularly in long-duration contracts such as mortgage and/or financial guaranty products. The actuary may include the Premium Deficiency Reserve in Exhibit A and comment accordingly within the Opinion. The CASTF advises actuaries to contact the regulator of domicile for further guidance on expected disclosure.

The understanding can be disclosed in the Opinion with Relevant Comment regarding what the actuary believes to be the financial condition of the obligor(s) for service contracts, the coverages subject to increased activity within the policyholder's retention, and the emerging risk factors. These are examples of what regulators expect the actuary to address as "specific characteristics of the company."

2. **Prepaid loss adjustment expenses** — According to Interpretation 02-21 in Appendix B of the NAIC's *Accounting Practices and Procedures Manual*, the liability for unpaid loss adjustment expenses should be established regardless of any payments made to third-party administrators (TPA), management companies, or other entities. The values should be recorded as loss adjustment expense reserves throughout the Annual Statement and not recorded as a write-in. Appointed Actuaries should be aware of any such arrangements, incorporate this consideration into their analysis, and include appropriate disclosures in the Opinion and the Actuarial Report.

The Scope paragraph also requires disclosure of the individual upon whom the Appointed Actuary relied for preparation of the data. In some cases, the Appointed Actuary, if a senior officer of the company, may be the individual who holds this responsibility. In these cases, it is acceptable for the actuary to identify himself/herself in this section.

The CASTF recognizes that the Appointed Actuary may receive data from a TPA, accounting firm or similar organization that provides service to the regulated entity. If such a relationship exists, it is informative to identify it in this section. However, any third party or firm is not the regulated entity.

Regulators expect the Appointed Actuary's disclosure to always include the senior official(s) of the regulated entity responsible for integrity of the data.

### **Paragraph 5: Opinion**

Paragraph 5 is unchanged for 2010. The CASTF expects points C and D of the Opinion paragraph to be the full and complete expression of the Appointed Actuary's conclusion on the type of opinion rendered. Regulators will presume that the conclusion will apply to both the net and the direct and assumed reserves. If the actuary reaches different conclusions, the actuary should use whatever language is appropriate to clearly convey a complete opinion. If faced with this situation, the actuary should prepare exhibit entries to reflect the opinion on the Net reserves. The CASTF encourages the actuary to include narrative comments to describe any differences with respect to the Direct and Assumed opinion.

### **Paragraph 6: Relevant Comments**

Paragraph 6 is unchanged for 2010. The CASTF considers the relevant comments of the Appointed Actuary to be the most valuable information in the Opinion. Relevant comments provide the context for the regulator to interpret the Opinion and to understand the actuary's reasoning and judgment.

### **Risk of Material Adverse Deviation (RMAD)**

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The *Instructions* require the Appointed Actuary to:

- 1) Identify the materiality standard.
- 2) Identify the basis, or rationale, for establishing this standard.
- 3) **Explicitly** state whether he or she believes that there are significant risks and uncertainties that could result in MAD.
- 4) If such risk exists, the actuary should describe the major factors or particular conditions underlying the risks and uncertainties that the actuary reasonably believes could result in MAD. (Note that the actuary is encouraged to comment on the risks and other factors considered even when no RMAD is judged to exist.)

The actuary's comments regarding RMAD should be consistent with the disclosure in Exhibit B, item 6. If the actuary concludes that RMAD is present, the CASTF expects the supporting Actuarial Report to clearly address each of the risk factors identified with descriptive and quantitative information on alternate outcomes that would drive adverse development beyond the selected materiality threshold. This information will be useful to both regulators and the Board in understanding the actuary's comments on this issue.

The Appointed Actuary is reminded that each statutory entity, except for those following paragraph 1C of the *Instructions*, is required to have a separate Opinion and, therefore, its own materiality standard. Where there are no unusual circumstances to consider, it may be acceptable to determine a standard for the entire pool and assign each member their proportionate share of the total. It is **not** appropriate to use the entire amount of the materiality threshold for the pool as the standard for each individual pool member. For those companies following paragraph 1C of the *Instructions*, the non-lead companies' materiality standard should be \$0.

The *Instructions* state that the RMAD explanatory paragraph should not include general broad statements about unspecified risks and uncertainties that could apply to nearly all companies in any situation. When considering the inclusion of risk disclosures in the Opinion, the actuary should take into account the likelihood of the event occurring. Risks and uncertainties may include items such as the uncertainty in the tail factors or the need to use industry benchmarks. *Specified* contemporary risks—such as subprime mortgage exposure or declining real estate values—may be relevant to the extent that they can be significant and directly related to adverse deviation.

When concluding whether RMAD exists, the Appointed Actuary is advised to consider the materiality standard in conjunction with the range and the carried reserves. For example, if the materiality standard when added to the carried reserves exceeds the high end of the range, it may be logical to conclude that RMAD does not exist. Likewise, if the materiality standard when added to the carried reserves is within the high end of the range, RMAD likely exists. In either case, the actuary should support the conclusion.

### IRIS Ratios

The CASTF considers it insufficient to attribute an unusual reserve development ratio to reserve strengthening alone and expects relevant comment on an unusual ratio to provide reasonable insight as to the company-specific factors that caused the result. Detailed documentation should be included in the Actuarial Report to support comments in the Opinion.

### Paragraph 7: The Actuarial Report

Paragraph 7 is unchanged for 2010. The CASTF believes that the *Instructions* and ASOP No. 9 provide the best guidance to actuaries regarding the Actuarial Report and supporting documentation.

Exhibits alone rarely convey professional conclusions and recommendations or the significance of the actuary's opinion or findings. A narrative section should provide clearly worded information so that readers are able to appreciate the significance of the actuary's findings and conclusions, the uncertainty in the estimates, and any differences between the actuary's estimates and the carried reserves. Sources of assumptions should be clearly supported. The CASTF has identified three notable weaknesses in the documentation of many actuarial reports.

1. **Expected Loss Ratios.** Methodologies that rely on an expected loss ratio may well be the most suitable in a given situation. When using these methodologies, particularly in a long-tailed line with high premium

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volume, the CASTF expects the documentation to include recognition of pricing and underwriting information in the recent years, loss costs, and loss inflation. Historical loss ratio indications have little value if rate actions, credit adjustments or program revisions have affected premium adequacy or inadequacy.

2. **Actuarial Judgment.** The use of this phrase in a Report, in either the narrative comments or in exhibits, is not considered to be proper explanation without sufficient descriptive rationale to provide meaningful context for this term.
3. **Schedule P Reconciliation.** The CASTF believes that a summary reconciliation (all years and all lines combined) is an insufficient demonstration of data integrity. A reconciliation should include enough detail to reflect the line of business structure used in the reserve analysis, the accident years of loss activity, and the methods used by the actuary. When premiums are relied upon in the analysis, premiums should be a part of the reconciliation.

The CASTF recognizes that company line of business definitions may be more meaningful than Annual Statement line of business definitions. Such differences in data classification should be addressed and clearly documented within the Report. The required reconciliation should illustrate differences between the data used in the actuary's analysis and the amounts presented in Schedule P of the Annual Statement. The actuary should address the reasons for any significant differences in order to reduce questions regarding data integrity.

In addition, the CASTF supports the recommendation of the Casualty Actuarial Society's Task Force on Actuarial Credibility that the Actuarial Report contain an exhibit that summarizes changes in the Appointed Actuary's estimates from the prior analysis, with extended discussion of significant factors underlying the change. The Task Force made this recommendation to improve the transparency of disclosures in actuarial work.

The CASTF recognizes that the majority of analysis supporting an Opinion may be done with data received prior to year-end and "rolled forward" to 12/31/20xx. By reviewing the Report, the regulator should be able to clearly identify why the actuary made changes in the ultimate loss selections and how those changes were incorporated into the final estimates. A summary of final selections without supporting documentation is not sufficient.

The CASTF believes that regulators should be able to rely on the Report as an alternative to developing their own independent estimates. A well-prepared and documented Actuarial Report that is consistent with the spirit of ASOP No. 9 can provide a foundation for efficient reserve evaluation within a statutory examination. This provides benefits to the examination process and potential cost-savings to the company.

#### **Paragraph 8: Signature**

Paragraph 8 is unchanged for 2010. The CASTF requests that actuaries include a current e-mail address.

#### **Paragraph 9: Notice regarding Errors**

Paragraph 9 is unchanged for 2010.

#### **Exhibits A and B**

Exhibit B, Item 12 is changed for 2010. The 2010 Annual Statement Instructions modifies the parenthetical reference to Schedule P Interrogatories. This has the effect of requiring Exhibit B, Item 12 to include extended loss and expense reserves for all P&C lines of business, not just Medical Professional Liability.

The reference to "Data Capture Format" from the Annual Statement Instructions merely means electronic filing. This allows for mechanical queries on demographic information and financial data. Appointed Actuaries should refer to the *Instructions* and prepare exhibits to assist the company in accurately populating the electronic submission.

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Special Note on Exhibit B, Question 6: Some actuaries have commented to regulators that the wording of the question implies a probability conclusion. That is not the regulatory intention. The question intends to mirror the disclosure in the Relevant Comments regarding the Appointed Actuary's conclusion as to significant risks and uncertainties that could result in material adverse deviation. Actuaries should respond with this guidance in mind.

For those companies meeting the requirements of paragraph 1C of the *Instructions*, Exhibits A and B of the lead company should be attached as an addendum to the PDF file and/or hard copy being filed for the non-lead companies.

## Appendix 9b



### REGULATORY GUIDANCE On the Property and Casualty Actuarial Opinion Summary For the Year 2010

#### Prepared by the NAIC's Casualty Actuarial and Statistical (C) Task Force

The Casualty Actuarial and Statistical (C) Task Force (CASTF) of the NAIC believes that the Actuarial Opinion Summary (Summary) is a valuable tool in serving the regulatory mission of protecting consumers. This Regulatory Guidance document supplements the NAIC's *Property and Casualty Annual Statement Instructions (Instructions)* in an effort to provide clarity and timely guidance to Appointed Actuaries regarding regulatory expectations with respect to the Summary.

#### Form

The Summary is intended to be a **confidential** document separate from the Statement of Actuarial Opinion (Opinion). The CASTF advises the Appointed Actuary to provide the Summary to their company separately from their Opinion. The Summary should be clearly labeled and identified prominently as a confidential document. The CASTF advises that, in order to avoid confusion, the Appointed Actuary should **not** attach the related Opinion to the Summary.

Not all states have adopted the Property and Casualty Actuarial Opinion Model Law that requires the Summary to be filed. Nevertheless, the CASTF recommends that the Appointed Actuary prepare the Summary regardless of the domiciliary state's requirements, so that the Summary will be ready for submission should a foreign state—having the appropriate confidentiality safeguards—request it. Most states provide the Annual Statement contact person with a checklist that addresses filing requirements. The CASTF advises the Appointed Actuary to work with the company in determining the logistic requirements for each state.

The Summary is **not** submitted to the NAIC.

#### Substance

The *Instructions* for the Summary are unchanged for year-end 2010.

Paragraphs 1–4 and 7 of the *Instructions* are unchanged for 2010 and are self-explanatory. The entire substance of the Summary rests in Paragraph 5. The required information for Parts A–D of Paragraph 5 is highlighted by the straightforward examples provided in the Summary section of the American Academy of Actuary's Property/Casualty Practice Note, *Statements of Actuarial Opinion on P&C Loss Reserves*. The content of the Summary should reflect the analysis performed by the Appointed Actuary, because the Summary is a synopsis of the conclusions drawn in the Actuarial Report.

Regulators expect that point or range estimates reported in the Summary are clearly supported and documented in the Actuarial Report. Without clarity, the documentation fails to meet Actuarial Standards of Practice and the expectation that another actuary can evaluate the work. Part E of Paragraph 5 of the *Instructions* addresses persistent adverse development. The actuary is in a unique position to be able to comment on the nature of this development. This section requires the actuary to do so. Comments can reflect common questions that regulators have, such as:

- Is development concentrated in one or two exposure segments, or is it broad across all segments?
- How does development in the carried reserve compare to the change in the actuary's estimate?

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- Is development related to specific and identifiable situations that are unique to the company?
- Does the development or the reasons for development differ depending on the individual calendar or accident years?

Paragraph 6 was new for 2008. It is relevant ONLY in pooling situations as defined in paragraph 1C of the *Instructions* for the Opinion and provides more relevant information to the domiciliary regulator of the 0% companies.

## Appendix 10a

### 2010 STATEMENT OF ACTUARIAL OPINION INSTRUCTIONS

#### ACTUARIAL OPINION

1. There is to be included or attached to Page 1 of the Annual Statement, the statement of a Qualified Actuary, entitled "Statement of Actuarial Opinion," setting forth his or her opinion relating to reserves specified in the SCOPE paragraph. The Actuarial Opinion, both the narrative and required Exhibits, shall be in the format of and contain the information required by this Section of the *Annual Statement Instructions Property and Casualty*.

The Qualified Actuary must be appointed by the Board of Directors, or its equivalent, or by a committee of the Board, by December 31 of the calendar year for which the opinion is rendered. Upon initial appointment (or "retention"), the company shall notify the domiciliary commissioner within five business days of the appointment with the following information:

- a. Name and title (and, in the case of a consulting actuary, the name of the firm).
- b. Manner of appointment of the Appointed Actuary (e.g., who made the appointment and when).
- c. A statement that the person meets the requirements of a qualified actuary.

Once this notification is furnished, no further notice is required with respect to this person unless the actuary ceases to be appointed or retained or ceases to meet the requirements of a qualified actuary.

If an actuary who was the Appointed Actuary for the immediately preceding filed Actuarial Opinion is replaced by an action of the Board of Directors, the insurer shall within five (5) business days notify the Insurance Department of the state of domicile of this event. The insurer shall also furnish the domiciliary Commissioner with a separate letter within ten (10) business days of the above notification stating whether in the twenty four (24) months preceding such event there were any disagreements with the former Appointed Actuary regarding the content of the opinion on matters of the risk of material adverse deviation, required disclosures, scopes, procedure, or data quality. The disagreements required to be reported in response to this paragraph include both those resolved to the former actuary's satisfaction and those not resolved to the former actuary's satisfaction. The insurer shall also in writing request such former actuary to furnish a letter addressed to the insurer stating whether the actuary agrees with the statements contained in the insurer's letter and, if not, stating the reasons for which he does not agree; and the insurer shall furnish such responsive letter from the former actuary to the domiciliary Commissioner together with its own.

The Appointed Actuary must report to the Board of Directors or the Audit Committee each year on the items within the scope of the Actuarial Opinion. The Actuarial Opinion and the Actuarial Report must be made available to the Board of Directors. The minutes of the Board of Directors should indicate that the Appointed Actuary has presented such information to the Board of Directors or the Audit Committee and that the Actuarial Opinion and the Actuarial Report were made available. A separate Actuarial Opinion is required for each company filing an Annual Statement. When there is an affiliated company pooling arrangement, one Actuarial Report for the aggregate pool is sufficient, but there must be addendums to the Actuarial Report to cover non-pooled reserves for individual companies.

The Statement of Actuarial Opinion and the supporting Actuarial Report and Workpapers, should be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including but not limited to ASOPs 9, 23, and 36, as promulgated by the Actuarial Standards Board, and Statements of Principles adopted by the Casualty Actuarial Society.

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### 1A. Definitions

“Qualified Actuary” is a person who is either:

- (i) A member in good standing of the Casualty Actuarial Society, or
- (ii) A member in good standing of the American Academy of Actuaries who has been approved as qualified for signing casualty loss reserve opinions by the Casualty Practice Council of the American Academy of Actuaries.

“Insurer” means an insurer or reinsurer authorized to write property and/or casualty insurance under the laws of any state and who files on the Property and Casualty Blank.

“Actuarial Report” means a document or other presentation, prepared as a formal means of conveying the actuary’s professional conclusions and recommendations, of recording and communicating the methods and procedures, of assuring that the parties addressed are aware of the significance of the actuary’s opinion or findings and that documents the analysis underlying the opinion. The expected content of the report is further described in paragraph 7.

“Long Duration Contracts” refers to contracts, excluding financial guaranty contracts, mortgage guaranty contracts and surety contracts, that fulfill both of the following conditions: (1) the contract term is greater than or equal to thirteen months and (2) the insurer can neither cancel nor increase the premium during the contract term.

### 1B. Exemptions

An insurer who intends to file for one of the exemptions under this Section must submit a letter of intent to its domiciliary commissioner no later than December 1 of the calendar year for which the exemption is to be claimed. The commissioner may deny the exemption prior to December 31 of the same year if he or she deems the exemption inappropriate.

A copy of the approved exemption must be filed with the Annual Statement in all jurisdictions in which the company is authorized.

#### Exemption For Small Companies

An insurer that has less than \$1,000,000 total direct plus assumed written premiums during a calendar year, and less than \$1,000,000 total direct plus assumed loss and loss adjustment expense reserves at year-end, in lieu of the Actuarial Opinion required for the calendar year, may submit an affidavit under oath of an officer of the insurer that specifies the amounts of direct plus assumed written premiums and direct plus assumed loss and loss adjustment reserves.

#### Exemption for Insurers under Supervision or Conservatorship

Unless ordered by the domiciliary commissioner, an insurer that is under supervision or conservatorship pursuant to statutory provision is exempt from the filing requirements contained herein.

#### Exemption for Nature of Business

An insurer otherwise subject to the requirement and not eligible for an exemption as enumerated above may apply to its domiciliary commissioner for an exemption based on the nature of business written.

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### Financial Hardship Exemption

An insurer otherwise subject to this requirement and not eligible for an exemption as enumerated above may apply to the commissioner for a financial hardship exemption. Financial hardship is presumed to exist if the projected reasonable cost of the Actuarial Opinion would exceed the lesser of:

- (i) One percent of the insurer's capital and surplus reflected in the insurer's latest quarterly statement for the calendar year for that the exemption is sought; or
- (ii) Three percent of the insurer's direct plus assumed premiums written during the calendar year for which the exemption is sought as projected from the insurer's latest quarterly statements filed with its domiciliary commissioner.

### 1C. Special Requirements for Pooled Companies

The following paragraphs apply to companies that are members of an intercompany pooling arrangement whereby there is one lead company that has 100% of the pooled business and all other companies have a 0% share of the pool (no reported Schedule P data).

All companies in the pool shall submit a "pooled opinion" that includes a description of the pool, identification of the lead company, and a listing of all companies in the pool. The IRIS ratios, risk of material adverse deviation discussion, and other relevant comments shall relate to the pooled risks and to the surplus of the lead company.

Exhibits A and B for each company in the pool should represent the company's share of the pool and should reconcile to the financial statement for each company. For non-lead companies, the responses in Exhibit B to question 5 should be \$0 and to question 6 should be "not applicable." Also for the non-lead companies, Exhibits A and B of the lead company should be attached as an addendum to the PDF file and/or hard copy being filed (but would not be reported by the non-lead company in their data capture).

2. The Statement of Actuarial Opinion must consist of an IDENTIFICATION paragraph identifying the Appointed Actuary; a SCOPE paragraph identifying the subjects on which an opinion is to be expressed and describing the scope of the actuary's work; an OPINION paragraph expressing his or her opinion with respect to such subjects; and one or more additional RELEVANT COMMENTS paragraphs. These four Sections must be clearly designated.
3. The IDENTIFICATION paragraph should specifically indicate the Appointed Actuary's relationship to the company, qualifications for acting as appointed actuary, date of appointment, and specify that the appointment was made by the Board of Directors, or its equivalent, or by a committee of the Board.

A member of the American Academy of Actuaries qualifying under paragraph 1.A. (ii) must attach, each year, a copy of the approval letter from the Academy.

These Instructions require that a "qualified actuary" prepare the Opinion. Nevertheless, if a person who does not meet the definition of a "qualified actuary" has been approved by the insurance regulatory official of the domiciliary state, the company must attach, each year, a letter from that official stating that the individual meets the state's requirements for rendering the Opinion.

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4. The SCOPE paragraph should contain a sentence such as the following:

“I have examined the actuarial assumptions and methods used in determining reserves listed in Exhibit A, as shown in the Annual Statement of the Company as prepared for filing with state regulatory officials, as of December 31, 20\_\_.”

Exhibit A should list those items and amounts with respect to which the Appointed Actuary is expressing an opinion.

The Appointed Actuary should state that the items in the SCOPE, on which he or she is expressing an opinion, reflect the Loss Reserve Disclosure items (8 thru 13) in Exhibit B.

The SCOPE paragraph should include a paragraph such as the following regarding the data used by the Appointed Actuary in forming the opinion:

“In forming my opinion on the loss and loss adjustment expense reserves, I relied upon data prepared by \_\_\_\_\_ (name, affiliation and relation to Company). I evaluated that data for reasonableness and consistency. I also reconciled that data to Schedule P – Part 1 of the company’s current Annual Statement. In other respects, my examination included such review of the actuarial assumptions and methods used and such tests of the calculations as I considered necessary.”

5. The OPINION paragraph should include a sentence that at least covers the points listed in the following illustration:

“In my opinion, the amounts carried in Exhibit A on account of the items identified:

- A. Meet the requirements of the insurance laws of (state of domicile).
- B. Are computed in accordance with accepted actuarial standards and principles.
- C. Make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its contracts and agreements.”

If the Scope includes material Unearned Premium Reserves for Long Duration Contracts, the Opinion should cover the following illustration:

- D. “Make a reasonable provision for the unearned premium reserves for long duration contracts of the Company under the terms of its contracts and agreements.

If there is any aggregation or combination of items in Exhibit A, the opinion language should clearly identify the combined items.

Insurance laws and regulations shall at all times take precedence over the actuarial standards and principles.

If the actuary has relied on the Actuarial Opinion of another actuary (such as for pools and associations, for a subsidiary, or for special lines of business), the other actuary must be identified by name and affiliation within the OPINION paragraph.

A statement of actuarial opinion should be made in accordance with one of the following sections (a-e). The actuary must explicitly identify in Exhibit B which category applies.

- a. Determination of Reasonable Provision. When the stated reserve amount is within the actuary’s range of reasonable reserve estimates, the actuary should issue a statement of actuarial opinion that the stated reserve amount makes a reasonable provision for the liabilities associated with the specified reserves.

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- b. Determination of Deficient or Inadequate Provision. When the stated reserve amount is less than the minimum amount that the actuary believes is reasonable, the actuary should issue a statement of actuarial opinion that the stated reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves.
  - c. Determination of Redundant or Excessive Provision. When the stated reserve amount is greater than the maximum amount that the actuary believes is reasonable, the actuary should issue a statement of actuarial opinion that the stated reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves.
  - d. Qualified Opinion. When, in the actuary's opinion, the reserves for a certain item or items are in question because they cannot be reasonably estimated or the actuary is unable to render an opinion on those items, the actuary should issue a qualified statement of actuarial opinion. Such a qualified opinion should state whether the stated reserve amount makes a reasonable provision for the liabilities associated with the specified reserves, *except for* the item, or items, to which the qualification relates. The actuary is not required to issue a qualified opinion if the actuary reasonably believes that the item or items in question are not likely to be material.
  - e. No Opinion. The actuary's ability to give an opinion is dependent upon data, analyses, assumptions, and related information that are sufficient to support a conclusion. If the actuary cannot reach a conclusion due to deficiencies or limitations in the data, analyses, assumptions, or related information, then the actuary may issue a statement of no opinion. A statement of no opinion should include a description of the reasons why no opinion could be given.
6. The Appointed Actuary must provide RELEVANT COMMENT paragraphs to address the following topics of regulatory importance.

- a. Risk of Material Adverse Deviation

The Appointed Actuary must provide specific RELEVANT COMMENT paragraphs to address the risk of material adverse deviation. The actuary must identify the materiality standard and the basis for establishing this standard. The materiality standard must be disclosed in \$US in Exhibit B: Disclosures. The actuary should explicitly state whether or not he or she reasonably believes that there are significant risks and uncertainties that could result in material adverse deviation. If such risk exists, the actuary should include an explanatory paragraph to describe the major factors, combination of factors, or particular conditions underlying the risks and uncertainties that the actuary reasonably believes could result in material adverse deviation. The explanatory paragraph should not include general, broad statements about risks and uncertainties due to economic changes, judicial decisions, regulatory actions, political or social forces, etc., nor is the actuary required to include an exhaustive list of all potential sources of risks and uncertainties.

- b. Other Disclosures in Exhibit B

RELEVANT COMMENT paragraphs should describe the significance of each of the remaining Disclosure items in Exhibit B. The actuary should address the items individually and in combination when commenting on a material impact.

- c. Reinsurance

RELEVANT COMMENT paragraphs should address retroactive reinsurance, financial reinsurance and reinsurance collectibility. Before commenting on reinsurance collectibility, the actuary should solicit information from management on any actual collectibility problems, review ratings given to reinsurers by a recognized rating service, and examine Schedule F for the current year for indications of regulatory action or reinsurance recoverable on paid losses over 90 days past due. The comment should also reflect any other information the actuary has received from

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management or that is publicly available about the capability or willingness of reinsurers to pay claims. The actuary's comments do not imply an opinion on the financial condition of any reinsurer.

Retroactive reinsurance refers to agreements referenced in SSAP No. 62R, Property and Casualty Reinsurance, of the NAIC *Accounting Practices and Procedures Manual* (SSAP No. 62R).

Financial reinsurance refers to contracts referenced in SSAP No. 62R, of the NAIC *Accounting Practices and Procedures Manual* in which credit is not allowed for the ceding insurer because the arrangements do not include a transfer of both timing and underwriting risk that the reinsurer undertakes in fact to indemnify the ceding insurer against loss or liability by reason of the original insurance.

### d. IRIS Ratios

If the company reserves will create exceptional values using the NAIC IRIS Tests for One-Year Reserve Development to Surplus, Two-Year Reserve Development to Surplus and Estimated Current Reserve Deficiency to Surplus, the actuary must include RELEVANT COMMENT on the factors that led to the unusual value(s).

### e. Methods and Assumptions

If there has been any significant change in the actuarial assumptions and/or methods from those previously employed, that change should be described in a RELEVANT COMMENT paragraph.

7. The Actuarial Opinion must include assurance that an Actuarial Report and underlying actuarial workpapers supporting the actuarial opinion will be maintained at the company and available for regulatory examination for seven years. The Actuarial Report contains significant proprietary information. It is expected that the Report be held confidential and is not intended for public inspection. The report must be available by May 1 of the year following the year-end for which the opinion was rendered or within two weeks after a request from an individual state commissioner.

The Actuarial Report should be consistent with the documentation and disclosure requirements of ASOP #9. The Actuarial Report should contain both narrative and technical components. The narrative component should provide sufficient detail to clearly explain to company management, the regulator, or other authority the findings, recommendations and conclusions, as well as their significance. The technical component should provide sufficient documentation and disclosure for another actuary practicing in the same field to evaluate the work. This technical component must show the analysis from the basic data, e.g., loss triangles, to the conclusions.

The Report must also include:

- An exhibit which ties to the Annual Statement and compares the Actuary's conclusions to the carried amounts;
- Summary exhibit(s) of either the actuary's best estimate, range of reasonable estimates, or both, that led to the conclusion in the OPINION paragraph regarding the reasonableness of the provision for all unpaid loss and loss adjustment expense obligations;
- Documentation of the required reconciliation from the data used for analysis to the Annual Statement Schedule P;
- Extended comments on trends that indicate the presence or absence of risks and uncertainties that could result in material adverse deviation; and

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- Extended comments on factors that led to unusual IRIS ratios for One-Year Reserve Development to Surplus, Two-Year Reserve Development to Surplus, or Estimated Current Reserve Deficiency to Surplus, and how these factors were addressed in prior and current analyses.
8. The statement should conclude with the signature of the Appointed Actuary responsible for providing the Actuarial Opinion and the date when the opinion was rendered. The signature and date should appear in the following format:

---

Signature of actuary  
Printed name of actuary  
Address of actuary  
Telephone number of actuary  
Date opinion was rendered

9. The insurer required to furnish an Actuarial Opinion shall require its Appointed Actuary to notify its Board of Directors or its audit committee in writing within five (5) business days after any determination by the Appointed Actuary that the Opinion submitted to the domiciliary Commissioner was in error as a result of reliance on data or other information (other than assumptions) that, as of the balance sheet date, was factually incorrect. The Opinion shall be considered to be in error if the Opinion would have not been issued or would have been materially altered had the correct data or other information been used. The Opinion shall not be considered to be in error if it would have been materially altered or not issued solely because of data or information concerning events subsequent to the balance sheet date or because actual results differ from those projected.

Notification shall be required for any such determination made between the issuance of the Opinion and the balance sheet date that the next Opinion will be issued. The notification should include a summary of such findings and an amended Opinion.

An insurer who is notified pursuant to the preceding paragraphs shall forward a copy of the summary and the amended Opinion to the domiciliary Commissioner within five (5) business days of receipt of such and shall provide the Appointed Actuary making the notification with a copy of the summary and amended Opinion being furnished to the domiciliary Commissioner. If the Appointed Actuary fails to receive such copy within the five (5) business day period referred to in the previous sentence, the Appointed Actuary shall notify the domiciliary Commissioner within the next five (5) business days that the submitted Opinion should no longer be relied upon or such other notification recommended by the actuary's attorney.

If the Appointed Actuary learns that the data or other information relied upon was factually incorrect, but cannot immediately determine what, if any, changes are needed in the Actuarial Opinion, the actuary and the company should undertake as quickly as is reasonably practical those procedures necessary for the actuary to make the determination discussed above. If the insurer does not provide the necessary data corrections and other support (including financial support) within ten (10) business days, the actuary should proceed with the notification discussed above.

No Appointed Actuary shall be liable in any manner to any person for any statement made in connection with the above paragraphs if such statement is made in a good faith effort to comply with the above paragraphs.

10. Data in Exhibits A and B are to be filed in both print and data capture format.

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**Exhibit A: SCOPE**

**DATA TO BE FILED IN BOTH PRINT AND DATA CAPTURE FORMATS**

<u>Loss Reserves:</u>	<u>Amount</u>
1. Reserve for Unpaid Losses (Liabilities, Surplus and Other Funds page, Col 1, Line 1)	\$ _____
2. Reserve for Unpaid Loss Adjustment Expenses (Liabilities, Surplus and Other Funds page, Col 1, Line 3)	\$ _____
3. Reserve of Unpaid Losses – Direct and Assumed (Should equal Schedule P, Part 1, Summary, Totals from Cols. 13 and 15, Line 12 * 1000)	\$ _____
4. Reserve for Unpaid Loss Adjustment Expenses – Direct and Assumed (Should equal Schedule P, Part 1, Summary, Totals from Cols. 17, 19 and 21, Line 12 * 1000)	\$ _____
5. The Page 3 write-in item reserve, “Retroactive Reinsurance Reserve Assumed”	\$ _____
6. Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion (list separately)	\$ _____
 <u>Premium Reserves:</u>	
7. Reserve for Direct and Assumed Unearned Premiums for Long Duration Contracts	\$ _____
8. Reserve for Net Unearned Premiums for Long Duration Contracts	\$ _____
9. Other Premium Reserve items on which the Appointed Actuary is expressing an Opinion (list separately)	\$ _____

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**Exhibit B: DISCLOSURES**  
**DATA TO BE FILED IN BOTH PRINT AND DATA CAPTURE FORMATS**

NOTE: Exhibit B should be completed for Net dollar amounts included in the SCOPE. If an answer would be different for Direct and Assumed amounts, identify and discuss the difference within RELEVANT COMMENTS.

1. Name of the Appointed Actuary Last \_\_\_\_\_ First \_\_\_\_\_ Mid \_\_\_\_\_
2. The Appointed Actuary's Relationship to the Company.  
Enter E or C based upon the following:  
 E if an Employee  
 C if a Consultant \_\_\_\_\_
3. The Appointed Actuary is a Qualified Actuary based upon what qualification? Enter F, A, M, or O based upon the following:  
 F if a Fellow of the Casualty Actuarial Society (FCAS)  
 A if an Associate of the Casualty Actuarial Society (ACAS)  
 M if not a member of the Casualty Actuarial Society, but a Member of the American Academy of Actuaries (MAAA) approved by the Casualty Practice Council, as documented with the attached approval letter.  
 O for Other \_\_\_\_\_
4. Type of Opinion, as identified in the OPINION paragraph. Enter R, I, E, Q, or N based upon the following:  
 R if Reasonable  
 I if Inadequate or Deficient Provision  
 E if Excessive or Redundant Provision  
 Q if Qualified. Use Q when part of the OPINION is Qualified.  
 N if No Opinion \_\_\_\_\_
5. Materiality Standard expressed in US dollars (Used to Answer Question #6) \$ \_\_\_\_\_
6. Is there a Significant Risk of Material Adverse Deviation? Yes [ ] No [ ] Not Applicable [ ]
7. Statutory Surplus (Liabilities, Col 1, Line 3537) \$ \_\_\_\_\_
8. Anticipated net salvage and subrogation included as a reduction to loss reserves as reported in Schedule P (should equal Part 1 Summary, Col 23, Line 12 \* 1000) \$ \_\_\_\_\_
9. Discount included as a reduction to loss reserves and loss expense reserves as reported in Schedule P
  - 9.1 Nontabular Discount [Notes, Line 31B2332B23, (Amounts 1, 2, 3 & 4)], Electronic Filing Cols 7, 8, 9, & 10, \$ \_\_\_\_\_
  - 9.2 Tabular Discount [Notes, Line 31A2332A23, (Amounts 1 & 2)], Electronic Filing Col 7 & 8. \$ \_\_\_\_\_

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10. The net reserves for losses and expenses for the company's share of voluntary and involuntary underwriting pools' and associations' unpaid losses and expenses that are included in reserves shown on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines. \$ \_\_\_\_\_
11. The net reserves for losses and loss adjustment expenses that the company carries for the following liabilities included on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines. \*
- 11.1 Asbestos, as disclosed in the Notes to Financial Statements (Notes, Line 32A03D33A03D, ending net asbestos reserves for current year) Electronic Filing Col 11 \$ \_\_\_\_\_
- 11.2 Environmental, as disclosed in the Notes to Financial Statements (Notes, Line 32D03D33D03D, ending net environmental reserves for current year), Electronic Filing Col 11 \$ \_\_\_\_\_
12. The total claims made extended loss and expense reserve (Greater than or equal to Schedule P Interrogatories).
- 12.1 Amount reported as loss reserves \$ \_\_\_\_\_
- 12.2 Amount reported as unearned premium reserves \$ \_\_\_\_\_
13. Other items on which the Appointed Actuary is providing Relevant Comment (list separately) \$ \_\_\_\_\_

\* The reserves disclosed in item 11 above, should exclude amounts relating to contracts specifically written to cover asbestos and environmental exposures. Contracts specifically written to cover these exposures include Environmental Impairment Liability (post 1986), Asbestos Abatement, Pollution Legal Liability, Contractor's Pollution Liability, Consultant's Environmental Liability, and Pollution and Remediation Legal Liability.

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**Appendix 10b**

ACTUARIAL OPINION SUMMARY SUPPLEMENT

1. For all companies that are required by their domiciliary state to submit a confidential document entitled Actuarial Opinion Summary (AOS), such document shall be filed with the domiciliary state no later than March 15 (or by a later date otherwise specified by the domiciliary state). This AOS shall be submitted to a non-domiciliary state within fifteen days of request, but no earlier than March 15, provided that the requesting state can demonstrate, through the existence of law or some similar means, that they are able to preserve the confidentiality of the document.
2. The AOS should be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including but not limited to ASOPs 9, 23, and 36, as promulgated by the Actuarial Standards Board, and Statements of Principles adopted by the Casualty Actuarial Society.
3. Exemptions for filing the AOS are the same as those for filing the Statement of Actuarial Opinion.
4. The AOS contains significant proprietary information. It is expected that the AOS be held confidential and is not intended for public inspection. The AOS should not be filed with the NAIC and should be kept separate from any copy of the Statement of Actuarial Opinion in order to maintain confidentiality of the AOS. The AOS can contain a statement that refers to the Statement of Actuarial Opinion and the date of that opinion.
5. The AOS should be signed and dated by the Appointed Actuary who signed the Statement of Actuarial Opinion and should include at least the following:
  - A. The Appointed Actuary's range of reasonable estimates for loss and loss adjustment expense reserves, net and gross of reinsurance; and/or
  - B. The Appointed Actuary's point estimates for loss and loss adjustment expense reserves, net and gross of reinsurance; and
  - C. The Company's recorded loss and loss adjustment expense reserves, net and gross of reinsurance; and
  - D. The difference between the company's carried reserves and the Appointed Actuary's point estimate and/or range of reasonable estimates, net and gross of reinsurance; and
  - E. Where there has been one-year adverse development in excess of 5% of surplus as measured by Schedule P, Part 2 Summary in at least three of the past five calendar years, include explicit description of the reserve elements or management decisions which were the major contributors.
6. The AOS for non-lead companies in a pool (as defined in paragraph 1c of the instructions for the Statement of Actuarial Opinion) shall include a statement that the company is a 0% pool participant. For the non-lead company, the information provided for paragraph 5 should be that of the lead company.
7. No Appointed Actuary shall be liable in any manner to any person for any statement made in connection with the above paragraphs if such statement is made in a good faith effort to comply with the above paragraphs.

## Appendix 11

### Data Testing Requirements

The data testing requirement has now been in effect for several years, and we have modified the answer to FAQ # 10 in Attachment 3 of this guidance document to clarify the responsibilities of the auditor and the Appointed Actuary with regard to the scope of data to be subjected to testing procedures.

Note that the data testing requirement paragraph, included in this Appendix as Attachment 1, is found in the NAIC P&C Annual Statement Instructions Section 9, "Scope of Examination and Report of Independent Certified Accountant." That data testing paragraph is not found in the NAIC Annual Statement Instructions for Title Insurance Companies, and accordingly, this guidance related to data testing does not apply to the Appointed Actuary for a Title Insurance Company.

#### **Data Testing Requirement in 2010 P/C Annual Statement Instructions: Guidance for Actuaries Signing Statements of Actuarial Opinions on Loss and Loss Expense Reserves**

The 2010 Annual Statement Instructions issued by the National Association of Insurance Commissioners (NAIC) contain a paragraph in Section 9, "Scope of Examination and Report of Independent Certified Accountant." This statutory guidance is included as Attachment 1 and referred to as "the data testing requirement" in this document. The Annual Statement Instructions further address the auditor's review of data used by the Appointed Actuary. For purposes of this letter, the term "loss reserves" is intended to include loss adjustment expense reserves and any other items within the scope of the statutory Statement of Actuarial Opinion.

As it regards testing data used in actuarial analyses, auditors are guided by Statement of Position (SOP) 92-4, Auditing Insurance Entities' Loss Reserves, which requires the auditor to subject the data underlying loss reserve estimates to testing procedures. The data relied upon by the auditor may or may not be the same as the data used by management in developing the loss reserve estimate. Under SOP 92-4, data used by the Appointed Actuary might not have been subject to testing if that data was not also relied upon by the auditor in the course of the statutory financial statement audit. The data testing requirement ensures that the auditor will become aware of the data and/or data elements that the Appointed Actuary identifies as being significant. However, not all data identified as significant by the Appointed Actuary will necessarily be tested in the statutory financial statement audit; this is a matter of auditor judgment as well as the auditor's assessment of materiality.

This communication by the American Academy of Actuaries Committee on Property and Liability Financial Reporting (COPLFR) is intended to provide advisory, non-binding guidance to the actuarial community and help describe the respective roles of management, the actuary

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and the auditor in fulfilling this requirement. *This communication is not an Actuarial Standard of Practice. It has not been adopted by the Actuarial Standards Board (ASB) and is not binding on any actuary.*

Although the term “significant” is not defined within the data testing requirement, COPLFR suggests the following as an example of a definition for use in this instance: A data item or attribute would normally be considered to be “significant” to an analysis of loss reserves if, in the Appointed Actuary’s professional judgment, the correctness of the data item or attribute in the loss reserve analysis is likely to have a material effect on the opinion. Examples of a “material effect” might include a change in the type of opinion rendered (reasonable, qualified, redundant, deficient, or no opinion) or the presence or absence of a risk of material adverse deviation. *[Note: actuaries are not required to use or practice consistent with this definition. It has not been adopted by the ASB and is not binding on any actuary.]* Once the Appointed Actuary has communicated to management and the auditor the data and attributes that he/she believes to be significant, the auditor has responsibility for considering testing such data in the statutory financial statement audit.

To satisfy the data testing requirement, appointed actuaries identify to management and the auditor the data that is deemed significant in the actuaries’ analysis of loss reserves. Appointed Actuaries are encouraged to contact the company’s management and its auditors before beginning their loss reserve analysis. A sample letter from the Appointed Actuary to management and the audit firm is included as Attachment 2. *While there is no requirement to this effect, written communication among the actuary, the company’s management and the company’s auditor, to be retained for a reasonable time period, may be very beneficial in order to clarify information and create a documentation trail. However, there is no requirement that the actuary make use of the sample letter, and the actuary is encouraged either to adapt the sample letter or use alternative language as appropriate to the actuary’s circumstances. The actuary may wish to consult with legal counsel concerning the specific provisions of the NAIC’s data testing requirements.*

In addition, the American Institute of Certified Public Accountants (AICPA) and COPLFR strongly encourage appointed actuaries to meet with the company’s management and its audit firm to discuss the data and the audit in greater depth.

Attachment 3 is a list of questions and answers that may be useful to you as you work through this process with companies and their auditors. Actuaries may also wish to consult Actuarial Standard of Practice (ASOP) 23 regarding the nature and boundaries of the actuary’s responsibilities regarding data quality.

*COPLFR generated this document after discussions with the AICPA, the NAIC/AICPA Working Group and the NAIC Casualty Actuarial Task Force. Actuaries are not normally trained to define or specify audit procedures and therefore we look to insurance companies and their auditors as having the ultimate responsibility for determining how to comply with the data testing requirement. Questions about the data testing requirement as it relates to specific companies should be directed to the companies’ domiciliary regulators.*

**Data Testing Requirement**  
**(from 2010 P&C Annual Statement Instructions Page 19,**  
**“Annual Audited Financial Reports”)**

The insurer shall also require that the independent certified public accountant subject the data used by the Appointed Actuary to testing procedures. The auditor is required to determine what historical data and methods have been used by management in developing the loss reserve estimate and whether the auditor will rely on the same data or other statistical data in evaluating the reasonableness of the loss reserve estimate. After identifying the relevant data, the auditor should obtain an understanding of the controls related to the completeness, accuracy, and classification of loss data and perform testing as the auditor deems appropriate. Through inquiry of the Appointed Actuary, the auditor should obtain an understanding of the data identified by the Appointed Actuary as significant. It is recognized that there will be instances when data identified by the Appointed Actuary as significant to his or her reserve projections would not otherwise have been tested as part of the audit, and separate testing would be required. Unless otherwise agreed among the Appointed Actuary, management and the auditor, the scope of the work performed by the auditor in testing the claims data in the course of the audit would be sufficient to determine whether the data tested is fairly stated in all material respects in relation to the statutory financial statements taken as a whole. The auditing procedures should be applied to the claim loss and defense and cost containment expense data used by the Appointed Actuary and would be applied to activity that occurred in the current calendar year (e.g., tests of payments on claims paid during the current calendar year).

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Attachment 2

**Sample Letter to Company Management (Copy to Auditor)**

*[This letter is intended solely as one possible example of the kind of letter an Appointed Actuary might wish to issue to company management (typically with a copy to the auditor) under the NAIC's data testing requirements. Significant data and attributes will vary depending on the circumstances of a particular assignment and may call for varying approaches to compliance with the NAIC's requirements. There is no requirement that the Appointed Actuary use this letter or any of the specific language or provisions contained herein, or to identify the lines of business or attributes used as examples herein as significant. In fact, the actuary is encouraged either to adapt the language of this sample to the circumstances of a particular company or to develop entirely different language if, in the actuary's professional judgment, it is appropriate or desirable to do so. The actuary may wish to consult with legal counsel concerning the specific provisions of the NAIC's data testing requirements.]*

Mr. CFO  
XYZ Insurance Company

Dear Mr. CFO:

I understand that ABC CPA has been appointed to audit XYZ Insurance Company's financial statements for the year ended December 31, 201X. I understand that the NAIC Annual Statement Instructions direct insurers to require that the auditor subject the data used by the Appointed Actuary to testing procedures. As the Appointed Actuary of XYZ, I am providing this letter to communicate what data and attributes I believe to be significant to my analysis in support of the XYZ Statement of Actuarial Opinion (SAO).

In this letter, a data item or attribute would normally be considered to be "significant" to my analysis of loss reserves if, in my professional judgment, the correctness of the data item or attribute in the loss reserve analysis is likely to have a material effect on the opinion. Examples of "material effect" might include a change in the type of opinion rendered (reasonable, qualified, redundant, deficient, or no opinion) or the presence or absence of a risk of material adverse deviation.

As of the date of this letter, I expect my analysis of loss and loss adjustment expense reserves to be based on the following data:

1. Direct and Ceded Paid Loss and Defense and Cost Containment Expense (DCC) by statutory line of business and by accident year, at annual evaluations as of XX/XX/201X. For Workers' Compensation, this data is also split to Medical vs. Indemnity. For Commercial Multi-Peril, this data is also split to Property vs. Liability.
2. Direct and Ceded Case Reserves for Loss by statutory line of business and by accident year, at annual evaluations as of XX/XX/201X. For Workers' Compensation, this data is also split to Medical vs. Indemnity. For Commercial Multi-Peril, this data is also split to Property vs. Liability.

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3. Direct and Ceded Earned premium by statutory line of business by calendar year as of XX/XX/201X.
4. Reported Claim Counts by statutory line of business and by accident year, at annual evaluations as of XX/XX/201X, for the following lines of business: Workers' Compensation, Personal Auto Liability and Commercial Auto Liability. For Workers' Compensation, this data is also split to Medical vs. Indemnity. For Commercial Multi-Peril, this data is also split to Property vs. Liability.
5. Direct Paid Adjusting and Other Expense (AOE) by calendar year as of XX/XX/201X.

I believe the Workers' Compensation and Commercial Multi-Peril lines of business to be most significant with respect to the SAO.

The attributes that are significant with respect to the above items are as follows:

- For items 1 through 4, the assignment to line of business and accident year.
- For items 1, 3 and 4, the annual amounts of premiums, payments or reported claims
- For item 2 the amount of reserves at XX/XX/201X.
- For items 1, 2 and 4, the split for Workers' Compensation of Medical vs. Indemnity.
- For items 1, 2 and 4, the split for Commercial Multi-Peril of Property vs. Liability.

The data used in support of the SAO comes to me from Ms. Analyst of XYZ and is generally provided on the 10th workday following the close of the year. Direct AOE and payroll are provided by Mr. Controller of XYZ. I have attached an extract of last year's data files, highlighted to show the data fields that I used for last year's review.

The decision to designate the items listed in this letter as "significant" was based upon my professional judgment and my understanding of XYZ's operations at this time as represented to me by XYZ's management. This listing is intended solely for the use of XYZ and its auditors, and should not be used or relied upon by any other party or for any other purpose. This listing does not indicate in any way that all of these items will, in fact, prove to be significant to the company's reserves or that additional items not specified here will not be identified at some time in the future as having been a significant influence on the company's reserves.

The above list was based on my work for XYZ in prior years, and is subject to change during the course of my review. If I become aware of additional data items that are significant to my review of reserves as of December 31, 201X, I will notify you and, with your concurrence, inform ABC accordingly.

I will rely upon the data identified in this letter when performing my analysis. Any significant discrepancies discovered in the data identified in this letter should be communicated to me by XYZ as soon as possible so that my analysis can be amended accordingly.

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I would be happy to meet with you and ABC and answer any questions you may have. Please contact me after you have had a chance to review this letter.

Yours truly,  
Ms. Actuary

cc: Mr. Partner, ABC CPA

**Answers to Frequently Asked Questions**

*[These questions and answers, while intended to be of interest and assistance to the actuary, are not authoritative and are not intended to be binding. COPLFR believes these questions and answers reflect factors that many actuaries will take into account when working under the data testing rules, but other approaches will, no doubt, be used as well.]*

Question 1: With respect to the NAIC Data Testing Requirement, what are the roles of the insurance company, the Appointed Actuary, and the auditor?

Answer:

- The company selects the Appointed Actuary and provides appropriate company data to the Appointed Actuary. The company has the sole contractual relationship with the auditor, including agreement on fees. The company's management is ultimately responsible for the fair presentation of the data. Under the data testing requirement, the company requires that the auditor subject the data underlying the Appointed Actuary's loss reserve estimates to testing procedures.
- The auditor is responsible for determining the scope of work and designing appropriate testing procedures within the scope of the financial statement audit. Under the requirement, the auditor should obtain an understanding of the data identified by the Appointed Actuary as "significant."
- Consistent with past practice, the Appointed Actuary requests the data that he/she deems necessary for the loss reserve review. The Appointed Actuary determines whether the data is appropriate for the methods and assumptions he/she uses in the loss reserve analysis. The Appointed Actuary is allowed to rely on the company for the data underlying the SAO, subject to checks for reasonableness and consistency in accordance with ASOP No. 23. Under the requirement, the Appointed Actuary will be expected to identify to the auditor the data and/or attributes he/she believes are significant to the SAO.

Question 2: Will all data identified by the Appointed Actuary as significant be tested by the auditor in the financial statement audit? Will all data be tested each year? Is the Appointed Actuary required to include disclosures in the opinion or report as to what data has been tested?

Answer:

- Not all data identified by the Appointed Actuary as significant will be tested by the auditor, and not all data will be tested each year. This is a matter of auditor judgment and depends on the auditor's assessment of materiality and other considerations.
- The Appointed Actuary is relying on management for the fair presentation of the data. The Appointed Actuary is not required to follow up with the auditor as to what data has been tested, nor to disclose such information in the opinion or report.

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Question 3: What work regarding data testing is currently performed in the financial statement audit?

Answer:

- Under SOP 92-4, the auditor is required to subject the data underlying loss reserve estimates to testing procedures. The data relied upon by the auditor may or may not be the same as the data used by management in developing the loss reserve estimate.
- For the audit opinion, the auditor subjects to testing what she/he deems material in the context of the financial statements taken as a whole.
- In connection with the statutory audit as stated in SOP 92-8, *Auditing Property/Casualty Insurance Entities' Statutory Financial Statements – Applying Certain Requirements of the NAIC Annual Statement Instructions*, certain of the information in Schedule P-Part 1 is typically subjected to auditing procedures applied in the audit of the basic statutory financial statements (for example, earned premiums and paid losses).

Question 4: Who determines how the testing gets done? Who determines the sample size and attributes to be tested? Who determines how often the testing needs to be done?

Answer:

- The auditor determines the scope of the audit.
- Within the scope of the statutory financial statement audit, the auditor determines the sample size and attributes, how testing gets done, and how often to test data.
- There may be instances in which the data used by the Appointed Actuary is tested outside the scope of the audit. If these instances occur, the determination of how the testing is done will be handled on a case-by-case basis.
- In general, actuaries are not trained to define or specify data testing procedures. Therefore, if the Appointed Actuary is prescribing or signing off on agreed-upon procedures outside the scope of the audit, he/she is encouraged to obtain appropriate support. The support might encompass such areas as developing appropriate data testing procedures, interpreting the results, and deciding whether or not to use the data in the loss reserve analysis.
- If there are questions about the data testing requirement in a specific instance, it may be helpful to contact the domiciliary regulators.

Question 5: Is there a difference in procedure if the Appointed Actuary is an employee of the company, the audit firm, or a consulting firm?

Answer:

- No, with respect to the duties identified in this document as being those of the “Appointed Actuary.”
- If the Appointed Actuary serves in additional roles, such as being a member of company management or a member of the audit team, he/she may have additional duties. For example, if the Appointed Actuary is also the company CFO, he/she may be responsible for the fair presentation of the data.

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Question 6: Most actuaries use multiple methods and various sources of data. Does the actuary need to identify significant data used for all methods, or just those that are ultimately used or heavily weighted in the final range or point estimate?

Answer:

- The Appointed Actuary takes into account his/her level of reliance on the data in determining which data and attributes are deemed “significant.”
- In general, significant data would include just the data that is ultimately used or heavily weighted in the final range or point estimate, whether the data is incorporated into methods or diagnostic tests.

Question 7: What is the process of coordination between management, the Appointed Actuary and the auditor?

Answer:

- The company is responsible for instructing the auditor to subject the data underlying the Appointed Actuary’s loss reserve estimates to testing procedures.
- The Appointed Actuary informs the auditor of the data he/she believes is “significant.”
- Within the scope of the financial statement audit, the auditor is responsible for determining the scope of work and designing appropriate testing procedures.
- In instances where additional testing is handled outside the scope of the audit, the coordination will be handled on a case-by-case basis.
- It is usually preferable that the Appointed Actuary, company management and the auditor begin having discussions before the loss reserve review is performed.

Question 8: What if the Appointed Actuary materially changes his/her view of what is "significant" based upon work the Appointed Actuary performs subsequent to attaining agreement with the auditor and management?

Answer:

- As soon as practicable, the Appointed Actuary discusses the change with management and the auditor.
- The actuary should not be limited in the use of various methods or data by the original list of “significant” data.

Question 9: What if the auditor's data testing yields significant data discrepancies?

Answer:

- Management advises the Appointed Actuary.
- The actuary revises his/her estimates accordingly to see if there is a material impact on the opinion.
- If so, management is advised and, as the Appointed Actuary deems necessary, a revised opinion is sent to regulators.

Question 10: What data is in scope vs. out of scope of the data testing requirement?

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Answer:

- The Appointed Actuary provides the auditor with a list of data elements significant to the analysis in support of the SAO. However, it is the auditor's responsibility to determine which data elements are to be included in the testing procedures within the scope of the financial statement audit.

Question 11: Will the NAIC Data Testing Requirement have an impact on the work done by an auditor for every statutory audit?

Answer:

- Yes. At a minimum, there will need to be identification of data deemed to be significant by the Appointed Actuary, and discussion among the company, the auditor and the Appointed Actuary.
- The data used by the Appointed Actuary might not otherwise be subject to testing as part of the financial statement audit.
- Beyond this, it is difficult to generalize.

Question 12: Will testing required for the NAIC Data Testing Requirement already be performed by the auditor under his/her work under Sarbanes-Oxley Section 404?

Answer:

- Not necessarily. Sarbanes - Oxley Section 404 has a different focus than the data testing requirement.

## Appendix 12

The following guidance document was first published by COPLFR in 2007 to assist practicing actuaries in communicating with a company's Board of Directors or Audit Committee concerning uncertainties in the process of estimating unpaid loss and loss adjustment expense claims liabilities. In response to regulatory concerns about the need for more frequent and direct communication between the Appointed Actuary and the company's Board of Directors, we reproduce the document here for the convenience of the reader. COPLFR hopes this document will serve as a reference for the Appointed Actuary when assembling materials for a presentation to a Board or Audit Committee.

### An Overview for Audit Committee Members of P/C Insurers: Effective Use of Actuarial Expertise

#### *Summary*

The reliability of financial statements for property/casualty insurance companies depends significantly on the accuracy of the recorded liabilities for unpaid claims, commonly referred to as "loss reserves." Unlike most balance-sheet liabilities common to other industries, the loss reserves of a property/casualty insurer are, by necessity, based on actuarial estimates.

Loss reserve estimates are often subject to significant uncertainties. In the recent past, property/casualty insurers have announced significant loss reserve increases for reasons that include, but are not limited to: asbestos litigation; construction defect claims; and unpredictable medical malpractice awards. For some companies, these loss reserve increases impair the financial condition of the insurer; for others, reported profitability is affected.

Property/casualty insurance companies' audit committees and boards of directors have a fiduciary responsibility for overseeing the financial reporting process. Since loss reserves are crucial to property/casualty insurers' financial statements, audit committees and boards of directors may benefit from comprehensive interaction with their actuarial professionals to obtain a better understanding of the loss reserve estimation process and the uncertainty inherent in its results.

This document is intended to provide members of boards of directors and audit committees of property/casualty insurance companies with a more complete understanding of the information and assistance that actuarial professionals can provide as members perform their oversight roles.

The considerations contained herein are based on broad generalizations and are not intended to describe or establish actuarial standards of practice or requirements. The information presented herein is intended to apply to a large percentage of property/casualty insurers. Within the property/casualty insurance industry, there is wide diversity of actuarial practice. Each company and each situation must be evaluated on the basis of its own circumstances.

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This document is offered primarily for members of audit committees and boards of directors of property/casualty insurers subject to regulation by the member states of the National Association of Insurance Commissioners (NAIC). While most of the considerations apply as well to other insurance entities, including non-U.S. insurance companies, captive insurance companies, corporate self-insurers, etc., some of the references contained herein are specific to the NAIC's requirements regarding the recording of loss reserves in insurers' financial statements.

This document is organized as follows:

- Background on loss reserves and the roles of actuaries in setting them
- Actuarial considerations for members of audit committees and boards of directors
- Sample checklist

### *Background on Loss Reserves and Roles of Actuaries in Setting Them*

#### **Property/Casualty Insurance Loss Reserves**

It is helpful for audit committee and board members to develop an effective working understanding of the nature of property/casualty insurance claim liabilities.

A property/casualty insurance policy is a promise to pay claims related to covered, or insured, events. Usually, covered events take place during the time the policy is in effect (e.g., an auto accident, injury, or loss of property as a result of a loss covered under the terms of the policy). In some cases, the insurance company is not presented with a claim or demand for payment by the insured or a third party until years after the covered event has occurred. It often takes many additional years for the claim, once made, to be investigated and settled.

When these claims are eventually settled, the insurance company must have the resources to pay the claim in accordance with the policy provisions. Therefore, until all claims are resolved and the related amounts are paid, insurance accounting rules require the insurer to establish a "loss reserve" (including loss adjustment expenses<sup>33</sup> [LAE] or settlement costs) as a liability on the company's balance sheet. The loss reserve is based on the company management's best estimate of the amounts that will be paid in the future for losses and settlement costs related to covered events that have occurred as of the date of the financial statement, whether or not all claims have been reported at that time.

The duration and the uncertainty of the claims-settlement process require loss reserves to be based on estimates. A property/casualty insurer's loss reserves are typically the company's largest balance-sheet liability by a wide margin and its greatest source of financial statement uncertainty. Loss reserves can be difficult to estimate, and the amounts ultimately paid may be far less than, or greater than, amounts previously estimated.

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<sup>33</sup> LAE is discussed in greater detail in Actuarial Standard of Practice No. 43, *Property/Casualty Unpaid Claim Estimates*, which can be found at [http://www.actuarialstandardsboard.org/pdf/asops/asop043\\_106.pdf](http://www.actuarialstandardsboard.org/pdf/asops/asop043_106.pdf) (last viewed on August 16, 2007).

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A conclusion that prior years' loss reserves need to be revised, based on current facts and circumstances, affects both the company's reported surplus and its income during the period in which that conclusion is reached. Changes in loss reserve estimates have consequences both for the financial condition of the company and for its apparent operating profitability. It is important that the loss reserves be set as accurately as possible, reflecting all information available at the statement date, to lessen the likelihood of distortions in the insurer's financial reporting.

#### **Role of Actuaries in the Reserving Process**

Actuaries usually play an integral role in the loss-reserving process. The actuarial role is generally provided by one or more of the following sources:

- *Internal Actuaries* – Many insurance companies employ actuaries to aid in setting loss reserves. Typically, the internal actuary provides periodic analyses of loss reserves and assists management in understanding underlying claim trends, the judgments and assumptions used in the analyses, and any material risk factors that may affect the loss reserves. The internal actuary may also lead presentations regarding estimated loss reserves to boards of directors and audit committees.
- *Audit Firms* – Often, insurance companies' external audit firms will assign actuaries to their engagement teams. The audit firms' actuaries evaluate the reasonableness of the recorded amounts. To assist them in this evaluation, they may develop an alternative point estimate and/or range of reasonable estimates of the loss reserves. This range is usually much narrower than a range of possible outcomes, and it is intended to be an independent assessment of whether the recorded loss reserve amounts are reasonable in light of the available information.
- *Consulting Actuaries* – Some companies engage third-party actuarial consultants to perform independent analyses of the loss reserves. Such analyses can encompass the entire claim population or can be limited to some unusual or especially problematic portion of the exposures. The detailed analysis performed by consulting actuaries often includes independent methodologies, judgments, and assumptions.

Regardless of the source of the actuarial analysis that a property/casualty insurer utilizes in its determination of the loss reserve, U.S.-domiciled insurers appoint a qualified actuary, or "appointed actuary," to render an opinion on the recorded loss reserves; this opinion is based on specifications described by the National Association of Insurance Commissioners. The opinion of the appointed actuary is contained in a formal, public document called the Statement of Actuarial Opinion (SAO).<sup>34</sup> The SAO is an important tool used by insurance regulators to assess insurer solvency. In addition to the actuarial opinion on the reasonableness of the recorded loss reserves, the SAO contains informative disclosures regarding the factors affecting the variability

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<sup>34</sup> In the United States, the SAO is prepared at the legal entity level, i.e., for each individual insurance company within a group rather than for the consolidated group of companies. (See the NAIC's Annual Statement Instructions for Property/Casualty Actuarial Opinions for the Year 2006, available at <http://tinyurl.com/2kp223>, last viewed on October 28, 2010).

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of the loss reserves and the appointed actuary's view as to whether there is a risk of material adverse deviation.

### ***Actuarial Considerations for Members of Audit Committees and Boards***

There are several fundamental issues that audit committees and board members may find useful to consider in the context of the loss-reserving process. They include:

- **Setting of Loss Reserves:** A management process resulting in the amounts recorded in the financial statements, including the key controls around that process, which improve objectivity.
- **Loss Reserve Uncertainty:** Understandable, meaningful information on the uncertainty in the ultimate amount and timing of the payment of loss reserves.
- **Historical Reserving Accuracy:** Critical analysis of the accuracy of previous estimates, both specifically for the company and generally for the industry.
- **Industry and Competitor Company Trends and Risks:** Industry reserving trends and risks and how they may affect the company.
- **Disclosures:** Both public and privately held insurance companies are required to disclose information in filings with regulatory officials about recorded loss reserves and the various risks associated with those loss reserves.<sup>35</sup>

The discussion below further explains these items and is intended to provide members of audit committees and boards with ideas about information that can be requested from their actuarial professionals.

### **Setting of Loss Reserves**

While determining the amount to record for loss reserves for property/casualty insurance companies is the responsibility of the company management, the process often involves significant input from actuaries. As such, it is very helpful for members of audit committees and boards of directors to understand the principles of the reserving process. These considerations include the following:

- The process of setting loss reserves
- How objectivity is achieved
- How actuarial estimates are considered
- Actuarial ranges of reasonable estimates
- Key statistics and benchmarks

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<sup>35</sup> Public insurance companies that are Securities and Exchange Commission (SEC) registrants follow U.S. GAAP and SEC rules and related interpretations, primarily FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, AICPA Statement of Position No. 94-5, *Disclosures of Certain Matters in the Financial Statements of Insurance Enterprises*, Industry Guide 6, *Disclosures Concerning Unpaid Claims and Claim Adjustment Expenses of Property-Casualty Insurance Underwriters*, and the Management's Discussion and Analysis, which require disclosures intended to help a reader understand the complexity, judgment, and uncertainty inherent in their estimate of unpaid losses and LAE. Disclosures for both public and private insurers subject to regulation by the member states of the NAIC follow guidance in the NAIC Annual Statement Instructions.

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### The Process of Setting Loss Reserves

An understanding of the loss reserve setting process begins with an understanding of the person or management group responsible for setting and updating loss reserve amounts, the fundamental process used by that person or group, and actuaries' role or roles in that process. It is equally important to understand the nature of, and reasons for, any differences in the processes that are used among financial reporting periods (i.e., calendar quarters and/or at year-end).

Members of audit committees and boards of directors benefit from understanding the significant judgments and assumptions that enter into the loss reserving process. In addition to its impact on loss reserve estimation, this information can be useful for many business decisions, such as the pricing of insurance policies or increasing or decreasing market share in a line of business or geographic area.

### How Objectivity is Achieved

Additionally, members of audit committees and boards of directors would benefit from an understanding of the steps that management uses to attain objective results and the internal controls established around those steps, including the following key concepts:

- *Segregation of duties.* While input from those responsible for pricing or developing business (e.g., underwriters, pricing actuaries) is often very useful to the loss reserving process, objectivity typically improves when different actuaries perform the primary reserving and pricing roles. The perspectives of the pricing and reserving actuaries are often different, with the pricing actuary focusing on the profitability of current and future business. In contrast, the reserving actuary focuses on the potential outcomes connected with business written in the past, even business written in discontinued lines and geographic areas.
- *Use of reserve committees.* Some insurance companies have reserve committees or an equivalent oversight management group, often organized at one or more management segment levels (e.g., legal entity, line of business, region). The committee might include the segment's executive management, the segment's internal reserving actuary, and heads of key operating functions (e.g., claims, underwriting, marketing).

Having a reserve committee does not ensure objectivity, and members of audit committees and boards of directors may wish to inquire further to determine its effectiveness. The extent to which a reserve committee improves objectivity is partly a function of the quality and efforts of the reserve committee members. Members of audit committees and boards of directors should learn the identities and qualifications of reserve committee members. The reserve committee members may find value in meeting separately with the lead actuary to obtain the actuary's view of the reserve committee's effectiveness.

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### How Actuarial Estimates Are Considered

Actuarial estimates are not necessarily adopted unilaterally in the loss-reserving process. Typically, reserving actuaries develop estimates of the loss reserves, and the company management records an amount that may differ from the actuary's estimate. It is important that members of audit committees and boards of directors ascertain the differences between the actuarial and management estimates. They may also wish to inquire about the reasons for the differences. In particular, members of audit committees and boards of directors may find it helpful to understand the answers to the following questions:

- Does management's process typically result in differences between the actuary's estimates and the recorded amounts, and if so, why?
- How do management's estimates compare to a range of estimates that the actuary may develop?
- Has due diligence been performed to identify the reserving effect, if any, of any significant recent changes in the company's operations (e.g., claims, underwriting, reinsurance)?
- If such changes exist, what adjustments, if any, are made (by management and/or the actuary) to reflect the effect of the changes on the estimates of loss reserves?

### Key Statistics and Benchmarks

In addition to these items, there are benchmarks that may be useful in the audit committee's or the board of director's understanding of the recorded loss reserve, such as:

- Recorded and actuarially estimated loss ratios by accident year and product line
- Various ratios of quantities, such as incurred-but-not-reported (IBNR) losses to case reserves and/or number-of-claims-closed to number-of-claims-reported at successive points in time
- Changes in prior-period estimates of loss reserves and ultimate losses. The changes to estimated amounts during the current period should be clearly identified and explained to the audit committee.

This list of benchmarks is not exhaustive, and it does not apply in all situations. In all cases, an effective oversight process should involve meaningful dialogue among the parties responsible for estimating and recording the loss reserves with the audit committee or board of directors.

### Loss Reserve Uncertainty

In addition to contributing to the loss reserve setting process, actuaries are uniquely qualified to provide insights into the potential for variability in loss reserve estimates.

Estimating loss reserves involves predicting future loss payments based on historical and current information and knowledge, as well as judgment about future conditions. However, changes to historical patterns and trends—changes due to, among other factors, an evolving legal or social

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environment, claimants' attitudes regarding insurance claims, changes in the national or regional economic performance, or changes in company operations and its book of business—make the incidence of claims more or less likely and claims' settlement values lower or higher.

Actuaries often employ several methods to estimate loss reserves in a given situation. These methods often consider historical information when predicting the future. Typically, multiple actuarial methods are appropriate, and, for each of those methods, numerous assumptions are reasonable. The actuary may provide a “range of reasonable estimates” of loss reserves based on various combinations of these methods and assumptions. This range is typically developed by the appointed actuary to assist in creating an opinion on the reasonableness of the recorded loss reserves.

A range of reasonable estimates considers variability similar to what may have been observed in the past. However, this range typically excludes the possibility of sudden shifts in the legal, judicial, and economic-reserving environments. Nevertheless, such shifts can and do occur. For example, in the past 15 years, the following have been witnessed:

- Significant loss reserve increases for asbestos and environmental liabilities;
- Large loss reserve decreases for personal lines in the mid-1990s;
- Large loss reserve increases relating to professional and general liability lines.

Each of these trends resulted in reserve development that likely exceeded the size of a range of reasonable estimates, sometimes substantially. Actuaries understand that the range of possible future outcomes is wider, sometimes significantly wider, than the range of reasonable estimates generated at any point in time.

While it may not be possible to quantify future losses resulting from unforeseeable events, members of audit committees and boards of directors may benefit from a conceptual discussion of risk factors that threaten reserve development outside of the current range of estimates.

### **Historical Loss Reserve Development**

A company's record for accuracy in setting loss reserves is a standard disclosure in the U.S., both for publicly-traded and for non-public property/casualty insurers.

The SEC requires each publicly traded U.S. property/casualty insurance company to include as part of its annual Form 10-K a ten-year loss reserve development table. This table compares the company's consolidated loss reserves recorded at each of the past 10 year-ends to updated estimates for those same years based on the most recently recorded amounts for those years.

For U.S. property/casualty insurers, a summary of similar information is provided in Schedule P, Part 2 – Summary (Schedule P) of the NAIC statutory Annual Statement, which is filed by each individual insurance company for regulatory purposes. Schedule P shows the annual development of ultimate losses for each of the past 10 coverage years (“accident years”).

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Both the SEC disclosures and Schedule P filings provide 10 years of history showing the accuracy of management's loss reserve decisions over time. These schedules are used by analysts and other users of the information to assess the reliability of the company's current reserving practices and the accuracy of the balance sheet estimates relative to those of its peers.

With regard to this historical information, members of audit committees and boards of directors may find it helpful to examine:

- The specific reasons for past years' revisions to loss reserve estimates, including the lines of business, programs, and years affected.
- A comparison to industry trends for the same coverages during the same period.
- A comparison to the reserve activity of the company's closest competitors for the same coverages during the same period.

### **Industry and Competitor Company Trends and Risks**

Members of audit committees and boards of directors may consider significant industry risks, loss reserve developments, and business trends. Useful perspective may be provided by:

- Analyses of historical industry loss reserve adequacy for lines of business written by the company. Stock analysts, rating agencies, and third-party consulting actuaries regularly produce and publish such reports.
- Summaries, with comments, of competitors' loss reserve developments and published disclosures in their Management's Discussion and Analysis, prepared in conjunction with their 10Ks and/or as a supplement to their Annual Statements.
- Explanations of how industry and competitor trends and developments are being considered by the company in setting loss reserves, managing risk, and developing public disclosures on loss reserves.

### **Disclosures**

For insurance regulatory purposes, each company operating in the United States (as well as many in other jurisdictions) is required to file a SAO on loss reserves to accompany its annual statement in its jurisdiction of domicile. The SAO is provided to regulators for solvency regulation, and that is the context in which it is created and expected to be used. The scope of the SAO includes loss reserves calculated both gross and net of reinsurance, and, typically, the actuary will opine as to whether the loss reserves: (a) meet state requirements; (b) are computed in accordance with generally accepted actuarial standards and principles; and (c) make a reasonable provision for unpaid loss and LAE obligations. The SAO also includes a discussion of risk factors affecting the loss reserves, reasons for unusual adverse prior period development, reinsurance recoverability, and other required topics.

In addition, most states require property/casualty insurance companies to provide a supplemental document known as the Actuarial Opinion Summary (AOS). The AOS provides confidential information about the relationship between the recorded loss reserves and the appointed

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actuary's estimates. Also, in some cases of recent adverse loss reserve development, the AOS provides the appointed actuary's explanation of the factors contributing to that development.

For public companies, filings made with the SEC serve as additional company disclosures regarding loss reserves and related risk factors. SEC disclosures are intended to provide investors with management's assessment of the reasonably likely variation in loss reserves and the effect of that variation on the financial condition of the company. These disclosures are also intended to justify changes in loss reserve estimates from prior recorded amounts.

Members of audit committees and boards of directors may obtain meaningful information in the SAO filed with the annual statement, the separately provided AOS, and, for public companies, SEC filings. The SAO includes, for example:

- A discussion of each of the risk factors identified in the opinion as a potential source of variability and/or uncertainty.
- The appointed actuary's view on whether there is a risk of material adverse deviation and the definition of "materiality" (in amount). Audit committees and/or boards of directors may want to ask their actuaries how these determinations were made.
- Explanatory comments in cases in which there was adverse development during recent years or in which there is an estimated current loss reserve deficiency based on historical loss reserve ratios to premium.

The NAIC requires that the appointed actuary report on the actuarial analysis and the SAO to the company's board of directors each year. This report may be made in person. Often, the dialogue between members of audit committees or boards of directors and the appointed actuary provides additional insights into key judgments, assumptions, and risk factors associated with the company's recorded loss reserves. In some cases, the audit committee and the board of directors might find it useful to meet in executive session with the appointed actuary absent the company's management.

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A strong understanding of the loss reserve setting process, key risks and uncertainties, and industry developments and trends can improve the ability of members of audit committees and boards of directors to oversee the financial reporting process of property/casualty insurance companies. Actuarial professionals may be able to provide helpful information on each of these points. The standard disclosures and required filings may also be useful in understanding the loss reserving process.

In addition, provided on the next page is a sample checklist, developed in conjunction with the creation of this document, of certain items that members of audit committees and boards of directors may consider helpful.

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### *Sample Checklist*

Members of audit committees and boards of directors of property/casualty insurance companies may wish to refer to the checklist below when requesting information from their actuaries.

#### Roles and Responsibility

- Name and background of primary internal actuarial contact, often the chief actuary
- Name and employer of each third-party actuary retained by the company to evaluate loss reserves
- Name and background of lead audit firm actuary

#### Loss Reserve Process and Loss Reserve Uncertainty

- Description of the process that management uses to set loss reserves
- An understanding of the steps that management takes to achieve objectivity
- How management considers internal and external actuarial indications when determining what to record as a best estimate and why there may be differences between recorded and indicated amounts
- The internal and external actuaries' point estimates and/or ranges of reasonable estimates and a comparison of these estimates to the recorded amounts over at least the most recent several years
- Key statistics and/or benchmarks appropriate for each line of business, such as loss ratios by accident year
- Amounts and explanations for changes in loss estimates that are being recognized in the current period
- Identification of the potential risk factors that could result in significant changes to loss reserve estimates in the future
- Estimates of developments that may be considered reasonably possible and examples of events that could cause such developments, perhaps based on historical sudden shifts in loss development

#### Historical Analysis

- The company's 10-year runoff table in the SEC 10K and the Schedule P – Part 2 Summary schedule, if available
- A summary of the loss reserve changes shown in these tables
- An understanding of the details of revisions to loss reserve estimates—what lines of business, which years, why such changes were identified
- A comparison to industry trends for the same coverages at this time and an understanding of why the company may or may not show similar development
- A comparison to the company's closest competitors

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Industry and Competitor Trends

- Analyses of loss reserve adequacy for the lines of business that are relevant to the company
- Loss reserve development trends from competitors, and an explanation of whether, and if so, why the company may show similar development

Public Disclosures

- Oral and written report by opining actuary on their SAO, AOS, and analysis
- Explanation for the risk factors discussed in the opinion
- Identification of considerations useful in determining whether there is a risk of material adverse deviation
- Explanation of unusual values for the NAIC's Insurance Regulatory Information System ratios related directly to reserves

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