



AMERICAN ACADEMY of ACTUARIES

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February 12, 2016

Melissa Greiner, Chair
Actuarial Opinion (C) Working Group
National Association of Insurance Commissioners
Via email

Dear Ms. Greiner:

On behalf of the Committee on Property and Liability Financial Reporting (COPLFR) of the American Academy of Actuaries,¹ I am pleased to follow up on our offer on the Feb. 3 conference call of the NAIC's Actuarial Opinion (C) Working Group to provide comments on items we would like to see discussed as the working group considers updates to the Actuarial Opinion Instructions.

This list below² was compiled by COPLFR while developing the 2015 *Statements of Actuarial Opinion on P/C Loss Reserves* practice note. This list is not intended to encompass all possible enhancements; rather, it contains those topics that generated discussion by a COPLFR subcommittee when drafting the practice note.

Paragraph 1

1. With respect to the change in Appointed Actuary (AA), one interpretation of “*disagreements ... regarding ... procedures*” could be that there is disagreement when the AA prepares an initial estimate that is different from the Company's estimate. Of course, the AA and Company typically resolve this disagreement. However, the disagreement and resolution would be required disclosures in the insurer's letter to the commissioner. Is this the intent?
2. Additionally, are all disagreements with respect to the matters identified required to be disclosed? Or should the qualifier “material” be added to “disagreements”?

¹ The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policy makers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

² Note: Throughout this letter we have underlined certain text for emphasis.

3. Consider including the definition of NAIC Statement of Actuarial Opinion (SAO) and the definition of AA in Paragraph 1A.

Paragraphs 4 and 5—SCOPE and OPINION

4. The Instructions require that the SCOPE include a sentence such as the following: “I have examined the actuarial assumptions and methods used in determining the reserves listed in Exhibit A...” Further, within the OPINION paragraph, the Instructions indicate that there should be a sentence stating that the amounts in Exhibit A “are computed in accordance with accepted actuarial standards and principles.” Does independent testing of the assumptions and methods (for example, through the evaluation of consistency with an alternate actuarial central estimate or range of estimates) meet this requirement, or is an explicit examination of the assumptions and methods used in recording reserves required? Generally, a large component of an actuary’s ability to attest to this part of an opinion is strongly based on the consistency of the carried reserve with the AA’s independent testing.
5. Consider providing further clarity on requirements of Schedule P reconciliations given wide differences observed in practice.
6. The NAIC Instructions refer to making use of the work of “another actuary.” However, ASOP No. 36, [*Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves*](#), does not specify that “another” is “another actuary.” According to section 3.7 of ASOP No. 36, “The actuary may develop estimates of the unpaid claims for all or a portion of the reserve or make use of another’s unpaid claims estimate analysis or opinion for all or a portion of the reserve.” Should it be clarified in the Instructions that “another” is not necessarily an actuary, and that “another” refers to one not within the actuary’s control?

Paragraph 6—RELEVANT COMMENTS and Exhibit B

7. Consider adding a sentence at the beginning of Paragraph 6 explaining that if a disclosure would be different for Direct and Assumed vs. Net amounts, the difference would be identified and discussed within RELEVANT COMMENTS (similar to the note at the top of Exhibit B). Presumably this would also mean that the AA could have a different Risk of Material Adverse Deviation (RMAD) gross vs. net. However, perhaps this too could be explicit in the Instructions. A gross vs. net RMAD will have different meanings and potentially different materiality standards. So if the intent is to have separate RMAD disclosures for net and gross, additional considerations may be needed as well as additional instructions.
8. With respect to RMAD, consider adding the subject of adverse deviation. Assuming the subject is the reserves (i.e., risk of material adverse deviation in

loss and Loss Adjustment Expense (LAE) reserves), the first sentence of Paragraph 6a might read, “The Appointed Actuary must provide specific RELEVANT COMMENT paragraphs to address the risk of material adverse deviation in the loss and LAE reserves.”

9. There are often questions and confusion around the expectations and intent of the RMAD paragraph, which requires the AA to “address the risk of material adverse deviation.” However, the required statement is a conclusion as to whether the AA reasonably believes there are “significant risks and uncertainties that could result in material adverse deviation.” These two concepts of adverse deviation are two different things. If the actuary were to “address the risk of material adverse deviation,” presumably there would need to be a statement as to the probability of material adverse deviation.

Further, one might interpret the statement “could result in material adverse deviation” as encompassing the situation where there is simply a chance that reserves could develop by a material amount. In other words, if the actuary believes that the reserves are exposed to significant risks (e.g., monoline, long tail, jury verdicts, low frequency/high severity, latent exposures, etc.), then it would seem that there is always a chance that these risks *could* result in MAD in the reserves, unless there is a mitigating factor that restricts the MAD, such as an adverse development cover.

However, given that a significant number of SAOs have RMADs, presumably AAs instead consider the likelihood that reserves could develop by more than the materiality standard.

- According to the CASTF guidance, the expectation is that the AA will take into account the likelihood of the risk factor occurring, but the guidance does not mention the likelihood that reserves could develop by a material amount.
 - The CASTF guidance also refers to mitigating factors, but this doesn’t appear to be addressed in the actual Instructions.
10. Should the RELEVANT COMMENT regarding reinsurance collectability be consistent with Note 23, which is the amount written off? Or should it be the prospective amount the Company estimates as uncollectible and potentially included in the net reserves?
 11. Item 10 of Exhibit B regarding pools and associations could be negative if the Company cedes more to underwriting pools than it assumes from underwriting pools. Is that the intent? Or does “net reserves for the Company’s share” imply the Company’s net (of the pool’s reinsurance) share of business assumed from pools and associations?

12. With respect to significant changes to actuarial assumptions and/or methods, disclosure is required if the AA is “unable to review the work of the prior Appointed Actuary.” Assuming the AA is qualified, he/she is usually “able” to review another’s work. The question is whether the AA has access to the work of the prior AA. This also brings into question as to whether regulators might require the AA to be provided access to the prior work through the NAIC SAO Instructions.

Paragraph 9—Errors in the SAO or AOS

13. The “errors in opinion” paragraphs may need clarification in terms of the unclear timeline. Additionally, consider whether notification should also be made when a person other than the AA identifies an error (such as the auditor or insurer).

Exhibit A

14. Can enhanced Instruction be provided around the intended requirements of Items 6 through 9 of Exhibit A?
- Should the AA list amounts in Items 6 through 9 regardless of whether the amounts are material (and therefore regardless of whether the AA is expressing an opinion on them)?
 - Other Loss Reserve items (Item 6) and Other Premium Reserve Items (Item 9)—What is the intent and why is there only one line item for each of these “items” (plural), yet the AA is required to “list separately”?

Actuarial Opinion Summary (AOS)

15. We suggest including instruction as to whether the figures in the AOS are required to reconcile to the amounts in Exhibit A of the SAO. For example, discounting can cause a reconciling difference between the reserves listed in Exhibit A and the AOS. Exhibit A, item 4 is comprised of Schedule P Part 1, columns 17, 19, and 21, which are gross of non-tabular discounting. However, the AA range provided in the AOS on a direct and assumed basis may be net of discounting, thereby creating a difference.

General

16. Consider using consistent capitalization of terms throughout the Instructions (e.g., Qualified Actuary).

Clearly, this is a subject of considerable interest to the members of COPLFR. We look forward to continuing this dialogue with the working group and to contributing to enhancements to the Annual Statement instructions.

If you have any questions or would like to discuss further, please contact Senior Casualty Policy Analyst Marc Rosenberg (rosenberg@actuary.org; 202-223-8196).

Sincerely,

Lisa Slotznick, MAAA, FCAS
Chairperson, COPLFR
American Academy of Actuaries