Statements of Actuarial Opinion on P&C Loss Reserves as of December 31, 2004

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Property and Casualty Practice Note  
December 2004

Statements of Actuarial Opinion on  
P&C Loss Reserves as of December 31, 2004

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. It has not been promulgated by the Actuarial Standards Board nor is it binding on any actuary.

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 2004 issued by the National Association of Insurance Commissioners (NAIC). Actuaries may also find this guidance 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. NAIC materials are reproduced with the permission of the NAIC. Further replication or distribution of NAIC materials without written consent of the NAIC is strictly prohibited.

The NAIC Recommended Language for Actuarial Opinions for Pools and Associations is attached as Appendix 3. The NAIC has not yet updated the language to conform to the revised P&C Actuarial Opinion format.

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 of Practice is binding on all actuaries.

Actuaries are also reminded that the material covered by this practice note is a Prescribed Statement of Actuarial Opinion as contemplated by the Academy’s Qualification Standards for Prescribed Statements of Actuarial Opinion, and the actuary must meet the qualifications contained therein.

Individual states may have requirements that modify 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 Property/Casualty Loss Reserve Law Manual for guidance on both of these points.
In the Annual Statement Instructions and in this practice note, the term loss reserves should be interpreted to include loss adjustment expense reserves unless specified otherwise. This has been done to follow NAIC Instruction terminology.

COPLFR appreciates the comments it has received since the issuance of the 2003 practice note and has incorporated a number of suggestions in this update. COPLFR would also welcome any suggested improvements for future updates of this practice note. Suggestions may be sent to Nancy Watkins, Chair of the Committee on Property and Liability Financial Reporting for 2004-2005, through the American Academy of Actuaries.

Organization

In the following pages, the NAIC Annual Statement Instructions related to the Statement of Actuarial Opinion are presented first in bold print, section by section. Next, where COPLFR thought it appropriate, a description of possible practice related to interpreting the particular section of the Instructions follows. Finally, illustrative wording is presented in italics if applicable. The illustrative wording given is meant to cover a variety of common situations but does not cover all possible situations and may be altered as the actuary deems necessary or appropriate. The actuary is not required or expected to make unaltered use of the illustrative language. To the contrary, the individual actuary is responsible for assuring that the language used in the Statement of Actuarial Opinion accurately represents the given situation and the actuary’s opinion. The actuary should not use the illustrative wording provided herein as a substitute for language that is more appropriate to a given situation.

Changes From 2003 Practice Note

Substantive changes from the 2003 note are indicated by gray block of the changed text. Please note, however, that the substantial structural re-wording of the NAIC Instructions for Statements of Actuarial Opinion, and the re-ordering of the corresponding COPLFR Discussions, have not been indicated by gray block, nor have other non-substantive changes such as dates and exhibit numbers.

There are both structural and substantive changes in the NAIC Instructions for 2004 regarding Actuarial Opinions:

- The seventeen sections of the Annual Statement instructions regarding P/C Actuarial Opinions have been consolidated into 9 Sections and 2 Exhibits. All Scope and Disclosure amounts are contained in the 2 Exhibits. Substantive changes generally involve additional disclosures, as well as formally acknowledging regulatory reliance on Actuarial Standards of Practice and Statements of Principles.
• The first major structural change takes place in Section 4 where Exhibits A (Scope) and B (Disclosures) are defined. The notable addition is the requirement for all opinions to disclose the materiality standard used to determine the Risk of Material Adverse Deviation (RMAD). This standard must also be expressed in $US in Exhibit B.

• Section 4 contains the additional substantive disclosure of the name and affiliation of the person(s) responsible for the data used by the actuary in his/her analysis.

• Section 7 identifies specific requirements for the Actuarial Report. These 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 the Insurance Regulatory Information System (IRIS) ratios for One-Year Reserve Development to Surplus, Two-Year Reserve Development to Surplus, and/or Estimated Current Reserve Deficiency to Surplus, and how these factors were addressed in prior and current analyses.

• The Instructions no longer require commentary on major risk factors in the Opinion, unless the actuary is discussing the Risk of Material Adverse Deviation. However, the actuary is encouraged to continue to provide discussion of major risk factors that influence reserve variability, in the RELEVANT COMMENTS section of the Opinion.

• Disclosures requirements in the Opinion related to the actuary’s opinion on unearned premium for long duration contracts have been reduced.

Appendix 9, Regulatory Guidance on Property Casualty Statutory Actuarial Opinions, prepared by the Casualty Actuarial Task Force (CATF) of the NAIC, is a document written by regulatory actuaries for publication in the Practice Note. It is meant to clarify the expectations of regulatory actuaries regarding Statements of Actuarial Opinions. Although approved by the CATF, its contents are not binding and do not replace authoritative directives issued by any given domiciliary state. The CATF expects to update that Regulatory Guidance document annually.

In recent years, there have been a number of changes to the Annual Statement Instructions for the Notes to the Annual Statement. The actuary may wish to review these Notes for consistency with his/her analysis, and in particular:
• Note 20. September 11 Event
Note 23. Reinsurance

Note 25. Changes in Incurred Losses and Loss Adjustment Expenses

Note 33. Asbestos and Environmental Reserves

The actuary is reminded that COPLFR considers the NAIC project on Codification of Statutory Accounting Principles which was implemented in 2001 to be significant. Codification caused several significant changes in statutory accounting. The excess of statutory reserves over statement reserves (Schedule P penalty) was eliminated. Codification also requires that management record its best estimate of loss reserves by line of business and in total.

Codification includes a balance sheet liability, if needed, for premium deficiency reserves. The NAIC Annual Statement Instructions do not include any requirement for the actuary to comment on these reserves, except as may be required regarding long duration contracts.

COPLFR has collected additional material concerning frequently asked questions in Appendix 2 and wording in common use in Appendix 5.

New Data Testing Requirement for 2004 Annual Statements

The 2004 Annual Statement Instructions contain a new paragraph in Section 9, “Scope of Examination and Report of Independent Certified Accountant,” requiring the auditor to obtain an understanding of the data and/or data elements that the Appointed Actuary identifies as being significant.

In October 2004, the American Academy of Actuaries issued a document entitled Data Testing Requirement in 2004 P/C Annual Statement Instructions: Guidance for Actuaries Signing Statements of Actuarial Opinions on Loss and Loss Expense Reserves. That document is included in this Practice Note as Appendix 11.

Advance Notification of Future Changes

There are two significant changes for the year-end 2005 Statements of Actuarial Opinion. For your convenience, the draft 2005 Instructions are included as Appendix 10.

1. The 2005 changes include the submission of a confidential document, the Actuarial Opinion Summary (AOS), by March 15 to a domiciliary state that requires it. The AOS should include at least:
   - the actuary’s range, both gross and net; and/or
   - the actuary’s point estimate, both gross and net; and
   - the company’s recorded reserves, both gross and net; and
   - the difference between the carried reserves and the actuary’s point estimate or range, both gross and net; and
where there has been one year adverse development greater than 5% of surplus in at least 3 of the last 5 calendar years, explicit discussion of the reserve elements or management decisions that were the major contributors.

In conjunction with the AOS, there is a Model Law to protect the confidentiality of the AOS and the actuarial report. Passage of the Model Law is expected to become an accreditation standard. This process is expected to take several years. It is possible that states will request voluntary submission of the AOS as early as year-end 2004. Actuaries may consult the Law Manual or contact regulators for further information.

2. In 2005, the process for replacing the Appointed Actuary will be similar to the process currently in effect for replacing the independent auditor. This process will require submission of letters from the company and the actuary regarding any disagreements concerning matters within the scope of the actuary’s opinion. Additionally, the timeframe for notification to the domiciliary commissioner after action by the Board has been shortened from within 30 days to within 5 days. An additional 10 days is allowed for the submission of the letters regarding any disagreements.

Electronic Filing

The NAIC central office requires that an electronic version of the Statement of Actuarial Opinion be filed with the electronic version of the Annual Statement that is filed with the central office. At this time there is not a similar requirement at the state level. 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 Statement of Actuarial Opinion.
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Statements of Actuarial Opinion on P&C Loss Reserves as of December 31, 2004

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 NAIC 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. Whenever the Board of Directors replaces the Appointed Actuary, the company must notify the domiciliary commissioner within 30 days of the date of the Board action and give the reasons for the replacement.

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 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.

This Opinion and the supporting Actuarial Report should be consistent with Actuarial Standards of Practice 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 appropriate 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. Under the Instructions, any change in the Appointed Actuary requires notification to the domiciliary commissioner. If, for example, one actuary is appointed in November 2003 for the December 2003 opinion without mention of subsequent year-ends, and a different actuary is appointed in November 2004 for the December 2004 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 Statement of Actuarial Opinion (Sections 4 through 6, and Exhibits A and B of the Instructions) and to convey clearly the findings given in the Statement of Actuarial Opinion. The report usually provides more discussion than the Statement of Actuarial Opinion itself. An oral report may be desirable (although it is not required) in order 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. See Appendix 9 for the regulators’ discussion of this presentation.

Since a Statement of Actuarial Opinion 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.

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 Actuarial Standard of Practice (ASOP) No. 9 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.

The actuary should note that the Statement of Actuarial Opinion is a Prescribed Statement of Actuarial Opinion as contemplated in the Qualification Standards for Prescribed Statements of Actuarial Opinion promulgated by the American Academy of Actuaries, and the actuary must meet the qualifications contained therein.

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.

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 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 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 – SECTIONS 2 AND 3:

No specific description of possible practice is provided for sections 2 and 3 of the NAIC Instructions.

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 (3 thru 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 – 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.

Detailed description of possible practice concerning the evaluation and reconciliation of data is provided in Appendix 1. Further guidance 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 will generally be appropriate, absent any extenuating circumstances that may warrant the use of alternative language.

Certain states interpret these Instructions literally, and expect the actuary to have examined the Company’s methodology for determining its reserves. The actuary should be familiar with the Company’s domiciliary state interpretation and may need to perform additional work in order 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:

_In the opinion paragraph, the following should be included:_

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._

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 under ASOP No. 36 and the actuary is required by the ASOP 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 which covers at least 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 the OPINION paragraph 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.
DISCUSSION – THE OPINION:

In accordance with ASOP No. 36, the actuary should state whether the opinion is for losses and loss adjustment expenses combined or separately.

ASOP No. 36 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 contains specific disclosure requirements for Deficient or Inadequate Opinions, Redundant or Excessive Opinions, Qualified Opinions and situations where No Opinion can be formed. Appendix 2 contains further guidance.

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 causes such as 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 requires this disclosure when the actuary reasonably believes that there are significant risks and 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 should follow ASOP No. 36 and be guided by the principles contained in the Statement of Principles Regarding Property and Casualty Loss and Loss Adjustment Expense Reserves of the Casualty Actuarial Society (CAS) contained in an Appendix to ASOP No. 9.

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

Because of changes due to Codification, management is required to record management’s 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 should represent management’s best estimate. The actuary may wish to ascertain from management that the recorded reserves are management’s best estimate by line of business and in total.
Section 5 also requires that if an actuary has relied on the Actuarial Opinion of another actuary, the actuary must state that other actuary’s name and affiliation in the opinion. ASOP No. 36 further outlines the actuary’s responsibilities when relying on the opinions of other actuaries.

**DISCUSSION-DEFICIENT OR REDUNDANT PROVISION:**

Note that ASOP No. 36 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.

e. 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.


Financial reinsurance refers to contracts referenced in SSAP No. 62, Property and Liability Reinsurance, Paragraph 34, 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 previously employed, that change should be described in a RELEVANT COMMENT paragraph.
DISCUSSION-RISK OF MATERIAL ADVERSE DEVIATION:

ASOP No. 36 requires an additional explanatory paragraph when the actuary reasonably believes that there are significant risks and uncertainties that could result in material adverse deviation. This paragraph should contain the following:

a) the amount of adverse deviation that the actuary judges to be material with respect to the Statement of Actuarial Opinion; and

b) a description of the major factors or particular conditions underlying risks and uncertainties that the actuary believes could result in material adverse deviation.

The NAIC Instructions requires that the actuary explicitly state whether or not he or she reasonably believes that there are significant risks and uncertainties that could result in material adverse deviation. Further, the actuary is always required to disclose the materiality standard in Exhibit B, and the basis for establishing this materiality standard in a RELEVANT COMMENT paragraph.

The actuary may wish to consider the interaction between this NAIC requirement and the ASOP No. 36 disclosure.

The opining actuary is expected to use his or her discretion as to which risk factors and issues merit discussion in the opinion. Preparation of an all inclusive list of significant risk factors is impossible, but the following listing may provide some guidance for the types of risk factors and underlying loss exposures for which comments may be appropriate:

Asbestos
Construction Defect
Cumulative Injury
Other Mass Torts
High Excess Layers
Large Deductible Workers Compensation
Recently Enacted Legislation
Tobacco
Medical Malpractice Legislative Issues
New Products and/or New Markets
Rapid Growth
Coverage Disputes
Mold
Terrorist Attacks of September 11, 2001

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. The actuary may consider wording which describes that additional factors other than those described in the opinion may
also have an impact on the reserves. The wording may be an introduction to the extended comments such as the following:

The Company writes a variety of coverages whose major risk factors materially impact on the variability of the Company’s reserves. I have identified the major risk factors as ____________, ____________, and ____________. The potential impact of these risk factors is 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 been a significant influence on the Company’s reserves.

DISCUSSION-ADDITIONAL RELEVANT COMMENTS:

The actuary should also describe the significance of each of the remaining Disclosure items in Exhibit B.

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

Commentary is also required to explain any exceptional values using the IRIS Tests for One-Year Reserve Development to Surplus, Two-Year 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 should be described in a RELEVANT COMMENT paragraph.

DISCUSSION-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.

If the actuary is providing a Statement of Actuarial Opinion for discounted loss and loss adjustment expense reserves, the actuary should be guided by both ASOP No. 36, and ASOP No. 20, Discounting of Property and Casualty Loss and Loss Adjustment Expense Reserves.

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

DISCUSSION-POOLS AND ASSOCIATIONS:
Some key considerations for the Actuarial Opinion concerning company practice will generally be:

1. Are pool reserves material?

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 booking of pool losses, does the company accrue for this or not? Are premiums treated similarly? Are these items material? Note that requirements for accrual for booking lag are addressed by Codification.

Appendix 3 contains further guidance.

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 independently review 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 ___%. 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 to be 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 to be immaterial.*

**DISCUSSION-MASS TORT EXPOSURE:**

Many mass tort situations have significant uncertainties associated with reserve estimation. Recent advances in actuarial methodologies have assisted in the quantification of some such situations; however, there may be some cases where the actuary may believe that the reserve is not actuarially estimable, and this may create a qualified opinion as defined by ASOP No. 36. The examples that follow deal with specific types of this exposure, namely, environmental and asbestos liability. However, the discussion provided may be of assistance to an actuary when dealing with other mass tort situations.

In most cases, one of two 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 should result in either a scope limitation (which may be appropriate in those situations where 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 Statement.) 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.

For situation (2) above, the actuary may choose to review the company’s disclosure in the Notes to the Annual Statement as well as, for publicly held companies, the form 10K (SEC document) and possibly the Annual Statement Notes and 10Ks of similar companies. The actuary may choose to consider commenting on the following items:

1. whether or not there appears to be a *material* exposure,

2. the *aggregate* dollar amount of reserves held for this exposure, and

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,

c. whether these liabilities are being handled by a dedicated experienced claim/legal unit, and

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 loss and loss adjustment for asbestos and environmental claims. Estimation of ultimate liabilities for these claims is unusually difficult due to outstanding issues such as whether coverage exists, 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 include significant unresolved legal issues including such items as the existence of coverage, the definition of an occurrence as, well as the general risks inherent in major litigation, expanded theories of liability, and future court coverage decisions.

DISCUSSION-RETROACTIVE REINSURANCE/FINANCIAL REINSURANCE:

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

In addition, the 2004 Instructions require that any write-in assumed reserves on Page 3 be listed in Exhibit A: SCOPE.

A determination of whether a particular contract is retroactive reinsurance (loss portfolio transfer) or financial reinsurance is required of the Company for accounting purposes. If any contract was accounted for by the Company 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 was 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 should be made by the Company’s accounting experts. The actuary may choose to be familiar with the important aspects of the reinsurance coverage, but can rely on summaries of the reinsurance prepared by others, rather than reading and evaluating each contract. However, if the actuary is aware of a determination that the actuary believes to be clearly incorrect, the actuary ordinarily would indicate this in the Statement of Actuarial Opinion, and describe his or her treatment of the contract(s) in question and the impact on the actuary’s opinion.

It typically will not be necessary to identify specific reinsurers or contracts in the Statement of Actuarial Opinion.

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),

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 as financial reinsurance.

DISCUSSION-REINSURANCE COLLECTIBILITY:

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

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

The actuary may choose to discuss 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 these 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, information is publicly available that materially impacts the perceived value of ceded reinsurance. The Instructions provide that the actuary’s comments should reflect any such information that the actuary has. For example, large cessions to a company recently placed under regulatory control would ordinarily be commented on if the actuary has knowledge of such.

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

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 either with residual market pools or with companies rated XX or better by A.M. Best Company or fully collateralized. Past uncollectibility levels and current amounts in dispute have been reviewed and found to be immaterial relative to 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 uncovered 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-NAIC IRIS TESTS:

No specific description of possible practice is provided with respect to IRIS tests.

ILLUSTRATIVE WORDING-NAIC IRIS TESTS:
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 claims 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.*

Or

*During the past year, the Company booked significant amounts of additional premiums in long tail lines from various loss-sensitive programs. This additional premium caused an exceptional value for the IRIS Test regarding Estimated Current Reserve Deficiency to Surplus. These lines have also shown some upward reserve development, but not substantial development.*

**DISCUSSION-LACK OF HISTORICAL DATA:**

In situations where 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;

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 company for which the actuary is rendering an opinion;

3. whether disclosures should be provided concerning the data used; and

4. whether disclosures should be provided concerning the resulting variability and uncertainty.

**ILLUSTRATIVE WORDING-LACK OF HISTORICAL DATA:**

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

1. **New Company-Opinion Formed**

   *The ABC Insurance Company commenced operations in 20XX. Certain critical assumptions the Company relied on 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 need to use these external data.*
2. New Company-No Opinion Formed

_The ABC Insurance Company 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 December 31, 20XX. I am not aware of appropriate external data upon which to base an estimate._

DISCUSSION: CHANGE IN METHODS AND ASSUMPTIONS:

The NAIC requirement is similar to the ASOP No. 36 required disclosure of changes in the opining actuary’s assumptions, procedures, or methods that the actuary believes is likely to have a material effect on reserves. Not all changes need to be commented on in the opinion, only the ones that are, in the actuary’s professional judgment, material.

For example, in some situations the revised definitions related to loss adjustment expense introduced in 1998 created a material change in actuarial assumptions or methods. The actuary may have chosen to include wording similar to the following:

_A material change in actuarial methods and/or assumptions was made to reflect the changes in loss adjustment expense definitions. Details are contained in the Actuarial Report._

Under ASOP No. 36, 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 is a change in assumptions, procedures or methods for these purposes.

Where 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 usually would be to disclose the change.

It is advisable in most instances to describe briefly the reason for the change along with the change itself.

If there is a change in appointed actuaries, 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 the predecessor’s basic methodology and conclusions. If the predecessor’s methods are materially different from the newly Appointed Actuary’s, the newly Appointed Actuary may choose to note the difference in the Statement of Opinion.

ASOP No. 36 requires disclosure if 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 a 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.*

2. **Change made, materiality unknown**

   *A change in actuarial methods was made in the supporting reserve analysis (versus the prior year), the materiality of which 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 excessive. Instead, a new method was used that produces a tail more in line with historical claim development.*

**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 Actuarial Standard of Practice (ASOP) No. 9 Documentation and Disclosure in Property and Casualty Insurance Ratemaking, Loss Reserving, and Valuations. Section 5.2 of ASOP No. 9 provides guidance as follows:

1. 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 to contain all the items listed in Section 7. These Instructions also require that the Actuarial Reports 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 work papers. The actuary may wish to consider both ASOP No. 9 and the regulatory guidance in Appendix 9 when developing the Actuarial Report.
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 for which 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
Property and Casualty Practice Note
December 2004

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.

<table>
<thead>
<tr>
<th>Loss Reserves:</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Reserve for Unpaid Losses (Liabilities, Surplus and Other Funds page, Line 1)</td>
<td>$</td>
</tr>
<tr>
<td>B. Reserve for Unpaid Loss Adjustment Expenses (Liabilities, Surplus and Other Funds page, Line 3)</td>
<td>$</td>
</tr>
<tr>
<td>C. Reserve of Unpaid Losses – Direct and Assumed (Schedule P, Part 1, Totals from Cols. 13 and 15)</td>
<td>$</td>
</tr>
<tr>
<td>D. Reserve for Unpaid Loss Adjustment Expenses – Direct and Assumed (Schedule P, Part 1, Totals from Cols. 17, 19 and 21)</td>
<td>$</td>
</tr>
<tr>
<td>E. The Page 3 write-in item reserve, “Retroactive Reinsurance Reserve Assumed”</td>
<td>$</td>
</tr>
<tr>
<td>F. Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion (list separately)</td>
<td>$</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Premium Reserves:</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>G. Reserve for Direct and Assumed Unearned Premiums for Long Duration Contracts</td>
<td>$</td>
</tr>
<tr>
<td>H. Reserve for Net Unearned Premiums for Long Duration Contracts</td>
<td>$</td>
</tr>
<tr>
<td>I. Other Premium Reserve items on which the Appointed Actuary is expressing an Opinion (list separately)</td>
<td>$</td>
</tr>
</tbody>
</table>

DISCUSSION-RETROACTIVE REINSURANCE RESERVE:

This is a contra liability for the ceding company and a liability for the assuming company. Scope Items A, B, C, and D typically are not reduced by the retroactive reinsurance reserve ceded and thus are gross to these ceded reserves. Scope items A, B, C, and D 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.

### Exhibit B: DISCLOSURES

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Materiality Standard expressed in $US</td>
<td>$ ________</td>
</tr>
<tr>
<td>2. Statutory Surplus</td>
<td>$ ________</td>
</tr>
<tr>
<td>3. Anticipated net salvage and subrogation included as a reduction to loss reserves as reported in Schedule P</td>
<td>$ ________</td>
</tr>
<tr>
<td>4. Discount included as a reduction to loss reserves and loss expense reserves as reported in Schedule P</td>
<td>$ ________</td>
</tr>
<tr>
<td>4 (a) Nontabular Discount</td>
<td>$ ________</td>
</tr>
<tr>
<td>4 (b) Tabular Discount</td>
<td>$ ________</td>
</tr>
<tr>
<td>5. 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.</td>
<td>$ ________</td>
</tr>
<tr>
<td>6. 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. *</td>
<td>$ ________</td>
</tr>
<tr>
<td>6 (a) Asbestos, as disclosed in the Notes to Financial Statements</td>
<td>$ ________</td>
</tr>
<tr>
<td>6 (b) Environmental, as disclosed in the Notes to Financial Statements</td>
<td>$ ________</td>
</tr>
<tr>
<td>7. The total claims made extended loss and expense reserve (Schedule P Interrogatories).</td>
<td>$ ________</td>
</tr>
<tr>
<td>7 (a) amount reported as loss reserves</td>
<td>$ ________</td>
</tr>
<tr>
<td>7 (b) amount reported as unearned premium reserves</td>
<td>$ ________</td>
</tr>
<tr>
<td>8. Other items on which the Appointed Actuary is providing Relevant Comment (list separately)</td>
<td>$ ________</td>
</tr>
</tbody>
</table>

* The reserves disclosed in item 6 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:

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 5 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 Statement of Opinion.

Disclosure 5 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.

Disclosure 7 reflects the breakout of the extended loss and loss adjustment expense reserve, reported in the Schedule P Interrogatories, into its loss reserve and unearned premium reserve components. The Annual Statement Instructions for Schedule P require that companies disclose the extended loss and expense reserve - direct and assumed - for certain classes of business, in the Interrogatories even if it is not reported elsewhere in Schedule P but otherwise reported as a liability.

It is important to note that the scope of the actuary’s opinion includes the amount of the extended loss and expense reserve. 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 to this reserve.
Appendix 1
Evaluation and Reconciliation of Data
(Section 4 of Opinion Instructions)

“T evaluated that 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 should 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 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. The actuary generally is 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 in the particular circumstances). However, if the estimation methods used by the actuary for that line of business do not involve review of paid loss developments, the paid loss developments 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, in most instances, be used without qualification.

4. If data were identified by the actuary 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:
   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 can be described in the Statement of Actuarial Opinion and can 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 that 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 should 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 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 could be compared after the minimum 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 often 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 Years line of Schedule P were relied upon significantly, such data may be compared to Schedule P on
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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., October 31st). 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 commonly compare the actual year-end data against expected year-end values based on the earlier evaluation. The actual year-end values would commonly still be reconciled to Schedule P.

10. The Actuarial Report ordinarily contains a description of the comparison performed and of any data that were relied upon significantly but that could not be compared against Schedule P.

11. If significant, unexplained differences remain (after attempting to resolve the differences) between the data used by the actuary and those shown in Schedule P, the actuary may choose to do the following:

   a. make sure 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 get the differences resolved);

   b. recommend that the company inform its outside auditors of the unexplained differences; and

   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 should be guided by ASOP No. 36, and may wish to consider issues such as 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 can be given that is meaningful and appropriate in all circumstances. In the final analysis, materiality will depend upon the actuary’s judgment.

Materiality is also discussed in Appendix 7.

QUESTION 2:

When is a carried reserve reasonable?

DISCUSSION 2:

ASOP No. 36 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 would not make a reasonable provision for all unpaid loss and loss expense obligations.

The actuary should be guided by ASOP No. 36.

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?

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 is not generally 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, under Codification, management is required to book management’s 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 exactly should an actuary indicate that an opinion is qualified?

DISCUSSION 4:

According to ASOP No. 36, the actuary should 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 should 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 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. Actuaries typically are careful to avoid language that may imply the opinion is qualified when in fact it is not.

QUESTION 5:

How should an opining actuary treat a situation where 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, when should 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 typically reflect information such as the number of open claims, dollars of total case loss reserves and the type 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 situations that may arise.

**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 is not required to 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 is not required to 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 judgmental conclusion about materiality. The actuary should disclose this in the opinion and the supporting report. The opinion should be 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 should disclose this in the opinion and the supporting report. The opinion should be qualified to exclude this portion of the business.

**Situation 5:** A portion of the business is deemed to be out of the scope of the actuary’s review. For example, this may occur when a different actuary reviews and opines on reserves for the accident & health line of business. The actuary should disclose this in the opinion and the supporting report. The opinion should be qualified to exclude this portion of the business. If the actuary has information regarding the materiality of the business, it would be helpful to disclose this information in the opinion.

**Situation 6:** On a portion of the business, the opining actuary has relied upon on 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 opining actuary should be guided by the provisions of ASOP 36 addressing reliance on the opinions of other actuaries. The actuary should disclose the reliance in the opinion and the supporting report. The opinion should not be qualified to exclude this portion of the business.
QUESTION 6:

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

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 likely adverse deviation would not affect the actuary’s conclusion on the total reserve and should 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 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 is not required to do so. In this situation 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 does not define a “clean opinion,” and there is currently no accepted definition of this term. COPLFR believes that the five categories of opinion in ASOP No. 36 (Reasonable, Deficient, Redundant, Qualified, and No Opinion) are usually sufficient and notes that the disclosure of significant risk of material adverse deviation generally can be viewed as a disclosure and not in any way 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 should the actuary define the term “significant?”

**DISCUSSION 8:**

Although the term “significant” is not defined within the new 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.]
Appendix 3

NAIC Recommended Language for Actuarial Opinions for Pools and Associations

The Casualty Actuarial Task Force of the NAIC recommends the following language be used by pools and associations that are required by regulators to supply an actuarial opinion. This language is reproduced for the convenience of the reader. The CATF has not modified this language to be consistent with the new P & C Instructions but they have indicated they intend to do this for 2005.

Actuarial Opinion for a Pool

1. There is to be forwarded to each pool Board of Directors, the statement of a Qualified Actuary, entitled “Statement of Actuarial Opinion,” setting forth his or her opinion relating to loss and loss adjustment expense reserves. The Qualified Actuary must be appointed by the Board of Directors, or its equivalent, or by a committee of the Board, by the end of the year for which the opinion is rendered. The Appointed Actuary must present a report to the Board of Directors each year on the items within the scope of the opinion. The pool administrator will forward a copy of the actuary’s Statement of Opinion to pool members by January 31st of the succeeding year or as otherwise agreed by voluntary pool members.

2. Definitions

Qualified Actuary is a person who is either:

A. a member in good standing of the Casualty Actuarial Society, or

B. 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.

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.

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, and of insuring that the parties addressed are aware
of the significance of the actuary’s opinion or findings and which documents the analysis underlying the opinion.

*Annual report* means the annual financial statement prepared by pools or related entities.

3. Such a Statement of Opinion must consist of a paragraph identifying the actuary; a SCOPE paragraph identifying the subjects on which an opinion is to be expressed and describing the scope of the actuary’s work (see sections 6-11 below); and an OPINION paragraph expressing his or her opinion with respect to such subjects (see section 12-14 below). One or more additional paragraphs may be needed in individual cases if the actuary considers it necessary to state a qualification of his or her opinion or to explain some aspect of the annual report which is not already sufficiently explained in the annual report.

4. The opening paragraph should generally indicate that actuary’s relationship to the entity. For an employee/actuary the opening paragraph of the actuarial opinion should contain the sentence:

   “I, (name and title of actuary), am an officer (employee) of (named entity) and a member of the American Academy of Actuaries and meet its qualification standards. (and/or) I am a Fellow/Associate of the Casualty Actuarial Society. I was appointed by the Board of Directors (or equivalent authority) on (insert date) to render this opinion.”

For a consulting actuary, the opening paragraph of the actuarial opinion should contain the sentence:

   “I, (name and title of actuary), am associated with the firm of (name of firm). I am a member of the American Academy of Actuaries and meet its qualification standards. (and/or) I am a Fellow/Associate of the Casualty Actuarial Society. I was appointed by the Board of Directors (or equivalent authority) or (insert date) to render this opinion.”

A member of the American Academy of Actuaries qualifying under paragraph 2(B) must attach the approval letter from the Academy.

5. The following are examples, for illustrative purposes, of language which in typical circumstances would be included in the remainder of the Statement of Actuarial Opinion. The illustrative language should be modified as needed to meet the circumstances of a particular case, and the actuary should in any case use language which clearly expresses his or her professional judgment.

6. The SCOPE paragraph should contain a sentence such as the following: “I have examined the actuarial assumptions and methods used in determining reserves listed below, as shown in the annual report of the entity as prepared for filing with state regulatory officials and/or members.”
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The paragraph should list those items and amounts with respect to which the actuary is expressing an opinion. The list should include but not necessarily be limited to:

A. reserve for unpaid losses-net;
B. reserve for unpaid loss adjustment expenses-net;
C. reserve for unpaid losses-direct and assumed; and,
D. reserve for unpaid loss adjustment expenses-direct and assumed.

The net reserve shown above is net of reinsurance other than cessions used to distribute the losses to pool members.

7. The actuary should state that the items in paragraph 6, on which he or she is expressing an opinion, reflect the following items and their amounts:

A. anticipated salvage and subrogation included as a reduction to loss reserves;
B. discount for time value of money (tabular versus non-tabular) included as a reduction to loss reserves and loss expense reserves;
C. the net reserves for loss and expense for the entity’s share of other underwriting pools and associations unpaid losses and expenses which are included in reserves. This paragraph should also indicate the accounting basis on which the entity is providing its financial information, indicate the valuation date of data used in support of the opinion and whether this data has been adjusted to reflect expected values at December 31 of the year in question. Alternatively, if data reported by the entity is on a lagged basis, the number of months by which data are lagged should be noted.

8. The SCOPE paragraph should include a paragraph such as the following regarding the data used by the actuary in forming the opinion:

“In forming my opinion on the loss and loss adjustment expense reserves, I relied upon data prepared by the responsible officers or employees of the entity. I evaluated that data for reasonableness and consistency and also reconciled the data to the data included in the annual report. 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.”

9. The actuary should comment in the SCOPE section on each of the following topics, describing the effect of each on loss or loss expense reserves: discounting, salvage/subrogation, other underwriting pools or associations, loss portfolio transfers, financial reinsurance, and reinsurance collectibility.
For the purpose of this instruction, loss portfolio transfer refers to any agreement for which the liability decreases by an amount greater than the consideration to effect the transaction and for which the consideration paid by the transferring entity is derived from present value or discounting concepts.

Financial reinsurance refers to contractual arrangements for which credit is not allowed by the NAIC Accounting Practices and Procedures Manual for the ceding entity because the arrangements do not include a transfer of both timing and underwriting risk by which the reinsurer undertakes in fact to indemnify the ceding entity against loss or liability by reason of the original insurance.

Before commenting on reinsurance collectibility, the actuary should solicit information from management on any actual collectibility problems and review ratings given to reinsurers by a recognized rating service. The comment should also reflect any other information the actuary has received from management or which 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.

10. The actuary should comment on and describe the effects of any additional relevant topics which in the actuary’s judgment materially affect loss or loss expense reserves, such as collectibility of assessments, the mechanism for recovering any pool deficits, or the nature of member’s liability as part of the pool.

11. 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 should include an explanation.

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

   “In my opinion, the amounts carried in the SCOPE paragraph on account of the items identified:

   A. are computed and allocated in their actuarial aspects to pool members in accordance with accepted loss reserving standards and principles.

   B. make a reasonable provision for all unpaid loss and loss expense obligations of the entity under the terms of its policies and agreements.”

13. If there has been any material change in the actuarial assumptions and/or methods from those previously employed, that change should be described in the Statement of Actuarial Opinion by inserting a phrase such as:

   “A material change in actuarial assumptions (and/or methods) was made during the past year, but such change accords with accepted loss reserving standards.”

A brief description of the change should follow.
The adoption of new issues or coverages requiring underlying actuarial assumptions which differ from actuarial assumptions used for prior issues or coverages is not a change in actuarial assumption within the meaning of this paragraph.

14. If the actuary’s opinion is adverse or qualified, the actuary should issue an adverse or qualified actuarial opinion explicitly stating the reason(s) for such opinion. If the actuary is unable to form an opinion, he or she should issue a statement explicitly stating the reasons why an opinion cannot be formed. The entity must make this statement from the actuary available to its members.

15. The statement must include assurance that an Actuarial Report and underlying work papers supporting the actuarial opinion and describing how the actuary treated each of the topics listed in paragraphs 9, 10, and 11 will be maintained at the entity’s offices and available for examination for seven years. The report should be available by April 1 of the year following the year of the opinion. The wording for an actuary employed by the entity should be similar to the following:

“An Actuarial Report and underlying work papers supporting the findings expressed in this Statement of Actuarial Opinion will be retained for a period of seven years in the entity’s offices and available for examination by members and for regulatory examination, if appropriate.”

The wording for a consulting actuary retained by the entity should be similar to the following:

“An Actuarial Report and underlying work papers supporting the findings expressed in this Statement of Actuarial Opinion have been provided to the entity to be retained for a period of seven years at the entity’s offices and available for examination by members and for regulatory examination, if appropriate.”

16. The statement should conclude with the signature of the actuary responsible for providing the opinion. The signature should appear in the following format:

________________________________________
Signature of actuary
Printed name of actuary
Address of actuary
Telephone number of actuary
Date of opinion

17. The entity 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 was in error as a result of reliance on data or other information (other than assumptions) that, as of the valuation 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 valuation date or because actual results differ from those projected.

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

An entity who is notified pursuant to the preceding paragraphs shall forward a copy of the summary and the amended opinion to all recipients of the previous opinion 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 such previous recipients. 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 such previous recipients to the extent they are known to him/her 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 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 Statement of Opinion, the actuary and the entity should undertake as quickly as is reasonably practical those procedures necessary for the actuary to make the determination discussed above. If the entity 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 Qualified 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 4

Statements of Actuarial Opinion on Title Loss Reserves

In 1996 the NAIC Annual Statement Instructions, Title Insurance, was amended to include, for the first time, a requirement for an actuarial opinion. The Instructions for the Title actuarial opinion are very similar to the old property and casualty Instructions. This Appendix was prepared to provide assistance to actuaries preparing Title opinions by commenting on significant differences from the old property and casualty Instructions by section. This language is reproduced for the convenience of the reader.

The CATF has not modified this language to be consistent with the new P & C 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 loss and loss adjustment expense reserves. 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. Whenever the appointed actuary is replaced by the Board of Directors, the company must notify the domiciliary commissioner within 30 days of the date of the Board action and give the reasons for the replacement. The appointed actuary must present a report to the Board of Directors 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 a report 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.

2. Definitions

“Qualified actuary” is a person who is either:

A. A member in good standing of the Casualty Actuarial Society, or

B. 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, or
C. A person who otherwise has competency in loss reserve evaluation as demonstrated to the satisfaction of the insurance regulatory official of the domiciliary state. In such case, at least 90 days prior to the filing of its annual statement, the insurer must request approval that the person is deemed qualified and that request must be approved or denied. The request must include the NAIC Biographical Form and a list of all loss reserve opinions issued in the last 3 years by this person.

Notwithstanding the above, a domiciliary commissioner may, by bulletin or regulation, specify who may sign an opinion. Also, a domiciliary commissioner may require particular qualifications, including independence, for specific insurers.

“Insurer” means an insurer authorized to write title insurance under the laws of any state.

“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 showing the analysis from the basic data, e.g., loss triangles, to the conclusions, and of assuring that the parties addressed are aware of the significance of the actuary’s opinion or findings and which documents the analysis underlying the opinion.

“Annual Statement” means the annual financial statement required to be filed by insurers with the commissioner.

3. Content

The opinion shall be in the format of and contain the information required by this Section of the NAIC Annual Statement Instructions: Title Insurance.

4. 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/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 otherwise subject to the requirement 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 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

A. 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.

B. 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 net 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.

5. Such a statement of opinion must consist of an IDENTIFICATION paragraph identifying the actuary; a SCOPE paragraph identifying the subjects on which an opinion is to be expressed and describing the scope of the actuary’s work (see paragraphs 8–11 below); and an OPINION paragraph expressing his or her opinion with respect to such subjects (see paragraphs 12–14 below). One or more additional RELEVANT COMMENTS paragraphs may be needed in individual cases if the actuary considers it necessary to state a qualification of his or her opinion or to explain some aspect of the annual statement which is not already sufficiently explained in the annual statement. These four sections must be clearly designated.
6. The identification paragraph should generally indicate the actuary’s relationship to the company. For a company actuary the identification paragraph of the actuarial opinion should contain the sentence:

“I, (name and title of actuary), am an officer (employee) of (named insurer) and a member of the American Academy of Actuaries and meet its qualification standards. (and/or) I am a Fellow/Associate of the Casualty Actuarial Society. I was appointed by the Board of Directors (or equivalent authority) on (insert date) to render this opinion.”

For a consulting actuary, the identification paragraph of the actuarial opinion should contain the sentence:

“I, (name and title of actuary), am associated with the firm of (name of firm). I am a member of the American Academy of Actuaries and meet its qualification standards. (and/or) I am a Fellow/Associate of the Casualty Actuarial Society. I was appointed by the Board of Directors (or equivalent authority) on (insert date) to render this opinion.”

A member of the American Academy of Actuaries qualifying under paragraph 2B must attach the approval letter from the Academy.

For a person other than a member of the American Academy of Actuaries or a member of the Casualty Actuarial Society, the identification paragraph of the opinion should contain the sentence:

“I, (name and title), am an officer (employee) of (name of insurer), and I have demonstrated competency in loss reserving to the satisfaction of (regulatory official of domiciliary state). I was appointed by the Board of Directors (or equivalent authority) on (insert date) to render this opinion.”

or

“I, (name and title of consultant), am associated with the firm of (name of firm). I have demonstrated competency in loss reserving to the satisfaction of (regulatory official of domiciliary state). I was appointed by the Board of Directors (or equivalent authority) on (insert date) to render this opinion.”

A person who is neither a member of the American Academy of Actuaries nor a member of the Casualty Actuarial Society and who has qualified under paragraph 2C must attach the approval letter from the insurance regulatory official of the domiciliary state.

7. The following are examples, for illustrative purposes, of language that in typical circumstances would be included in the remainder of the Statement of Actuarial Opinion. The illustrative language should be modified as needed to meet the
circumstances of a particular case, and the actuary should in any case use language that clearly expresses his or her professional judgment.

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

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

The paragraph should list those items and amounts with respect to which the actuary is expressing an opinion. The list should include but not necessarily be limited to:

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)

9. The actuary should state that the items in paragraph 8, on which he or she is expressing an opinion, reflect the following items:

   A. No anticipated salvage and subrogation is included as a reduction of paid losses or the known claims reserves. Salvage and subrogation is only included when received in the form of an admitted asset;

   B. Discount for time value of money included as a reduction to loss reserves and loss expense reserves as reported in Schedule P – Analysis of Losses and Loss Expenses, Operations and Investment Exhibit –Part 3B; and

   C. The net reserves for losses and expenses for the company’s share of underwriting pools’ and associations’ unpaid losses and expenses which are included in reserves shown on Page 3 – Liability, Surplus and Other Funds, the sum of Lines 1, 2, 3 and 4.

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

   “In forming my opinion on the loss and loss adjustment expense reserves, I relied upon data prepared by the responsible officers or employees of the company or group to which it belongs. 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.”
11. The actuary should comment in the scope section on each of the following topics, describing the effect of each on loss or loss expense reserves: discounting, salvage/subrogation, underwriting pools or associations, retroactive reinsurance, financial reinsurance, and reinsurance collectibility. The actuary should also comment on and describe the effects of any additional relevant topics that in the actuary’s judgment materially affect loss or loss expense reserves.

For the purpose of this instruction, “retroactive reinsurance” refers to any agreement which increases the transferring insurer’s Surplus to Policyholders as a result of the transferee undertaking any loss obligation already incurred, and for which the consideration paid by the transferring insurer is derived from present value or discounting concepts.

“Financial reinsurance” refers to contractual arrangements for which credit is not allowed by the NAIC Accounting Practices and Procedures manual for the ceding insurer because the arrangements do not include a transfer of both timing and underwriting risk by which the reinsurer undertakes in fact to indemnify the ceding insurer against loss or liability by reason of the original insurance.

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 which 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.

12. 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 the scope paragraph 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 loss reserving standards and principles.

C. Make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.”

Insurance laws and regulations shall at all times take precedence over the actuarial standards and principles.
13. If there has been any material change in the actuarial assumptions and/or methods from those previously employed, that change should be described in the Statement of Actuarial Opinion by inserting a phrase such as:

“A material change in actuarial assumptions (and/or methods) was made during the past year, but such change accords with accepted loss reserving standards.”

A brief description of the change should follow.

The adoption of new issues or coverages requiring underlying actuarial assumptions which differ from actuarial assumptions used for prior issues or coverages is not a change in actuarial assumption within the meaning of this paragraph.

14. If the actuary’s opinion is adverse or qualified, the actuary should issue an adverse or qualified actuarial opinion explicitly stating the reason(s) for such opinion. If the actuary is unable to form an opinion, he or she should issue a statement explicitly stating the reason(s) why an opinion cannot be formed. The company must include this statement from the actuary with its annual statement.

15. The statement must include assurance that an actuarial report and underlying actuarial workpapers supporting the actuarial opinion, including documentation of the reconciliations required by paragraph 10, and the description of how the actuary treated each of the topics listed in paragraph 11, will be maintained at the company and available for examination for seven years. The above 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 wording for an actuary employed by the company should be similar to the following:

“An actuarial report and any underlying actuarial workpapers supporting the findings expressed in this Statement of Actuarial Opinion will be retained for a period of seven years in the administrative offices of the Company and available for regulatory examination.”

The wording for a consulting actuary retained by the company should be similar to the following:

“An actuarial report and any underlying actuarial workpapers supporting the findings expressed in this Statement of Actuarial Opinion have been provided to the Company to be retained for a period of seven years in the administrative offices of the company and available for regulatory examination.”
16. The statement should conclude with the signature of the actuary responsible for providing the 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

17. 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 for which 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 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 statement of 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 qualified 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-OPINION:

In section 8, the actuary is required 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 incurred but not reported losses and ALAE (“IBNR”), and a provision for unallocated loss adjustment expense.

The Schedule P reserves are not always the same as the liabilities shown on page 3 of the Annual Statement (Liabilities, Surplus and Other Assets). Page 3 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. There may be instances where the actuary may wish to comment on the amounts shown on the balance sheet, but the Instructions do not require any comment on them.

The reconciliation of the Schedule P reserves and the balance sheet reserves occurs in Part 3B of the Operations and Investment Exhibit of the Annual Statement.

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.

DISCUSSION-RECONCILIATION OF DATA:

Section 10 of the Title Instructions is similar to 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 are on a policy-year basis. Part 1 shows written premium instead of earned premium. Part 2 requires twenty 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 is on a report-year basis, does not require reconciliation but could be used to evaluate the adequacy of known case reserves.

DISCUSSION-RELEVANT COMMENTS:

The Title Opinion Instructions require comment on discounting, salvage/subrogation, and underwriting pools or associations, regardless of materiality. They do not require discussion of asbestos and environmental exposures or NAIC IRIS tests.
Appendix 5

Miscellaneous Illustrative Wordings in Common Use

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 above, 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. It is certain that 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 above represent a reasonable provision based on the appropriate application of actuarial techniques to the available data, there can be no guarantee that the actual future payments will not differ from the reserve values stated above.

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

My projections make no provision for the extraordinary future emergence of new classes of losses or types of losses not sufficiently represented in the Company’s historical database or which are not yet quantifiable.

The actuary may wish to include language in those situations where 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 A and B as well as the sum of items C and D above:

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 only to be relied upon by, the Company and the various state insurance departments with which it files its Annual Statement.

Opinions may include wording concerning special circumstances which 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 control of the insurance department, placed in run off, downgraded by a major rating agency, subject to a number of stories in the trade press regarding BBBBBB.) As a result of these events, I have identified the following risk factors which may materially 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 to 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.

Examples of Wordings on Material Adverse Deviation.

Some actuaries have expanded the discussion of risk factors and inherent uncertainty.

I believe that the risk factors above, coupled with the variability that is inherent in any reserve estimate, could result in material adverse deviation from the carried net reserve amounts. In making this determination, I have considered a material adverse deviation to be one in which the actual net outstanding losses and loss adjustment expenses exceed the total of A and B, above, by an amount greater than x% of the Company’s statutory surplus shown on the Liabilities, Surplus
and Other Funds page, of the Annual Statement (i.e., a reserve deviation greater than $z) and/or y% of the Company’s Loss and Loss Adjustment Expense Reserves.

With respect to the gross reserves, the materiality of adverse deviation as it relates to the Company’s surplus will depend on the Company’s reinsurance protection. If the company’s reinsurance protection does not respond to adverse reserve deviation, such deviation could materially affect the company’s surplus.

My selection of the materiality standard (x% of statutory surplus, and/or y% of Loss and Loss Adjustment Expense Reserves) was driven by the fact that this opinion is prepared for the regulatory review of the Company. Other measures of materiality might be used for reserves that are being evaluated in a different context.

The actuary may wish to include comment when reserves are large in relation to other financial statement items.

Because of the size of the Company’s loss and loss adjustment expense reserves relative to its surplus, there is more than a remote possibility that adverse fluctuations of actual versus expected liabilities will be material. For this reason I believe that there are significant risks and uncertainties that could result in material adverse deviation in the loss and loss adjustment expense reserves. In consideration of the intended use of this opinion for the purpose of solvency monitoring, as well the financial condition of the Company, I believe that x% of surplus and/or y% of Loss and Loss Adjustment Expense Reserves would be material for this Company.

Similar comments have been used when the reserves are at the low end of a reasonable range, when net retentions are such that a single claim can have material effect, when material amounts of reserves arise from lines of business with atypical volatility (e.g., excess workers compensation), or when the company is exposed to such difficult types of loss as asbestos, pollution, construction defect or Ohio uninsured motorists.

The actuary may wish to comment when the source of potential adverse deviation arises from ceded reinsurance matters.

As noted above, the Company cedes over $6 million of loss and loss adjustment expense reserves to reinsurers in comparison to the Company’s surplus as regards policyholders of $2 million. While the probability of failure to collect the full amount of the ceded reserves from these reinsurers is unknown, it is more than remote. Therefore I believe that there are significant risks and uncertainties that could result in material adverse deviation in the loss and loss adjustment expense reserves, possibly by amounts exceeding surplus. I believe that x% of surplus would be material for this Company.

Similar paragraphs address significant reinsurance disputes, or note that a large amount of the cessions are with reinsurers with low ratings from a reputable insurance rating agency, or are under state supervision.
The actuary may wish to comment when solvency or minimum capital and surplus are threatened, or risk-based capital thresholds (Company Action Level, Regulatory Action Level, Authorized Control Level, or Mandatory Control Level) are reached.

The Company’s surplus as regards policyholders as shown on the Liabilities, Surplus, and Other Funds page, Surplus as regards policyholders line, $5,000,000. I understand that the risk based capital authorized control level for the Company is $4,900,000. Because of the size of the Company’s loss and loss adjustment expense reserves relative to its surplus there is more than a remote possibility that adverse fluctuations of actual versus expected liabilities will cause surplus to fall below the risk based capital authorized control level. For this reason I believe that there are significant risks and uncertainties that could result in material adverse deviation in the loss and loss adjustment expense reserves.
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 their percentage 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 + assumed and ceded business be reported on a pooled basis. For companies within a group which 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% 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 section.

10. 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 above has been performed for all pool companies combined.

   or
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 impact pool members in a manner consistent 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.

11. 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, especially the Estimated Current Reserve Deficiency to Surplus.

14. 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.
Appendix 7
CAS VFIC Committee 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.

Several caveats are in order at this point:

- **This note is intended only as an aid and does not supercede 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 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.”
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.”

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. Secondarily, 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).

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. S.E.C. *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.

- 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
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• 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.
- 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.

Sao’s 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 its life are covered by the Section 4 and Exhibit A: SCOPE (Items G. and H.) requirements. Specific contract types are excluded: financial guaranty, mortgage guaranty, and surety. While the primary focus of SCOPE Items G. and H. is on 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 & 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 thirteen months or greater. The accounting rule, revised in 1997, is found in the NAIC Accounting Practices and Procedures Manual and is copied in the American Academy of Actuaries 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 the 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 which cover the contracts described in this Section, the actuary may choose to edit language throughout the opinion in order to keep the opinion consistent with the fact that loss, loss adjustment and unearned premium reserves are included in the opinion. 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 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 thirteen 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 G. and H.) 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:

**Premium Reserves:**

(G) **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)

(H) **Reserve for Net Unearned Premium for Long Duration Contracts**  
(subset of the Liabilities, Surplus, and Other Funds page, Unearned premiums line)

(I) **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 should clearly identify the combined items.

The following items are generally considered in calculating the needed unearned premium reserves and applying the three tests stipulated 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 expense 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 2004 NAIC Instructions no longer 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, should be included in the Actuarial Report supporting the Opinion.

**ILLUSTRATIVE WORDING:**

The Company for which the opinion is being made may be in 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; or

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 thirteen months or greater which 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 which develop an unearned premium reserve which 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 ___% 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 9

October 5, 2004

REGULATORY GUIDANCE ON
PROPERTY AND CASUALTY STATUTORY ACTUARIAL OPINIONS

Prepared by
THE CASUALTY ACTUARIAL TASK FORCE

The Annual Statement Instructions for the Property and Casualty Actuarial Opinion have been significantly revised for year-end 2004. In August 2001 the Casualty Actuarial Task Force (CATF) of the NAIC formed the Actuarial Opinion Instructions Working Group. Its purpose was to review the Instructions, consider the history and intent of the Opinion, and recommend changes, if any, to the CATF.

The 2004 Instructions reflect both structural and substantive changes. The structural changes are intended to bring more order to the Opinion Instructions. Seventeen (17) sections have been consolidated into nine (9) sections and two exhibits. All Scope and disclosure amounts are to be presented in exhibits. Substantive changes generally involve additional disclosures, as well as formally acknowledging regulatory reliance on Actuarial Standards of Practice of the Academy of Actuaries (AAA) and Statements of Principles of the Casualty Actuarial Society (CAS). The Working Group met monthly via conference call and at the Winter 2001 and Spring 2002 NAIC Meetings. During that time the members of the group:

Reviewed relevant materials:
- Life/Health and Canadian Actuarial Opinions
- The annual COPLFR Property and Casualty Practice Note
- AAA Actuarial Standards of Practice and Statements of Principles

Sought and received feedback:
- Representatives of the Examination Oversight Task Force (primarily Chief Examiners) responded to a questionnaire on the value and usefulness of the Opinion to them.
- AAA COPLFR participated in all non-confidential conference calls and meetings.
- Interested Parties and Interested Regulators similarly participated in non-confidential conference calls and meetings.

Several progressive drafts were developed and discussed during open meetings. Many of the revisions reflected the input from COPLFR, the Interested Parties, and Interested Regulators.

In May 2002 the Working Group presented recommendations to CATF. With edits for clarity, the recommendation was approved by the NAIC for implementation with Annual Statements for
year-end 2004. The revised Instructions do not create new schedules nor do they create any change to existing schedules of the Annual Statement. The most heavily debated issue that the Working Group dealt with was the degree of disclosure desired. There was a constituency of regulators favoring more disclosure within the Opinion than is reflected in the revised Instructions. There was a constituency who favored delay and further study. Despite debate on this issue, there was clear consensus among regulators that delay in implementation was not advisable. Agreement was reached to include critical disclosure items in a confidential Actuarial Opinion Summary, separate from the Statement of Actuarial Opinion, which will be required in many states beginning in 2005.

The CATF continues to discuss the value of the Actuarial Opinion in serving the regulatory mission of minimizing the impact of insurance company failures for the protection of consumers. The Instructions alone cannot convey the views of all regulators on all possible situations, nor can they respond in a timely manner to the changing issues that affect the industry or the work of actuaries. This document is prepared by the CATF to provide clarity and timely guidance to companies and to appointed actuaries regarding regulatory expectations. This document should be used in conjunction with the Annual Statement Instructions and/or the AAA Practice Note, both of which contain the revised Opinion Instructions in their entirety.

Paragraph 1. Appointment, Definitions and Exemptions
This paragraph is directed primarily to company management. It is relatively unchanged from the 2003 Instructions. However, both management and any potential appointed actuary should be mindful of the following:

- Reporting to the Board or Audit Committee. It is not required that the appointed actuary submit a paper report to the Board, although such a report must be written to support the Opinion. What is required is that the actuary report to the Board and inform them that the full Actuarial Report is available for their inspection. This may be done in a form of the actuary’s choosing, recognizing requirements that may be imposed by the company. The CATF strongly encourages the appointed actuary to present his or her analysis in a form that clearly and plainly conveys the risks and uncertainties that underlie the exposures. The Board should be aware of differences between the actuary’s estimates -- point and/or range -- and the carried reserves. The Board should be aware of the actuary’s opinion regarding the risk of material adverse deviation, and the standard by which the actuary determines material adverse deviation according to Actuarial Standard of Practice (ASOP) #36. The CATF expects that Board minutes will be reviewed for documentation of this report during the statutory financial examination.

- Consistency with Actuarial Standards of Practice and Statements of Principles. One might say that this is understood, but the CATF wants to make a clear statement of reliance on the expected professionalism of a “qualified actuary”.

Paragraph 2. Structure of the Opinion
This paragraph succinctly presents the four primary pieces of the opinion. The CATF expects that opinions will be presented in this order, with each section clearly marked.
Paragraph 3. Identification
The notable change to this paragraph is the elimination of illustrative language. Any Qualified Actuary should be able to clearly convey the required information.

Paragraph 4. Scope
This paragraph presents the first major structural change in the Instructions. The two required exhibits are shown at the end of the Instructions. Consolidating these amounts in one place allows the reader to quickly identify all items, recognize $0 values in one place, and make comparisons with the prior year.

- Exhibit A includes all required Loss and Premium reserves subject to the opinion. Space is provided to list “Other Loss Reserves” and “Other Premium Reserves” (e.g. Premium Deficiency Reserve) if the actuary determines that comment is appropriate.
- Exhibit B includes all required dollar disclosures that are to be considered when developing the opinion. The notable added disclosure for 2004 is the “Materiality Standard expressed in $US”. This is to be the materiality standard used to evaluate the Risk of Material Adverse Deviation as described in ASOP #36. Section 3.3.3 of ASOP #36 identifies the materiality standard as the amount of adverse deviation of the carried reserves that the actuary judges to be material. While ASOP #36 only requires disclosure of this standard IF the actuary reasonably believes that a risk of Material Adverse Deviation exists, the statutory opinion requires the appointed actuary to identify the standard in all opinions. Disclosure of this amount provides the reader with insight as to how the actuary evaluates materiality in this context.

Both Exhibits provide for additional items that the actuary decides to include, if appropriate. If additional items are included, the actuary is expected to identify the relevance of those items in forming the opinion.

The CATF preferred to avoid illustrative language as much as possible. However, the CATF felt illustrative language was advisable for this section due to the use of Exhibits A and B. The CATF encourages all actuaries to use whatever language they feel is appropriate to clearly convey their opinion and thought processes.

The Scope paragraph also requires a new substantive disclosure of the name, affiliation and relation to the Company of the individual upon whom the appointed actuary relied for preparation of the data. This replaces the reference to reliance on “responsible officers and employees of the company.” The CATF added this disclosure in response to two concerns:

i) In past situations where substantial adverse deviation has resulted, some appointed actuaries have responded with “I got bad data.”

ii) Reference to “responsible officers and employees of the company” provides no useful information in the opinion. The required disclosure looks for additional accountability and diligence on the part of the actuary to know who has provided key information.

The CATF expects the actuary to identify at most one or two senior individuals who are responsible for integrity of the actuarial data. In some cases the appointed actuary may be the individual who holds this responsibility.
Paragraph 5. Opinion
This paragraph consolidates sections on the Loss reserves and Premium reserves. It also adds specific definitions for five types of opinion, consistent with guidance in ASOP #36. The CATF expects the appointed actuary to clearly and specifically identify in point C which of the five types of opinion he or she is rendering. The actuary should not provide disclaimers, exclusions, reliances, and caveats about general uncertainty without explicitly identifying one of the five types of opinion.

While the Liability Page of the Annual Statement separately lists Losses (Line 1) and Loss Adjustment Expenses (Line 3) the CATF recognizes that accepted actuarial practice may combine losses and expenses in the development of some estimates. In such cases aggregation should be noted in the Opinion paragraph. Supporting documentation is expected in the report.

Reliance on the opinion of another actuary is addressed in ASOP #36, section 4.4. Such reliance does not extend to subordinates or colleagues of the appointed actuary. The appointed actuary is expected to review the work of his or her subordinates or colleagues and accept responsibility for that work. If the appointed actuary is unable to do that, the opinion should be issued as Qualified or as No Opinion.

Paragraph 6. Relevant Comments
The CATF considers the Relevant Comments of the appointed actuary to be the most valuable information in the opinion. Relevant Comments provide the context for interpretation by the regulator, and understanding of the actuary’s reasoning, judgment, and opinion.

The most important relevant comment relates to the Risk of Material Adverse Deviation (RMAD). The actuary must explicitly state whether or not he or she reasonably believes there are significant risks and uncertainties that could result in material adverse deviation. While ASOP #36, section 3.3.3, only requires the actuary to disclose the amount of adverse deviation judged to be material if the actuary reasonably believes that such risk exists, the Instructions require the actuary to disclose such a materiality standard in all cases. This provides perspective for the regulator to interpret the actuary’s judgment. The actuary is also required to comment on the basis for choosing this standard.

The CATF recognizes the importance of the individual actuary’s judgment in determining what is and is not material in the case of each individual insurance company’s financial statement. Accordingly, we have not chosen to specify in the Actuarial Opinion Instructions a specific standard or set of standards to be followed by actuaries issuing Statements of Actuarial Opinion to be filed with Annual Statements. Considerations in determining a threshold of material adverse deviation could include amounts:

- above a specified percent of surplus or carried reserves;
- that threaten a change in the company’s Risk Based Capital level to higher regulatory attention; or
- sufficient to change an underwriting or operating gain to a loss.
We believe, however, that there is value in setting forth an indicator that would define an outside bound for materiality considerations. We believe most reasonable persons would view reserve fluctuations outside of such bounds as being material deviations. In our review of 2004 Actuarial Opinions, we will consider the following Bright Line Indicator as an outside bound of what is material:

10% of the insurer’s net reserves, that is 10% of the sum of Lines 1 and 3 on Page 3 of the Annual Statement, are greater than the difference between the Total Adjusted Capital and Company Action Level Capital.

If this condition is met, the CATF expects to see explicit Relevant Comment paragraphs in the Actuarial Opinion discussing the factors giving rise to the presence or absence of the risk of material adverse deviation. This bright line indicator is not intended to provide a substitute for the individual actuary’s judgment as to what an appropriate materiality standard should be in the individual company’s case, nor should it be interpreted to relieve the actuary of the obligation of independently establishing his or her own materiality standard. In fact, we would expect an Appointed Actuary would choose a more restrictive standard in the great majority of situations.

Paragraph 7. The Actuarial Report
This paragraph again acknowledges the reliance of the regulator on the professionalism of a Qualified Actuary. It adds requirements for the content of the Report. The Report should be available in a timely manner and meet the definition of an Actuarial Report provided in ASOP #9: “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, and of ensuring that the parties addressed are aware of the significance of the actuary’s opinion or findings.” Exhibits alone rarely convey professional conclusions and recommendations, or the significance of the actuary’s opinion or findings. Sources of assumptions should be clearly supported; for example, documentation of Expected Loss Ratios calls for more than reference to “actuarial judgment.” 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 differences between the actuary’s estimates and the carried reserves. The CATF believes that company line of business definitions may be more meaningful than statutory line when actuarial principles and considerations are clearly addressed and documented within the report. However, the Actuarial Report must include an exhibit that ties to the Annual Statement and compares the Actuary’s conclusions to the carried amounts. Explanation of differences in the reconciliation of paid amounts, case reserves and earned premiums helps to reduce questions regarding data integrity.

The CATF believes that regulators should be able to rely on the report as an alternative to developing independent estimates. The actuarial report should not be merely a collection of data triangles with little or no rationale provided. A well-prepared and documented actuarial report that is consistent with the spirit of ASOP #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
This paragraph is unchanged.

Paragraph 9. Notice regarding Errors
This paragraph is also unchanged.
Appendix 10

2005 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 NAIC 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.

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.
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. 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.

The Statement of Actuarial Opinion, the AOS, 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.

1.A. 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.

1.B. 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.

**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 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 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.

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 (3 thru 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 – 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.
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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 the OPINION paragraph 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
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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 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.


Financial reinsurance refers to contracts referenced in SSAP No. 62, Property and Liability Reinsurance, Paragraph 34, 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 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 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.

8. 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 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.
9. 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

10. 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.

### Exhibit A: SCOPE

<table>
<thead>
<tr>
<th>Loss Reserves:</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Reserve for Unpaid Losses (Liabilities, Surplus and Other Funds page, Line 1)</td>
<td>$ _________</td>
</tr>
<tr>
<td>B. Reserve for Unpaid Loss Adjustment Expenses (Liabilities, Surplus and Other Funds page, Line 3)</td>
<td>$ _________</td>
</tr>
<tr>
<td>C. Reserve of Unpaid Losses – Direct and Assumed (Schedule P, Part 1, Totals from Cols. 13 and 15)</td>
<td>$ _________</td>
</tr>
<tr>
<td>D. Reserve for Unpaid Loss Adjustment Expenses – Direct and Assumed (Schedule P, Part 1, Totals from Cols. 17, 19 and 21)</td>
<td>$ _________</td>
</tr>
<tr>
<td>E. The Page 3 write-in item reserve, “Retroactive Reinsurance Reserve Assumed”</td>
<td>$ _________</td>
</tr>
<tr>
<td>F. Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion (list separately)</td>
<td>$ _________</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Premium Reserves:</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>G. Reserve for Direct and Assumed Unearned Premiums for Long Duration Contracts</td>
<td>$ _________</td>
</tr>
<tr>
<td>H. Reserve for Net Unearned Premiums for Long Duration Contracts</td>
<td>$ _________</td>
</tr>
<tr>
<td>I. Other Premium Reserve items on which the Appointed Actuary is expressing an Opinion (list separately)</td>
<td>$ _________</td>
</tr>
</tbody>
</table>
Exhibit B: DISCLOSURES

1. Materiality Standard expressed in $US $ ________
2. Statutory Surplus $ ________
3. Anticipated net salvage and subrogation included as a reduction to loss reserves as reported in Schedule P $ ________
4. Discount included as a reduction to loss reserves and loss expense reserves as reported in Schedule P
   4 (a) Nontabular Discount $ ________
   4 (b) Tabular Discount $ ________
5. 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. $ ________
6. 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. *
   6 (a) Asbestos, as disclosed in the Notes to Financial Statements $ ________
   6 (b) Environmental, as disclosed in the Notes to Financial Statements $ ________
7. The total claims made extended loss and expense reserve (Schedule P Interrogatories).
   7 (a) amount reported as loss reserves $ ________
   7 (b) amount reported as unearned premium reserves $ ________
8. Other items on which the Appointed Actuary is providing Relevant Comment (list separately) $ ________

* The reserves disclosed in item 6 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.
Data Testing Requirement in 2004 P/C Annual Statement Instructions: Guidance for Actuaries Signing Statements of Actuarial Opinions on Loss and Loss Expense Reserves

The 2004 Annual Statement Instructions issued by the National Association of Insurance Commissioners (NAIC) contain a new paragraph in Section 9, “Scope of Examination and Report of Independent Certified Accountant.” This new statutory guidance is included as Attachment 1 and referred to as “the new 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 new 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 and the auditor in fulfilling this new 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. It should not be deemed to describe or codify generally accepted actuarial practice. From the perspective of the actuarial profession, this is a new requirement and there does not yet exist generally accepted practice for complying with it.

Although the term “significant” is not defined within the new 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 new 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 new 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 guidance document after discussions with the AICPA, the NAIC/AICPA Working Group and the NAIC Casualty Actuarial Task Force. However, it is a working document and is still being reviewed for formal input from the AICPA and NAIC. Further, this document is directed at actuaries; COPLFR understands that there may be forthcoming guidance from the AICPA directed at the audit community. 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 new data testing requirement. Questions about the new data testing requirement as it relates to specific companies should be directed to the companies’ domiciliary regulators.
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).
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 new 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, 200X. 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/200X. 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/200X. 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/200X.

4. Reported Claim Counts by statutory line of business and by accident year, at annual evaluations as of XX/XX/200X, 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/200X.

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/200X.
- 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, 2004, 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.
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 new data testing rules, but other approaches will, no doubt, be used as well.]

Question 1: With respect to the new 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 new 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 new 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 23. Under the new 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.

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 new 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 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.

**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 new data testing requirement?

Answer:
• Though it is not definitively described in the new data testing requirement, we understand from discussions with the NAIC/AICPA Working Group that the following data items are generally within the scope of the new requirement as respects data used by the Appointed Actuary: earned premiums, unearned premiums, loss, and LAE. Claim counts can be in-scope but only if they are material to the fair presentation of the financial statements; usually they are out of scope.
• From those discussions, we also understand that non-financial statement data items (e.g. exposures, on-level premium, industry data) are generally not intended to be within the scope. In addition, data not provided by the company, such as industry loss development factors, proprietary data from a consulting firm, are also not intended to be within the scope.

Question 11: Will the new 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 new NAIC Data Testing Requirement already be performed by the auditor under his/her work under Sarbanes-Oxley Section 404?

Answer:
• Not necessarily. Sarbanes - Oxley 404 has a different focus than the new data testing requirement.
• Further, many insurance companies are not currently required to comply with Sarbanes-Oxley because it applies only to publicly traded companies. The new NAIC Data Testing Requirement applies to all insurance companies filing Annual Statements.
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