

A PUBLIC POLICY PRACTICE NOTE

Statements of Actuarial Opinion On Property and Casualty Loss Reserves

December 2023

Developed by
The Casualty Practice Council's
Committee on Property and Liability Financial Reporting



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2023

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



The American Academy of Actuaries is a 19,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policy makers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

**Committee on Property and Liability Financial Reporting
(2023)**

Stephen Koca MAAA, FCAS, Chairperson
Michelle Iarkowski MAAA FCAS, Vice Chairperson
Rebecca Armon MAAA, FCAS
Jennifer Balester MAAA, FCAS
Amy Baranek MAAA, ACAS
Betsy Branagan MAAA, FCAS
David Brown MAAA, FCAS
R. Scott Cederburg MAAA, FCAS
Dawn Fowle MAAA, FCAS
Aaron Hillebrandt MAAA, FCAS
George Levine MAAA, FCAS
Mary Jo Kannon MAAA, ACAS
Leslie Marlo MAAA, FCAS
Carver Royo MAAA, FCAS
Ernie Wilson MAAA, FCAS
Trevar Withers MAAA, ACAS

Special Thanks to Practice Note Subcommittee: Carver Royo (Chairperson), Rebecca Armon, Jennifer Balester, Amy Baranek, David Brown, Eduardo Esteva, Mary Jo Kannon, George Levine, and Ernest Wilson



1850 M Street NW, Suite 300
Washington, DC 20036-5805

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1. Introduction

This practice note is not a promulgation of the Actuarial Standards Board, is not an actuarial standard of practice, is not binding upon any actuary and is not a definitive statement as to what constitutes generally accepted practice in the area under discussion. Events occurring subsequent to the publication of this practice note may make the practices described in this practice note irrelevant or obsolete.

This practice note was prepared by the Committee on Property and Liability Financial Reporting (COPLFR) of the Casualty Practice Council of the American Academy of Actuaries (Academy). COPLFR is a committee comprised of actuaries from various roles in the property and casualty (P&C) industry that monitors and advises on activities as respects financial reporting related to property and casualty (P&C) risks. COPLFR annually updates and publishes this practice note to include discussion regarding changes in the *NAIC Annual Statement Instructions—Property/Casualty* (NAIC Annual Statement Instructions) regarding the Actuarial Opinion, the Actuarial Opinion Summary, and Actuarial Report.

COPLFR also authors other publications¹ useful for practicing actuaries and provides comment from an independent actuarial viewpoint on financial reporting issues and proposed reporting changes as they develop that may impact the work of practicing actuaries.

1.1 What are practice notes?

The Academy's Guidelines for Developing Practice Notes² states:

"The purpose of practice notes is to provide information to actuaries on current or emerging practices in which their peers are engaged. They are intended to supplement the available actuarial literature, especially where the practices addressed are subject to evolving technology, recently adopted external requirements, or advances in actuarial science and other applicable disciplines.

...

Practice notes are not interpretations of actuarial standards of practice nor are they meant to be a codification of generally accepted actuarial practice. Actuaries are not bound in any way to comply with practice notes or to conform their work to the practices described in practice notes."³

1.1.1 Discussion

Practice notes provide discussion and illustration on areas of common practice among actuaries. Each practice note focuses on a specific topic or application of practice.

As noted in the Academy's guidelines, practice notes are not intended to be an interpretation of the actuarial standards of practice, nor are practice notes meant to be a codification of generally accepted or

¹ For example, [An Overview for P/C Insurers' Audit Committees: Effective Use of Actuarial Loss Reserve Expertise](#), updated in 2020 and also included within this practice note as [Appendix III.6](#)

² Adopted by the Academy's Board of Directors in September 2006.

³ Id. See <http://www.actuary.org/content/guidelines-developing-practice-notes>.

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appropriate actuarial practice. Actuaries are not in any way bound to comply with practice notes or to conform their work to the practices they describe.

1.2 Purpose of this practice note

The purpose of this practice note is to provide information to actuaries on current practices in which their peers are engaged related to signing a P&C Statement of Actuarial Opinion (SAO) and Actuarial Opinion Summary (AOS) as required by the National Association of Insurance Commissioners (NAIC).

1.2.1 Discussion

Each year COPLFR reviews and updates the practice note for SAOs on P&C loss reserves. The updates typically include discussion around changes in the *NAIC Annual Statement Instructions—Property/Casualty, Actuarial Opinion* (NAIC SAO Instructions).

Changes to this year’s practice note that are a result of new 2023 requirements from the Actuarial Standards Board (ASB) or NAIC (i.e., new or revised actuarial standard of practice (ASOP), NAIC Annual Statement Instructions, or SSAP) are highlighted in yellow, while additional discussion or clarifying edits are highlighted in gray. Minor edits such as year changes, moving text, correcting typos, and areas with deleted text may not be highlighted.

1.2.2 Terms of construction

As with the ASOPs promulgated by the ASB, there are certain terms used throughout this practice note that are integral to an informed reading. These include “must”, “should,” and “may”. Rather than paraphrase these definitions, we will quote the definitions as provided in [ASOP No. 1, Introductory Standard of Practice](#), section 2.1; these definitions are equally applicable to this practice note.

“Must/Should — The words “must” and “should” are used to provide guidance in the ASOPs. “Must” as used in the ASOPs means that the ASB does not anticipate that the actuary will have any reasonable alternative but to follow a particular course of action. In contrast, the word “should” indicates what is normally the appropriate practice for an actuary to follow when rendering actuarial services. Situations may arise where the actuary applies professional judgment and concludes that complying with this practice would be inappropriate, given the nature and purpose of the assignment and the principal’s⁴ needs, or that under the circumstances it would not be reasonable or practical to follow the practice.

⁴ Principal is defined in ASOP No. 1 as “a client or employer of the actuary.”

FAQ: Are actuaries required to comply with this practice note or follow the illustrations provided herein?

A: No. The practice note provides information to actuaries on current and emerging practices in which their peers are engaged. Actuaries are not bound in any way to comply with practice notes or to conform their work to the practices described in practice notes.

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Failure to follow a course of action denoted by either the term “must” or “should” constitutes a deviation from the guidance of the ASOP. In either event, the actuary is directed to ASOP No. 41, Actuarial Communications.

The terms “must” and “should” are generally followed by a verb or phrase denoting action(s), such as “disclose,” “document,” “consider,” or “take into account.” For example, the phrase “should consider” is often used to suggest potential courses of action. If, after consideration, in the actuary’s professional judgment an action is not appropriate, the action is not required and failure to take this action is not a deviation from the guidance in the standard.

May—“May” as used in the ASOPs means that the course of action described is one that would be considered reasonable and appropriate in many circumstances. “May” in ASOPs is often used when providing examples (for example, factors the actuary may consider; methods that may be appropriate). It is not intended to indicate that a course of action is reasonable and appropriate in all circumstances, nor to imply that alternative courses of action are impermissible.”⁵

Additionally, this practice note uses the term “required” when the course of action is required by a particular body (e.g., the NAIC Annual Statement Instructions), as specified.

1.3 Scope of practice note

According to the NAIC SAO Instructions,

“There is to be included with or attached to Page 1 of the Annual Statement the statement of the Appointed Actuary, entitled “Statement of Actuarial Opinion” (Actuarial Opinion), setting forth his or her opinion relating to reserves specified in the SCOPE paragraph. The Actuarial Opinion, both the narrative and required Exhibits, shall be in the format of and contain the information required by this section of the Annual Statement Instructions - Property and Casualty.”⁶

FAQ: Does the scope of this practice note include title insurance opinions?

A: While the NAIC SAO Instructions for Title opinions are included in [Appendix I.3](#), there is no explicit discussion around title opinions. However, actuaries may look to this practice note for discussion around many topics that are similar.

This practice note is intended to assist actuaries by describing practices that COPLFR believes are commonly employed in issuing SAOs and AOSs on loss and loss adjustment expense (LAE) reserves in compliance with the NAIC SAO Instructions for 2023. Actuaries may also find this information useful in preparing statements of actuarial opinion for other audiences or regulators.

⁵ Actuarial Standards Board, ASOP No. 1, *Introductory Actuarial Standard of Practice*, Section 2.1. See <http://www.actuarialstandardsboard.org/asops/introductoryactuarialstandardpractice/>.

⁶ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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1.3.1 Discussion

Approaches other than the ones described within this practice note may also be in common use. The information contained in this practice note is not binding on any actuary and is not a definitive statement of what constitutes generally accepted or appropriate practice in this area.

Note:

- Information taken from NAIC materials has been reproduced with the NAIC's permission. Unauthorized replication or distribution of NAIC materials is strictly prohibited.
- COPLFR appreciates the comments it has received since the issuance of the prior year's practice note and has incorporated a number of suggestions in this update. COPLFR also welcomes suggested improvements for future updates of this practice note. Suggestions may be sent to the current chairperson of COPLFR through the Academy's casualty policy analyst at casualty@actuary.org.

1.4 Overview of resources

The [Code of Professional Conduct](#) (the Code) requires actuaries to "be familiar with, and keep current with, not only the Code, but also applicable Law and rules of professional conduct for the jurisdictions in which the Actuary renders Actuarial Services."⁷

[Appendix I](#) of this practice note provides the NAIC SAO Instructions with respect to the P&C SAO and AOS. The NAIC SAO Instructions for Title Insurance SAOs are also included for informational purposes only. No discussion is included.

Individual states may have requirements that modify or supplement the NAIC Annual Statement Instructions. The Appointed Actuary is encouraged to refer to the Academy's [2023 P/C Loss Reserve Law Manual](#) for guidance on these points. The 2023 P/C Loss Reserve Law Manual is available for purchase from the Academy.

Additionally, actuaries are encouraged to carefully read and consider *Regulatory Guidance on Property and Casualty Statutory Statements of Actuarial Opinion, Actuarial Opinion Summaries, and Actuarial Reports for the Year 2023*, as prepared by the NAIC's Actuarial Opinion (C) Working Group (AOWG) of the Casualty Actuarial and Statistical (C) Task Force (CASTF) (hereinafter referred to as AOWG Regulatory Guidance) and included in [Appendix II](#). The AOWG Regulatory Guidance pertains to the 2023 SAO and the AOS and supplements the NAIC SAO Instructions. The purpose is to provide timely regulatory guidance and clarity to companies and Appointed Actuaries regarding regulatory expectations with respect to the SAO and AOS. Note that absent a possible reference in state law or regulation, the

⁷ American Academy of Actuaries, [Code of Professional Conduct](#), January 1, 2001, Purpose section, last paragraph.

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AOWG Regulatory Guidance is not binding. References to the AOWG Regulatory Guidance are included throughout this practice note.

Chapter 9 provides a listing of the most relevant Actuarial Standards of Practice (ASOPs) and Statements of Statutory Accounting Principles (SSAPs) that apply to the material covered by this practice note. It also provides resources to actuaries providing opinions other than those covered by the scope of this practice note.

1.4.1 Definitions

ASB—As explained in [ASOP No. 1](#), *“The Actuarial Standards Board (ASB) promulgates actuarial standards of practice (ASOPs) for use by actuaries when rendering actuarial services in the United States. The ASB is vested by the U.S.-based actuarial organizations⁸ with the responsibility for promulgating ASOPs for actuaries rendering actuarial services in the United States. Each of these organizations requires its members, through its Code of Professional Conduct⁹ (Code), to satisfy applicable ASOPs when rendering actuarial services in the United States.”*¹⁰

CASTF—According to the NAIC website, the mission of the NAIC CASTF *“is to identify, investigate and develop solutions to actuarial problems and statistical issues in the P/C insurance industry. The Task Force’s goals are to assist state insurance regulators with maintaining the financial health of P/C insurers; ensuring that P/C insurance rates are not excessive, inadequate or unfairly discriminatory; and ensuring that appropriate data regarding P/C insurance markets are available.”*¹¹

AOWG—According to the NAIC website, the 2023 charges of the AOWG were: *“A. Propose revisions to the following, as needed, especially to improve actuarial opinions, actuarial opinion summaries and actuarial reports, as well as the regulatory analysis of these actuarial documents and loss and premium reserves:*

- A. *Financial Analysis Handbook.*
- B. *Financial Condition Examiners Handbook.*
- C. *Annual Statement Instructions-Property/Casualty.*
- D. *Regulatory guidance to appointed actuaries and companies.*
- E. *Other financial blanks and instructions, as needed.”*¹²

FAQ: Are ASOPs binding on members of the U.S.-based actuarial organizations when rendering actuarial services in the U.S.?

A: Yes. According to ASOP No. 1, Section 1: *“ASOPs are binding on members of the U.S.-based actuarial organizations when rendering actuarial services in the U.S. While these ASOPs are binding, they are not the only considerations that affect an actuary’s work. Other considerations may include legal and regulatory requirements, professional requirements promulgated by employers or actuarial organizations, evolving actuarial practice, and the actuary’s own professional judgment informed by the nature of the engagement. The ASOPs provide a basic framework that is intended to accommodate these additional considerations.”*

⁸ The American Academy of Actuaries, the American Society of Pension Professionals and Actuaries, the Casualty Actuarial Society, the Conference of Consulting Actuaries, and the Society of Actuaries.

⁹ These organizations adopted the Code of Professional Conduct effective January 1, 2001.

¹⁰ Actuarial Standards Board, ASOP No. 1, *Introductory Actuarial Standard of Practice*, <http://www.actuarialstandardsboard.org/asops/introductoryactuarialstandardpractice/>, Section 1.

¹¹ https://content.naic.org/cmte_c_catf.htm

¹² https://content.naic.org/cmte_c_act_opin_wg.htm

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ASOPs—According to the ASB website, ASOPs “identify what the actuary should consider, document, and disclose when performing an actuarial assignment” and “set standards for appropriate practice for the U.S.”¹³

SSAPs—“Statements of Statutory Accounting Principles (SSAPs) are published by the NAIC in its Accounting Practices and Procedures Manual. The manual includes more than 100 SSAPs, which serve as the basis for preparing and issuing statutory financial statements for insurance companies in the U.S. in accordance with, or in the absence of, specific statutes or regulations promulgated by individual states.”¹⁴

1.5 Organization of this practice note

Each chapter in this practice note begins with an opening paragraph describing the contents and includes an excerpt of the actual NAIC SAO Instructions pertaining to the chapter. Separate sections within the chapter provide details on the topic, including further quoted instruction, definitions, discussion, and illustrative language. The FAQs reside with the relevant chapter/section for ease of use.

The chapters are organized to facilitate use of the practice note and to align it with the structure of the SAO. [Chapter 1](#) introduces the practice note. It is followed by four chapters ([Chapter 2](#) through [Chapter 5](#)) that line up with the four required sections of the SAO: IDENTIFICATION, SCOPE, OPINION, and RELEVANT COMMENTS (sections 3 through 6 of the NAIC SAO Instructions). As described in the NAIC SAO Instructions,

“The 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 Appointed 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.”¹⁵

[Chapter 6](#) provides additional considerations around the SAO, including filing requirements and considerations when the Appointed Actuary becomes aware of errors in the SAO. [Chapter 7](#) covers the AOS and [Chapter 8](#) covers the Actuarial Report, which is considered to be the culmination of the SAO process. Finally, [Chapter 9](#) provides resources for the Appointed Actuary.

The four appendices have been organized to make it easier to locate pertinent information. [Appendix I](#) provides the NAIC SAO and AOS Instructions, along with the excerpt of the NAIC Annual Statement Instructions regarding auditor data testing. [Appendix II](#) provides the 2023 AOWG Regulatory Guidance. [Appendix III](#) contains more detailed information about specific topics that may not be common to all

¹³ Actuarial Standards Board, ASOP No. 1, *Introductory Actuarial Standard of Practice*, <http://www.actuarialstandardsboard.org/asops/introductoryactuarialstandardpractice/>, Section 1.

¹⁴ Odomirok et al, *Financial Reporting through the Lens of a Property/Casualty Actuary* (https://www.casact.org/library/studynotes/Odomirok-et-al_Financial-Reportingv5.pdf), CAS 2020, page 10.

¹⁵ 2023 NAIC Annual Statement Instructions Property/Casualty. Section I.1.2

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SAOs. [Appendix IV](#) provides the SSAPs from NAIC's Accounting Practices and Procedures Manual deemed to be particularly applicable to actuaries signing NAIC P&C SAOs.

Following the terminology in the NAIC Annual Statement Instructions, this practice note uses the term "loss reserves" to include LAE reserves unless specified otherwise.

1.6 Changes from the 2022 practice note

COPLFR has made enhancements to the 2022 practice note based on feedback from users and a thorough review by the committee. Changes to this year's practice note that are a result of new 2023 requirements from the ASB or NAIC (i.e., new or revised ASOP, NAIC Annual Statement Instructions, or SSAP) are highlighted in yellow, while additional discussion or clarifying edits are highlighted in gray. Changes to the 2022 practice note include:

- Review and update citations of 2023 version of NAIC documents (throughout):¹⁶
 - NAIC SAO Instructions ([Appendix I.1](#)). Note, there were no changes to the NAIC SAO Instructions for 2023
 - AOWG Regulatory Guidance ([Appendix II](#))
- Updates for revised ASOP No. 20, which was adopted June 2023 and is effective for any actuarial work product covered by the standard's scope issued on or after December 1, 2023 ([Section 5.3.2](#))
- Removal of section on considerations related to COVID-19 (previously [Section 5.7](#))
- Additional clarification on "Relevant Comments" when amounts are zero or N/A (see new FAQs in sections [3.7.1](#) and [5.3](#))
- Sample language when the SAO applies to Exhibit A items on a combined basis ([Section 4.11](#))
- Additional clarification on subsequent events—type 1 and type 2 ([Section 3.4.2](#))
- Update of external references and hyperlinks (throughout)
- Other minor edits (throughout)

The 2023 AOWG Regulatory Guidance was updated for: 1) Potential changes regarding the frequency of providing "qualification documentation" beginning in 2024, 2) clarification regarding when an opinion or AOS may be revised, and 3) removal of the remaining COVID-19 discussion.

¹⁶ For information, the following NAIC documents had no changes from 2022 to 2023:
NAIC Property and Casualty AOS Instructions ([Appendix I.2](#))
NAIC Title SAO Instructions ([Appendix I.3](#))

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2. IDENTIFICATION section

This, the IDENTIFICATION chapter, is the first of four chapters (i.e., [Chapter 2](#) through [Chapter 5](#)) in this practice note that discuss each of the four required sections of the Statement of Actuarial Opinion: IDENTIFICATION, SCOPE, OPINION, and RELEVANT COMMENTS (sections 3 through 6 of the NAIC SAO Instructions).

The SAO starts with an identification paragraph, which according to the NAIC SAO Instructions should:

“...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. Additionally, the IDENTIFICATION paragraph should include a statement asserting that the Appointed Actuary has complied with the requirements to provide qualification documentation to the Board of Directors, either directly or through company management.”¹⁷

2.1 Appointment of the Qualified Actuary

According to the NAIC SAO Instructions,

“Upon initial engagement, the Appointed Actuary must be appointed by the Board of Directors by December 31 of the calendar year for which the opinion is rendered. The Company shall notify the domiciliary commissioner within five business days of the initial appointment with the following information:

- a. *Name and title (and, in the case of a consulting actuary, the name of the firm).*
- b. *Manner of appointment of the Appointed Actuary (e.g., who made the appointment and when).*
- c. *A statement that the person meets the requirements of a Qualified Actuary (or was approved by the domiciliary commissioner) and that documentation was provided to the Board of Directors.*

Once this notification is furnished, no further notice is required with respect to this person unless the Board of Directors takes

FAQ: Do actuaries need to be reappointed each year?

A: NAIC Instructions do not necessarily require the Appointed Actuary to be reappointed every year.

However, when the appointment is specific to the year-end in question, then reappointment would normally be necessary.

The most recent date of appointment (if there is more than one) may be quoted in the identification paragraph.

¹⁷ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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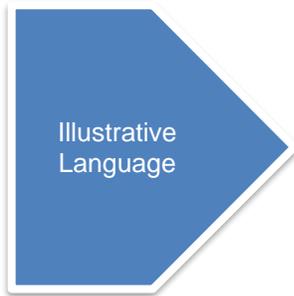
action to no longer appoint or retain the actuary or the actuary no longer meets the requirements of a Qualified Actuary.”¹⁸

The Appointed Actuary might consider obtaining and retaining documentation of his or her appointment, including the date of the appointment, as support for this statement. For this purpose, the Appointed Actuary may wish to retain materials such as minutes of the Board of Directors’ meeting indicating the appointment or written confirmation by a company officer.

The term “Board of Directors” is used broadly throughout the 2023 NAIC SAO Instructions and specifically defined as “*Board of Directors can include the designated Board of Directors, its equivalent or an appropriate committee directly reporting to the Board of Directors.*”¹⁹ For example, an actuary may be appointed by the Audit Committee of the Board of Directors.

2.1.1 Illustrative language

In the case where the Appointed Actuary is a consultant, the following may be appropriate:



I, [Name of Appointed Actuary] [professional designation(s)], am associated with ABC Consulting. I was appointed by the Board of Directors of XYZ Insurance Company on November 3, 2023 to render this opinion. I meet the definition of a Qualified Actuary per the NAIC Annual Statement Instructions – Property and Casualty, Actuarial Opinion. I have provided my Qualification Documentation to the Board of Directors ([directly] OR [through the Company’s management.]

2.1.2 Definition of a Qualified Actuary

Paragraph 1A of the NAIC SAO Instructions sets out the requirements for an actuary to be qualified to sign SAOs:

“Qualified Actuary” is a person who:

- (i) meets the basic education, experience and continuing education requirements of the Specific Qualifications Standard for Statements of Actuarial Opinion, NAIC Property and Casualty Annual Statement, as set forth in the Qualification Standards for Actuaries Issuing Statements of Actuarial Opinion in the United States (U.S. Qualification Standards), promulgated by the American Academy of Actuaries (Academy), and*

¹⁸ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

¹⁹ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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(ii) *has obtained and maintains an Accepted Actuarial Designation; and*

(iii) *Is a member of a professional actuarial association that requires adherence to the same Code of Professional Conduct promulgated by the Academy, requires adherence to the U.S. Qualification Standards, and participates in the Actuarial Board for Counseling and Discipline when its members are practicing in the U.S.*

An exception to parts (i) and (ii) of this definition would be an actuary evaluated by the Academy's Casualty Practice Council and determined to be a Qualified Actuary for particular lines of business and business activities.²⁰

FAQ: Does the definition of Qualified Actuary and other related requirements (e.g., Qualification Documentation) in the NAIC Property/Casualty Opinion Instructions apply to NAIC title insurers? What about captive insurers?

A: *The definition of Qualified Actuary in the NAIC Title Opinion Instructions is different than what is presented in this section; the Title Instructions definition of Qualified Actuary has not recently changed. Additionally, the NAIC Title Opinion Instructions do not include reference to other requirements that were introduced in the 2019 NAIC Property/Casualty Opinion Instructions such as the qualification documentation discussed in section 2.2.1 herein. For informational purposes, the NAIC Title Opinion Instructions are included as [Appendix I.3](#)*

For captive insurance company requirements, refer to captive laws and regulations of the specific captive domicile.

Special Situations:

- NAIC SAO Instructions state that in the case of:
 1. an Appointed Actuary meeting the definition of Qualified Actuary per the exception to parts (i) and (ii) via evaluation and determination by the Academy's Casualty Practice Council; or
 2. an Appointed Actuary not meeting the definition of Qualified Actuary but being approved by the domiciliary commissioner,

"...the company must attach, each year, the approval letter and reference such in the Identification paragraph."

²⁰ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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2.2 Qualifications

The Identification paragraph of the Opinion includes the Appointed Actuary's qualifications to sign the SAO. Before taking on or renewing an Appointed Actuary assignment, actuaries should review the definition of Qualified Actuary per the NAIC SAO Instructions and all other applicable qualification standards and ensure compliance.

Actuaries are reminded that the Academy promulgated amended *Qualification Standards for Actuaries Issuing Statements of Actuarial Opinion in the United States Including Continuing Education Requirements, effective January 1, 2022 (the "U.S. Qualification Standards")*. This practice note refers to NAIC SAOs as contemplated in Section 3 of the U.S. Qualification Standards. The Appointed Actuary must meet the general and specific qualification standards, basic and continuing education (CE) requirements, and other requirements described therein.

The following table summarizes the applicable Qualification Standards.

NAIC SAOs

Overview of Applicable Qualification Standards

U.S.

Qualification Standards – General²¹

To satisfy the General Qualification Standard, before issuing a Statement of Actuarial Opinion, an actuary must meet all of the following criteria:

- Basic Education: Have achieved through education or mutual recognition, a Fellow or Associate designation from either the SOA or CAS, or has an Enrolled Actuary designation, or has membership in the Academy through its approval process
- Experience: Have three years of responsible actuarial experience, defined as work that requires knowledge and skill in solving actuarial problems
- U.S. Specific Knowledge: Have knowledge of the applicable U.S. law and U.S. actuarial practices and principles through education or documented professional development
- Subject Area Knowledge: In order to issue Statements of Actuarial Opinion in an area of actuarial practice or any particular subject within an area of actuarial practice, an actuary must meet either 1) or 2) below:
 - 1) Have attained fellowship in the CAS or SOA or attained the highest possible level of membership in a non-U.S. organization. In addition, meet one of the following:

²¹ Information presented here reflects the amended U.S. Qualification Standards which took effect January 1, 2022, for statements of actuarial opinion issued on or after January 1, 2023.

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NAIC SAOs

Overview of Applicable Qualification Standards

- i. Successfully completed education relevant to the subject of the SAO. Such education may have been obtained in attaining the fellowship designation or highest possible designation of a non-U.S. actuarial organization, or by completing additional education relevant to the subject of the SAO, or
 - ii. Have a minimum of one year of responsible actuarial experience in the particular subject relevant to the SAO under the review of an actuary who was qualified to issue the SAO at the time the review took place.²²
- 2) Have a minimum of three years of responsible actuarial experience in the relevant area under the review of an actuary qualified to issue the SAO at the time the review took place under standards in effect at that time.
- 30 hours of “relevant” continuing education (CE)
 - ≥ 6 “organized activities”
 - ≥ 3 professionalism
 - ≥ 1 bias topics
 - ≤ 3 general business

Refer to <https://www.actuary.org/content/us-qualification-standards>

U.S. Qualification Standards – Specific

In addition to the requirements of the General Qualification Standard, these Specific Qualification Standards should be met:

- Basic Education: Successfully complete relevant examinations administered by the Academy, the CAS or the SOA on (a) policy forms and coverages, underwriting, and marketing; (b) principles of ratemaking; (c) statutory insurance accounting and expense analysis; (d) premium, loss, and expense reserves; and (e) reinsurance; OR obtain a signed statement from another actuary who is qualified to issue the SAO, NAIC P&C Annual Statement, indicating that the writer is familiar with the actuary’s professional history and that the actuary has obtained sufficient alternative education to satisfy the

²² An actuary qualified to issue the SAO at the time of the review may include an actuary with an Associate designation.

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NAIC SAOs

Overview of Applicable Qualification Standards

basic education requirement for the specific qualification standard. This statement should be obtained before issuing a SAO.

- Experience: Three years of responsible experience relevant to the subject of the SAO under the review of an actuary qualified to issue the SAO at the time the review took place under standards in effect at that time
- Continuing Education: Obtain 15 continuing education (CE) hours per year related directly to the particular topic of which a minimum of 6 CE hours must be “organized.”

Refer to <https://www.actuary.org/content/us-qualification-standards>

NAIC

- Meet [U.S. Qualification Standards](#)’ Specific Qualification Standard for NAIC SAOs (or be evaluated by the Academy’s CPC and determined to be a Qualified Actuary for particular lines of business and business activities)
- Obtained an “Accepted Actuarial Designation,” as defined in the NAIC SAO Instructions (or be evaluated by the Academy’s CPC and determined to be a Qualified Actuary for particular lines of business and business activities)
- Member of one of the following actuarial organizations—the American Academy of Actuaries, the ASPPA College of Pension Actuaries, the Casualty Actuarial Society, the Conference of Consulting Actuaries, and/or the Society of Actuaries. Each of these organizations:
 - Require adherence to the Code of Professional Conduct;
 - Require adherence to the U.S. Qualification Standards; and
 - Are within the Actuarial Board for Counseling and Discipline’s jurisdiction to investigate alleged violations of the Code of Professional Conduct
- State requirements may vary
- Refer to [NAIC SAO Instructions; AOWG Regulatory Guidance](#); and the Academy’s [2023 P/C Loss Reserve Law Manual](#)

CAS

- The CAS Continuing Education Policy requires actuaries providing SAOs in the U.S. to comply with the U.S. Qualification Standards

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NAIC SAOs

Overview of Applicable Qualification Standards

- Refer to <http://www.casact.org/education/index.cfm?fa=ceinfo>

SOA

- Refer to <https://www.soa.org/professional-development/cpd-requirement/>
-

2.2.1 Qualification Documentation

The NAIC SAO Instructions include a description of the qualification documentation pertaining to how the Appointed Actuary meets the definition of “Qualified Actuary.” Additionally, the NAIC SAO Instructions require that the Identification paragraph should include a statement asserting that the Appointed Actuary has provided qualification documentation to the Board of Directors. Per the NAIC SAO Instructions:

The Appointed Actuary shall provide to the Board of Directors qualification documentation on occasion of their appointment, and on an annual basis thereafter, directly or through Company management. The documentation should include brief biographical information and a description of how the definition of “Qualified Actuary” is met or expected to be met (in the case of continuing education) for that year. The documentation should describe the Appointed Actuary’s responsible experience relevant to the subject of the Actuarial Opinion. The Board of Directors shall document their review of those materials and any other information they may deem relevant, including information that may be requested directly from the Appointed Actuary. It is generally expected that the review of the Appointed Actuary’s qualification documentation should take place at the level within a holding company structure that is responsible for overseeing insurance operations. If a statutory entity is a subsidiary or a non-lead pool member with an Appointed Actuary whose qualifications were reviewed by the pool lead or principal’s Board, the statutory entity’s Board can satisfy the review requirement by acknowledging the parent Board’s review. This can be done by noting in the meeting minutes the name of the principal or lead entity and the date the parent Board reviewed the qualification documentation, or by attaching a copy of the parent Board’s meeting minutes reflecting their review of the qualification documentation. The qualification documentation shall be considered workpapers and be available for inspection upon regulator request or during a financial examination.²³

COPLFR understands that the intention of considering the qualification documentation to be work papers was to make the qualification documentation subject to the same confidentiality provisions as the Actuarial Report. The Appointed Actuary should review state laws for any specific situation.

The 2023 AOWG Regulatory Guidance, available in [Appendix II](#), provides extensive guidance and sample language that Appointed Actuaries may find useful in drafting qualification documentation. However, note that the content, depth, and form of the qualification documentation are left to the

²³ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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discretion of the individual Appointed Actuary who must meet the requirements as cited above in the NAIC SAO Instructions.

The qualification documentation is to be provided on occasion of appointment so that the Board can make an informed decision regarding appointment. The Board is also required to document the company's review of the qualification documentation materials. As discussed in the [FAQ at the beginning of this chapter](#), appointment does not necessarily have to re-occur each year.

The timing of providing qualification documentation to the company in years subsequent to the appointment ("on an annual basis thereafter") is not specifically mentioned in the NAIC SAO Instructions. However, the NAIC SAO Instructions require the Appointed Actuary to assert in the Identification paragraph of the Opinion that he or she has provided the qualifications documentation to the Board, which implies the qualifications documentation must be provided prior to the issuance of the Opinion. Appointed Actuaries may wish to provide the documentation subsequent to completion of their continuing education applicable for the year of the Opinion or prior to completion with description of how continuing education requirements are expected to be met.

COPLFR notes that there will be situations where the subject of the Opinion is an emerging risk or line of business where the actuary has minimal experience (e.g., the recent emergence of cyber liability). Experience with other risks as they emerged in the past and broad familiarity with the topic and the insurance coverages may satisfy the responsible experience requirement per the NAIC SAO Instructions. Consultation with the U.S. Qualification Standards may also be appropriate in this situation.

In some cases, a single actuarial report might support the Opinion for multiple individual companies (e.g., a group of companies participating in an intercompany pool; or a group of companies that write and/or retain different books of business). In these situations, a single qualification documentation may be appropriate which discusses the Appointed Actuary's responsible experience across the individual companies that comprise the actuarial report. In these situations, the qualifications documentation may be reviewed at a level other than the statutory entity as outlined in the in the NAIC SAO Instructions excerpt above.

FAQ: What are the requirements of the Appointed Actuary with respect to ensuring the Board of Directors reviews the actuary's qualification documentation?

A: The NAIC SAO Instructions require the actuary to provide his or her qualification documentation to the Board of Directors, directly or through company management. Presumably, the minutes of the Board of Directors meeting would document management's discussion of their review of the actuary's qualification documentation. The actuary is not obligated to take additional steps to ensure the company's review of this documentation.

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2.2.2 Accepted Actuarial Designation

The definition of a “Qualified Actuary” in the NAIC SAO Instructions include the requirement to obtain and maintain an “Accepted Actuarial Designation.” Per the NAIC SAO Instructions:

“Accepted Actuarial Designation” in item (ii) of the definition of a Qualified Actuary, is an actuarial designation accepted as meeting or exceeding the NAIC’s Minimum Property/Casualty (P/C) Actuarial Educational Standards for a P/C Appointed Actuary (published on the NAIC website). The following actuarial designations, with any noted conditions, are accepted as meeting or exceeding basic education minimum standards:

(i) Fellow of the CAS (FCAS) – Condition: basic education must include Exam 6 – Regulation and Financial Reporting (United States);

(ii) Associate of the CAS (ACAS) – Conditions: basic education must include Exam 6 – Regulation and Financial Reporting (United States) and Exam 7 – Estimation of Policy Liabilities, Insurance Company Valuation, and Enterprise Risk Management;

(iii) Fellow of the SOA (FSA) – Conditions: basic education must include completion of the general insurance track, including the following optional exams: the United States’ version of the Financial and Regulatory Environment Exam and the Advanced Topics in General Insurance Exam.²⁴

The NAIC SAO Instructions provide additional information regarding allowable substitutions for the specific exams cited in items (i), (ii), and (iii) above. This includes an exception to substitute experience and/or continuing education, but only for those who earned their FCAS or ACAS credential prior to 2019. Refer to the NAIC SAO Instructions attached hereto in [Appendix I](#) for details.

FAQ: I am an ACAS or FCAS and do not have credit for Exam 6-US. How do I document my knowledge of U.S. P/C statutory accounting and regulation?

A: The NAIC SAO Instructions note that the actuary “may substitute experience and/or continuing education for CAS Exam 6 (US) provided the Appointed Actuary explains in his/her qualification documentation how knowledge of U.S. financial reporting and regulation was obtained.” The ability to substitute experience and/or continuing education in this manner applies only to individuals who earned their credential prior to 2019.

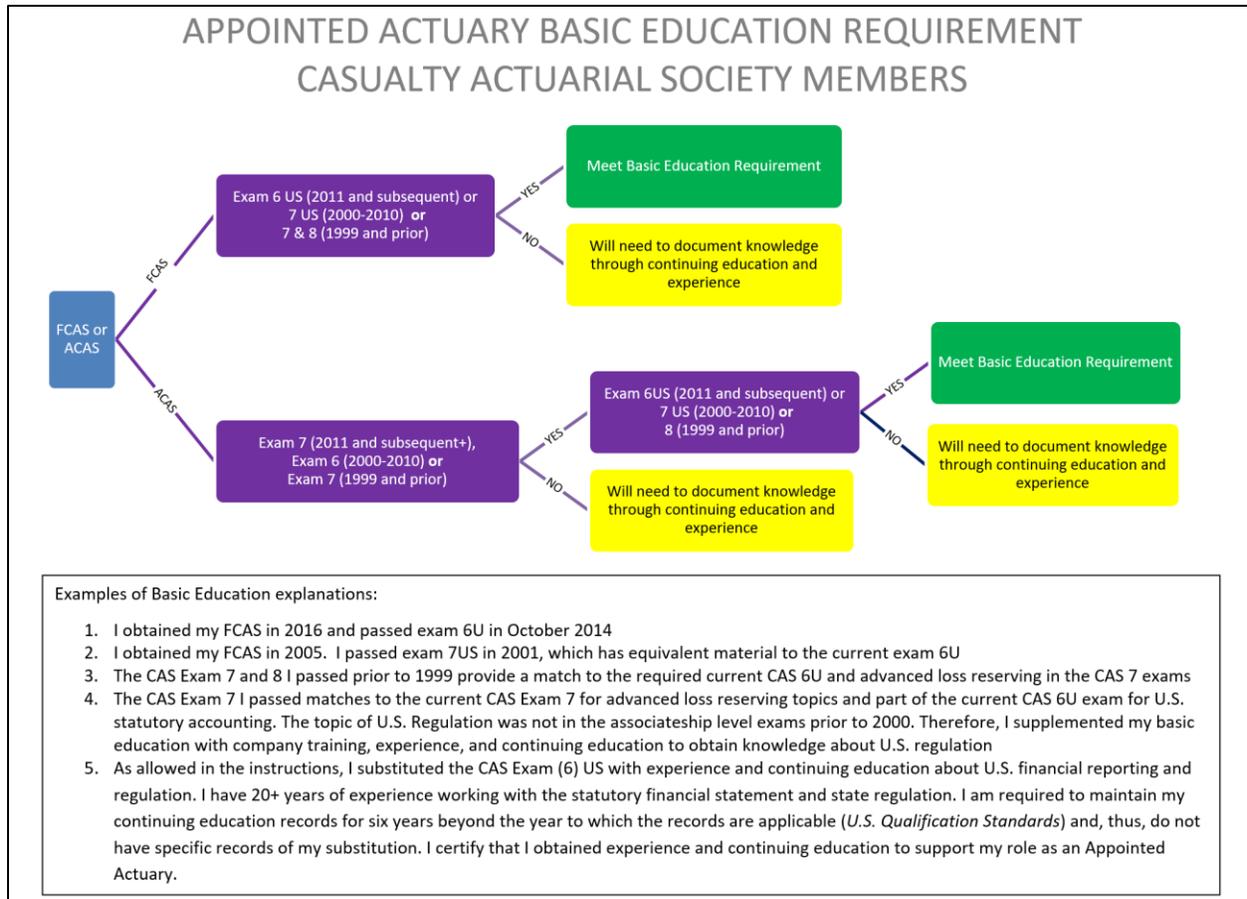
The Appointed Actuary may wish to use language in their qualification documentation such as the following: “Knowledge relating to U.S. financial reporting and regulation was obtained through experience working as a credentialed actuary in the U.S. property/casualty insurance industry for over 30 years as well as obtaining relevant continuing education.” Within the documentation, the AA may wish to expand on his/her experiences with U.S. financial reporting and regulation and relevant CE obtained in order to comply with the requirement.

²⁴ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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Refer to the CAS (office@casact.org) or SOA (customerservice@soa.org) for any questions regarding exam transcripts to see if the basic education minimum standard is satisfied. The CAS provides exam transcripts for its members that reflect actual exam history and translation to exam credit under the current system. In addition, the CAS has published the flow chart below for its members.



Special Situations:

For an ACAS who received their credential under the current CAS syllabus but does not have credit for Exam 7, both the USQS Specific Qualification Standards and the definition of *Accepted Actuarial Designation* in the NAIC SAO Instructions may be relevant for further review.

The USQS Specific Qualification Standards for *Statements of Actuarial Opinion, NAIC Property and Casualty Annual Statement* name five areas in which the actuary must have completed relevant examinations, “(a) policy forms and coverages, underwriting, and marketing; (b) principles of ratemaking; (c) statutory insurance accounting and expense analysis; (d) premium, loss, and expense reserves; and (e) reinsurance”. An actuary who has not successfully completed Exam 7 may not meet this requirement for all five areas. If the actuary believes he or she does meet this requirement through other means, Section 3.1.2 of the USQS discusses alternative basic education and required documentation thereof.

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The NAIC SAO Instructions include a table within the definition of Accepted Actuarial Designation, which notes that an actuary with an ACAS credential “may substitute experience and/or continuing education for CAS Exam 7 provided the Appointed Actuary explains in his/her qualification documentation how knowledge of the additional reserving topics in CAS Exam 7 (Section A) in the May 2019 syllabus was obtained.” The ability to substitute experience and/or continuing education in this manner apply only to individuals who earned their credential prior to 2019.

2.2.3 Continuing Education Requirements per NAIC SAO Instructions

The NAIC SAO Instructions include a requirement on annually attesting to meeting continuing education requirements:

If subject to the U.S. Qualification Standards, the Appointed Actuary shall annually attest to having met the continuing education requirements under Section 3 of the U.S. Qualification Standards for issuing Actuarial Opinions. As agreed with the actuarial organizations, the Casualty Actuarial Society (CAS) and Society of Actuaries (SOA) will determine the process for receiving the attestations for their respective members and make available the attestations to the public. An Appointed Actuary subject to the U.S. Qualification Standards and not a member of the CAS or SOA shall select one of the above organizations to submit their attestation.²⁵

Related to the requirements in the paragraph above, the CAS and SOA each have online portals to attest to having met continuing education requirements:

- [Certify Compliance with the CAS Continuing Education Policy](#)
- [SOA Continuing Professional Development Requirement](#)

As part of the 2022 update to the SAO instructions, the NAIC removed the additional categorization of continuing education requirement for Appointed Actuaries; however, Appointed Actuaries should continue to maintain appropriate timely records as evidence that their continuing education requirements have been met. Although there is no specific continuing education recordkeeping format, such records should²⁶ contain information similar to that illustrated below and be retained for at least six years beyond the year(s) to which they are applicable.

- a. The date of continuing education,
- b. The credit hours obtained,
- c. A brief description of the subject matter of the continuing education,
- d. Whether it applies to a Specific Qualifications Standard and, if applicable, which Specific Qualification Standard,

²⁵ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

²⁶ U.S. Qualification Standards ([Section 6.1](#))

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- e. Whether it is an organized activity, and
- f. Whether it counts as professionalism, bias, and/or business skills topics.

A sample recordkeeping format is provided in Appendix 5 of the U.S. Qualification Standards.

2.3 Change in Appointed Actuary

NAIC SAO Instructions require a formal process for changing Appointed Actuaries. The steps are set out in paragraph 1 of the NAIC SAO Instructions. The process involves actions by the insurer and prior Appointed Actuary and is set into motion by the formal Board of Directors action replacing the Appointed Actuary. NAIC SAO Instructions state that:

1. **Within five days of the action**, the company must advise the relevant domiciliary insurance department in writing of the change.
2. **Within 10 days of the notification**, the company must write to the domiciliary Commissioner stating whether in the 24 months preceding the change “*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, type of opinion issued, substantive wording of the opinion or data quality. The disagreements required to be reported... include both those resolved to the former Appointed Actuary’s satisfaction and those not resolved to the former Appointed Actuary’s satisfaction.*”²⁷

The letter should list and describe such disagreements, as well as the nature of the resolution, or that the items were not resolved, as applicable.

The letter must be accompanied by a response from the former Appointed Actuary addressed to the company “*stating whether the Appointed Actuary agrees with the statements contained in the Insurer’s letter and, if not, stating the reasons for which he or she does not agree.*”²⁸

The 2023 AOWG Regulatory Guidance states “*While regulators are interested in material disagreements regarding differences between the former Appointed Actuary’s final estimates and the insurer’s carried reserves, they do not expect notification on routine discussions that occur during the course of the Appointed Actuary’s work.*”²⁹

FAQ: Could an actuary be appointed after year-end?

A: Under extraordinary circumstances (e.g., illness of prior Appointed Actuary), the appointment of a new actuary may occur after year-end. Companies would typically communicate with the regulator about the reasons for the late change.

²⁷ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

²⁸ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

²⁹ 2023 AOWG Regulatory Guidance ([Appendix II](#)).

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Note:

- It may be appropriate to also consider any disagreements related to the AOS, although the NAIC SAO and AOS Instructions do not state this explicitly.
- Newly appointed actuaries would typically request and review this correspondence as part of their pre-work.

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3. SCOPE section

This, the SCOPE chapter, is the second of four chapters (i.e., [Chapter 2](#) through [Chapter 5](#)) in this practice note that discuss each of the four required sections of the Statement of Actuarial Opinion: IDENTIFICATION, SCOPE, OPINION, and RELEVANT COMMENTS (sections 3 through 6 of the NAIC SAO Instructions).

The SCOPE section identifies both the reserve items upon which the Appointed Actuary is providing an opinion and also the basis for the presentation of those reserve items. The SCOPE section also identifies the “review date.” The “review date” is defined in [ASOP No. 36, Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves](#), as “the date (subsequent to the valuation date) through which material information known to the actuary is included in forming the reserve opinion.”³⁰

The NAIC SAO Instructions also indicate that the SCOPE should include a paragraph regarding the data relied upon in forming the opinion, including who provided the data and that the Appointed Actuary reconciled the data to Schedule P, Part 1 of the Company’s Annual Statement.

Additionally, if the company participates in intercompany pooling, the Appointed Actuary discloses this in the SCOPE. This disclosure should include a description of the pool, an identification of the lead company, a listing of all companies with their state of domicile and pooling percentages. It must also discuss how the data used in the Appointed Actuary’s analysis was reconciled to Schedule P (either on a pooled basis or for each company on its own).

3.1 Scope of SAO

The SCOPE section identifies the reserve items upon which the Appointed Actuary is providing an opinion. The reserve items may include

- Loss and LAE reserves;
- Retroactive reinsurance assumed reserves;
- Unearned premium reserves for P&C long-duration contracts;
- Unearned premium reserves for extended reporting endorsements, including, but not necessarily limited to those items included in Schedule P Interrogatory No. 1 of the company’s Annual Statement; and,

FAQ: Is the Appointed Actuary required to opine on all of the reserve items listed in section 3.1 of this chapter?

A: No. The Appointed Actuary should identify those items that will be included within the scope of the opinion.

³⁰ Actuarial Standards Board; ASOP No. 36, *Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves*; <http://www.actuarialstandardsboard.org/asops/statements-actuarial-opinion-regarding-property-casualty-loss-loss-adjustment-expense-reserves/>; December 2010; Section 2.10.

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- Other reserve items for which the Appointed Actuary is providing an opinion.

These items, and their corresponding amounts, are listed in Exhibit A: Scope. Exhibit A: Scope and Exhibit B: Disclosures are two exhibits that are required to be attached to the Statement of Actuarial Opinion.

3.1.1 Discussion

The Appointed Actuary should state that the items in the SCOPE, on which he or she is expressing an opinion, reflect Disclosure items 8 through 13.2 in Exhibit B.³¹

Note:

- The NAIC SAO Instructions intentionally excluded items 13.3 and 13.4 from the above sentence (i.e., carried reserves for A&H Long Duration Contract unearned premium and Write-In Items, respectively). This is due to the Appointed Actuary not being asked to opine on the reasonableness of the reserves associated with A&H Long Duration Contracts except to the extent that the reserves are included within the amounts reported on Exhibit A.
- If the Appointed Actuary is not opining on certain items in Exhibit A: SCOPE (or a subset of those items), then the Appointed Actuary should clearly state this in the SCOPE section of the SAO. In this case, if the Appointed Actuary believes the excluded items could be material, the SAO would be “Qualified” and noted as such in item 4 of Exhibit B. (For further discussion on Qualified SAOs, please refer to [Section 4.5](#) of this practice note.)

3.1.2 Illustrative Language

The following language may be appropriate:



I have examined the actuarial assumptions and methods used in determining 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, 2023. The reserves listed in Exhibit A, where applicable, include provisions for Disclosure items (disclosures 8 through 13.2) in Exhibit B.

³¹ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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3.2 Stated basis of presentation

The SCOPE of the SAO should identify the basis upon which the reserves are stated. [ASOP No. 36](#) explains that the stated basis of reserve presentation is:

“a description of the nature of the reserves, usually found in the financial statement and the associated footnotes and disclosures. The stated basis often depends upon regulatory or accounting requirements. It includes, as appropriate, the following:

- a. *whether reserves are stated as being nominal or discounted for the time value of money and, if discounted, the items discounted (for example, tabular reserves only) and the stated basis for the interest rate (for example, risk-free rate, portfolio rate, or fixed rate of x%);*
- b. *whether the reserves are stated to include an explicit risk margin and, if so, the stated basis for the explicit risk margin (for example, stated percentile of distribution, or stated percentage load above expected);*
- c. *whether the reserves are gross or net of specified recoverables (for example, deductibles, ceded reinsurance, and salvage and subrogation);*
- d. *whether the potential for uncollectible recoverables is considered in the reserves, when recoverables are involved and, if so, the categories of such uncollectible recoverables considered and whether those categories reflect currently known collectibility concerns or potential ultimate collectibility concerns. Possible categories of uncollectibles include those related to disputes and those related to counterparties in financial difficulty (credit default);*
- e. *the types of unpaid loss adjustment expenses covered by the reserve (for example, coverage dispute costs, defense costs, and adjusting costs);*
- f. *when the opinion is only for a portion of a reserve, the claims exposure to be covered by the opinion (for example, type of loss, line of business, year, and state); and*
- g. *any other items that, in the actuary’s professional judgment, are needed to describe the reserves sufficiently for the actuary’s evaluation of the reserves.”*³²

FAQ: What is an accounting basis?

A: An accounting basis refers to the reporting principles underlying the presentation of the financial report. Two common examples are SAP (Statutory Accounting Principles) and GAAP (Generally Accepted Accounting Principles).

³² Actuarial Standards Board; ASOP No. 36, *Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves*; <http://www.actuarialstandardsboard.org/asops/statements-actuarial-opinion-regarding-property-casualty-loss-loss-adjustment-expense-reserves/>; December 2010; section 3.4.

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3.2.1 Illustrative Language

The following language may be appropriate:



I have reviewed the December 31, 2023, loss and loss adjustment expense reserves recorded under U.S. Statutory Accounting Principles.

3.3 Intercompany pooling

For companies participating in an intercompany pool, the Appointed Actuary is required to include a description of the intercompany pool in the SAO. This could be included in the SCOPE. The following section discusses intercompany pooling and offers information regarding what may be included in this description.

According to the NAIC SAO Instructions,

“For each company in the pool, the Appointed Actuary shall include a description of the pool, identification of the lead company and a listing of all companies in the pool, their state of domicile and their respective pooling percentages.

Exhibits A and B for each company in the pool should represent the company’s share of the pool and should reconcile to the financial statement for that company.”³³

FAQ: Is there a difference between intercompany pooling and intercompany reinsurance among affiliated carriers?

A: Yes! Please see the “Definitions” section (3.3.1) below.

For companies that have a zero percent share and zero net reserves, the information for the lead company in the pool must be provided. (See [Section 3.3.1](#) of this practice note for additional details.)

3.3.1 Definitions

Intercompany Reinsurance refers to a transaction whereby one company (the reinsurer), for a consideration, agrees to indemnify the other (ceding company) against all or part of the loss that the latter may sustain under the policy or policies that it has issued.

Intercompany Pooling in this context refers to business that is pooled among affiliated insurance companies who are party to a pooling agreement in which the participants receive a fixed and

³³ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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predetermined share of all business written by the pool. Intercompany pooling arrangements involve establishment of a conventional quota share reinsurance agreement under which all the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares.

In addition to the discussion below, pooling is discussed in [Appendix III.2](#) as well as in the AOWG Regulatory Guidance included as [Appendix II](#). The reader is referred in particular to the AOWG Regulatory Guidance related to pooling arrangements in the Opinion paragraph (section 1C of the NAIC SAO Instructions).

Section 1C of the NAIC SAO Instructions was expanded in 2014 to apply to all companies that operate in an intercompany pooling agreement. Companies participating in intercompany pooling arrangements, regardless of their participation percentage, are required to include a description of the pool, identification of the lead company, and a listing of all companies in the pool. This listing is to include their state(s) of domicile and their respective pooling percentages in each of the SAOs.

Additionally, regardless of the company's participation percentage in the intercompany pool, each company is required to include in the Statement of Actuarial Opinion Exhibits A and B information reflective of their share. Companies having a zero (0) percent share are required to include relevant comments that relate to the risks of the lead pool member and are required to file Exhibits A and B of the lead company as an addendum to their SAO.

One of the following situations may present itself to the Appointed Actuary:

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

If it is unclear whether section 1C of the NAIC SAO Instructions applies, refer to the Financial Statement Note titled "*Intercompany Pooling Arrangements*," read the contract itself, and/or contact the regulator for

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the company's domiciliary state. The Appointed Actuary may refer to [Appendix III.2](#) of this practice note for more information.

Note:

- Note the distinction between pooling to a 100 percent lead company with no retrocession and ceding 100 percent via a reinsurance agreement. Any reinsurance agreement with affiliates must be approved by the U.S. domiciliary regulator(s). The financial reporting depends on the approved filing—the regulator may approve an intercompany pooling arrangement or a reinsurance agreement—with the company required to follow the approval regardless of how a company views the contract.

3.3.2 Illustrative Language

The following language may be appropriate:



The Company is the lead member of an intercompany pooling agreement with its subsidiaries, DEF Insurance Company and GHI Insurance Company. Premiums and losses are allocated to the Company based on its assigned percentage to the total pool, XX%. Analysis of the reserve items identified in Exhibit A has been performed for all pool companies combined and allocated to the pool companies based on their pooling percentages. Any favorable or adverse development will affect pool members in a manner commensurate with their pool participation. The following is a listing of all companies in the pool, their respective pooling percentages, and their state of domicile:

*ABC Insurance Company: 80%, New York
DEF Insurance Company: 15%, New York
GHI Insurance Company: 5%, New York*

3.4 Review date

The SCOPE of the SAO also identifies the “review date.” This section defines and discusses this topic.

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3.4.1 Definitions

Review date is defined in [ASOP No. 36](#) as:

“the date (subsequent to the valuation date) through which material information known to the actuary is included in forming the reserve opinion.”³⁴

Note “review date” is a specific disclosure required for SAOs. “Information date” is a disclosure required for any Actuarial Communication, as discussed in [ASOP No. 41](#), *Actuarial Communications*, however, we believe the two terms are conceptually similar. According to [ASOP No. 41](#):

“The actuary should communicate to the intended user the date(s) through which data or other information has been considered in developing the findings included in the report.”³⁵

FAQ: Is the “review date” the same date that the Appointed Actuary issues the Opinion?

A: The “review date” is the date through which the Appointed Actuary considers material information in forming the reserve opinion. While it can be the date the Appointed Actuary signs the Opinion, it may in fact precede the signature date.

3.4.2 Discussion

The 2023 AOWG Regulatory Guidance, which can be found in [Appendix II](#), notes that when the Appointed Actuary is silent regarding the review date, this can indicate either a review date that is the same as the date the SAO is signed or that the Appointed Actuary overlooked this disclosure. In instances in which the Appointed Actuary’s review date is the same date that the SAO is signed, regulators suggest actuaries clarify that in the SAO. Such language may include, “...and reviewed information provided to me through the date of this opinion.”³⁶

With respects to the review date and information date, the Actuary may review SSAP No. 9, located in Appendix IV, which discusses **Material** “Type I—Recognized Subsequent Events” These are:

“Events or transactions that provide additional evidence with respect to conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements.”³⁷

The following is one example of a Type I recognized subsequent event provided in SSAP No. 9:

“If the events that gave rise to litigation had taken place before the balance sheet date and that litigation is settled, after the balance sheet date but before the financial statements are issued or

³⁴ Actuarial Standards Board; ASOP No. 36, *Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves*; <http://www.actuarialstandardsboard.org/asops/statements-actuarial-opinion-regarding-property-casualty-loss-loss-adjustment-expense-reserves/>; December 2010; section 2.10.

³⁵ Actuarial Standards Board; ASOP No. 41, *Actuarial Communications*, <http://www.actuarialstandardsboard.org/asops/actuarial-communications/>; December 2010; section 3.4.5.

³⁶ 2023 AOWG Regulatory Guidance ([Appendix II](#)).

³⁷ SSAP 9, paragraph 3.

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*are available to be issued, for an amount different from the liability recorded in the accounts, then the settlement amount **should be considered in estimating the amount of liability recognized in the financial statements at the balance sheet date.***³⁸

SSAP No. 9 describes **Material** “Type II—Nonrecognized Subsequent Events” as:

*“Events or transactions that provide evidence with respect to conditions that did not exist at the balance sheet date but arose after that date.”*³⁹

and SSAP No. 9 further notes that “*Type II subsequent events shall not be recorded in the financial statements.*”⁴⁰

ASOP No. 36 explains in section 3.4, “*The actuary should identify the stated basis of reserve presentation, which is a description of the nature of the reserves, usually found in the financial statement and the associated footnotes and disclosures. The stated basis often depends upon regulatory or accounting requirements.*” Note further discussion is included in [Section 3.2](#) of this Practice Note.

3.4.3 Illustrative Language

The following language may be appropriate:

A blue arrow-shaped callout box pointing to the right, containing the text "Illustrative Language".

Illustrative
Language

My review considered information provided to me through ([date] OR [the date of this opinion]).

³⁸ SSAP 9, paragraph 11.

³⁹ SSAP 9, paragraph 3.

⁴⁰ SSAP 9, paragraph 8.

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3.5 Provider of data relied upon by the Appointed Actuary

The NAIC SAO Instructions require that the SCOPE paragraph 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 _____ (officer name and title at the 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.”⁴¹

FAQ: What if the data is provided by a third-party administrator rather than by an officer of the Company?

A: According to the 2017 version of AOWG Regulatory Guidance, while it is informative to identify the third party in the SCOPE, the regulated entity will be ultimately responsible for the data. Regulators expect that a Company official will be identified in the SCOPE paragraph.

3.5.1 Discussion

The Appointed Actuary should disclose the title of the officer of the company responsible for the data used by the Appointed Actuary in his/her analysis, in addition to the name of the officer. One or two officers of the regulated entity will usually be named in the SAO. The Appointed Actuary may also be the person responsible for the data.

3.5.2 Illustrative Language

The following language may be appropriate:

Illustrative
Language

In forming my opinion on the loss and loss adjustment expense reserves, I relied upon data prepared by _____ (officer name and title at the Company).

3.5.3 Representations of the Company to Appointed Actuary

Although not explicitly referenced, nor required, in the NAIC SAO instructions or AOWG Regulatory Guidance, non-employee Appointed Actuaries often request a letter of representation from company management. Items that are cited in such letters could include the following:

⁴¹ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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- Company-provided complete and accurate data necessary for Appointed Actuary to form Opinion ([Section 3.5](#))
- Information on events subsequent to loss data valuation date ([Section 3.4](#))
- Basis of carried reserves (e.g., net/gross of specified recoverable; gross/net of salvage/subrogation, discounting ([Section 5.3.2](#)); risk margin; deductibles ([Section 5.3.7b](#))
- Changes in company methodology to determine carried reserves
- Assumed and ceded reinsurance program(s); existence of retroactive/financial reinsurance; reinsurance collectability ([Section 5.4.1](#))
- Participation in pools / associations ([Section 5.3.3](#))
- Existence of death, disability, or retirement “free” tail provisions ([Section 5.3.5](#))
- Existence of long-duration contracts ([Section 5.3.6](#));

For Appointed Actuaries who are employees of the company, the items in the list above provide a good checklist of information about the company that is often requested in financial examinations. The [NAIC Financial Analysis Handbook](#) provides information about the NAIC risk-focused surveillance process.

3.6 Evaluation of data for reasonableness and consistency

The NAIC SAO Instructions require the Appointed Actuary to evaluate the data relied upon in the analysis underlying the SAO. This statement normally means that the Appointed Actuary reviewed the data triangles, etc., used in the course of forming the SAO. During this review, the Appointed Actuary observes whether data points were found to be either outside the range of reasonable possibilities or internally inconsistent to a significant degree (or that appropriate adjustments have been reflected in the Appointed Actuary’s analysis).

3.6.1 Discussion

The objective of the evaluation for reasonableness and consistency is to identify significant data errors that would ordinarily be observed by the Appointed Actuary in the course of analyzing the reserves.

Note [ASOP No. 23, Data Quality](#), provides guidance on this issue; the Appointed Actuary is to comply with [ASOP No. 23](#) when evaluating data. In addition, as highlighted in [ASOP No. 56, Modeling](#),

“The actuary should use, or confirm use of, data appropriate for the model’s intended purpose and should refer, as applicable, to ASOP No. 23, Data Quality, when

FAQ: Is the actuary required to attest that no errors exist in the data examined?

A: No.

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selecting, reviewing, or evaluating data used in the model, either directly or as the basis for deriving, estimating, or testing assumptions used in the model."⁴²

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

1. The key question in reviewing a specific, unusual data point is normally whether the data point is so unusual that it may indicate a possible data error of significance to the Appointed Actuary's SAO on the reserves or whether special attention should be taken with unusual but valid data. 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 Appointed Actuary may well inquire about the causes of unusual data points for purposes of evaluating the reserves.)
2. There may be inconsistencies in the data compilations used directly in the actuarial analysis. For example, if the Appointed Actuary is using a paid loss development method, the Appointed Actuary may choose to investigate significant atypical accelerations or decelerations in the development.
3. If data initially appeared to be unreasonable or inconsistent, but were either explained or adjusted satisfactorily, then the data does comport with a finding of reasonableness and consistency. There may be discussion within the Actuarial Report addressing these circumstances.

Note:

- If the Appointed Actuary identified the data as being unreasonable or inconsistent to a significant degree (relative to the Appointed Actuary's opinion on the reserves), and the apparent data problem was not resolved satisfactorily, some possible alternatives are as follows:
 - Do not rely on the data in question: If, in the Appointed Actuary's judgment, this causes a significant increase in the uncertainty inherent in the Appointed Actuary's opinion on the reserves, then the situation is typically described in the Statement of Actuarial Opinion and elaborated upon in the Actuarial Report, or
 - Conclude that an actuarial opinion cannot be formed based on the available data.

⁴² Actuarial Standards Board; ASOP No. 56, *Modeling*; section 3.1.5. See <http://www.actuarialstandardsboard.org/asops/modeling-3/#312-selecting-reviewing-or-evaluating-the-model>.

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3.6.2 Illustrative Language

The following language may be appropriate:



I evaluated the data for reasonableness and consistency.

3.7 Reconciliation to Schedule P

The NAIC SAO Instructions require the Appointed Actuary to make a statement regarding the reconciliation of data relied upon in the analysis underlying the opinion to Schedule P of the company's Annual Statement. This statement is intended to mean the following:

- A. "Schedule P reconciliations are expected to be performed on both a Direct & Assumed basis and a Net of Reinsurance basis. If circumstances specific to the company lead the Appointed Actuary to perform the reconciliation on only one basis, the rationale for this decision should be explained in the Actuarial Report."⁴³
- B. Each of the following types of data, if relied upon significantly in forming the actuarial opinion (on a Net of Reinsurance or a Direct & 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, claim counts and earned premiums. "If the Appointed Actuary chooses not to reconcile certain data elements used in the analysis, such as claim counts, a brief explanation should be included in the Actuarial Report to make it clear that these elements were not inadvertently overlooked."⁴⁴
- C. 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.
- D. The differences, if any, were deemed by the Appointed Actuary to be either insignificant or explainable by known causes that did not represent errors in the data relied upon by the Appointed

FAQ: Should the reconciliation be performed at a level of detail and refinement identical to that displayed in the Statutory Annual Statement?

A: Not necessarily. See the discussion below.

⁴³ 2023 AOWG Regulatory Guidance ([Appendix II](#)).

⁴⁴ 2023 AOWG Regulatory Guidance ([Appendix II](#)).

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Actuary (e.g., the case basis reserves for LAE were based on formulas that differed between the two sources). Per the AOWG Regulatory Guidance, “When differences appear in the reconciliation but are viewed as immaterial by the Appointed Actuary, the Appointed Actuary should acknowledge the immateriality of the differences in the Actuarial Report in order to assure regulators that the Appointed Actuary is aware of the differences and has considered the potential impact of the differences on the analysis underlying the Actuarial Opinion.”⁴⁵ Per the NAIC SAO Instructions “... An explanation should be provided for any material differences.”⁴⁶

3.7.1 Discussion

Schedule P reconciliations often include complicated mapping of the data used by the Appointed Actuary to the data within Schedule P. Generally, the Appointed Actuary will put together exhibits and explanations that document this mapping. Regulators and other users of the report are interested in this level of detail and therefore, the Appointed Actuary should consider including within the report. The following discussion points are relevant to the process of mapping the data used in the analysis to Schedule P data.

1. The Appointed Actuary may use types of data that are not included in the above reconciliation (e.g., numbers of units of exposure, numbers of claims, policy limits distributions, and loss data for older years adjusted to reflect subsequent years’ reinsurance retentions). Salvage and subrogation received would normally be reconciled if the losses are reviewed gross of salvage and subrogation and/or a separate analysis is performed for salvage and subrogation. Additionally, the Appointed 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 Appointed 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 may be aggregated to the level shown in Schedule P. Similarly, if the Appointed Actuary chooses to combine some Schedule P lines of business for purposes of the actuarial study, then the Schedule P data may be aggregated as needed for comparison.
3. If the data used by the Appointed 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 those data and the Schedule P data require aggregation before being compared, then the data can be compared after minimal necessary aggregation. Alternatively, more finely detailed data may be compiled that, when aggregated in different ways, reproduce both the data used by the Appointed Actuary and the Schedule P data. A brief comment indicating the inability to compare data directly (i.e., before some aggregation of both the data used by the Appointed 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.

⁴⁵ 2023 AOWG Regulatory Guidance ([Appendix II](#)).

⁴⁶ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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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 Appointed 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 LAE data that were relied upon significantly cannot be compared in detail by line of business and year for reasons other than those in notes (2) through (5) above (e.g., if the data used in the actuarial analysis were grouped by policy year), then this may be indicated in the Statement of Actuarial Opinion and may be elaborated upon in the Actuarial Report. If it is not possible to compare the data with Schedule P by year, the data may be compared with Schedule P on an all-years-combined basis. This may be appropriate for calendar-year paid losses, calendar-year defense and cost containment expenses, current year-end case basis loss reserves, and current year-end case basis defense and cost containment expense reserves.
7. If any loss or LAE data corresponding to the prior year's line of Schedule P were relied upon significantly, such data may be compared to Schedule P on an all-years combined basis. This comparison may include calendar-year paid losses, calendar-year paid defense and cost containment expenses, current year-end case basis loss reserves, and current year-end case basis defense and cost containment expense reserves. This may be the case for a discontinued line of business.
8. As with other aspects of the work underlying the Statement of Actuarial Opinion, if the reconciliation was performed by someone other than the Appointed Actuary, the Appointed Actuary should review the methodology used in the reconciliation and its results but need not have personally done or checked the calculations.
9. The Appointed Actuary's analysis may be based primarily on data evaluated earlier than year-end (e.g., Oct. 31). If actual year-end data are not used as the base for projection of the outstanding amounts then, in forming the opinion on year-end reserves, the Appointed Actuary would typically compare the actual year-end data against expected year-end values based on the earlier evaluation. The data source used for the analysis would typically 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 could not be compared against Schedule P.
11. Upon completion of the Schedule P reconciliation, if, after attempting to resolve the differences, significant, unexplained differences remain between the data used by the Appointed Actuary and those shown in Schedule P, the Appointed Actuary may choose to do the following:

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- a. Confirm that the person(s) responsible for the data used by the Appointed 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 Appointed Actuary's efforts to resolve them.)
 - b. Recommend that the company inform its outside auditors of the unexplained differences.
 - c. Discuss the situation in the Statement of Actuarial Opinion and elaborate on it in the Actuarial Report. Note [ASOP No. 36](#) provides guidance on this issue; the Appointed Actuary is to comply with ASOP No. 36 when determining the type of Opinion to be rendered.
 - d. The NAIC SAO Instructions require that the Appointed Actuary include an explanation in the Actuarial Report for any material differences in the Schedule P Reconciliation.
12. According to the 2023 AOWG Regulatory Guidance, if immaterial differences exist, these should be acknowledged by the Appointed Actuary in the Actuarial Report to assure users of the report that the Appointed Actuary is aware of the differences and has considered the potential impact of the differences on the analysis underlying the Actuarial Opinion.

FAQ: Do I need to comment on the Schedule P reconciliation if the differences are not material?

A: According to the AOWG Regulatory Guidance, even immaterial differences should be acknowledged in the Actuarial Report.

3.7.2 Illustrative Language

The following language may be appropriate:



I also reconciled that data to Schedule P – Part 1 of the Company's current Annual Statement.

OR

I also reconciled that data to Schedule P – Part 1 of the Company's current Annual Statement. The data generally reconciled with one exception: The total amount of Company XXX's paid loss differs by \$21,000. This difference results from rounding and is not material.

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3.8 Data testing requirement

The data testing requirement has been in effect for several years and is specified in the Annual Audited Financial Reports section of the NAIC Annual Statement Instructions. This is included in [Appendix I.4](#) of this practice note. According to this requirement, “through inquiry of the Appointed Actuary, the auditor should obtain an understanding of the data identified by the Appointed Actuary as significant.”⁴⁷ The auditor’s responsibility is to determine which data elements are to be included in the testing procedures within the scope of the financial statement audit.

Note that a similar data testing paragraph can be found in the NAIC Annual Statement Instructions for title insurance companies.

3.8.1 Discussion⁴⁸

As noted above, the 2023 NAIC SAO Instructions include a data testing paragraph in the Annual Audited Financial Reports section. This statutory guidance is included in [Appendix I.4](#) and referred to as *the data testing requirement* in this document. The NAIC Annual Statement Instructions further address the auditor’s review of data used by the Appointed Actuary.

The data testing requirement ensures that the auditor will become aware of the data and/or data elements that the Appointed Actuary identifies as being significant.

The term *significant* is not defined within the data testing requirement; the opining actuary should determine a meaning of *significant* that is best suited for the situation that is the subject of the SAO. COPLFR believes that a data item or attribute would normally be considered to be *significant* to the actuary’s reserve evaluation⁴⁹ if, in the Appointed Actuary’s professional judgment, a material error in the data item or attribute in the reserve evaluation is likely to have a material effect on the SAO. Examples of a *material effect* might include a change in the type of SAO rendered (reasonable, qualified, redundant, deficient, or no opinion) or the presence or absence of a risk of material (RMAD) adverse deviation. (Note: The NAIC has not adopted a specific definition of *significant* as it pertains to this data testing requirement, hence the meaning of *significant* suggested by COPLFR in this paragraph is not binding on any actuary.)

Once the auditor has obtained an understanding of the data identified by the Appointed Actuary as being significant, the auditor

FAQ: What data are in scope vs. out of scope of the data testing requirement?

A: Upon request from the auditor, the Appointed Actuary identifies the data they have deemed significant to the analysis in support of the SAO. However, it is the auditor’s responsibility to determine which data elements are to be included in the testing procedures within the scope of the financial statement audit.

⁴⁷ 2023 NAIC Data Testing Requirement ([Appendix I.4](#))

⁴⁸ Note that COPLFR generated this section after discussions with the American Institute of Certified Public Accountants (AICPA), the NAIC/AICPA Working Group, and the NAIC Casualty Actuarial and Statistical Task Force (CASTF). Actuaries are not normally trained to define or specify audit procedures and therefore look to insurance companies and their auditors as having the ultimate responsibility for determining how to comply with the data testing requirement. Questions about the data testing requirement as it relates to specific companies should be directed to the companies’ domiciliary regulators.

⁴⁹ Note the definition of reserve evaluation per ASOP No. 36—“The process of evaluating the reasonableness of a reserve.”

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will determine the scope of testing procedures for purposes of assessing “whether the data tested is fairly stated in all material respects in relation to the statutory financial statement taken as a whole.”⁵⁰

The auditor may not test all data identified by the Appointed Actuary as significant each year. The level of testing 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, or to disclose such information in the opinion or report.

As an accommodation, Appointed Actuaries often provide a letter addressed to company management, with a copy to the company’s financial statement auditors, identifying the data that the Appointed Actuary deems significant to his/her reserve evaluation. An example of such letter is included in the illustrative language section below. While there is no requirement to this effect, written communication among the Appointed Actuary, the company’s management, and the company’s auditor, to be retained for a reasonable time period, may help clarify information and create a documentation trail.

The Appointed Actuary should not be limited in the use of various reserving methods or data by the original list of significant data provided. If the Appointed Actuary materially changes his/her view of what is significant based upon work the Appointed Actuary performs subsequent to providing the data letter to the auditor and management, it is likely appropriate to discuss these changes with both company management and the auditor.

Appointed Actuaries may meet with the company’s management and its financial statement auditors to discuss the data in greater depth. Note, [ASOP No. 21](#), *Responding to or Assisting Auditors or Examiners in Connection with Financial Audits, Financial Reviews, and Financial Examinations*, provides guidance to actuaries on responding to or assisting auditors in connection with financial statements.

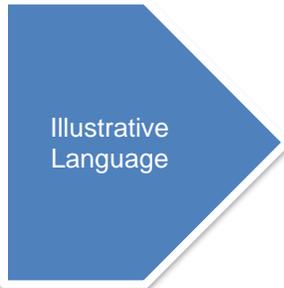
Actuaries may also wish to consult [ASOP No. 23](#) regarding the nature and boundaries of the Appointed Actuary’s responsibilities regarding data quality.

3.8.2 Illustrative Language

The following provides one possible example of a letter the Appointed Actuary may wish to issue to company management (typically with a copy to the auditor) regarding items significant to the reserve evaluation supporting the SAO. 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 it contains, or to identify the lines of business or attributes used as examples as significant. If the Appointed Actuary chooses to issue such a letter, consideration will be made of the facts and circumstances of a particular company; entirely different language may be used. The Appointed Actuary may wish to consult with legal counsel on the contents of such a letter and/or concerning the specific provisions of the NAIC’s data testing requirements.

⁵⁰ 2023 NAIC Data Testing Requirement ([Appendix I.4](#))

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Illustrative
Language

Dear CFO:

I understand that ABC CPA has been appointed to audit XYZ Insurance Company's financial statements for the year ended December 31, 2023. 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, a material error in 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 Defence and Cost Containment Expense (DCC) by reviewed line of business and by accident year, at annual evaluations as of XX/XX/2023. For Workers' Compensation, these data are also split to Medical vs. Indemnity. For Commercial Multi-Peril, these data are also split to Property vs. Liability.*
- 2. Direct and Ceded Case Reserves for Loss by reviewed line of business and by accident year, at annual evaluations as of XX/XX/2023. For Workers' Compensation, this data is also split to Medical vs. Indemnity. For Commercial Multi-Peril, these data are also split to Property vs. Liability.*
- 3. Direct and Ceded Earned premium by reviewed line of business by calendar year as of XX/XX/2023.*
- 4. Reported Claim Counts by reviewed line of business and by accident year, at annual evaluations as of XX/XX/2023, for the following lines of business: Workers' Compensation and Personal Auto Liability. For Workers' Compensation, these data are also split to Medical vs. Indemnity.*
- 5. Direct Paid Adjusting and Other Expense (AOE) by calendar year as of XX/XX/2023. 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/2023.*

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- 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 come to me from the Analyst of XYZ and are generally provided on the 10th workday following the close of the year. Direct AOE is provided by the 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, 2023, 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,
The Actuary*

cc: The Partner, ABC CPA

3.9 Methodology

The NAIC SAO Instructions state that the SCOPE paragraph should include a statement regarding the examination of the assumptions and methodology underlying the company's recorded reserves.

3.9.1 Discussion

Certain states may interpret the NAIC SAO Instructions literally and expect the Appointed Actuary to have examined the company's methodology for determining its reserves. The Appointed Actuary may need to perform additional work to comply with that state's interpretation, particularly when not an employee of the company.

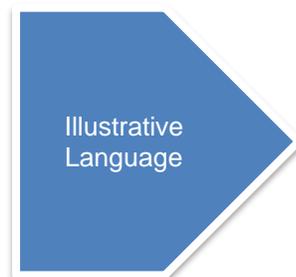
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As indicated in ASOP No. 56, “When selecting, reviewing, or evaluating the model, the actuary should confirm that, in the actuary’s professional judgment, the model reasonably meets the intended purpose.” Please refer to ASOP No. 56 for further discussion regarding models and methods.⁵¹

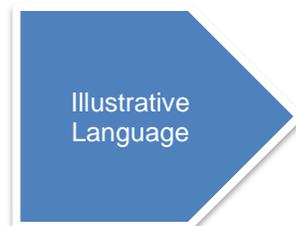
3.9.2 Illustrative Language

If the Appointed Actuary examined the assumptions and methodology underlying the company’s recorded reserves, the following wording may be appropriate (as shown in 3.1.2), absent any circumstances that may warrant the use of alternative language:



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, 2023, and reviewed information provided to me through XX/XX/2023 ...my examination included such review of the actuarial assumptions and methods used and such tests of the calculations as I considered necessary.

If the Appointed Actuary did not review the methods and assumptions used in determining the reserves but rather performed independent tests to evaluate the reserves, wording similar to the following may be appropriate in place of the SCOPE paragraph of the NAIC SAO Instructions (above):



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, 2023, and reviewed information provided to me through XX/XX/2023...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 Appointed Actuary is not giving an opinion, such qualification may be stated here. This would be a qualified SAO in accordance with [ASOP No. 36](#), which requires the Appointed Actuary to indicate the segment of business and the

⁵¹ Actuarial Standards Board; ASOP No. 56, *Modeling*; section 3.1.2. See <http://www.actuarialstandardsboard.org/asops/modeling-3/#312-selecting-reviewing-or-evaluating-the-model>.

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associated reserve amounts. The Appointed Actuary is referred to [Section 4.5](#) for a detailed discussion of what constitutes a qualified SAO.

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4. OPINION section

This, the OPINION chapter, is the third of four chapters (i.e., [Chapter 2](#) through [Chapter 5](#)) in this practice note that discuss each of the four required sections of the Statement of Actuarial Opinion: IDENTIFICATION, SCOPE, OPINION, and RELEVANT COMMENTS (sections 3 through 6 of the NAIC SAO Instructions).

According to NAIC SAO Instructions,

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

If the Scope includes material Unearned Premium Reserves for P&C Long Duration Contracts or Other Loss Reserve items on which the Appointed Actuary is expressing an opinion, the Actuarial Opinion should contain language such as the following:

- D. “Make a reasonable provision for the unearned premium reserves for P&C Long Duration Contracts and/or <insert Other Loss Reserve item on which the Appointed Actuary is expressing an Opinion> 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.”⁵²(See [Section 4.11](#) of this practice note)

Each of these items is discussed in detail in this chapter.

When the reserve estimate is subject to an exceptionally high degree of variability, or when a reasonable fluctuation in reserves can have a material effect on surplus, the Appointed Actuary may choose to discuss this in the SAO. More discussion is in the RELEVANT COMMENTS chapter of this practice note.

⁵² 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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4.1 Meet the relevant state laws

Section 5(A) of the NAIC SAO Instructions requires an opinion that the reserves meet the requirements of the insurance laws of the state of domicile.

4.1.1 Discussion

The insurance laws of the states are generally interpreted to include statutory accounting requirements. Thus, to comply with insurance law, reserves ordinarily represent management's best estimate.

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

Management is required to record its best estimate of reserves by line of business and in total in the statutory accounts. The Appointed Actuary should consider that management's obligations in this regard may be different than the Appointed Actuary's. The Appointed Actuary is required in sections 5(B) and 5(C) of the NAIC SAO Instructions to opine on the reasonableness of the reserves in the aggregate.

FAQ: How can I find the relevant state laws?

A: There are several resources that may be used to find relevant state laws. The American Academy of Actuaries' [2023 P/C Loss Reserve Law Manual](#) is one resource (see note below). In addition, state insurance laws are often available on the website of the particular state regulatory authority. One can also contact the applicable state regulator directly to obtain that state's insurance laws. The responsibility to identify all relevant state laws rests with the individual actuary and legal counsel should be consulted where the actuary is unable to identify all relevant state laws.

Note:

- The Academy's [2023 P/C Loss Reserve Law Manual](#) provides a compilation of state regulatory requirements concerning P&C loss reserves. The law manual is updated annually and is available for purchase from the Academy.

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4.1.2 Illustrative language

The following language may be appropriate:



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

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

4.2 Accepted actuarial standards

The NAIC SAO Instructions state that the OPINION paragraph should include a sentence that the amounts identified in Exhibit A are computed in accordance with accepted actuarial standards.

4.2.1 Discussion

As discussed in [3.9 of this practice note](#), the ability to make this statement depends on the Appointed Actuary's role in reviewing the reserves. The Appointed Actuary may instead perform an independent analysis of the reserves.

If a state were to interpret the NAIC SAO Instructions literally it might expect the Appointed Actuary to have examined the company's methodology for determining its reserves. The Appointed Actuary would need to perform additional work if required to comply with the relevant state's interpretation.

Note:

- Insurance laws and regulations take precedence over the actuarial standards. The Code of Professional Conduct states, for example: "Laws impose obligations upon an Actuary. Where requirements of Law conflict with the Code, the requirements of Law shall take precedence."

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4.2.2 Illustrative language

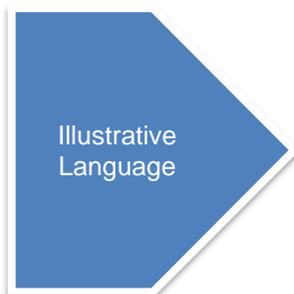
The following wording may be appropriate in situations where the Appointed Actuary reviewed the assumptions and methods used in setting the recorded reserves, assuming it is factually correct:



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.***
- C. *Make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements.*

In situations in which the Appointed Actuary performs an independent analysis of the reserves, the opinion statement in 5(B) of the NAIC SAO Instructions may read:



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 consistent with reserves computed in accordance with accepted actuarial standards.***
- C. *Make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements.*

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4.3 Reasonable opinion

There are five possible types of SAOs: Reasonable, Inadequate/deficient, Redundant/excessive, Qualified, or No opinion. The type of SAO must be explicitly identified in item 4 of Exhibit B as follows:

- R if Reasonable
- I if Inadequate or Deficient Provision
- E if Excessive or Redundant Provision
- Q if Qualified, including the situation when part of the OPINION is Qualified
- N if No Opinion

This section discusses the reasonable type of SAO. Sections [4.4](#) through [4.6](#) of this practice note discuss the other types of SAOs.

The NAIC SAO Instructions explain the determination of a reasonable SAO as follows:

“When the carried reserve amount is within the Appointed Actuary’s range of reasonable reserve estimates, the Appointed Actuary should issue a Statement of Actuarial Opinion that the carried reserve amount makes a reasonable provision for the liabilities associated with the specified reserves.”⁵³

4.3.1 Definitions

[ASOP No. 36](#), section 3.7, states that an actuary should consider a reserve to be reasonable if it is within a range of estimates that could be produced by an unpaid claim estimate analysis that is, in the actuary’s professional judgment, consistent with both [ASOP No. 43](#), *Property/Casualty Unpaid Claim Estimates*, and the identified stated basis of reserve presentation.

4.3.2 Discussion

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

FAQ: What if the Appointed Actuary concludes that the net loss reserves and the direct-plus-assumed loss reserves make reasonable provisions for the unpaid loss and LAE obligations of the company, but 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?

A: The determination of whether to issue a deficient/inadequate opinion is based upon the overall evaluation of the loss reserves as disclosed in the SCOPE paragraph of the SAO as discussed in Chapter 3. For this purpose, it may not be relevant whether the actuary believes that each subset of the reserves makes a reasonable provision for the associated obligations, as long as the carried reserve amount is reasonable in the aggregate. However, the Actuary would still need to assess whether the reserves are stated in accordance with the laws of the state of domicile and accepted actuarial standards.

⁵³ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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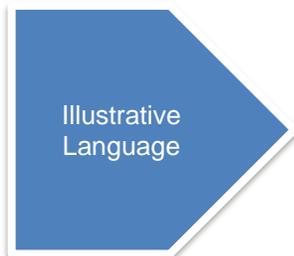
for gross reserves (direct plus assumed reserves), then the SAO would usually include language that explicitly conveys the intended category of SAO for each of the SCOPE items.

Note:

- If the Appointed Actuary reaches different conclusions regarding net reserves versus gross reserves (direct plus assumed reserves), then item 4 in Exhibit B ordinarily would reflect the SAO category for net reserves. In this situation the Appointed Actuary would be expected to include discussion about both gross and net in the SAO.
- 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 outside the bounds of the range of reasonable estimates would not normally make a reasonable provision for all unpaid loss and LAE obligations. The Appointed Actuary will be guided by [ASOP No. 36](#).

4.3.3 Illustrative language

The following language may be appropriate:



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 consistent with reserves computed in accordance with accepted actuarial standards.*

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

In situations in which the Appointed Actuary reaches different conclusions regarding the SCOPE items, e.g., the determination of a reasonable provision for net reserves versus a determination of a redundant or deficient provision for gross reserves (direct plus assumed reserves), the opinion statement in 5(C) of the NAIC SAO Instructions may be appropriate:

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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 consistent with reserves computed in accordance with accepted actuarial standards.*

C. Make a reasonable provision for all net unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements, but a deficient [or redundant] provision on a gross of reinsurance basis. The provision for all gross unpaid losses and loss adjustment expenses is \$X less than [or greater than] the minimum [or maximum] amount I consider necessary to be within the range of reasonable estimates.

4.4 Inadequate/deficient opinion or excessive/redundant opinion

The NAIC SAO Instructions explain the determination of an inadequate/deficient SAO as follows:

“When the carried reserve amount is less than the minimum amount that the Appointed Actuary believes is reasonable, the Appointed Actuary should issue a Statement of Actuarial Opinion that the carried reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves. In addition, the Appointed Actuary should disclose the minimum amount that the Appointed Actuary believes is reasonable.”⁵⁴

In addition, the determination of an excessive/redundant SAO is explained in the NAIC SAO Instructions as follows:

“When the carried reserve amount is greater than the maximum amount that the Appointed Actuary believes is reasonable, the Appointed Actuary should issue a Statement of Actuarial Opinion that the carried reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves. In addition, the Appointed Actuary should disclose the maximum amount that the Appointed Actuary believes is reasonable.”⁵⁵

Further, [ASOP No. 36](#) contains specific disclosure requirements for SAOs where the actuary determines the reserve amount is inadequate or deficient.

⁵⁴ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

⁵⁵ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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4.4.1 Definitions

To determine whether the reserves make a reasonable provision for all unpaid loss and LAE obligations, the Appointed Actuary can refer to [ASOP No. 36](#).

4.4.2 Discussion

[ASOP No. 36](#), section 4.2.b, requires disclosure of the minimum amount the Appointed Actuary believes is reasonable, if the actuary determines the reserve is deficient or inadequate; section 4.2.c requires disclosure of the maximum amount the Appointed Actuary believes is reasonable, if the actuary determines the reserve amount is redundant or excessive. NAIC SAO Instructions are consistent with these requirements.

Note:

- As noted in section 3.7.1 of [ASOP No. 43](#), the reasonableness of an unpaid claim estimate should be determined based on facts known to and circumstances known to or reasonably foreseeable by the Appointed Actuary at the time of the evaluation.
- The minimum amount the Appointed Actuary believes is reasonable is not synonymous with the lowest possible amount. Likewise, the maximum amount the Appointed Actuary believes is reasonable is not synonymous with the highest possible amount.
- If the opinion is that reserves are anything other than “reasonable,” the Appointed Actuary may want to reconsider whether the carried amounts being opined on meet the first two points of the OPINION paragraph, namely that they meet the requirements of the insurance laws and are consistent with reserves computed in accordance with accepted actuarial standards.

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4.4.3 Illustrative language

The following language may be appropriate:



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 consistent with reserves computed in accordance with accepted actuarial standards.*
- C. *Make an inadequate [or excessive] provision for the unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements. The provision for unpaid losses and loss adjustment expenses is \$X less [greater] than the minimum [maximum] amount I consider necessary to be within the range of reasonable estimates.***

4.5 Qualified opinion

The NAIC SAO Instructions explain the determination of a qualified SAO as follows:

“When, in the Appointed Actuary’s opinion, the reserves for a certain item or items are in question because they cannot be reasonably estimated or the Appointed Actuary is unable to render an opinion on those items, the Appointed Actuary should issue a qualified Statement of Actuarial Opinion. The Appointed Actuary should disclose the item (or items) to which the qualification relates, the reason(s) for the qualification and the amounts for such item(s), if disclosed by the Company. Such a qualified opinion should state whether the carried 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 Appointed Actuary is not required to issue a qualified opinion if the Appointed Actuary reasonably believes that the item or items in question are not likely to be material.”⁵⁶

[ASOP No. 36](#) contains specific disclosure requirements for qualified SAOs.

4.5.1 Discussion

According to [ASOP No. 36](#), the Appointed Actuary is to issue a qualified SAO when, in the Appointed Actuary’s opinion, the reserves for a certain item or items are in question because they cannot be

⁵⁶ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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reasonably estimated, or the Appointed Actuary is unable to render an opinion on those items⁵⁷. Examples of situations in which this may occur are as follows:

1. An actuary identifies a portion of the business that may be material to loss reserves, but there is insufficient information with which to perform a quantitative review or draw a conclusion about materiality. The actuary discloses this in the opinion and the supporting report. The opinion is qualified to exclude this portion of the business.
2. An actuary identifies a portion of the business that is material to loss reserves, but there is insufficient information with which to perform a review. The actuary discloses this in the opinion and the supporting report. The opinion is qualified to exclude this portion of the business.
3. A portion of the business is deemed to be outside the scope of the actuary's review. For example, a different actuary reviews and opines on reserves for the accident and health line of business. The actuary discloses this in the opinion and supporting report. The opinion is qualified to exclude this portion of the business. If the actuary has information regarding the materiality of the business, the actuary typically discloses this information in the opinion

If the SAO is qualified, the Appointed Actuary is required to explicitly state in the OPINION paragraph that it is a qualified opinion and properly disclose it as such in Exhibit B, item 4. Additionally, the OPINION paragraph should provide 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 SAO normally will state whether the stated reserve amount makes a reasonable provision for the liabilities associated with the specified reserves, except for the item, or items, to which the qualification relates.

Actuaries typically are careful to avoid language that may imply the SAO is qualified when in fact it is not. There are a number of situations in which the Appointed Actuary might issue an unqualified opinion even though the actuary did not review all of the reserves. Examples of these situations are as follows:

FAQ: How would an opining actuary treat a situation in which there is a portion of reserves for which he or she did not perform an independent analysis? Does this necessarily mean that the opinion is qualified?

A: 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. However, 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, – and a quantitative analysis is not needed. This professional judgment would typically reflect information such as the number of open claims, dollars of total case loss reserves, and types of policies written. The use of such professional judgment does not necessarily require a qualified opinion. We note that the actuary's review process should be well-documented in the Actuarial Report.

⁵⁷ Section 3.11(d) of [ASOP No. 36](#).

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1. The Appointed Actuary reviews information regarding a portion of the company's business, concludes based on professional judgment that loss reserves for this portion are likely to be immaterial to the overall reserves, and decides not to perform a quantitative analysis of that business. The actuary may or may not disclose this in the opinion. The actuary may wish to address this professional judgment in the report supporting the opinion. In this instance, because loss reserves for that business are deemed immaterial, there is no apparent need to qualify the opinion.
2. The Appointed Actuary reviews a quantitative analysis performed by another 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. In this situation, according to paragraph 4.2.f of [ASOP No. 36](#), the actuary should disclose (a) whether he/she reviewed the other's underlying analysis and (b) if a review was performed, the extent of the review. In this instance, there is no need to qualify the opinion. Refer to [4.10](#) for further details on making use of the work of another.

Note:

- [ASOP No. 36](#), section 4.2.d, requires disclosure of the item(s) to which the qualification(s) relate(s), the reason(s) for the qualification(s), and the amounts of such item(s), if disclosed by the reporting entity, that are included in the reserve. The 2014 NAIC SAO Instructions were revised to include this requirement as well. Further, [ASOP No. 36](#) states that, if the amounts for such items are not disclosed by the entity, the Appointed Actuary should disclose that the reserve includes unknown amounts for such items.
- A qualified SAO does not carry a negative connotation; it merely identifies a component of reserves not covered by the SAO.
- The company's regulator is likely to follow up with the company to understand the qualification and how the company is satisfied with the adequacy of the reserves related to it.

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4.5.2 Illustrative language

The following language may be appropriate:



In my opinion, **with the qualification that it does not include the [identify the item(s) to which the qualification(s) relate(s)]**, 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 consistent with reserves computed in accordance with accepted actuarial standards.
- C. Make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements.

The Company's management has informed me that the reserves listed in Exhibit A include \$X (x.x%) on a net of reinsurance basis, and \$Y (y.y%) on a direct and assumed basis, for [item(s) to which the qualification(s) relate(s)]. I did not include in my review an evaluation of the reserves related to [item(s) to which the qualification(s) relate(s)] because there was not sufficient information available for me to assess the reasonableness of those reserves. Thus, this is a qualified statement of actuarial opinion.

4.6 No opinion

The NAIC SAO Instructions explain the determination of “no opinion” as follows:

“The Appointed 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 Appointed Actuary cannot reach a conclusion due to deficiencies or limitations in the data, analyses, assumptions, or related information, then the Appointed 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.”⁵⁸

[ASOP No. 36](#), Section 3.11(e) states: “A statement of no opinion should include a description of the reasons no opinion could be given.”

⁵⁸ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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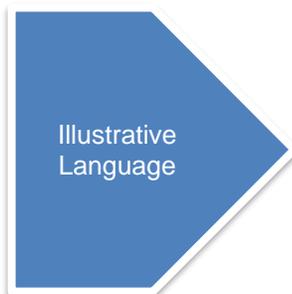
4.6.1 Discussion

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

- Whether there exists adequate data to evaluate the reserves;
- If industry data or another company's data were used, whether there is reason to believe that these data are likely to be reasonably similar to the data patterns of the company for which the Appointed Actuary is rendering an SAO;
- Whether to provide disclosures concerning the data used; and
- Whether to provide disclosures concerning the resulting variability and uncertainty.

4.6.2 Illustrative language

The following language may be appropriate:



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

4.7 Other Loss Reserve items

The opinion statement in 5(D) of the NAIC SAO Instructions is usually appropriate for the situation in which the Scope includes material Other Loss Reserve items on which the Appointed Actuary is expressing an opinion. These items would be listed separately in Exhibit A, item 6.

4.7.1 Definitions

Other Loss Reserve items may include a specific loss reserve item for which an opinion is required by state regulation. Based on discussion of COPLFR members with AOWG, we understand that some regulators have seen the following included in item 6 of Exhibit A:

- The accrual for Death, Disability, or Retirement provisions in claims-made insurance policies if recorded as a loss reserve rather than Unearned Premium Reserve (UPR);

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- The amount of discount for workers' compensation loss reserves;
- Retroactive reinsurance ceded loss reserves; and
- Contingent liabilities

4.7.2 Discussion

Whether Other Loss Reserve items are included within the scope of the SAO depends on materiality. According to the NAIC SAO Instructions,

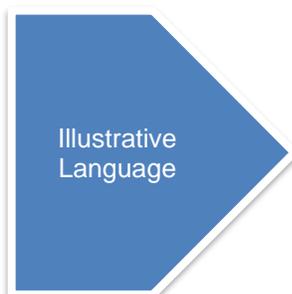
If the Scope includes material Unearned Premium Reserves for P&C Long Duration Contracts or Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion, the Opinion should contain language such as the following:

- D. *“Make a reasonable provision for the unearned premium reserves for P&C Long Duration contracts and/or <insert Other Loss Reserve item on which the Appointed Actuary is expressing an Opinion> of the Company under the terms of its contracts and agreements.”⁵⁹*

If there is any aggregation or combination of items in Exhibit A, NAIC SAO Instructions require the OPINION paragraph to clearly identify the combined items.

4.7.3 Illustrative language

If the SCOPE includes Other Loss Reserve items as a write-in item in the Exhibit A, SCOPE, line 6, the Appointed Actuary may find it appropriate to add a statement in the OPINION paragraph, item “D” (or “E,” if appropriate), such as:



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

- D. (or E.) Make a reasonable provision for the <insert Other Loss Reserve item(s) on which the Appointed Actuary is expressing an Opinion> of the Company under the terms of its contracts and agreements.*

⁵⁹ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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4.8 UPR for P&C Long Duration Contracts

The amounts recorded by the company for unearned premium reserves for P&C Long Duration Contracts are identified in Exhibit A: SCOPE, items 7 and 8 on direct plus assumed and net bases, respectively. If the company has material amounts for these reserves, then the Actuary should opine on the reasonableness of the balances per the NAIC SAO Instructions. Note that these requirements are specific to P&C Long Duration Contracts. Further disclosures specific to A&H Long Duration Contracts that are identified in Exhibit B item 13 are included in the Relevant Comments as discussed in [Section 5.3.6](#).

As discussed in [4.7](#), the opinion statement in 5(D) is usually appropriate when the Appointed Actuary is opining on unearned premium reserves for extended losses and expenses or Other Loss Reserve items, as separately identified in Exhibit A: SCOPE.

4.8.1 Definitions

P&C Long Duration Contracts for the purposes of the SAO are defined in the NAIC SAO Instructions as:

“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 the contract nor increase the premium during the contract term. These contracts are subject to the three tests of SSAP No. 65-Property and Casualty Contracts of the NAIC Accounting Practices and Procedures Manual”⁶⁰

4.8.2 Discussion

Unearned premium reserves related to direct and assumed P&C Long Duration contracts are covered by the section 4 and Exhibit A: SCOPE (items 7 and 8) requirements of the NAIC SAO Instructions. The following specific contract types are excluded: financial guaranty, mortgage guaranty, and surety. While the primary focus of SCOPE items 7 and 8 is extended warranty contracts, companies may write other contracts with durations greater than 13 months that the insurer can neither cancel nor increase the premium during the contract term, such as residual value contracts or certain directors' and officers' liability insurance. These may fall within the SCOPE of this section of the NAIC SAO Instructions.

⁶⁰ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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SSAP 65 establishes methodology for determining a minimum level of unearned premium reserves for single or fixed premium policies with coverage periods of 13 months or greater. The accounting rule is found in the NAIC *Accounting Practices and Procedures Manual* and is reprinted in the Academy's [2023 P/C Loss Reserve Law Manual](#).

Further discussion of this topic can be found in [Appendix III.1](#).

Section 4 and Exhibit A: SCOPE (items 7 and 8) of the NAIC SAO Instructions require disclosure of the unearned premium reserve amounts for P&C Long Duration Contracts within the scope of the opinion. The following entries are required to be included on Exhibit A: SCOPE:

Premium Reserves:

(7) Reserve for Direct and Assumed Unearned Premium for P&C Long Duration Contracts

(8) Reserve for Net Unearned Premium for P&C Long Duration Contracts

If there is any aggregation or combination of items in Exhibit A, NAIC SAO Instructions require the OPINION paragraph to clearly identify the combined items.

FAQ: Are all policies of duration not less than 13 months considered P&C Long Duration for the purposes of this requirement?

A: No. SSAP 65 specifies certain criteria for the policies that are subject to this requirement. Surety policies are explicitly excluded from this requirement. Policies that are cancellable under certain conditions may also be exempted, such as a D&O policy that can be cancelled upon a major change in the insured (such as a major acquisition).

Note:

- For SAOs that cover the contracts described in this section, the Appointed Actuary may choose to edit language throughout the SAO to keep it consistent with the fact that loss, LAE, and unearned premium reserves are included. Some of the places in a SAO where an Appointed Actuary typically uses the phrase “loss and loss adjustment expense” to refer to what is covered in the SAO are in the IDENTIFICATION paragraph, the SCOPE paragraph, the OPINION paragraph, the description of reconciliation issues, and the RELEVANT COMMENTS section. The Appointed Actuary could choose to refer throughout the SAO to the unearned premium reserves by some description such as “the unearned premium reserves related to single or fixed premium policies with coverage periods of 13 months or greater which are non-cancellable 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 “P&C long duration unearned premium reserves.”
- Exhibit A, items 7 and 8 require disclosure of the amount of the reserve for unearned premium for P&C Long Duration Contracts, and the NAIC SAO Instructions further require the Appointed Actuary to include a paragraph (D) regarding the reasonableness of the unearned premium reserve in the OPINION paragraph when these reserves are material. However, regulators have

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noted that some SAOs include paragraph (D) regardless of materiality. The AOWG expects that actuaries either add paragraph (D) if they can and are indeed expressing an opinion on the reasonableness of this reserve and/or add an explanatory paragraph about these unearned premium reserves in RELEVANT COMMENTS and state whether the amounts are material or immaterial.

4.8.3 Illustrative language

If the SCOPE of the SAO includes material unearned premium reserves for P&C Long Duration Contracts, the NAIC SAO Instructions state that, the SAO “should contain language such as the following” as item (D) of the OPINION paragraph of the SAO:



Make a reasonable provision for the unearned premium reserves for P&C Long Duration Contracts of the Company under the terms of its contracts and agreements.

4.9 Other Premium Reserve items

If the company has Other Premium Reserve items which the Appointed Actuary has listed separately in Exhibit A, item 9, and are included within the scope of the opinion, then the Actuary should conclude on the reasonableness of these balances if they are material.

4.9.1 Definitions

Other Premium Reserve items may include a specific premium reserve item for which an Opinion is required by state regulation, or the accrual for Death, Disability, or Retirement (DDR) provisions if recorded as an unearned premium reserve.

There is further discussion on disclosures for DDR provisions in the RELEVANT COMMENTS section of this practice note ([Section 5.3.5](#)).

4.9.2 Discussion

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

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4.9.3 Illustrative language

If the SCOPE includes Other Premium Reserve items as a write-in item in the Exhibit A, SCOPE, line 9, the actuary may wish to add an additional statement in the OPINION paragraph, item “D” (or “E,” if appropriate), such as:



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

D. (or E.) Make a reasonable provision for the unearned premium reserves for <insert other premium reserve item(s) on which the Appointed Actuary is expressing an Opinion> under the terms of its contracts and agreements.

Or using an unearned premium for DDR as an example, the actuary may wish to expand upon the OPINION paragraph, item “C”, such as:



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

C. Make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements, including amounts under yet to be issued extended reporting endorsements from the Company’s death, disability, and retirement contract provision that the Company holds as part of its unearned premium reserve.

4.10 Use of the work of another

According to the NAIC SAO Instructions,

If the Appointed Actuary has made use of the analysis of another actuary not within the Appointed Actuary’s control (such as for pools and associations, for a subsidiary or for special lines of business) for a material portion of the reserves, the other actuary must be identified by name, credential and affiliation within the OPINION paragraph. If the Appointed Actuary has made use of the work of a non-actuary (such as for modeling) for

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*a material portion of the reserves, that individual must be identified by name and affiliation and a description of the type of analysis performed must be provided.*⁶¹

4.10.1 Discussion

Section 5 of the NAIC SAO Instructions also requires that, if an actuary has used the work of another actuary for a material portion of the reserves, he or she must provide that other actuary's name, credentials and affiliation in the opinion. In 2016 the NAIC SAO Instructions were expanded to include the use of the work of a non-actuary, which is consistent with the phraseology in [ASOP No. 36](#).⁶²

[ASOP No. 36](#) takes this disclosure requirement several steps further. [ASOP No. 36](#) states that the actuary should make use of another's supporting analyses or opinions only when it is reasonable to do so. According to section 3.7.2 of [ASOP No. 36](#), in determining whether it is reasonable to use the work of another, the Appointed Actuary should consider the following:

- a. The amount of the reserves covered by another's analyses or opinions in comparison to the total reserves subject to the actuary's opinion;
- b. The nature of the exposures and coverage;
- c. The way in which reasonably likely variations in estimates covered by another's analyses or opinions may affect the actuary's opinion on the total reserves subject to the actuary's opinion; and
- d. The credentials of the individual(s) that prepared the analyses or opinions.

In situations where the work was done by someone not under the actuary's control, and after considering these items, the actuary determines that it is reasonable to use the work of another without performing any independent analysis, and the actuary uses another's work for a material portion of the reserves, the actuary should disclose (a) whether he/she reviewed the other's analysis and (b) if a review was performed, the extent of the review (see paragraph 4.2.f). Where, in the opinion of the actuary, the analyses or opinions of another need to be modified or expanded, the actuary should perform such analyses as necessary to issue the opinion on the total reserves. Please refer to [ASOP No. 36](#) for additional requirements in this area. If the actuary is unable to determine that it is reasonable to use the work of another, it may be necessary to issue a qualified opinion. Refer to section 4.5 for further details on qualified opinions.

The actuary may consider consulting sections 3.4 and 3.5 of [ASOP No. 56](#) when relying on models designed, developed or modified by others or when relying on experts in the fields of knowledge used in the development of the model.

⁶¹ 2022 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

⁶² ASOP No. 36 refers to making use of "another's" work. According to section 3.7 of ASOP No. 36, "The actuary may develop estimates of the unpaid claims for all or a portion of the reserve or make use of another's unpaid claims estimate analysis or opinion for all or a portion of the reserve. For purposes of this section, 'another' refers to one not within the actuary's control."

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4.10.2 Illustrative language

If the work of another was used, whether an actuary or not, (such as for pools and associations, for a subsidiary, or for special lines of business) for a material portion of the reserves, the other person must be identified by name and affiliation within the OPINION paragraph. The following provides sample wording that could be included in the OPINION section in the situation where the Appointed Actuary makes use of the work of the actuary for an underwriting pool that the company participates in:



The Company participates in the [name of underwriting pool] (“the Pool”). In forming my opinion, I made use of the analysis and opinion issued by [Name of Actuary], MAAA, FCAS, Chief Actuary for the Pool, regarding reserves held by the Company for the Pool.

This wording would follow items A. through E. of the OPINION.

4.11 Aggregation or combination of items in Exhibit A

Section 5 of the NAIC SAO Instructions, which describes the OPINION paragraph, states that:

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

In addition to the NAIC Instructions, the Appointed Actuary must follow the requirements of section 3.5 of [ASOP No. 36](#), which states that *“the actuary should identify the scope of the analysis upon which the opinion is based.”* This includes the following, among others:

“If separate reserve amounts for different reserve items, such as losses and loss adjustment expenses, are disclosed in the statement of actuarial opinion, whether the actuary’s opinion applies to those items in the aggregate or individually”

4.11.1 Discussion

Appointed Actuaries commonly opine on a combination of Exhibit A items rather than individually. For example, Appointed Actuaries often combine items (1) Unpaid Losses and (2) Unpaid Loss Adjustment Expenses, on a net of ceded reinsurance basis, and items (3) Direct and Assumed Unpaid Losses and (4) Direct and Assumed Unpaid Loss Adjustment Expenses. The combination is often driven by how the Appointed Actuary performs their analysis.

Note that the illustrative language used throughout Section 4, *“In my opinion, the amounts carried in Exhibit A on account of the items identified”* may, in the absence of further commentary, imply that the

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Appointed Actuary is opining on each item in Exhibit A individually rather than on an aggregated or combined basis.

4.11.2 Illustrative language

If there is any aggregation or combination of items in Exhibit A, NAIC SAO Instructions require the OPINION paragraph to clearly identify the combined items. The following illustrative language provides three examples that might be appropriate in the OPINION paragraph in the situation where the Appointed Actuary is combining items in Exhibit A:



In my opinion, the amounts shown in Exhibit A for the sum of items (1), (2), and (5) (net loss and loss adjustment expense reserves including Retroactive Reinsurance Reserve Assumed) as well as the sum of items (3) and (4) (direct and assumed loss and loss adjustment expense reserves):

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

OR

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 consistent with reserves computed in accordance with accepted actuarial standards.*
- C. Make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements.*

My opinion with respect to the direct and assumed loss and loss adjustment expense reserves of the Company relates to the aggregate amounts reflected in items 3 and 4 of Exhibit A. Likewise, my opinion with respect to the net loss and loss adjustment expense reserves of the Company relates to the aggregate amounts reflected in items 1 and 2 of Exhibit A.

OR

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 consistent with reserves computed in accordance with accepted actuarial standards.*
- C. Make a reasonable provision in the aggregate, both net of ceded reinsurance and direct and assumed, for all unpaid loss and loss*

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adjustment expense obligations of the Company under the terms of its contracts and agreements.

In addition to the illustrations above, other language and combination of items (e.g. [1, 2, 5, and 6], [1, 2, and 9], etc.) in Exhibit A may be acceptable, while keeping in mind that the opinion language should clearly identify the combined items.

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5. RELEVANT COMMENTS section

This, the RELEVANT COMMENTS chapter, is the last of four chapters (i.e., [Chapter 2](#) through Chapter 5) in this practice note that discuss each of the four required sections of the Statement of Actuarial Opinion: IDENTIFICATION, SCOPE, OPINION, and RELEVANT COMMENTS (sections 3 through 6 of the NAIC SAO Instructions).

According to the NAIC SAO Instructions,

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

- a. *Company-Specific Risk Factors...*
- b. *Risk of Material Adverse Deviation....*
- c. *Other Disclosures in Exhibit B...*
- d. *Reinsurance...*
- e. *IRIS Ratios...*
- f. *Methods and Assumptions...⁶³*

In addition, the NAIC SAO Instructions state the comments should describe the significance of the Other Disclosures in Exhibit B:

“RELEVANT COMMENT paragraphs should describe the significance of each of the remaining Disclosure items (8 through 14) in Exhibit B. The Appointed Actuary should address the items individually and in combination when commenting on a material impact.”⁶⁴

The 2023 AOWG Regulatory Guidance further states:

In addition to the required Relevant Comments, the Appointed Actuary should consider providing information on other material items such as reinsurance with affiliates, mergers or acquisitions, other premium reserves, and catastrophe risk.

In addition to the disclosures on Exhibit B, the Appointed Actuary must follow the disclosure requirements of sections 4.1 and 4.2 of [ASOP No. 36](#), which include the following, among others:

- The intended user(s) of the SAO
- The intended purpose of the SAO

⁶³ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

⁶⁴ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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- The stated basis of reserve presentation
- Whether any material assumption or method was prescribed by applicable law
- Whether the Appointed Actuary disclaims responsibility for any material assumption or method selected by another party

The following sections discuss each of the required RELEVANT COMMENT paragraphs per the NAIC SAO Instructions in further detail.

5.1 Company-Specific Risk Factors

According to the NAIC SAO Instructions:

“The Appointed Actuary should include an explanatory paragraph to describe the major factors, combination of factors or particular conditions underlying the risks and uncertainties the Appointed Actuary considers relevant. 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 Appointed Actuary required to include an exhaustive list of all potential sources of risks and uncertainties.”⁶⁵

In this section we will discuss required commentary on major factors or particular conditions underlying the significant risks or uncertainties that the Appointed Actuary considers relevant to the statutory entity.

5.1.1 Discussion

The 2023 NAIC SAO Instructions require the Appointed Actuary to comment on company specific risk factors even when no risk of material adverse deviation is judged to exist. COPLFR has prepared a list of possible risk factors; these are not meant to be all-inclusive and certainly are not meant to apply to every company. For example, one would not expect to see discussion of the risk of A&E losses for a personal lines company. The list below is meant to provide some suggestions for the types of risk factors and underlying loss exposures for which comment may be appropriate:

- COVID-19⁶⁶
- A&E losses
- Other emerging mass torts
- Construction defects
- Catastrophic weather events
- Conflagration events

⁶⁵ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

⁶⁶ Because the AOWG Regulatory Guidance has removed the paragraph with specific expectations regarding COVID-19, we have removed Section 5.7 for 2023. Additional information from the American Academy of Actuaries related to the subject may be found here ([COVID-19 resources](#)).

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- Exposure related to mortgage defaults
- Exposure to cyber liability
- High excess layers
- Impact of soft/hard market conditions
- Changes in inflation or in the expected persistence of inflation (e.g., wage, social, medical, cost of goods sold)
- Large deductible workers' compensation claims
- Medical professional liability legislative issues
- New products or new markets
- Opioid epidemic
- Supply chain disruption
- Rapid growth in one or more lines of business or segments
- Lack of data or unexpected and unexplained changes in data
- Operational changes that are not objectively quantified
- Sudden unexplained changes in frequency or severity of reported data for a line of business or segment
- Changes in adequacy of known case reserves
- Changes in distribution of policy limits and/or policy attachments/deductibles
- Terms and conditions of reinsurance contracts

Note:

- The Appointed Actuary may refer to section 3.6 of [ASOP No. 43](#), particularly sections 3.6.6-3.6.8, which pertain to External Conditions, Changing Conditions, and Uncertainty, for further guidance regarding factors associated with the unpaid claim estimate analysis.

The NAIC SAO Instructions direct the Appointed Actuary to address “the major factors, combination of factors or particular conditions underlying the risks and uncertainties the Appointed Actuary considers relevant.” The list below is meant to provide some suggestions for the types of combinations of risk factors and conditions about which comment may be appropriate:

- Rapid growth during a soft market in a line of business in which the company has limited historical experience
- Risk of adverse medical inflation on a large book of excess workers' compensation business
- Risk of increased sustained unemployment, along with reductions in home prices on a mortgage insurance book of business
- Significant shifts upward in policy limits and attachment points sold, along with a reduction in reinsurance protection purchased

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Note:

- The Appointed Actuary may refer to section 4.2.e of [ASOP No. 36](#), which pertains to Significant Risks and Uncertainties, for further guidance about the explanatory paragraph.

5.1.2 Illustrative language

The following language may be appropriate. Note that the 2023 AOWG Regulatory Guidance requires this section of the SAO to go beyond the mention of general risk factors, such as the first three sentences of the following illustrative language. Including only these first three sentences would not satisfy the regulatory requirement around risk factors; subsequent sentences would be necessary:



Actuarial estimates of property and casualty loss and loss adjustment expense reserves are inherently uncertain because they are dependent on future contingent events. Also, these reserve estimates are generally derived from analyses of historical data, and future events or conditions may differ from the past. The actual amount necessary to settle the unpaid claims may therefore be significantly different from the reserve amounts listed in Exhibit A.

The following provides major factors and/or particular conditions underlying the risks and uncertainties that I consider relevant to the Company's carried reserves at December 31, 2023:

1. *<Description of Item 1>* _____
2. *<Description of Item 2>* _____
3. *<Description of Item 3>* _____

5.2 Risk of Material Adverse Deviation and the Materiality Standard

The NAIC SAO Instructions require the Appointed Actuary to include RELEVANT COMMENT paragraphs that specifically address material adverse deviation. These paragraphs would contain the following:

- A description of the major factors or particular conditions underlying the significant risks or uncertainties that the Appointed Actuary considers relevant to the statutory entity;
- The amount of adverse deviation in U.S. dollars that the Appointed Actuary judges to be material with respect to the SAO (i.e., materiality standard disclosed as item 5 in Exhibit B) and an explanation of how that amount was determined; and

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- An explicit statement of whether the Appointed Actuary reasonably believes that there are significant risks or uncertainties that could result in material adverse deviation. This determination is also disclosed in item 6 of Exhibit B.

In this section we discuss the materiality standard and address the determination of Risk of Material Adverse Deviation.

5.2.1 Definitions

Materiality: The Appointed Actuary may refer to section 3.6 of [ASOP No. 36](#), which pertains to materiality.

5.2.2 Discussion

According to the NAIC SAO Instructions,

“The Appointed Actuary must identify the materiality standard and the basis for establishing this standard. The materiality standard must also be disclosed in U.S. dollars in Exhibit B: Disclosures.”⁶⁷

Examples of possible considerations in the choice of a materiality standard are:

- Percentage of surplus
- Percentage of reserves
- The amount of adverse deviation that would cause surplus to fall below minimum capital requirements
- The amount of adverse deviation that would cause Risk-Based Capital (RBC) to fall to the next action level (assuming no change in the Authorized Control Level Risk-Based Capital)
- Multiples of net retained risk
- The upper limit of a company’s reinsurance protection on reserve development, if any

Other bases for establishing the standard may be appropriate as well. The actuary may also want to consider the impacts of reinsurance, such as levels of ceded reserves compared to surplus or concerns about solvency or collectability of reinsurance.

FAQ: If a company is a 0% pool participant, what is the company’s materiality standard?

A: According to the NAIC Instructions, a 0% pool participant should enter a materiality standard of zero dollars for Question 5 on Exhibit B of the SAO. Furthermore, the response to Question 6 of Exhibit B regarding whether there are significant risks that could result in material adverse deviation should be “not applicable”.

⁶⁷ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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The NAIC Financial Analysis Handbook provides a Bright Line Indicator Test in regard to the Risk of Material Adverse Deviation for those companies subject to RBC reporting requirements. If the Appointed Actuary does not address material adverse deviation, yet ten percent (10%) of the company's net loss reserves is greater than the difference between the Total Adjusted Capital and the company Action Level capital, then comments from the Appointed Actuary should be pursued by the Financial Analyst. In situations where the test is triggered, the Appointed Actuary may consider disclosing why he/she does not feel there is a RMAD, if that is the conclusion. The Appointed Actuary may also wish to consider this test in the selection of the materiality standard.

FAQ: What percentage of SAOs concludes an RMAD exists?

A: Approximately one-third of SAOs reach this conclusion.

The Five Year Historical Data Exhibit of the Annual Statement is a convenient source for these RBC values. Total Adjusted Capital and Authorized Control Level Risk Based Capital are shown on this Annual Statement exhibit:

$$\text{Company Action Level Capital} = 2 * \text{Authorized Control Level Risk Based Capital}$$

In addition, the 2023 AOWG Regulatory Guidance includes the following:

“When deciding whether RMAD exists, the Appointed Actuary should consider the materiality standard in relation to the range of reasonable estimates and the carried reserves. For example, RMAD should likely exist when the sum of the materiality standard plus the carried reserves is within the range of reasonable estimates. Regardless, the Appointed Actuary should support the conclusion of whether RMAD exists.”⁶⁸

We reiterate that while RMAD may not exist under the aforementioned quantitative consideration, there still may be risks and uncertainties that could result in material adverse deviation. Therefore, both quantitative and qualitative considerations might be contemplated in determining whether there are significant risks that could result in material adverse deviation.

The Appointed Actuary may find it appropriate to consider including a discussion of steps the company has taken to mitigate the risk factors discussed in the explanatory paragraph.

While typical practice and the input on Exhibit B of the Opinion base the materiality standard and decision of a risk of material deviation on net reserves, the 2023 AOWG Regulatory Guidance includes the following:

“the materiality standard in Exhibit B, Item 5 and the RMAD conclusion in Exhibit B, Item 6 should pertain to the net reserves. If the Appointed Actuary reaches a different conclusion on the risk of material adverse deviation in the net versus the direct and

⁶⁸ 2023 AOWG Regulatory Guidance ([Appendix II](#)).

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assumed reserves, the Appointed Actuary should include a Relevant Comments paragraph to address the differences. Regulators understand that a net versus a direct and assumed RMAD will have different meanings and, potentially, different materiality standards.”⁶⁹

The Appointed Actuary may consider a materiality standard for direct and assumed reserves that focuses more on the total amount of these reserves rather than on standards that are based on policyholder’s surplus or RBC.

Potential considerations of an RMAD decision on a direct and assumed basis versus a net basis may be the carried reserve in relation to the actuary’s range or varying magnitude of reinsurance protection across the company’s portfolio (e.g., the company maintains additional reinsurance protection on lines of business that have greater uncertainty in results).

Note:

- No matter how the materiality standard is determined, [ASOP No. 36](#), section 3.2 requires the Appointed Actuary to consider the purpose and intended uses for which the Appointed Actuary prepares the SAO.

5.2.3 *Illustrative language*

The following provide examples of language that could be appropriate; note however that there are additional possibilities for the choice of the materiality standard (examples of which are provided above):

⁶⁹ 2023 AOWG Regulatory Guidance ([Appendix II](#)).

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My Materiality Standard for purposes of addressing the risk of material adverse deviation of the Company's reserves for unpaid losses and loss adjustment expenses has been established as xx% of the Company's net loss and LAE reserves, or \$X million.

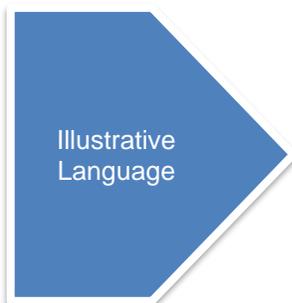
OR

My Materiality Standard for purposes of addressing the risk of material adverse deviation of the Company's reserves for unpaid losses and loss adjustment expenses has been established as yy% of the Company's policyholders surplus, or \$Y million.

OR

My Materiality Standard for purposes of addressing the risk of material adverse deviation of the Company's reserves for unpaid losses and loss adjustment expenses has been established as \$Y million. This represents the reduction in surplus that would result in additional action based on the NAIC RBC formula assuming no change in the Authorized Control Level Risk-Based Capital. A reduction in surplus of \$Y would result in the Company moving into the [state which RBC level, e.g., Company] Action Level.

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. However, the following provides illustrative wording that might be appropriate in a situation where there is a RMAD:



I believe there are significant risks and uncertainties associated with the Company's net loss and loss adjustment expense reserves that could result in material adverse deviation. I have identified those risk factors as _____, _____, and _____. These risk factors are described in greater detail in the preceding paragraph and in the report supporting this opinion. The absence of other risk factors from this commentary is not meant to imply that additional factors cannot be identified in the future as having had a significant influence on the Company's reserves.

There may be situations where mitigating factors reduce or eliminate the risk of material adverse deviation. An example of illustrative language for a situation where retroactive reinsurance is a mitigating factor is as follows:

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Illustrative
Language

It should be noted, however, that the company has entered into a retroactive reinsurance contract which would serve to mitigate the impact of adverse deviation in loss and LAE reserves on the company's statutory surplus if recoverables from that contract were considered as a reduction in net loss and LAE reserves.

Relevant comments on retroactive reinsurance are discussed in [5.4](#) below.

The following provides illustrative wording in a situation where there is no RMAD:

Illustrative
Language

In my analysis I considered [the aforementioned risk factors and] the implications of uncertainty in estimates of unpaid losses and loss adjustment expenses in determining a range of reasonable unpaid claim estimates. I have also observed that the difference between the high end of my range of reasonable unpaid claim estimate and the Company's carried reserve for losses and loss adjustment expense is less than my materiality standard. I further considered whether there are significant risks and uncertainties that could result in material adverse deviation. In light of the materiality considerations within this analysis, and after considering the potential risks and uncertainties that could bear on the Company's reserve development, I concluded that those risks and uncertainties would not reasonably be expected to result in material adverse deviation in the Company's carried reserves for unpaid losses and loss adjustment expenses.

5.3 Other Disclosures in Exhibit B

Paragraph 6.C. of the NAIC SAO Instructions requires commentary on the significance of each of the remaining disclosures in Exhibit B, i.e., items 8 through 14. These are described in the subsections of 5.3 below.

FAQ: Do I have to include relevant comments for items that are \$0 or not material?

A: The NAIC SAO Instructions require commentary on **each** of the disclosure items 8 through 14 in Exhibit B regardless of the size or amount.

5.3.1 Anticipated salvage and subrogation

In item 8 of Exhibit B, the Appointed Actuary is required to disclose the amount of anticipated net salvage and subrogation included as a reduction to loss reserves as reported in Schedule P. This section provides discussion and illustrative wording around this disclosure item.

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5.3.1.a Discussion

SAOs are expected to be prepared on the same basis with regard to anticipated salvage and subrogation as the disclosed basis for the carried loss reserves.

ASOP 36 states that the Appointed Actuary should state whether reserves are gross or net of specified recoverable, including salvage and subrogation. The amount of anticipated salvage and subrogation, if any, is disclosed in Schedule P, Part 1.

The Appointed Actuary is reminded that states' regulations may differ in the required treatment of anticipated salvage and subrogation recoveries.

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Note:

- The amount of anticipated salvage and subrogation reported in item 8 of Exhibit B should reconcile to Schedule P, Part 1, column 23. Column 23 is a memorandum column (i.e., it is not used to calculate other columns).
- During August 2021, the Statutory Accounting Principles (E) Working Group of the NAIC recommended nonsubstantive revisions to *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* to clarify that salvage and subrogation estimates and recoveries can include amounts related to both claims losses and loss adjusting expenses. [[SAPWG 2021-13](#)]

The Appointed Actuary might find it appropriate to choose to use wording similar to the following:



The Company's reserves listed in Exhibit A are established net of anticipated salvage and subrogation. Anticipated salvage and subrogation disclosed in item 8 of Exhibit B is X% of the Company's policyholders surplus.

OR

The Company's reserves listed in Exhibit A are established gross of anticipated salvage and subrogation.

OR

The Company does not explicitly provide for anticipated salvage and subrogation, although cedant data, and ultimate liabilities derived from that data, include an implicit provision for anticipated salvage and subrogation.

5.3.2 Discounting

In item 9 of Exhibit B, the Appointed Actuary is required to disclose the amount of non-tabular (item 9.1) and tabular (item 9.2) discount included as a reduction to loss reserves as reported in Schedule P. This section provides discussion and illustrative wording around this disclosure item.

5.3.2.a Definition

According to SSAP 65, paragraph 11, tabular reserves are indemnity reserves that are calculated using discounts determined with reference to actuarial tables which incorporate interest and contingencies such

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as mortality, remarriage, inflation, or recovery from disability applied to a reasonably determinable payment stream. Tabular reserves shall not include medical loss reserves or LAE reserves.

5.3.2.b Discussion

SAOs are expected to be prepared on the same basis with regard to discounting as the disclosed basis for the carried loss reserves.

The amount of discount is required by the NAIC SAO Instructions to be disclosed separately for tabular and non-tabular reserves. The amount of non-tabular discount, if any, is disclosed in Schedule P, Part 1. Both tabular and non-tabular amounts are disclosed in Annual Statement Note 32.

If the Appointed Actuary is providing an SAO for discounted loss reserves, the Appointed Actuary can find guidance in [ASOP No. 36](#) and [ASOP No. 20](#), *Discounting of Property/Casualty Unpaid Claim Estimates*. The insurance laws of the state of domicile will provide information on whether discounting is allowed. Further, inquiry can be made about whether the state insurance regulator has allowed the company to discount reserves by authorizing a permitted practice. In addition to information provided directly to the Appointed Actuary, discussion on a company's discounting procedures and Permitted Practices may be found in Annual Statement Note 1.

Note:

- If discounting causes a reconciling difference between the reserves listed in Exhibit A and the AOS, an explanation of this difference should be disclosed in the AOS. Exhibit A, item 4 is comprised of Schedule P Part 1, columns 17, 19, and 21, which are gross of non-tabular discounting. If the direct and assumed reserves in the AOS are net of discounting, this may create a reconciling difference.
- Schedule P, Part 2 is gross of all discounting, including tabular discounts.

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In a typical situation, the Appointed Actuary might find it appropriate to choose to use wording similar to the following:



The Company discounts its liabilities for certain workers' compensation claims and certain other liability claims related to annuity obligations from Structured Settlements at a before/after income tax rate of Z.Z%. Note 32 contains details for the amounts disclosed in item 9. The amount of discount is X% of the Company's net loss and LAE reserves and Y% of the Company's policyholders surplus.

OR

The Company does not discount its reserves listed in Exhibit A for the time value of money.

There are various other situations where, if there is a material impact, the Appointed Actuary may wish to consider further discussion on the amount of discount in the Opinion. For example, if the Appointed Actuary believes the amount of discount is either excessive or too low, and that amount of redundancy or deficiency causes the actuary to change the type of Opinion from reasonable to not reasonable, further discussion may be necessary. ASOP No. 36 includes the following:

“4.2.g. 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 evaluation, the actuary should disclose that present values were used in forming the opinion, the interest rate(s) used by the actuary, and the monetary amount of discount that was reflected in the reserve amount.”

Extended comments may be appropriate in the actuarial report depending on guidance in ASOP No. 20 or ASOP No. 41. In these and other possible scenarios the Appointed Actuary may wish to describe the issue in the actuarial report, as well as the impact of using what the actuary believes to be more reasonable assumptions or appropriate practices in the actuarial report.

An update to ASOP No. 20 was adopted June 2023 and is effective for any actuarial work product covered by the standard's scope ([section 1.2](#)) issued on or after December 1, 2023. There are several [“Notable Changes from the Existing ASOP”](#) that are highlighted at the top of the document above the standard. In particular, section 3.4.1.3 represents a significant change from the previous version of ASOP No. 20. The updated version states, “When using discount rates selected by another party, the actuary should assess the discount rates for reasonableness” whereas the previous version stated, “The actuary is responsible for the discount rates employed in preparing the actuarial findings unless the actuary appropriately discloses otherwise.” Note, there are numerous required disclosures outlined in ASOP No. 20, many of which have been updated since the prior version, that should be included in an actuarial report ([sections 4.1 and 4.2](#)).

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5.3.3 Voluntary and/or involuntary underwriting pools and associations

In item 10 of Exhibit B, the Appointed Actuary is required to disclose the amount of “net reserves for losses and loss adjustment expenses for the company’s share of voluntary and involuntary underwriting pools’ and associations’ unpaid losses and loss adjustment expenses that are included in reserves shown on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines”. This section provides discussion and illustrative wording around this disclosure item. Note that NAIC Statutory Issue Paper 97 defines three categories of underwriting pools and associations, involuntary, voluntary, and intercompany. This section describes the treatment for involuntary and voluntary pools and associations. Further information regarding intercompany pools is included in [Section 3.3](#).

5.3.3.a Discussion

Some key considerations for the SAO for a company that participates in voluntary and/or involuntary underwriting pools and associations are:

- Are pool reserves material?
- 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, make use of the pool Appointed Actuary’s SAO, or some combination of the above?
- If there is a lag in the booking of pool losses, does the company accrue for this or not? Are premiums treated similarly? Are these items material?
- How does the company’s ceded reinsurance program treat business that comes in from these pools?

The Appointed Actuary is reminded that unless the SAO is qualified, the Appointed Actuary is responsible for opining on the reasonableness of the reserves in aggregate. This may include consideration and clearly stating his/her level of review of and use of others’ SAOs for any material reserves related to pools, and/or explaining their immateriality.

[Appendix III.3](#) contains further guidance, including commentary from the CASTF regarding SAOs for pools and associations.

FAQ: What if I didn’t review another’s work supporting the reserve balance for a voluntary or involuntary underwriting pool? Does this mean that my opinion should be qualified?

A: No, not if the pool reserves are immaterial. Section 4.10 provides further details on making use of the work of another.

Note:

- The amount disclosed in item 10 of Exhibit B represents the reserve for the company’s net participation in the voluntary or involuntary pool(s), net of reinsurance purchased by the pool.

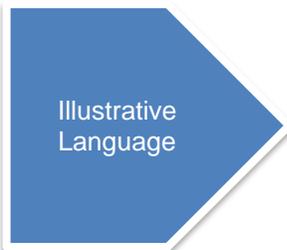
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5.3.3.b Illustrative language

The Appointed Actuary might find it appropriate to use wording similar to the following:

Situation 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.

Situation 2: Material reserves; independent review of significant pools or use of pool SAO; balance of non-reviewed reserves immaterial; adjustment for lag



The Company participates in a number of voluntary and involuntary pooling arrangements. Company practice is to review the reserves for the larger pools, which account for \$ABC of pool reserves, independently. Based on this review, the Company has increased the reserves reported by these pools by ___ percent. The Company has made use of actuarial opinions prepared by (insert name and affiliation of opining actuary) for other pools, which account for \$DEF of pool reserves. I have reviewed the analysis underlying these actuarial opinions and have concluded that the analysis is reasonable. I have not performed an independent analysis for these pools. 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.

As a reminder, when the Appointed Actuary makes use of the work of another for a material portion of reserves, this needs to be disclosed in the OPINION paragraph.

Situation 3: Immaterial pool exposure

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The Company participates in a small number of voluntary and involuntary pools. Company practice is to record the loss and loss adjustment expense reserves reported to it by the pools without adjusting for a reporting lag. Reserve exposure with respect to pools is considered immaterial.

5.3.4 A&E liabilities

In item 11 of Exhibit B, the Appointed Actuary is required to disclose the amount of net reserves for losses and LAE that the company carries for asbestos (item 11.1) and environmental (item 11.2) liabilities included on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines.

This section provides discussion and illustrative wording around this particular disclosure item.

Note this section addresses only the required discussion of A&E liabilities and no other possible mass tort exposures. However, while not directly applicable, the ideas presented within this Section 5.3.4 may also be useful for disclosure of other possible mass torts when relevant to the disclosure of major risk factors.

5.3.4.a Definitions

Asbestos exposures – *“any loss or potential loss (including both first party and third party claims) related directly or indirectly to the manufacture, distribution, installation, use, and abatement of asbestos-containing material, excluding policies specifically written to cover these exposures.”*⁷⁰

Environmental exposures – *“any loss or potential loss, including third party claims, related directly or indirectly to the remediation of a site arising from past operations or waste disposal. Examples of environmental exposures include but are not limited to chemical waste, hazardous waste treatment, storage and disposal facilities, industrial waste disposal facilities, landfills, superfund sites, toxic waste pits, and underground storage tanks.”*⁷¹

For the purposes of what is disclosed in Exhibit B, A&E exposures *“should exclude amounts related 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,*

FAQ: Do all asbestos & environmental (A&E) claim liabilities of an insurer get reported in the A&E Note in the statutory Annual Statement?

A: Not necessarily. The statutory Note does not include liabilities from policies clearly designed to cover A&E, such as asbestos abatement policies and many claims-made pollution policies.

⁷⁰ SSAP 65, paragraph 41 ([Appendix IV](#)).

⁷¹ SSAP 65, paragraph 41 ([Appendix IV](#)).

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*Contractor's Pollution Liability, Consultant's Environmental Liability, and Pollution and Remediation Legal Liability.*⁷²

5.3.4.b Discussion

While mass torts in general have significant uncertainties associated with claim liability estimation, asbestos liabilities and the environmental liabilities associated with hazardous waste sites have been especially problematic. Over the years mass torts arising from these sources have resulted in material levels of adverse development for the industry, hence the special attention they have received in the SAO and in both statutory and GAAP disclosures.

Traditional actuarial methods (i.e., squaring triangles and other accident year development approaches) are typically not applied to the estimation of these liabilities. This is because such claims often attach multiple accident/policy years, and because new claim filings continue to arise for several decades after the policies were issued. Various methodologies have been developed over the years to address these situations, yet the resulting indications have historically still been subject to significant uncertainty and risk of adverse deviation.

In most cases, one of the following situations will present itself to the Appointed Actuary:

1. The company has not provided any 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 that may rise to the level of a RMAD or combined with other risks significantly contribute to the determination of a RMAD.
3. The company has provided coverage that can reasonably be expected to produce material levels of asbestos and/or environmental claims activity, but it is believed unlikely to rise to the level of a RMAD alone or in combination with other risks of the company.

Note that knowledge of any A&E claims (other than those immediately denied due to asbestos or environmental exclusions) may create such uncertainty regarding ultimate liability for this category that further investigation may be warranted. Such investigation may benefit from study of prior A&E disclosures in the statutory statement Notes, as well as required disclosure in SEC filings (10-K, 10-Q). (These GAAP disclosures are required where the A&E exposures are material for companies filing SEC statements. Note, however, that SEC filings are generally done only on a consolidated basis for groups, and not by legal entity, hence the SEC disclosure may pertain to companies within the group other than the one being opined upon.)

⁷² 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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Companies writing no commercial liability coverage, whether on a primary, excess, or assumed basis, may be candidates for the first situation above. Companies that have written commercial liability coverage in the past without sufficient exclusions would normally be candidates for the second and third situations.

The third situation could arise in a variety of situations, such as

- A predominately personal lines company that historically wrote only a small amount of commercial liability on a direct or assumed basis whereby there exists material but limited levels of exposure relative to the materiality criteria for a RMAD
- A company that has retroactive ceded reinsurance protection such that its gross exposure is sufficiently ceded and, on a net basis, is unlikely to rise to the level of a RMAD⁷³
- A company that has already reserved up to policy limits on all such policies

In rare cases the Appointed Actuary might make a determination that these exposures were not reasonably estimable. This will usually result in a qualified SAO under [ASOP No. 36](#) if the items are likely to be material. There is no requirement to issue a qualified opinion if the Appointed Actuary reasonably believes the items to be immaterial.

The Appointed Actuary may believe 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 a deficient/inadequate SAO 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 A&E reserves in the Notes to the Financial Statements.

The Appointed Actuary may want to comment on the following issues:

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

FAQ: The Company whose reserves I'm opining on has bought a retroactive cover that assumes all asbestos losses. Do I still have to discuss A&E in my opinion?

A: Retroactive reinsurance accounting does not impact booked loss reserves on either a gross or net basis. But the benefit from such cover does show up in surplus. Hence you may still have to discuss the impact on a gross basis, and the impact on net reserves.

⁷³ Note that a contract accounted for as retroactive reinsurance will have no impact on the loss reserves reported in Schedule P, per SSAP 62R, paragraph 34 ([Appendix IV](#)). Instead, the reserves assumed or ceded for contracts under retroactive reinsurance accounting are reported in write-in lines of the Annual Statement. Surplus is impacted by such contracts, but not loss reserve schedules of the Annual Statement. For more discussion of this topic, see [Section 5.4.2](#) and [Appendix III.4](#).

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Additionally, the Appointed Actuary may choose to comment on some of the following related items (assuming that the Appointed Actuary finds the liability to be material and reasonably estimable):

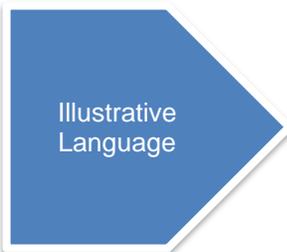
- The difficulties attendant in providing an actuarial estimate of these liabilities
- Whether these liabilities are being handled by a dedicated experienced claim/legal unit
- Any other factors the Appointed Actuary may have considered in forming his or her SAO

5.3.4.c Illustrative language

The following language may be appropriate:

The Appointed Actuary may consider using wording similar to the following:

Situation 1: No material A&E exposure



I have reviewed the Company's exposure to asbestos and environmental claims. In my opinion, the chance of material liability is remote, since reported claim activity levels are minimal [or, that there have been no claims reported in the Annual Statement A&E Note], and the Company has never written commercial liability coverages on a primary, excess, or assumed basis.

Situation 2: Material A&E exposure, possible or likely RMAD



I have reviewed the Company's exposure to asbestos and environmental claims, and I have concluded that this exposure is material. The Company currently holds \$XYZ million of reserves for losses and loss adjustment expenses for asbestos and environmental claims. Estimation of liabilities for these claims is unusually difficult due to the extreme latency of claim activity, issues related to allocation of claim costs (including defense costs) across policy years and insurers, and the potential for coverage disputes with insureds and other insurers (regarding allocation of such costs). Therefore, any estimation of these liabilities is subject to significantly greater than normal variation and uncertainty.

An Appointed Actuary that uses language such as above may want to pay particular attention to A&E in the RMAD evaluation. If the Appointed Actuary in this circumstance concludes that the A&E uncertainty creates or significantly contributes to a RMAD, then the above language may be appropriate to include in

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the discussion of risk factors and the RMAD, rather than in the RELEVANT COMMENTS section, including the following addition to the above illustration.



In my opinion, this uncertainty in asbestos and environmental claim liabilities rises to the level of a risk of material adverse deviation, given my materiality standard of \$XXX.

If this is included in the RMAD section, then the RELEVANT COMMENTS section might include the following wording:



I have reviewed the Company's exposure to asbestos and environmental claims, and concluded that this exposure creates a significant risk of material adverse deviation. Please see the above RMAD discussion for more details.

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Situation 3: Material exposure but RMAD unlikely due to a mitigating factor or relative size



Illustrative
Language

I have reviewed the Company's exposure to asbestos and environmental claims, and I have concluded that this exposure is material. The Company currently holds \$XYZ million of reserves for losses and loss adjustment expenses for asbestos and environmental claims. Estimation of liabilities for these claims is unusually difficult due to the extreme latency of claim activity, issues related to allocation of claim costs (including defence costs) across policy years and insurers, and the potential for coverage disputes with insured and other insurers (regarding allocation of such costs). Therefore, any estimation of these liabilities is subject to significantly greater than normal variation and uncertainty.

Although this uncertainty in asbestos and environmental claim liabilities rises to the level of a risk of material adverse deviation, given my material standard of \$XXX, it should be noted that the Company has a retroactive reinsurance contract with {Name of Reinsurer}. This retroactive reinsurance agreement would limit the impact of any adverse deviation in loss and loss adjustment expense reserves on the Company's statutory surplus. Therefore, if considered on the basis of surplus impact and not reserve impact, then I do not believe that this asbestos and environmental risk could result in material adverse deviation.

Note that the first paragraph of Situation 3 is the same as the first paragraph in Situation 2, however the conclusion regarding RMAD differs.

The last paragraph of Situation 3 is for the situation where the RMAD is mitigated. The following is an illustrative paragraph that may be appropriate for the situation where RMAD is unlikely due to relative size:



Illustrative
Language

Despite the uncertainty associated with asbestos and environmental claim liabilities, my opinion is that it is unlikely to rise to the level of a risk of material adverse deviation due to the limited number of policies with this exposure (and the potential loss on those policies) relative to my materiality standard of \$XXX.

Note that where material A&E exposure exists for a company that files with the SEC, the Appointed Actuary may want to evaluate their final wording for consistency with pertinent GAAP disclosures.

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5.3.5 Extended reporting endorsements

In item 12 of Exhibit B, the Appointed Actuary is required to disclose the total claims-made extended loss and expense reserve (greater than or equal to Schedule P interrogatories) that the company carries as a loss reserve (item 12.1) and/or unearned premium reserve (item 12.2).

This section provides discussion and illustrative wording around this particular disclosure item.

5.3.5.a Definitions

Extended Reporting Endorsements – *“Endorsements to claims-made policies covering insured events reported after the termination of a claims-made contract but subject to the same retroactive dates where applicable.”*⁷⁴

There are essentially two types of extended reporting endorsements, those that extend reporting of claims-made policies for a defined period, such as one or two years, and those that extend reporting for an indefinite period.

*Where extended reporting endorsements provide coverage for only a fixed reporting period, the premium is earned over that period, with an unearned premium reserve recorded for the unexpired portion of the premium. Associated losses are recorded as reported, with incurred but not reported (IBNR) loss recorded in the loss reserves as the coverage is provided. Where the endorsements provide coverage for an indefinite reporting period, premium is fully earned and the liability associated with associated IBNR claims is recognized immediately.*⁷⁵

Additionally, certain claims-made policies include provisions such as DDR. DDR provisions generally extend reporting under a claims-made policy for an indefinite period, at no additional cost, in the event that the insured dies, becomes disabled or retires during the policy period. Because coverage is extended at no additional charge, a portion of the claims-made premium should be recorded as a policy reserve for liability stemming from this coverage provision. This is an example of what is being requested in Exhibit B, item 12. According to SSAP No. 65,

*Some claims-made policies provide extended reporting coverage at no additional charge in the event of death, disability, or retirement of a natural person insured. In such instance, a policy reserve is required to assure that premiums are not earned prematurely. The amount of the reserve should be adequate to pay for all future claims arising from these coverage features, after recognition of future premiums to be paid by current insureds for these benefits. The reserve, entitled “extended reporting endorsement policy reserve” shall be classified as a component part of the unearned premium reserve considered to run more than one year from the date of the policy.*⁷⁶

⁷⁴ SSAP 65, paragraph 3c ([Appendix IV](#)).

⁷⁵ SSAP 65, paragraph 7 ([Appendix IV](#)).

⁷⁶ SSAP 65, paragraphs 8 ([Appendix IV](#)).

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Additionally, to the extent that a premium deficiency reserve exists under extended reporting endorsements the amount should be recognized. According to SSAP No 65:

When the anticipated losses, loss adjustment expenses, and maintenance costs anticipated to be reported during the extended reporting period exceed the recorded unearned premium reserve for a claims-made policy, a premium deficiency reserve shall be recognized in accordance with SSAP No. 53—Property Casualty Contracts—Premiums⁷⁷

5.3.5.b Discussion

The scope of the Appointed Actuary's SAO includes the total claims-made extended loss and expense reserves reported in Exhibit B, item 12. While these provisions are often found in Medical Professional Liability policies, the Appointed Actuary is reminded that the RELEVANT COMMENT paragraphs, as well as the corresponding entries in Exhibit A and Exhibit B, item 12 should include all of the company's extended loss and expense reserves, not just the Medical Professional Liability portion of these reserves reported in the Schedule P Interrogatory #1. Where values are reported for that interrogatory, the Appointed Actuary may want to confirm that the value reported in Exhibit B, Disclosure 12 is at least as high as those interrogatory values.

Note:

- Some Directors & Officers Liability (D&O) policies may also have similar provisions that cover suits against past directors and officers after they leave the company (albeit possibly only for a limited time after the claims-made policy expiration).
- Schedule P Interrogatory #1 asks for the amount of the DDR reserve for the Medical Professional Liability line of business that is reported as an unearned premium reserve (per SSAP No. 65) separately from the amount reported as loss or LAE reserve, if any. This is consistent with the NAIC SAO reporting requirement of Other Premium Reserve items in Exhibit A, item 9, and Other Loss Reserve items in Exhibit A, item 6.
- References to “activated tail” and “paid tail” relate to “triggered” or “issued” reporting endorsements, and, therefore, any related loss reserves are not considered to be “extended loss and expense reserves.”

5.3.5.c Illustrative language

If there are contracts of this type with material levels of reserves, the Appointed Actuary might find it appropriate to use wording similar to the following:

⁷⁷ SSAP 65, paragraphs 9 ([Appendix IV](#)).

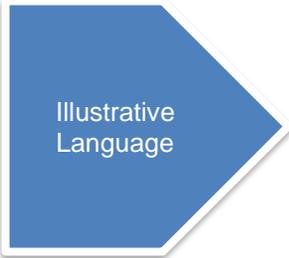
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Language

The Company writes extended loss and expense contracts on claims-made professional liability policies, which provide extended reporting coverage in the event of death, disability, or retirement at no additional premium charge. The Company's accrual for this liability is included in its unearned premium reserves and is shown in item 9 on Exhibit A.

Alternatively, if the material accrual for these contracts is recorded as loss reserves, the Appointed Actuary may choose to use wording similar to the following:



Illustrative
Language

The Company writes extended loss and expense contracts on claims-made professional liability policies, which provide extended reporting coverage in the event of death, disability, or retirement at no additional premium charge. The Company's accrual for this liability is included in its loss and loss adjustment expense reserves and is shown in item 6 on Exhibit A.

5.3.6 Accident and Health Long Duration Contracts

In item 13 of Exhibit B, the Appointed Actuary is required to disclose the net reserves for Accident and Health ("A&H") Long Duration contracts. Specifically, items for losses, loss adjustment expense reserves, unearned premium reserves and each write-in item need to be listed.

A&H Long Duration contracts are defined in the NAIC SAO instructions to be:

A&H contracts in which the contract term is greater than or equal to 13 months and contract reserves are required. See Schedule H instructions for a description of categories of contract reserves as well as policy features that give rise to contract reserves. Two specific examples of contracts that typically require contract reserves are long-term care and disability income insurance.

The Schedule H instructions state:

Companies must carry a reserve for any block of contracts for which future gross premiums when reduced by expenses for administration, commissions, and taxes will be insufficient to cover future claims or services.

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For most P&C companies with A&H Long Duration contracts, these relevant comments would be all that is required from the opining actuary.

The Appointed Actuary is not required to opine on the reasonableness of these reserves in isolation. The 2023 AOWG Regulatory Guidance states:

The Appointed Actuary is not asked to opine on the reasonableness of the reserves associated with A&H Long Duration Contracts except to the extent that the reserves are included within the amounts reported on Exhibit A of the Actuarial Opinion.

However, for companies with over 10,000 in force lives covered by long-term care (LTC) contracts as of the valuation date, the Appointed Actuary is required to perform an additional asset adequacy analysis for those contracts per Actuarial Guideline LI (“AG 51”). Per the NAIC SAO Instructions, “[t]he Actuarial Report and workpapers summarizing the results, assumptions and testing procedures for the asset adequacy testing of LTC business must be in compliance with AG 51 requirements”. It is COPLFR’s understanding that only a small number of P&C companies are subject to these requirements.

5.3.6.a Illustrative Language

If there are contracts of this type with material levels of reserves, the Appointed Actuary may choose to use wording similar to the following:



The Company writes A&H Long Duration Contracts where the contract term is greater than or equal to 13 months and contract reserves are required. The Company’s accrual for this liability is shown in item 13 on Exhibit B.

5.3.7 Other Items

Item 14 of Exhibit B provides a place for disclosure of “Other items on which the Appointed Actuary is providing relevant comment...” This means that if item 14 of Exhibit B of the SAO includes a non-zero value (or values), then the SAO should include RELEVANT COMMENT paragraph(s) with discussion of the significance of each item(s) individually and within context of the other disclosure items in Exhibit B.

5.3.7.a Discussion

Item 14 of Exhibit B serves as a “catch-all” for other items the Appointed Actuary is discussing in RELEVANT COMMENTS section of the SAO, that are not otherwise already disclosed within Exhibit B. While the majority of SAOs do not contain anything under item 14, if the Appointed Actuary believes it is appropriate to disclose an item within the RELEVANT COMMENTS section it should also be disclosed, along with the source of the figure, in Exhibit B.

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P&C Long Duration Contracts form a part of the RELEVANT COMMENTS section in this practice note. However, if the resultant liabilities are material, they should be listed in Exhibit A and opined on in item (D) of the OPINION paragraph (see section 4.8).

The listing of potential risk factors in section 5.1.1 of this document may provide some instances of items that could be disclosed within item 14 of Exhibit B.

5.3.7.b Illustrative language that could be appropriate in this situation

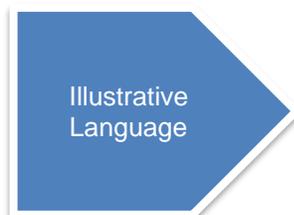
Situation 1: The company's reserves include an explicit risk margin and are discounted. The Appointed Actuary discusses each of these items individually and combined in RELEVANT COMMENT paragraphs and uses item 14 of Exhibit B to identify the amount of risk margin.



The Company has represented that the carried reserves include an explicit risk margin. The amount of risk margin as of December 31, 2023, is \$x.x million on a net of reinsurance basis and is shown as item 14 on Exhibit B. The amount of discount is X% of the Company's net loss and LAE reserves and Y% of the Company's policyholders surplus.

The combined effect of the Company's discount and risk margin is to decrease the carried net loss and loss adjustment expense reserve by \$y.y million (or approximately z.z%) if compared to the implied undiscounted reserve with no risk margin.

Situation 2: The company's reserves are stated net of policyholder deductibles, and the Appointed Actuary has identified the collectability of such as a company specific risk factor.



The Company's carried net loss and loss adjustment expense reserve is stated net of outstanding policyholder deductibles. The amount of outstanding policyholder deductibles is \$x.x million, shown as item 14 on Exhibit B, and represents X% of the Company's net loss and LAE reserves and Y% of the Company's policyholders surplus. Due to the significance of this amount, I have identified the collectability and/or timing of reimbursement as a Company specific risk factor.

Situation 3: The unearned premium reserve for P&C Long Duration Contracts is immaterial in relation to the aggregate of the loss, LAE, and P&C Long Duration unearned premium reserves. When the company writes an amount of P&C Long Duration Contracts that develop an unearned premium

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reserve that is immaterial when combined with the loss reserves, the Appointed Actuary would be prudent to include the amounts in Exhibit A: SCOPE (items 7 and 8) but need not include item (D) in the OPINION paragraph. A brief disclosure in the RELEVANT COMMENTS section of the SAO 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 P&C Long Duration Contracts is _____, representing ___percent of the total net unearned premium for the Company. This component of the unearned premium is not material to the Company when combined with the loss and loss adjustment expense reserves. I therefore relied on the Company for its representation of the reasonableness of the unearned premium reserves.

5.4 Reinsurance

According to the NAIC SAO Instructions,

RELEVANT COMMENT paragraphs should address reinsurance collectability, retroactive reinsurance and financial reinsurance.⁷⁸

Section 5.4.1 covers reinsurance collectability whereas 5.4.2 discusses retroactive reinsurance and section 5.4.3 encompasses financial reinsurance. Further discussion regarding retroactive reinsurance and financial reinsurance is available in Appendix III.4.

5.4.1 Reinsurance Collectability

According to the NAIC SAO Instructions,

“The Appointed Actuary’s comments on reinsurance collectability should address any uncertainty associated with including potentially-uncollectable amounts in the estimate of ceded reserves. Before commenting on reinsurance collectability, the Appointed Actuary should solicit information from management on any actual collectability 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 ninety (90) days past due. The comment should also reflect any other information the Appointed Actuary has received from management or that is publicly available about the capability or willingness of reinsurers to pay claims. The Appointed

⁷⁸ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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*Actuary's comments do not imply an opinion on the financial condition of any reinsurer.*⁷⁹

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Additionally, section 3.10 of ASOP No. 36 states that if "...the amount of ceded reinsurance is material, the actuary should consider the collectibility of the ceded reinsurance in evaluating net reserves. The actuary should solicit information from the management regarding collectibility problems, significant disputes with reinsurers, and practices regarding provisions for uncollectible reinsurance. The actuary's consideration of collectibility does not imply an opinion on the financial condition of any reinsurer."⁸¹

5.4.1.a Discussion

Ceded reinsurance recoverable balances are shown in several places in the Annual Statement:

- Schedule F, Part 3 lists all ceded reinsurance recoverable balances in one place. These balances include amounts billed but unpaid (labelled "Reinsurance Recoverable on Paid Losses" in Schedule F⁸²), ceded case reserves, ceded incurred but not reported (IBNR) reserves, ceded unearned premiums and even ceded contingent commissions. (Presumably the last two items are not relevant to the SAO as they are not "loss" items.)
- Page 2 (Assets) contains ceded recoverable amounts on paid losses.

⁷⁹ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

⁸⁰ For a Company also filing financial statements for US GAAP, uncollectible reinsurance reserves (URR) related to credit risk are set based on expected ultimate uncollectible amount. The URR is meant to address uncollectible amounts due to both credit risk and dispute risk.

⁸¹ [ASOP No. 36](#).

⁸² When an insurer bills its reinsurer under a ceded reinsurance contract for a paid loss, this is recorded under statutory and US GAAP accounting as a ceded paid amount when billed, even if it hasn't been collected yet. Statutory accounting also requires the ceded paid entry to be reversed if the bill is ultimately written off as uncollectible, which results in an increase in paid and incurred losses unless offset by a reserve change at the time of the write-off.

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- Page 3 (Liabilities) includes ceded case reserves and ceded IBNR reserves in the net loss reserves shown.
- The Underwriting & Investment Exhibit and Schedule P show ceded case reserves and IBNR reserves, although these may be on a pool basis in Schedule P.
- Note 23 of the statutory Annual Statement also includes discussion of various reinsurance topics, including Note 23D (*Uncollectible Reinsurance*).

Collectability of ceded unpaid loss and LAE (and ceded billed but uncollected loss and LAE when material) will generally have an effect of the future development of reserves as well as surplus. The NAIC requires commentary on reinsurance collectability.

The Appointed Actuary might find it appropriate to discuss the materiality of amounts ceded to troubled reinsurers (e.g., those in liquidation or rehabilitation) if the overall amount is material. The Appointed Actuary might also find it appropriate to discuss the materiality of major ceded reinsurance concentrations, either concentrations to a single reinsurer or pertaining to a single (or a select few) event(s).

This discussion may be aided by investigation into GAAP disclosures of ceded reinsurance concentration (for SEC filers), or by analysis of ceded reinsurance write-offs found in Note 23.D. In addition, Schedule F, Part 3 provides detail on the amount of reinsurance recoverable by reinsurer. The confidential RBC filing will also include a summarization of the Schedule F, Part 3 ceded balances by reinsurer credit rating.

If any issues are raised by the above considerations, the Appointed Actuary might find it appropriate to provide some discussion as to amounts already set up to cover this risk (e.g., uncollectible reinsurance reserve, Schedule F penalty). The Appointed Actuary might also consider the effects of any existing collateral. If the amounts already set up are deemed by the Appointed Actuary to be inadequate, the Appointed Actuary may choose to indicate how the shortfall is being treated in the SAO. For example, is the shortage in these amounts being added to the otherwise indicated liabilities? Is the reserve being evaluated net of the indicated and held amounts for reinsurance collectability?

At various times, publicly available information materially affects the perceived value of ceded reinsurance. The NAIC SAO Instructions provide that the Appointed Actuary's comments should also reflect any such information. For example, the Appointed Actuary may want to comment on large cessions to a company recently placed under regulatory control, if the Appointed Actuary has knowledge of such cessions.

In some cases, other parties may already perform the above analysis. When the Appointed Actuary is relying on other parties for the reinsurance collectability analysis, the Appointed Actuary may find it appropriate to consider to so state and to discuss the qualifications of these parties.

FAQ: Don't I only have to look at the collectability of ceded loss reserves and not ceded paid?

A: Not necessarily. Reinsurance collectability issues include the collectability of amounts billed to reinsurers but not yet collected. These billed but uncollected balances are included in Schedule F-Part 3, Column 16, and can also be found on Page 2, Line 16. If those billed amounts are not collected then the original ceded paid entry is reversed, which could impact reported loss development.

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Section 3.4 of [ASOP No. 36](#) contains other provisions relating to other disclosures about uncollectible recoverable.

The Appointed Actuary might consider whether potential uncollectible cessions create risks and uncertainties to be disclosed and contribute to risk of material adverse deviation. Whether such a situation leads to a qualified opinion might also be a consideration.

Note:

- Reinsurance collectability can be impacted by both inability to pay (sometimes called credit default risk) and unwillingness to pay (dispute risk). It can also be caused by overly aggressive estimates of ceded loss potential or by overly aggressive billing of the reinsurer by the cedant.
- In some situations, it may be very unclear what the proper ceded amounts should be under a contract.
- A change made in 2020 by the NAIC ([2020-09BWG](#)) may be relevant to Appointed Actuaries reviewing ceded reinsurance collectability. The NAIC has eliminated category 7 as an option for Schedule F, Part 3, Column 34—Reinsurer Designation Equivalent, and combined reinsurers that would have fallen in that rating into category 6. This change impacts the calculations for Schedule F, Part 3, Column 36; reinsurers in the prior category 7 had a 10% charge in column 36 while reinsurers in category 6 have a 14% factor.

5.4.1.b Illustrative language

The Appointed Actuary might find it appropriate to use wording similar to one of the following examples.

Situation 1: Immaterial ceded reinsurance levels

A blue arrow-shaped icon pointing to the right, containing the text "Illustrative Language".

Illustrative
Language

Use of ceded reinsurance is minimal, resulting in an immaterial risk of uncollectible reinsurance relative to loss and loss adjustment expense reserves and surplus. (In addition, the Company's ceded billed but uncollected balances are not material.)

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



Illustrative
Language

Ceded loss reserves are all with residual market pools, with companies rated XX or better by A.M. Best Co. (or its substantive equivalent), or fully collateralized. Past collectability issues and current amounts in dispute have been reviewed and found to be immaterial relative to surplus. My opinion on the loss and loss adjustment expense reserves net of ceded reinsurance assumes that all ceded reinsurance is valid and collectible.

Note that even if reinsurance is with highly rated reinsurers, it is possible that reinsurance credits are overstated. If such credits were overstated in the past, an analysis of past uncollectible levels or of amounts currently in dispute may discover such an overstatement.

Situation 3: Potential collectability problems—insolvent reinsurer



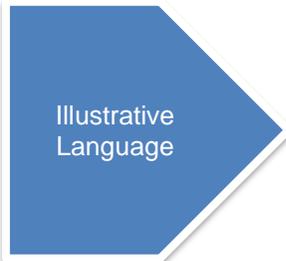
Illustrative
Language

According to the Company's Schedule F disclosures, the Company cedes \$XX million of loss and LAE reserves to currently insolvent reinsurers. Provisions for uncollectible reinsurance account for \$YY million of this amount. In forming my opinion of the net reserves, I have recognized this \$YY million as uncollectible.

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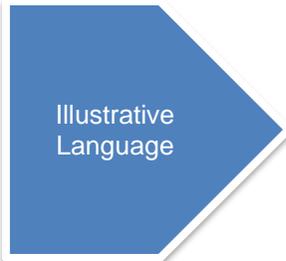
Situation 4: Potential collectability problems—public information

A blue arrow-shaped icon pointing to the right, containing the text "Illustrative Language".

Illustrative
Language

The Company has a high portion of its reinsurance recoverable with the XYZ Corporation, which has recently had its A.M. Best rating downgraded. 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 Appointed Actuary could go on to discuss a need to adjust the indicated net reserves, or state that the situation has been adequately addressed.}

Situation 5: Potential collectability problems—dispute with reinsurer

A blue arrow-shaped icon pointing to the right, containing the text "Illustrative Language".

Illustrative
Language

The Company has a large ceded reserve with regard to {event X}, with a public dispute with its reinsurers with regard to that cession. The inability of the Company to collect on that cession would be material to its {surplus and/or reserves}. My analysis assumes that such cession will {be collectible, uncollectible, partially collectible, etc.}.

Regardless of the situation, the Appointed Actuary may wish to add language that confirms, that in accordance with the NAIC SAO Instructions, the Appointed Actuary 1) solicited information from management on any actual collectability problems, 2) reviewed ratings given to reinsurers by a recognized rating service, and 3) examined Schedule F.

5.4.2 *Retroactive Reinsurance*

Note the requirement to discuss retroactive reinsurance only pertains to those treaties following retroactive reinsurance accounting, not those following prospective reinsurance accounting. This issue is discussed more in the definitions section below.

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5.4.2.a Definitions

According to the NAIC SAO Instructions:

Retroactive reinsurance refers to agreements referenced in SSAP No. 62R, Property and Casualty Reinsurance, of the NAIC Accounting Practices and Procedures Manual.⁸³

The SAO requirement regarding retroactive reinsurance applies only to contracts given retroactive reinsurance accounting treatment. Per SSAP 62R, retroactive reinsurance accounting does not apply to all retroactive reinsurance contracts. SSAP 62R paragraph 36 lists the types of retroactive reinsurance contracts that qualify for prospective reinsurance accounting treatment. A common example of a retroactive reinsurance contract that qualifies for prospective reinsurance accounting treatment is an intercompany reinsurance agreement among companies 100% owned by a common parent (provided certain other criteria are met). See [Appendix III.4](#) for more discussion of these exceptions.

FAQ: Is all reinsurance entered into after policy expiration accounted for as retroactive reinsurance?

A: No. SSAP 62R makes exceptions for certain retroactive reinsurance contracts between affiliates, such as those undertaken to reconfigure a quota share reinsurance pool within a group.

5.4.2.b Discussion

Comment on this item is always required by the NAIC SAO Instructions.

The NAIC SAO Instructions require that any write-in retroactive reinsurance assumed reserves that are reported on the Annual Statement balance sheet also be listed in the SAO's Exhibit A: SCOPE. Retroactive reinsurance assumed reserves (and retroactive reinsurance ceded reserves) are reported as a write-in line of the balance sheet and are not included in any loss reserve schedules of the Annual Statement such as Schedule P or the Underwriting & Investment Exhibit. Even though retroactive reinsurance ceded reserves are not specifically reported in Exhibit A, they are subject to the discussion requirement in the RELEVANT COMMENT section of the NAIC SAO Instructions.

Reinsurance contracts that constitute retroactive reinsurance are required to be accounted as per paragraph 34 of SSAP 62R, and are disclosed in Note 23F "Retroactive Reinsurance."

Annual Statement General Interrogatories, Part 2, No. 7 and No. 9, which disclose certain aspects of the company's use of ceded reinsurance, will ordinarily provide the Appointed Actuary with necessary information. Any positive response to Interrogatory No. 9.1 or 9.2 will require the company to file a reinsurance summary supplement. In addition, the CEO and CFO must provide a reinsurance attestation with the Annual Statement, which may contain additional valuable information about the company's ceded reinsurance contracts.

⁸³ SSAP No. 62R ([Appendix IV](#)).

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For accounting purposes, the company is required to determine whether a particular contract constitutes retroactive reinsurance (e.g., loss portfolio transfer, adverse development covers). If the company accounted for any contract as retroactive reinsurance, it may be appropriate for the Appointed Actuary to give it similar treatment in evaluating the reserves. It may also be appropriate for the Appointed Actuary to indicate in the SAO whether any contract was accounted for in this way and, if so, whether the Appointed Actuary's evaluation of the reserves is consistent with that treatment.

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

It typically is not necessary to identify specific reinsurers or contracts in this comment.

FAQ: Can I find disclosure of retroactive reinsurance in GAAP statements?

A: Not necessarily. GAAP treats retroactive reinsurance differently from statutory accounting, as GAAP does allow a deduction for net loss reserves for retroactive reinsurance that contains sufficient risk transfer.

Note:

- Retroactive reinsurance is a contra-liability for the ceding company and a liability for the assuming company. Exhibit A: SCOPE items 1, 2, 3, and 4 typically are not reduced by the retroactive reinsurance reserve ceded and thus are gross of retroactive reinsurance. Exhibit A: SCOPE items 1, 2, 3, and 4 generally exclude retroactive reinsurance assumed, as such assumed reserves are recorded on a write-in line on Page 3 of the Annual Statement. The Page 3 write-in item reserve, "Retroactive Reinsurance Reserve Assumed," is disclosed in item 5 of Exhibit A: Scope and included in the Appointed Actuary's SAO.
- Just like prospective reinsurance contracts, it is possible for cessions under retroactive reinsurance contracts to be overstated. The Appointed Actuary may want to be aware of this possibility if consideration is made of the ceded retroactive reinsurance in a supporting analysis.

5.4.2.c Illustrative language

The Appointed Actuary might find it appropriate to use wording similar to one of the following examples.

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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 adjustment expense reserves) that either has been or should have been accounted for as retroactive reinsurance.

If a similar conclusion occurs with regard to financial reinsurance (discussed in the next section), the Appointed Actuary may want to combine the two conclusions by adding the words “or financial reinsurance” to the above illustration.

If a contract was appropriately accounted for as retroactive reinsurance:



One ceded reinsurance contract was accounted for by the Company as retroactive 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 adjustment expense reserves) that either has been or should have been accounted for as retroactive reinsurance.

If a contract was appropriately accounted for as retroactive reinsurance, and the materiality standard used was based solely on surplus impact (and the risk of a RMAD impact on surplus was materially affected by this retroactive reinsurance and this was considered in the RMAD assessment):



A ceded reinsurance contract was accounted for by the Company as retroactive reinsurance, covering [describe the ceded losses] up to a limit of [limit], with [remaining amount] remaining. My evaluation of the net reserves was performed on a gross basis with regard to that contract, but given that the basis of my materiality standard was surplus, my evaluation as to whether a RMAD exists did consider the impact of this contract.

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The above illustrative language implies that this ceded retroactive contract would also be mentioned in the earlier RMAD discussion.

5.4.3 Financial reinsurance

5.4.3.a Definitions

According to the NAIC SAO Instructions:

“Financial reinsurance refers to contracts referenced in SSAP No. 62R 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.”⁸⁴

See [Appendix III.4](#) for more discussion of this topic.

5.4.3.b Discussion

Comment on this item is always required by the NAIC SAO Instructions.

For accounting purposes, the company is required to determine whether a particular contract constitutes financial reinsurance. If the company accounted for any contract as financial reinsurance, it may be appropriate for the Appointed Actuary to give it similar treatment in evaluating the reserves. It may also be appropriate for the Appointed Actuary to indicate in the SAO whether any contract was accounted for in this way and, if so, whether the Appointed Actuary’s evaluation of the reserves is consistent with that treatment.

Reinsurance contracts that constitute financial reinsurance are required to be accounted for using deposit accounting, per SSAP 62R, and are disclosed in Note 23G “Reinsurance Accounted for as a Deposit.”⁸⁵

If the Appointed Actuary is reviewing contracts accounted for as financial reinsurance, the Appointed Actuary may want to review more than just the loss and loss adjustment expense portion of that contract. That is because the risk transfer requirements provide for analysis of the entire contract, including possible loss sensitive features such as sliding scale commissions that may negate any risk transfer occurring from just the loss provisions of the contract.

The determination of whether a particular contract is financial reinsurance is sometimes a matter of judgment, and, customarily, that judgment is made by the company’s accounting experts (but likely with substantial input from actuaries, as many insurers rely on actuaries to perform the technical risk transfer

⁸⁴ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

⁸⁵ SSAP No. 62R, paragraph 40 ([Appendix IV](#)).

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analysis). The scope of the SAO does not include an evaluation of risk transfer or an assessment of the appropriateness of the accounting treatment of the reinsurance contracts of a company.

In 2022, the Academy updated its 2007 practice note, *Reinsurance Attestation Supplement 20-1: Risk Transfer Testing Practice Note*, which was itself an update to its 2005 *Risk Transfer in P&C Reinsurance: Report to the Casualty Actuarial Task Force of the National Association of Insurance Commissioners*.⁸⁶ While the scope of the SAO does not include an evaluation of risk transfer or an assessment of the appropriateness of the accounting treatment of the reinsurance contracts of a company, the Appointed Actuary may review the procedures that the company utilizes to determine risk transfer for its reinsurance contracts in order to be in a position to properly apply the NAIC SAO Instructions.

Note:

- The NAIC has previously investigated certain “Risk Limiting” reinsurance contracts due to concerns that the level of risk transfer is not clear as a result of certain loss sensitive features. If the Appointed Actuary does perform an analysis of such contracts, the Appointed Actuary may want to investigate any loss-sharing features (such as sliding scale commissions) in the analysis.

5.4.3.c Illustrative language

The Appointed Actuary may choose to use wording similar to one of the following examples.

If there are no contracts accounted for as financial reinsurance:



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 adjustment expense reserves} that either has been or should have been accounted for as financial reinsurance.

If the Appointed Actuary has a similar conclusion with regard to retroactive reinsurance, the Appointed Actuary may want to combine the two discussions.

⁸⁶ (2022 [Risk Transfer Practice Note](#) developed by the Committee on Property Liability Financial Reporting of the American Academy of Actuaries.)

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If a contract was appropriately accounted for as financial reinsurance:



One ceded reinsurance contract was accounted for by the Company as 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 adjustment expense reserves} that either has been or should have been accounted for as financial reinsurance.

5.5 IRIS Ratios

According to the NAIC SAO Instructions,

"If the Company's reserves will create exceptional values under the NAIC IRIS Tests for One-Year Reserve Development to Policyholders' Surplus, Two-Year Reserve Development to Policyholders' Surplus or Estimated Current Reserve Deficiency to Policyholders' Surplus, the Appointed Actuary must include RELEVANT COMMENT on the factors that led to the unusual value(s)."⁸⁷

5.5.1 Definitions

IRIS Test 11 One-Year Reserve Development to Surplus measures the development of net loss reserves over the past calendar year, relative to prior year surplus. The usual range for the ratio includes results less than 20 percent.

IRIS Test 12 Two-Year Reserve Development to Surplus measures the development of net loss reserves over the past two calendar years, relative to surplus at the end of the second prior year. The usual range for the ratio includes results less than 20 percent.

IRIS Test 13 Estimated Current Reserve Deficiency to Surplus takes the net outstanding loss reserves for the most recent prior two calendar years relative to the calendar year earned premium for those years and adds to the reserves the development that has emerged over that period (one-year development for the first prior calendar year; two-year development for the second prior calendar year). The average of the resulting two "adjusted" loss reserve ratios is applied to earned premium for the most recent calendar year to determine what the outstanding loss reserve should be according to this estimate. The difference

⁸⁷ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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between this reserve estimate and the recorded loss reserve is related to current year surplus. A calculated deficiency in recorded loss reserves of 25 percent or more is deemed to be unusual.

The [NAIC Insurance Regulatory Information System \(IRIS\) Ratios Manual](#) contains calculation details along with Annual Statement source references for all of the IRIS Ratios.

5.5.2 Discussion

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

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

Note:

- Part E of Paragraph 5 of the AOS addresses persistent adverse development. The NAIC AOS Instructions are included as [Appendix I.2](#).

5.5.3 Illustrative language

The Appointed Actuary may choose to use wording similar to one of the following examples, to the extent they apply:

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During the past year, the Company strengthened net reserves for prior accident years by \$100,000,000. Most of the increase was for asbestos and environmental claims included in the prior year row. 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. These additional premiums caused an exceptional value for the IRIS test regarding Estimated Current Reserve Deficiency to Surplus. These lines have also shown some non-substantial upward reserve development.

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



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

5.6 Changes in Methods and Assumptions

According to the NAIC SAO Instructions,

“If there has been any significant change in the actuarial assumptions and/or methods from those previously employed, that change should be described in a RELEVANT COMMENT paragraph. If the Appointed Actuary is newly-appointed and does not review the work of the prior Appointed Actuary, then the Appointed Actuary should disclose this.”⁸⁸

⁸⁸ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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5.6.1 Discussion

The NAIC requirement is similar to that in [ASOP No. 36](#), section 4.2.a required disclosure of changes in the Appointed Actuary's assumptions, procedures, or methods from those employed in the most recent prior opinion prepared in accordance with [ASOP No. 36](#) if the Appointed Actuary believes that such changes are likely to have a material effect on the Appointed Actuary's estimate(s) of liabilities for which reserves the Appointed Actuary is opining. The Appointed Actuary is obliged to comment only on changes that are, in the Appointed Actuary's professional judgment, material to the actuary's unpaid claim estimate.

Pursuant to [ASOP No. 36](#), section 3.8, 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 constitute a change in assumptions, procedures, or methods for this disclosure.

According to the NAIC SAO Instructions, when an Appointed Actuary is changing assumptions and/or methods from the prior year, and the impact of the change is not known, the Appointed Actuary should disclose the change. It is advisable in most instances to describe briefly the change itself and the reason for it.

If there is a change in Appointed Actuary, the new Appointed Actuary is not expected to calculate the year-end unpaid claim estimates 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 Appointed Actuary to always copy a predecessor's methodology. However, the new Appointed Actuary may choose to become familiar with his or her predecessor's basic methodology and conclusions. If the changes in assumptions, procedures or methods are likely to have a material impact on unpaid claim estimates, the new Appointed Actuary may choose to note the difference(s) in the SAO.

FAQ: I changed the methods and assumptions from the prior year; do I need to disclose the changes?

A: Per the Instructions and ASOP No. 36, if the effect of the change is material, then you should disclose the change; if the effect of the change is not material, disclosure can be made at your discretion.

If the newly Appointed Actuary is able to review the prior opining actuary's work, section 3.8 of [ASOP No. 36](#) states that the actuary should determine whether the current assumptions, procedures, or methods differ from those employed in providing the most recent prior opinion. In the event that the current assumptions, procedures, or methods differ from those of the prior opinion, then the actuary should consider whether the changes are likely to have had a material effect on the actuary's unpaid claim estimate.

[ASOP No. 36](#) requires disclosure of instances in which the Appointed Actuary is not able to review the prior Appointed Actuary's work. In this event, according to section 4.2.a, the Appointed Actuary should disclose that the prior assumptions, procedures, and methods are unknown.

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5.6.2 Illustrative language

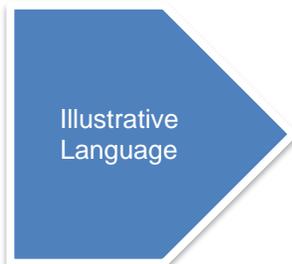
The Appointed Actuary may choose to use wording similar to one of the following examples.

Situation 1: Material change due to distortions affecting old method



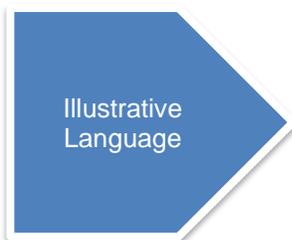
A material change in actuarial methods was made in the analysis supporting this opinion. The change entailed using a reported loss development procedure in place of the paid loss development procedure used last year. This change was necessitated by the implementation of a new claim payment system, distorting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

Situation 2: Change made, materiality unknown



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

Situation 3: Not possible to quantify impact of changes from the prior Appointed Actuary



The Appointed Actuary has changed from the prior year. A comparison of my estimates to the prior Appointed Actuary's estimates is not possible because [explain why: for example, the analysis done by the prior Appointed Actuary was performed using a different aggregation of the data]. Therefore, I am unable to determine whether there has been a material change in actuarial assumptions or methodology.

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Situation 4: Not able to review the work of the prior Appointed Actuary



Illustrative
Language

The Appointed Actuary has changed from the prior year. I was not able to review the work of the prior Appointed Actuary. Therefore, the prior assumptions, procedures, and methods are unknown and I am unable to determine whether there has been a material change in actuarial assumptions or methodology.

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6. Additional considerations

In this chapter we discuss the additional details regarding the format of the SAO and actions that are required when an error in the SAO has been uncovered.

6.1 Formatting requirements

There are specific requirements in terms of the format of the signature of the Appointed Actuary, the presentation of Exhibits A and B, and the technical specifications of the electronic format of Exhibits A and B. Each of these is discussed in detail in the following sections.

6.1.1 Signature of the Appointed Actuary

The SAO concludes with the dated signature of the Appointed Actuary. The NAIC SAO Instructions are quite clear in terms of the presentation of the Appointed Actuary's signature.

The signature and date should appear in the following format:

Signature of Appointed Actuary
Printed name of Appointed Actuary
Employer's name
Address of Appointed Actuary
Telephone number of Appointed Actuary
Email address of Appointed Actuary
*Date opinion was rendered*⁸⁹

6.1.2 Presentation of Exhibit A

Exhibit A should follow the same format outlined in the NAIC SAO Instructions. Every item in Exhibit A will typically contain a value, even if the company's value for an individual item is \$0. Write-in lines should be inserted into Exhibit A if applicable. Also, if the Appointed Actuary is including a value, or multiple values if needed, in items 6 and/or 9, then the SAO is expected to include an

FAQ: Is an original signature required?

A: This depends on the requirements of each state. Suggested resources for these requirements include the [2023 P/C Loss Reserve Law Manual](#) and state statutes, regulations and bulletins. Knowledge of and compliance with legal and regulatory requirements rests with the individual actuary. Legal counsel should be consulted where the actuary is unable to identify all relevant legal requirements.

FAQ: What types of reserves may be included in Exhibit A, items 6 and 9?

A: If an actuary opines on a particular reserve segment that is not included in items 1-4 or 7-8, e.g., DDR, this may be handled in item 6 and/or 9.

⁸⁹ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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explanation in the RELEVANT COMMENTS of why that value or values are being included in the Exhibit A disclosure.

6.1.3 Presentation of Exhibit B

Exhibit B should follow the same format outlined in the NAIC SAO Instructions with no items deleted and write-in lines included if applicable.

According to NAIC SAO Instructions,

Exhibit B should be completed for Net dollar amounts included in the SCOPE. If an answer would be different for Direct and Assumed amounts, identify and discuss the difference within RELEVANT COMMENTS.⁹⁰

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

According to AOWG Regulatory Guidance, the regulator expects the response to Exhibit B item 4 to reflect the SAO on net reserves. Therefore, if the Appointed Actuary reaches different conclusions regarding net reserves versus gross reserves (direct plus assumed reserves), then item 4 should reflect the SAO category for net reserves.

Regulators expect the answer to Exhibit B item 6 to be consistent with the disclosure in the RELEVANT COMMENTS of the SAO of whether there are significant risks or uncertainties that could result in material adverse deviation. The response "Not Applicable" for item 6 is intended to only be used in the situation of a company with 0 percent participation under an intercompany pooling agreement in which the lead company retains 100 percent of the pooled reserves.

In addition, as directed by section 1C of the NAIC SAO Instructions, Exhibits A and B for each company in the pool should represent the company's share of the pool and reflect values specific to the individual company. If a company is a 0 percent pool participant, then Exhibits A and B of the lead company should be attached as an addendum to the SAO of the 0 percent company.

Exhibit B item 10 is a disclosure of 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 Appointed Actuary may choose to show the voluntary and involuntary participation separately in the body of the SAO. Note: Refer to [Section 5.3.3](#) for more information on the disclosure in Exhibit B, Item 10.

⁹⁰ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#))

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Exhibit B item 13 was a new disclosure in the 2018 SAO. For P&C insurers with over 10,000 in-force lives from long-term care (LTC) contracts, there are additional requirements for the opining actuary. For all other P&C insurers with no LTC coverage—or fewer than 10,000 insured lives for LTC—there are no additional requirements for the opinion, except for the item 13 disclosure. Actuaries for insureds with any volume of A&H Long Duration Contracts are required to complete this item 13 disclosure. Normally any active life reserves on these A&H Long Duration Contracts would be included in item 13. Refer to [Section 5.3.6](#) for more information on the disclosure in Exhibit B, Item 13.

Exhibit B would typically contain information and amounts for all of items 1 through 14, even if the company's value for an individual item is \$0. Also, if the Appointed Actuary is including a non-zero value or values in item 14, then the SAO would normally include, within a RELEVANT COMMENT paragraph, an explanation of why each value is being included in the Exhibit B disclosure.

6.1.4 Technical specifications of filing (i.e., data capture format of Exhibits A & B)

According to the NAIC SAO Instructions,

“Data in Exhibits A and B are to be filed in both print and data capture format.”⁹¹

In addition to filing the Annual Statement, the company is required to file certain information reported in the Annual Statement in electronic format. The information reported in Exhibit A: SCOPE and Exhibit B: DISCLOSURES of the SAO will be included in the company's electronic filing. This underscores the importance of preparing Exhibits A and B in the exact format shown in the NAIC SAO Instructions.

Note:

- For companies participating in an intercompany pool with a zero percent (0%) share, exhibits A and B of the lead company must be attached as an addendum to the company's SAO.

6.2 Errors in SAOs

The NAIC SAO Instructions and the AOWG Regulatory Guidance include information on reissuing SAOs when the Appointed Actuary determines that the SAO 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. This includes instruction on timing, format, and content of the revised submission.

6.2.1 Definitions

According to the NAIC SAO Instructions,

⁹¹ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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“The Actuarial Opinion shall be considered to be in error if the Actuarial Opinion would have not been issued or would have been materially altered had the correct data or other information been used. The Actuarial 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.”⁹²

6.2.2 Discussion

NAIC SAO Instructions specify a formal process when an SAO is considered to be in error. The process involves notifications to the Board, as well as the domiciliary commissioner, as described below:

1. According to NAIC SAO Instructions, the insurer *“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 Actuarial 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”⁹³* and meets the definition above.

The Appointed Actuary should include a summary of the finding of the error and an amended SAO.

2. Within five (5) business days of receipt from the Appointed Actuary, the company is required to forward a copy of the amended SAO to the domiciliary commissioner, with notification to the Appointed Actuary of doing so.

If the Appointed Actuary does not receive such notification, the Appointed Actuary is required to notify the domiciliary Commissioner within the next five (5) business days that an amended actuarial opinion has been finalized.

3. According to the NAIC SAO Instructions, *“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 Appointed Actuary and the company should quickly undertake procedures necessary for the Appointed Actuary to make such determination. If the insurer does not provide the necessary data corrections and other support (including financial*

FAQ: What if the actuary cannot determine what, if any, changes are needed to the SAO within the required timeline?

A: *The actuary and insurer should perform the necessary procedures to determine the impact of the SAO as soon as reasonably practical. If the insurer does not provide the necessary data and/or support within ten (10) business days, the actuary should notify the domiciliary Commissioners that the original SAO should no longer be relied upon.*

⁹² 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#))

⁹³ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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support) within ten (10) business days, the Appointed Actuary should proceed with the notification to the Board of Directors and the domiciliary commissioner.”⁹⁴

There are other situations in which the SAO may need to be revised and reissued. An example of such a situation is a request from a regulator for expanded wording in the SAO. In these situations, the Appointed Actuary may wish to discuss the timing/format/content of the revised SAO with the regulator in consultation and conjunction with the company to which the SAO relates.

Note:

- If an error is discovered between the issuance of the SAO and December 31 of that year, the domiciliary commissioner must be notified.
- According to the NAIC SAO Instructions, “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.”⁹⁵
- According to the AOWG Regulatory Guidance, “*It would be prudent for the company to contact the regulator if mistakes or problems are discovered but do not meet the specific definition of ‘in error.’*”⁹⁶

⁹⁴ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

⁹⁵ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.2](#)).

⁹⁶ AOWG Regulatory Guidance (Appendix II).

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7. Actuarial Opinion Summary

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

Of particular importance is that the AOS is a confidential document. As stated in the NAIC AOS Instructions,

The AOS contains significant proprietary information. It is expected that the AOS be held confidential; it is not intended for public inspection. The AOS should not be filed with the NAIC and should be kept separate from any copy of the Statement of Actuarial Opinion (Actuarial Opinion) in order to maintain confidentiality of the AOS. The AOS can contain a statement that refers to the Actuarial Opinion and the date of that opinion.⁹⁷

The AOWG Regulatory Guidance repeats this information and adds:

The AOS is a confidential document and should be clearly labelled and identified prominently as such.

We expect the actuary will transmit the AOS to the company department responsible for filing this document by e-mail (with the AOS as an attachment) or by delivery of a hard copy with an attached cover letter or by some similar means. Based on the AOWG Regulatory Guidance, Appointed Actuaries commonly repeat these instructions in the transmittal email or the cover letter:

- This attached document should not be filed with the NAIC;
- This attached document should be filed with the domiciliary state's regulator; and
- This attached document should not be filed with any other state's regulator, unless specifically requested.

The following provides discussion and illustrative language for consideration when issuing an AOS.

⁹⁷ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.2](#)).

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7.1 Filing the AOS

This section provides discussion around the filing requirements of the AOS. According to the NAIC AOS Instructions,

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 by March 15 (or by a later date otherwise specified by the domiciliary state). This AOS shall be submitted to a non-domiciliary state within fifteen days of request, but no earlier than March 15, provided that the requesting state can demonstrate, through the existence of law or some similar means, that it is able to preserve the confidentiality of the document.

7.1.1 Discussion

The AOS is to be filed with the company's domiciliary state insurance department separately from the Annual Statement and the SAO. The AOS generally must be filed by March 15, unless the state's insurance department has specified a different date. The Appointed Actuary may want to refer to the Academy's [2023 P/C Loss Reserve Law Manual](#) to find the state-specific due date. If requested, the AOS must be submitted to a non-domiciliary state within fifteen days of request, but no earlier than March 15. The requesting state must demonstrate its ability to preserve the confidentiality of the AOS to the Company, in accordance with item 1 of the NAIC AOS Instructions provided in [Appendix I.2](#).

FAQ: I have completed the Statement of Actuarial Opinion and Actuarial Opinion Summary at the same time and provided them to the Company. Does the Company file them with its domiciliary state insurance department together?

A: No, the SAO and AOS are separate documents. The AOS is not included with the Company's Annual Statement and other documents that are filed with the NAIC due to its confidential nature. The AOWG Regulatory Guidance advises that, in order to avoid confusion, the Appointed Actuary should provide the AOS to company personnel separately from the SAO.

Note:

- The AOS is not included with the company's Annual Statement and other documents filed directly with the NAIC.
- The AOS is filed separately from the SAO, but the wording of the AOS may make reference to the SAO.
- The Appointed Actuary is not required to submit a copy of the SAO with the AOS, since that SAO will have been submitted along with the company's Annual Statement.
- The AOS should be consistent with applicable Actuarial Standards of Practice (ASOPs).
- Exemptions for filing the SAO apply equally to the filing requirements of the AOS.

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7.1.2 Illustrative language

Because it is sent separately from the SAO, the Appointed Actuary may wish to consider including some basic information along with the AOS. Sample wording is presented below:



Date: March 13, 2024
Actuarial Opinion Summary
Company: THE Insurance Company
NAIC#: #####
Appointed Actuary: [Name of Appointed Actuary]

I have signed the Company's Statement of Actuarial Opinion on Feb. 23, 2024. These two documents are closely linked; the Actuarial Opinion Summary is an extension of the Statement of Actuarial Opinion. Therefore, all limitations, caveats, and reliances in the Statement of Actuarial Opinion should also be applied to the Actuarial Opinion Summary. Moreover, it is my understanding that, consistent with the Annual Statement Instructions, the Actuarial Opinion Summary will be kept confidential by state regulators and is not intended for public inspection, subject to applicable law.

7.2 Content of the AOS

The principal content of the AOS is provided in five items, A through E. The first four items provide figures pertaining to the Appointed Actuary's unpaid claim estimates on both a point and range basis when calculated, the company's carried reserve, and differences between them on both a net and gross of reinsurance basis. In item E the Appointed Actuary is required to state whether the company has experienced one-year adverse development in excess of five percent of the respective prior year-end's policyholders' surplus in three or more of the past five years, and if so, provide explanation for the adverse experience.

This section provides discussion and illustrative language around the content of the AOS, with illustrative language for item E. Following this section are sample AOSs containing illustrations of items A through E ([7.3](#)).

7.2.1 Definitions

Section 3.7 of [ASOP No. 36](#) states "The actuary should consider a reserve to be reasonable if it is within a range of estimates that could be produced by an unpaid claim analysis that is, in the actuary's

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professional judgment, consistent with both [ASOP No. 43, Property/Casualty Unpaid Claim Estimates](#), and the identified stated basis of reserve presentation.”⁹⁸

7.2.2 Discussion

The AOS requires the Appointed Actuary to disclose, on a gross and net basis, the Appointed Actuary’s point estimate and/or the Appointed Actuary’s range and compare this to the carried reserves.

Items 5 (A) through 5 (D) in the NAIC AOS Instructions clarify that there is no requirement to produce both a range and a point estimate. However, the reserve estimates presented in the AOS must follow the Appointed Actuary’s analysis (i.e., if the Appointed Actuary prepares both a point estimate and a range in the analysis, then both the point estimate and the range must be disclosed in the AOS).

If the Appointed Actuary produces a range of estimates for a portion of total liabilities and a point estimate for the remaining liabilities, then the AOS should include both. The Appointed Actuary should show how the point estimate and the range combine to form the Appointed Actuary’s SAO, which can be categorized as reasonable, deficient, redundant, qualified, or no opinion. The AOS Exhibit should be consistent with the type of opinion provided in the SAO.

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

Note:

- NAIC AOS Instructions state *“the net and gross reserve values reported by the Appointed Actuary in the AOS should reconcile to the corresponding values reported in the Insurer’s Annual Statement, the Appointed Actuary’s Actuarial Opinion, and the Actuarial Report. If not, the Appointed Actuary shall provide an explanation of the difference.”*⁹⁹
- The Appointed Actuary may want to consider potential responses in the AOS section E for consistency with commentary in the SAO on IRIS test exceptional values.

⁹⁸ Actuarial Standards Board of the American Academy of Actuaries; Actuarial Standard of Practice No. 36, *Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves*; <http://www.actuarialstandardsboard.org/asops/statements-actuarial-opinion-regarding-property-casualty-loss-loss-adjustment-expense-reserves/>; December 2010; page 3.

⁹⁹ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.2](#)).

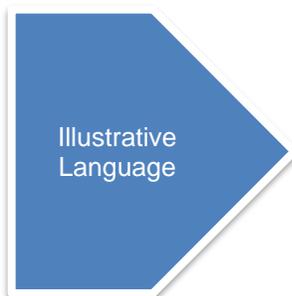
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- NAIC SAO Instructions indicate that the Actuarial Report should include detailed descriptions and calculations that support the point estimate and/or range of estimates.

7.2.3 Illustrative language

If, for example, reserve strengthening for A&E was one of the causes for one-year development to exceed five percent of the respective prior year's surplus in at least three of the last five calendar years, then the Appointed Actuary might consider language like the following in item E of the AOS. This language would be in addition to explanations of any other causes of adverse development for those years:



The Company's one-year development exceeded five percent of surplus in three of the five most recent years. During this period, the Company was evaluating its asbestos exposures using a ground up evaluation. These evaluations included input from claims, legal, and actuarial personnel. These evaluations resulted in several increases in the Company's net asbestos liabilities, which in turn resulted in the adverse one-year development in those three prior years.

NAIC AOS Instructions require “an explicit description of the reserve elements or management's decisions which were the major contributors,”¹⁰⁰ which may be more detailed than comments in the RELEVANT COMMENTS section of the SAO. Recall, for example, the illustrative language provided in the RELEVANT COMMENTS section pertaining to exceptional values for IRIS Ratios (5.5) was as follows:

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

If one-year development has been adverse by at least five percent of the respective prior year's surplus in at least three of the last five calendar years, but the Appointed Actuary has not issued the SAO in each of those five years, the Appointed Actuary may wish to begin the required commentary with language such as the following:

¹⁰⁰ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.2](#)).

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Illustrative
Language

The Company had one-year adverse development in excess of five percent of the prior year-end's policyholders' surplus in three or more of the last five calendar years. I became the Appointed Actuary on [date] and have issued the Statement of Actuarial Opinion on the Company's loss and loss adjustment expense reserves, beginning with year-end [year]. The Company's management has represented to me that the one-year adverse development in prior years were due to...

OR

The Company had one-year adverse development in excess of five percent of the prior year-end's policyholders' surplus in three or more of the last five calendar years. I became the Appointed Actuary on [date] and have issued the Statement of Actuarial Opinion on the Company's loss and loss adjustment expense reserves, beginning with year-end [year]. I have reviewed the Actuarial Reports for the years prior to my appointment, and I have determined that the one-year adverse development in prior years were due to...

If fewer than three years fail the test, then the Appointed Actuary is not required to comment but may wish to include a sentence such as the following for clarity:



Illustrative
Language

The calculations of one-year development of the Company's reserves yielded results in excess of five percent of prior year-end's policyholders' surplus in only one of the last five years.

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7.3 Sample formats of the AOS

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

SAMPLE FORMAT FOR THE AOS

[Name] Insurance Company
December 31, 2023

Sample # 1: If the Appointed Actuary provides a range without a point estimate:

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

Sample # 2: If the Appointed Actuary provides a point estimate without a range:

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

Sample # 3: If the Appointed Actuary provides both a range and a point estimate:

	<u>Net Reserves</u>			<u>Gross Reserves</u>		
	<u>Low</u>	<u>Point</u>	<u>High</u>	<u>Low</u>	<u>Point</u>	<u>High</u>
A Actuary's range of estimates	9,000		11,000	10,000		12,000
B Actuary's point estimate		10,500			11,600	
C Company carried reserves		10,000			11,000	
D Difference between Company carried and actuary's estimate	1,000	(500)	(1,000)	1,000	(600)	(1,000)

Sample # 4: If the Appointed Actuary provides a qualified opinion – point estimate without a range:

	<u>Net Reserves</u>			<u>Gross Reserves</u>		
	<u>Low</u>	<u>Point</u>	<u>High</u>	<u>Low</u>	<u>Point</u>	<u>High</u>
A Actuary's range of estimates	NA		NA	NA		NA
B Actuary's point estimate		9,500			10,000	
C1 Company carried reserves - TOTAL		10,000			11,000	
C2 Company carried reserves - portion excluded by opinion		1,000			1,600	
C3 Company carried reserves covered by opinion		9,000			9,400	
D Difference between Company carried and actuary's estimate (C3-B)		(500)			(600)	

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Following items A through D in each of the above samples would be item E. The following provides an illustration of item E for the situation where the company has not experienced one-year adverse development by more than five percent of surplus in three or more of the last five calendar years:

- E. *The Company has not had one-year adverse development, as measured by Schedule P, Part 2 Summary, in excess of five percent of the prior year-end's policyholders' surplus in three or more of the last five calendar years.*

NAIC AOS instructions indicate that the Appointed Actuary is required to sign and date the Actuarial Opinion Summary. The Appointed Actuary may choose to use a signature similar to the signature line of the Actuarial Opinion. A sample format is shown below.



*Signature of Appointed Actuary
Printed name of Appointed Actuary
Employer's name
Address of Appointed Actuary
Telephone number of Appointed Actuary
Email address of Appointed Actuary
Date AOS was rendered*

The following are examples of illustrative wording that might be appropriate for including within the AOS to note that the information provided is expected to be kept confidential. See important note below to assist in determining the appropriate language for each situation.



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

OR

This Actuarial Opinion Summary was prepared solely for the Company for filing with regulatory agencies and is not intended for any other purpose. Furthermore, it contains information that is a trade secret and therefore, if disclosed, would cause substantial injury to ABC Insurance Company's competitive position. Therefore, I request that this Summary and information contained therein be maintained confidential and I request an exception from disclosure under the Freedom of Information Act/Laws of your state.

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Note:

- Because the confidentiality laws differ from state to state, Appointed Actuaries are encouraged to reference the Academy's [2023 P/C Loss Reserve Law Manual](#) to assist in identifying differences among the states. Knowledge of and compliance with legal and regulatory requirements rests with the individual actuary. Legal counsel should be consulted where the actuary is unable to identify all relevant legal requirements.

7.4 AOS for pooled companies

According to the NAIC AOS Instructions,

The AOS for a pooled Company ... shall include a statement that the Company is a xx% pool participant. For a non-0% Company, the information provided for paragraph 5 should be numbers after the Company's share of the pool has been applied; specifically, the point or range comparison should be for each statutory Company and should not be for the pool in total. For any 0% pool participant, the information provided for paragraph 5 should be that of the lead company.¹⁰¹

7.4.1 Discussion

Paragraph 6 of the NAIC AOS Instructions requires the AOS to include the participation percentage for companies participating in an intercompany pooling agreement, as discussed in paragraph 1C of the NAIC SAO Instructions. For those companies whose participation percentage is zero, the information provided in paragraph 5 of the AOS should be that of the lead company.

For those companies whose pooling is other than 0%, AOWG Regulatory Guidance ([Appendix II](#)) encourages actuaries to display both the consolidated pool amounts in addition to the statutory entity's amounts. This can be accomplished with two separate tables.

¹⁰¹ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.2](#)).

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7.4.2 Illustrative language

The following language may be appropriate when a company is a 0% pool participant in an intercompany pooling arrangement:



XYZ Insurance Company is a member of an intercompany pooling arrangement, with zero percent participation. The lead company is ABC Insurance Company with an XX% share of the consolidated pool amount. The following information is that of the lead company, ABC Insurance Company.

7.5 Errors in the AOS

If an amended SAO is required that impacts AOS results, filing an amended AOS is also necessary. The 2023 AOWG Regulatory Guidance, included as [Appendix II](#), discusses regulatory expectations in cases where an error is discovered by the Appointed Actuary, the company, or the regulator.

7.5.1 Definitions

According to the NAIC AOS Instructions,

“The AOS shall be considered to be in error if the AOS would have not been issued or would have been materially altered had the correct data or other information been used. The AOS 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.”¹⁰²

7.5.2 Discussion

When an AOS is in error, as defined above, AOWG Regulatory Guidance indicates the revised Summary should

- be submitted to the regulator
- clearly state that it is an amended document
- contain or accompany an explanation for the revision and
- include the date of the revision.

¹⁰² 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.2](#)).

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NAIC AOS Instructions added the following language to expand the requirements in the case where an AOS is considered to be in error:

“The Insurer required to furnish an AOS shall require its Appointed Actuary to notify its Board of Directors in writing within five (5) business days after any determination by the Appointed Actuary that the AOS 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...Notification shall be required when discovery is made between the issuance of the AOS and Dec. 31 of that year. Notification should include a summary of such findings.

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 AOS, the Appointed Actuary and the Company should quickly undertake procedures necessary for the Appointed Actuary to make such determination. If the Insurer does not provide the necessary data corrections and other support (including financial support) within ten (10) business days, the Appointed Actuary should proceed with the notification to the Board of Directors and the domiciliary commissioner.

An Insurer who is notified pursuant to the preceding paragraphs shall forward a copy of the amended AOS 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 letter and amended AOS submitted 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 an amended AOS has been finalized.”¹⁰³

Note:

- According to the NAIC AOS Instructions, “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.”¹⁰⁴

¹⁰³ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.2](#)).

¹⁰⁴ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.2](#)).

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8. Actuarial Report

This chapter provides discussion related to the Actuarial Report and underlying actuarial work papers supporting an SAO. The NAIC Instructions include specific requirements for the technical component of the Actuarial Report and various disclosures, as discussed within this chapter. These requirements are in addition to following documentation and disclosure requirements of [ASOP No. 41](#), in particular section 3.2:

An actuarial report may comprise one or several documents. The report may be in several different formats (such as formal documents produced on word processing, presentation or publishing software, e-mail, paper, or web sites). Where an actuarial report for a specific intended user comprises multiple documents, the actuary should communicate which documents comprise the report.

In the actuarial report, the actuary should state the actuarial findings, and identify the methods, procedures, assumptions, and data used by the actuary with sufficient clarity that another actuary qualified in the same practice area could make an objective appraisal of the reasonableness of the actuary's work as presented in the actuarial report.¹⁰⁵

8.1 Actuarial Report requirements per the NAIC SAO Instructions

According to the NAIC SAO Instructions,

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 (7) years. The Actuarial Report contains significant proprietary information. It is expected that the Actuarial Report be held confidential and not be intended for public inspection....

The technical component must show the analysis from the basic data (e.g., loss triangles) to the conclusions.¹⁰⁶

The NAIC SAO Instructions go on to include a discussion on long-term care and A&H Long Duration Contracts as well as provide a list of six bulleted items Actuarial Reports must also include. The long-term care and A&H Long Duration Contracts are discussed in Section 8.2 while the six bulleted items in the NAIC SAO Instructions correspond to sections [8.3](#) to [8.8](#) of this chapter, respectively.

¹⁰⁵ Actuarial Standards Board, "ASOP No. 41, *Actuarial Communications*," <http://www.actuarialstandardsboard.org/asops/actuarial-communications/>, December 2010, section 3.2.

¹⁰⁶ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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8.1.1 Definitions

According to the NAIC SAO Instructions,

“Actuarial Report” means a document or other presentation, prepared as a formal means of conveying to the state regulatory authority and the Board of Directors the Appointed 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 Appointed Actuary’s opinion or findings and of documenting the analysis underlying the opinion.¹⁰⁷

8.1.2 Discussion

The requirements for the Actuarial Report per the NAIC SAO Instructions are much more specific than those contained in [ASOP No. 41](#). The NAIC SAO Instructions require the Actuarial Report show the analysis from the basic data to the conclusions, and contain six additional listed items (these are discussed in more detail in sections [8.3](#) through [8.8](#)). Additionally, the NAIC SAO Instructions require that the reconciliation papers in [3.7.1](#) become a part of the report.

The definition of the Actuarial Report in paragraph 7 of the NAIC SAO Instructions includes a company’s Board of Directors as part of the intended audience to be consistent with paragraph 1, which states that the Actuarial Report should be made available to the Board. This clarification is not intended to change the content of the Actuarial Report as described in paragraph 7. The Appointed Actuary may still elect to present findings to the board in any suitable manner (for example, an oral report or executive summary). In this event, the full Actuarial Report as defined in paragraph 7 must still be made available to the board upon request. The NAIC SAO Instructions further state that the minutes of the Board of Directors’ meeting should indicate that a presentation was made. The NAIC SAO Instructions further state that the minutes should identify the form of presentation (e.g., webinar, in-person, written) in the minutes.

The Appointed Actuary usually includes within the Actuarial Report commentary on all material items covered in the SAO, including some detail on how the materiality threshold was chosen and commentary on what items were considered in choosing the threshold. In addition, regulators further expect the

FAQ: What is the due date of the Actuarial Report supporting an SAO?

A: According to NAIC SAO Instructions, Actuarial Reports “...must be available by May 1 of the year following the year-end for which the Opinion was rendered or within two (2) weeks after a request from an individual state commissioner.” However, requirements may vary by state. For example, Colorado requires the Actuarial Report to be issued within 30 days of the Actuarial Opinion if the carried reserves are less than the Appointed Actuary’s best estimate (Statute Title 10, 3-1-3 § 6).

The Appointed Actuary is encouraged to refer to the Academy’s [2023 P/C Loss Reserve Law Manual](#) and relevant statutes for specific guidance.

¹⁰⁷ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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Actuarial Report to address the risk factors identified in the SAO, with descriptions of alternate outcomes that could result in adverse development in excess of the materiality threshold.

According to the NAIC SAO Instructions for year-end 2023, in addition to the date the Actuarial Report was finalized, the Actuarial Report should also include the following information, consistent with what is required in the SAO:

- Signature of Appointed Actuary
- Printed name of Appointed Actuary
- Employer's name
- Address of Appointed Actuary
- Telephone number of Appointed Actuary
- Email address of Appointed Actuary
- Date the Opinion was rendered

The 2023 AOWG Regulatory Guidance supplements the NAIC SAO Instructions with regulatory expectations on Actuarial Reports.

Note:

- The Appointed Actuary should consider the requirements of the NAIC SAO Instructions and ASOP No. 41 when developing the Actuarial Report, as well as guidance provided by the AOWG (see [2023 AOWG Regulatory Guidance](#)).
- The Actuarial Report and the AOS show company carried reserves along with the Appointed Actuary's estimate(s). Exhibit A of the SAO and the company's Annual Statement show the company carried reserves. Reconciliation of the net and gross reserve figures among these various related documents is expected to be a straightforward process. Exceptions should be noted and explained in the Actuarial Report.

8.2 Long-Term Care and A&H Long Duration Contracts

The NAIC SAO Instructions reference Actuarial Guideline LI related to certain long-term care contracts:

Actuarial Guideline LI—The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves (AG 51) in the NAIC Accounting Practices and Procedures Manual requires a company with over 10,000 in force lives covered by long-term care (LTC) insurance contracts as of the valuation date to perform a stand-alone asset adequacy analysis for its in force long-term care (LTC) contracts. The Actuarial Report and workpapers summarizing the results, assumptions and testing procedures for the asset adequacy testing of LTC business must be in compliance with AG

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51 requirements. When referring to AG 51, the term “Actuarial Memorandum” is synonymous with Actuarial Report and workpapers.¹⁰⁸

In addition, the NAIC SAO Instructions include the following requirement of Actuarial Reports:

*Actuarial Report should contain disclosure of all reserve amounts associated with A&H Long Duration Contracts reported by the Company; the reserve amounts in the Actuarial Report should tie to the Annual Statement.*¹⁰⁹

8.3 Description of Appointed Actuary’s relationship to the Company

The NAIC SAO Instructions include the following requirement of Actuarial Reports:

*A description of the Appointed Actuary’s relationship to the Company, with clear presentation of the Actuary’s role in advising the Board and/or management regarding the carried reserves. The Actuarial Report should identify how and when the Appointed Actuary presents the analysis to the Board and, where applicable, to the officer(s) of the Company responsible for determining the carried reserves.*¹¹⁰

8.3.1 Discussion

The Appointed Actuary is required to include in the Actuarial Report a clear description of the Appointed Actuary’s role in advising the board and/or management regarding the carried reserves, including a disclosure of how and when the actuarial analysis is presented to the board and/or management.

8.3.2 Illustrative language

The following sample wording is provided to illustrate the level of detail and nature of information typically intended to be included in the Report to fulfill each element of this requirement. Please note that these examples are not meant to represent all potential situations.

The Appointed Actuary’s relationship to the Company:



- *I am the Chief Actuary of the Company.*
- *[Alternative] I am an independent consultant to the Company.*

¹⁰⁸ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

¹⁰⁹ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

¹¹⁰ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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- *[Alternative] I am an independent consultant retained by the insurance department.*

The Appointed Actuary's role in advising the board and/or management:



- *I provide input to management and the board of directors in the reserve setting process.*
- *[Addition] I establish a range of reasonable reserve estimates and understand that Company management selects the carried reserves based on my range of reasonable reserve estimates.*
- *[Alternative or Addition] My role is to evaluate the reasonableness of the carried reserves. I do not explicitly advise management or the board of directors in the reserve setting process.*

How and when the Appointed Actuary presents the analysis to the board:



- *The Appointed Actuary is required to present to the Board of Directors on ABC's carried reserves. This report constitutes this presentation, and the minutes of ABC's Board of Directors should indicate that the report was made available to the Board.*
- *[Alternative] A summary of the findings of my analysis was/will be presented to the Board of Directors on (Date).*

8.4 Exhibit comparing Appointed Actuary's conclusions to carried amounts in Annual Statement

The NAIC SAO Instructions include the following requirement of Actuarial Reports:

"An exhibit that ties to the Annual Statement and compares the Appointed Actuary's conclusions to the carried amounts consistent with the segmentation of exposure or liability groupings used in the analysis. The Appointed Actuary's conclusions include the Appointed Actuary's point estimate(s), range(s) of reasonable estimates or both."¹¹¹

¹¹¹ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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8.4.1 Discussion

The NAIC SAO Instructions require the Actuarial Report to include an exhibit that ties to the Annual Statement and compares the Appointed Actuary's conclusions to the carried amounts. This exhibit is to be consistent with the segmentation used in the Appointed Actuary's analysis, and conclusions must include the Appointed Actuary's point estimate(s), range(s) of reasonable estimates, or both.

Further, AOWG Regulatory Guidance includes additional commentary based on the regulator's interpretation of the requirement:

"The Actuarial Opinion Summary already provides this information at the highest level of aggregation; this information should still be presented in the Actuarial Report... [The Actuarial Report is] intended to capture the comparisons at a more detailed level consistent with how the reserves were analyzed, to the extent these comparisons are possible."¹¹²

8.4.2 Illustrative language

An exhibit similar to the below may be appropriate:

Analysis Segment	Actuary Estimated	Actuarial Report Exhibit	Company Carried	Source of Company Carried	Difference
	(1)	(2)	(3)	(4)	(5) = (3) - (1)
Homeowners	\$XX,XXX	Exhibit B	\$YY,YYY	Schedule P, Part 1A	\$ZZ,ZZZ
Private Passenger Auto	XXX,XXX	Exhibit C	YYY,YYY	Schedule P, Part 1B	ZZZ,ZZZ
All Other LOB - State A	X,XXX	Exhibit D	Y,YYY	Company workpaper	Z,ZZZ
All Other LOB - All Other States	X,XXX	Exhibit E	Y,YYY	Company workpaper	Z,ZZZ
Total	\$XXX,XXX	Exhibit A	\$YYY,YYY	AS, Page 3	\$ZZZ,ZZZ

8.5 Reconciling and mapping data in the Actuarial Report to Schedule P

The NAIC SAO Instructions include the following requirement of Actuarial Reports:

"An exhibit that reconciles and maps the data used by the Appointed Actuary, consistent with the segmentation of exposure or liability groupings used in the Appointed Actuary's analysis, to the Annual Statement Schedule P line of business reporting. An explanation should be provided for any material differences."¹¹³

¹¹² 2022 AOWG Regulatory Guidance ([Appendix II](#)).

¹¹³ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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8.5.1 Discussion

The Schedule P reconciliation is intended to be consistent with the segmentation used in the Appointed Actuary's analysis.

The 2023 AOWG Regulatory Guidance provides extended commentary on the topic that the Appointed Actuary may wish to consider. The intent of the Schedule P reconciliation is to clearly demonstrate to a regulator or other user of the Actuarial Report how the actuarial data shown in the Schedule P reconciliation is mapped in the supporting actuarial analysis prior to reconciliation of that data to Schedule P. Detailed reconciliations of the data "... is generally expected to be on the same level as used in the analysis underlying the Actuarial Opinion..." The AOWG Regulatory Guidance goes on to state that, if the reconciliation cannot be performed, the reasons should be noted in the Report.

According to AOWG Regulatory Guidance, all data elements material to the analysis should be included in the reconciliation:

*"The Appointed Actuary should reconcile all data material to the analysis, including claim counts and earned premium if appropriate. If the Appointed Actuary chooses not to reconcile certain data elements used in their analysis, such as claim counts, a brief explanation should be included in the Actuarial Report to make it clear that these elements were not inadvertently overlooked."*¹¹⁴

There are nuances that the Appointed Actuary may decide to take into consideration with respect to the Schedule P reconciliation. For example,

- The 2023 AOWG Regulatory Guidance specifies a number of circumstances such as "mergers, acquisitions, changes in claim systems, and the use of underwriting year data in the analysis"¹¹⁵ that present challenges to Appointed Actuaries, and "encourages Appointed Actuaries to disclose reconciliation issues in the Actuarial Report."¹¹⁶
- The 2023 AOWG Regulatory Guidance also encourages Appointed Actuaries to consider whether a calendar year reconciliation of total paid losses (all accident years combined) "provides sufficient assurance of the integrity of the data used in the analysis..."¹¹⁷
- COPLFR further recognizes there may be issues in the way in which claims are counted (e.g., per claim versus per occurrence, the availability of assumed claim counts, etc.) and notes that there is no requirement to audit the claim counts presented in Schedule P.

The NAIC SAO Instructions are explicit that material differences arising from the Schedule P reconciliation must be explained by the Appointed Actuary.

¹¹⁴ 2023 AOWG Regulatory Guidance ([Appendix II](#)).

¹¹⁵ 2023 AOWG Regulatory Guidance ([Appendix II](#)).

¹¹⁶ 2023 AOWG Regulatory Guidance ([Appendix II](#)).

¹¹⁷ 2023 AOWG Regulatory Guidance ([Appendix II](#)).

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For further discussion, please see [Chapter 3](#) and the AOWG Regulatory Guidance.

Note:

- The mapping between analysis segments and Schedule P lines of business may also be used for the comparison of Actuary's conclusions to the carried amounts as discussed in section 8.4.
- AOWG Regulatory Guidance highlights the relationship between the reconciliation performed by the Appointed Actuary of the actuarial data to that shown in Schedule P, and that performed by the independent auditors, focused on the consistency between Schedule P and the data in the company's claims system.

8.6 Exhibit and discussion on change in Appointed Actuary's estimates

In addition to comparing estimates and reconciling data to the company's Annual Statement, the NAIC SAO Instructions also include a requirement to compare the Actuary's estimates to the prior Actuarial Report:

An exhibit or appendix showing the change in the Appointed Actuary's estimates from the prior Actuarial Report, including extended discussion of factors underlying any material changes. The exhibit or appendix should illustrate the changes on a net basis, but should also include the changes on a gross basis, if relevant. If the Appointed Actuary is newly-appointed and does not review the work of the prior Appointed Actuary, then the Appointed Actuary should disclose this.¹¹⁸

8.6.1 Discussion

The NAIC SAO Instructions require the Appointed Actuary to include in the Actuarial Report an exhibit that summarizes changes in the Appointed Actuary's estimates from the prior analysis, with extended discussion of significant factors underlying the changes. These requirements seem to be intended to apply to the change in the Appointed Actuary's prior period estimates since the previous Actuarial Report. This exhibit or appendix is to show the change in the Appointed Actuary's estimates, not the company's.

The requirement was clarified in the year-end 2016 NAIC SAO Instructions to include illustration of the changes on a net basis, and on a gross basis if relevant.

¹¹⁸ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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NAIC SAO Instructions require discussion of significant changes. The level of detail used to describe the significant factors underlying material changes in estimates is left to the discretion of the Appointed Actuary. The AOWG Regulatory Guidance suggests that an explanation be provided for any significant fluctuations in estimates among accident years or segments, or possibly in even more granular detail. Further, the amount of change that constitutes a significant amount is left to the Appointed Actuary's judgment. "Significant" in this context would typically be lower than the materiality standard used in consideration of the risk of material adverse deviation in the SAO.

To meet the requirements of this part of the NAIC SAO Instructions, and in accordance with the spirit in which COPLFR believes these Instructions are intended, the Appointed Actuary may wish to consider including the following in the Actuarial Report (gross and net of reinsurance):

- 1) Exhibit(s) and discussion related to significant changes in point estimates from the prior Actuarial Report (if a point estimate is included in the Actuarial Report), categorized by reviewed segment, accident year, and in total.
- 2) Exhibit(s) and discussion related to significant changes in the range of estimates from the prior year (if a range is included in the Actuarial Report), if meaningful and practical, including discussion of any significant expansion or contraction of the range relative to the prior Actuarial Report.

When there is a change in Appointed Actuary, the new Appointed Actuary is encouraged to discuss material changes in estimates in the Report, to the extent that it is reasonably possible to do so. If no such comparison is practical or meaningful, the Appointed Actuary should make a disclosure consistent with that reported in the SAO.

FAQ: My analysis of the Company includes interim reserve evaluations in addition to the analysis supporting the SAO. What should be included in the exhibit showing the change in actuary's estimates?

A: While a comparison to interim analysis estimates may be instructive, the requirement is for the change in estimates and relevant discussion be relative to the Actuarial Report that supported the prior SAO.

Note:

- If the Appointed Actuary estimated ultimate amounts (losses and/or LAE) in the previous Actuarial Report, then, in this Actuarial Report, the change in estimates would be calculated as the change in estimated ultimate amounts, for prior periods. If the Appointed Actuary estimated reserves directly in the previous Actuarial Report (e.g., because of the specific methodology used or because a complete history of paid losses was not available), then the change in estimates would be calculated as the incremental paid amounts plus the change in the estimated unpaid amounts between Actuarial Reports, again for prior periods.

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8.7 Extended comments on risks and uncertainties

The NAIC SAO Instructions also include a requirement for the Actuary to expand on certain items that are included in the SAO:

Extended comments on trends that indicate the presence or absence of risks and uncertainties that could result in material adverse deviation.

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8.7.1 Discussion

As noted in the NAIC SAO Instructions, the Actuarial Report is expected to be held confidential and not intended for public inspection. Thus, the extended comments about risks and uncertainties may include details that may not be in the public domain. At a minimum, the Actuarial Report should support the Actuary's conclusion about whether RMAD exists and this often will require more detail than is included in the SAO.

Extended comments could include additional discussion on the major factors discussed in the SAO and how they are (or are not) applicable to the company, how the risk factors could lead to adverse deviation in excess of the materiality threshold (a sensitivity analysis for example), or any other commentary or analyses that the Actuary believes would be helpful to the company and/or the Regulator in support of the conclusion about the existence of RMADs.

FAQ: Is this still a requirement if the Opinion states there are not significant risks that could result in material adverse deviation?

A: Yes. Section 4.1.3d of [ASOP No. 41](#) states that the actuary should disclose "any cautions about risks and uncertainty" in any actuarial report, unless the actuary determines it is inappropriate to do so. In addition, the 2023 NAIC SAO Instructions state that a discussion of risk factors is to be included in the SAO even when the actuary concludes there is no material risk of adverse deviation, and this requirement would similarly extend to the Actuarial Report.

Note:

- Despite the NAIC SAO Instructions requiring "Extended comments on trends that indicate the presence or absence of risks and uncertainties that could result in material adverse deviation,"¹²⁰ the Appointed Actuary may wish to comment on sources of risk and uncertainty that are not trends, such as significant, one-time events.

¹¹⁹ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

¹²⁰ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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8.8 Extended comments on unusual values for IRIS Ratio 11, 12, and/or 13

The NAIC SAO Instructions also include a requirement for the Actuary to include additional discussion in the Actuarial Report if the company triggers an unusual result on one of the reserve-based IRIS Ratios:

*Extended comments on factors that led to unusual IRIS ratios for One-Year Reserve Development to Policyholders' Surplus, Two-Year Reserve Development to Policyholders' Surplus, or Estimated Current Reserve Deficiency to Policyholders' Surplus, and how these factors were addressed in prior and current analyses.*¹²¹

8.8.1 Discussion

As noted in the NAIC SAO Instructions, the Actuarial Report is expected to be held confidential and not intended for public inspection. Thus, the extended comments may include detail such as operational details or information on specific claims that may not be appropriate for the SAO document, which rests in the public domain. The Actuary may wish to further provide sensitivity analyses and/or exhibits supporting the expanded discussion on this topic.

¹²¹ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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9. Resources

This chapter provides a listing of the ASOPs and SSAPs that apply to the material covered by this practice note. It also provides resources to actuaries providing opinions other than those covered by the scope of this practice note.

9.1 Applicable ASOPs

*ASOPs are binding on members of the U.S.-based actuarial organizations when rendering actuarial services in the U.S. While these ASOPs are binding, they are not the only considerations that affect an actuary's work. Other considerations may include legal and regulatory requirements, professional requirements promulgated by employers or actuarial organizations, evolving actuarial practice, and the actuary's own professional judgment informed by the nature of the engagement. The ASOPs provide a basic framework that is intended to accommodate these additional considerations.*¹²²

According to the ASB, the ASOPs “identify what the actuary should consider, document, and disclose when performing an actuarial assignment.”¹²³

While all ASOPs are binding, the following are specifically cited or referenced within this practice note:

[ASOP No. 1, Introductory Actuarial Standard of Practice](#)

[ASOP No. 20, Discounting of Property/Casualty Unpaid Claim Estimates \(Updated June 2023, Effective December 1, 2023\)](#)

[ASOP No. 21, Responding to or Assisting Auditors or Examiners in Connection with Financial Audits, Financial Reviews, and Financial Examinations](#)

[ASOP No. 23, Data Quality](#)

[ASOP No. 36, Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves \(Exposed for comment in 2022\)](#)¹²⁴

[ASOP No. 41, Actuarial Communications \(Exposed for comment in 2022\)](#)¹²⁵

[ASOP No. 43, Property/Casualty Unpaid Claim Estimates](#)

[ASOP No. 56, Modeling](#)

The above can be found at the ASB website: <http://www.actuarialstandardsboard.org/>

¹²² Actuarial Standards Board, ASOP No. 1; *Introductory Actuarial Standard of Practice*; <http://www.actuarialstandardsboard.org/asops/introductoryactuarialstandardpractice/>; section 1.

¹²³ Ibid.

¹²⁴ Commentary throughout this practice note relate to the current version of ASOP No. 36, which became effective May 1, 2011.

¹²⁵ Commentary throughout this practice note relate to the current version of ASOP No. 41, which became effective May 1, 2011.

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9.2 Applicable SSAPs

According to the NAIC,

The Statutory Accounting Principles (E) Working Group is responsible for developing and adopting substantive, nonsubstantive and interpretation revisions to the NAIC Accounting Practices and Procedures Manual (AP&P Manual). The AP&P Manual provides the basis for insurers to prepare financial statements for financial regulation purposes. Substantive statutory accounting revisions introduce original or modified accounting principles.

...

SSAPs are considered the highest authority (Level 1) in the statutory accounting hierarchy.¹²⁶

There are over 100 SSAPs and they are published in the NAIC's *Accounting Practices and Procedures Manual*, available for sale from the NAIC at https://www.naic.org/prod_serv_publications_for_sale.htm#app_manual. COPLFR has received permission to reproduce SSAPs deemed to be particularly applicable to actuaries signing NAIC P&C SAOs per a COPLFR review. We have included these in [Appendix IV](#) of this practice note. These SSAPs are as follows:

SSAP 5R: *Liabilities, Contingencies and Impairment of Assets*

SSAP 9: *Subsequent Events*

SSAP 29: *Prepaid Expenses*

SSAP 53: *Property Casualty Contracts—Premiums*

SSAP 55: *Unpaid Claims, Losses and Loss Adjustment Expenses*

SSAP 57: *Title Insurance*

SSAP 58: *Mortgage Guaranty Insurance*

SSAP 62R: *Property and Casualty Reinsurance*

SSAP 63: *Underwriting Pools and Associations Including Intercompany Pools*

SSAP 65: *Property and Casualty Contracts*

SSAP 66: *Retrospectively Rated Contracts*

The NAIC adopted codification of statutory accounting principles effective January 1, 2001 to serve as a common set of principles for individual states to follow. The SSAPs promote consistency and ease regulatory burden. However, individual state regulation is still permissible, and individual states may have specific statutes or regulations that supersede SSAPs. The NAIC publishes a summary of state differences available free of charge online at [2023 States' Prescribed Differences \(naic.org\)](https://www.naic.org/2023_states_prescribed_differences).

¹²⁶ https://www.naic.org/cmte_e_app_sapwg.htm

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Note that the SSAPs are subject to change every year and have seen numerous changes since they were originally issued in 2001.

9.3 Available resources for opinions not covered by this practice note

As noted in the Introduction to this document,

This practice note is intended to assist actuaries by describing practices that COPLFR believes are commonly employed in issuing SAOs and AOSs on loss and loss adjustment expense (LAE) reserves in compliance with the Property and Casualty Annual Statement Instructions (Annual Statement Instructions) for 2023 issued by the NAIC. Actuaries may also find this information useful in preparing statements of actuarial opinion for other audiences or regulators.

While P&C actuaries may also find the information contained in this practice note useful in preparing statements of actuarial opinion for other audiences or regulators (other than in accordance with the NAIC SAO Instructions), there are other resources available. Generally, actuaries will look to the regulatory authority for specific requirements pertaining to the type of opinion being prepared. These requirements are often found on the website of the regulatory authority. The Academy's [2023 P/C Loss Reserve Law Manual](#) may also provide information on these points. Some examples include:

Type of opinion	Regulatory authority	Website
Bermuda opinion of the Loss Reserve Specialist	Bermuda Monetary Authority	http://www.bma.bm/SitePages/Home.aspx
Cayman captive Statement of Actuarial Opinion	Cayman Islands Monetary Authority	https://www.cima.ky/
Hawaii captive Statement of Actuarial Opinion	State of Hawai'i Insurance Division, Department of Commerce & Consumer Affairs	http://cca.hawaii.gov/captive/
Vermont captive Statement of Actuarial Opinion	Vermont Department of Financial Regulation	https://dfr.vermont.gov/document/vermont-captive-annual-report-vc-ar-general-instructions

The Appointed Actuary may wish to contact the regulatory authority directly to obtain the specific opinion requirements.

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APPENDICES

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I. 2023 NAIC SAO Instructions

This appendix to the practice note provides the 2023 NAIC SAO Instructions with respect to the P&C SAO ([Appendix I.1](#)) and AOS ([Appendix I.2](#)). The NAIC Instructions for Title Insurance SAOs ([Appendix I.3](#)) are also included for informational purposes only. [Appendix 1.4](#) provides the 2023 NAIC Annual Statement Instructions section on Annual Audited Financial Reports, including auditor data testing requirements. No discussion is included.

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I.1 2023 NAIC Property and Casualty SAO Instructions

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ACTUARIAL OPINION

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

Upon initial engagement, the Appointed Actuary must be appointed by the Board of Directors by Dec. 31 of the calendar year for which the opinion is rendered. The Company shall notify the domiciliary commissioner within five business days of the initial appointment with the following information:

- a. Name and title (and, in the case of a consulting actuary, the name of the firm).
- b. Manner of appointment of the Appointed Actuary (e.g., who made the appointment and when).
- c. A statement that the person meets the requirements of a Qualified Actuary (or was approved by the domiciliary commissioner) and that documentation was provided to the Board of Directors.

Once this notification is furnished, no further notice is required with respect to this person unless the Board of Directors takes action to no longer appoint or retain the actuary or the actuary no longer meets the requirements of a Qualified Actuary.

If subject to the *U.S. Qualification Standards*, the Appointed Actuary shall annually attest to having met the continuing education requirements under Section 3 of the *U.S. Qualification Standards* for issuing Actuarial Opinions. As agreed with the actuarial organizations, the Casualty Actuarial Society (CAS) and Society of Actuaries (SOA) will determine the process for receiving the attestations for their respective members and make available the attestations to the public. An Appointed Actuary subject to the *U.S. Qualification Standards* and not a member of the CAS or SOA shall select one of the above organizations to submit their attestation.

The Appointed Actuary shall provide to the Board of Directors qualification documentation on occasion of their appointment, and on an annual basis thereafter, directly or through company management. The documentation should include brief biographical information and a description of how the definition of “Qualified Actuary” is met or expected to be met (in the case of continuing education) for that year. The documentation should describe the Appointed Actuary’s responsible experience relevant to the subject of the Actuarial Opinion. The Board of Directors shall document their review of those materials and any other information they may deem relevant, including information that may be requested directly from the Appointed Actuary. It is generally expected that the review of the Appointed Actuary’s qualification documentation should take place at the level within a holding company structure that is responsible for overseeing insurance operations. If a statutory entity is a subsidiary or a non-lead pool member with an Appointed Actuary whose qualifications were reviewed by the pool lead or principal’s Board, the statutory entity’s Board can satisfy the review requirement by acknowledging the parent Board’s review. This can be done by noting in the meeting minutes the name of the principal or lead entity and the date the parent Board reviewed the qualification documentation, or by attaching a copy of the parent Board’s meeting minutes reflecting their review of the qualification documentation. The qualification documentation shall be considered workpapers and be available for inspection upon regulator request or during a financial examination.

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, scope, procedures, type of opinion issued, substantive wording of the opinion or data quality. The disagreements required to be reported in response to this paragraph include both those resolved to the former Appointed Actuary's satisfaction and those not resolved to the former Appointed Actuary's satisfaction. The letter should include a description of the disagreement and the nature of its resolution (or that it was not resolved). Within this same ten (10) business days, the Insurer shall in writing also request such former Appointed Actuary to furnish a letter addressed to the Insurer stating whether the Appointed Actuary agrees with the statements contained in the Insurer's letter and, if not, stating the reasons for which he or she does not agree. The former Appointed Actuary shall provide a written response to the insurer within ten (10) business days of such request, and the Insurer shall furnish such responsive letter from the former Appointed Actuary to the domiciliary commissioner together with its own responses.

The Appointed Actuary must 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 such information to the Board of Directors and identify the manner of presentation (e.g., webinar, in-person presentation, written). A separate Actuarial Opinion is required for each company filing an Annual Statement. When there is an affiliated company pooling arrangement, one Actuarial Report for the aggregate pool is sufficient, but there must be addendums to the Actuarial Report to cover non-pooled reserves for individual companies.

The Actuarial Opinion and the supporting Actuarial Report and workpapers should be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including, but not limited to, ASOP No. 23, ASOP No. 36, ASOP No. 41 and ASOP No. 43, as promulgated by the Actuarial Standards Board.

1A. Definitions

“Appointed Actuary” is a Qualified Actuary (or individual otherwise approved by the domiciliary commissioner) appointed by the Board of Directors in accordance with Section 1 of these instructions.

“Board of Directors” can include the designated Board of Directors, its equivalent or an appropriate committee directly reporting to the Board of Directors.

“Qualified Actuary” is a person who:

- (i) Meets the basic education, experience and continuing education requirements of the Specific Qualification Standard for Statements of Actuarial Opinion, NAIC Property and Casualty Annual Statement, as set forth in the *Qualification Standards for Actuaries Issuing Statements of Actuarial Opinion in the United States (U.S. Qualifications Standards)*, promulgated by the American Academy of Actuaries (Academy);
- (ii) Has obtained and maintains an Accepted Actuarial Designation; and
- (iii) Is a member of a professional actuarial association that requires adherence to the same *Code of Professional Conduct* promulgated by the Academy, requires adherence to the *U.S. Qualification Standards*, and participates in the Actuarial Board for Counseling and Discipline when its members are practicing in the U.S.

An exception to parts (i) and (ii) of this definition would be an actuary evaluated by the Academy's Casualty Practice Council and determined to be a Qualified Actuary for particular lines of business and business activities.

“Accepted Actuarial Designation” in item (ii) of the definition of a Qualified Actuary, is an actuarial designation accepted as meeting or exceeding the NAIC’s Minimum Property/Casualty (P/C) Actuarial Educational Standards for a P/C Appointed Actuary (published on the NAIC website). The following actuarial designations, with any noted conditions, are accepted as meeting or exceeding basic education minimum standards:

- (i) Fellow of the CAS (FCAS) – Condition: basic education must include Exam 6 – Regulation and Financial Reporting (United States);
- (ii) Associate of the CAS (ACAS) – Conditions: basic education must include Exam 6 – Regulation and Financial Reporting (United States) and Exam 7 – Estimation of Policy Liabilities, Insurance Company Valuation, and Enterprise Risk Management;
- (iii) Fellow of the SOA (FSA) – Conditions: basic education must include completion of the general insurance track, including the following optional exams: the United States’ version of the Financial and Regulatory Environment Exam and the Advanced Topics in General Insurance Exam.

The table below provides some allowable exam substitutions for (i), (ii) and (iii) in the definition of “Accepted Actuarial Designation.” Noting that CAS exams have changed over time, exceptions for (i) and (ii) provide for FCAS/ACAS designations achieved before an exam was created (e.g. CAS Exam 6-US) or with an earlier version of an exam or exam topic (e.g., 2010 CAS Exam 6 instead of the current CAS Exam 7 Section A). FCAS/ACAS qualified under the 2018 and prior Statement of Actuarial Opinion instructions can use the noted substitution rules to achieve qualification under the new instructions by demonstrating basic and/or continuing education of the required topics including material in CAS Exam 6 (US) and section A of CAS Exam 7 (in the May 2019 CAS syllabus). Exceptions for (iii) for an FSA are also included in the table. The SOA exams completed in the general insurance track in 2019 and prior should be supplemented with continuing education and experience to meet basic education requirements in the *U.S. Qualification Standards*. For purpose of these instructions only, the table also includes specific exams from other organizations that are accepted as substitutes.

Exception for (i), (ii), or (iii)	Exam:	Exam Substitution Allowed*
(i) and (ii)	CAS Exam 6 (US)	<ol style="list-style-type: none"> 1. Any CAS version of a U.S. P/C statutory accounting and regulation exam administered prior to creation of the CAS Exam 6 (US) in 2011. 2. An FCAS or ACAS earned prior to 2021 who did not pass CAS Exam 6 (US) or an allowable exam substitution, may substitute experience and/or continuing education for CAS Exam 6 (US) provided the Appointed Actuary explains in his/her qualification documentation how knowledge of U.S. financial reporting and regulation was obtained. 3. SOA FREU (US) Exam
(ii)	CAS Exam 7	<ol style="list-style-type: none"> 1. Any CAS version of an exam including advanced P/C reserving administered prior to creation of Exam 7 in 2011. 2. An ACAS earned prior to 2021 who did not pass CAS Exam 7 or an allowable exam substitution, may substitute experience and/or continuing education for CAS Exam 7 provided the Appointed Actuary explains in his/her qualification documentation how knowledge of the additional reserving topics in CAS Exam 7 (Section A) in the May 2019 syllabus was obtained. 3. SOA Advanced Topics Exam (Note: The ERM portion of Exam 7 is not needed to meet NAIC educational standards, therefore SOA ERM Exam is not needed for the substitution for this purpose.)
(iii)	SOA FREU (US) Exam	<ol style="list-style-type: none"> 1. CAS Exam 6 (US) 2. Any CAS version of a U.S. statutory accounting and regulation exam administered prior to creation of the CAS Exam 6 in 2011.
(iii)	SOA Advanced Topics Exam	<ol style="list-style-type: none"> 1. CAS Exam 7 2. Any CAS version of an exam containing the advanced techniques to estimate policy liabilities (i.e., advanced reserving).
*Note: These exam substitutions only apply to these instructions and are not applicable for CAS or SOA exam waivers.		

“Insurer” or “Company” 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 to the state regulatory authority and the Board of Directors the Appointed 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 Appointed Actuary’s opinion or findings, and of documenting the analysis underlying the opinion. The required content of the Actuarial Report is further described in paragraph 7. (Note that the inclusion of the Board of Directors as part of the intended audience for the Actuarial Report does not change the content of the Actuarial Report as described in paragraph 7. The Appointed Actuary should present findings to the Board of Directors in a manner deemed suitable for such audience.)

“Property and Casualty (P&C) 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 13 months; and (2) the insurer can neither cancel the contract nor increase the premium during the contract term. These contracts are subject to the three tests of *SSAP No. 65—Property and Casualty Contracts* of the *NAIC Accounting Practices and Procedures Manual*.

“Accident and Health (A&H) Long Duration Contracts” refers to A&H contracts in which the contract term is greater than or equal to 13 months and contract reserves are required. See Schedule H instructions for a description of categories of contract reserves, as well as policy features that give rise to contract reserves. Two specific examples of contracts that typically require contract reserves are long-term care and disability income insurance.

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 (1%) 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 (3%) of the insurer's direct plus assumed premiums written during the calendar year for which the exemption is sought as projected from the insurer's latest quarterly statements filed with its domiciliary commissioner.

1C. Reporting Requirements for Pooled Companies

For each company in the pool, the Appointed Actuary shall include a description of the pool, identification of the lead company and a listing of all companies in the pool, their state of domicile and their respective pooling percentages.

Exhibits A and B for each company in the pool should represent the company's share of the pool and should reconcile to the financial statement for that company.

The following paragraph applies to companies that have a 0% share of the pool (no reported Schedule P data). The company shall submit an Actuarial Opinion that reads similar to that provided for the lead company. For example, the IRIS ratio and risk of material adverse deviation discussions, and other relevant comments shall relate to the risks of the lead company in the pool. The Exhibit B responses to question 5 should be \$0 and to question 6 should be "not applicable." Exhibits A and B of the lead company should be attached as an addendum to the PDF file and/or hard copy being filed (but would not be reported by the 0% companies in their data capture).

2. The 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 Appointed 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 indicate the Appointed Actuary's relationship to the Company, qualifications for acting as Appointed Actuary and date of appointment and specify that the appointment was made by the Board of Directors. Additionally, the IDENTIFICATION paragraph should include a statement asserting that the Appointed Actuary has complied with the requirement to provide qualification documentation to the Board of Directors, either directly or through company management.

If the Appointed Actuary was approved by the Academy to be a "Qualified Actuary," with or without limitation, or if the Appointed Actuary is not a Qualified Actuary but was approved by the domiciliary commissioner, the company must attach, each year, the approval letter and reference such in the identification paragraph.

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__, and reviewed information provided to me through XXX date."

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 Disclosure items 8 through 13.2 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 _____ (officer name and title at the 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.
 - C. Make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements.”

If the Scope includes material Unearned Premium Reserves for P&C Long Duration Contracts or Other Loss Reserve items on which the Appointed Actuary is expressing an opinion, the Actuarial Opinion should contain language such as the following:

- D. Make a reasonable provision for the unearned premium reserves for P&C Long Duration Contracts and/or <insert Other Loss Reserve item on which the Appointed Actuary is expressing an Opinion> 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.

If the Appointed Actuary has made use of the analysis of another actuary not within the Appointed Actuary’s control (such as for pools and associations, for a subsidiary or for special lines of business) for a material portion of the reserves, the other actuary must be identified by name, credential and affiliation within the OPINION paragraph. If the Appointed Actuary has made use of the work of a non-actuary (such as for modeling) for a material portion of the reserves, that individual must be identified by name and affiliation and a description of the type of analysis performed must be provided.

A Statement of Actuarial Opinion should be made in accordance with one of the following sections (1 through 5). The Appointed Actuary must explicitly identify in Exhibit B which type applies.

1. Determination of Reasonable Provision. When the carried reserve amount is within the Appointed Actuary’s range of reasonable reserve estimates, the Appointed Actuary should issue a Statement of Actuarial Opinion that the carried reserve amount makes a reasonable provision for the liabilities associated with the specified reserves.
2. Determination of Deficient or Inadequate Provision. When the carried reserve amount is less than the minimum amount that the Appointed Actuary believes is reasonable, the Appointed Actuary should issue a Statement of Actuarial Opinion that the carried reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves. In addition, the Appointed Actuary should disclose the minimum amount that the Appointed Actuary believes is reasonable.
3. Determination of Redundant or Excessive Provision. When the carried reserve amount is greater than the maximum amount that the Appointed Actuary believes is reasonable, the Appointed Actuary should issue a Statement of Actuarial Opinion that the carried reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves. In addition, the Appointed Actuary should disclose the maximum amount that the Appointed Actuary believes is reasonable.

4. Qualified Opinion. When, in the Appointed Actuary's opinion, the reserves for a certain item or items are in question because they cannot be reasonably estimated or the Appointed Actuary is unable to render an opinion on those items, the Appointed Actuary should issue a qualified Statement of Actuarial Opinion. The Appointed Actuary should disclose the item (or items) to which the qualification relates, the reason(s) for the qualification and the amounts for such item(s), if disclosed by the Company. Such a qualified opinion should state whether the carried 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 Appointed Actuary is not required to issue a qualified opinion if the Appointed Actuary reasonably believes that the item (or items) in question are not likely to be material.
5. No Opinion. The Appointed 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 Appointed Actuary cannot reach a conclusion due to deficiencies or limitations in the data, analyses, assumptions, or related information, then the Appointed 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. Company-Specific Risk Factors

The Appointed Actuary should include an explanatory paragraph to describe the major factors, combination of factors or particular conditions underlying the risks and uncertainties the Appointed Actuary considers relevant. 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 Appointed Actuary required to include an exhaustive list of all potential sources of risks and uncertainties.

B. Risk of Material Adverse Deviation

The Appointed Actuary must provide specific RELEVANT COMMENT paragraphs to address the risk of material adverse deviation. The Appointed Actuary must identify the materiality standard and the basis for establishing this standard. The materiality standard must also be disclosed in U.S. dollars in Exhibit B: Disclosures. The Appointed 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. This determination is also to be disclosed in Exhibit B.

C. Other Disclosures in Exhibit B

RELEVANT COMMENT paragraphs should describe the significance of each of the remaining Disclosure items (8 through 14) in Exhibit B. The Appointed Actuary should address the items individually and in combination when commenting on a material impact.

D. Reinsurance

RELEVANT COMMENT paragraphs should address reinsurance collectability, retroactive reinsurance and financial reinsurance.

The Appointed Actuary's comments on reinsurance collectability should address any uncertainty associated with including potentially uncollectable amounts in the estimate of ceded reserves. Before commenting on reinsurance collectability, the Appointed Actuary should solicit information from management on any actual collectability 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 ninety (90) days past due. The comment should also reflect any other information the Appointed Actuary has received from management or that is publicly available about the capability or willingness of reinsurers to pay claims. The Appointed Actuary's comments do not imply an opinion on the financial condition of any reinsurer.

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

Financial reinsurance refers to contracts referenced in SSAP No. 62R 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.

E. IRIS Ratios

If the Company's reserves will create exceptional values under the NAIC IRIS Tests for One-Year Reserve Development to Policyholders' Surplus, Two-Year Reserve Development to Policyholders' Surplus or Estimated Current Reserve Deficiency to Policyholders' Surplus, the Appointed Actuary must include RELEVANT COMMENT on the factors that led to the unusual value(s).

F. Methods and Assumptions

If there has been any significant change in the actuarial assumptions and/or methods from those previously employed, that change should be described in a RELEVANT COMMENT paragraph. If the Appointed Actuary is newly appointed and does not review the work of the prior Appointed Actuary, then the Appointed Actuary should disclose this.

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 (7) years. The Actuarial Report contains significant proprietary information. It is expected that the Actuarial Report be held confidential and not be intended for public inspection. The Actuarial Report must be available by May 1 of the year following the year-end for which the Actuarial Opinion was rendered or within two (2) weeks after a request from an individual state commissioner.

The Actuarial Report should be consistent with the documentation and disclosure requirements of ASOP No. 41, Actuarial Communications. The Actuarial Report must contain both narrative and technical components. The narrative component should provide sufficient detail to clearly explain to Company management, the Board of Directors, 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.

Actuarial Guideline LI—The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves (AG 51) in the *NAIC Accounting Practices and Procedures Manual* requires a company with over 10,000 in force lives covered by long-term care (LTC) insurance contracts as of the valuation date to perform a stand-alone asset adequacy analysis for its in force long-term care (LTC) contracts. The Actuarial Report and workpapers summarizing the results, assumptions and testing procedures for the asset adequacy testing of LTC business must be in compliance with AG 51 requirements. When referring to AG 51, the term "Actuarial Memorandum" is synonymous with Actuarial Report and workpapers.

The Actuarial Report should contain disclosure of all reserve amounts associated with A&H Long Duration Contracts reported by the Company; the reserve amounts in the Actuarial Report should tie to the Annual Statement.

The Actuarial Report must also include:

- A. A description of the Appointed Actuary's relationship to the Company, with clear presentation of the Appointed Actuary's role in advising the Board of Directors and/or management regarding the carried reserves. The Actuarial Report should identify how and when the Appointed Actuary presents the analysis to the Board of Directors and, where applicable, to the officer(s) of the Company responsible for determining the carried reserves.
 - B. An exhibit that ties to the Annual Statement and compares the Appointed Actuary's conclusions to the carried amounts consistent with the segmentation of exposure or liability groupings used in the analysis. The Appointed Actuary's conclusions include the Appointed Actuary's point estimate(s), range(s) of reasonable estimates or both.
 - C. An exhibit that reconciles and maps the data used by the Appointed Actuary, consistent with the segmentation of exposure or liability groupings used in the Appointed Actuary's analysis, to the Annual Statement Schedule P line of business reporting. An explanation should be provided for any material differences.
 - D. An exhibit or appendix showing the change in the Appointed Actuary's estimates from the prior Actuarial Report, including extended discussion of factors underlying any material changes. The exhibit or appendix should illustrate the changes on a net basis but should also include the changes on a gross basis, if relevant. If the Appointed Actuary is newly appointed and does not review the work of the prior Appointed Actuary, then the Appointed Actuary should disclose this.
 - E. Extended comments on trends that indicate the presence or absence of risks and uncertainties that could result in material adverse deviation.
 - F. Extended comments on factors that led to unusual IRIS ratios for One-Year Reserve Development to Policyholders' Surplus, Two-Year Reserve Development to Policyholders' Surplus or Estimated Current Reserve Deficiency to Policyholders' Surplus, and how these factors were addressed in prior and current analyses.
8. The Actuarial Opinion should conclude with the signature of the Appointed Actuary responsible for providing the Actuarial Opinion and the date when the Actuarial Opinion was rendered. The signature and date should appear in the following format:

Signature of Appointed Actuary
Printed name of Appointed Actuary
Employer's name
Address of Appointed Actuary
Telephone number of Appointed Actuary
Email address of Appointed Actuary
Date opinion was rendered

The same information should be reproduced within the Actuarial Report, along with the date the Actuarial Report was finalized.

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 Actuarial 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 Actuarial Opinion shall be considered to be in error if the Actuarial Opinion would have not been issued or would have been materially altered had the correct data or other information been used. The Actuarial 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 is required when discovery is made between the issuance of the Actuarial Opinion and Dec. 31 of that year. Notification should include a summary of such findings.

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 Appointed Actuary and the Company should quickly undertake procedures necessary for the Appointed Actuary to make such determination. If the Insurer does not provide the necessary data corrections and other support (including financial support) within ten (10) business days, the Appointed Actuary should proceed with the notification to the Board of Directors and the domiciliary commissioner.

An Insurer who is notified pursuant to the preceding paragraphs shall forward a copy of the amended Actuarial 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 letter and amended Actuarial Opinion submitted 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 an amended Actuarial Opinion has been finalized.

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

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

Exhibit A: SCOPE
DATA TO BE FILED IN BOTH PRINT AND DATA CAPTURE FORMATS

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

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

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

1. Name of the Appointed Actuary Last _____ First _____ Mid _____
2. The Appointed Actuary's relationship to the Company
 Enter E or C based upon the following:
 E if an Employee of the Company or Group
 C if a Consultant _____
3. The Appointed Actuary's Accepted Actuarial Designation (indicated by the letter code):
 F if a Fellow of the Casualty Actuarial Society (FCAS)
 A if an Associate of the Casualty Actuarial Society (ACAS)
 S if a Fellow of the Society of Actuaries (FSA) through the General Insurance track
 M if the actuary does not have an Accepted Actuarial Designation but is approved by the Academy's Casualty Practice Council.
 O for Other _____
4. Type of Opinion, as identified in the OPINION paragraph. Enter R, I, E, Q, or N based upon the following:
 R if Reasonable
 I if Inadequate or Deficient Provision
 E if Excessive or Redundant Provision
 Q if Qualified. Use Q when part of the OPINION is Qualified.
 N if No Opinion _____
5. Materiality Standard expressed in U.S. dollars (used to Answer Question #6) \$ _____
6. Are there significant risks that could result in Material Adverse Deviation? Yes [] No [] Not Applicable []
7. Statutory Surplus (Liabilities, Surplus and Other Funds page, Col 1, Line 37) \$ _____
8. Anticipated net salvage and subrogation included as a reduction to loss reserves as reported in Schedule P (should equal Part 1 Summary, Col 23, Line 12 * 1000) \$ _____
9. Discount included as a reduction to loss reserves and loss adjustment expense reserves as reported in Schedule P
 - 9.1 Nontabular Discount [Notes, Line 32B23, (Amounts 1, 2, 3 & 4)], Electronic Filing Cols 1, 2, 3, & 4 \$ _____
 - 9.2 Tabular Discount [Notes, Line 32A23, (Amounts 1 & 2)], Electronic Filing Col 1 & 2 \$ _____
10. The net reserves for losses and loss adjustment expenses for the Company's share of voluntary and involuntary underwriting pools' and associations' unpaid losses and loss adjustment expenses that are included in reserves shown on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines \$ _____

- 11. The net reserves for losses and loss adjustment expenses that the Company carries for the following liabilities included on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines *
 - 11.1 Asbestos, as disclosed in the Notes to Financial Statements (Notes, Line 33A03D, ending net asbestos reserves for current year) Electronic Filing Col 5 \$ _____
 - 11.2 Environmental, as disclosed in the Notes to Financial Statements (Notes, Line 33D03D, ending net environmental reserves for current year), Electronic Filing Col 5 \$ _____
- 12. The total claims made extended loss and loss adjustment expense, and unearned premium reserves (Greater than or equal to Schedule P Interrogatories)
 - 12.1 Amount reported as loss and loss adjustment expense reserves \$ _____
 - 12.2 Amount reported as unearned premium reserves \$ _____
- 13. The net reserves for the A&H Long Duration Contracts that the Company carries on the following lines on the Liabilities, Surplus and Other Funds page:
 - 13.1 Losses \$ _____
 - 13.2 Loss Adjustment Expenses \$ _____
 - 13.3 Unearned Premium \$ _____
 - 13.4 Write-In (list separately, adding additional lines as needed, and identify (e.g., “Premium Deficiency Reserves”, “Contract Reserves other than Premium Deficiency Reserves” or “AG 51 Reserves”)) \$ _____
- 14. Other items on which the Appointed Actuary is providing relevant comment (list separately, adding additional lines as needed) \$ _____

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

**Property and Casualty Practice Note
2023**

I.2 2023 NAIC Property and Casualty AOS Instructions

ACTUARIAL OPINION SUMMARY SUPPLEMENT

1. For all Companies that are required by their domiciliary state to submit a confidential document entitled Actuarial Opinion Summary (AOS), such document shall be filed with the domiciliary state by March 15 (or by a later date otherwise specified by the domiciliary state). This AOS shall be submitted to a non-domiciliary state within 15 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 it is able to preserve the confidentiality of the document.
2. The AOS should be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including but not limited to ASOP No. 23, ASOP No. 41 and ASOP No. 43, as promulgated by the Actuarial Standards Board.
3. Exemptions for filing the AOS are the same as those for filing the Statement of Actuarial Opinion.
4. The AOS contains significant proprietary information. It is expected that the AOS be held confidential; it is not intended for public inspection. The AOS should not be filed with the NAIC and should be kept separate from any copy of the Statement of Actuarial Opinion (Actuarial Opinion) in order to maintain confidentiality of the AOS. The AOS can contain a statement that refers to the Actuarial Opinion and the date of that opinion.
5. The AOS should be signed and dated by the Appointed Actuary who signed the Actuarial Opinion and shall 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, when calculated;
 - B. The Appointed Actuary's point estimates for loss and loss adjustment expense reserves, net and gross of reinsurance, when calculated;
 - C. The Company's carried loss and loss adjustment expense reserves, net and gross of reinsurance;
 - D. The difference between the Company's carried reserves and the Appointed Actuary's estimates calculated in A and B, net and gross of reinsurance; and
 - E. Where there has been one-year adverse development in excess of 5% of the prior year-end's policyholders' surplus as measured by Schedule P, Part 2 Summary in three (3) or more of the past five (5) calendar years, an explicit description of the reserve elements or management decisions that were the major contributors.
6. The AOS for a pooled Company (as referenced in paragraph 1C of the instructions for the Actuarial Opinion) shall include a statement that the Company is a xx% pool participant. For a non-0% Company, the information provided for paragraph 5 should be numbers after the Company's share of the pool has been applied; specifically, the point or range comparison should be for each statutory Company and should not be for the pool in total. For any 0% pool participant, the information provided for paragraph 5 should be that of the lead company.
7. The net and gross reserve values reported by the Appointed Actuary in the AOS should reconcile to the corresponding values reported in the Insurer's Annual Statement, the Appointed Actuary's Actuarial Opinion and the Actuarial Report. If not, the Appointed Actuary shall provide an explanation of the difference.

8. The Insurer required to furnish an AOS shall require its Appointed Actuary to notify its Board of Directors in writing within five (5) business days after any determination by the Appointed Actuary that the AOS 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 AOS shall be considered to be in error if the AOS would have not been issued or would have been materially altered had the correct data or other information been used. The AOS 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 when discovery is made between the issuance of the AOS and Dec. 31 of that year. Notification should include a summary of such findings.

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 AOS, the Appointed Actuary and the Company should quickly undertake procedures necessary for the Appointed Actuary to make such determination. If the Insurer does not provide the necessary data corrections and other support (including financial support) within ten (10) business days, the Appointed Actuary should proceed with the notification to the Board of Directors and the domiciliary commissioner.

An Insurer who is notified pursuant to the preceding paragraphs shall forward a copy of the amended AOS 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 letter and amended AOS submitted 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 an amended AOS has been finalized.

9. 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.

**Property and Casualty Practice Note
2023**

I.3 2023 NAIC Title SAO Instructions

ACTUARIAL OPINION

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

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

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

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

If an actuary who was the Appointed Actuary for the immediately preceding filed Actuarial Opinion is replaced by an action of the Board of Directors, the Insurer shall within five (5) business days notify the Insurance Department of the state of domicile of this event. The Insurer shall also furnish the domiciliary commissioner with a separate letter within ten (10) business days of the above notification stating whether in the twenty-four (24) months preceding such event there were any disagreements with the former Appointed Actuary regarding the content of the opinion on matters of the risk of material adverse deviation, required disclosures, scope, procedures, type of opinion issued, substantive wording of the opinion 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 letter should include a description of the disagreements and the nature of its resolution (or that it was not resolved). The Insurer shall also request in writing such former actuary to furnish a letter addressed to the Insurer stating whether the actuary agrees with the statements contained in Insurer’s letter and, if not, stating the reasons for which he or she does not agree; and the Insurer shall furnish such responsive letter from the former actuary to the domiciliary commissioner together with its own.

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

The Actuarial Opinion and the supporting Actuarial Report and workpapers, should be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including but not limited to ASOP No. 23, ASOP No. 36, ASOP No. 41 and ASOP No. 43, as promulgated by the Actuarial Standards Board.

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” or “Company” means a reporting entity authorized to write title insurance under the laws of any state and who files on the Title Blank.

“Actuarial Report” means a document or other presentation, prepared as a formal means of conveying to the state regulatory authority and the Board of Directors, or its equivalent, 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 of documenting the analysis underlying the opinion. The expected content of the Actuarial Report is further described in paragraph 7. (Note that the inclusion of the Board of Directors as part of the intended audience for the Actuarial Report does not change the content of the Actuarial Report as described in paragraph 7. The Appointed Actuary should present findings to the Board of Directors in a manner deemed suitable for such audience.)

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 the exemption is deemed inappropriate.

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

Exemption for Small Companies

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

Exemption for Insurers under Supervision or Conservatorship

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

Exemption for Nature of Business

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

Financial Hardship Exemption

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

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

- (i) One percent (1%) 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 (3%) 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 indicate the Appointed Actuary's relationship to the Company, qualifications for acting as Appointed Actuary, and date of appointment, and specify that the appointment was made by the Board of Directors (or its equivalent) or by a committee of the Board.

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

These instructions require that a Qualified Actuary prepare the Actuarial Opinion. If a person who does not meet the definition of a Qualified Actuary has been approved by the insurance regulatory official of the domiciliary state, the Company must attach, each year, a letter from that official stating that the individual meets the state's requirements for rendering the Actuarial 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__, and reviewed information provided to me through XXX date."

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

The Appointed Actuary should state that the items in the SCOPE paragraph, on which he or she is expressing an opinion, reflect the Disclosure items (8 through 14) in Exhibit B.

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

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

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

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

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

If the actuary has made use of the work of another actuary (such as for pools and associations, for a subsidiary or for special lines of business) for a material portion of the reserves, 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 through e). The actuary must explicitly identify in Exhibit B which type applies.

- a. Determination of Reasonable Provision. When the carried reserve amount is within the actuary’s range of reasonable reserve estimates, the actuary should issue a Statement of Actuarial Opinion that the carried reserve amount makes a reasonable provision for the liabilities associated with the specified reserves.
- b. Determination of Deficient or Inadequate Provision. When the carried 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 carried reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves. In addition, the actuary should disclose the minimum amount that the actuary believes is reasonable.
- c. Determination of Redundant or Excessive Provision. When the carried 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 carried reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves. In addition, the actuary should disclose the maximum amount that the actuary believes is reasonable.
- 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. The actuary should disclose the item (or items) to which the qualification relates, the reasons for the qualification, and the amounts for such item(s), if disclosed by the Company. Such a qualified opinion should state whether the stated reserve amount makes a reasonable provision for the liabilities associated with the specified reserves, *except for* the item (or items) to which the qualification relates. The actuary is not required to issue a qualified opinion if the actuary reasonably believes that the item (or items) in question are not likely to be material.
- e. No Opinion. The actuary’s ability to give an opinion is dependent upon data, analyses, assumptions, and related information that are sufficient to support a conclusion. If the actuary cannot reach a conclusion due to deficiencies or limitations in the data, analyses, assumptions, or related information, then the actuary may issue a statement of no opinion. A statement of no opinion should include a description of the reasons why no opinion could be given.

6. The Appointed Actuary must provide RELEVANT COMMENT paragraphs to address the following topics of regulatory importance.
- a. Risk of Material Adverse Deviation.

The Appointed Actuary must provide specific RELEVANT COMMENT paragraphs to address the risk of material adverse deviation. The Appointed Actuary must identify the materiality standard and the basis for establishing this standard with respect to the relevant characteristics of the Company. The materiality standard must also be disclosed in U.S. dollars in Exhibit B: Disclosures. The Appointed Actuary should include an explanatory paragraph to describe the major factors, combination of factors or particular conditions underlying the risks and uncertainties the actuary considers relevant. 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 Appointed Actuary required to include an exhaustive list of all potential sources of risks and uncertainties. The Appointed 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. This determination is also to be disclosed in Exhibit B.

- b. Other Disclosures in Exhibit B

RELEVANT COMMENT paragraphs should describe the significance of each of the remaining Disclosure items (8 through 14) in Exhibit B. The Appointed Actuary should address the items individually and in combination when commenting on a material impact.

If the Company's reserves will cause the ratio of One-Year or Two-Year Known Claims Reserve Development (shown in Schedule P, Part 3) to the respective prior year's Policyholders' Surplus to be greater than 20%, the Appointed Actuary must include RELEVANT COMMENT on the factors that led to the exceptional reserve development.

- c. Reinsurance

RELEVANT COMMENT paragraphs should address reinsurance collectability, retroactive reinsurance and financial reinsurance .

The Appointed Actuary's comments on reinsurance collectability should address any uncertainty associated with including potentially-uncollectable amounts in the estimate of ceded reserves. Before commenting on reinsurance collectability, the Appointed Actuary should solicit information from management on any actual collectability 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 ninety (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 Appointed Actuary's comments do not imply an opinion on the financial condition of any reinsurer.

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

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

- d. Reserve Development

If the Company's reserves will cause the ratio of One-Year or Two-Year Reserve Development (shown in Schedule P, Part 2) to the respective prior year's Policyholders' Surplus to be greater than 20%, the Appointed actuary must include RELEVANT COMMENT on the factors that led to the exceptional reserve development.

e. Methods and Assumptions

If there has been any significant change in the actuarial assumptions and/or methods from those previously employed, that change should be described in a RELEVANT COMMENT paragraph. If the Appointed Actuary is newly-appointed and does not review the work of the prior Appointed Actuary, then the Appointed Actuary should disclose this.

7. The Actuarial Opinion must include assurance that an Actuarial Report and underlying actuarial workpapers supporting the Actuarial Opinion will be maintained at the Company and available for examination for seven years. The Actuarial Report contains significant proprietary information. It is expected that the Actuarial Report be held confidential and not be intended for public inspection. The Actuarial Report must be available by May 1 of the year following the year-end for which the Opinion was rendered or within two (2) weeks after a request from an individual state commissioner.

The Actuarial Report should be consistent with the documentation and disclosure requirements of ASOP No. 41, Actuarial Communications. The Actuarial Report must contain both narrative and technical components. The narrative component should provide sufficient detail to clearly explain to company management, the Board of Directors, 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 Actuarial Report must also include:

- A description of the Appointed Actuary's relationship to the Company, with clear presentation of the Appointed Actuary's role in advising the Board and/or management regarding the carried reserves. The Actuarial Report should identify how and when the Appointed Actuary presents the analysis to the Board and, where applicable, to the officer(s) of the Company responsible for determining the carried reserves.
- An exhibit that ties to the Annual Statement and compares the Appointed Actuary's conclusions to the carried amounts consistent with the segmentation of exposure or liability groupings used in the analysis. The Appointed Actuary's conclusions include the Appointed Actuary's point estimate(s), range(s) of reasonable estimates or both.
- An exhibit that reconciles and maps the data used by the Appointed Actuary, consistent with the segmentation of exposure or liability groupings used in the Appointed Actuary's analysis, to the Annual Statement Schedule P.
- An exhibit or appendix showing the change in the Appointed Actuary's estimates from the prior Actuarial Report, including extended discussion of factors underlying any material changes. If the Appointed Actuary is newly-appointed and does not review the work of the prior Appointed Actuary, then the Appointed Actuary should disclose this.
- Extended comments on trends that indicate the presence or absence of risks and uncertainties that could result in material adverse deviation.
- Extended comments on factors that led to exceptional reserve development, as defined in 6C and 6D, and how these factors were addressed in prior and current analyses.

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

Signature of Appointed Actuary
Printed name of Appointed actuary
Employer's name
Address of Appointed Actuary
Telephone number of Appointed Actuary
Email address of Appointed 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 Actuarial Opinion and the balance sheet date for which the next Actuarial Opinion will be issued. The notification should include a summary of such findings and an amended Actuarial Opinion.

An Insurer who is notified pursuant to the preceding paragraphs shall forward a copy of the summary and the amended Actuarial 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 Actuarial 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 Actuarial 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 Appointed Actuary to make the determination discussed above. If the Insurer does not provide the necessary data corrections and other support (including financial support) within ten (10) business days, the actuary should proceed with the notification discussed above.

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

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

STATEMENT OF ACTUARIAL OPINION

Exhibit A: SCOPE

DATA TO BE FILED IN BOTH PRINT AND DATA CAPTURE FORMAT

LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES:	<u>Amount</u>
1. Unpaid Losses and Loss Adjustment Expenses (Schedule P, Part 1, Total Column 24 or 34 if discounting is allowable under state law)	\$ _____
2. Unpaid Losses and Loss Adjustment Expenses - Direct and Assumed (Should equal Schedule P, Part 1, Summary, Totals from Columns 17, 18, 20, 21, and 23, Line 12 x 1000)	\$ _____
3. Other items on which the Appointed Actuary is expressing an Opinion (list separately, adding additional lines as needed)	\$ _____

Exhibit B: DISCLOSURES

DATA TO BE FILED IN BOTH PRINT AND DATA CAPTURE FORMAT

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

	Last	First	Middle
1. Name of the Appointed Actuary	_____	_____	_____
2. The Appointed Actuary's relationship to the Company. Enter E or C based upon the following: E - If an Employee of the Company or Group C - If a Consultant			_____
3. The Appointed Actuary has the following designation (indicated by the letter code): F - If a Fellow of the Casualty Actuarial Society (FCAS) A - If an Associate of the Casualty Actuarial Society (ACAS) M - If not a member of the Casualty Actuarial Society, but a Member of the American Academy of Actuaries (MAAA) approved by the Casualty Practice Council, as documented with the attached approval letter. O - For Other			_____

4. Type of Opinion, as identified in the OPINION paragraph.
Enter R, I, E, Q, or N based upon the following:

R - If Reasonable

I - If Inadequate or Deficient Provision

E - If Excessive or Redundant Provision

Q - If Qualified (use Q when part of the OPINION is
Qualified)

N - If No Opinion

5. Materiality Standard expressed in U.S. dollars (used to
answer question #6)

\$ _____

6. Are there significant risks that could result in Material
Adverse Deviation?

7. Statutory Surplus (Liabilities, Surplus, and Other Funds Page,
Line 32)

\$ _____

8. Known claims reserve (Liabilities, Surplus, and Other Funds
Page, Line 1)

\$ _____

9. Statutory premium reserve (Liabilities, Surplus, and Other Funds
Page, Line 2)

\$ _____

10. Aggregate of other reserves required by law (Liabilities,
Surplus, and Other Funds Page, Line 3)

\$ _____

11. Supplemental reserve (Liabilities, Surplus, and Other Funds
Page, Line 4)

\$ _____

12. Anticipated net salvage and subrogation included as a
reduction to loss reserves as reported in Schedule P

\$ _____

13. Discount included as a reduction to loss reserves and loss
adjustment expense reserves as reported in Schedule P

\$ _____

14. Other items on which the Appointed Actuary is providing
relevant comment (list separately, adding additional lines as
needed)

\$ _____

Property and Casualty Practice Note

2023

I.4 2023 NAIC Annual Statement Instructions – Excerpt Regarding Auditor Data Testing

ANNUAL AUDITED FINANCIAL REPORTS

All states have a statute or regulation that requires an annual audit of their insurance companies by an independent certified public accountant based on the NAIC *Annual Financial Reporting Model Regulation (#205)*. For guidance regarding this model, see Appendix G of the NAIC *Accounting Practices and Procedures Manual*.

The reporting entity shall require the independent certified public accountant to subject the current Schedule P – Part 1 (excluding those amounts related to bulk and IBNR reserves and claim counts) to the auditing procedures applied in the audit of the current statutory financial statements to determine whether Schedule P – Part 1 is fairly stated in all material respects in relation to the basic statutory financial statements taken as a whole. It is expected that the auditing procedures applied by the independent CPA to the claim loss and loss adjustment expense data from which Schedule P – Part 1 is prepared would be applied to activity that occurred in the current calendar year (e.g., tests of payments on claims for all accident years that were paid during the current calendar year). [Refer to American Institute of Certified Public Accountants Statement of Position 92-8.]

The reporting entity shall also require the independent certified public accountant to 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 statement 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).

**Property and Casualty Practice Note
2023**

II. 2023 AOWG Regulatory Guidance

Adopted by the Actuarial Opinion (C) Working Group: Sept. 27, 2023

REGULATORY GUIDANCE on Property and Casualty Statutory Statements of Actuarial Opinion, Actuarial Opinion Summaries, and Actuarial Reports for the Year 2023

Prepared by the NAIC Actuarial Opinion (C) Working Group
of the Casualty Actuarial and Statistical (C) Task Force

The NAIC Actuarial Opinion (C) Working Group of the Casualty Actuarial and Statistical (C) Task Force believes that the Statement of Actuarial Opinion (SAO), Actuarial Opinion Summary (AOS), and Actuarial Report are valuable tools in serving the regulatory mission of protecting consumers. This regulatory guidance document supplements the NAIC *Annual Statement Instructions—Property/Casualty* (Instructions) to provide clarity and timely guidance to companies and Appointed Actuaries with regulatory expectations on the SAO, AOS, and Actuarial Report.

An Appointed Actuary has a responsibility to know and understand both the Instructions and the expectations of state insurance regulators. One expectation of regulators clearly presented in the Instructions is that the SAO, AOS, and supporting Actuarial Report and work papers be consistent with relevant Actuarial Standards of Practice (ASOPs). Although it is the responsibility of the Appointed Actuary to identify the applicable ASOPs, the Appointed Actuary may find it useful to review the Applicability Guidelines for Actuarial Standards of Practice published by the Actuarial Standards Board (ASB).

Changes to the 2021 and 2022 Instructions were minor. The Working Group did not propose any significant changes to the 2023 Instructions.

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I. General Comments

A. Reconciliation Between Documents

If there are any differences between the values reported in the Statement of Actuarial Opinion (SAO), Actuarial Opinion Summary (AOS), Actuarial Report, and annual statement, the Actuarial Opinion (C) Working Group expects Appointed Actuaries to include an explanation for these differences in the appropriate document; i.e., the SAO, AOS, or Actuarial Report. The use of a robust peer review process by the Appointed Actuary should reduce reporting errors and non-reconciling items.

One situation in which a legitimate difference might arise is in the case of non-tabular discounting; i.e., the direct and assumed loss reserves on line three of the SAO's Exhibit A come from Schedule P, Part 1, which is gross of non-tabular discounting, while the Actuarial Report and AOS might present the direct and assumed loss reserves on a net of discounting basis.

B. Role of Illustrative Language in the Instructions

While the *Annual Statement Instructions—Property/Casualty* (Instructions) provide some illustrative language, the Working Group encourages Appointed Actuaries to use whatever language they believe is appropriate to clearly convey their opinion and the basis for that opinion. In forming their opinion, Appointed Actuaries should consider company-specific characteristics (e.g., intercompany pooling arrangements; recent mergers or acquisitions; and significant changes in operations, product mix, or reinsurance arrangements).

C. Qualification Documentation

Starting with the 2019 Instructions, the Appointed Actuary is required to provide qualification documentation to the Board of Directors upon initial appointment and annually thereafter. The Working Group is considering an amendment to this requirement starting with year-end 2024 opinions, which would only require the Appointed Actuary to provide qualification documentation to the Board upon initial appointment and eliminate the requirement to provide the documentation annually thereafter.

The documentation provided to the Board of Directors must be available to the state insurance regulator upon request and during a financial examination. Guidance on qualification documentation is in Section IV of this document.

D. Replacement of an Appointed Actuary

The Instructions require two letters when the Board of Directors replaces an Appointed Actuary: 1) one addressed from the insurer to the domiciliary commissioner; and 2) one addressed from the former Appointed Actuary to the insurer. The insurer must provide both letters to the domiciliary commissioner.

The detailed steps are as follows:

1. Within five business days, the insurer shall notify its domiciliary commissioner that the former Appointed Actuary has been replaced.
2. Within 10 business days of the notification in step 1, the insurer shall provide the domiciliary commissioner with a letter stating whether there were disagreements with the former Appointed Actuary in the 24 months preceding the replacement. The Instructions describe the types of disagreements required to be reported in the letter.
3. Within the same 10 business days referred to in step 2, the insurer shall request in writing that the former Appointed Actuary provide a letter addressed to the insurer stating whether the former Appointed Actuary agrees with the statements contained in the insurer's letter referenced in step 2.
4. Within 10 business days of the request from the insurer described in step 3, the former Appointed Actuary shall provide a written response to the insurer.
5. The insurer shall provide the letter described in step 2 and the response from the former Appointed Actuary described in step 4 to the domiciliary commissioner.

Regarding the disagreements referenced in step 2, state insurance regulators understand that there may be disagreements between the Appointed Actuary and the insurer during the course of the Appointed Actuary's analysis that are resolved by the time the Appointed Actuary concludes the analysis. For instance, the Appointed Actuary's analysis may go through several iterations, and an insurer's comments on the Appointed Actuary's draft Actuarial Report may prompt the Appointed Actuary to make changes to the report. While state insurance regulators are interested in material disagreements regarding differences between the former Appointed Actuary's final estimates and the insurer's carried reserves, they do not expect notification on routine discussions that occur during the course of the Appointed Actuary's work.

E. Reporting to the Board of Directors

The Appointed Actuary is required to report to the insurer's Board every year, and the Instructions were amended in 2016 to require that the Board's minutes specify the manner in which the Appointed Actuary presents the required information. This may be done in a form of the Appointed Actuary's choosing, including, but not limited to, an executive summary or PowerPoint presentation. The Working Group strongly encourages the Appointed Actuary to present his or her analysis in person so the risks and uncertainties that underlie the exposures and the significance of the Appointed Actuary's findings can be adequately conveyed and discussed. Regardless of how the Appointed Actuary presents his or her conclusions, the Actuarial Report must be made available to the Board.

Management is limited to reporting single values on lines 1 and 3 of the Liabilities, Surplus, and Other Funds page of the balance sheet. However, actuarial estimates are uncertain by nature, and point estimates do not convey the variability in the projections. Therefore, the Board of Directors should be made aware of the Appointed Actuary's opinion regarding the risk of material adverse deviation, the sources of risk, and what amount of adverse deviation the Appointed Actuary judges to be material.

F. Requirements for Pooled Companies

Effective with the 2014 Instructions, requirements for companies that participate in intercompany pools are as follows:

For all intercompany pooling members:

- Text of the SAO should include the following:
 - Description of the pool.
 - Identification of the lead company.
 - A listing of all companies in the pool, their state of domicile, and their respective pooling percentages.
- Exhibits A and B should represent the company's share of the pool and reconcile to the financial statement for that company.

For intercompany pooling members with a 0% share of the pooled reserves:

- Text of the SAO should be similar to that of the lead company.
- Exhibits A and B should reflect the 0% company's value.
 - Response to Exhibit B, Item 5 (materiality standard) should be \$0.
 - Response to Exhibit B, Item 6 (risk of material adverse deviation) should be "not applicable."
- Exhibits A and B of the lead company should be filed with the 0% company's SAO.
- Information presented in the AOS should be that of the lead company.

Note the distinction between pooling with a 100% lead company with no retrocession and ceding 100% via a quota share reinsurance agreement. The state insurance regulator must approve these affiliate agreements as either an intercompany pooling arrangement or a quota share reinsurance agreement. The proper financial reporting is dependent on the approved filings, regardless of how company management regards its operating platform.

For intercompany pooling members with a greater than 0% share of the pooled reserves, state insurance regulators encourage the Appointed Actuary to display values in the AOS on a pooled (or consolidated) basis in addition to the statutory entity basis. This can be accomplished by displaying two tables of information.

G. Explanation of Adverse Development

1. Comments on Unusual Insurance Regulatory Information System Ratios in the Statement of Actuarial Opinion

The Appointed Actuary is required to provide comments in the SAO on factors that led to unusual values for Insurance Regulatory Information System (IRIS) ratios 11, 12, or 13. The Working Group considers it insufficient to attribute unusual reserve development to “reserve strengthening” or “adverse development,” and it expects the Appointed Actuary to provide insight into the company-specific factors that caused the unusual value. Detailed documentation should be included in the Actuarial Report to support statements provided in the SAO.

2. Comments on Persistent Adverse Development in the Actuarial Opinion Summary

The Appointed Actuary is required to comment on persistent adverse development in the AOS. Comments can reflect common questions state insurance regulators have, such as:

- Is development concentrated in one or two exposure segments, or is it broad across all segments?
- How does development in the carried reserve compare to the change in the Appointed Actuary’s estimate?
- Is development related to specific and identifiable situations that are unique to the company?
- Does the development or the reasons for development differ depending on the individual calendar or accident years?

H. Revisions

The Instructions contain a detailed definition of what it means for the SAO or AOS to be “in error,” along with a description of steps the company and Appointed Actuary should take in that situation.

Even if the SAO or AOS does not meet the Instructions’ specific definition of “in error,” submitting a revised SAO or AOS might be appropriate or recommended in other situations. It would be prudent for the company to contact the state insurance regulator if mistakes or problems are discovered but do not meet the specific definition of “in error.”

A revised SAO or AOS should clearly state that it is an amended document, and it should contain or accompany an explanation for the revision and include the date of revision.

II. Comments on the Statement of Actuarial Opinion and Actuarial Report

A. Review Date

The illustrative language for the Scope paragraph includes “... and reviewed information provided to me through XXX date.” This is intended to capture the Actuarial Standard of Practice (ASOP) No. 36, *Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves*, requirement to disclose the date through which material information known to the Appointed Actuary is included in forming the reserve opinion—i.e., the review date—if it differs from the date the Actuarial Opinion is signed. When the Appointed Actuary is silent regarding the review date, this can indicate either that the review date is the same as the date the SAO is signed or that the Appointed Actuary overlooked this disclosure requirement. When the Appointed Actuary’s review date is the same as the date the SAO is signed, state insurance regulators suggest that the Appointed Actuary clarify this in the SAO by including a phrase such as “... and reviewed information provided to me through the date of this opinion.”

B. Making Use of Another’s Work

If the Appointed Actuary makes use of the work of another not within the Appointed Actuary’s control for a material portion of the reserves, the *Annual Statement Instructions—Property/Casualty* (Instructions) note that the Appointed Actuary must provide the following information in the SAO:

- The person’s name.
- The person’s affiliation.

- The person’s credential(s) if the person is an actuary.
- A description of the type of analysis performed if the person is not an actuary.

Furthermore, Section 4.2.f of ASOP No. 36 says the actuary should disclose whether he or she reviewed the other’s underlying analysis and, if so, the extent of the review. Though this is not mentioned in the ASOP, the Working Group encourages the Appointed Actuary to consider discussing his or her conclusions from the review.

Section 3.7.2 of ASOP No. 36 describes items the actuary should consider when determining whether it is reasonable to make use of the work of another. One of these items is the amount of the reserves covered by the other’s analyses or opinions in comparison to the total reserves subject to the actuary’s opinion. The Working Group encourages the Appointed Actuary to disclose these items in the SAO by providing the dollar amount of the reserves covered by the other’s analyses or opinions and the percentage of the total reserves subject to the Appointed Actuary’s opinion that these other reserves represent.

C. Points A and B of the Opinion Paragraph When Opinion Type is Other Than “Reasonable”

State insurance regulators encourage Appointed Actuaries to think about their responses to point A—meet the requirements of the insurance laws of the state—and point B—computed in accordance with accepted actuarial standards—of the Opinion paragraph when they issue an SAO of a type other than “Reasonable.”

D. Conclusions on a Net Versus a Direct and Assumed Basis

Unless the Appointed Actuary states otherwise, state insurance regulators will assume that the Appointed Actuary’s conclusion on the type of opinion rendered, provided in points C and D of the Opinion paragraph, applies to both the net and the direct and assumed reserves. If the Appointed Actuary reaches different conclusions on the net versus the direct and assumed reserves, the Appointed Actuary should include narrative comments to describe the differences and clearly convey a complete opinion. The response to Exhibit B, Item 4 should reflect the Appointed Actuary’s opinion on the net reserves.

Similarly, the materiality standard in Exhibit B, Item 5 and the Risk of Material Adverse Deviation (RMAD) conclusion in Exhibit B, Item 6 should pertain to the net reserves. If the Appointed Actuary reaches a different conclusion on the risk of material adverse deviation in the net versus the direct and assumed reserves, the Appointed Actuary should include a Relevant Comments paragraph to address the differences. State insurance regulators understand that a net versus a direct and assumed RMAD will have different meanings and, potentially, different materiality standards.

E. Unearned Premium for Property/Casualty Long-Duration Contracts

Exhibit A, Items 7 and 8 require disclosure of the unearned premium reserve for property/casualty (P/C) long-duration contracts. The Instructions require the Appointed Actuary to include a point D in the Opinion paragraph regarding the reasonableness of the unearned premium reserve when these reserves are material.

The Working Group expects that the Appointed Actuary will include documentation in the Actuarial Report to support a conclusion on reasonableness whenever point D is included in the SAO. This documentation may include the three tests of *Statement of Statutory Accounting Principles (SSAP) No. 65—Property and Casualty Contracts* or other methods deemed appropriate by the Appointed Actuary to support his or her conclusion.

State insurance regulators see many SAOs where dollar amounts are included in Exhibit A, Items 7 and 8; some SAOs include a Relevant Comments paragraph discussing these amounts, and some do not. State insurance regulators prefer at a minimum that Appointed Actuaries include some discussion in Relevant Comments on these amounts, including an explicit statement as to whether these amounts are material or immaterial.

F. Other Premium Reserve Items

Regarding “Other Premium Reserve Items” in Exhibit A, Item 9, the Appointed Actuary should include an explanatory paragraph about these premium reserves in Relevant Comments and state whether the amounts are material or immaterial.

If the amounts are material and the Appointed Actuary states that the amounts are reasonable in an Opinion paragraph, state insurance regulators would expect the actuarial documentation to support this conclusion in the Actuarial Report.

Typical items state insurance regulators see listed as other premium reserve items are medical professional liability death, disability, and retirement (DD&R) unearned premium reserves (UPRs) and other liability claims DD&R UPRs. Depending on the nature of these exposures, these items may be also listed on Exhibit B, Line 12.2 as claims made extended UPRs.

G. The Importance of Relevant Comments Paragraphs

The Working Group considers the Relevant Comments paragraphs to be the most valuable information in the SAO. Relevant Comments help the state insurance regulator interpret the SAO and understand the Appointed Actuary's reasoning and judgment. In addition to the required Relevant Comments, the Appointed Actuary should consider providing information on other material items, such as reinsurance with affiliates, mergers or acquisitions, other premium reserves, and catastrophe risk.

H. Risk of Material Adverse Deviation

The Relevant Comments paragraphs on the RMAD are particularly useful to state insurance regulators. The first two RMAD comments below respond to questions that Appointed Actuaries have posed to state insurance regulators. The second two stem from state insurance regulators' reviews of SAOs.

1. No Company-Specific Risk Factors—The Appointed Actuary is asked to discuss company-specific risk factors regardless of the RMAD conclusion. If the Appointed Actuary does not believe there are any company-specific risk factors, the Appointed Actuary should state that.
2. Mitigating Factors—State insurance regulators generally expect Appointed Actuaries to comment on significant company-specific risk factors that exist prior to the company's application of controls or use of mitigation techniques. The company's risk management behaviors may, however, affect the Appointed Actuary's RMAD conclusion.
3. Consideration of Carried Reserves, Materiality Standard, and Reserve Range When Making Risk of Material Adverse Deviation Conclusion—When deciding whether RMAD exists, the Appointed Actuary should consider the materiality standard in relation to the range of reasonable estimates and the carried reserves. For example, RMAD should likely exist when the sum of the materiality standard plus the carried reserves is within the range of reasonable estimates. Regardless, the Appointed Actuary should support the conclusion of whether RMAD exists.
4. Materiality Standards for Intercompany Pool Members—With the exception of intercompany pooling members that retain a 0% share, each statutory entity is required to have a separate SAO with its own materiality standard. Where there are no unusual circumstances to consider, it may be acceptable to determine a standard for the entire pool and assign each member its proportionate share of the total. It is not appropriate to use the entire amount of the materiality threshold for the pool as the standard for each individual pool member.

I. State Insurance Regulators' Use of the Actuarial Report

State insurance regulators should be able to rely on the Actuarial Report as an alternative to developing their own independent estimates. A well-prepared and well-documented Actuarial Report that complies with ASOP No. 41, *Actuarial Communications*, can provide a foundation for efficient reserve evaluation during a statutory financial examination. This expedites the examination process and may provide cost savings for the company.

1. Schedule P Reconciliation

The Working Group acknowledges that myriad circumstances (e.g., mergers, acquisitions, changes in claim systems, and the use of underwriting year data in the analysis) may make it difficult for the Appointed Actuary to reconcile the analysis data to Schedule P. The Working Group encourages Appointed Actuaries to disclose reconciliation issues in the Actuarial Report. If the data cannot be reconciled, the Appointed Actuary should document the reasons.

The Working Group believes:

- A summary reconciliation that combines all years and all lines is an insufficient demonstration of data integrity. A reconciliation should include enough detail to reflect the segmentation of exposures used in the reserve analysis, the accident years of loss activity, and the methods used by the Appointed Actuary. While it is important that the Appointed Actuary is provided with complete and accurate data, reconciling the data **provided** to the Appointed Actuary to Schedule P is not sufficient to demonstrate that the data **used** by the Appointed Actuary reconciles to Schedule P. It is important for the Appointed Actuary to demonstrate that in the process of performing the actuarial analysis, data was neither created nor destroyed. This is commonly accomplished by showing a clear mapping from the Appointed Actuary's analysis exhibits to the actuarial data shown in the Schedule P reconciliation.
- The Appointed Actuary should map the data groupings used in the analysis to Schedule P lines of business and provide detailed reconciliations of the data at the finest level of segmentation that is possible and practical. The Working Group recognizes that the Appointed Actuary chooses the data segmentation for the analysis, and there is often not a direct correspondence between analysis segments and Schedule P lines of business.
- The Appointed Actuary should reconcile all data material to the analysis, including claim counts and earned premium if appropriate. If the Appointed Actuary chooses not to reconcile certain data elements used in the analysis, such as claim counts, a brief explanation should be included in the Actuarial Report to make it clear that these elements were not inadvertently overlooked.
- Schedule P reconciliations are expected to be performed on both a direct and assumed basis and a net of reinsurance basis. If circumstances specific to the company lead the Appointed Actuary to perform the reconciliation on only one basis, the rationale for this decision should be explained in the Actuarial Report. Similarly, while the reconciliation of the loss-related elements, such as defense and cost containment and adjusting and other expenses, is generally expected to be on the same level as used in the analysis underlying the SAO, the Appointed Actuary has the discretion to deviate as long as the rationale is explained in the Actuarial Report.
- The Instructions require that the Appointed Actuary include an explanation for any material differences in the Schedule P Reconciliation. When differences appear in the reconciliation but are viewed as immaterial by the Appointed Actuary, the Appointed Actuary should acknowledge the immateriality of the differences in the Actuarial Report in order to assure state insurance regulators that the Appointed Actuary is aware of the differences and has considered the potential impact of the differences on the analysis underlying the SAO.

The Working Group draws a distinction between two types of data checks:

- The Schedule P reconciliation performed by the Appointed Actuary to show the user of the Actuarial Report that the data significant to the Appointed Actuary's analysis ties to the data in Schedule P.
- Annual testing performed by independent certified public accountants (CPAs) to verify the completeness and accuracy of the data in Schedule P or the analysis data provided by the company to the Appointed Actuary.

One key difference is that independent CPAs generally apply auditing procedures to loss and loss adjustment expense activity that occurred in the current calendar year (e.g., tests of payments on claims for all accident years that were paid during the current calendar year). Projection methodologies used by Appointed Actuaries, on the other hand, often use cumulative loss and loss adjustment expense data, which may render insufficient a testing of activity during the current calendar year alone.

Along similar lines, state insurance regulators encourage Appointed Actuaries to consider whether a reconciliation of incremental payments during the most recent calendar year for all accident/report years combined provides sufficient assurance of the integrity of the data used in the analysis, given that development factors are generally applied to cumulative paid losses by accident/report year.

2. Change in Estimates

The Working Group expects the Appointed Actuary to discuss any significant change in the Appointed Actuary's total estimates from the prior Actuarial Report. However, an explanation should also be included for any significant fluctuations within accident years or segments. When preparing the change-in-estimates exhibits, the Appointed Actuary should choose a level of granularity that provides meaningful comparisons between the prior and current year's results.

3. Narrative

The narrative section of the Actuarial Report should clearly convey the significance of the Appointed Actuary's findings and conclusions, the uncertainty in the estimates, and any differences between the Appointed Actuary's estimates and the carried reserves.

4. Support for Assumptions

Appointed Actuaries should support their assumptions. The use of phrases like "actuarial judgment," either in the narrative comments or in exhibit footnotes, is not sufficient. A descriptive rationale is needed.

The selection of expected loss ratios could often benefit from expanded documentation. When making their selection, Appointed Actuaries should consider incorporating rate changes, frequency and severity trends, and other adjustments needed to on-level the historical information. Historical loss ratio indications have little value if items, such as rate actions, tort reform, schedule rating adjustments, or program revisions, have materially affected premium adequacy.

5. Support for Roll-Forward Analyses

The Working Group recognizes that most of the analysis supporting an SAO may be done with data received prior to year-end and "rolled forward" to year-end. By reviewing the Actuarial Report, the state insurance regulator should be able to clearly identify why the Appointed Actuary made changes in the ultimate loss selections and how those changes were incorporated into the final estimates. A summary of final selections without supporting documentation is not sufficient.

J. Exhibits A and B

1. Data Capture Format

The term "data capture format" in Exhibits A and B of the Instructions refers to an electronic submission of data in a format usable for computer queries. This process allows for the population of an NAIC database that contains qualitative information, and financial data Appointed Actuaries should assist the company in accurately completing the electronic submission.

2. Scope of Exhibit B, Item 12

Exhibit B, Item 12 requests information on extended loss and unearned premium reserves for all P/C lines of business, not just medical professional liability. The Schedule P Interrogatories referenced in the parenthetical only address reserves associated with yet-to-be-issued extended reporting endorsements offered in the case of DD&R of an individual insured under a medical professional liability claims-made policy.

3. Exhibit B, Item 13

The Working Group added disclosure item Exhibit B, Item 13 in 2018. This item requests information on reserves associated with accident and health (A&H) long-duration contracts, defined in the Instructions as "A&H contracts in which the contract term is greater than or equal to 13 months, and contract reserves are required."

This disclosure item was added for several reasons:

- **A desire by state insurance regulators to gain a greater understanding of P/C insurers' exposure to A&H long-duration contracts.**

- This guidance does not specify how P/C insurers should report the liabilities associated with A&H long-duration contracts on the annual statement. Through work performed on financial examinations, state insurance regulators have found that P/C insurers may include the liabilities in various line items of the Liabilities, Surplus and Other Funds page. *SSAP No. 54R—Individual and Group Accident and Health Contracts* provides accounting guidance for insurers.
- Regardless of where the amounts are reported on the annual statement, the materiality of the amounts, and whether the insurer is subject to *Actuarial Guideline LI—The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves* (AG 51), the Appointed Actuary should disclose the amounts associated with A&H long-duration contracts on Exhibit B, Item 13. The Appointed Actuary should provide commentary in a relevant comments paragraph in accordance with paragraph 6.C of the Instructions. The Appointed Actuary should also disclose all reserve amounts associated with A&H long-duration contracts in the Actuarial Report.
- **The adoption of AG 51 in 2017.** On Aug. 9, 2017, the NAIC’s Executive (EX) Committee and Plenary adopted AG 51 requiring stand-alone asset adequacy analysis of long-term care (LTC) business. The text of AG 51 is included in the March 2019 edition of the NAIC’s *Accounting Practices and Procedures Manual* (AP&P Manual). The effective date of AG 51 was Dec. 31, 2017, and it applies to companies with over 10,000 in-force lives covered by long-term care insurance (LTCI) contracts as of the valuation date. The Instructions state that the Actuarial Report and workpapers summarizing the asset adequacy testing (AAT) of LTC business must comply with AG 51 requirements.
- **Recent adverse reserve development in LTC business.** State insurance regulators expect Appointed Actuaries to disclose company-specific risk factors in the SAO. Given the recent adverse experience for LTC business, Appointed Actuaries should consider whether exposure to A&H long-duration contracts poses a risk factor for the company.

The Appointed Actuary is not asked to opine on the reasonableness of the reserves associated with A&H long-duration contracts except to the extent that the reserves are included within the amounts reported on Exhibit A of the SAO. For this reason, the Working Group intentionally excluded Items 13.3 and 13.4 from this sentence in paragraph 4 of the Instructions: “The Appointed Actuary should state that the items in the SCOPE, on which he or she is expressing an opinion, reflect Disclosure items 8 through 13.2 in Exhibit B.” Exhibit B, Item 13.1 asks the Appointed Actuary to disclose the reserves for A&H long-duration contracts that the company carries on the Losses line of the Liabilities, Surplus and Other Funds page. The Appointed Actuary is not asked to opine on the reasonableness of the reserves disclosed on Exhibit B, Item 13.1 in isolation, but these reserves are a subset of the amount included on Exhibit A, Item 1, and Exhibit A lists amounts with respect to which the Appointed Actuary is expressing an opinion. The same is true for Exhibit B, Item 13.2, whose reserves are a subset of the amount included on Exhibit A, Item 2.

A&H long-duration contracts are distinct from P/C long-duration contracts. There were no changes to the opinion requirements in 2018 regarding P/C long-duration contracts, but the Working Group added a reference to SSAP No. 65 in the definition of P/C long-duration contracts to clarify the difference between A&H long-duration contracts and P/C long-duration contracts. The newly-added mention of SSAP No. 65 in the Instructions is not intended to change the Appointed Actuary’s treatment of P/C long-duration contracts in the SAO or the underlying analysis, but insurers and Appointed Actuaries may refer to SSAP No. 65, paragraphs 21 through 33 for a description of the three tests, a description of the types of P/C contracts to which the tests apply, guidance on the minimum required reserves, and instructions on the SAO and Actuarial Report.

III. Comments on the Actuarial Opinion Summary

A. Confidentiality

The AOS is a confidential document, and it should be clearly labeled and identified prominently as such. The AOS is not submitted to the NAIC. The Working Group advises the Appointed Actuary to provide the AOS to company personnel separately from the Actuarial Opinion and avoid attaching the related SAO to the AOS.

B. Different Requirements by State

Not all states have enacted the NAIC *Property and Casualty Actuarial Opinion Model Law* (#745), which requires the AOS to be filed. Nevertheless, the Working Group recommends that the Appointed Actuary prepare the AOS regardless of the domiciliary state's requirements, so the AOS will be ready for submission should a foreign state, having the appropriate confidentiality safeguards, request it.

Most states provide the annual statement contact person with a checklist that addresses filing requirements. The Working Group advises the Appointed Actuary to work with the company to determine the requirements for its domiciliary state.

C. Format

The purpose of the AOS is to show a comparison between the company's carried reserves and the Appointed Actuary's estimates. Because the AOS is a synopsis of the conclusions drawn in the Actuarial Report, the content of the AOS should reflect the analysis performed by the Appointed Actuary. Therefore, all the Appointed Actuary's calculated estimates, including actuarial central estimates and ranges, are to be presented in the AOS consistent with estimates presented in the Actuarial Report.

The American Academy of Actuaries' (Academy's) Committee on Property and Liability Financial Reporting (COPFLR) annual practice note, "Statements of Actuarial Opinion on Property and Casualty Loss Reserves," provides illustrative examples that show how the Appointed Actuary might choose to display the required information. These examples present the numerical data in an easy-to-read table format.

IV. Guidance on Qualification Documentation

The Instructions were modified for 2019 to require the Appointed Actuary to document qualifications in what is called "qualification documentation." The qualification documentation needs to be provided to the Board of Directors at initial appointment and annually thereafter. The Working Group is considering amending this requirement, starting with year-end 2023 Opinions, to provide the qualification documentation to the Board of Directors at initial appointment and only once every five years thereafter, unless there are material changes in the company's operations or exposure. An example of such material changes could include the company acquiring a book of business with a significantly different loss exposure.

The following provides guidance Appointed Actuaries may find useful in drafting qualification documentation. Appointed Actuaries should use professional judgment when preparing the documentation, and they need not use the sample wording or format provided below. As a general principle, Appointed Actuaries should provide enough detail within the documentation to demonstrate that they satisfy each component of the Qualified Actuary definition. In crafting the qualification documentation, it may be helpful to think about what is important for the Board of Directors to know about their Appointed Actuary's qualifications and remember that documentation should be relevant to the subject of the Actuarial Opinion being issued.

A. Brief Biographical Information

- The Appointed Actuary may provide resume-type information.
- Information may include the following:
 - Professional actuarial designation(s) and year(s) first attained.
 - Insurance or actuarial coursework or degrees.
 - Actuarial employment history: company names, position title, years of employment, and relevant information regarding the type of work (e.g., reserving, ratemaking, enterprise risk management [ERM]).

B. "Qualified Actuary" Definition

The Appointed Actuary should provide a description of how the definition of Qualified Actuary in the Instructions is met or expected to be met—in the case of continuing education (CE)—for that year. The Appointed Actuary should provide information similar to the following. Items 1 through 3 below correspond with items (i) through (iii) in the Qualified Actuary definition.

1. I meet the basic education, experience, and CE requirements of the Specific Qualification Standards for Statements of Actuarial Opinion, NAIC Property and Casualty Annual Statement, as set forth in the Qualification Standards for Actuaries Issuing Statements of Actuarial Opinion in the United States (U.S. Qualification Standards), promulgated by the American Academy of Actuaries (Academy). The following describes how I meet these requirements:
 - a. Basic education:
 - [Option 1] met through relevant examinations administered by the Casualty Actuarial Society (CAS).
 - [Option 2] met through alternative basic education. The Appointed Actuary should further review documentation necessary per Section 3.1.2 of the U.S. Qualification Standards.
 - b. Experience requirements: met through relevant experience as described below.
 - To describe the Appointed Actuary's responsible experience relevant to the subject of the SAO, information may include specific actuarial experiences relevant to the company's structure (e.g., insurer, reinsurer, risk retention group [RRG]), lines of business, or special circumstances.
 - Experiences may include education (through organized activities or readings) about specific types of company structures, lines of business, or special circumstances.
 - c. CE: met (or expected to be met) through a combination of industry conferences, seminars (both in-person and webinar), online courses, committee work, self-study, etc., on topics including _____ (provide a brief overview of the CE topics. For example, "trends in workers' compensation" or "standards of actuarial practice on reserving"). A detailed log of my CE credit hours is available upon request.
 - Section 3.3 of the Specific Qualification Standards for Statements of Actuarial Opinion, NAIC Property and Casualty Annual Statement requires the Appointed Actuary to earn 15 hours of CE on topics mentioned in Section 3.1.1.2.
2. I have obtained and maintain an Accepted Actuarial Designation. One of the following statements may be made, depending on the Appointed Actuary's exam track:
 - I am a Fellow of the CAS (FCAS), and my basic education includes credit for Exam 6—Regulation and Financial Reporting (U.S.).
 - I am an Associate of the CAS (ACAS), and my basic education includes credit for Exam 6—Regulation and Financial Reporting (U.S.) and Exam 7—Estimation of Policy Liabilities, Insurance Company Valuation, and Enterprise Risk Management.
 - I am a Fellow of the SOA (FSA), and my basic education includes completion of the general insurance track, including the following optional exams: the U.S. version of the Financial and Regulatory Environment Exam and the Advanced Topics in General Insurance Exam.

Alternatively, if the actuary was evaluated by the Academy's Casualty Practice Council and determined to be a Qualified Actuary, the Appointed Actuary may note such and identify any restrictions or limitations, including those for lines of business and business activities.

3. I am a member of [professional actuarial association] that requires adherence to the same Code of Professional Conduct promulgated by the Academy, requires adherence to the U.S. Qualification Standards, and participates in the Actuarial Board for Counseling and Discipline (ABCD) when its members are practicing in the U.S.

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III. Special interest topics

This appendix to the practice note contains more detailed information about specific topics that may not be common to all SAOs.

III.1 Unearned premium for Long Duration Contracts

This section discusses the special rules that apply to the unearned premium reserve calculation for certain long duration contracts.

According to the NAIC SAO Instructions,

“If the Scope includes material Unearned Premium Reserves for Long Duration Contracts or Other Loss Reserve items on which the Appointed Actuary is expressing an opinion, the Actuarial Opinion should contain language such as the following:

- D. *Make a reasonable provision for the unearned premium reserves for long duration contracts and/or <insert Other Loss Reserve item on which the Appointed Actuary is expressing an Opinion> of the Company under the terms of its contracts and agreements.”¹²⁷*

The Appointed Actuary should opine on the unearned premium reserves for long duration contracts if the amount of those reserves is material.

III.1.1 Definitions

According to the NAIC SAO Instructions,

“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 the contract nor increase the premium during the contract term.”¹²⁸

III.1.2 Discussion

For policies that meet the criteria provided in the above definition, SSAP 65 contains special rules for the calculation of the unearned premium reserves. These rules are found in SSAP 65, paragraphs 24-33, and

¹²⁷ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

¹²⁸ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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consist of three UPR “tests” or steps. While not definitive, SSAP 65 does say that “*this guidance is primarily focused on home warranty and mechanical breakdown policies*”.¹²⁹

Given the complexity involved, the actuary may want to confirm whether certain policies meet the criteria for performing these calculations. In particular, the actuary may want to confirm that the policies in question do not have cancellation or repricing provisions that would exempt them from this calculation.

The three tests are essentially:

Test 1: The amount subject to refund to the contract holders as of the reporting date.

Test 2: The gross premium times the percentage of expected total gross losses and expenses under the contract that have yet to be incurred during the unexpired term of the contracts.

Test 3: “[T]he projected future gross losses and expenses to be incurred during the unexpired term of the contracts [after specified adjustments], reduced by the present value of future guaranteed gross premiums, if any.”¹³⁰ This is very similar to a premium deficiency calculation.

These tests are applied to the three most recent policy years individually, with the highest of the three values recorded for each of those policy years. For all earlier policy years, all Test 1 results are aggregated, all Test 2 results are aggregated, and all Test 3 results are aggregated, with the largest of those aggregated results being the amount booked for those earlier years on a combined basis.

The adjustments made for Test 3 are to reflect future investment income, but with several limitations. Only investment income related to future incurred losses is considered, not investment income on already incurred losses. The time period for the calculation of the investment income is from the valuation date to the date of incurred losses on the current unexpired portion of a policy, not to the date that those future losses are paid. The interest rate used for this calculation is capped based on the company’s portfolio and on 5-year Treasury Bonds. An additional cap exists to the extent that this test implies more invested assets than a company actually holds.

For tests 2 and 3, the projected losses may be reduced for expected salvage and subrogation, but not for anticipated deductible recoveries unless the recoveries are properly secured. According to SSAP No. 65, “*Projected salvage and subrogation (net of associated expenses) shall be established based on reporting entity experience, if credible; otherwise, based on industry experience.*”¹³¹ SSAP No. 65 goes on further to say, “*The actuarial report shall include a description of the manner in which the adequacy of the amount of security for deductibles and self-insured retentions is determined.*”¹³²

¹²⁹ SSAP No. 65, paragraph 21 ([Appendix IV](#)).

¹³⁰ SSAP No. 65, paragraph 29 ([Appendix IV](#)).

¹³¹ SSAP No. 65, paragraph 26 ([Appendix IV](#)).

¹³² SSAP No. 65, paragraph 33 ([Appendix IV](#)).

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The impact of ceded reinsurance is allowed to be reflected in the calculation of the net unearned premium reserves.

We refer the reader of this practice note to SSAP No. 65 for further details underlying the three Tests.

III.2 Intercompany pooling

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

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

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

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

There are a number of impacts from intercompany pooling on reserve analyses and actuarial opinions. This section provides a discussion of these impacts in the order the impacts are addressed in the NAIC SAO Instructions.

III.2.1 Definitions

“Intercompany Pooling” in this context refers to business which is pooled among affiliated insurance companies who are party to a pooling agreement in which the participants receive a fixed and predetermined share of all business written by the pool. Intercompany pooling arrangements involve establishment of a conventional quota share reinsurance agreement under which all the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares.

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III.2.2 Discussion: Identification and disclosure of the pooling arrangement

Section 1C of the NAIC SAO Instructions was expanded in 2014 to apply to all companies that operate in an intercompany pooling agreement. Regardless of their participation percentage, companies participating in intercompany pooling arrangements are required to include a description of the pool, identification of the lead company, and a listing of all companies in the pool, their state(s) of domicile, and their respective pooling percentages in each of the SAOs.

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.

III.2.3 Discussion: Reserve analyses for pooled companies

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 following provides illustrative language that the actuary may wish to include in the SCOPE section of the SAO. We note that the first illustration is the same as that provided in [3.3.2](#) of the practice note, repeated here for convenience.



Illustrative
Language

The Company is the lead member of an intercompany pooling agreement with its subsidiaries, DEF Insurance Company and GHI Insurance Company. Premiums and losses are allocated to the Company based on its assigned percentage to the total pool, XX%. Analysis of the reserve items identified in Exhibit A has been performed for all pool companies combined and allocated to the pool companies based on their pooling percentages. Any favorable or adverse development will affect pool members in a manner commensurate with their pool participation. The following is a listing of all companies in the pool, their respective pooling percentages, and their state of domicile:

....

OR

The Company is part of an intercompany pooling agreement with other affiliates of [name of group]. Premiums and losses are allocated to the Company based on its assigned percentage of the total pool. Analysis of the reserve items identified in Exhibit A has been performed for all pool companies combined and allocated to the pool companies based on their pooling percentages. The following is a listing of all companies in the pool, their respective pooling percentages, their state(s) of domicile, and an identification of the lead company:

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III.2.4 Discussion: Reconciliation to Schedule P for pooled companies

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:

Illustrative
Language

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

III.2.5 Discussion: Compilation of Exhibits A and B for pooled companies

Additionally, regardless of the company's participation percentage in the intercompany pool, each company is required to include Exhibits A and B reflecting its share. Companies having a zero percent share are required to include relevant comments that relate to the risks of the lead pool member and are required to file Exhibits A and B of the lead as an addendum to their SAOs.

III.2.6 Discussion: Actuarial Opinion Summary

The AOS Instructions pertaining to companies participating in intercompany pooling were modified in 2014 to require the Appointed Actuary to state the company's intercompany pooling percentage.

In cases of intercompany pooling, the actuary often performs his or her analysis and draws his or her conclusions on the basis of total reserves. This information is usually described within the opinion. According to the AOS Instructions, for non-zero percent companies, the information provided for paragraph 5 of the AOS should be numbers after the company's share of the pool has been applied; specifically, the point or range comparison should be for each statutory company and should not be for the pool in total. However, for those companies whose participation percentage is zero, the information provided for paragraph 5 should be that of the lead company.

Note:

- Intercompany pooling agreements may create substantial cessions on Schedule F between members of the pool.
- A change in pooling percentage can cause a company to fail IRIS Tests, particularly the Estimated Current Reserve Deficiency to Surplus.

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III.3 NAIC Guidance for Actuarial Opinions for Pools and Associations

The Casualty Actuarial and Statistical Task Force (CASTF) of the NAIC has provided guidance for a required SAO for Pools and Associations. This guidance document (a portion which is reproduced here), is for the convenience of the reader. Note that this document was last updated by the CASTF in September 2010 and, therefore, does not reflect the changes made by the NAIC in the Statement of Actuarial Opinion Instructions since.

September 2010

NAIC Guidance for Actuarial Opinions for Pools and Associations

Prepared by the
Casualty Actuarial & Statistical Task Force

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

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

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

1.A. Definitions

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

4. SCOPE Paragraph

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

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The SCOPE paragraph should indicate the accounting basis on which the entity is providing its financial information, the valuation date of data used in support of the opinion, and whether this data has been adjusted to reflect expected values as of December 31 of the calendar year for which the SAO is provided. Alternatively, if data reported by the entity is on a lagged basis, the number of months by which data is lagged should be noted.

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

6. RELEVANT COMMENTS paragraphs

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

b. Other Disclosures in Exhibit B

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

d. IRIS Ratios

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

III.4 Retroactive and financial reinsurance

This section provides additional detail on the topics of retroactive and financial reinsurance, beyond that discussed in Sections [5.4](#) and [5.4.3](#) of the practice note.

According to the NAIC SAO Instructions,

"RELEVANT COMMENT paragraphs should address reinsurance collectability, retroactive reinsurance and financial reinsurance."¹³³

The reference to retroactive reinsurance relates to contracts subject to retroactive reinsurance accounting, not to retroactive reinsurance contracts subject to prospective reinsurance accounting.

¹³³ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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III.4.1 Definitions

“Retroactive reinsurance refers to agreements referenced in SSAP No. 62R, Property and Casualty Reinsurance, of the NAIC Accounting Practices and Procedures Manual.”¹³⁴

For the purpose of the SAO this definition refers to retroactive reinsurance contracts subject to retroactive reinsurance accounting. Some retroactive reinsurance contracts instead are subject to prospective reinsurance accounting. Paragraph 36 of SSAP 62R lists those retroactive contracts subject to prospective reinsurance accounting:

- *Structured settlement annuities:* These are accounted for as reinsurance for GAAP purposes but as paid losses with contingent liabilities for statutory accounting purposes. See SSAP 65, paragraphs 17 through 19 for more information.
- *Novations*
- *The termination of, or reduction in participation in, reinsurance treaties entered into in the ordinary course of business*
- *Intercompany reinsurance agreements, and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person provided there is no gain in surplus as a result of the transaction*
- *Certain runoff agreements:* These are described in detail in paragraphs 80 through 83 of SSAP 62R.

“Financial reinsurance refers to contracts referenced in SSAP No. 62R [of the NAIC Accounting Practices and Procedures Manual] in which credit is not allowed for the ceding insurer because the arrangements do not include a transfer of both timing and underwriting risk that the reinsurer undertakes in fact to indemnify the ceding insurer against loss or liability by reason of the original insurance.”¹³⁵

III.4.2 Discussion: Retroactive Reinsurance

Retroactive reinsurance contracts discussed herein are only those subject to retroactive reinsurance accounting treatment.

Retroactive reinsurance contracts do not affect the losses reported in Schedule P or the Underwriting & Expense Exhibits, but they do affect the surplus of the parties involved. The loss reserves (ceded and assumed) for such contracts are reported separately as write-in liabilities (or contra-liabilities) on the balance sheet. For the ceding company, any surplus gain from the retroactive reinsurance is recorded as “special surplus” until (and to the extent that) it reflects actual reinsurance recoveries above reinsurance considerations paid. These “special surplus” amounts are recognized for RBC and other similar solvency evaluation purposes, but may not be available for dividend and similar purposes.

Since the contracts do not impact the loss schedules of the Annual Statement the financial impact of these contracts may not be readily apparent, requiring the use of different data sources or different reconciliation approaches. The contracts also will not impact reported loss development (and hence the

¹³⁴ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

¹³⁵ 2023 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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risk of adverse loss development) that may be reported in Schedule P – Part 2, but do impact statutory surplus. As such, the actuary may want to evaluate and set the RMAD criteria in recognition of this situation. A RMAD focusing on changes to surplus will reflect the risk and impact of retroactive reinsurance, while one focusing on the risk to Schedule P reserves will not be impacted by retroactive reinsurance.

Note that retroactive reinsurance contracts have to pass risk transfer to qualify for reinsurance accounting treatment (prospective or retroactive). Contracts that don't meet risk transfer requirements will be accounted for as deposits.

An actuary that has access to both statutory and GAAP financial statements may benefit from knowing how GAAP accounting for such contracts differs from the statutory accounting. GAAP loss reserves will include the impact of retroactive reinsurance contracts, but any surplus gain that results will be amortized over time. Hence GAAP loss reserve disclosures will benefit from these contracts, but GAAP equity will have any benefit deferred.

III.4.3 Discussion: Financial Reinsurance

Financial reinsurance contracts are contracts that do not transfer sufficient risk so as to qualify for reinsurance accounting treatment. These contracts could be prospective or retroactive in nature (i.e., they could cover only claims incurred in the future, claims incurred in the past, or some combination of the two). The one constant is that these contracts are accounted for as deposits, with no impact on loss reserves and (normally) minimal impact on surplus.

These contracts were the subject of various investigations by both state insurance regulators and the SEC in the past due to the potential for such contracts to distort financial statements if not recorded as deposits. If recorded as deposits then these contracts should not impact the actuarial opinion analysis. If incorrectly reported then these contracts may understate the risk associated with the company's balance sheet.

The risk transfer analysis to determine if reinsurance or deposit accounting applies is discussed in SSAP 62R. It says that determining whether risk transfer exists "*requires a complete understanding of that contract and other contracts or agreements between the ceding entity and related reinsurers. A complete understanding includes an evaluation of all contractual features....*"¹³⁶ These include cancellation provisions, loss-sensitive features and investment income potential, not just undiscounted losses that may result from that contract.

¹³⁶ SSAP No. 62R, paragraph 12 ([Appendix IV](#)).

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III.5 Prepaid Loss Adjustment Expense

Third-party administrators (TPAs) often provide loss adjustment services on a fixed price basis to their insurance company customers. For example, a TPA may agree to handle all claims from Accident Year 20XX arising from a specific line of business or from a specific program—for a fee of X% of the line’s 20XX earned premium. These agreements often are “cradle to grave,” providing for loss adjustment services into the future until all claims covered by the agreement are closed.

The 2023 AOWG Regulatory Guidance states:

“According to SSAP 55, Paragraph 5 of the NAIC’s Accounting Practice and Procedures Manual, the liability for unpaid loss adjustment expenses shall be established regardless of any payments made to third-party administrators (TPA), management companies or other entities. The values should be recorded as loss adjustment expense reserves throughout the Annual Statement and not recorded as a write-in. Appointed Actuaries should be aware of any such arrangements, incorporate this consideration into their analysis, and include appropriate disclosures in the Opinion and the Actuarial Report.”¹³⁷

Statutory accounting requires the actuary to include a full reserve for these loss adjustment expenses, regardless of any amounts which have been pre-paid.

III.5.1 Illustrative language

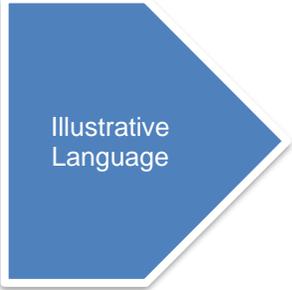
Comments on prepaid loss adjustment expenses should be included in the SAO, if this item is material. In addition, regulators will expect an appropriate discussion of this topic in the Actuarial Report.

FAQ: This requirement violates the economics of these situations. Our company has paid another organization to assume these costs. Why should we now set up an additional liability?

A: Statutory Accounting is often more conservative than GAAP accounting and is often more conservative than the economic fundamentals of a situation would indicate. Regulators have taken a conservative approach to pre-paid loss adjustment expenses.

¹³⁷ 2023 AOWG Regulatory Guidance ([Appendix II](#)).

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Language

The Company has an agreement with {name of TPA} to adjust all claims from the 20XX accident year from the {name of program or line of business}, until all of these claims have been closed. A pre-payment for these services has been made by the Company to {name of TPA}. Regardless of this pre-payment, the Company has established the liability for unpaid loss adjustment expenses and included this balance in the loss adjustment expenses reserves included in Exhibit A.

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III.6 Guidance for Audit Committee Members of P/C Insurers

The following document was first published by COPLFR in 2007 and was updated in 2014 and 2020. It is reproduced here to assist practicing actuaries in communicating with a company's board of directors or audit committee concerning uncertainties in the process of estimating unpaid loss and loss adjustment expense claims liabilities. This document serves as an overview of loss reserves for an Audit Committee of a Board, and may serve as reference for the Appointed Actuary when assembling materials for a presentation to a board or audit committee.

A PUBLIC POLICY OVERVIEW

**An Overview for P/C Insurers’
Audit Committees:
Effective Use of Actuarial
Loss Reserve Expertise**

September 2020

Developed by the
Committee on Property and Liability
Financial Reporting



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A PUBLIC POLICY OVERVIEW

An Overview for P/C Insurers' Audit Committees: Effective Use of Actuarial Loss Reserve Expertise

September 2020

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



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The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

A PUBLIC POLICY OVERVIEW

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Glenn Tobleman MAAA, FCAS, FSA

Ernie Wilson MAAA, FCAS

Rich Gibson, MAAA, FCAS, Senior Casualty Fellow

Marc Rosenberg, Senior Casualty Policy Analyst

Special thanks to Brenda Hebert, Eduardo Esteva, Dave Heppen and John Pierce



AMERICAN ACADEMY *of* ACTUARIES

1850 M Street NW, Suite 300

Washington, DC 20036-5805

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A PUBLIC POLICY OVERVIEW

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A PUBLIC POLICY OVERVIEW

This document¹ is intended to provide members of boards of directors and audit committees of property/casualty insurance companies with a more complete understanding of the information and assistance that actuarial professionals can provide as such board/committee members perform their financial reporting oversight roles.

Summary

The reliability of financial statements for property/casualty insurance companies depends significantly on the accuracy of the recorded liabilities for unpaid claims, commonly referred to as “loss reserves.” Unlike most balance-sheet liabilities common to other industries, the loss reserves of a property/casualty insurer are estimates at a point in time, not known amounts. These estimates are generally based on the work of actuaries, which has a great amount of uncertainty associated with estimating the occurrence, timing, and ultimate cost to settle and close all claims.

Loss reserve estimates are subject to significant uncertainties. Understanding the uncertainties and potential range of variation is important in assessing the reasonableness of the reserve estimates and therefore the company’s financial position. At times, property/casualty insurers have announced significant loss reserve increases for reasons that include but are not limited to: high rates of growth, entry into new lines of business (where the company did not have preexisting experience), the impact of major court rulings and new regulations or laws (such as reviver statutes), unanticipated increases in loss trends (e.g., sustained higher trends in medical costs and utilization), and emerging mass torts (e.g., opioids abuse, and talc). For some companies, such loss reserve increases are large enough to impair their financial condition; for others, reported profitability is affected. Material assumption improvements may arise because of favorable medical inflationary trends relative to prior long-term averages on lines such as workers’ compensation, as one example.

Property/casualty insurance companies’ boards of directors and audit committees have a fiduciary responsibility in addition to regulators’ expectation for overseeing the financial reporting process. Because loss reserves are crucial to property/casualty insurers’ financial statements, audit committees and boards of directors are advised to have direct discussions

¹ The considerations contained herein are based on broad generalizations and are not intended to describe or establish actuarial standards of practice or requirements. The information presented is intended to apply to a large percentage of property/casualty insurers. Within the property/casualty insurance industry, there is wide diversity of actuarial practice. Each company and each situation must be evaluated on the basis of its own circumstances.

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

For most property/casualty companies, loss reserves are the largest and most uncertain balance sheet liability. However, for companies that specialize in certain long-duration contracts such as auto warranty, loss reserves are minimal, and the unearned premium reserve is a much larger and more uncertain balance sheet liability. For these specialty companies, COPLFR believes all comments in this practice note about loss reserves would generally apply equally to unearned premium reserves.

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with their actuarial professionals to obtain a better understanding of the loss reserve estimation process and the policies related to that process. These discussions, via both periodic presentations and special workshops, help to increase appreciation of members of boards of directors and audit committees for the risks and uncertainties inherent in loss reserve estimates.

Three fundamental requirements for boards of directors and audit committees to meet their fiduciary responsibilities with respect to loss reserves include:

- 1) Appointing an actuary who is appropriately qualified to opine on the company's loss reserves;
- 2) Understanding the basis for management's best estimate of loss reserves in relation to the Appointed Actuary's estimate of unpaid claims; and
- 3) Understanding the drivers of risk and uncertainty in the reserves from the perspective of the Appointed Actuary.

There are numerous sources of information available to help boards and audit committees meet these requirements. However, in order for boards and audit committees to understand the Appointed Actuary's perspective, there is no substitute for direct discussion on at least an annual basis.

This document addresses each of these three items. It begins with a background on loss reserves and the roles of actuaries in determining them, followed by a discussion of oversight function considerations related to those reserves.

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Background on Loss Reserves and Roles of Actuaries

Property/Casualty Insurance Loss Reserves

A property/casualty insurance policy is a promise to pay claims related to covered, or insured, events. Usually, covered events take place during the time the policy is in effect (e.g., auto accident, injury, or loss of property as a result of a loss covered under the terms of the policy). In some cases, the insurance company is not presented with a claim or demand for payment by the insured or a third party until years after the covered event has occurred. It can take many years for a claim, once made, to be investigated and settled.

When these claims are eventually settled, the insurance company must have the resources to pay the claim in accordance with the policy provisions. Therefore, until all claims are resolved and the related amounts are paid, insurance accounting rules require the insurer to establish a “loss reserve” as a liability on the company’s balance sheet. (These loss reserves include a provision for loss adjustment expenses² (LAE) or settlement costs.) The loss reserve is based on the company management’s best estimate of the amounts that will be paid in the future for losses and loss adjustment expenses related to claims arising from past events (i.e., events on or prior to the accounting “as of” date), whether or not all claims have been reported at that time.

The duration and the uncertainty of the claims-settlement process necessitate that loss reserves be based on estimates. A property/casualty insurer’s loss reserves are typically the company’s largest balance-sheet liability by a wide margin and its greatest source of financial statement uncertainty. Loss reserves can be difficult to estimate, and the amounts ultimately paid may be materially less than, or greater than, amounts previously estimated.

A conclusion that prior years’ loss reserves need to be revised, based on current facts and circumstances, affects both the company’s reported surplus and its income during the period in which that conclusion is reached. As such, changes in loss reserve estimates have consequences both for the financial condition of the company and for its perceived ongoing operating profitability. It is therefore important that loss reserves be set as accurately as possible, given the information available at the time.

Role of Actuaries in the Reserving Process

Actuaries typically play an integral role in the loss reserving process. The actuarial role is generally provided by one or more of the following sources:

- *Internal actuaries*—Many insurance companies employ actuaries to aid in setting loss reserves. Typically, an internal actuary provides periodic analyses of loss reserves and assists management in understanding underlying claim trends and the judgments and

² LAE are discussed in greater detail in Actuarial Standard of Practice No. 43, *Property/Casualty Unpaid Claim Estimates*, promulgated by the Actuarial Standards Board (ASB), which can be found at http://www.actuarialstandardsboard.org/pdf/asops/asop043_159.pdf.

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assumptions used in the analyses, and describes any material risk factors that might affect the loss reserves. The internal actuary may also lead presentations regarding estimated loss reserves to boards of directors and audit committees.

- *Audit firm actuaries*—Often, insurance companies’ external audit firms will assign actuaries to the audit engagement teams. The audit firms’ actuaries evaluate the reasonableness of the recorded amounts in the context of the financial statements as a whole. As part of the audit testing, the auditing actuary may develop an alternative point estimate and/or “range of reasonable estimates”³ of the loss reserves. This range is narrower than a range of possible outcomes and is intended to provide an independent view of whether the recorded loss reserve amounts are reasonable in light of the available information, in conjunction with an audit of the insurance entity. The auditor’s range is not a range that management would rely on to record its best estimate.
- *Consulting actuaries*—Consulting actuaries may be engaged to take on the actuarial role in setting loss reserves (as described in the *Internal Actuaries* discussion above). Some companies also engage third-party actuarial consultants to perform independent analyses of the loss reserves. Such analyses can encompass the entire claim population or can be limited to some unusual or especially difficult-to-estimate portion of the exposures. The detailed analyses performed by consulting actuaries often include independent methodologies, judgments, and assumptions.

The boards of directors of all U.S.-domiciled insurers are required to appoint a qualified actuary, or “Appointed Actuary,” to render an opinion on the recorded loss reserves for the regulatory (or “statutory”) year-end financial statements. The Appointed Actuary could be either an internal actuary, a consulting actuary, or an audit firm actuary acting as a consultant.

The actuary providing the opinion must meet the NAIC definition of “Qualified Actuary”⁴ The actuarial opinion follows specifications described by the NAIC, and is contained in a formal, public document called the *P/C Statement of Actuarial Opinion* (SAO).⁵ The SAO is an important tool used by insurance regulators to assess insurer solvency. In addition to the actuarial opinion on the reasonableness of the recorded loss reserves, the SAO contains informative disclosures regarding the factors affecting the variability of the loss reserves and the Appointed Actuary’s view as to whether there is a significant risk of material adverse deviation⁶ from the recorded estimate. The significant risk factors along with the assessment of risk of material adverse deviation are important items for boards of directors and audit

³ The term “range of reasonable estimates” is defined and described later in the section labeled “Loss Reserve Variability and Uncertainty.” The term is also discussed in a 2008 Academy paper, [P/C Actuarial Communication on Reserves Ranges and Variability of Unpaid Claim Estimates](#).

⁴ Effective with the 12-2019 Opinion year, the NAIC revised the definition of “Qualified Actuary.”

⁵ In the United States, the SAO is prepared at the legal entity level, i.e., for each individual insurance company within a group rather than for the consolidated group of companies. (See NAIC Instructions or NAIC’s Regulatory Guidance for Annual Statement Instructions for Property/Casualty Actuarial Opinions, available at http://www.naic.org/committees_c_catf.htm. https://content.naic.org/cmte_c_catf.htm. See Appendix for more notes and links to sources for current requirements.

⁶ The SAO instructions require the Appointed Actuary to disclose their materiality standard.

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committees to understand and discuss with the Appointed Actuary.

Since 2019, the Appointed Actuary must submit documentation of their qualification to the company's board for review.⁷ Boards are required to document the company's review the qualification documentation. The NAIC requirements allow boards and actuaries to structure this process in a manner appropriate for the company's circumstances.

Oversight Function Considerations—Loss Reserve Estimates

The following are some of the major considerations for those providing an oversight function on recorded loss reserves.

- Unavoidable use of judgment—input from multiple disciplines
- How actuarial estimates are considered
- Extensive public (and non-public) disclosure
- Variability and uncertainty in the loss reserves
- Quality of data and the impact on loss reserve uncertainty
- Context of the reserves
- Impact and collectability of ceded reinsurance
- Governance (control) structure around the company's loss reserving process

Unavoidable Use of Judgment—Input From Multiple Disciplines

As mentioned above, loss reserves are estimates of the ultimate amounts payable and are not known with certainty. The amounts that will eventually be paid will be the result of numerous investigations, settlement negotiations, jury trials, court decisions, contract interpretations, and other items not knowable with certainty in advance. Hence the use of judgment in the estimation process is inevitable.

The basis for these estimates is “past experience adjusted for current trends, and any other factors that would modify past experience.”⁸ This estimation process is often led by actuaries and requires the input of others from multiple disciplines. Those providing input typically include the claims department, legal counsel, underwriting, and relevant business units, with the final decision on the estimate to book being the responsibility of company management. That said, actuarial input is vital to management's process, as the actuarial estimates typically consider and incorporate input from all involved disciplines.

Members of audit committees and boards of directors benefit from understanding the significant judgments and assumptions incorporated into the loss reserve estimates that are made by management and by the actuary. The significance of this understanding can extend beyond loss reserves, as the findings or observations that inform those judgments may also

⁷ See Appendix for resources and links to source websites to verify current requirements.

⁸ 2020 NAIC Accounting Practices & Procedures Manual – Statement of Statutory Accounting Practices (SSAP) No. 55, paragraph 10.

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provide valuable input to decisions regarding pricing or marketing plans.

How Actuarial Estimates Are Considered

Actuarial estimates are not necessarily adopted by management as the booked loss reserves, as company management may record an amount that differs from the actuary's estimate. In such cases, members of audit committees and boards of directors should understand the differences between the actuarial and management estimates. In particular, members of audit committees and boards of directors may request management to provide clarity through answers to the following questions:⁹

- Does management's process typically result in differences between the actuary's estimates and the recorded amounts, and, if so, why?
- How do management's estimates compare to a range of estimates that may be developed by the actuary? How has management's position within the actuarial range changed over time and why?
- Has due diligence been performed to identify the potential impact, if any, on the loss reserve estimates of any significant recent changes in the company's operations (e.g., claims, underwriting, reinsurance)?
- Has the impact of changes in the market or economic activity been properly factored into the analysis with consideration specific to line of business?
- If such changes exist, either internal or external to the company, what adjustments or other considerations are made (by management and/or the actuary) to reflect the potential impact of the changes on the estimates of loss reserves?
- How have the estimates of loss reserves changed over time? Have the reserve estimates developed adversely or favorably, and if so, does this indicate some potential bias in the process? Is there a history of the accuracy of the estimates that can be reviewed that could indicate potential biases in methodologies?

Extensive Public and Non-Public Disclosures

The loss reserves recorded by a U.S. property/casualty insurer are subject to extensive public and non-public disclosure, allowing many parties to view and potentially form their own view of the insurer's estimates.

Each publicly traded U.S. property/casualty insurance company in its annual Securities and Exchange Commission (SEC) 10-K filing incorporates Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2015-09 loss reserve development disclosures. These disclosures, outlined in the FASB's ASU, require annual disaggregated claim development by accident year evaluated as of a number of year-end points representing the period over which claims typically remain open. Additional disclosure items along with reconciliations are required (effective with 2016 year-end reporting for publicly traded companies). These triangles, referred to as disaggregated, represent a subgrouping of the

⁹ Note that these sample questions are not an exhaustive list of questions that could be asked.

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insurer's overall business. These blocks of business are uniquely defined by the company (such as line of business) and includes the most recent estimate of those liabilities.¹⁰

Additional (largely) qualitative disclosures are also required in the SEC 10-K Filing regarding loss reserves and related risk factors. These disclosures include information on the reasonably likely variation in the insurer's loss reserves and the effect of that variation on the financial condition of the company. The disclosures also contain explanation of the source of any recent changes in prior loss reserve estimates. In addition to the disclosures within the SEC filings, many public companies issue press releases and hold investor conference calls that incorporate information related to loss reserves.

For U.S. property/casualty insurers, similar loss development information is provided in Schedule P of the NAIC Statutory Annual Statement, which is filed by each individual insurance company for regulatory purposes. Schedule P shows the annual development of ultimate losses and defense and cost containment expense (DCC) for each of the past 10 coverage years (often referred to as "accident years") and by Schedule P lines of business. Note that Statutory Schedule P defined lines may be different from the blocks of business chosen to be reported in the Form 10-K GAAP filing.

Both the SEC disclosures and the NAIC Schedule P filings provide up to 10 years of history showing the accuracy of management's loss reserve decisions over time. These schedules are used by analysts and other users¹¹ to assess the reliability of a company's current reserving practices and the accuracy of the balance sheet estimates relative to those of its competitors.

Members of audit committees and boards of directors can request the company actuary provide the following information with regard to these disclosures:

- The specific reasons for past years' revisions to loss reserve estimates, including the lines of business, programs, and years affected.
- A comparison to industry trends for the same coverages during the same period.
- A comparison to the reserve activity of the company's closest competitors for the same coverages during the same period.
- A comparison to the loss ratios of the company's closest competitors for the same coverages for the same accident years.

Besides the public SAO mentioned above, in which the Appointed Actuary is required, by state law or regulation,¹² to opine on the reasonableness of recorded loss reserves, the Appointed Actuary is also required to provide a confidential, non-public disclosure (the

¹⁰ See SEC guidance at <https://www.sec.gov/corpfin/cf-manual/topic-11> on short-duration contract disclosures under U.S. GAAP.

¹¹ The list of other users includes the Internal Revenue Service (IRS). The Schedule P filings are the basis for the loss reserve tax deduction under current tax losses, with the IRS and tax courts also making use of actuarial analyses in evaluating the reasonableness of these deductions. See *Acuity v. IRS* tax court decision, "T.C. Memo. 2013-209."

¹² These state laws or regulations are based on an NAIC model law on the topic of P/C insurer loss reserve opinions by appointed actuaries.

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Actuarial Opinion Summary, or AOS) to insurance regulators every year. This confidential document discloses the actuary's estimate or range of unpaid claim estimates relative to management's recorded loss reserve estimates, and, where applicable, the causes of continued significant adverse reserve development. The Appointed Actuary documents the analysis underlying the SAO and AOS in the detailed Actuarial Report,¹³ which is made available to the insurance regulator upon request. The P/C Actuarial Opinion and Actuarial Report must be made available to the board of directors. The Appointed Actuary must also submit a qualification document annually to the board for its review. This was a new NAIC requirement beginning with SAOs on year-end 2019 reserves.¹⁴

Large U.S. property/casualty insurers¹⁵ are required by the NAIC to conduct an Own Risk and Solvency Assessment (ORSA). This non-public analysis is submitted to the domiciliary state insurance department. Loss reserves are one of the key risk areas which are addressed in the ORSA. For those companies which are required to conduct an ORSA, members of audit committees may wish to review the company's ensuing ORSA report.

Loss Reserve Variability and Uncertainty

The management of a U.S. property/casualty insurer is required to include an analysis of variability and uncertainty in the loss reserve estimation process.¹⁶ A qualified actuary can provide insights into the potential for this variability and uncertainty.

Estimating loss reserves involves predicting future loss payments based on historical and current information and knowledge, as well as judgment about future conditions. Actuaries typically employ several methods to estimate loss reserves and may consider multiple reasonable assumptions regarding future conditions when applying the methods. The actuary may develop a "range of reasonable estimates"¹⁷ of loss reserves based on various combinations of these methods and assumptions. This range is typically developed by the Appointed Actuary to assist in creating an opinion on the reasonableness of the recorded loss reserves. The range of reasonable estimates is not intended to be a range of all potential outcomes; rather, it is a narrower range of estimates that the actuary considers to be appropriate for the carried reserve.

While the range of reasonable estimates may encompass multiple reasonable assumptions about future conditions, it typically will not include the possibility of sudden shifts in the

¹³ The Actuarial Report is required and defined by the SAO instructions, and its purpose is to document the SAO findings.

¹⁴ See Appendix for resources and links to source websites to verify current requirements.

¹⁵ The ORSA, as required under the NAIC Risk Management and Own Risk and Solvency Assessment Model Act #505, effective 1/1/2015, applies to any individual U.S. insurer that writes more than \$500 million of annual direct written and assumed premium, and/or insurance groups that collectively write more than \$1 billion of annual direct written and assumed premium.

¹⁶ 2014 NAIC Accounting Practices & Procedures Manual, SSAP No. 55, paragraph 12: "Management ... shall include an analysis of the amount of variability in the estimate."

¹⁷ As pointed out in footnote 3, this term is also discussed in [P/C Actuarial Communication on Reserves Ranges and Variability of Unpaid Claim Estimates](#). ASOP Nos. 36 & 41 discuss reserve range and reasonability.

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statutory, judicial, and economic-reserving environments, nor will it include major unexpected changes in company operations. Nevertheless, such shifts can and do occur.

As part of the actuarial opinion, the actuary reports on events and circumstances that pose significant risks and/or uncertainties to the company and that could, on their own or collectively, result in a material adverse deviation from the carried reserves. Such events and circumstances could be systemic to the company's segment of the insurance industry or particular to the specific company. Historic examples of systemic events and circumstances include changes in the legal environment that led to significant asbestos and environmental losses long after policies had expired; the rapid unexpected inflation that led to mispricing and initial under-reserving in workers' compensation in the late 1990s; and the financial crisis of 2007–2008 that led to a wave of mortgage defaults, resulting in severe stress to the mortgage insurance industry.

More recently, at the time of this publication, we are in the midst of economic stress and uncertainty related to COVID-19. The effects of COVID-19 are very difficult to quantify but boards and audit committees should be asking their appointed actuaries about both direct and ancillary impacts that COVID-19 may have on the unpaid claims estimates.

Systemic changes can be positive as well: Medical professional liability lines, in addition to experiencing rapid loss reserve increases, have also seen rapid decreases in claims costs (neither of which were reflected in the initial reserves).

Examples of significant internal risks include mispricing of a block of business that is not discovered for a period of time or, for smaller companies, the emergence of more than the expected number of large losses. For some companies, particularly very large personal lines carriers, the risk of material adverse deviation in the carried reserves might be remote, while other companies could be subject to reserve deviation risk so great that the difference between the high end of the actuary's range and management's best estimate is material.

Members of audit committees and boards of directors should seek to understand the significant risks that could result in reserve development outside of the current range of estimates, both in terms of their potential magnitude and the actuary's estimation of the likelihood of such events. Strong oversight could include frank discussions of such risks among the parties responsible for estimating and recording the loss reserves with the audit committee or board of directors.

Data Quality and the Impact on Loss Reserve Uncertainty

The actuarial analysis process is heavily dependent upon data quality, which is often determined by each company's systems and processes for collecting, storing, and making available its historical data relative to losses, exposures, and premiums. Due to the evolving data processing environment, some companies have a blend of historical systems that provide the data used by the reserving actuary. In addition, for companies that have undergone a series of mergers in the past, the systems of each of the legacy companies may not be fully

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integrated. Data elements may not have been consistently defined or available. Company managements and actuaries need to work together to define the data elements and then provide the data required for the actuarial evaluation.

The level of controls and granularity of the information around these systems can lead to concerns about the quality of the data used by the actuary and may hamper the ability to perform a detailed review. Limitations posed by less-than-perfect data may introduce new uncertainties to the estimation process and impact the actuary's ability to assess reasonableness.

Even in the absence of these legacy system issues, data quality problems at a company can impact the reliability of the actuary's projections. For this reason, beyond reconciling with Schedule P, the actuary is required to review the data for sufficiency, reasonableness and consistency¹⁸ and determine whether the data is of acceptable quality to perform the analysis. It is recommended that in case the valuation cannot be made by groups of homogenous risk, that the actuary explain the different aggregation.

The board and/or the audit committee may consider asking management and/or its Appointed Actuary about the quality of the data and whether there are limitations on its use and/or reliability for projection purposes. The actuary will have a view related to the degree of uncertainty that any data issues add to the process.

Context of the Reserves

Loss reserving issues and variability can vary drastically across product lines and companies within the insurance industry. Hence, members of audit committees and boards of directors will benefit in their oversight function from being aware of the context underlying the reserve estimates, including the company's areas of concentration, recent industry trends in those areas, and material developments within the company that might affect the estimation process. Knowing this context can help generate more probing questions of management and the Appointed Actuary regarding the recorded loss reserve and associated risks.

The following provides additional information that the board or the audit committee may wish to obtain from company management responsible for establishing the recorded reserve and/or the Appointed Actuary:

- The breakdown of the company's loss reserves by coverage or product line.
- Recent industry trends in the company's products/lines (with regard to profitability, underwriting, claims, and reserving issues) and how these have been contemplated in the current reserve estimates.
- Recent changes in the company's experience in those lines vis-à-vis profitability, claim handling, or reserve development, and the drivers of those changes.
- Significant risks and uncertainties inherent in the company's reserves for those lines.

¹⁸ This is a requirement of both Actuarial Standard of Practice No. 23, *Data Quality*, as well as the SAO instructions.

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- Whether competitors are experiencing the same or different/additional risk factors, recent changes, etc.
- The causes of recent changes in reserve estimates (favorable or unfavorable) and whether competitors have noted similar causes.
- Questions about the reserves raised by major outside stakeholders, including regulators, rating agencies, and, where relevant, investors or investment analysts.

The feedback received should be determined to be consistent with information available from other available sources, such as trade publications, competitor SEC filings, and investor analyst reports.

Ceded Reinsurance

Much of the focus on recorded loss reserves is on a net of reinsurance basis, or those reserves after the impact of reinsurance cessions. However, those loss reserves that are expected to be ceded under reinsurance agreements are also estimates. The reasonableness of both the estimated cessions, and, perhaps more importantly, the collectability of such cessions, are matters for board/audit committee oversight, as overstatement of ceded reinsurance or failure to collect such cessions has caused adverse impacts to financial statements and has even caused insurer insolvencies in the past.

The P/C Statement of Actuarial Opinion requires the Appointed Actuary to have a separate view on both gross loss reserves (i.e., before the impact of such cessions) and net loss reserves. As such, the board/audit committee should expect the Appointed Actuary to be conversant in this area. Issues that the audit committee might consider querying include:

- Possible concentration(s) of reinsurance with particular reinsurers
- Financial strength ratings of current reinsurers
- Collateral held to secure reinsurance recoverables
- The policy regarding required financial strength for possible future reinsurers
- Reliability/variability of the ceded reserve estimates underlying the recorded reserves

Governance (Control) Structure Underlying Loss Reserves

Any material balance sheet estimate needs to have a well-defined governance process and system of controls supporting it, and the loss reserve estimate is no exception. The following are some of the typical controls, both internal and external, that exist for loss reserve estimates. The board/audit committee member may want to be familiar with the extent to which these controls exist and are followed for the insurance company.

Internal Controls

- *Segregation of duties.* While input from those responsible for pricing or developing business (e.g., underwriters, pricing actuaries) is often very useful to the loss reserving process, objectivity typically improves when different people perform the primary

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reserving and pricing roles. The perspectives provided by the pricing and reserving functions are often different, with the pricing function focusing on the profitability of current and future business. By contrast, the reserving function focuses on the potential outcomes connected with business written in the past (sometimes even in markets that the company has since left). As such, the reserving function acts to some extent as an early warning test or report card on past pricing and/or underwriting performance. This creates a potential conflict of interest when the same people perform both functions. Where resources do not allow separate staffing of these two functions, audit committee members should be aware of the potential conflict of interest that arises from the same people performing both functions.

Use of reserve committees. Some insurance companies have reserve committees or an equivalent oversight management group, often organized at one or more management segment level(s) (e.g., legal entity, line of business, region). The committee might include the segment's executive management, the segment's internal reserving actuary or actuarial consultant, and heads of key operating functions (e.g., claims, underwriting, marketing).

Having a reserve committee does not ensure objectivity, and members of audit committees and boards of directors may wish to inquire further to determine its effectiveness. The extent to which a reserve committee improves objectivity is partly a function of the quality and efforts of the reserve committee members. Members of audit committees and boards of directors may wish to learn the identities and qualifications of reserve committee members. The audit committee and board of directors may find value in meeting separately with the lead reserving actuary or chief actuary to obtain the actuary's view of the reserve committee's effectiveness and may also find value in obtaining certain summary information and/or minutes from the reserve committee meetings on a regular basis.

- *Internal audit.* Many insurance companies have an internal audit function that includes in its scope the loss reserve process. This internal audit function can include testing of data quality used in the loss reserve analysis and monitoring any in-house reserving actuaries' compliance with professional practice standards.
- *Actuarial peer review.* Many actuarial firms and in-house actuarial departments have implemented peer review programs or use external actuarial resources to provide an additional set of eyes on professional work product.¹⁹ Such a review may serve as an internal control on the reserving process.
- *Report from the Appointed Actuary.* Each statutory insurer's Appointed Actuary is required by the NAIC to report to the board or audit committee each year on the items within the scope of the actuary's loss reserve opinion. While not required, many of these are in-person, allowing for immediate response to questions the board/audit committee may have. Regardless, the NAIC SAO Instructions say, "The minutes of

¹⁹ While not required by the actuarial standards, peer review is a strongly recommended practice. See [Peer Review—Concepts on Professionalism](#), a 2005 discussion paper by the Academy's Committee on Professional Responsibility.

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the Board of Directors should indicate that the Appointed Actuary has presented such information to the Board of Directors and identify the manner for presentation (e.g., webinar, in-person presentation, written).”

External Controls

- *External Audit.* As loss reserve estimates have a material impact on earnings and technical solvency, external auditors of public companies typically include a review of these estimates in every reporting cycle (although more attention may be paid to this issue at year-end than for interim periods). Many insurers’ boards/audit committees include discussions with their external auditors on a regular basis in their agendas.
- *Attestations.* Through its Model Audit rule, the NAIC requires larger insurers to provide an attestation regarding the operating effectiveness of its control structure. This control structure will include controls related to the loss reserving process. For public companies, the Sarbanes-Oxley Act of 2002 requires not only internal attestations, but an attestation by the independent auditors related to controls. An audit committee or board may seek reports related to how well the controls are operating and request specific information related to the controls on actuarial processes in particular.
- *Financial examinations by insurance regulators.* State insurance laws require each insurer to undergo a financial examination by state insurance regulators at least once every three to five years. Given the significance and inherent judgments involved in the estimation process, the exam will include a risk-based review of loss reserves recorded within the financial statements that are within the scope of the particular examination. This review is performed by either insurance department personnel or external actuarial consultants working on behalf of the insurance departments. As part of these exams, the state’s examiners inquire about board and audit committee oversight of the loss reserving process, indicating that the expectations of the regulators include a strong awareness and involvement in oversight of the loss reserves by the board.
- *Replacement of Appointed Actuary.* Whenever an Appointed Actuary is replaced, the NAIC requires both the company and the outgoing Appointed Actuary to exchange letters discussing any disagreements over loss reserves during the last 24 months which are then forwarded by the company to the domiciliary state regulator. These disagreement letters are not public information, but audit committees benefit from review of these letters whenever an Appointed Actuary is replaced.
- *Qualification documentation.* NAIC P/C Opinion Instructions describe the documentation of the Appointed Actuary’s qualifications, which is to be submitted to the board of the company. That documentation includes brief biographical information and a description of how the definition of “Qualified Actuary” is met for that year. The documentation describes the Appointed Actuary’s responsible experience relevant to the subject of the P/C Actuarial Opinion. This requirement was

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added in the 2019 Opinion year, so requirements may evolve over time. (See Appendix resource list to check sources for any subsequent updates to these 2019 requirements.)

Executive Session With Actuaries

Members of boards of directors or audit committees are strongly encouraged to consider meeting in executive session with the Appointed Actuary, without other management present, potentially including other internal or external actuaries who are significantly involved in the reserving process. Including the audit firm actuary in the audit committee's executive session with the audit firm is also beneficial. It should be noted that both external auditors and regulators use a private discussion with the Appointed Actuary as an investigative tool in regard to reserves. Such executive sessions are of particular value in determining whether management may have attempted to exercise undue influence on the reserve estimation process. While such undue influence is uncommon, its potential is a key focus of regulators, as it has been a contributing factor in a number of past insolvencies. Possible signs of undue management influence that could be identified during executive session may include:

- The actuary is not provided with comprehensive information on potentially emerging problem areas (e.g., newer coverages with adverse experience).
- Information is provided late to the actuary, leaving inadequate time to properly incorporate into their analysis.
- The actuary is denied access to certain individuals at the company who may respond to specific questions or provide corroboration of other information obtained.
- Management makes clear to the actuary that his/her continued employment is contingent upon agreement with management's viewpoint on reserve estimates.
- The opining actuary is replaced, and the new actuary immediately agrees with management's position.

* * * * *

Loss reserves are a major part of an insurer's reported balance sheet, subject to public (and non-public) disclosure and review, and, by their nature, require the use of judgment. Oversight of such reserves is a material part of the board or audit committee's responsibility. Actuarial input in this oversight process is inevitable and invaluable. This practice note attempts to aid in audit committees' and boards of directors' understanding of the issues and resources related to this important oversight function.

A PUBLIC POLICY OVERVIEW

Appendix

Sources for Current Requirements:

- **NAIC Statutory P/C Opinion Instructions:**

The NAIC Statutory requirements are updated annually. The Actuarial Opinion requirements may or may not change annually depending on NAIC decisions.

Current requirements can be found by consulting the NAIC website homepage at naic.org.

- **NAIC Regulatory Guidance:**

Regulatory Guidance supplements the *NAIC Annual Statement Instructions—Property/Casualty* and provides guidance to companies and Appointed Actuaries regarding regulatory expectations on the Actuarial Opinion, AOS, and Actuarial Report. The Regulatory Guidance is usually updated at least once every two years and whenever there are Opinion requirement changes.

The Regulatory Guidance can be found by consulting the NAIC website (naic.org), under the P&C (C) Committee, Actuarial Opinion Working Group (AOWG) (under the “Related Documents” tab).

https://content.naic.org/cmte_c_act_opin_wg.htm

- **American Academy of Actuaries COPLFR P/C Opinion Practice Note:**

The Statements of Actuarial Opinion on P/C Loss Reserves Practice Note provides information to actuaries on current practices by their peers related to signing a Property and Casualty Statement of Actuarial Opinion (SAO) and Actuarial Opinion Summary (AOS) given the current requirements by the NAIC.

The practice note is updated each year and reflects updates to NAIC requirements. (The practice note also includes the current year’s NAIC Opinion Instructions and Regulatory Guidance described above.)

Current practice notes can be found on the American Academy of Actuaries website at <https://www.actuary.org/content/practice-notes>.

**Property and Casualty Practice Note
2023**

IV. SSAPs

The following documents are the Statement of Statutory Accounting Principles.

SSAP 5R: *Liabilities, Contingencies and Impairment of Assets*

SSAP 9: *Subsequent Events*

SSAP 29: *Prepaid Expenses*

SSAP 53: *Property Casualty Contracts - Premiums*

SSAP 55: *Unpaid Claims, Losses and Loss Adjustment Expenses*

SSAP 57: *Title Insurance*

SSAP 58: *Mortgage Guaranty Insurance*

SSAP 62R: *Property and Casualty Reinsurance*

SSAP 63: *Underwriting Pools and Associations Including Intercompany Pools*

SSAP 65: *Property and Casualty Contracts*

SSAP 66: *Retrospectively Rated Contracts*

Statement of Statutory Accounting Principles No. 5 – Revised

Liabilities, Contingencies and Impairments of Assets

STATUS

Type of Issue.....	Common Area
Issued	Initial draft; Substantively revised October 18, 2010
Effective Date	January 1, 2001; Substantive revisions December 31, 2011
Affects.....	Nullifies and incorporates INT 04-01 and INT 08-06
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SUMMARY CONCLUSION	1
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SCOPE OF STATEMENT

1. This statement defines and establishes statutory accounting principles for liabilities, contingencies and impairments of assets.

SUMMARY CONCLUSION

Liabilities

2. A liability is defined as certain or probable¹ future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).

¹ *FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements*, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in *FASB Statement 5, Accounting for Contingencies*, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

3. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable¹ future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

Joint and Several Liabilities

5. Joint and several liability arrangements for which the total obligation amount under the arrangement is fixed² at the reporting dates shall be measured and reported as the sum of:

- a. The amount the reporting entity agreed to pay on the basis of the agreements among its co-obligors, and
- b. Any additional amount the reporting entity expects to pay on behalf of its co-obligors. When an amount within management's estimate of the range of a loss appears to be a better estimate than any other amount within the range, that amount shall be the additional amount included in the measurement of the obligation. If no amount within the range is a better estimate than any other amount, then the midpoint shall be used.

Loss Contingencies or Impairments of Assets

6. For purposes of implementing the statutory accounting principles of loss contingency or impairment of an asset described below, the following additional definitions shall apply:

- a. Probable—The future event or events are likely to occur;
- b. Reasonably Possible—The chance of the future event or events occurring is more than remote but less than probable;
- c. Remote—The chance of the future event or events occurring is slight.

7. A loss contingency or impairment of an asset is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an enterprise that will ultimately be resolved when one or more future event(s) occur or fail to occur (e.g., collection of receivables).

8. An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both of the following conditions are met:

- a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of

² Examples of items within the scope of this guidance include debt arrangements, other contractual obligations, and settled judicial litigation and judicial rulings. Loss contingencies, guarantees, pension and other postretirement benefit obligations and taxes are excluded from this guidance and shall be accounted for under the statutory accounting provisions specific to those topics.

the statutory financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and

- b. The amount of loss can be reasonably estimated.

9. This accounting shall be followed even though the application of other prescribed statutory accounting principles or valuation criteria may not require, or does not address, the recording of a particular liability or impairment of an asset (e.g., a known impairment of a bond even though the VOS manual has not recognized the impairment).

10. Additionally, in instances where a judgment, assessment or fine has been rendered against a reporting entity, there is a presumption that the criteria in paragraph 8.a. and 8.b. have been met. A judgment is considered “rendered” when a court enters a verdict, notwithstanding the entity’s ability to file post-trial motions and to appeal. The amount of the liability shall include the anticipated settlement amount, legal costs, insurance recoveries and other related amounts and shall take into account factors such as the nature of the litigation, progress of the case, opinions of legal counsel, and management’s intended response to the litigation, claim, or assessment.

11. When the condition in paragraph 8.a. is met with respect to a particular loss contingency, and the reasonable estimate of the loss is a range, which meets the condition in paragraph 8.b., an amount shall be accrued for the loss. When an amount within management’s estimate of the range of a loss appears to be a better estimate than any other amount within the range, that amount shall be accrued. When, in management’s opinion, no amount within management’s estimate of the range is a better estimate than any other amount, however, the midpoint (mean) of management’s estimate in the range shall be accrued. For purposes of this paragraph, it is assumed that management can quantify the high end of the range. If management determines that the high end of the range cannot be quantified, then a range does not exist, and management’s best estimate shall be used.

12. The use of the midpoint in a range will be applicable only in the rare instance where there is a continuous range of possible values, and no amount within that range is any more probable than any other. This guidance is not applicable when there are several point estimates which have been determined as equally possible values, but those point estimates do not constitute a range. If there are several point estimates with equal probabilities, management should determine their best estimate of the liability.

Tax Contingencies

13. As directed by *SSAP No. 101—Income Taxes*, tax loss contingencies (including related interest and penalties) for current and all prior years, shall be computed in accordance with this SSAP, with the following modifications:

- a. The term “probable” as used in this standard shall be replaced by the term “more likely than not (a likelihood of more than 50 percent)” for federal and foreign income tax loss contingencies only.
- b. For purposes of the determination of a federal and foreign income tax loss contingency, it shall be presumed that the reporting entity will be examined by the relevant taxing authority that has full knowledge of all relevant information.
- c. If the estimated tax loss contingency is greater than 50 percent of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to 100 percent of the original tax benefit recognized.

As noted in SSAP No. 101, state taxes (including premium, income and franchise taxes) shall also be computed in accordance with this SSAP. These items (as detailed in SSAP No. 101) are not impacted by the modifications detailed in paragraphs 13.a.-13.c.

Gain Contingencies

14. A gain is defined as an increase in surplus which results from peripheral or incidental transactions of a reporting entity and from all other transactions and other events and circumstances affecting the reporting entity except those that result from revenues or investments by owners. If, on or before the balance sheet date, (a) the transaction or event has been fully completed, and (b) the amount of the gain is determinable, then the transaction or event is considered a gain, and is recognized in the financial statements. The definition of a gain excludes increases in surplus that result from activities that constitute a reporting entity's ongoing major or central operations or activities. Because investment activities are central to an insurer's operations, increases in surplus that result from such investment activities are excluded from the definition of gains. Revenues are inflows or other enhancements of assets of a reporting entity or settlements of its liabilities (or a combination of both) from providing products, rendering services, or other activities that constitute the reporting entity's ongoing major or central operations. Investments by owners include any type of capital infused into the surplus of the reporting entity.

15. A gain contingency is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain (as defined in the preceding paragraph) to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur (e.g., a plaintiff has filed suit for damages associated with an event occurring prior to the balance sheet, but the outcome of the suit is not known as of the balance sheet date). Gain contingencies shall not be recognized in a reporting entity's financial statements. However, if subsequent to the balance sheet date but prior to the issuance of the financial statements, the gain contingency is realized, the gain shall be disclosed in the notes to financial statements and the unissued financial statements should not be adjusted to record the gain. A gain is generally considered realizable when noncash resources or rights are readily convertible to known amounts of cash or claims to cash.

Guarantees

16. A guarantee contract is a contract that contingently requires the guarantor to make payments (either in cash, financial instruments, other assets, shares of its stock, or provision of services) to the guaranteed party based on changes in the underlying that is related to an asset, a liability, or an equity security of the guaranteed party. Commercial letters of credit and loan commitments, by definition, are not considered guarantee contracts. Also excluded from the definition are indemnifications or guarantees of an entity's own performance, subordination arrangements or a noncontingent forward contract. This definition could include contingent forward contracts if the characteristics of this paragraph are met.

17. The following guarantee contracts are not subject to the guidance in paragraphs 20-26 and paragraphs 33-36:

- a. Guarantees already excluded from the scope of SSAP No. 5R;
- b. Guarantee contracts accounted for as contingent rent;
- c. Insurance contract guarantees, including guarantees embedded in deposit-type contracts;
- d. Contracts that provide for payments that constitute a vendor rebate by the guarantor based on either the sales revenue or the number of units sold by the guaranteed party;

- e. A guarantee or indemnification whose existence prevents the guarantor from being able to either account for a transaction as the sale of an asset that is related to the guarantee's underlying or recognize in earnings the profit from that sale transaction;
- f. Registration payment arrangements; and
- g. A guarantee that is accounted for as a credit derivative instrument at fair value under *SSAP No. 86—Derivatives*, as described in paragraph ~~61~~62.e. of SSAP No. 86.

18. The following types of guarantees are exempted from the initial liability recognition in paragraphs 20-26, but are subject to the disclosure requirements in paragraphs 33-36:

- a. Guarantee that is accounted for as a derivative instrument, other than credit derivatives within SSAP No. 86;
- b. Guarantee for which the underlying is related to the performance of nonfinancial assets that are owned by the guaranteed party, including product warranties;
- c. Guarantee issued in a business combination that represents contingent consideration;
- d. Guarantee in which the guarantor's obligation would be reported as an equity item;
- e. Guarantee by an original lessee that has become secondarily liable under a new lease that relieved the original lessee from being the primary obligator;
- f. Guarantees (as defined in paragraph 16) made to/or on behalf of directly or indirectly wholly-owned insurance or non-insurance subsidiaries³; and
- g. Intercompany and related party guarantees that are considered "unlimited" (e.g., typically in response to a rating agency's requirement to provide a commitment to support).

The exemptions for paragraphs 18.f. and 18.g. do not apply in situations in which a reporting entity has provided a financial guarantee or commitment to support a subsidiary, controlled or affiliated entity (SCA), and the SCA's equity is negative (see paragraph 25).

19. With the exception of the provision for guarantees made to/or on behalf of a wholly-owned subsidiaries in paragraph 18.f. and "unlimited" guarantees in 18.g., this guidance does not exclude guarantees issued as intercompany transactions or between related parties from the initial liability recognition requirement. Thus, unless the guarantee is provided on behalf of a wholly-owned subsidiary or considered "unlimited," guarantees issued between the following parties are subject to the initial recognition and disclosure requirements:

- a. Guarantee issued either between parents and their subsidiaries or between corporations under common control;
- b. A parent's guarantee of its subsidiary's debt to a third party; and

³ The exclusion for wholly-owned subsidiaries includes guarantees from a parent to, or on behalf of, a direct wholly-owned insurance or non-insurance subsidiary as well as guarantees made from a parent to, or on behalf of, an indirect wholly-owned insurance or non-insurance subsidiary. The "wholly-owned" exclusion in paragraph 18.f. does not include guarantees issued from one subsidiary to another subsidiary, regardless if both subsidiaries are wholly-owned (directly or indirectly) by a parent company.

- c. A subsidiary's guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.

20. At the inception of a guarantee, the guarantor shall recognize in its statement of financial position a liability for that guarantee. Except as indicated in paragraph 22, the objective of the initial measurement of the liability is the fair value⁴ of the guarantee at its inception.

21. The issuance of a guarantee obligates the guarantor (the issuer) in two respects: (a) the guarantor undertakes an obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur (the noncontingent aspect) and (b) the guarantor undertakes a contingent obligation to make future payments if those triggering events or conditions occur (the contingent aspect). Because the issuance of a guarantee imposes a noncontingent obligation to stand ready to perform in the event that the specified triggering event occurs, the provisions of paragraph 8 should not be interpreted as prohibiting the guarantor from initially recognizing a liability for that guarantee even though it is not probable that payments will be required under that guarantee.

22. In the event that, at the inception of the guarantee, the guarantor is required to recognize a liability under paragraph 8 for the related contingent loss, the liability to be initially recognized for that guarantee shall be the greater of (a) the amount that satisfies the fair value objective as discussed in paragraph 20 or (b) the contingent liability amount required to be recognized at inception of the guarantee by paragraph 8. For many guarantors, it would be unusual for the contingent liability under (b) to exceed the amount that satisfies the fair value objective at the inception of the guarantee.

23. The offsetting entry pursuant to the liability recognition at the inception of the guarantee depends on the circumstances in which the guarantee was issued. Examples include:

- a. If the guarantee was issued in a standalone transaction for a premium, the offsetting entry would be the consideration received.
- b. If the guarantee was issued in conjunction with the sale of assets, a product, or a business, the overall proceeds would be allocated between the consideration being remitted to the guarantor for issuing the guarantee and the proceeds from that sale. That allocation would affect the calculation of the gain or loss on the sale transaction.
- c. If a residual value guarantee were provided by a lessee-guarantor when entering into an operating lease, the offsetting entry would be reflected as prepaid rent, which would be nonadmitted under SSAP No. 29.
- d. If a guarantee were issued to an unrelated or related party for no consideration on a standalone basis, the offsetting entry would be to expense.

24. Except for the measurement and recognition of continued guarantee obligations after the settlement of a contingent guarantee liability described in paragraph 26, this standard does not describe in detail how the guarantor's liability for its obligations under the guarantee would be measured subsequent to initial recognition. The liability that the guarantor initially recognized in accordance with paragraph 20 would typically be reduced (as a credit to income) as the guarantor is released from risk under the guarantee. Depending on the nature of the guarantee, the guarantor's release from risk has typically been recognized over the term of the guarantee (a) only upon either expiration or settlement of the guarantee,

⁴ As practical expedients, when a guarantee is issued in a standalone arm's-length transaction, the liability recognized at the inception of the guarantee should be the premium received or receivable by the guarantor. When a guarantee is issued as part of a transaction with multiple elements, the liability recognized at the inception of the guarantee should be an estimate of the guarantee's fair value. In that circumstance, guarantors should consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm's-length transaction.

(b) by a systematic and rational amortization method, or (c) as the fair value of the guarantee changes (for example, guarantees accounted for as derivatives). The reduction of liability does not encompass the recognition and subsequent adjustment of the contingent liability recognized under paragraph 8 related to the contingent loss for the guarantee. If the guarantor is required to subsequently recognize a contingent liability for the guarantee, the guarantor shall eliminate any remaining noncontingent liability for that guarantee and recognize a contingent liability in accordance with paragraph 8.

25. In situations in which a reporting entity has provided a financial guarantee or commitment to support a subsidiary, controlled or affiliated entity (SCA), and the reporting entity's share of losses in the SCA exceed the equity method carrying amount of the SCA (resulting in a negative equity value in the SCA), the reporting entity shall recognize the greater impact of (i) the then-current fair value liability for the guarantee, or (ii) the negative equity position, limited to the maximum amount of the financial guarantee or commitment provided by the reporting entity. (This guidance requires the recognition of a guarantee liability for guarantees captured in paragraphs 18.f. and 18.g. when negative equity exists in an SCA.) The guidance in paragraphs 20 through 26 shall be followed for the recognition of a contingent liability and a noncontingent liability, as applicable.

26. After recognition and settlement of a contingent guarantee liability in accordance with paragraph 8, a guarantor shall assess whether remaining potential obligations exist under the guarantee agreement. If the guarantor still has potential obligations under the guarantee contract, the guarantor shall recognize the remaining noncontingent guarantee that represents the current fair value of the potential obligation remaining under the guarantee agreement. This noncontingent guarantee liability shall be released in accordance with paragraph 24.

Financial Instruments with Characteristics of Both Liabilities and Equity

27. Issued, free-standing financial instruments with characteristics of both liability and equity shall be reported as a liability to the extent the instruments embodies an unconditional obligation of the issuer. (Pursuant to SSAP No. 86, embedded features in derivative contracts shall not be separated from the host contract for separate recognition.) Free-standing financial instruments that meet any of the criteria below meet the definition of a liability:

- a. A mandatorily redeemable financial instrument shall be classified as a liability unless the redemption is required to occur only upon the liquidation or termination of the issuing reporting entity.
- b. A financial instrument, other than an outstanding share, that at inception both: 1) embodies an obligation to repurchase the issuer's equity shares or is indexed to such an obligation, and 2) requires or may require the issuer to settle the obligation by transferring assets.
- c. Obligations that permit the holder to require the issuer to transfer assets.
- d. A financial instrument is a liability if the issuer must settle the obligation by issuing a variable number of its equity shares and the obligation's monetary value is based solely or predominantly on: 1) a fixed monetary amount, 2) variation in something other than the fair value of the issuer's equity shares, or 3) variations inversely related to changes in the fair value of the issuer's equity shares.
- e. Instruments in which the counterparty (holder) is not exposed to the risks and benefits that are similar to those of a holder of an outstanding share of the entity's equity shall be classified as a liability.

28. If a free-standing financial instrument will be redeemed only upon the occurrence of a conditional event, redemption of that instrument is conditional and, therefore, the instrument does not meet the definition of mandatorily redeemable financial instrument. However, that financial instrument shall be assessed each reporting period to determine whether circumstances have changed such that the instrument meets the definition of a mandatorily redeemable instrument (that is, the event is no longer conditional). If the event has occurred, the condition is resolved, or the event has become certain to occur, the financial instrument shall be reclassified as a liability.

29. The classification of a free-standing financial instrument as a liability or equity shall only apply to the instrument issuer. Holders or purchasers of such instruments shall refer to the appropriate investment statement for valuation and reporting.

Disclosures

30. Disclose the following information for each joint and several liability arrangements accounted for under paragraph 5. If co-obligors are related parties, disclosure requirements in *SSAP No. 25—Affiliates and Other Related Parties* also apply.

- a. The nature of the arrangement including: 1) how the liability arose, 2) the relationship with co-obligors, and 3) the terms and conditions of the arrangements.
- b. The total outstanding amount under the arrangement, which shall not be reduced by the effect of any amounts that may be recoverable from other entities.
- c. The carrying amount, if any, of the entity's liability and the carrying amount of a receivable recognized, if any.
- d. The nature of any recourse provisions that would enable recovery from other entities of the amounts paid, including any limitations on the amounts that might be recovered.
- e. In the period the liability is initially recognized and measured or in a period the measurement changes significantly: 1) the corresponding entry, and 2) where the entry was recorded in the financial statements.

31. If a loss contingency or impairment of an asset is not recorded because only one of the conditions in paragraph 8.a. or 8.b. is met, or if exposure to a loss exists in excess of the amount accrued pursuant to the provisions described above, disclosure of the loss contingency or impairment of the asset shall be made in the financial statements when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. (Disclosures for tax contingencies as identified in paragraph 13 shall be completed as instructed within SSAP No. 101.)

32. Disclosure is not required of a loss contingency involving an unasserted claim or assessment when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable.

33. Certain loss contingencies, the common characteristic of each being a guarantee, shall be disclosed in financial statements even though the possibility of loss may be remote. Examples include (a) guarantees of indebtedness of others, and (b) guarantees to repurchase receivables (or, in some cases, to repurchase related properties) that have been sold or otherwise assigned. The disclosure of those loss contingencies, and others that in substance have the same characteristics, shall be applied to statutory financial statements. The disclosure shall include the nature and amount of the guarantee. Consideration

shall be given to disclosing, if estimable, the value of any recovery that could be expected to result, such as from the guarantor's right to proceed against an outside party.

34. A guarantor shall disclose the following information about each guarantee, or each group or similar guarantees (except product warranties addressed in paragraph 36), even if the likelihood of the guarantor's having to make any payments under the guarantee is remote. In addition, the nature of the relationship to the beneficiary of the guarantee or undertaking (affiliated or unaffiliated) shall also be disclosed:

- a. The nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose, and the events and circumstances that would require the guarantor to perform under the guarantee, the ultimate impact to the financial statements (specific financial statement line item) after the settlement of the contract guarantee if action under the guarantee was required (e.g., increase to the investment, dividends to stockholder, etc.) and the current status (that is, as of the date of the statement of financial position) of the payment/performance risk of the guarantee. For example, the current status of the payment/performance risk of a credit-risk-related guarantee could be based on either recently issued external credit ratings or current internal groupings used by the guarantor to manage its risk. An entity that uses internal groupings shall disclose how those groupings are determined and used for managing risk.
- b. The potential amount of future payments (undiscounted) the guarantor could be required to make under the guarantee. That maximum potential amount of future payments shall not be reduced by the effect of any amounts that may possibly be recovered under recourse or collateralization provisions in the guarantee (which are addressed under (d) below). If the terms of the guarantee provide for no limitation to the maximum potential future payments under the guarantee, that fact shall be disclosed. If the guarantor is unable to develop an estimate of the maximum potential amount of future payments under its guarantee, the guarantor shall disclose the reasons why it cannot estimate the maximum potential amount.
- c. The current carrying amount of the liability, if any, for the guarantor's obligations under the guarantee (including the amount, if any, recognized under paragraph 8), regardless of whether the guarantee is freestanding or embedded in another contract.
- d. The nature of (1) any recourse provisions that would enable the guarantor to recover from third parties any of the amounts paid under the guarantee and (2) any assets held either as collateral or by third parties that, upon the occurrence of any triggering event or condition under the guarantee, the guarantor can obtain and liquidate to recover all or a portion of the amounts paid under the guarantee. The guarantor shall indicate, if estimable, the approximate extent to which the proceeds from liquidation of those assets would be expected to cover the maximum potential amount of future payments under the guarantee.

35. An aggregate compilation of guarantee obligations shall include the maximum potential of future payments of all guarantees (undiscounted), the current liability (contingent and noncontingent) reported in the financial statements, and the ultimate financial statement impact based on maximum potential payments (undiscounted) if performance under those guarantees had been triggered.

36. As product warranties are excluded from the initial recognition and initial measurement requirements for guarantees, a guarantor is not required to disclose the maximum potential amount of future payments. Instead the guarantor is required to disclose for product warranties the following information:

- a. The guarantor's accounting policy and methodology used in determining its liability for product warranties (Including any liability associated with extended warranties).
- b. A tabular reconciliation of the changes in the guarantor's aggregate product warranty liability for the reporting period. That reconciliation should present the beginning balance of the aggregate product warranty liability, the aggregate reductions in that liability for payments made (in cash or in kind) under the warranty, the aggregate changes in the liability for accruals related to product warranties issued during the reporting period, the aggregate changes in the liability for accruals related to preexisting warranties (including adjustments related to changes in estimates), and the ending balance of the aggregate product warranty liability.

37. The financial statements shall contain adequate disclosure about the nature of any gain contingency. However, care should be exercised to avoid misleading implications as to the likelihood of realization.

38. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

39. This statement adopts *FASB Statement No. 5, Accounting for Contingencies* (FAS 5), *FASB Statement 114, Accounting by Creditors for Impairment of a Loan* only as it amends in part FAS 5 and paragraphs 35 and 36 of *FASB Statement of Financial Accounting Concepts No. 6—Elements of Financial Statements*. *FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5* (FIN No. 14) is adopted with the modification to accrue the loss amount as the midpoint of the range rather than the minimum as discussed in paragraph 3 of FIN No. 14. This statement adopts with modification *ASU 2013-04, Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date* with the same statutory modification adopted for FIN 14.

40. This statement adopts with modification *FASB Interpretation No. 45: Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No. 34* (FIN 45), *FASB Interpretation No. 45-3, Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Grated to a Business or Owner* (FSP FIN 45-3), and *FASB Staff Position FAS 133-1 and FIN 45-4, Disclosures about Credit Derivatives and Certain Guarantees, An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45* (FSP FAS 133-1 and FIN 45-4). Statutory Modifications to FIN 45 include initial liability recognition for guarantees issued as part of intercompany or related party transactions, assessment and recognition of non-contingent guarantee obligations after recognition and settlement of a contingent obligation and revise the GAAP guidance to reflect statutory accounting terms and restrictions. Under this statement, intercompany and related party guarantees (including guarantees between parents and subsidiaries) should have an initial liability recognition unless the guarantee is considered "unlimited" or is made to/or on behalf of a wholly-owned subsidiary. (An example of an intercompany "unlimited" guarantee would be a guarantee issued in response to a rating agency's requirement to provide a commitment to support.) In instances in which an "unlimited" guarantee exists or a guarantee has been made to/or on behalf of a wholly-owned subsidiary, this statement requires disclosure, pursuant to the disclosure requirements adopted from FIN 45. The adoption of FIN 45 superseded the previously adopted guidance in *FASB Interpretation No. 34, Disclosure of Indirect Guarantees of Indebtedness of Others, An interpretation of FASB Statement No. 5*. This statement also adopts Accounting Principles Board Opinion No. 12, Omnibus Opinion—1967, paragraphs 2 and 3 with the modification that AVR, IMR and Schedule F Penalty shall be shown gross. Appropriation of retained earnings discussed in paragraph 15 of FAS 5 is addressed in *SSAP No. 72—Surplus and Quasi-Reorganizations*.

41. This statement adopts with modification the guidance in paragraphs 7-11 of *FSP EITF 00-19-2, Accounting for Registration Payment Arrangements*. This guidance specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision for a financial instrument, other agreement, should be separately recognized and measured in accordance with *FAS 5, Accounting for Contingencies*. The guidance in FSP EITF 00-19-2 is modified as follows:

- a. Registration payment arrangements meet the definition of a loss contingency in accordance with paragraph 7.
- b. Financial instruments shall be accounted for in accordance with the statutory accounting principles for that specific asset type. Registration payment arrangement obligations shall be separate from the measurement and recognition of financial instruments subject to such arrangements.
- c. Transition revisions resulting from application of this guidance shall be accounted for as a change in accounting principle pursuant to *SSAP No. 3—Accounting Changes and Corrections of Errors*. In accordance with SSAP No. 3, the cumulative effect of changes in accounting principles shall be reported as adjustments to unassigned funds in the period of change in the accounting principles.

42. This statement rejects *ASU 2020-06, Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity’s Own Equity (Subtopic 815-40), Accounting for Convertible Instruments and Contracts in an Entity’s Own Equity*.

Effective Date and Transition

43. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

44. The guidance in paragraph 10 related to when a judgment is considered rendered was originally contained in *INT 04-05: Clarification of SSAP No. 5R Guidance on when a Judgment is Deemed Rendered* and was effective September 12, 2004. The guidance for guarantees included within paragraphs 16-26 and 34-36 shall be applicable to all guarantees issued or outstanding as of December 31, 2011. Thereafter, disclosure of all guarantees shall be annually reported, with interim reporting required for new guarantees issued, and/or existing guarantees when significant changes are made. Guidance in paragraph 41 was previously reflected within *INT 08-06: FSP EITF 00-19-2, Accounting for Registration Payment Arrangements* and was effective September 22, 2008.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*
- *Issue Paper No. 20—Gain Contingencies*
- *Issue Paper No. 135—Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*

Statement of Statutory Accounting Principles No. 9

Subsequent Events

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	No other pronouncements
Affected by.....	No other pronouncements
Interpreted by	INT 22-02
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Key Terms.....	1
Recognition Guidance.....	2
Disclosures.....	3
Relevant Literature.....	4
Effective Date and Transition	4
REFERENCES.....	4
Relevant Issue Papers	4

SCOPE OF STATEMENT

1. This statement defines subsequent events and establishes the criteria for recording such events in the financial statements and/or disclosing them in the notes to the financial statements. The conclusions in this statement apply to both quarterly and annual statement filings.

SUMMARY CONCLUSION

Key Terms

2. Subsequent events shall be defined as events or transactions that occur subsequent to the balance sheet date, but before the issuance of the statutory financial statements and before the date the audited financial statements are issued, or available to be issued. The issuance of the statutory financial statements includes not only the submission of the quarterly and annual statement but also the issuance of the audit opinion by the reporting entity's certified public accountant.

3. Material subsequent events shall be considered either:

- a. Type I – Recognized Subsequent Events: Events or transactions that provide additional evidence with respect to conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements;

- b. Type II – Nonrecognized Subsequent Events: Events or transactions that provide evidence with respect to conditions that did not exist at the balance sheet date but arose after that date.
4. **Financial statements are issued:** Financial statements are considered issued when they are widely distributed to shareholders and other financial statement users for general use and reliance in a form and format that complies with SAP.
5. **Financial statements are available to be issued:** Financial statements are considered available to be issued when they are complete in a form and format that complies with SAP and all approvals necessary for issuance have been obtained, for example, from management, the board of directors, and/or significant shareholders. The process involved in creating and distributing the financial statements will vary depending on an entity's management and corporate governance structure as well as statutory and regulatory requirements. An entity that has a current expectation of widely distributing its financial statements to its shareholders and other financial statement users shall evaluate subsequent events through the date that the financial statements are issued. All other entities shall evaluate subsequent events through the date that the financial statements are available to be issued.

Recognition Guidance

6. An entity shall recognize in the financial statements the effects of all material Type I subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Any changes in estimates resulting from the use of such evidence shall be recorded in the financial statements unless specifically prohibited, (e.g., subsequent collection of agents balances over 90 days due when determining nonadmitted agents balances as prohibited by *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*).
7. For material Type I subsequent events, the nature and the amount of the adjustment shall be disclosed in the notes to the financial statements only if necessary to keep the financial statements from being misleading.
8. Material Type II subsequent events shall not be recorded in the financial statements, but shall be disclosed in the notes to the financial statements. For such events, an entity shall disclose the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made.
9. An entity also shall consider supplementing the historical financial statements with pro forma financial data. Occasionally, a nonrecognized subsequent event may be so significant that disclosure can best be made by means of pro forma financial data. Such data shall give effect to the event as if it had occurred on the balance sheet date. In some situations, an entity also shall consider presenting pro forma statements. If an event is of such a nature that pro forma disclosures are necessary to keep the financial statements from being misleading, disclosure of supplemental pro forma financial data shall be made including the impact on net income, surplus, total assets, and total liabilities giving effect to the event as if it had occurred on the date of the balance sheet.
10. Identifying events that require adjustment of the financial statements under the criteria stated in the conclusion calls for the management of the entity to exercise judgment and accumulate knowledge of the facts and circumstances surrounding the event. For example, a loss on an uncollectible agent's balance as a result of an agent's deteriorating financial condition leading to bankruptcy subsequent to the balance sheet date would be indicative of conditions existing at the balance sheet date, thereby requiring the recording of such event to the financial statements before their issuance. On the other hand, a similar loss resulting from an agent's major casualty loss such as a fire or flood subsequent to the balance sheet date would not be indicative of conditions existing at the balance sheet date and recording of the event to the

financial statements would not be appropriate. However, this is a Type II subsequent event which would require disclosure in the notes to the financial statements.

11. The following are examples of Type I recognized subsequent events:
 - a. If the events that gave rise to litigation had taken place before the balance sheet date and that litigation is settled, after the balance sheet date but before the financial statements are issued or are available to be issued, for an amount different from the liability recorded in the accounts, then the settlement amount should be considered in estimating the amount of liability recognized in the financial statements at the balance sheet date.
 - b. Subsequent events affecting the realization of assets, such as receivables and inventories or the settlement of estimated liabilities, should be recognized in the financial statements when those events represent the culmination of conditions that existed over a relatively long period of time. For example, a loss on an uncollectible trade account receivable as a result of a customer's deteriorating financial condition leading to bankruptcy after the balance sheet date but before the financial statements are issued or are available to be issued ordinarily will be indicative of conditions existing at the balance sheet date. Thus, the effects of the customer's bankruptcy filing shall be considered in determining the amount of uncollectible trade accounts receivable recognized in the financial statements at the balance sheet date.
12. The following are examples of Type II nonrecognized subsequent events:
 - a. Sale of a bond or capital stock issued after the balance sheet date but before financial statements are issued or are available to be issued
 - b. A business combination that occurs after the balance sheet date but before financial statements are issued or are available to be issued
 - c. Settlement of litigation when the event giving rise to the claim took place after the balance sheet date but before financial statements are issued or are available to be issued
 - d. Loss of plant or inventories as a result of fire or natural disaster that occurred after the balance sheet date but before financial statements are issued or are available to be issued
 - e. Losses on receivables resulting from conditions (such as a customer's major casualty) arising after the balance sheet date but before financial statements are issued or are available to be issued
 - f. Changes in the fair value of assets or liabilities (financial or nonfinancial) or foreign exchange rates after the balance sheet date but before financial statements are issued or are available to be issued
 - g. Entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees after the balance sheet date but before financial statements are issued or are available to be issued

Disclosures

13. In addition to the disclosure of subsequent events as required throughout this statement, for annual and interim reporting periods, reporting entities shall disclose the dates through which subsequent events have been evaluated for statutory reporting and for audited financial statements along with the dates the statutory reporting statements and the audited financial statements were issued, or available to

be issued. In the audited financial statements, reporting entities shall specifically identify subsequent events identified after the date subsequent events were reviewed for statutory reporting.

14. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

15. The above guidance was originally adopted to be consistent with the AICPA *Statement on Auditing Standards No. 1*, Section 560, *Subsequent Events*. In 2009, FASB *Statement No. 165, Subsequent Events* (FAS 165), was adopted for statutory accounting. The adoption of this guidance should not result in significant changes in the subsequent events that an entity reports, through either recognition or disclosure, in its financial statements. FAS 165 introduced the concept of available to be issued and requires additional disclosures on the dates for which an entity evaluated subsequent events as well as the date the financial statements were issued, or available to be issued. Guidance within ASU 2010-09 (modifications to Subtopic 855-10 in the FASB Codification) has been rejected for statutory accounting.

Effective Date and Transition

16. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. Changes adopted as a result of FAS 165, are effective for years ending on and after December 31, 2009.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 9—Subsequent Events*

Statement of Statutory Accounting Principles No. 29

Prepaid Expenses

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Supersedes SSAP No. 87 with guidance incorporated August 2011; Nullifies and incorporates INT 08-04
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Disclosures.....	2
Relevant Literature.....	2
Effective Date and Transition	2
REFERENCES.....	2
Relevant Issue Papers	2

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the accounting for prepaid expenses. This statement does not address accounting for deferred policy acquisition costs and other underwriting expenses, income taxes, and guaranty fund assessments. This statement does not address nonrefundable advance payments for goods or services received for use in future research and development activities, which are addressed in *SSAP No. 17—Preoperating and Research and Development Costs*.

SUMMARY CONCLUSION

2. A prepaid expense is an amount which has been paid in advance of receiving future economic benefits anticipated by the payment. Prepaid expenses generally meet the definition of assets in *SSAP No. 4—Assets and Nonadmitted Assets*. Such expenditures also meet the criteria defining nonadmitted assets as specified in SSAP No. 4, (i.e., the assets are not readily available to satisfy policyholder obligations). Prepaid expenses shall be reported as nonadmitted assets and charged against unassigned funds (surplus). They shall be amortized against net income as the estimated economic benefit expires.

3. In accordance with the reporting entity's written capitalization policy, prepaid expenses less than a predefined threshold shall be expensed when purchased. The reporting entity shall maintain a

capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.

Disclosures

4. The financial statements shall disclose if the written capitalization policy and the resultant predefined thresholds changed from the prior period and the reason(s) for such change.

Relevant Literature

5. This statement rejects *AICPA Practice Bulletin No. 13, Direct-Response Advertising and Probable Future Benefits*, *AICPA Statement of Position 93-7, Reporting on Advertising Costs* and *FASB Emerging Issues Task Force No. 88-23, Lump-Sum Payments under Union Contracts*.

Effective Date and Transition

6. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. Guidance reflected in paragraphs 3 and 4, incorporated from SSAP No. 87, was originally effective for years beginning on and after January 1, 2004.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 29—Prepaid Expenses (excluding deferred policy acquisition costs and other underwriting expenses, income taxes and guaranty fund assessments)*
- *Issue Paper No. 119—Capitalization Policy, An Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82*

Statement of Statutory Accounting Principles No. 53

Property and Casualty Contracts—Premiums

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 99-23, INT 01-23, INT 02-11 and INT 05-06
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	A-225

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Earned but Unbilled Premium.....	3
Earned but Uncollected Premium	3
Advance Premiums	3
Premium Deposits on Perpetual Fire Deposits	4
Premium Deficiency Reserve	4
Disclosures.....	4
Relevant Literature.....	4
Effective Date and Transition	5
REFERENCES.....	5
Relevant Issue Papers	5

SCOPE OF STATEMENT

1. This statement establishes general statutory accounting principles for the recording and recognition of premium revenue for property and casualty contracts as defined in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts*.
2. Specific statutory requirements for certain property and casualty premiums are addressed in the following statements: (a) *SSAP No. 57—Title Insurance*, (b) *SSAP No. 58—Mortgage Guaranty Insurance*, (c) *SSAP No. 60—Financial Guaranty Insurance*, (d) *SSAP No. 62R—Property and Casualty Reinsurance*, (e) *SSAP No. 65—Property and Casualty Contracts*, and (f) *SSAP No. 66—Retrospectively Rated Contracts and Contracts*.

SUMMARY CONCLUSION

3. Except as provided for in paragraph 4, written premium is defined as the contractually determined amount charged by the reporting entity to the policyholder for the effective period of the contract based on the expectation of risk, policy benefits, and expenses associated with the coverage provided by the

terms of the insurance contract. Frequently, insurance contracts are subject to audit by the reporting entity and the amount of premium charged is subject to adjustment based on the actual exposure. Premium adjustments are discussed in paragraphs 10-13 of this statement.

4. For workers' compensation contracts, which have a premium that may periodically vary based upon changes in the activities of the insured, written premiums may be recorded on an installment basis to match the billing to the policyholder. Under this type of arrangement, the premium is determined and billed according to the frequency stated in the contract, and written premium is recorded on the basis of that frequency.

5. Premiums for prepaid legal expense plans shall be recognized as income on the gross basis (amount charged to the policyholder or subscriber exclusive of copayments or other charges) when due from policyholders or subscribers, but no earlier than the effective date of coverage, under the terms of the contract. Due and uncollected premiums shall follow the guidance in *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*, to determine the admissibility of premiums and related receivables.

6. Written premiums for all other contracts shall be recorded as of the effective date of the contract. Upon recording written premium, a liability, the unearned premium reserve, shall be established to reflect the amount of premium for the portion of the insurance coverage that has not yet expired. Flat fee service charges on installment premiums¹ (fees charged to policyholders who pay premiums on an installment basis rather than in full at inception of contract) are reported in the Other Income section of the Underwriting and Investment Exhibit as Finance and Service Charges. Flat fee service charges on installment premiums, which do not meet the requirements outlined in footnote 1 (e.g., policy may be cancelled for non-payment of fee or fee is refundable), shall be recorded as written premium on the effective date of the contract and subject to the unearned premium guidelines included in paragraph 8.

7. The exposure to insurance risk for most property and casualty insurance contracts does not vary significantly during the contract period. Therefore, premiums from those types of contracts shall be recognized in the statement of income, as earned premium, using either the daily pro-rata or monthly pro-rata methods as described in paragraph 8. Certain statements provide for different methods of recognizing premium in the statement of operations for specific types of contracts. For contracts not separately identified in specific statements where the reporting entity can demonstrate the period of risk differs significantly from the contract period, premiums shall be recognized as revenue over the period of risk in proportion to the amount of insurance protection provided.

8. One of the following methods shall be used for computation of the unearned premium reserve:

- a. Daily pro rata method—Calculate the unearned premium on each policy—At the end of each period, the calculation is made on each item of premium to ascertain the unexpired portion and to arrive at the aggregate unearned premium reserve;
- b. Monthly pro rata method—This method assumes that, on average, the same amount of business is written each day of any month so that the mean will be the middle of the

¹ If the policyholder elects to pay an installment rather than the full amount or the full remaining balance, the policyholder is traditionally charged a flat fee service charge on the subsequent billing cycle(s). The amount charged is primarily intended to compensate the insurer for the additional administrative costs associated with processing more frequent billings and has no relationship to the amount of insurance coverage provided, the period of coverage, or the lost investment income associated with receiving the premium over a period of time rather than in a lump sum. As described, there is no underwriting risk associated with this service charge. If a policyholder does not pay the service charge, the policy is not cancelled (unlike non-payment of premium), but instead the policy is converted back to an annual pay plan. If a policyholder cancels coverage, the premium is returned but the service charge is not, as the service charge is not a part of premium. Note that this footnote on flat fee service charges on installment premium is intentionally narrow and specific, and this guidance should not be applied to other fees or service charges. Reporting of installment fees in finance and service charges as other income should not be construed as having any bearing on whether such charges are subject to premium taxation, which remains an issue of state law and regulation.

month. For example, one-year premiums written during the first three months of the year have, at the end of the year, the following unearned fractions: January-1/24; February-3/24; March-5/24.

9. Additional premiums charged to policyholders for endorsements and changes in coverage under the contract shall be recorded on the effective date of the endorsement and accounted for in a manner consistent with the methods discussed in paragraphs 4-8. This is done so that, at any point in time, a liability is accrued for unearned premium related to the unexpired portion of the policy endorsement.

Earned but Unbilled Premium

10. Adjustments to the premium charged for changes in the level of exposure to insurance risk (e.g., audit premiums on workers' compensation policies) are generally determined based upon audits conducted after the policy has expired. Reporting entities shall estimate audit premiums, the amount generally referred to as earned but unbilled (EBUB) premium, and shall record the amounts as an adjustment to premium, either through written premium or as an adjustment to earned premium. The estimate for EBUB may be determined using actuarially or statistically supported aggregate calculations using historical company unearned premium data, or per policy calculations.

11. EBUB shall be adjusted upon completion of the audit and the adjustment shall be recognized as revenue immediately. Upon completion of an audit that results in a return of premiums to the policyholder, earned premiums shall be reduced.

12. Reporting entities shall establish all of the requisite liabilities associated with the asset such as commissions and premium taxes. These liabilities shall be determined based on when premium is earned, not collected².

13. Ten percent of EBUB in excess of collateral specifically held and identifiable on a per policy basis shall be reported as a nonadmitted asset. To the extent that amounts in excess of the 10% are not anticipated to be collected, they shall be written off against operations in the period the determination is made.

Earned but Uncollected Premium

14. Reporting entities may utilize a voluntary procedure whereby policies are not cancelled for non-payment of the premium until after an extended cancellation period (example 30 days), as opposed to the shorter statutory cancellation period. There are other instances when a reporting entity provides coverage for periods when the payment has not been received. Prior to the cancellation of the policy the reporting entity acknowledges it is "at risk" and subject to "actual exposure" for a valid claim despite the fact that the reporting entity may not have received payment of the premium for this exposure. Reporting entities shall record earned but uncollected premium as direct and assumed written premium since the reporting entity is "at risk" and subject to "actual exposure" for the extended period of time when the policy is still in force and effective, whether or not the reporting entity collects a premium for this time period. Earned but uncollected premium would be charged to expenses "net gain or (loss) from agents or premium balances charged off" when it is determined to be uncollectible.

Advance Premiums

15. Advance premiums result when the policies have been processed, and the premium has been paid prior to the effective date. These advance premiums are reported as a liability in the statutory financial

² If an entity feels comfortable enough in their ability to collect the premium that an asset is recorded, they should also book the associated liabilities. Once an estimate of the premium has been made and the entity feels certain that it will be collected, it should also book the liabilities that will be due when they receive the cash. If the premiums were unearned and the policyholder had the ability to cancel, the definition of a liability has not been met.

statement and not considered income until due. Such amounts are not included in written premium or the unearned premium reserve.

Premium Deposits on Perpetual Fire Deposits

16. Premium deposits on perpetual fire insurance risks should be charged as a liability to the extent of at least 90% of the gross amount of such deposit.

Premium Deficiency Reserve

17. When the anticipated losses, loss adjustment expenses, commissions and other acquisition costs, and maintenance costs exceed the recorded unearned premium reserve, and any future installment premiums on existing policies, a premium deficiency reserve shall be recognized by recording an additional liability for the deficiency, with a corresponding charge to operations. Commission and other acquisition costs need not be considered in the premium deficiency analysis to the extent they have previously been expensed. For purposes of determining if a premium deficiency exists, insurance contracts shall be grouped in a manner consistent with how policies are marketed, serviced and measured. A liability shall be recognized for each grouping where a premium deficiency is indicated. Deficiencies shall not be offset by anticipated profits in other policy groupings.

18. If a premium deficiency reserve is established in accordance with paragraph 17, disclose the amount of that reserve. If a reporting entity utilizes anticipated investment income as a factor in the premium deficiency calculation, the reporting entity's disclosures shall include a statement that anticipated investment income was utilized; however, the dollar amount need not be included. Reporting entities need to disclose by statement only that anticipated investment income was utilized in the calculation of premium deficiency reserves whether a reserve is recorded or not (i.e., the use of anticipated investment income mitigated the need for recording a premium deficiency reserve).

Disclosures

19. Disclose the aggregate amount of direct premiums written through managing general agents or third party administrators. For purposes of this disclosure, a managing general agent means the same as in Appendix A-225. If this amount is equal to or greater than 5% of surplus, provide the following information for each managing general agent and third party administrator:

- a. Name and address of managing general agent or third party administrator;
- b. Federal Employer Identification Number;
- c. Whether such person holds an exclusive contract;
- d. Types of business written;
- e. Type of authority granted (i.e., underwriting, claims payment, etc.); and
- f. Total premium written.

20. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

21. This statement rejects *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises*.

Effective Date and Transition

22. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The guidance in paragraph 5 was originally contained within *INT 01-23: Prepaid Legal Insurance Premium Recognition* and was effective June 11, 2001. The guidance reflected in paragraph 12, incorporated from *INT 02-11: Recognition of Amounts Related to Earned but Unbilled Premium*, was effective September 10, 2002. The guidance reflected in paragraph 14, incorporated from *INT 05-06: Earned but Uncollected Premium*, was effective December 3, 2005. The guidance in paragraph 18 incorporated from *INT 99-23: Disclosure of Premium Deficiency Reserves* was effective December 6, 1999.

REFERENCES**Relevant Issue Papers**

- *Issue Paper No. 53—Property Casualty Contracts—Premiums*

Statement of Statutory Accounting Principles No. 55

Unpaid Claims, Losses and Loss Adjustment Expenses

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Supersedes SSAP No. 85 with guidance incorporated August 2011; Nullifies and incorporates INT 00-31, INT 01-28, INT 02-21, INT 03-17 and INT 06-14
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SUMMARY CONCLUSION	2
Property/Casualty.....	2
Life, Accident and Health	4
Managed Care	4
Managed Care and Accident and Health.....	5
General.....	7
Disclosures.....	8
Relevant Literature.....	9
Effective Date and Transition	9
REFERENCES.....	10
Relevant Issue Papers	10

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for recording liabilities for unpaid claims and claim adjustment expenses for life insurance contracts and accident and health contracts and unpaid losses and loss adjustment expenses for property and casualty insurance contracts. This guidance applies equally to those entities with direct and reinsurance-assumed obligations. This statement applies to all insurance contracts as defined in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts*.

2. This statement does not address policy reserves for life and accident and health policies. These reserves are addressed in *SSAP No. 51R—Life Contracts*, *SSAP No. 52—Deposit-Type Contracts*, *SSAP No. 54R—Individual and Group Accident and Health Contracts*, and *SSAP No. 59—Credit Life and Accident and Health Insurance Contracts*.

3. This statement does not address liabilities for punitive damages. These liabilities shall be recorded in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*.

SUMMARY CONCLUSION

4. Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims-made type policies, the covered or insured event is the reporting to the entity of the incident that gives rise to a claim. Until claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event, and in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related to extra contractual obligations and bad-faith lawsuits.

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts for which the liability is established net of capitated payments to providers.

Property/Casualty

6. The following are types of future costs relating to property and casualty contracts, as defined in SSAP No. 50, which shall be considered in determining the liabilities for unpaid losses and loss adjustment expenses:

- a. Reported Losses: Expected payments for losses relating to insured events that have occurred and have been reported to, but not paid by, the reporting entity as of the statement date;
- b. Incurred But Not Reported Losses (IBNR): Expected payments for losses relating to insured events that have occurred but have not been reported to the reporting entity as of the statement date. As a practical matter, IBNR may include losses that have been reported to the reporting entity but have not yet been entered to the claims system or bulk provisions. Bulk provisions are reserves included with other IBNR reserves to reflect deficiencies in known case reserves;
- c. Loss Adjustment Expenses: Expected payments for costs to be incurred in connection with the adjustment and recording of losses defined in paragraphs 6.a. and 6.b. Examples of expenses incurred in these activities are estimating the amounts of losses, disbursing loss payments, maintaining records, general clerical, secretarial, office maintenance, occupancy costs, utilities, computer maintenance, supervisory and executive duties, supplies, and postage. Loss adjustment expenses can be classified into two broad categories: Defense and Cost Containment (DCC) and Adjusting and Other (AO):
 - i. DCC include defense¹, litigation, and medical cost containment expenses, whether internal or external. DCC include, but are not limited to, the following items:
 - (a) Surveillance expenses;

¹ Legal defense costs incurred under the definition of covered damages or losses as the only insured peril would be accounted for as losses, while legal defense costs incurred under a duty to defend would be accounted for as Defense and Cost Containment (DCC). For policies where legal costs are the only insured peril, the insurer would record the legal costs that reimburse the policyholder as loss and, to the extent the insurer participated in the defense, would record its legal costs as DCC. This is not intended to change the classifications of legal expenses for existing long tailed lines of liability coverage, such as medical malpractice and workers' compensation insurance.

- (b) Fixed amounts for medical cost containment expenses;
 - (c) Litigation management expenses;
 - (d) Loss adjustment expenses for participation in voluntary and involuntary market pools if reported by accident year;
 - (e) Fees or salaries for appraisers, private investigators, hearing representatives, reinspectors and fraud investigators, if working in defense of a claim, and fees or salaries for rehabilitation nurses, if such cost is not included in losses;
 - (f) Attorney fees incurred owing to a duty to defend, even when other coverage does not exist; and
 - (g) The cost of engaging experts;
- ii. AO are those expenses other than DCC as defined in (i) above assigned to the expense group "Loss Adjustment Expense". AO include, but are not limited to, the following items:
- (a) Fees and expenses of adjusters and settling agents;
 - (b) Loss adjustment expenses for participation in voluntary and involuntary market pools if reported by calendar year;
 - (c) Attorney fees incurred in the determination of coverage, including litigation between the reporting entity and the policyholder;
 - (d) Fees and salaries for appraisers, private investigators, hearing representatives, reinspectors and fraud investigators, if working in the capacity of an adjuster; and
 - (e) Adjustment expenses arising from claims related lawsuits such as extra contractual obligations and bad faith lawsuits.
- d. The contractual terms for arrangements (i.e., variable, fixed or bundled amounts) to third-party administrators, management companies, or other entities for unpaid claims, losses and losses/claims adjustment expenses, shall be evaluated to determine if the arrangement meets the criteria to be reported as a prepaid asset and nonadmitted in accordance with *SSAP No. 29—Prepaid Expenses*. These payments shall not be offset against any amounts required to be reported in accordance with paragraph 4 or paragraph 5 within this guidance. Only when loss/claim and related adjusting expense payments, which are made by the third-party administrators, management companies or other entities, to the policyholder or claimant, shall the insurer's liability (loss/claim or loss/claim adjustment expense reserves) be reduced.
- e. Prepayments to third-party administrators, management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as aggregate write-ins for miscellaneous underwriting benefits in the Underwriting and Investment Exhibit Part 3.

Life, Accident and Health

7. The following future costs relating to life and accident and health indemnity contracts, as defined in SSAP No. 50, shall be considered in determining the liability for unpaid claims and claim adjustment expenses:

- a. Accident and Health Claim Reserves: Reserves for claims that involve a continuing loss. This reserve is a measure of the future benefits or amounts not yet due as of the statement date which are expected to arise under claims which have been incurred as of the statement date. This shall include the amount of claim payments that are not yet due such as those amounts commonly referred to as disabled life reserves for accident and health claims. The methodology used to establish claim reserves is discussed in SSAP No. 54R.
- b. Claim Liabilities for Life/Accident and Health Contracts:
 - i. Due and Unpaid Claims: Claims for which payments are due as of the statement date;
 - ii. Resisted Claims in Course of Settlement: Liability for claims that are in dispute and are unresolved on the statement date. The liability either may be the full amount of the submitted claim or a percentage of the claim based on the reporting entity's past experience with similar resisted claims;
 - iii. Other Claims in the Course of Settlement: Liability for claims that have been reported but the reporting entity has not received all of the required information or processing has not otherwise been completed as of the statement date;
 - iv. Incurred But Not Reported Claims: Liability for which a covered event has occurred (such as death, accident, or illness) but has not been reported to the reporting entity as of the statement date.
- c. Claim Adjustment Expenses for Accident and Health Reporting Entities are those costs expected to be incurred in connection with the adjustment and recording of accident and health claims defined in paragraphs 7.a. and 7.b. Certain claim adjustment expenses reduce the number or cost of health services thereby resulting in lower premiums or lower premium increases. These claim adjustment expenses shall be classified as cost containment expenses.
- d. Claim Adjustment Expenses for Life Reporting Entities: Costs expected to be incurred (including legal and investigation) in connection with the adjustment and recording of life claims defined in paragraph 7.b. This would include adjustment expenses arising from claims-related lawsuits such as extra contractual obligations and bad-faith lawsuits.
- e. In cases where insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants, the guidance in paragraph 9 applies.

Managed Care

8. The following costs relating to managed care contracts as defined in SSAP No. 50 shall be considered in determining the claims unpaid and claims adjustment expenses:

- a. Claims unpaid for Managed Care Reporting Entities:

- i. Unpaid amounts for costs incurred in providing care to a subscriber, member or policyholder including inpatient claims, physician claims, referral claims, other medical claims, resisted claims in the course of settlement and other claims in the course of settlement;
 - ii. Incurred But Not Reported Claims: Liability for which a covered event has occurred (such as an accident, illness or other service) but has not been reported to the reporting entity as of the statement date;
 - iii. Additional unpaid medical costs resulting from failed contractors under capitation contracts and provision for losses incurred by contractors deemed to be related parties for which it is probable that the reporting entity will be required to provide funding;
- b. Claim Adjustment Expenses for Managed Care Reporting Entities are those costs expected to be incurred in connection with the adjustment and recording of managed care claims defined in paragraph 8.a. Certain claim adjustment expenses reduce the number or cost of health services thereby resulting in lower premiums or lower premium increases. These claim adjustment expenses shall be classified as cost containment expenses.
 - c. Liabilities for percentage withholds (“withholds”) from payments made to contracted providers;
 - d. Liabilities for accrued medical incentives under contractual arrangements with providers and other risk-sharing arrangements whereby the health entity agrees to share savings with contracted providers.
 - e. In cases where insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants, the guidance in paragraph 9 applies.

Managed Care and Accident and Health

9. In some instances, insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants. In such cases the following guidance applies:

- a. For capitated payments under managed care contracts, the liability for claims and claim adjusting expenses shall be established in an amount necessary to adjudicate and pay all unpaid claims irrespective of payments to third-party administrators, management companies or other entities, and is reported net of capitated payments to providers.
- b. For non-capitated advance payments, the liability for unpaid losses/claims and related adjustment expenses shall be established regardless of any payments made to third-party administrators, management companies or other entities, and such payments shall be reported by the insurer as prepayments. All prepayments (i.e., variable, fixed or bundled amounts) to third-party administrators, management companies, or other entities for unpaid claims, losses and losses/claims adjustment expenses, shall be initially reported as a prepaid asset and nonadmitted in accordance with SSAP No. 29. These payments shall not be offset against any amounts required to be reported in accordance with paragraph 4 or paragraph 5 within this guidance. Only when loss/claim and related adjusting expense payments which are made by the third-party administrators, management companies or

other entities, to the policyholder or claimant, shall the insurer's liability (loss/claim or loss/claim adjustment expense reserves) be reduced.

- c. Prepayments to third-party administrators, management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as (1) aggregate write-ins for expenses - Life/Health (Exhibit 2 – General Expenses) or (2) aggregate write-ins for expenses (General Administrative Expenses) - Health (Underwriting and Investment Exhibit Part 3).

Note that the guidance in paragraph 9 does not alter existing guidance regarding the admissibility of loans and advances to providers which apply to health insurance and managed care contracts which is addressed in *SSAP No. 84—Health Care and Government Insured Plan Receivables*.

10. Claim adjustment expenses for accident and health contracts and managed care contracts (identified in paragraphs 7.c. and 8.b.), including legal expenses, can be subdivided into cost containment expenses and other claim adjustment expenses:

- a. Cost containment expenses: Expenses that actually serve to reduce the number of health services provided or the cost of such services. The following are examples of items that shall be considered “cost containment expenses” only if they result in reduced levels of costs or services:
 - i. Case management activities;
 - ii. Utilization review;
 - iii. Detection and prevention of payment for fraudulent requests for reimbursement;
 - iv. Network access fees to Preferred Provider Organizations and other network-based health plans (including prescription drug networks), and allocated internal salaries and related costs associated with network development and/or provider contracting;
 - v. Consumer education solely relating to health improvement and relying on the direct involvement of health personnel (this would include smoking cessation and disease management programs, and other programs that involve hands on medical education); and
 - vi. Expenses for internal and external appeals processes.
- b. Other claim adjustment expenses: Claim adjustment expenses as defined in paragraph 7.c. or 8.b. that are not cost containment expenses. Examples of other claim adjustment expenses are:
 - i. Estimating the amounts of losses and disbursing loss payments;
 - ii. Maintaining records, general clerical, and secretarial;
 - iii. Office maintenance, occupancy costs, utilities, and computer maintenance;
 - iv. Supervisory and executive duties;
 - v. Supplies and postage;
 - vi. This would include adjustment expenses arising from claims-related lawsuits such as extra contractual obligations and bad-faith lawsuits; and

- vii. Interest paid in accordance with prompt payment laws or regulations to claimants. (Interest paid to regulatory authorities is reported as regulatory fines and fees.)

General

11. The liability for claim reserves and claim liabilities, unpaid losses, and loss/claim adjustment expenses shall be based upon the estimated ultimate cost of settling the claims (including the effects of inflation and other societal and economic factors), using past experience adjusted for current trends, and any other factors that would modify past experience. These liabilities shall not be discounted unless authorized for specific types of claims by specific SSAPs, including SSAP No. 54R and *SSAP No. 65—Property and Casualty Contracts*.

12. Various analytical techniques can be used to estimate the liability for IBNR claims, future development on reported losses/claims, and loss/claim adjustment expenses. These techniques generally consist of statistical analysis of historical experience and are commonly referred to as loss reserve projections. The estimation process is generally performed by line of business, grouping contracts with like characteristics and policy provisions. The decision to use a particular projection method and the results obtained from that method shall be evaluated by considering the inherent assumptions underlying the method and the appropriateness of those assumptions to the circumstances. No single projection method is inherently better than any other in all circumstances. The results of more than one method should be considered.

13. For each line of business and for all lines of business in the aggregate, management shall record its best estimate of its liabilities for unpaid claims, unpaid losses, and loss/claim adjustment expenses. Because the ultimate settlement of claims (including IBNR for death claims and accident and health claims) is subject to future events, no single claim or loss and loss/claim adjustment expense reserve can be considered accurate with certainty. Management's analysis of the reasonableness of claim or loss and loss/claim adjustment expense reserve estimates shall include an analysis of the amount of variability in the estimate. If, for a particular line of business, management develops its estimate considering a range of claim or loss and loss/claim adjustment expense reserve estimates bounded by a high and a low estimate, management's best estimate of the liability within that range shall be recorded. The high and low ends of the range shall not correspond to an absolute best-and-worst case scenario of ultimate settlements because such estimates may be the result of unlikely assumptions. Management's range shall be realistic and, therefore, shall not include the set of all possible outcomes but only those outcomes that are considered reasonable. Management shall also follow the concept of conservatism included in the Preamble when determining estimates for claim and loss and loss/claim adjustment expense reserves. However, there is not a specific requirement to include a provision for adverse deviation in claims.

14. In the rare instances when, for a particular line of business, after considering the relative probability of the points within management's estimated range, it is determined that no point within management's estimate of the range is a better estimate than any other point, the midpoint within management's estimate of the range shall be accrued. It is anticipated that using the midpoint in a range will be applicable only when there is a continuous range of possible values, and no amount within that range is any more probable than any other. For purposes of this statement, it is assumed that management can quantify the high end of the range. If management determines that the high end of the range cannot be quantified, then a range does not exist, and management's best estimate shall be accrued. This guidance is not applicable when there are several point estimates which have been determined as equally possible values, but those point estimates do not constitute a range. If there are several point estimates with equal probabilities, management should determine its best estimate of the liability.

15. If a reporting entity chooses to anticipate salvage and subrogation recoverables (including amounts recoverable from second injury funds, other governmental agencies, or quasi-governmental agencies, where applicable), the recoverables shall be estimated in a manner consistent with

paragraphs 11-13 of this statement. Estimated salvage and subrogation recoveries (net of associated recovery expenses) shall be deducted from the liability for unpaid claims, unpaid losses, and unpaid loss/claim adjustment expenses, depending on whether the subrogation represents a recovery of claims/losses or loss/claims adjustment expenses. If a reporting entity chooses to anticipate coordination of benefits (COB) recoverables of Individual and Group Accident and Health Contracts, the recoverables shall be estimated in a manner consistent with paragraphs 11-13 of this statement and shall be deducted from the liability for unpaid claims or losses. A separate receivable shall not be established for these recoverables. In addition, all of these recoverables are also subject to the impairment guidelines established in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* and an entity shall not reduce its reserves for any recoverables deemed to be impaired. Salvage and subrogation recoveries received (net of associated recovery expenses) are reported as a reduction to paid losses/claims and/or paid loss/claim adjustment expenses. Coordination of benefits (COB) recoveries received of Individual and Group Accident and Health Contracts (net of associated recovery expenses) are reported as a reduction to paid claims.

16. Changes in estimates of the liabilities for unpaid claims or losses and loss/claim adjustment expenses resulting from the continuous review process, including the consideration of differences between estimated and actual payments, shall be considered a change in estimate and shall be recorded in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. SSAP No. 3 requires changes in estimates to be included in the statement of operations in the period the change becomes known. This guidance also applies to the period subsequent to the March 1 filing deadline for annual financial statements through the filing deadline of June 1 for audited annual financial statements.

Disclosures

17. The financial statements shall include the following disclosures for each year full financial statements are presented. The disclosure requirement in paragraph 17.d. is also applicable to the interim financial statements if there is a material change from the amounts reported in the annual filing. Life and annuity contracts are not subject to this disclosure requirement.

- a. The balance in the liabilities for unpaid claims and unpaid losses and loss/claim adjustment expense reserves at the beginning and end of each year presented;
- b. Incurred claims, losses, and loss/claim adjustment expenses with separate disclosures of the provision for insured or covered events of the current year and increases or decreases in the provision for insured or covered events of prior years;
- c. Payments of claims, losses, and loss/claim adjustment expenses with separate disclosures of payments of losses and loss/claim adjustment expenses attributable to insured or covered events of the current year and insured or covered events of prior years;
- d. The reasons for the change in the provision for incurred claims, losses, and loss/claim adjustment expenses attributable to insured or covered events of prior years. The disclosure should indicate whether additional premiums or return premiums have been accrued as a result of the prior-year effects. (For Title reporting entities, “provision” refers to the known claims reserve included in Line 1 of the Liabilities page, and “prior years” refers to prior report years);
- e. Information about significant changes in methodologies and assumptions used in calculating the liability for unpaid claims and claim adjustment expenses, including reasons for the change and the effects on the financial statements for the most recent reporting period presented;

- f. A summary of management's policies and methodologies for estimating the liabilities for losses and loss/claim adjustment expenses, including discussion of claims for toxic waste cleanup, asbestos-related illnesses, or other environmental remediation exposures;
 - g. Disclosure of the amount paid and reserved for losses and loss/claim adjustment expenses for asbestos and/or environmental claims, on a direct, assumed and net of reinsurance basis (the reserves required to be disclosed in this section shall exclude amounts relating to policies specifically written to cover asbestos and environmental exposures). Each company should report only its share of a group amount (after applying its respective pooling percentage) if the company is a member of an intercompany pooling agreement; and
 - h. Estimates of anticipated salvage and subrogation (including amounts recoverable from second injury funds, other governmental agencies, or quasi-governmental agencies, where applicable), deducted from the liability for unpaid claims, losses or their associated adjusting expenses.
18. All reporting entity types are required to disclose the dollar amount of any claims/losses related to extra contractual obligation lawsuits or bad faith lawsuits paid during the reporting period on a direct basis. The number of such claims paid shall be disclosed in a note.
19. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

20. Although FASB *Statement No. 60, Accounting and Reporting by Insurance Enterprises* (FAS 60), is rejected in SSAP No. 50, this statement is consistent with the guidance provided for the recognition of claim costs in FAS 60 with the exception of the statutory requirement to accrue the midpoint of a range of loss or loss adjustment expense reserve estimates when no point within management's continuous range of reasonably possible estimates is determined to be a better estimate than any other point.
21. This statement also rejects *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*, *AICPA Statement of Position 92-4, Auditing Insurance Entities' Loss Reserves* and *ASU 2015-09, Disclosures about Short-Duration Contracts*. Although the disclosures in ASU 2015-09 are similar to existing statutory accounting disclosures on claims development, the U.S. GAAP disclosures would reflect consolidated information, with potential for different aggregations than what is used for a legal entity basis under statutory accounting. As such, ASU 2015-09 is rejected for statutory accounting, and reporting entities shall follow the established statutory accounting disclosures.
22. Guidance in paragraphs 7.c., 8.b. and 10 was incorporated from SSAP No. 85. SSAP No. 85 was issued in 2002 to amend SSAP No. 55 and provide clarification regarding what costs should be classified as claim adjustment expenses on accident and health contracts. In August 2011, SSAP No. 85 was nullified and the guidance was incorporated into this SSAP. *Issue Paper No. 116—Claim Adjustment Expenses, Amendments to SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* provides historical reference on the original guidance included in SSAP No. 55 as well as the revisions originally reflected in SSAP No. 85.

Effective Date and Transition

23. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3. Guidance reflected in paragraphs 7.c., 8.b. and 10, incorporated from SSAP No. 85, is effective for years ending on and after December 31, 2003. The guidance incorporated into paragraphs 1, 3, 6.c.ii., 7.d. and 10.b.vi. was originally included in *INT 03-17: Classification of Liabilities from Extra*

Contractual Obligation Lawsuits and was initially effective March 10, 2004. The guidance in paragraph 5 was previously included in *INT 02-21: Accounting for Prepaid Loss Adjustment Expenses and Claim Adjustment Expenses* effective for reporting periods ending on or after December 31, 2002, for all contracts except for capitated managed care contracts and December 31, 2006, for capitated managed care contracts. The guidance in paragraph 13 related to conservatism and adverse deviation was originally contained in *INT 01-28: Margin for Adverse Deviation in Claim Reserve* and was effective October 16, 2001. The guidance in paragraph 15 related to coordination of benefits was originally contained within *INT 00-31: Application of SSAP No. 55 Paragraph 12 to Health Entities* and was effective December 4, 2000. The guidance reflected in footnote 1, incorporated from *INT 06-14: Reporting of Litigation Costs Incurred for Lines of Business in which Legal Expenses Are the Only Insured Peril*, was effective June 2, 2007. The guidance in paragraph 10.b.vii. regarding interest on managed care and accident and health claims is effective January 1, 2020, with early adoption permitted, and shall be applied prospectively.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*
- *Issue Paper No. 116—Claim Adjustment Expenses, Amendments to SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*

Statement of Statutory Accounting Principles No. 57

Title Insurance

STATUS

Type of Issue.....	Property and Casualty
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	No other pronouncements
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	A-628

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SCOPE OF STATEMENT

1. Title insurance insures that the policyholder has title to the property on the subject real estate as of the date of policy issuance, subject to exceptions and exclusions in the policy. When issued, a title policy has a one-time premium and reserves are established by the title insurance company. Title insurance differs from other lines of property and casualty insurance because its basic goal is risk elimination.

2. This statement establishes statutory accounting principles for title insurance and addresses areas where title insurance accounting differs from other lines of insurance. To the extent a topic is not covered by this statement, title insurance accounting shall comply with statutory accounting guidance for other lines of property and casualty insurance.

SUMMARY CONCLUSION**General**

3. Title insurers perform many services in connection with the transfer of real estate; however, their principal function involves insuring, guaranteeing, or indemnifying owners of real property or the holders of liens or encumbrances thereon against loss or damage due to defective titles, liens, or encumbrances or, in most states, the unmarketability of the title.

4. In addition to insuring against defective records or examination of those records, an insurer insures against “non-record defects” such as:

- a. Forgeries;
- b. Fraud;
- c. Confusion of name in change of title;
- d. Incompetence (minors or persons of unsound mind);
- e. Mistakes in public records;
- f. Undisclosed or missing heirs;
- g. Instruments executed under a fabricated or expired power of attorney;
- h. Deeds delivered after death of grantor or grantee or without the consent of the grantor;
- i. Deeds by persons supposedly single but actually married;
- j. Wills not probated;
- k. Liens against property (e.g., mechanics liens and tax liens);
- l. Falsified records.

5. Before a title insurance policy is issued, the title insurer, or its agent, must search and examine public records concerning the ownership, liens, and encumbrances on the subject real estate together with information relating to persons having an interest in the real property as well as maps and other records to determine that title to the property is insurable, or defects can be overcome.

Premium Revenue and Loss Reserve Recognition

6. A variety of services are generally provided (either by the title insurance underwriter, its agent, or others) in connection with the transfer of title to real estate. Title insurance premiums frequently are determined in the rate-making process based on the bundle of services provided, including some or all of title search and examination and closing or escrow fees. By statute or custom, certain states exclude a combination of title search, examination and closing or escrow fees from the rate-making process for title insurance premiums. Premiums shall be recorded at the date of policy issuance, on a gross premium basis, consistent with the rate-making method used. The premium related to a title insurance policy is due upon the effective date of the insurance and is not refundable. The term of a title insurance policy is indefinite because the policyholder is insured for as long as he or his heirs or devisees have an interest in the property.

7. Amounts paid to or retained by agents shall be reported as an expense.

8. A liability shall be established for all known unpaid claims and loss adjustment expenses (known claims reserve) with a corresponding charge to income. The known claim reserve is further detailed in the Title Annual Statement Operations and Investment Exhibit on Unpaid Losses and Loss Adjustment Expenses. The known claims reserve should be the estimated costs to settle reported claims based upon the most current information available to the company as of the balance sheet date. This amount cannot be less than the aggregate of the individual case reserves.

9. Premium revenue shall be deferred to the extent necessary to maintain a Statutory or Unearned Premium Reserve (SPR or UPR) determined in accordance with the reserve section of Appendix A-628.

10. If the actuarially determined liability (the sum of the known claims reserve, IBNR claims reserve, and loss adjustment expense reserve) exceeds the sum of the known claims reserve and SPR or UPR, a supplemental reserve shall be established that is equal to the difference between these sums. This calculation is explicitly detailed in the Title Annual Statement Operations and Investment Exhibit for Unpaid Losses and Loss Adjustment Expenses.

11. The actuarially determined liability for the sum of known claims reserve required in paragraph 8 and the IBNR claims and loss adjustment expenses required in paragraph 10 of this statement shall be determined consistently with the guidance detailed in *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* and consistent with paragraph 13 of this statement.

12. Assets acquired in settlement of claims (e.g., mortgages and real estate) shall be accounted for consistent with the guidance related to the asset acquired. For example, an impaired loan shall be accounted for in accordance with *SSAP No. 37—Mortgage Loans*, and real estate acquired in foreclosure shall be accounted for in accordance with *SSAP No. 40R—Real Estate Investments*.

Salvage and Subrogation

13. Salvage and subrogation shall be reflected as follows:

- a. Paid losses shall be reported net of realized, but not anticipated, salvage and subrogation. Case basis loss and loss adjustment expense reserves shall not be reduced for anticipated salvage and subrogation, nor shall an asset be established;
- b. Paid salvage and subrogation is not realized until a salvage asset or an actual payment pursuant to a subrogation right is in the direct control of the insurer and admissible as an asset for statutory reporting purposes in its own right;
- c. Salvage assets and payments pursuant to a subrogation right shall be recorded at current fair value. Current fair value of real estate shall be established through an appraisal conducted by a qualified independent appraiser;
- d. If a salvage asset is sold or revalued by the insurer within twelve months of realization for an amount less than the value at which it was originally placed on the books of the insurer, then the loss on disposition shall be treated as a decrease in paid salvage (same effect as an addition to the paid loss) on the corresponding claim. After twelve months, such salvage revaluation will be treated as a loss on disposition or change in value of an asset, and shall not be deducted from the salvage on the corresponding claim;
- e. If a salvage asset is sold or revalued by the insurer within twelve months of realization for an amount greater than the value at which it was originally placed on the books of the insurer, then the gain on disposition shall be treated as an increase in paid salvage (same effect as a deduction to the paid loss) on the corresponding claim. After twelve months, such salvage revaluation shall be treated as a gain on disposition or change in value of an asset and shall not be added to the salvage on the corresponding claim;

- f. In completing Schedule P and Part 3B, IBNR reserves may make an actuarially determined provision for the expected value of future salvage and subrogation on open claims and IBNR claims.

Reinsurance

14. Although by their nature, title claims relate to errors or omissions that occurred prior to the inception of the reinsurance agreement, title reinsurance contracts shall be accounted for as prospective reinsurance agreements if they meet all of the other criteria established in *SSAP No. 62R—Property and Casualty Reinsurance*.

Allocation of Expenses

15. This statement establishes uniform allocation rules to classify title insurance expenses within prescribed principal groupings. It is necessary to allocate those expenses which may contain characteristics of more than one classification, which this statement will refer to as allocable expenses.

16. Allocable expenses for title insurance companies shall be classified into the following categories on the expense section of the Operations and Investment Exhibit of the annual statement.

- a. Title and Escrow Operating Expenses—Title and escrow operating expenses consist of all expenses incurred in relation to engaging in the business of title insurance, including costs associated with the following: (i) issuing or offering to issue a title insurance policy; (ii) soliciting or negotiating the issuance of a title insurance policy; (iii) guaranteeing, warranting or otherwise insuring the correctness of title searches affecting title to real property; (iv) handling of escrows, settlements or closings; (v) executing title insurance policies, effecting contracts of reinsurance, and abstracting, searching or examining titles. Also included are specifically identifiable and allocated expenses relating to the following activities; (i) supervision and training of employees and agents; (ii) operating costs for branch offices or agencies; (iii) underwriting activities; (iv) receiving and paying of premiums and commissions; (v) maintaining general and detailed records; (vi) data processing, advertising, and publicity, clerical, secretarial, office maintenance, supervisory, and executive duties; (vii) postage and delivery; and (viii) all other functions reasonably associated with the business of title insurance. Title and escrow operating expenses do not include losses, loss adjustment expenses (allocated or unallocated), expense of other operations, or investment expenses. The expenses include only amounts incurred directly by the insurer and do not include expenses incurred by any agents (regardless of ownership interest).
- b. Title and Escrow Operating Expenses are further broken down in the annual statement by the distribution network that gives rise to the expense incurrence. Accordingly, expenses are specifically identified or allocated (in accordance with reasonable allocation procedures consistently applied) to either Direct Operations, Non-affiliated Agency Operations, or Affiliated Agency Operations.
- c. Unallocated Loss Adjustment Expenses (ULAE)—ULAE are those indirect costs incurred by a title insurer, typically internal to the company, which are necessary to process claims or manage the claims settlement function and which are not incurred on a claim-specific basis. ULAE shall include all costs of outside parties involved in claims adjusting services, but shall not include any costs incurred by agents in settlement of title or other claims.
- d. Investment Expenses—Investment expenses are those expenses incurred in the investing of funds and the pursuit of investment income, including specifically identifiable and

allocated expenses related to such activities as: (i) initiating or handling orders and recommendations for investments; (ii) research, pricing, appraising, and valuing; (iii) disbursing funds and collecting income; (iv) safekeeping of securities and valuable papers; (v) maintaining general and detailed records; (vi) data processing; (vii) general clerical, secretarial, office maintenance, supervisory, and executive duties; (viii) supplies, postage, and the like; and (ix) all other functions reasonably attributable to the investment of funds. Real estate expenses and real estate taxes are attributable to the Investment Expenses group.

- e. Other Operations—The amounts shown for this category represent the allocable expenses incurred by the company in operations other than title and escrow, unallocated loss adjustment, or investment activities.

17. Allocation to the above categories should be based on a method that yields the most accurate results. Specific identification of an expense with an activity that is represented by one of the categories above will generally be the most accurate method. Where specific identification is not feasible, allocation of expenses should be based upon pertinent factors or ratios such as studies of employee activities, salary ratios, or similar analyses.

18. Many companies operate within a group where personnel and facilities are shared. Shared expenses, including expenses under the terms of a management contract, shall be apportioned to the companies incurring the expense as if the expense had been paid solely by the incurring company. The apportionment shall be completed based upon specific identification to the company incurring the expense. Where specific identification is not feasible, apportionment shall be based upon pertinent factors or ratios. Any basis adopted to apportion expenses shall be that which yields the most accurate results and may result from special studies of employee activities, salary ratios, premium ratios or similar analyses. Expenses that relate solely to the operations of an insurance company, such as personnel costs associated with the adjusting and paying of claims, must be borne solely by the insurance company and are not to be apportioned to other companies within a group. Pertinent factors in making this determination shall include which entity has the ultimate obligation to pay the expense. Apportioned expenses are subject to presentation and allocation as provided in paragraphs 16 and 17.

Title Plant

19. Title plants are an integrated and indexed collection of title records consisting of documents, maps, surveys, or entries affecting title to real property or any interest in or encumbrance on the property, which have been filed or recorded in the jurisdiction for which the title plant is established or maintained. They are tangible assets unique to the title insurance industry and are the principal productive asset used to generate title insurance revenue and to mitigate the risk of claims. Title plant shall be reported as an admitted asset, subject to the following valuation restrictions:

- a. Costs incurred to construct a title plant, including the costs incurred to obtain, organize, and summarize historical information in an efficient and useful manner, shall be capitalized until the title plant can be used by the company to conduct title searches and issue title insurance policies. The capitalized costs shall be directly related to, and properly identified with, the activities necessary to construct the title plant;
- b. Purchased title plants, including a purchased undivided interest in a title plant, shall be recorded at cost at the date of acquisition. For a title plant acquired separately, cost shall be measured by the fair value of the consideration given. For title plant acquired as part of a group of assets, cost shall be measured by the fair value of the consideration given and then cost shall be allocated to the title plant based on its fair value in relation to the total fair value of the group of assets acquired. For title plants acquired as part of a

purchase of assets or in a business combination, cost shall be determined in accordance with *SSAP No. 68—Business Combinations and Goodwill*;

- c. A backplant, i.e., a title plant that antedates the period of time covered by the existing title plant may be purchased or constructed. Costs to construct a backplant must be properly identifiable to qualify for capitalization;
- d. Costs incurred after a title plant is operational to (i) convert the information from one storage and retrieval system to another, or (ii) modify or modernize the storage and retrieval system shall not be capitalized;
- e. Costs incurred to maintain a title plant shall be expensed as incurred;
- f. Costs incurred to perform title searches shall be expensed as incurred;
- g. An investment in a title plant or plants in an amount equal to the actual cost shall be allowed as an admitted asset for title insurers. The aggregate carrying value of an investment in a title plant or plants shall not exceed the lesser of 20% of admitted assets or forty percent (40%) of surplus to policyholders, both as required to be shown on the statutory balance sheet of the insurer for its most recently filed statement with the domiciliary state commissioner; if the amount of the investment exceeds the above limits, the excess amount shall be recorded as a nonadmitted asset.

20. Certain circumstances may indicate that the value of the title plant may be impaired and, thus, the carrying value of the asset may not be recoverable. If there is an indication of possible impairment of value, the title plant shall be evaluated for impairment and recorded in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. The following are examples of circumstances that may indicate impairment:

- a. Effects of obsolescence, demand, and other economic factors;
- b. A significant change in legal requirements or statutory practices in the jurisdiction for which the title plant is established and maintained;
- c. A current period operating or cash flow loss combined with a history of such losses or projections that indicate continued losses associated with the revenue produced by the title plant;
- d. Failure to maintain the title plant on a current basis and/or lack of appropriate maintenance to keep the title plant up to date; or,
- e. Abandonment of a title plant.

21. A properly maintained title plant has an indeterminate life and does not diminish in value with the passage of time, and accordingly, shall not be depreciated.

22. A title insurer may (a) sell its title plant and relinquish all rights to its future use, (b) sell an undivided ownership interest in its title plant, or (c) sell a copy of its title plant or the right to use it. Accounting and presentation for each type of sale noted shall be as follows:

- a. When a title insurer sells its title plant and relinquishes all rights to its future use, consideration received shall be presented as a separate component of revenue net of the carrying value of the title plant sold;

- b. When a title insurer sells an undivided ownership interest in its title plant, consideration received shall be presented as a separate component of revenue net of the pro rata portion of the carrying value of the title plant;
- c. When a title insurer sells a copy of its title plant or the right to use it, consideration received shall be presented as a separate component of revenue and the carrying value of the title plant shall not be reduced.

Disclosures

23. The financial statements shall disclose the following for each period presented:
 - a. The amount of the known claims reserve, SPR/UPR, and the supplemental reserve;
 - b. Whether the insurer uses discounting in the calculation of its supplemental reserve, the method and rate used to determine the discount, and the amount of such discount.
24. Any material individual component of the reported expense categories shall be presented either on the face of the Summary of Operations or within the footnotes or related exhibits to the financial statements.
25. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

26. This statement rejects *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises* (FAS 60); however, it is considered appropriate to use the factors to be considered in the determination of the ultimate cost of settling claims included in FAS 60 when establishing the reserves in accordance with paragraphs 8 and 10 of this statement.
27. This statement adopts *FASB Statement No. 61, Accounting for Title Plant*, with modification for carrying value restrictions. Restrictions on the total carrying value of an investment in a title plant or plants are determined by paragraph 19.g.

Effective Date and Transition

28. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.
29. Additions to the SPR or UPR as a result of the provisions of paragraph 17.b.v. of Appendix A-628 shall be phased in pursuant to the provisions of paragraph 17.b.iv. of Appendix A-628.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 57—Title Insurance*

Statement of Statutory Accounting Principles No. 58

Mortgage Guaranty Insurance

STATUS

Type of Issue.....	Property and Casualty
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	No other pronouncements
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	A-630

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SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for mortgage guaranty insurance and addresses areas where mortgage guaranty insurance accounting differs from other lines of insurance. To the extent a topic is not covered by this statement and Appendix A-630, mortgage guaranty insurance accounting shall comply with statutory accounting guidance for other lines of property and casualty insurance.
2. Mortgage guaranty insurance protects a lender against loss of all or a portion of the principal amount of a mortgage loan upon default of the mortgagor. Mortgage guaranty insurance differs from other types of property and casualty insurance in that coverage is long-term, and in most cases premiums are level and paid monthly. Most states require issuers of mortgage guaranty contracts to be monoline insurers and impose limitations on the aggregate amount of risk insured based on geographic territories. Additionally, states may require mortgage guaranty insurers to reinsure with only selected reinsurers.

SUMMARY CONCLUSION

General

3. Mortgage guaranty insurance is provided on residential loans (one to four family residences, including condominiums and townhouses). Coverage can range from as little as 5% on pool insurance to as much as 100% of the outstanding loan amount on individual policies. Most policies cover 10% to 30% of the loan amount and are written on first mortgage loans where the loan amount is a high percentage (generally 80% to 95%) of the value of the mortgaged property.

4. Lenders obtain mortgage guaranty insurance to facilitate sales of mortgage loans in secondary markets. It also enables lenders to make a greater number of high ratio (above 80%) loans and allows them to diversify their portfolio of loans.

5. Mortgage guaranty insurers market directly to mortgage lenders. Individual mortgage loans or pools of mortgage loans are insured under individual insurance certificates or policies; each loan, however, is separately underwritten.

6. Mortgage guaranty insurance companies generally offer the following premium payment plans: (a) monthly premiums, (b) a single premium which provides coverage for periods ranging from three to 15 years, (c) nonlevel annual premiums, and (d) level annual premiums. All policies are renewable at the discretion of the lender. The mortgage guaranty insurer does not have an option to cancel or nonrenew the policy, except for fraud or nonpayment of the premium.

7. Premiums are based upon: (a) the percentage of insurance coverage provided, (b) the ratio of the insured mortgage loan to the property value or sales price, and (c) the term and/or premium payment method selected by the lender. Premiums are quoted as a percentage of the total mortgage loan insured and increase as insurance coverage and loan-to-value ratio increases.

8. If a default occurs, the mortgage guaranty insurer generally requires the lender to foreclose and tender merchantable title to the mortgaged property in order to make a claim. The insurer may then, at its option: (a) purchase the property for the lender's cost (generally the entire remaining principal loan balance plus accumulated interest and allowable expenses), (b) pay the percentage of the lender's cost specified by the policy, or (c) arrange for the lender to sell the property and reimburse the lender for any loss up to an agreed amount. Under settlement option (a), the insurer intends to resell the property with the expectation of reducing the amount of loss which would have resulted if option (b) had been elected.

Insured Risk

9. The nature of the insured risk is influenced by certain factors which set mortgage guaranty insurance apart from other types of insurance. These factors are addressed in paragraphs 10-12.

Exposure Period

10. The exposure period is significantly longer for mortgage insurance than for most other property and casualty insurance products. The exposure period can run for the term of the mortgage; however, the average policy life is seven years. The policy is terminated when the mortgage obligation is satisfied or the lender elects to cancel or not renew the policy. In contrast to mortgage guaranty insurance, most property and casualty products need not be renewed by the insurer at the expiration of the policy. Mortgage insurance is renewable at the option of the insured at the renewal rate quoted when the policy commitment was issued.

Losses

11. Losses are affected by the following factors specific to mortgage guaranty insurance:
 - a. The insured peril—the default of a borrower arises from the credit risk associated with mortgage loans. The frequency of loss is strongly influenced by economic conditions. The likelihood of individual default is further increased if the property has deteriorated since a borrower in financial difficulty will be less able to sell the property at a price sufficient to discharge the mortgage;
 - b. Mortgage insurance losses can be divided into three categories:
 - i. Normal losses associated with regular business cycles, interruptions in the borrower's earning power, and errors made in evaluating the borrower's willingness or ability to meet mortgage obligations;
 - ii. Defaults caused by adverse local economic conditions;
 - iii. Widespread defaults caused by a severe depression in the U.S. economy.

Loss Incidence

12. Losses are incurred over the exposure period which runs for the term of the mortgage. However, loss incidence peaks in the earlier years. When a loan has been delinquent two to four months, the policy requires the lender to notify the insurer. The lender generally agrees to institute foreclosure proceedings six to nine months from the date of delinquency. Foreclosure can require an additional 18 months which means a considerable delay between the delinquency and the presentation of the claim. Without adverse economic conditions, most delinquencies do not result in a loss payment. Once a claim is presented, payment normally is made within one or two months and ultimate loss costs can be known relatively quickly.

Pool Insurance

13. Mortgage guaranty insurance may be provided on pools of mortgage loans. Typically, pool insurance supports mortgage-backed securities or group sales. Unlike other pool or group products, each loan is individually underwritten.

14. Pool insurance may be provided on loans that are already insured by primary insurance, in which case the pool insurance provides an additional level of coverage, or it may be provided on loans without primary insurance (usually loans with loan-to-value ratios below 80%). Generally, pool insurance provides 100% coverage and includes a stop-loss limit of liability which may range from 5% to 20% of the initial aggregate principal balance. Because of regulatory requirements in some states, pool insurance usually uses participating reinsurance arrangements to limit the exposure of any one mortgage insurer of a pool of loans to 25% of each mortgage insured.

15. Pool insurance policies are not cancelable by the insurer except for nonpayment of premium. These policies may be written on mortgage pools having terms of up to 30 years. However, the average policy life is 8 to 12 years.

16. Upon default, the insurer has the same options as with individual insured mortgage loans. However, pool insurance loss payments are reduced by settlements under primary insurance and subject to the stop-loss limit.

17. Three kinds of mortgage-backed securities which use pool insurance are:
- a. Mortgage-backed bonds—Issued by banks, savings and loan associations and other mortgage lenders as a general obligation of the issuing institution. These bonds are collateralized by a pool of mortgages and have a stated rate of return and maturity date;
 - b. Mortgage revenue bonds—Issued by state and local housing authorities to support housing affordability for targeted income groups;
 - c. Mortgage pass-through certificates—Issued by banks, savings and loan associations, mortgage bankers, and others providing an undivided interest in a pool of mortgages with principal and interest payment passed to the certificate holder as received.

Premium Revenue Recognition

18. Written premium shall be recorded in accordance with *SSAP No. 53—Property and Casualty Contracts—Premiums*. Premium revenue shall be earned as follows:
- a. For monthly premium plans, revenues shall be earned in the month to which they relate;
 - b. For annual premium plans, revenues shall be earned on a pro rata basis over the applicable year;
 - c. For single premium plans, revenues shall be earned over the policy life in relation to the expiration of risk;
 - d. Additional first year premiums or initial renewal premiums on nonlevel policies shall be deferred and amortized to income over the anticipated premium paying period of the policy in relation to the expiration of risk.

Unpaid Losses and Loss Adjustment Expense Recognition

19. Unpaid losses and loss adjustment expenses shall be recognized in accordance with *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*. For mortgage guaranty insurance contracts, the default shall be considered the incident that gives rise to a claim as discussed in *SSAP No. 55*. If a claim is ultimately presented, the date of default shall be considered the loss incurred date.

20. The process for estimating the liability shall include projections for losses that have been reported as well as those that have been incurred but not reported. The estimates shall be made based on historical data, trends, economic factors, and other statistical information including paid claims, reported losses, insurance in force statistics, and risk statistics.

21. Real estate and mortgages are acquired by mortgage guaranty insurers to mitigate losses. These assets shall be shown on the balance sheet at the lower of cost or net realizable value, net of encumbrances. Gains or losses from the holding or disposition of these assets shall be recorded as a component of losses incurred. Rental income or holding expenses shall be included in loss adjustment expenses.

Contingency Reserve

22. In addition to the unearned premium reserve, mortgage guaranty insurers shall maintain a liability referred to as a statutory contingency reserve. The purpose of this reserve is to protect policyholders against loss during periods of extreme economic contraction. The annual addition to the liability shall equal 50% of the earned premium from mortgage guaranty insurance contracts and shall be maintained for ten years regardless of the coverage period for which premiums were paid. With commissioner

approval, when required by statute, the contingency reserve may be released in any year in which actual incurred losses exceed 35% of the corresponding earned premiums. Any such reductions shall be made on a first-in, first-out basis. Changes in the reserve shall be recorded directly to unassigned funds (surplus).

Premium Deficiency Reserve

23. When the anticipated losses, loss adjustment expenses, commissions and other acquisition costs, and maintenance costs exceed the recorded unearned premium reserve, contingency reserve, and the estimated future renewal premium on existing policies, a premium deficiency reserve shall be recognized by recording an additional liability for the deficiency with a corresponding charge to operations. Commissions and other acquisition costs need not be considered in the premium deficiency analysis to the extent they have been expensed. If an insurer utilizes anticipated investment income as a factor in the premium deficiency calculation, disclosure of such shall be made in the financial statements.

U.S. Mortgage Guaranty Tax and Loss Bonds

24. To obtain a current federal income tax benefit derived from annual additions to the statutory contingency reserve (for tax purposes, the mortgage guaranty account), mortgage guaranty insurers must purchase tax and loss bonds to the extent of the tax benefits. These bonds are noninterest bearing obligations of the U.S. Treasury and mature 10 years after issue. The usual purpose of tax and loss bonds is to satisfy taxes that will be due in 10 years when the tax benefit is reversed; however, the bonds may be redeemed earlier in the event of excess underwriting losses. These bonds are reported as admitted assets allowing mortgage insurers to conserve capital. In accordance with *SSAP No. 101—Income Taxes*, temporary differences (as defined in that statement) do not include amounts attributable to the statutory contingency reserve to the extent that “tax and loss” bonds have been purchased.

Contingency Reserve (for Tax Purposes, the Mortgage Guaranty Account)

25. Under IRS Code Section 832(e), mortgage guaranty insurers are permitted to deduct the annual addition to the contingency reserve from gross income. The tax deduction is generally an amount equal to (a) 50% of earned premium, or (b) taxable income as computed prior to this special deduction if less than 50% of earned premium. Annual deductions not utilized for tax purposes during the current period may be carried forward for eight years on a basis similar to net operating losses. The amount deducted must be restored to gross income after ten years; however, it may be restored to gross income at an earlier date in the event of a taxable net operating loss.

26. The tax deduction is permitted only if special U.S. Mortgage Guaranty Tax and Loss Bonds are purchased in an amount equal to the tax benefit derived from the deduction. Upon redemption the tax and loss bonds can be used to satisfy the additional tax liability that arises when the deduction is restored to income.

Disclosures

27. Mortgage guaranty insurers shall make all disclosures required by other statements within the *Accounting Practices and Procedures Manual*, including but not limited to the requirements of SSAP No. 55, and *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*.

28. Refer to the Preamble for further discussion regarding disclosure requirements.

Effective Date and Transition

29. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 88—Mortgage Guaranty Insurance*

Statement of Statutory Accounting Principles No. 62 – Revised

Property and Casualty Reinsurance

STATUS

Type of Issue.....	Common Area
Issued	Finalized March 13, 2000; Substantively revised December 5, 2009, and December 18, 2012; November 15, 2018
Effective Date	January 1, 2001; Substantive revisions in paragraphs 36.e., 102-105 and 120 (detailed in Issue Paper No. 137) effective January 1, 2010; Certified reinsurer changes effective December 31, 2012; Substantive revisions adopted November 2018 are effective January 1, 2019
Affects.....	Supersedes SSAP No. 75 with guidance incorporated August 2011; Nullifies and incorporates INT 02-06 and INT 02-09
Affected by	No other pronouncements
Interpreted by	INT 02-22; INT 03-02
Relevant Appendix A Guidance	A-440; A-785

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SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for property and casualty reinsurance. A wide range of methods for structuring reinsurance arrangements can be employed depending on the requirements of individual companies. This statement deals with the more commonly employed methods.

SUMMARY CONCLUSION

General

2. Reinsurance is the assumption by an insurer of all or part of a risk undertaken originally by another insurer. The transaction whereby a reinsurer cedes all or part of the reinsurance it has assumed to another reinsurer is known as a retrocession.

3. Reinsurance has many beneficial purposes. Among them are that it enables an insurance entity to (a) expand its capacity, (b) share large risks with other insurers, (c) spread the risk of potential catastrophes and stabilize its underwriting results, (d) finance expanding volume by sharing the financial burden of reserves, (e) withdraw from a line or class of business, and (f) reduce its net liability to amounts appropriate to its financial resources.

4. Reinsurance agreements are generally classified as treaty or facultative. Treaty reinsurance refers to an arrangement involving a class or type of business written, while facultative reinsurance involves individual risks offered and accepted.

5. Reinsurance coverage can be pro rata (i.e., proportional reinsurance) where the reinsurer shares a pro rata portion of the losses and in the same proportion as it shares premium of the ceding entity or excess of loss (i.e., non-proportional) where the reinsurer, subject to a specified limit, indemnifies the ceding entity against the amount of loss in excess of a specified retention. Most reinsurance agreements fall into one of the following categories:

- a. Treaty Reinsurance Contracts—Pro Rata:
 - i. Quota Share Reinsurance—The ceding entity is indemnified against a fixed percentage of loss on each risk covered in the agreement;
 - ii. Surplus Share Reinsurance—The ceding entity establishes a retention or “line” on the risks to be covered and cedes a fraction or a multiple of that line on each policy subject to a specified maximum cession;
- b. Treaty Reinsurance Contracts—Excess of Loss:
 - i. Excess Per Risk Reinsurance—The ceding entity is indemnified, subject to a specified limit, against the amount of loss in excess of a specified retention with respect to each risk covered by a treaty;
 - ii. Aggregate Excess of Loss Reinsurance—The ceding entity is indemnified against the amount by which the ceding entity’s net retained losses incurred during a specific period exceed either a predetermined dollar amount or a percentage of the entity’s subject premiums for the specific period subject to a specified limit;
- c. Treaty Reinsurance Contracts—Catastrophe: The ceding entity is indemnified, subject to a specified limit, against the amount of loss in excess of a specified retention with respect to an accumulation of losses resulting from a catastrophic event or series of events;
- d. Facultative Reinsurance Contracts—Pro Rata: The ceding entity is indemnified for a specified percentage of losses and loss expenses arising under a specific insurance policy in exchange for that percentage of the policy’s premium;
- e. Facultative Reinsurance Contracts—Excess of Loss: The ceding entity is indemnified, subject to a specified limit, for losses in excess of its retention with respect to a particular risk.

Characteristics of Reinsurance Agreements

- 6. Common contract provisions that may affect accounting practices include:
 - a. Reporting responsibility of the ceding entity—Details required and time schedules shall be established;
 - b. Payment terms—Time schedules, currencies intended, and the rights of the parties to withhold funds shall be established;
 - c. Payment of premium taxes—Customarily the responsibility of the ceding entity, a recital of nonliability of the reinsurer may be found;
 - d. Termination—May be on a cut-off or run-off basis. A cut-off provision stipulates that the reinsurer shall not be liable for loss as a result of occurrences taking place after the date of termination. A run-off provision stipulates that the reinsurer shall remain liable for loss under reinsured policies in force at the date of termination as a result of occurrences taking place after the date of termination until such time as the policies expire or are canceled; and
 - e. Insolvency clause—Provides for the survival of the reinsurer’s obligations in the event of insolvency of the ceding entity, without diminution because of the insolvency.

7. Reinsurance contracts shall not permit entry of an order of rehabilitation or liquidation to constitute an anticipatory breach by the reporting entity, nor grounds for retroactive revocation or retroactive cancellation of any contracts of the reporting entity.

Required Terms for Reinsurance Agreements

8. In addition to credit for reinsurance requirements applicable to reinsurance transactions generally, no credit or deduction from liabilities shall be allowed by the ceding entity for reinsurance recoverable where the agreement was entered into after the effective date of these requirements (see paragraphs 129 and 130) unless each of the following conditions is satisfied:

- a. The agreement must contain an acceptable insolvency clause;
- b. Recoveries due the ceding entity must be available without delay for payment of losses and claim obligations incurred under the agreement, in a manner consistent with orderly payment of incurred policy obligations by the ceding entity;
- c. The agreement shall constitute the entire contract between the parties and must provide no guarantee of profit, directly or indirectly, from the reinsurer to the ceding entity or from the ceding entity to the reinsurer;
- d. The agreement must provide for reports of premiums and losses, and payment of losses, no less frequently than on a quarterly basis, unless there is no activity during the period. The report of premiums and losses shall set forth the ceding entity's total loss and loss expense reserves on the policy obligations subject to the agreement, so that the respective obligations of the ceding entity and reinsurer will be recorded and reported on a basis consistent with this statement;
- e. The agreement must include a proper reinsurance intermediary clause, if applicable, which stipulates that the credit risk for the intermediary is carried by the assuming insurance entity;
- f. With respect to reinsurance contracts involving a certified reinsurer, the agreement must include a proper funding clause, which requires the certified reinsurer to provide and maintain security in an amount sufficient to avoid the imposition of any financial statement penalty on the ceding insurance entity for reinsurance ceded to the certified reinsurer. However, this does not preclude negotiation for higher contractual collateral amounts; and
- g. With respect to retroactive reinsurance agreements, the following additional conditions apply:
 - i. The consideration to be paid by the ceding entity for the retroactive reinsurance must be a sum certain stated in the agreement;
 - ii. Direct or indirect compensation to the ceding entity or reinsurer is prohibited;
 - iii. Any provision for subsequent adjustment on the basis of actual experience in regard to policy obligations transferred, or on the basis of any other formula, is prohibited in connection with a retroactive reinsurance transaction, except that provision may be made for the ceding entity's participation in the reinsurer's ultimate profit, if any, under the agreement;
 - iv. A retroactive reinsurance agreement shall not be canceled or rescinded without the approval of the commissioner of the domiciliary state of the ceding entity.

Reinsurance Agreements with Multiple Cedents

9. Reinsurance agreements with multiple cedents require allocation agreements. The allocation agreement can be part of the reinsurance agreement or a separate agreement. If the agreement has multiple cedents:

- a. The allocation must be in writing and
- b. The terms of the allocation agreement must be fair and equitable.

Reinsurance Contracts Must Include Transfer of Risk

10. The essential ingredient of a reinsurance contract is the transfer of risk¹. The essential element of every true reinsurance agreement is the undertaking by the reinsurer to indemnify the ceding entity, i.e., reinsured entity, not only in form but in fact, against loss or liability by reason of the original insurance. Unless the agreement contains this essential element of risk transfer, no credit shall be recorded.^(INT 02-22)

11. Insurance risk involves uncertainties about both (a) the ultimate amount of net cash flows from premiums, commissions, claims, and claims settlement expenses (underwriting risk) and (b) the timing of the receipt and payment of those cash flows (timing risk). Actual or imputed investment returns are not an element of insurance risk. Insurance risk is fortuitous—the possibility of adverse events occurring is outside the control of the insured.

12. Determining whether an agreement with a reinsurer provides indemnification against loss or liability (transfer of risk) relating to insurance risk requires a complete understanding of that contract and other contracts or agreements between the ceding entity and related reinsurers. A complete understanding includes an evaluation of all contractual features that (a) limit the amount of insurance risk to which the reinsurer is subject (e.g., experience refunds, cancellation provisions, adjustable features, or additions of profitable lines of business to the reinsurance contract) or (b) delay the timely reimbursement of claims by the reinsurer (e.g., payment schedules or accumulating retentions from multiple years).

13. Indemnification of the ceding entity against loss or liability relating to insurance risk in reinsurance requires both of the following:

- a. The reinsurer assumes significant insurance risk under the reinsured portions of the underlying insurance agreements; and
- b. It is reasonably possible that the reinsurer may realize a significant loss from the transaction.

The conditions are independent and the ability to meet one does not mean that the other has been met. A substantive demonstration that both conditions have been met is required to transfer risk.

14. The reference in paragraph 13.a. acknowledges that a ceding entity may reinsure only part of the risks associated with the underlying contracts. For example, a proportionate share of all risks or only specified risks may be reinsured. The conditions for reinsurance accounting are evaluated in relation to the reinsured portions of the underlying insurance contracts, rather than all aspects of those contracts.

15. The word “timely” is used in paragraph 12 in the ordinary temporal sense to refer to the length of time between payment of the underlying reinsured claims and reimbursement by the reinsurer. While the test for reasonable possibility of significant loss to the reinsurer provides for a present-value-based assessment of the economic characteristics of the reinsurance contract, the concept of timely reimbursement

¹ Exhibit A Questions and Answers, questions 6-19 provide additional risk transfer implementation guidance.

relates to the transfer of insurance risk (the condition in paragraph 13.a.), not the reasonable possibility of significant loss (the condition in paragraph 13.b.). Accordingly, timely reimbursement shall be evaluated based solely on the length of time between payment of the underlying reinsured claims and reimbursement by the reinsurer.

16. Whether underwriting risk has transferred to the reinsurer depends on how much uncertainty about the ultimate amount of net cash flows from premiums, commissions, claims, and claim settlement expenses paid under a contract has been transferred to the reinsurer. A reinsurer shall not have assumed significant insurance risk under the reinsured contracts if the probability of a significant variation in either the amount or timing of payments by the reinsurer is remote. Implicit in this condition is the requirement that both the amount and timing of the reinsurer's payments depend on and directly vary with the amount and timing of claims settled by the ceding entity. Accordingly, the significance of the amount of underwriting risk transferred shall be evaluated in relation to the ceding entity's claims payments. Contractual provisions that delay timely reimbursement to the ceding entity prevent this condition from being met.

17. The ceding entity's evaluation of whether it is reasonably possible for a reinsurer to realize a significant loss from the transaction shall be based on the present value of all cash flows between the ceding and assuming companies under reasonably possible outcomes, without regard to how the individual cash flows are described or characterized. An outcome is reasonably possible if its probability is more than remote. The same interest rate shall be used to compute the present value of cash flows for each reasonably possible outcome tested. A constant interest rate shall be used in determining those present values because the possibility of investment income varying from expectations is not an element of insurance risk. Judgment is required to identify a reasonable and appropriate interest rate. To be reasonable and appropriate, that interest rate shall reflect both of the following:

- a. The expected timing of payments to the reinsurer; and
- b. The duration over which those cash flows are expected to be invested by the reinsurer.

18. Significance of loss shall be evaluated by comparing the present value of all cash flows, determined as described in paragraph 17, with the present value of the amounts paid or deemed to have been paid to the reinsurer. If, based on this comparison, the reinsurer is not exposed to the reasonable possibility of significant loss, the ceding entity shall be considered indemnified against loss or liability relating to insurance risk only if substantially all of the insurance risk relating to the reinsured portions of the underlying insurance agreements has been assumed by the reinsurer. In this narrow circumstance, the reinsurer's economic position is virtually equivalent to having written the insurance contract directly. This condition is met only if insignificant insurance risk is retained by the ceding entity on the retained portions of the underlying insurance contracts, so that the reinsurer's exposure to loss is essentially the same as that of the reporting entity. The assessment of that condition shall be made by comparing both of the following:

- a. The net cash flows of the reinsurer under the reinsurance contract; and
- b. The net cash flows of the ceding entity on the reinsured portions of the underlying insurance contracts.

If the economic position of the reinsurer relative to the insurer cannot be determined, the contract shall not qualify under the exception in this paragraph².

19. An extremely narrow and limited exemption is provided for contracts that reinsure either an individual risk or an underlying book of business that is inherently profitable. When substantially all of the insurance risk relating to the reinsured portions of the underlying insurance contracts has been assumed by the reinsurer, the contract meets the conditions for reinsurance accounting. To qualify under this exception,

² See additional detail on this topic in Exhibit A, question 19.

no more than insignificant insurance risk on the reinsured portions of the underlying insurance contracts may be retained by the ceding entity.

20. Payment schedules and accumulating retentions from multiple years are contractual features inherently designed to delay the timing of reimbursement to the ceding entity. Regardless of what a particular feature might be called, any feature that can delay timely reimbursement violates the conditions for reinsurance accounting. Transfer of insurance risk requires that the reinsurer's payment to the ceding entity depend on and directly vary with the amount and timing of claims settled under the reinsured contracts. Contractual features that can delay timely reimbursement prevent this condition from being met. Therefore, any feature that may affect the timing of the reinsurer's reimbursement to the ceding entity shall be closely scrutinized.

21. Contracts that reinsure insurance risks over a significantly longer period than the underlying insurance contract are, in substance, financing transactions, if any of the following conditions exist:

- a. Premiums are deferred over a period beyond the term of the underlying insurance contracts;
- b. Losses are recognized in a different period than the period in which the event causing the loss takes place; or
- c. Both events, 21.a. and 21.b., occur at different points in time.

Contracts that are in substance financing receive deposit accounting treatment.

Accounting for Reinsurance

22. Reinsurance recoverables shall be recognized in a manner consistent with the liabilities (including estimated amounts for claims incurred but not reported) relating to the underlying reinsured contracts. Assumptions used in estimating reinsurance recoverables shall be consistent with those used in estimating the related liabilities. Certain assets and liabilities are created by entities when they engage in reinsurance contracts. Reinsurance assets meet the definition of assets as defined by *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted to the extent they conform to the requirements of this statement.

23. Accounting for members of a reinsurance pool shall follow the accounting for the pool member which issued the underlying policy.^(INT 03-02) Specific accounting rules for underwriting pools and associations are addressed in *SSAP No. 63—Underwriting Pools*.

24. Reinsurance recoverable on loss payments is an admitted asset. Notwithstanding the fact that reinsurance recoverables on paid losses may meet the criteria for offsetting under the provisions of *SSAP No. 64—Offsetting and Netting of Assets and Liabilities*, reinsurance recoverables on paid losses shall be reported as an asset without any available offset. Unauthorized reinsurance and reinsurance ceded to certified reinsurers is included in this asset and reflected separately as a liability to the extent required. Penalty for overdue authorized reinsurance shall be reflected as a liability.

25. Funds held or deposited with reinsured companies, whether premiums withheld as security for unearned premium and outstanding loss reserves or advances for loss payments, are admitted assets provided they do not exceed the liabilities they secure and provided the reinsured is solvent. Those funds which are in excess of the liabilities, and any funds held by an insolvent reinsured shall be nonadmitted.

26. Prospective reinsurance is defined as reinsurance in which a reinsurer agrees to reimburse a ceding entity for losses that may be incurred as a result of future insurable events covered under contracts subject to the reinsurance. Retroactive reinsurance is defined as reinsurance in which a reinsurer agrees to reimburse a ceding entity for liabilities incurred as a result of past insurable events covered under contracts subject to

the reinsurance. A reinsurance agreement may include both prospective and retroactive reinsurance provisions.

27. The distinction between prospective and retroactive reinsurance agreements is based on whether the agreement reinsures future or past insured events covered by the underlying insurance policies. For example, in occurrence-based insurance, the insured event is the occurrence of a loss covered by the insurance contract. In claims-made insurance, the insured event is the reporting to the insurer, within the period specified by the policy, of a claim for a loss covered by the insurance agreement. A claims-made reinsurance contract that reinsures claims asserted to the reinsurer in a future period as a result of insured events that occurred prior to entering into the reinsurance agreement is a retroactive agreement. (However, a reinsurance agreement that reinsures claims reported to an insurer that are covered under currently effective claims-made insurance policies is a prospective reinsurance agreement.)

28. It is not uncommon for a reinsurance arrangement to be initiated before the beginning of a policy period but not finalized until after the policy period begins. Whether there was agreement in principle at the beginning of the policy period and, therefore, the agreement is substantively prospective shall be determined based on the facts and circumstances. However, except as respects business assumed by a U.S. reinsurer from ceding companies domiciled outside the U.S. and not affiliated with such reinsurer, or business assumed by a U.S. reinsurer where either the lead reinsurer or a majority of the capacity on the agreement is domiciled outside the U.S. and is not affiliated with such reinsurer, if an agreement entered into, renewed or amended on or after January 1, 1994 has not been finalized, reduced to a written form and signed by the parties within nine months after the commencement of the policy period covered by the reinsurance arrangement, then the arrangement is presumed to be retroactive and shall be accounted for as a retroactive reinsurance agreement. This presumption shall not apply to: (a) facultative reinsurance contracts, nor to (b) reinsurance agreements with more than one reinsurer which are signed by the lead reinsurer (i.e., the reinsurer setting the terms of the agreement for the reinsurers) within nine months after the commencement of the policy period covered by the reinsurance agreement, nor to (c) reinsurance agreements with more than one reinsurer (whether signed by the lead reinsurer or not) which were entered into, renewed or amended on or before December 31, 1996, (and which were not renewed or amended after that date) if reinsurers representing more than 50% of the capacity on the agreement have signed cover notes, placement slips or similar documents describing the essential terms of coverage and exclusions within nine months after the commencement of the policy period covered by the reinsurance arrangement. Also exempt from this presumption are reinsurance agreements where one of the parties is in conservation, rehabilitation, receivership or liquidation proceedings.

29. Prospective and retroactive provisions included within a single agreement shall be accounted for separately. If separate accounting for prospective and retroactive provisions included within a single agreement is impracticable, the agreement shall be accounted for as a retroactive agreement provided the conditions for reinsurance accounting are met.

Accounting for Prospective Reinsurance Agreements

30. Amounts paid for prospective reinsurance that meet the conditions for reinsurance accounting shall be reported as a reduction of written and earned premiums by the ceding entity and shall be earned over the remaining contract period in proportion to the amount of reinsurance protection provided or, if applicable, until the reinsurer's maximum liability under the agreement has been exhausted. If the amounts paid are subject to adjustment and can be reasonably estimated, the basis for amortization shall be the estimated ultimate amount to be paid. Reinstatement premium, if any, shall be earned over the period from the reinstatement of the limit to the expiration of the agreement.

31. Changes in amounts of estimated reinsurance recoverables shall be recognized as a reduction of gross losses and loss expenses incurred in the current period statement of income. Reinsurance recoverables on paid losses shall be reported as an asset, reinsurance recoverables on loss and loss adjustment expense payments, in the balance sheet. Reinsurance recoverables on unpaid case-basis and incurred but not reported

losses and loss adjustment expenses shall be netted against the liability for gross losses and loss adjustment expenses.

32. Prospective reinsurance agreements that meet the conditions for reinsurance accounting shall only reflect reinsurance credit for the portion of risk which is ceded. Provisions that would limit the reinsurer's losses (e.g., a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions) caused by any applicable risk limiting provision(s) shall be reflected adjustments to ceded premiums, commissions or losses. Reporting entities shall only take credit for reinsurance, i.e., record a reinsurance recoverable, for non-proportional reinsurance when and to the extent that incurred losses on the underlying subject business exceed the attachment point of the applicable reinsurance contract(s).

Accounting for Retroactive Reinsurance Agreements

33. Certain reinsurance agreements which transfer both components of insurance risk cover liabilities which occurred prior to the effective date of the agreement. Due to potential abuses involving the creation of surplus to policyholders and the distortion of underwriting results, special accounting treatment for these agreements is warranted.

34. All retroactive reinsurance agreements entered into, renewed or amended on or after January 1, 1994 (including subsequent development of such transactions) shall be accounted for and reported in the following manner:

- a. The ceding entity shall record, without recognition of the retroactive reinsurance, loss and loss expense reserves on a gross basis on the balance sheet and in all schedules and exhibits;
- b. The assuming entity shall exclude the retroactive reinsurance from loss and loss expense reserves and from all schedules and exhibits;
- c. The ceding entity and the assuming entity shall report by write-in item on the balance sheet, the total amount of all retroactive reinsurance, identified as retroactive reinsurance reserve ceded or assumed, recorded as a contra-liability by the ceding entity and as a liability by the assuming entity;
- d. The ceding entity shall, by write-in item on the balance sheet, restrict surplus resulting from any retroactive reinsurance as a special surplus fund, designated as special surplus from retroactive reinsurance account;
- e. The surplus gain from any retroactive reinsurance shall not be classified as unassigned funds (surplus) until the actual retroactive reinsurance recovered exceeds the consideration paid;
- f. The special surplus from retroactive reinsurance account for each respective retroactive reinsurance agreement shall be reduced at the time the ceding entity begins to recover funds from the assuming entity in amounts exceeding the consideration paid by the ceding entity under such agreement, or adjusted as provided in paragraph 34.j.;
- g. For each agreement, the reduction in the special surplus from retroactive reinsurance account shall be limited to the lesser of (i) the actual amount recovered in excess of consideration paid or (ii) the initial surplus gain resulting from the respective retroactive reinsurance agreement. Any remaining balance in the special surplus from retroactive reinsurance account derived from any such agreement shall be returned to unassigned funds (surplus) upon elimination of all policy obligations subject to the retroactive reinsurance agreement;

- h. The ceding entity shall report the initial gain arising from a retroactive reinsurance transaction (i.e., the difference between the consideration paid to the reinsurer and the total reserves ceded to the reinsurer) as a write-in item on the statement of income, to be identified as Retroactive Reinsurance Gain and included under Other Income;
- i. The assuming entity shall report the initial loss arising from a retroactive reinsurance transaction, as defined in the preceding paragraph 34.g., as a write-in item on the statement of income, to be identified as Retroactive Reinsurance Loss and included under Other Income;
- j. Any subsequent increase or reduction in the total reserves ceded under a retroactive reinsurance agreement shall be reported in the manner described in the preceding paragraphs 34.h. and 34.i., in order to recognize the gain or loss arising from such increase or reduction in reserves ceded. The Special Surplus from Retroactive Reinsurance Account write-in entry on the balance sheet shall be adjusted, upward or downward, to reflect such increase or reduction in reserves ceded. The Special Surplus from Retroactive Reinsurance Account write-in entry shall be equal to or less than the total ceded reserves under all retroactive reinsurance agreements in-force as of the date of the financial statement. Special surplus arising from a retroactive reinsurance transaction shall be considered to be earned surplus (i.e., transferred to unassigned funds (surplus)) only when cash recoveries from the assuming entity exceed the consideration paid by the ceding entity as respects such retroactive reinsurance transaction; and
- k. The consideration paid for a retroactive reinsurance agreement shall be reported as a decrease in ledger assets by the ceding entity and as an increase in ledger assets by the assuming entity.

(For an illustration of ceding entity accounting entries see question 31 in Exhibit A.)

35. Portfolio reinsurance is the transfer of an insurer's entire liability for in force policies or outstanding losses, or both, of a segment of the insurer's business. Loss portfolio transactions are to be accounted for as retroactive reinsurance.

36. The accounting principles for retroactive reinsurance agreements in paragraph 34 shall not apply to the following types of agreements (which shall be accounted for as prospective reinsurance agreements unless otherwise provided in this statement):

- a. Structured settlement annuities for individual claims purchased to implement settlements of policy obligations;
- b. Novations, (i.e., (i) transactions in which the original direct insurer's obligations are completely extinguished, resulting in no further exposure to loss arising on the business novated or (ii) transactions in which the original assuming entity's obligations are completely extinguished) resulting in no further exposure to loss arising on the business novated, provided that (1) the parties to the transaction are not affiliates (or if affiliates, that the transaction has the prior approval of the domiciliary regulators of the parties) and (2) the accounting for the original reinsurance agreement will not be altered from retroactive to prospective;
- c. The termination of, or reduction in participation in, reinsurance treaties entered into in the ordinary course of business;

- d. Intercompany reinsurance agreements, and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person provided there is no gain in surplus as a result of the transaction; or
- e. Reinsurance/retrocession agreements that meet the criteria of property/casualty run-off agreements described in paragraphs 102-105.

37. Retroactive reinsurance agreements resulting in surplus gain to the ceding entity (with or without risk transfer) entered into between affiliates or between insurers under common control (as those terms are defined in Appendix A-440) shall be reported as follows:

- a. The consideration paid by the ceding entity shall be recorded as a deposit and reported as a nonadmitted asset; and
- b. No deduction shall be made from loss and loss adjustment expense reserves on the ceding entity's balance sheet, schedules, and exhibits.

38. The accounting and reporting provisions applicable to retroactive reinsurance apply to all transactions transferring liabilities in connection with a court-ordered rehabilitation, liquidation, or receivership. The requirement to include stipulated contract provisions in the reinsurance agreements shall not apply to these transactions, with written approval of the ceding entity's domiciliary commissioner.

39. Novations meeting the requirements of paragraph 36.b. shall be accounted for as prospective reinsurance agreements. The original direct insurer, or the original assuming insurer, shall report amounts paid as a reduction of written and earned premiums, and unearned premiums to the extent that premiums have not been earned. Novated balances (e.g., loss and loss adjustment expense reserves) shall be written off through the accounts, exhibits, and schedules in which they were originally recorded. The assuming insurer shall report amounts received as written and earned premiums, and obligations assumed as incurred losses in the statement of income.

Deposit Accounting

40. To the extent that a reinsurance agreement does not, despite its form, transfer both components of insurance risk, all or part of the agreement shall be accounted for and reported as deposits in the following manner:

- a. At the outset of the reinsurance agreement, the net consideration paid by the ceding entity (premiums less commissions or other allowances) shall be recorded as a deposit by the ceding company and as a liability by the assuming entity. The deposit shall be reported as an admitted asset by the ceding company if (i) the assuming company is licensed, accredited or otherwise qualified in the ceding company's state of domicile as described in Appendix A-785 or (ii) there are funds held by or on behalf of the ceding company which meet the requirements of paragraph 19 of Appendix A-785;
- b. At subsequent reporting dates, the amount of the deposit/liability shall be adjusted by calculating the effective yield on the deposit agreement to reflect actual payments to date (receipts and disbursements shall be recorded through the deposit/liability accounts) and expected future payments (as discussed below), with a corresponding credit or charge to interest income or interest expense;
- c. The calculation of the effective yield shall use the estimated amount and timing of cash flows. If a change in the actual or estimated timing or amount of cash flows occurs, the effective yield shall be recalculated to reflect the revised actual or estimated cash flows. The deposit shall be adjusted to the amount that would have existed at the reporting date

had the new effective yield been applied since the inception of the reinsurance agreement. Changes in the carrying amount of the deposit asset/liability resulting from changes in the effective yield shall be recorded as interest income or interest expense;

- d. It shall be assumed that any cash transactions for the settlement of losses will reduce the asset/liability accounts by the amount of the cash transferred. When the remaining losses are revalued upward, an increase in the deposit liability shall be recorded as interest expense – by the assuming company. Conversely, the ceding company shall increase its deposit (asset) with an offsetting credit to interest income; and increase its outstanding loss liability with an offsetting charge to incurred losses;
- e. No deduction shall be made from the loss and loss adjustment expense reserves on the ceding company's Statement of Financial Position, schedules, and exhibits;
- f. The assuming company shall record net consideration to be returned to the ceding company as a liability.

(For an illustration of the provisions of paragraph 40, see Exhibit C)

41. Deposit accounting shall not be used to avoid loss recognition that would otherwise be required. For example, if the ceding entity has no future coverage relating to the deposit with the reinsurer, the deposit is not recoverable.

Assumed Reinsurance

42. Reinsurance premiums receivable at the end of the accounting period are combined with direct business receivables and reported as agents' balances or uncollected premiums. Where the ceding entity withholds premium funds pursuant to the terms of the reinsurance agreement, such assets shall be shown by the assuming entity as funds held by or deposited with reinsured companies. Reporting entities shall record any interest earned or receivable on the funds withheld as a component of aggregate write-ins for miscellaneous income.

43. If the assuming entity receives reinsurance premium prior to the effective date of the reinsurance contract, consistent with *SSAP No. 53—Property and Casualty Contracts-Premiums*, paragraph 15, advance premiums shall be reported as a liability in the statutory financial statement and not considered income until the effective date of the coverage. Such amounts are not included in written premium or the unearned premium reserve. If the assuming entity receives reinsurance premium after the effective date of the reinsurance contract but prior to the due date, the amount received shall be reported as a reduction of the asset for deferred but not yet due (earned but unbilled premiums).

44. Reinsurance premiums more than 90 days overdue shall be nonadmitted except (a) to the extent the assuming entity maintains unearned premium and loss reserves as to the ceding entity, under principles of offset accounting as discussed in *SSAP No. 64*, or (b) where the ceding entity is licensed and in good standing in assuming entity's state of domicile. Reinsurance premiums are due pursuant to the original contract terms (as the agreement stood on the date of execution). In the absence of a specific contract date, reinsurance premiums will be deemed due thirty (30) days after the date on which (i) notice or demand of premium due is provided to the ceding entity or (ii) the assuming entity books the premium (see *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*).

45. A lag will develop between the time of the entry of the underlying policy transaction on the books of the ceding entity and the transmittal of information and entry on the books of the assuming entity. Assuming companies shall estimate unreported premiums and related costs to the extent necessary to

prevent material distortions in the loss development contained in the assuming entity's annual statement schedules where calendar year premiums are compared to accident year losses.

46. Proportional reinsurance (i.e., first dollar pro rata reinsurance) premiums shall be allocated to the appropriate annual statement lines of business in the Underwriting and Investment exhibits. Non-proportional assumed reinsurance premiums shall be classified as reinsurance under the appropriate subcategories.

47. Assumed retroactive reinsurance premiums shall be excluded from all schedules and exhibits as addressed in paragraph 34.

48. Amounts payable by reinsurers on losses shall be classified as unpaid losses. Assumed reinsurance payable on paid losses shall be classified as a separate liability item on the balance sheet. IBNR losses on assumed reinsurance business shall be netted with ceded losses on the balance sheet and listed separately by annual statement line of business in the Underwriting and Investment exhibits.

Ceded Reinsurance

49. Ceded reinsurance premiums payable (net of ceding commission) shall be classified as a liability. Consistent with SSAP No. 64, ceded reinsurance premiums payable may be deducted from amounts due from the reinsurer, such as amounts due on assumed reinsurance, when a legal right of offset exists.

50. With regard to reinsurance premium paid prior to the effective date of the contract, the ceding entity shall reflect the prepaid item as a write-in admitted asset and it should not be recognized in the income statement until the effective date of the coverage. Such amounts are not included in ceded written premiums or ceded unearned premium but should be subject to impairment analysis. With regard to reinsurance premium paid by ceding entity after the reinsurance contract is in effect but prior to the due date, the ceding entity shall treat this item as a reduction to the liability for ceded reinsurance premiums payable. That liability reflects not only premiums unpaid but also amounts booked but deferred and not yet due.

51. Amounts withheld by the ceding entity that would otherwise be payable under the reinsurance agreement shall be reported as funds held by entity under reinsurance treaties. Reporting entities shall record any interest due or payable on the amounts withheld as a component of aggregate write-ins for miscellaneous income.

52. Ceded reinsurance transactions shall be classified in the annual statement line of business which relates to the direct or assumed transactions creating the cession or retrocession.

53. Ceded retroactive reinsurance premiums shall be excluded from all schedules and exhibits as addressed in paragraph 34.

54. Reinsurance accounting shall not be allowed for modeled trigger securitizations. Modeled trigger securitization transactions do not result in the kind of indemnification (in form and in fact) required by this SSAP, and are therefore not eligible for reinsurance accounting. Modeled trigger transactions should be evaluated as securitization transactions rather than as reinsurance transactions and should receive the accounting treatment recommended for securitization transactions.

Adjustable Features/Retrospective Rating

55. Reinsurance treaties may provide for adjustment of commission, premium, or amount of coverage, based on loss experience. The accounting for common examples is outlined in the following paragraphs:

Commission Adjustments

56. An accrual shall be maintained for the following adjustable features based upon the experience recorded for the accounting period:

- a. Contingent or Straight Profit—The reinsurer returns to the ceding entity a stipulated percentage of the profit produced by the business assumed from the ceding entity. Profit may be calculated for any specified period of time, but the calculation is often based on an average over a period of years; and
- b. Sliding Scale—A provisional rate of commission is paid over the course of the agreement, with a final adjustment based on the experience of the business ceded under the agreement.

Premium Adjustments

57. If the reinsurance agreement incorporates an obligation on the part of the ceding entity to pay additional premium to the assuming entity based upon loss experience under the agreement, a liability in the amount of such additional premium shall be recognized by the ceding entity during the accounting period in which the loss event(s) giving rise to the obligation to pay such additional premium occur(s). The assuming entity shall recognize an asset in a consistent manner. If the reinsurance agreement incorporates an obligation on the part of the assuming entity to refund to the ceding entity any portion of the consideration received by the assuming entity based upon loss experience under the agreement, an asset in the amount of any such refund shall be recognized by the ceding entity during the accounting period in which the loss event(s) giving rise to the obligation to make such refund occur(s). The initial provisional or deposit premium is recalculated retrospectively, based on loss experience under the agreement during a specified period of time; the calculation is often based on an average over a period of years. The assuming entity shall recognize a liability in a consistent manner.

Adjustments in the Amount of Coverage

58. The amount of coverage available for future periods is adjusted, upward or downward, based on loss experience under the agreement during a specified period of time. If the reinsurance agreement incorporates a provision under which the reinsurance coverage afforded to the ceding entity may be increased or reduced based upon loss experience under the agreement, an asset or a liability shall be recognized by the ceding entity in an amount equal to that percentage of the consideration received by the assuming entity which the increase or reduction in coverage represents of the amount of coverage originally afforded. The asset or liability shall be recognized during the accounting period in which the loss event(s) (or absence thereof) giving rise to the increase or decrease in reinsurance coverage occur(s), and shall be amortized over all accounting periods for which the increased or reduced coverage is applicable. The term “consideration” shall mean, for this purpose, the annualized deposit premium for the period used as the basis for calculating the adjustment in the amount of coverage to be afforded thereafter under the agreement.

59. The ceding entity and the assuming entity shall account for changes in coverage in the same manner as changes in other contract costs. For example, the effects of decreases in coverage without a commensurate reduction in premium shall be recognized as a loss by the ceding entity and as a gain by the assuming entity when the event causing the decrease in coverage takes place.

60. Changes in either the probability or amount of potential future recoveries are considered a change in coverage. For example, if the contract limit stayed the same but the ceding entity could not receive any recoveries unless losses for the industry as a whole reached a certain level, coverage has been reduced. What matters is not the specific contract provisions regarding coverage, but whether the probability or amount of potential future recoveries has increased or decreased as a result of those provisions.

Multiple-Year Retrospectively-Rated Contracts

61. Many short-duration insurance and reinsurance contracts have retrospective rating provisions. A retrospectively-rated contract is a multiple-year contract in which events in one period of the contract create rights and obligations in another. For example, if losses above a certain level occur in one contract year, premiums increase in future years unless the ceding entity compensates the reinsurer through a settlement adjustment. The ceding entity has an obligation because it must pay either the settlement adjustment or the higher future premiums.

62. An insurer (ceding entity) may enter into a multiple-year retrospectively-rated reinsurance contract with a reinsurer (assuming entity). Examples of these contracts may include transactions referred to as funded catastrophe covers. These contracts include a retrospective rating provision that provides for at least one of the following based on contract experience:

- a. Changes in the amount or timing of future contractual cash flows, including premium adjustments, settlement adjustments, or refunds to the ceding entity; or
- b. Changes in the contract's future coverage.

63. A critical distinguishing feature of these contracts is that part or all of the retrospective rating provision is obligatory such that the retrospective rating provision creates future rights and obligations as a result of past events. Therefore, a retrospectively-rated contract that could be cancelled without further obligation (because it does not create rights and obligations that will be realized in a future period) is excluded.

64. The principal issues in accounting for a multiple-year retrospectively-rated contract involve how to recognize and measure assets and liabilities resulting from the obligatory retrospective rating provisions. While it may be difficult for some types of multiple-year retrospectively-rated contracts to pass the risk transfer test, the recognition and measurement questions are present regardless of whether the contract transfers risk. In fact, the questions become clearly evident with contracts that meet the risk transfer test and are accounted for as reinsurance.

Multiple-Year Retrospectively-Rated Contracts by Ceding and Assuming Entities

65. To be accounted for as reinsurance, a reinsurance contract must meet all of the following conditions:

- a. The contract shall not contain features that prevent the risk transfer criteria from being reasonably applied and the risk transfer criteria shall be met.
- b. The ultimate premium expected to be paid or received under the contract shall be reasonably estimable and allocable in proportion to the reinsurance protection provided.

If any of these conditions are not met, a deposit method of accounting shall be applied by the ceding and assuming entities.

66. The condition in paragraph 65.a. applies to a contract and determining the substance of a contract is a judgmental matter. If an agreement with a reinsurer consists of both risk transfer and non-risk transfer coverages that have been combined into a single legal document, those coverages must be considered separately for accounting purposes. This statement does not intend for different kinds of exposures combined in a program of reinsurance to be evaluated for risk transfer and accounted for together because that would allow contracts that do not meet the conditions for reinsurance accounting to be accounted for as reinsurance by being designated as part of a program that in total meets the conditions for reinsurance accounting.

67. Recognizing a smaller asset based on potential unfavorable loss development implies that claim liabilities are understated at the financial reporting date. Accordingly, changes in estimates of claim liabilities shall not be recognized in measuring the related asset until the change in estimate takes place.

Obligatory Retrospective Rating Provisions

68. This guidance discusses how the guidance on multiple-year retrospectively-rated contracts is based on the concept that there is a substantive difference between a contract that contains an obligatory retrospective rating provision and one that does not. This distinction is derived from *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, which requires recognition of liabilities (which are defined as present obligations) as of a financial reporting date but prohibits recognition of losses and expenses that will result from future events. For example, it may be a virtual certainty that an entity will pay employee salaries next year. But because there is no present obligation to pay those salaries, they are not recognized today.

69. Similarly, under SSAP No. 5R even if there is a high probability that an asset will be impaired in the future or a liability incurred in the future, the conditions for accrual have not been met because there is no present impairment or obligation to be recognized. Consistent with this principle, the guidance on multiple-year retrospectively rated contracts does not permit recognition of the effects of retrospective rating provisions unless those provisions are obligatory.

Allocation of Certain Payments Between Coverage and Past Losses

70. This guidance addresses a circumstance in which, under a multiple-year retrospectively rated reinsurance contract, the ceding entity has to make additional payments to the reinsurer but the ceding entity also receives expanded coverage. The single payment is allocated to the two separate transactions. In one transaction, the ceding entity has acquired an asset by making a payment to the reinsurer in exchange for expanded coverage. In the other, the ceding entity has incurred a loss or liability to the extent that it is reimbursing the reinsurer for past losses. Because a variety of factors may affect the value of reinsurance coverage at any point in time, the most appropriate measure of the value of additional coverage generally is the price of the initial coverage. For example, if coverage of \$6.00 was acquired for a \$1.00 premium, and the ceding entity would pay \$4.00 more for another \$6.00 of coverage if a loss occurs, the most relevant measure of the amount of premium that relates to the new coverage would be \$1.00. The other \$3.00 presumably is a reimbursement for the loss that has been incurred.

Contractual Termination Features

71. In some circumstances, the ceding entity will be relieved of its obligation if the reinsurer cancels the contract and only has to pay additional amounts if either:

- a. The contract remains in force; or
- b. The ceding entity cancels before the end of the contract term.

Unless the reinsurer has terminated the contract, the ceding entity has an obligation for the additional amounts and must recognize the related liability. The effect of termination, which is to relieve the ceding entity of its liability, shall not be recognized until termination takes place.

72. If either party entering into a new contract in consideration for canceling a retrospectively-rated contract would not have agreed to cancel the existing retrospectively-rated contract unless a new contract were entered into, the two contracts are, in effect, the same contract for purposes of measuring assets and liabilities and shall be accounted for in that way.

Impairment

73. Include as a nonadmitted asset, amounts accrued for premium adjustments on retrospectively rated reinsurance agreements with respect to which all uncollected balances due from the ceding company have been classified as nonadmitted.

74. The amount of the asset to be recognized may be affected by credit risk, and appropriate impairment shall be recognized for any amounts deemed uncollectible. The relevant recorded claim liability at that date represents the ceding entity's best estimate of the expected ultimate claim liability and is the liability that must be used in measuring the refundable amount based on contract experience to date.

Commissions

75. Commissions payable on reinsurance assumed business shall be included as an offset to Agents' Balances or Uncollected Premiums. Commissions receivable on reinsurance ceded business shall be included as an offset to Ceded Reinsurance Balances Payable.

76. If the ceding commission paid under a reinsurance agreement exceeds the anticipated acquisition cost of the business ceded, the ceding entity shall establish a liability, equal to the difference between the anticipated acquisition cost and the reinsurance commissions received, to be amortized pro rata over the effective period of the reinsurance agreement in proportion to the amount of coverage provided under the reinsurance contract.

Unauthorized Reinsurance

77. If the assuming reinsurer is not authorized, otherwise approved or certified to do business in the ceding entity's domiciliary state, the assumed reinsurance is considered to be unauthorized. A provision is established to offset credit taken in various balance sheet accounts for reinsurance ceded to unauthorized reinsurers. Credit for reinsurance with unauthorized reinsurers shall be permitted to the extent the ceding entity holds collateral in accordance with Appendix A-785. If the assuming reinsurer is not licensed or is not an authorized reinsurer in the domiciliary state of the ceding entity or if the reinsurance does not meet required standards, the ceding entity must set up a provision for reinsurance liability in accordance with the NAIC Annual Statement Instructions for Property and Casualty Insurance Companies Schedule F.

78. The provision defined in paragraph 77 shall never be less than zero for any particular reinsurer. The change in liability for unauthorized reinsurance is a direct charge or credit to surplus.

Reinsurance Ceded to a Certified Reinsurer

79. The term certified reinsurer shall have the same meaning as set forth in the Appendix A-785.

80. Credit for reinsurance ceded to a certified reinsurer is permitted if security is held by or on behalf of the ceding entity in accordance with the certified reinsurer's rating assigned by the domestic state of the ceding insurance entity, and in accordance with Appendix A-785 of this manual. However, nothing in this guidance would prohibit the parties to a reinsurance agreement from agreeing to provisions establishing security requirements that exceed the minimum security requirements established for certified reinsurers.

81. An upgrade in a certified reinsurer's assigned rating applies on a prospective basis, i.e., the revised collateral requirement applies only to contracts entered into or renewed on or after the effective date of the new rating (see A-785). A downgrade in a certified reinsurer's rating applies on a retroactive basis, i.e., the revised collateral requirement applies to all reinsurance obligations incurred by the assuming insurer under its certified reinsurer status. Notwithstanding a change in a certified reinsurer's rating or revocation of its certification, a reporting entity that has ceded reinsurance to such certified reinsurer is allowed a three (3)-month grace period before recording a provision for reinsurance due to collateral deficiency associated with

such rating downgrade and increased collateral requirement for all reinsurance ceded to such assuming insurer under its certified reinsurer status, unless the reinsurance is found by the commissioner of the reporting entity's domestic state to be at high risk of uncollectibility.

82. A provision is established by the ceding entity to offset credit taken in various balance sheet accounts for reinsurance ceded to a certified reinsurer in an amount proportionate to any deficiency in the amount of acceptable security that is provided by the certified reinsurer as compared to the amount of security that is required to be provided in accordance with the certified reinsurer's rating. The calculation of the provision for a collateral shortfall is separate from the calculation of the provision for overdue reinsurance ceded to certified reinsurers and shall be calculated in accordance with the NAIC Annual Statement Instructions for Property and Casualty Insurance Companies.

83. The provision defined in paragraph 82 shall never be less than zero for any particular certified reinsurer. The change in liability for reinsurance with certified reinsurers is a direct charge or credit to surplus.

Funds Held Under Reinsurance Treaties

84. This liability is established for funds deposited by or contractually withheld from reinsurers or reinsurers.

Provision for Reinsurance

85. The NAIC Property/Casualty Annual Statement Instructions, Schedule F, Part 3 – Ceded Reinsurance, references the provision for overdue reinsurance, which provides for a minimum reserve for uncollectible reinsurance with an additional reserve required if an entity's experience indicates that a higher amount should be provided. The minimum reserve provision for reinsurance is recorded as a liability and the change between years is recorded as a gain or loss directly to unassigned funds (surplus). Any reserve over the minimum amount shall be recorded on the statement of income by reversing the accounts previously utilized to establish the reinsurance recoverable.

86. The provision for reinsurance is calculated separately for unauthorized, authorized and certified reinsurers. An authorized reinsurer is licensed, accredited or approved by the ceding entity's state of domicile; a certified reinsurer is certified by the ceding entity's state of domicile; an unauthorized reinsurer is not so licensed, accredited, approved or certified.

Asbestos and Pollution Contracts – Counterparty Reporting Exception

87. Upon approval by the domiciliary regulator(s) of the ceding entity (either the original direct insurer in the case of a reinsurance agreement or the original assuming reinsurer in the case of a retrocession agreement), an exception may be allowed with respect to a retroactive reinsurance agreement providing substantially duplicate coverage as prior reinsurance agreements on asbestos and/or pollution exposures, including reinsurance provided through an affiliated reinsurer that retrocedes to the retroactive reinsurance counterparty. Under this exception, a reporting entity may aggregate reinsurers into one line item in Schedule F reflecting the counterparty under the retroactive agreement for the purposes of determining the Provision for Reinsurance regarding overdue amounts paid by the retroactive counterparty (both authorized and unauthorized). This exception would allow the Provision for Reinsurance to be reduced by reflecting that amounts have been recovered by the reporting entity under the duplicate coverage provided by the retroactive contract, and that inuring balances from the original contract(s) are payable to the retroactive counterparty. In addition, such approval would also permit the substitution of the retroactive counterparty for authorized original reinsurers without overdue balances for purposes of reporting on the primary section of the annual statement Schedule F. An agreement must meet all of the requirements in paragraphs 87.a. through 87.e. in order to be considered for this exception.

- a. The underlying agreement clearly indicates the credit risk associated with the collection of the reporting entity's inuring reinsurance recoverables and losses related to the credit risk will be covered by the retroactive reinsurance counterparty.
- b. The retroactive reinsurance agreement must transfer significant risk of loss.
- c. The assuming retroactive reinsurance counterparty must have a financial strength rating from at least two nationally recognized statistical rating organizations (NRSRO), the lowest of which is higher than or equal to the NRSRO ratings of the underlying third-party reinsurers.
- d. The transaction is limited to reinsurance recoverables attributable to asbestos, and/or pollution.
- e. The recoverables from the inuring reinsurers remain subject to credit analysis and contingent liability analysis.

88. With the approval of the reporting entity's domestic state commissioner pursuant to the applicable state credit for reinsurance law regarding the use of other forms of collateral acceptable to the commissioner, the reporting entity shall present the amount of other approved security related to the retroactive reinsurance agreement as an "Other Allowed Offset Item" with respect to the uncollateralized amounts recoverable from unauthorized reinsurers for paid and unpaid losses and loss adjustment expenses under the original reinsurance contracts. Amounts approved as "Other Allowed Offset Items" shall be reflected as amounts recoverable from the retroactive counterparty and aggregated reporting described in paragraph 87 shall also be applied for unpaid losses and loss adjustment expenses under the original reinsurance contracts. The security applied as an "Other Allowed Offset Item" shall also be reflected in the designated sub-schedule and disclosed as a prescribed or permitted practice. (See Exhibit D of this statement.)

89. The reporting entity will continue to detail the reporting of original reinsurers that were aggregated for one-line reporting per paragraph 87 as provided in the annual statement instructions. The aggregation reporting in schedule F applies only to the extent that inuring balances currently receivable under original reinsurance contracts are also payable to the retroactive reinsurance counterparty, and additionally to reinsurance recoverable on unpaid losses if the domestic state commissioner has approved amounts related to the retroactive reinsurance contract as any other form of security acceptable under the applicable provisions of the state's credit for reinsurance law. This guidance is not intended to otherwise change the application of retroactive accounting guidance for the retroactive portions of the contract that are not duplicative of the original reinsurance. Other than measurement of the provision for reinsurance and presentation in Schedule F, the retroactive contracts should continue to follow guidance applicable to retroactive accounting and reporting.

Syndicated Letters of Credit

90. With a Syndicated Letter of Credit (Syndicated LC), the reinsurer enters into an agreement with a group of banks (the "Issuing Banks") and an agent bank (the "Agent"). Each Issuing Bank and the Agent is an NAIC-approved bank and a "qualified bank". This agreement requires the Agent to issue, on behalf of the each of the Issuing Banks, letters of credit in favor of the ceding insurer. The credit is issued (as an administrative matter) only through the Agent's letter of credit department. Each issuing bank signs the Syndicated LC through the Agent, as its attorney-in-fact. Syndicated LCs are consistent with A-785, in that the Syndicated LC is the legal equivalent of multiple letters of credit separately issued by each of the issuing banks. Reporting entities shall take a reduction in the liability on account of reinsurance recoverables secured by the Syndicated LC if all of the following conditions are met:

- a. All listed banks on the letter of credit are qualified and meet the criteria of the NAIC SVO approved bank listing;
- b. Banks are severally and not jointly liable; and
- c. Specific percentages for each assuming bank are listed in the letter of credit.

Disputed Items

91. Occasionally a reinsurer will question whether an individual claim is covered under a reinsurance agreement or may even attempt to nullify an entire agreement. A ceding entity, depending upon the individual facts, may or may not choose to continue to take credit for such disputed balances. A ceding entity shall take no credit whatsoever for reinsurance recoverables in dispute with an affiliate.

92. Items in dispute are those claims with respect to which the ceding entity has received formal written communication from the reinsurer denying the validity of coverage.

Uncollectible Reinsurance

93. Uncollectible reinsurance balances shall be written off through the accounts, exhibits, and schedules in which they were originally recorded.

Commutations

94. A commutation of a reinsurance agreement, or any portion thereof, is a transaction which results in the complete and final settlement and discharge of all, or the commuted portion thereof, present and future obligations between the parties arising out of the reinsurance agreement.

95. In commutation agreements, an agreed upon amount determined by the parties is paid by the reinsurer to the ceding entity. The ceding entity immediately eliminates the reinsurance recoverable recorded against the ultimate loss reserve and records the cash received as a negative paid loss. Any net gain or loss shall be reported in underwriting income in the statement of income.

96. The reinsurer eliminates a loss reserve carried at ultimate cost for a cash payout calculated at present value. Any net gain or loss shall be reported in underwriting income in the statement of income.

97. Commuted balances shall be written off through the accounts, exhibits, and schedules in which they were originally recorded.

National Flood Insurance Program

98. The National Flood Insurance Program was created by the Federal Emergency Management Agency (FEMA) and is designed to involve private insurers in a write-your-own (WYO) flood insurance program financially backed by FEMA at no risk to the insurer. To become a participating WYO entity, the entity signs a document with the Federal Insurance Administration (FIA) of the Federal Emergency Management Agency known as the Financial Assistance/Subsidy Arrangement.

99. Premium rates are set by FEMA. The WYO participating companies write the flood insurance coverage qualifying for the program on their own policies, perform their own underwriting, premium collections, claim payments, administration, and premium tax payments for policies written under the program.

100. Monthly accountings are made to FIA and participants draw upon FEMA letters of credit for deficiencies of losses, loss expenses, and administrative expenses in excess of premiums, subject to certain percentage limitations on expenses.

101. Policies written by the reporting entity under the National Flood Insurance Program are considered insurance policies issued by the reporting entity, with reinsurance ceded to FEMA. (Such policies are not considered uninsured plans under *SSAP No. 47—Uninsured Plans.*) Balances due from or to FEMA shall be reported as ceded reinsurance balances receivable or payable. The commission and fee allowances received from FEMA shall be reported consistent with reinsurance ceding commission.

Accounting for the Transfer of Property and Casualty Run-Off Agreements

102. Property and casualty run-off agreements are reinsurance or retrocession agreements that are intended to transfer essentially all of the risks and benefits of a specific line of business or market segment that is no longer actively marketed by the transferring insurer or reinsurer. A property and casualty run-off agreement is not a novation as the transferring insurer or reinsurer remains primarily liable to the policyholder or ceding entity under the original contracts of insurance or reinsurance. Reinsurance agreements between affiliates or between insurers under common control (as those terms are defined in Appendix A-440) are not eligible for the exception for property and casualty run-off agreements in paragraph 36.e.

Criteria

103. The accounting treatment for property and casualty run-off agreements must be approved by the domiciliary regulators of the transferring entity (either the original direct insurer in the case of a reinsurance agreement or the original assuming reinsurer in the case of a retrocession agreement) and the assuming entity. If the transferring entity and assuming entity are domiciled in the same state, then the regulator of the state where the majority of the transferred liabilities is located shall be asked to approve the accounting treatment. In determining whether to approve an agreement for this accounting treatment, the regulators shall require the following:

- a. **Assuming Entity Properly Licensed** – The entity assuming the run-off agreement must have the appropriate authority or license to write the business being assumed.
- b. **Limits and Coverages** – The reinsurance or retrocession agreement shall provide the same limits and coverages that were afforded in the original insurance or reinsurance agreement.
- c. **Non-recourse** – The reinsurance or retrocession agreement shall not contain any adjustable features or profit share or retrospective rating, and there shall be no recourse (other than normal representations and warranties that would be associated with a purchase and sale agreement) directly or indirectly against the transferring entity.
- d. **Risk Transfer** – The reinsurance or retrocession agreement must meet the requirements of risk transfer as described in this statement.
- e. **Financial Strength of Reinsurer** – The assuming reinsurer shall have a financial strength rating from at least two independent rating agencies (from NAIC credit rating providers (CRP)) which is equal to or greater than the current ratings of the transferring entity. The lowest financial strength rating received from an NAIC acceptable rating organization rating agency will be used to compare the financial strength ratings of the transferring and assuming entities.
- f. **Assessments** – The assuming reinsurer or retrocessionaire (if required in the original reinsurance contract) shall be financially responsible for any and all assessments, including

guaranty fund assessments, that are assessed against the transferring entity related to the insurance business being assumed.

- g. Applicable Only to “Run-off” Business – The reinsurance or retrocession agreement shall only cover liabilities relating to a line(s) of business or specific market segments no longer actively marketed by the transferring entity.
- h. Non-cancelable Reinsurance – The reinsurance or retrocession agreement shall provide that the reinsurance or retrocessional coverage provided by the proposed agreement cannot be cancelable by either party for any reason. (However, this provision will not override standard contracts law and principles and will not prevent any remedies, including rescission or termination that might be available for breach, misrepresentation, etc.)

Statutory Schedules and Exhibits

104. At the inception of the transaction, the transferring entity shall record the consideration paid to the assuming entity as a paid loss. If the consideration paid by the transferring entity is less than the loss reserves transferred, the difference shall be recorded by the ceding entity as a decrease in losses incurred. The assuming entity shall record the consideration received as a negative paid loss. In addition, the transferring entity shall record an increase to ceded reinsurance recoverable for the amount of the transferred reserve. Journal entries illustrating these transactions, including situations in which the transaction includes an unearned premium reserve, are included in Exhibit B of this statement.

105. The assuming entity will report the business in the same line of business as reported by the original insurer or reinsurer. The assuming entity will report the business at the same level of detail using the appropriate statutory schedules and exhibits.

Disclosures

106. Unsecured Reinsurance Recoverables:

- a. If the entity has with any individual reinsurers, authorized, reciprocal jurisdiction, unauthorized, or certified an unsecured aggregate recoverable for losses, paid and unpaid including IBNR, loss adjustment expenses, and unearned premium, that exceeds 3% of the entity’s policyholder surplus, list each individual reinsurer and the unsecured aggregate recoverable pertaining to that reinsurer; and
- b. If the individual reinsurer is part of a group, list the individual reinsurers, each of its related group members having reinsurance with the reporting entity, and the total unsecured aggregate recoverables for the entire group.

107. Reinsurance Recoverables in Dispute—Reinsurance recoverable on paid and unpaid (including IBNR) losses in dispute by reason of notification, arbitration or litigation shall be identified if the amounts in dispute from any entity (and/or affiliate) exceed 5% of the ceding entity’s policyholders surplus or if the aggregate of all disputed items exceeds 10% of the ceding entity’s policyholders surplus. Notification means a formal written communication from a reinsurer denying the validity of coverage.

108. Uncollectible Reinsurance—Describe uncollectible reinsurance written off during the year reported in the following annual statement classifications, including the name(s) of the reinsurer(s):

- a. Losses incurred;
- b. Loss adjustment expenses incurred;

- c. Premiums earned; and
- d. Other.

109. Commutation of Ceded Reinsurance—Describe commutation of ceded reinsurance during the year reported in the following annual statement classifications, including the name(s) of the reinsurer(s):

- a. Losses incurred;
- b. Loss adjustment expenses incurred;
- c. Premiums earned; and
- d. Other.

110. Retroactive Reinsurance—The table illustrated in the NAIC Annual Statement Instructions for Property and Casualty Companies under Retroactive Reinsurance in the Notes to Financial Statements section shall be completed for all retroactive reinsurance agreements that transfer liabilities for losses that have already occurred and that will generate special surplus transactions. The insurer (assuming or ceding) shall assign a unique number to each retroactive reinsurance agreement and shall utilize this number for as long as the agreement exists. Transactions utilizing deposit accounting shall not be reported in this note.

111. Reinsurance Assumed and Ceded—The tables illustrated in the NAIC Annual Statement Instructions for Property and Casualty Companies under “Reinsurance Assumed and Ceded in the Notes to Financial Statements” section shall be completed as follows:

- a. The financial statements shall disclose the maximum amount of return commission which would have been due reinsurers if all reinsurance were canceled with the return of the unearned premium reserve; and
- b. The financial statements shall disclose the accrual of additional or return commission, predicated on loss experience or on any other form of profit sharing arrangements as a result of existing contractual arrangements.

112. A specific interrogatory requires information on reinsurance of risk accompanied by an agreement to release the reinsurer from liability, in whole or in part, from any loss that may occur on the risk or portion thereof.

113. Disclosures for paragraphs 114-119 represent annual statement interrogatories, which are required to be included with the annual audit report beginning with audit reports on financial statements as of and for the period ended December 31, 2006. The disclosures required within paragraphs 114-119 shall be included in accompanying supplemental schedules of the annual audit report beginning in year-end 2006. These disclosures shall be limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1994. This limitation applies to the annual audit report only and does not apply to the statutory annual statement interrogatories and the reinsurance summary supplemental filing.

114. Disclose if any risks are reinsured under a quota share reinsurance contract with any other entity that includes a provision that would limit the reinsurer’s losses below the stated quota share percentage (e.g. a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)? If yes, indicate the number of reinsurance contracts containing such provisions and if the amount of reinsurance credit taken reflects the reduction in quota share coverage caused by any applicable limiting provision(s).

115. Disclose if the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards

policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:

- a. A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;
- b. A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;
- c. Aggregate stop loss reinsurance coverage;
- d. A unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions which are only triggered by a decline in the credit status of the other party;
- e. A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or
- f. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

116. Disclose if the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders. This disclosure is limited to reinsurance contracts with written premium cessions or loss and loss expense reserve cessions described in this paragraph that meet the criteria of paragraph 116.a. or paragraph 116.b. This disclosure excludes cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member.

- a. The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or
- b. Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates in separate reinsurance contract.

117. If affirmative disclosure is required for paragraph 115 or 116, provide the following information:

- a. A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting paragraph 115 or 116;
- b. A brief discussion of management's principal objectives in entering into the reinsurance contract including the economic purpose to be achieved; and
- c. The aggregate financial statement impact gross of all such ceded reinsurance contracts on the balance sheet and statement of income.

118. Except for transactions meeting the requirements of paragraph 36, disclose if the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

- a. Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles (SAP) and as a deposit under generally accepted accounting principles (GAAP); or
- b. Accounted for that contract as reinsurance under GAAP and as a deposit under SAP.

119. If affirmative disclosure is required for paragraph 118, explain in a supplemental filing why the contract(s) is treated differently for GAAP and SAP.

120. Disclosures for the Transfer of Property and Casualty Run-off Agreements

- a. Disclose if the reporting entity has entered into any agreements which have been approved by their domiciliary regulator and have qualified pursuant to paragraph 36.e. (also see paragraphs 102-105).
- b. If affirmative, provide a description of the agreement and the amount of consideration paid and liabilities transferred.

121. The financial statements shall disclose the following with respect to reinsurance agreements which qualify for reinsurer aggregation in accordance with paragraphs 87-89:

- a. A description of the significant terms of the reinsurance agreement, including established limits and collateral, and
- b. The amount of unexhausted limit as of the reporting date.
- c. To the extent that the domestic state insurance department approves the use of the retroactive contract as an acceptable form of security related to the original reinsurers under the applicable provisions of the state's credit for reinsurance law, the use of such discretion shall be disclosed in the annual statement Note 1 as a prescribed or permitted practice. In addition, Note 1 shall disclose as part of the total impact on the provision for reinsurance the impact on the overdue aspects of the calculation if the reporting entity also receives commissioner approval pursuant to paragraph 87 related to overdue paid amounts (both authorized and unauthorized).

122. The financial statements shall disclose the following with respect to reinsurance agreements that have been accounted for as deposits:

- a. A description of the reinsurance agreements.
- b. Any adjustment of the amounts initially recognized for expected recoveries. The individual components of the adjustment (e.g., interest accrual, change due to a change in estimated or actual cash flow) shall be disclosed separately.

123. The financial statements shall disclose the impact on any reporting period in which a certified reinsurer's rating has been downgraded or its certified reinsurer status is subject to revocation and additional collateral has not been received as of the filing date. The disclosure should include the following:

- a. Name of certified reinsurer downgraded or subject to revocation of certified reinsurer status and relationship to the reporting entity;

- b. Date of downgrade or revocation and jurisdiction of action;
- c. Collateral percentage requirements pre and post downgrade or revocation;
- d. Net ceded recoverable subject to collateral;
- e. As of the end of the current quarter, the estimated impact of the collateral deficiency to the reporting entity as a result of the assuming entity's downgrade or revocation of certified reinsurer status. (At year-end the actual impact of the collateral deficiency on the provision for reinsurance shall be disclosed.)

124. U.S. domiciled reinsurers are eligible for certified reinsurer status. If the reporting entity is a certified reinsurer, the financial statements shall disclose the impact on any reporting period in which its certified reinsurer rating is downgraded or status as a certified reinsurer is subject to revocation. Such disclosure shall include information similar to paragraphs 123.b., 123.c. and 123.d. and the expectation of its certified reinsurer's ability to meet the increased requirements.

125. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

126. This statement adopts with modification *FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (FAS 113) and *FASB Emerging Issues Task Force No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises* for the following:

- a. Reinsurance recoverables on unpaid case-basis and incurred but not reported losses and loss adjustment expenses shall be reported as a contra-liability netted against the liability for gross losses and loss adjustment expenses;
- b. Amounts paid for prospective reinsurance that meet the conditions for reinsurance accounting shall be reported as a reduction of unearned premiums;
- c. The gain created by a retroactive reinsurance agreement because the amount paid to the reinsurer is less than the gross liabilities for losses and loss adjustment expenses ceded to the reinsurer is reported in the statement of income as a write-in gain in other income by the ceding entity and a write-in loss by the assuming entity. The gain created by a retroactive reinsurance agreement is restricted as a special surplus account until the actual retroactive reinsurance recovered is in excess of the consideration paid;
- d. This statement requires that a liability (provision for reinsurance) be established through a provision reducing unassigned funds (surplus) for unsecured reinsurance recoverables from unauthorized or certified reinsurers and for certain overdue balances due from authorized reinsurers;
- e. Some reinsurance agreements contain adjustable features that provide for adjustment of commission, premium or amount of coverage, based on loss experience. This statement requires that the asset or liability arising from the adjustable feature be computed based on experience to date under the agreement, and the impact of early termination may only be considered at the time the agreement has actually been terminated;
- f. Structured settlements are addressed in *SSAP No. 65—Property and Casualty Contracts*. Statutory accounting and FAS 113 are consistent in accounting for structured settlement annuities where the reporting entity is the owner and payee and where the claimant is the payee and the reporting entity has been released from its obligation. FAS 113 distinguishes

structured settlement annuities where the claimant is the payee and a legally enforceable release from the reporting entity's liability is obtained from those where the claimant is the payee but the reporting entity has not been released from its obligation. GAAP requires the deferral of any gain resulting from the purchase of a structured settlement annuity where the reporting entity has not been released from its obligation; and

- g. This statement requires that reinsurance recoverables on unpaid losses and loss adjustment expenses be presented as a contra-liability. Requirements for offsetting and netting are addressed in SSAP No. 64.

127. This statement adopts American Institute of Certified Public Accountants (AICPA) *Statement of Position 98-7, Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk* (SOP 98-7) paragraphs 10-12 and 19 (subsection b only). This statement rejects AICPA SOP 98-7 paragraphs 13-17 and 19 (subsections a and c).

128. This statement rejects AICPA *Statement of Position No. 92-5, Accounting for Foreign Property and Liability Reinsurance*. This statement incorporates Appendix A-785 as applicable.

Effective Date and Transition

129. This statement shall apply to:

- a. Reinsurance agreements entered into, renewed, or amended on or after January 1, 1994. An amendment is any revision or adjustment of contractual terms. The payment of premiums or reimbursement of losses recoverable under the agreement shall not constitute an amendment; and
- b. Reinsurance agreements in force on January 1, 1995, which cover losses occurring or claims made on or after that date on policies reinsured under such agreements.

130. The guidance shall not apply to:

- a. Reinsurance agreements which cover only losses occurring or claims made before January 1, 1994, and which were entered into before January 1, 1994, and were not subsequently renewed or amended; and
- b. Reinsurance agreements that expired before and were not renewed or amended after January 1, 1995.

131. The guidance in paragraphs 55-74 shall be effective for all accounting periods beginning on or after January 1, 1996, and shall apply to reinsurance agreements entered into, renewed or amended on or after January 1, 1994.

132. This statement, including the guidance in paragraph 40 incorporated from SSAP No. 75, is effective for years beginning January 1, 2001. Changes resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

- a. Revisions to paragraph 36.e., related to paragraphs 102-105, and disclosures in paragraph 120 documented in *Issue Paper No. 137—Transfer of Property and Casualty Reinsurance Run-off Agreements* are effective for contracts entered on or after January 1, 2010.
- b. The guidance in paragraphs 40, 122 and 127 was previously included within *SSAP No. 75—Reinsurance Deposit Accounting—An Amendment to SSAP No. 62R, Property and Casualty Reinsurance* and was also effective for years beginning January. 1, 2001. In 2011,

the guidance from SSAP No. 75 was incorporated within this statement, with SSAP No. 75 nullified. The original guidance included in this statement for deposit accounting, as well as the original guidance adopted in SSAP No. 75, are retained for historical purposes in Issue Paper No. 104. The guidance in paragraph 54 was originally contained within *INT 02-06: Indemnification in Modeled Trigger Transactions* and was effective June 9, 2002. The guidance in paragraph 90 was originally contained within *INT 02-09: A-785 and Syndicated Letters of Credit* and was effective September 12, 2004.

- c. The guidance related to certified reinsurers is applicable only to cedents domiciled in states that have enacted/promulgated the new collateral framework and only for their cessions to reinsurers certified under that domestic law/rule. The requirements applicable to contracts with certified reinsurers shall be effective for all reporting periods beginning on or after December 31, 2012.

133. The guidance in paragraphs 87-89 and 121 which allowed retroactive reinsurance exceptions for asbestos and pollution contracts was effective for all accounting periods beginning on or after January 1, 2014, for paid losses. This guidance was revised to also allow for unpaid losses effective for reporting periods ending on and after December 31, 2015.

134. The substantive revisions adopted November 15, 2018, which primarily incorporated guidance originally from *EITF 93-6, Accounting for Multiple-Year Retrospectively-Rated Contracts by Ceding and Assuming Enterprises*, and from *EITF Topic D-35, FASB Staff Views on Issue No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises*, are effective for contracts in effect on or after January 1, 2019. These revisions are required for contracts in effect as EITF 93-6 had been adopted with modification in this statement from its original 2001 effective date. The revisions adopted in November 2018 primarily added clarification and implementation guidance. (Companies that have previously been following the original intent, as clarified in the revisions, should not be impacted by the November 2018 revisions.) However, if a reporting entity becomes aware that the prior application of reinsurance credit guidance was not consistent with the adopted guidance, the updates should be applied as a change in accounting principle to contracts in effect as of January 1, 2019.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 75—Property and Casualty Reinsurance*
- *Issue Paper No. 104—Reinsurance Deposit Accounting – An Amendment to SSAP No. 62R—Property and Casualty Reinsurance*
- *Issue Paper No. 137—Transfer of Property and Casualty Reinsurance Run-off Agreements*
- *Issue Paper No. 153—Counterparty Reporting Exception for Asbestos and Pollution Contracts*

CLASSIFYING REINSURANCE CONTRACTS

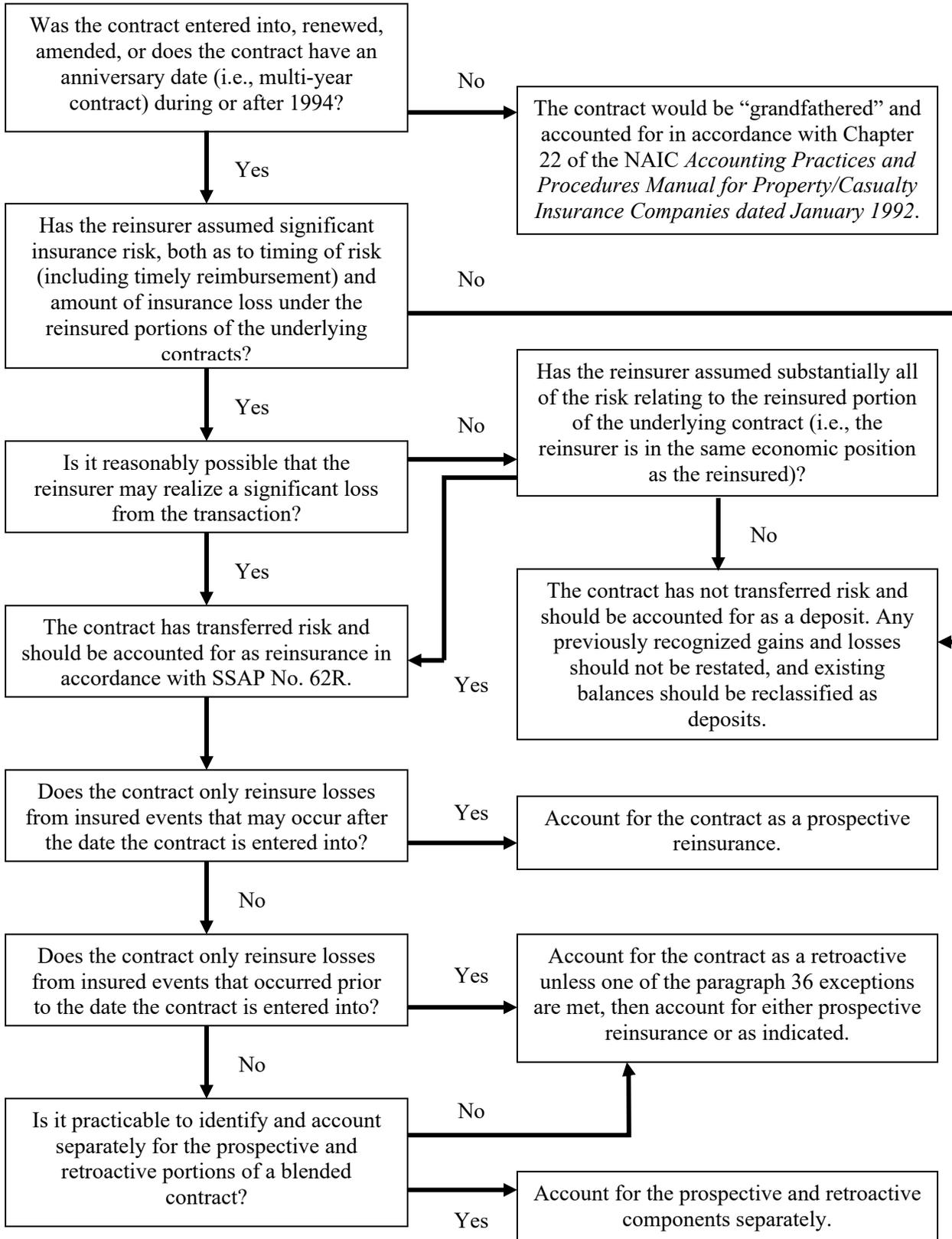


EXHIBIT A – IMPLEMENTATION QUESTIONS AND ANSWERS

This exhibit addresses common questions regarding implementation of the property and casualty reinsurance accounting standards.

Index to Questions

No.	Question
Applicability	
1	The accounting practices in SSAP No. 62R specify the accounting and reporting for reinsurance contracts. What contracts are considered reinsurance contracts for purposes of applying these accounting practices?
2	The provisions of this statement will apply to (a) reinsurance contracts entered into, renewed or amended on or after January 1, 1994, and (b) any other reinsurance contracts that are in force on January 1, 1995, and cover insurable events on the underlying insurance policies that occur on or after that date. What contracts would be exempt from the accounting rules included in SSAP No. 62R?
3	This statement is to be applied to contracts which are amended on or after January 1, 1994. What if the change in terms is not significant, or the terms changed have no financial effect on the contract?
4	Must the accounting provisions of SSAP No. 62R be applied to an <i>otherwise exempt</i> contract if the ceding entity pays additional premiums under the contract on or after January 1, 1994?
5	Prospective and retroactive portions of a reinsurance contract are allowed to be accounted for separately, if practicable. Can the retroactive portion of an existing contract be segregated and, therefore, exempted with other retroactive contracts covering insured events occurring prior to January 1, 1994?
Risk Transfer	
6	Do the risk transfer provisions apply to existing contracts?
7	How does the effective date affect the assessment of whether a significant loss to the reinsurer was reasonably possible?
8	Should risk transfer be reassessed if contractual terms are subsequently amended?
9	How should the risk transfer assessment be made when a contract has been amended?
10	For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract?
11	If the assessment of risk transfer changes after the initial assessment at contract inception, how should the ceding entity account for the change?
12	SSAP No. 62R requires that reasonably possible outcomes be evaluated to determine the reinsurer's exposure to significant loss. What factors should be considered in determining whether a scenario being evaluated is reasonably possible?

No.	Question
13	In determining the amount of the reinsurer's loss under reasonably possible outcomes, may cash flows directly related to the contract other than those between the ceding and assuming companies, such as taxes and operating expenses of the reinsurer, be considered in the calculation?
14	In evaluating the significance of a reasonably possible loss, should the reasonably possible loss be compared to gross or net premiums?
15	How does a commutation clause affect the period of time over which cash flows are evaluated for reasonable possibility of significant loss to the reinsurer?
16	SSAP No. 62R refers to payment schedules and accumulating retentions from multiple years as features that delay timely reimbursement of claims. Does the presence of those features generally prevent a contract from meeting the conditions for reinsurance accounting?
17	What if a contract contains a feature such as a payment schedule or accumulating retention but could still result in the reasonable possibility of significant loss to the reinsurer?
18	Can a reinsurance agreement compensate a reinsurer for losses?
19	In determining whether a reinsurance contract qualifies under the exception referred to in paragraph 18 of SSAP No. 62R, how should the economic position of the reinsurer be assessed in relation to that of the ceding entity?
Accounting Provisions	
20	An existing contract that was accounted for as reinsurance no longer qualifies for reinsurance accounting under the accounting rules included in SSAP No. 62R. How should the ceding and assuming companies account for the contract in future periods?
21	What is the definition of past insurable events that governs whether reinsurance coverage is prospective or retroactive? For example, could a reinsurance contract that covers losses from asbestos and pollution claims on occurrence-based insurance policies effective during previous periods be considered prospective if the reinsurance coverage is triggered by a court interpretation that a loss is covered within the terms of the underlying insurance policies?
22	Would the answer to the above question change if the reinsurance were written on a claims-made basis?
23	What is the effect of adjustments to future premiums or coverage in determining whether reinsurance is prospective or retroactive?
24	A reinsurance contract is entered into after the contract's effective date. Is the coverage between the contract's effective date and the date the contract was entered into prospective or retroactive?
25	How is the date the reinsurance contract was entered into determined?
26	Are contracts to reinsure calendar-year incurred losses considered blended contracts that have both prospective and retroactive elements?
27	When the prospective and retroactive portions of a contract are being accounted for separately, how should premiums be allocated to each portion of the contract?

No.	Question
28	A retroactive reinsurance contract contains a cut-through provision that provides the ceding entity's policyholders and claimants with the right to recover their claims directly from the reinsurer. May the ceding entity immediately recognize earned surplus associated with this type of contract?
29	A ceding entity enters into a retroactive reinsurance agreement that gives rise to segregated surplus. If the reinsurer prepays its obligation under the contract, may the ceding entity recognize earned surplus at the time the prepayment is received?
30	If the ceding entity does not expect to receive any recoveries because the reinsurer has agreed to reimburse claimants under the reinsured contracts directly, would the ceding entity be considered to have recovered or terminated its transferred liabilities?
31	What accounting entries would a ceding entity make to report a retroactive reinsurance contract?
32	How should the parties account for an adverse loss development reinsurance contract where, as of the statement date, the attachment level of the contract exceeds the ceding company's current case and IBNR reserves for the covered accident years (i.e., no surplus gain and no reinsurance recoverable as of the statement date), and the ceding company transferred cash to the reinsurer at the inception of the contract?
33	How should a ceding company account for payment of the premium for a retroactive reinsurance contract by the ceding company's parent company or some other person not a party to the reinsurance contract (for example, adverse loss development reinsurance contracts purchased by the parent company in the context of the purchase or sale of the ceding company)?

Applicability

1. Q: The accounting practices in SSAP No. 62R specify the accounting and reporting for reinsurance contracts. What contracts are considered reinsurance contracts for purposes of applying these accounting practices?

A: Any transaction that indemnifies an insurer against loss or liability relating to insurance risk shall be accounted for in accordance with the accounting practices included in SSAP No. 62R. Therefore, all contracts, including contracts that may not be structured or described as reinsurance, shall be accounted for as reinsurance when those conditions are met.

2. Q: The provisions of this statement will apply to (a) reinsurance contracts entered into, renewed or amended on or after January 1, 1994, and (b) any other reinsurance contracts that are in force on January 1, 1995 and cover insurable events on the underlying insurance policies that occur on or after that date. What contracts would be exempt from the accounting rules included in SSAP No. 62R?

A: The only exempt contracts are:

- 1) Purely retroactive reinsurance contracts that cover only insured events occurring before January 1, 1994, provided those contracts were entered into before that date and are not subsequently amended and
- 2) Contracts that expired before January 1, 1995 and are not amended after that date.

3. Q: This statement is to be applied to contracts which are amended on or after January 1, 1994. What if the change in terms is not significant, or the terms changed have no financial effect on the contract?
- A: In general, the term amendment should be viewed broadly to include all but the most trivial changes. Examples of amendments include, but are not limited to, replacing one assuming entity with another (including an affiliated entity), or modifying the contract's limit, coverage, premiums, commissions, or experience-related adjustable features. No distinction is made between financial and non-financial terms.
4. Q: Must the accounting provisions of SSAP No. 62R be applied to an *otherwise exempt* contract if the ceding entity pays additional premiums under the contract on or after January 1, 1994?
- A: The answer depends on why the additional premiums are paid. If the additional premiums are the result of a renegotiation, adjustment, or extension of terms, the contract is subject to the accounting provisions of SSAP No. 62R. However, additional premiums paid without renegotiation, adjustment, or extension of terms would not make an otherwise exempt contract subject to those provisions.
5. Q: Prospective and retroactive portions of a reinsurance contract are allowed to be accounted for separately, if practicable. Can the retroactive portion of an existing contract be segregated and, therefore, exempted with other retroactive contracts covering insured events occurring prior to January 1, 1994?
- A: No. The transition provisions apply to an entire contract, which is either subject to or exempt from the provisions of SSAP No. 62R. A ceding entity may bifurcate a contract already subject to the accounting rules in SSAP No. 62R and then account for both the prospective and retroactive portions in accordance with the accounting standard.

Risk Transfer

6. Q: Do the risk transfer provisions apply to existing contracts?
- A: Yes, the risk transfer provisions apply to some existing contracts. SSAP No. 62R applies in its entirety only to existing contracts which were renewed or amended on or after January 1, 1994, or which cover losses occurring or claims made after that date. Therefore, those contracts must be evaluated to determine whether they transfer risk and qualify for reinsurance accounting. For accounting periods commencing on or after January 1, 1995, balances relating to such contracts which do not transfer insurance risk shall be reclassified as deposits and shall be accounted for and reported in the manner described under the caption Reinsurance Contracts Must Include Transfer of Risk.
- SSAP No. 62R does not apply to existing contracts which were entered into before, and were not renewed or amended on or after, January 1, 1994, and which cover only losses occurring or claims made before that date, nor to contracts which expired before, and were not renewed or amended on or after, January 1, 1995. Those contracts will continue to be accounted for in the manner provided by SSAP No. 62R before these revisions.
7. Q: How does the effective date affect the assessment of whether a significant loss to the reinsurer was reasonably possible?
- A: The risk transfer assessment is made at contract inception, based on facts and circumstances known at the time. Because that point in time has passed for existing contracts, some have suggested that the risk transfer provisions be applied as of the effective date. However, that approach to the risk transfer assessment would violate the requirement to consider all cash flows from the contract.

Therefore, the test must be applied from contract inception, considering the effect of any subsequent contract amendments. Careful evaluation and considered judgment will be required to determine whether a significant loss to the reinsurer was reasonably possible at inception.

8. Q: Should risk transfer be reassessed if contractual terms are subsequently amended?

A: Yes. When contractual terms are amended, risk transfer should be reassessed. For example, a contract that upon inception met the conditions for reinsurance accounting could later be amended so that it no longer meets those conditions. The contract should then be reclassified and accounted for as a deposit.

9. Q: How should the risk transfer assessment be made when a contract has been amended?

A: No particular method is prescribed for assessing risk transfer in light of a contract amendment. Whether an amended contract in substance transfers risk must be determined considering all of the facts and circumstances in light of the risk transfer requirements. Judgment also will be required to determine whether an amendment in effect creates a new contract.

10. Q: For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract?

A: A contract is not defined, but is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract. For example, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist.

The inconsistency that could result from varying interpretations of the term *contract* is limited by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers, in the aggregate, do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

11. Q: If the assessment of risk transfer changes after the initial assessment at contract inception, how should the ceding entity account for the change?

A: The status of a contract should be determinable at inception and, absent amendment, subsequent changes should be very rare. If the risk of significant loss was not deemed reasonably possible at inception, and a significant loss subsequently occurred, the initial assessment was not necessarily wrong, because remote events do occur. Likewise, once a reasonable possibility of significant loss has been established, such loss need not occur in order to maintain the contract's status as reinsurance.

12. Q: SSAP No. 62R requires that reasonably possible outcomes be evaluated to determine the reinsurer's exposure to significant loss. What factors should be considered in determining whether a scenario being evaluated is reasonably possible?

A: The term *reasonably possible* means that the probability is more than remote. The test is applied to a particular scenario, not to the individual assumptions used in the scenario. Therefore, a scenario is not reasonably possible unless the likelihood of the entire set of assumptions used in the scenario occurring together is reasonably possible.

13. Q: In determining the amount of the reinsurer's loss under reasonably possible outcomes, may cash flows directly related to the contract other than those between the ceding and assuming companies, such as taxes and operating expenses of the reinsurer, be considered in the calculation?

A: No. The evaluation is based on the present value of all cash flows *between the ceding and assuming enterprises* under reasonably possible outcomes and, therefore, precludes considering other expenses of the reinsurer in the calculation.

14. Q: In evaluating the significance of a reasonably possible loss, should the reasonably possible loss be compared to gross or net premiums?

A: Gross premiums should be used.

15. Q: How does a commutation clause affect the period of time over which cash flows are evaluated for reasonable possibility of significant loss to the reinsurer?

A: All cash flows are to be assessed under reasonably possible outcomes. Therefore, unless commutation is expected in the scenario being evaluated, it should not be assumed in the calculation. Further, the assumptions used in a scenario must be internally consistent and economically rational in order for that scenario's outcome to be considered reasonably possible.

16. Q: SSAP No. 62R refers to payment schedules and accumulating retentions from multiple years as features that delay timely reimbursement of claims. Does the presence of those features generally prevent a contract from meeting the conditions for reinsurance accounting?

A: Yes. Payment schedules and accumulating retentions from multiple years are contractual features inherently designed to delay the timing of reimbursement to the ceding entity. Regardless of what a particular feature might be called, any feature that can delay timely reimbursement violates the conditions for reinsurance accounting. Transfer of insurance risk requires that the reinsurer's payments to the ceding entity depend on and directly vary with the amount and timing of claims settled under the reinsured contracts. Contractual features that can delay timely reimbursement prevent this condition from being met. Therefore, any feature that may affect the timing of the reinsurer's reimbursement to the ceding entity should be closely scrutinized.

17. Q: What if a contract contains a feature such as a payment schedule or accumulating retention but could still result in the reasonable possibility of significant loss to the reinsurer?

A: Both of the following conditions are required for reinsurance accounting:

- a. Transfer of significant risk arising from uncertainties about both (i) the ultimate amount of net cash flows from premiums, commission, claims, and claim settlement expenses paid under a contract (underwriting risk) and (ii) the timing of the receipt and payment of those cash flows (timing risk); and
- b. Reasonable possibility of significant loss to the reinsurer.

Because both condition (a) and condition (b) must be met, failure to transfer significant timing and underwriting risk is not overcome by the possibility of significant loss to the reinsurer.

18. Q: Can a reinsurance agreement compensate a reinsurer for losses?

A: A contract does not meet the conditions for reinsurance accounting if features of the reinsurance contract or other contracts or agreements directly or indirectly compensate the reinsurer or related reinsurers for losses to an extent that risk-transfer criteria is violated. That compensation may take many forms, and an understanding of the substance of the contracts or agreements is required to determine whether the ceding entity has been indemnified against loss or liability relating to insurance risk. For example, contractual features may limit the reinsurer's exposure to insurance risk or delay the reimbursement of claims so that investment income mitigates exposure to insurance risk. Examples of those contractual features noted in paragraph 12 are not all-inclusive.

19. Q: In determining whether a reinsurance contract qualifies under the exception referred to in paragraph 18, how should the economic position of the reinsurer be assessed in relation to that of the ceding entity?

A: The assessment should be made by comparing the net cash flows of the reinsurer under the reinsurance contract with the net cash flows of ceding entity on the reinsured portions of the underlying insurance contracts. This may be relatively easy for reinsurance of individual risks or for unlimited-risk quota-share reinsurance, because the premiums and losses on these types of reinsurance generally are the same as the premiums and losses on the reinsured portions of the underlying insurance policies.

In other types of reinsurance, determining the reinsurer's net cash flows relative to the insurer is likely to be substantially more difficult. For example, it generally would be difficult to demonstrate that the ceding entity's premiums and losses for a particular layer of insurance are the same as the reinsurer's premiums and losses related to that layer. If the economic position of the reinsurer relative to the insurer cannot be determined, the contract would not qualify under the exception.

Accounting Provisions

20. Q: An existing contract that was accounted for as reinsurance no longer qualifies for reinsurance accounting under the accounting rules included in SSAP No. 62R. How should the ceding and assuming companies account for the contract in future periods?

A: Because the statement of income cannot be restated, previously recognized gains and losses are not revised. If the contract was entered into before, and not renewed or amended on or after, January 1, 1994 and covers only losses occurring or claims made before that date, or the contract expired before January 1, 1995 and was not renewed or amended on or after that date, it would continue to be accounted for in the manner provided before these revisions.

For accounting periods commencing on or after January 1, 1995, existing balances relating to contracts which do not transfer insurance risk and which were entered into on or after January 1, 1994 (covering losses occurring or claims made after that date) would be reclassified as deposits.

Premium payments to a reinsurer would be recorded as deposits. Likewise, losses recoverable from a reinsurer would not be recognized as receivables. Rather, any reimbursement for losses would be accounted for upon receipt as a refund of a deposit.

21. Q: What is the definition of past insurable events that governs whether reinsurance coverage is prospective or retroactive? For example, could a reinsurance contract that covers losses from asbestos and pollution claims on occurrence-based insurance policies effective during previous periods be considered prospective if the reinsurance coverage is triggered by a court interpretation that a loss is covered within the terms of the underlying insurance policies?

A: The distinction between prospective and retroactive reinsurance is based on whether a contract reinsures future or past insured events covered by the underlying reinsurance contracts. In the example above, the insured event is the occurrence of loss within the coverage of the underlying insurance contracts, not the finding of a court. Therefore, the fact that the asbestos exposure or pollution is covered under insurance policies effective during prior periods makes the reinsurance coverage in this example retroactive.

22. Q: Would the answer to the above question change if the reinsurance were written on a claims-made basis?

A: No. The form of the reinsurance—whether claims-made or occurrence-based—does not determine whether the reinsurance is prospective or retroactive. A claims-made reinsurance contract that reinsures claims asserted to the reinsurer in a future period as a result of insured events that occurred prior to entering into the reinsurance contract is a retroactive contract.

23. Q: What is the effect of adjustments to future premiums or coverage in determining whether reinsurance is prospective or retroactive?

A: Adjustments to future premiums or coverage may affect the accounting for a reinsurance contract. Whenever an adjustment results in a reinsurer providing new or additional coverage for past insurable events, that coverage is retroactive. For example, if subsequent years' premiums under a multiple accident year contract create additional coverage for previous accident years, the additional coverage is retroactive, even if the original coverage provided in the contract for those accident years was prospective. Likewise, if current losses under a multiple-year contract eliminate coverage in future periods, some or all of the premiums to be paid in those future periods should be charged to the current period.

24. Q: A reinsurance contract is entered into after the contract's effective date. Is the coverage between the contract's effective date and the date the contract was entered into prospective or retroactive?

A: The portion of the contract related to the period of time between the effective date of the contract and the date the contract was entered into is retroactive because it covers insured events that occurred prior to entering into the reinsurance contract.

25. Q: How is the date the reinsurance contract was entered into determined?

A: It is not uncommon for a reinsurance arrangement to be initiated before the beginning of a policy period but not finalized until after the policy period begins. Whether there was agreement in principle at the beginning of the policy period and, therefore, the contract is substantively prospective must be determined based on the facts and circumstances. For example, a contract may be considered to have been substantively entered into even though regulatory approval of that contract has not taken place.

The absence of agreement on significant terms, or the intention to establish or amend those terms at a later date based on experience or other factors, generally indicates that the parties to the contract have not entered into a reinsurance contract, but rather have agreed to enter into a reinsurance contract at a future date. If contractual provisions under a contract substantively entered into at a future date covered insurable events prior to that date, that coverage is retroactive.

In any event, SSAP No. 62R provides that if a contract (except facultative contracts and contracts signed by the lead reinsurer and certain cover notes or similar documents signed by reinsurers representing more than 50% of the capacity on the contract) has not been finalized, reduced to written form and signed by the parties within 9 months after its effective date, it is presumed to be retroactive.

26. Q: Are contracts to reinsure calendar-year incurred losses considered blended contracts that have both prospective and retroactive elements?

A: Yes. Most reinsurance contracts covering calendar-year incurred losses combine coverage for insured events that occurred prior to entering into the reinsurance contract with coverage for future insured events and, therefore, include both prospective and retroactive elements.

In any event, SSAP No. 62R provides that if a contract (except facultative contracts, contracts signed by the lead reinsurer and certain cover notes or similar documents signed by reinsurers representing more than 50% of the capacity on the contract) has not been finalized, reduced to written form and signed by the parties within 9 months after its effective date it is presumed retroactive.

27. Q: When the prospective and retroactive portions of a contract are being accounted for separately, how should premiums be allocated to each portion of the contract?

A: No specific method for allocating the reinsurance premiums to the risks covered by the prospective and retroactive portions of a contract is required. However, separate accounting for the prospective and retroactive portions of a contract may take place only when an allocation is practicable.

Practicability requires a reasonable basis for allocating the reinsurance premiums to the risks covered by the prospective and retroactive portions of the contract, considering all amounts paid or deemed to have been paid regardless of the timing of payment. If a reasonable basis for allocating the premiums between the prospective and retroactive coverage does not exist, the entire contract must be accounted for as a retroactive contract.

28. Q: A retroactive reinsurance contract contains a cut-through provision that provides the ceding entity's policyholders and claimants with the right to recover their claims directly from the reinsurer. May the ceding entity immediately recognize earned surplus associated with this type of contract?

A: No. SSAP No. 62R states that earned surplus may not be recognized "until the actual retroactive reinsurance recovered exceeds the consideration paid."

29. Q: A ceding entity enters into a retroactive reinsurance agreement that gives rise to segregated surplus. If the reinsurer prepays its obligation under the contract, may the ceding entity recognize earned surplus at the time the prepayment is received?

A: Segregated surplus arising from retroactive reinsurance transactions is earned as actual liabilities that have been transferred are recovered or terminated. Therefore, earned surplus is based on when the reinsurer settles its obligations to the ceding entity, and it may be appropriate to recognize earned surplus at the time the prepayment is received.

However, all of the facts and circumstances must be considered to determine whether the ceding entity has substantively recovered the liabilities transferred to the reinsurer. For example, if the ceding entity agrees to compensate the reinsurer for the prepayment, such as by crediting the reinsurer with investment income on prepaid amounts or balances held, the ceding entity has not, in substance, recovered its transferred liabilities but rather has received a deposit from the reinsurer that should be accounted for accordingly.

30. Q: If the ceding entity does not expect to receive any recoveries because the reinsurer has agreed to reimburse claimants under the reinsured contracts directly, would the ceding entity be considered to have recovered or terminated its transferred liabilities?

A: No. In the example given, the reinsurer is substantively acting as disbursing agent for the ceding entity. Therefore, the ceding entity cannot be said to have recovered amounts due from the reinsurer before payment is made to the claimant.

31. Q: What accounting entries would a ceding entity make to report a retroactive reinsurance contract?

A: Accounting Entries for a Ceding Entity to Report a Retroactive Reinsurance Contract:

Entry 1

Retroactive Reinsurance Reserves		
Ceded or Assumed (B/S)	10,000	
Retroactive Reinsurance Gain (I/S)		2,000
Cash		8,000

To record initial portfolio transfer, see paragraph 34.c. and paragraph 34.h. The ceding entity must establish the segregated surplus per paragraph 34.d.

Entry 1A

Retro. Reins. Gain	2,000	
Profit/Loss Account		2,000

To close gain from retroactive transaction.

Entry 1B

Profit/Loss Account	2,000	
Special Surplus from Retro. Reins.		2,000

To close profit from retroactive reinsurance to special surplus.

Entry 2

Cash	2,000	
Retroactive Reinsurance Reserves		2,000
Ceded or Assumed (B/S)		

To record recovery of paid losses from the reinsurer. Outstanding ceded reserves after this recovery equals \$8,000, and special surplus from retroactive reinsurance account equals \$2,000; therefore, segregated surplus account is not changed per paragraph 34.j.

Entry 3

Retroactive Reinsurance Reserves		
Ceded or Assumed (B/S)	3,000	
Retroactive Reinsurance Gain (I/S)		3,000

To record subsequent revision of the initial reserves ceded per paragraph 34.j. The segregated surplus account is increased to \$5,000 as a result of this upward development.

Entry 3A

Retro. Reinsurance Gain	3,000	
Profit/Loss Account		3,000

To close profit from retroactive reinsurance.

Entry 3B

Profit/Loss (I/S)	3,000	
Special Surplus from Retro. Reins.		3,000

To close profit and loss account to special surplus. (Retroactive reinsurance reserves ceded or assumed account balance equals \$11,000. Special Surplus from retroactive reinsurance balance equals \$5,000.)

Entry 4

Cash	4,000	
Retroactive Reinsurance Reserves Ceded or Assumed (B/S)		4,000

To record recovery of paid losses from the reinsurer. Outstanding ceded reserves after this recovery equals \$7,000, therefore segregated surplus account is not changed per paragraph 34.j.

Entry 5

Cash	3,000	
Retroactive Reinsurance Reserves Ceded or Assumed (B/S)		3,000

To record recovery of paid losses from reinsurer. Outstanding ceded reserves after recovery equals \$4,000, therefore the following entry is needed per paragraph 34.f. and paragraph 34.j.

Entry 5A

Special Surplus—Retro. Reins.	1,000	
Unassigned Funds		1,000

Retroactive Reinsurance reserves ceded or assumed after this entry equals \$4,000.

Entry 6

Retroactive Reinsurance Loss (I/S)	1,000	
Retroactive Reinsurance Reserves Ceded or Assumed (B/S)		1,000

To record subsequent revision of the initial reserves ceded per paragraph 34.j. The segregated surplus account is decreased as a result of this downward development to \$3,000. The following entry is needed per paragraph 34.f. and paragraph 34.j.

Entry 6A

Profit/Loss Account	1,000	
Retro. Reins. Loss		1,000

To close loss to profit and loss account.

Entry 6B

Special Surplus from Retro. Reins.	1,000	
Profit/Loss Account		1,000

To close profit and loss account to special surplus. (Remaining balance of retroactive reinsurance reserve ceded or assumed account equals \$3,000.) (Special surplus from retro. reins. account balance equals \$3,000.)

Entry 7

Cash	2,500	
Retroactive Reinsurance Gain (I/S)	500	
Retroactive Reinsurance Reserves Ceded or Assumed (B/S)		3,000

Entry 7A

Profit and Loss Account	500	
Retro. Reins. Gain		500

To close other income to profit and loss account.

Entry 7B

Special Surplus from Retro. Reins.	500	
Profit/Loss Account		500

To close profit and loss account to special surplus. (Remaining balance of special surplus from retro. reins. account equals \$2,500.) (Remaining balance of retroactive reinsurance reserve ceded or assumed account -0-.)

Entry 7C

Special Surplus from Retro. Reins.	2,500	
Unassigned Funds		2,500

To close remaining special surplus account to unassigned surplus.

32. Q: How should the parties account for an adverse loss development reinsurance contract where, as of the statement date, the attachment level of the contract exceeds the ceding company’s current case and IBNR reserves for the covered accident years (i.e. no surplus gain and no reinsurance recoverable as of the statement date), and the ceding company transferred cash to the reinsurer at the inception of the contract?

A: An adverse loss development reinsurance contract covering prior accident years meets the definition of “retroactive reinsurance” set forth in paragraph 26 of SSAP No. 62R:

....reinsurance in which a reinsurer agrees to reimburse a ceding entity for liabilities incurred as a result of past insurable events covered under contracts subject to the reinsurance....

Paragraph 34.k. of SSAP No. 62R specifically provides that the consideration paid for a retroactive reinsurance contract is to be recorded as a decrease in ledger assets by the ceding entity and an increase in ledger assets by the assuming entity.

Question 31 illustrates the accounting entries for retroactive reinsurance contracts.

If the retroactive reinsurance contract transfers both components of insurance risk then, pursuant to paragraph 34 of SSAP No. 62R, the ceding company would record the consideration paid as a decrease in ledger assets, recognize an expense for the reinsurance ceded through Other Income or Loss accounts as a write-in item identified as “Retroactive Reinsurance Ceded”, and record the recoverable from the reinsurer as a contra liability.

No contra liability is established until and unless (and then only to the extent that) the ceding company establishes reserves which exceed the attachment point.

For the contract described, at inception no contra liability is recorded to offset current liability for the business ceded, since the ceded retroactive reinsurance premium relates to coverage in excess of the current liabilities recorded by the ceding company.

Once the ceding company’s recorded liabilities exceed the attachment point of the adverse loss development reinsurance contract and triggers reinsurance recoverable from the reinsurer, a contra

liability is established by the ceding company for the amount of the reinsurance recoverable. Any surplus resulting from the retroactive reinsurance is carried as a write-in item on the balance sheet designated as “Special Surplus from Retroactive Reinsurance Account.” The surplus gain may not be classified as unassigned funds (surplus) until the actual retroactive reinsurance recovered exceeds the consideration paid.

If any portion of a retroactive reinsurance contract does not transfer insurance risk, then the portion which does not transfer risk is accounted for as a deposit pursuant to paragraph 40. The deposit is reported as an admitted asset of the ceding company if the reinsurer is licensed, accredited, certified or otherwise qualified in the ceding company’s state of domicile as described in Appendix A-785, or if there are funds held by or on behalf of the ceding company as described in that appendix. Receipts and disbursements under the contract are recorded through the deposit/liability accounts. Amounts received in excess of the deposit made are recognized as a gain in the Other Income or Loss account.

Accounting entries for a ceding entity to report a retroactive reinsurance contract at the inception of which the cedent’s reserves are lower than the attachment point of the reinsurance coverage:

Assume the company pays \$16m to purchase adverse development coverage of \$50m, above an attachment point.

Entry 1: Payment of Retrospective Reinsurance Premium

Retrospective Reinsurance Expense*	\$16m	
Cash		\$16m

The company pays \$16m premium for the retrospective reinsurance contract.
 *This is an Other Expense item, it does not flow through Schedule F or Schedule P.

Entry 2: Adverse Development Reaches the Attachment Point

Losses Incurred	\$25m	
Gross Loss Reserve		\$25m
Recoverable on Retro Reinsurance Contract**	\$25m	
Other Income*		\$9m
Contra – Retro Reinsurance Expense*		\$16m
Surplus***	\$9m	
Segregated Surplus***		\$9m

The company incurs \$25m development on reserves related to the contract.
 *These are Other Income/Expense items do not flow through Schedule F or Schedule P.
 **A contra-liability write-in item, not netted against loss reserves.
 ***Surplus is segregated in the amount of [\$25m - \$16m = \$9m] recoverables less consideration paid.

Entry 3: Cash is Recovered on Paid Losses

Cash	\$20m	
Recoverable on Retrospective Reinsurance Contract		\$20m
Segregated Surplus	\$4m	
Surplus		\$4m

The company recovers \$20m cash from reinsurer on this retro contract. Segregated Surplus decreases in the amount of [\$20m - \$16m = \$4m] (decreases for amount recovered in excess of consideration paid).

33. Q: How should a ceding company account for payment of the premium for a retroactive reinsurance contract by the ceding company's parent company or some other person not a party to the reinsurance contract (for example, adverse loss development reinsurance contracts purchased by the parent company in the context of the purchase or sale of the ceding company)?
- A: If the reinsurance premium is not paid directly by the ceding company but is instead paid on behalf of the ceding company by the ceding company's parent company or some other entity not a party to the reinsurance contract, then the ceding company should (1) record an increase in gross paid in and contributed surplus in the amount of the reinsurance premium to reflect the contribution to surplus by the parent or third party payor, and (2) record an expense in the amount of the reinsurance premium and account for the contract as provided in questions 31 and 32.

EXHIBIT B – P&C RUNOFF REINSURANCE TRANSACTIONS

The following provides illustrative journal entries for P&C Runoff Reinsurance Transactions.

Example 1: Transfer of existing block of runoff business **with no residual UPR** on books of Transferor

Cedent/Transferor		DR	CR
Day 1 – Cedent transfers 50,000 in reserves for 50,000			
Ceded Reinsurance Recoverable (U&I Part 2A & Sch. F)	Contra Liab ↑	50,000	
Cash	Asset ↓		50,000
Losses Paid (U/W Part 2 & Sch. P)	I/S ↓	50,000	
Change in Reserves - Incurred Losses (U&I Part 2)	I/S ↑		50,000
<i>Unlike novation, gross reserves stay on books of transferor</i>			
Day 360 – Negative Development on Transferred Business - 3,000			
Reinsurance Recoverable on Unpaid Losses (Sch. F)	Contra Liab ↑	3,000	
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↑		3,000
Day 540 – Reinsurer Pays the Loss @ Reported Reserve			
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↓	53,000	
Ceded Reinsurance Recoverable (U&I Part 2A & Sch. F)	Contra Liab ↓		53,000
Reinsurer/ Transferee			
Day 1 – Cedent transfers 50,000 in reserves for 50,000			
Cash	Asset ↑	50,000	
Reported Losses on Reins. Assumed (U&I Part 2A & Sch. P)	Liab ↑		50,000
Change In Reserves – Incurred Losses (U&I Part 2)	I/S ↓	50,000	
Losses Paid or Incurred (negative) (U&I Part 2 & Sch. P)	I/S ↑		50,000
Day 360 – Negative Development on Transferred Business - 3,000:			
Change in Reserves – Incurred Losses (U&I Part 2)	I/S ↓	3,000	
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↑		3,000
Day 540 – Reinsurer Pays the Loss			
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↓	53,000	
Cash	Asset ↓		53,000

Comments:

Since the Transferor is ceding incurred losses neither party should have premium impacted. To do that would distort many financial ratios.

Example 2: Transfer of existing block of runoff business **with some residual UPR** of 10,000 on books of Transferor (this should be less common).

Cedent/Transferor		DR	CR
Day 1 – Cedent transfers 50k in reserves & 10k UPR for 60,000			
Ceded Reinsurance Recoverable (U&I Part 2A & Sch. F)	Contra Liab ↑	50,000	
Unearned Premium Reserve (U&I Part 1 & 1A)	Liab ↓	10,000	
Cash	Asset ↓		60,000
Ceded Premium Written (U&I Part 1B)	I/S ↓	10,000	
Losses Paid (U&I Part 2 & Sch. P)	I/S ↓	50,000	
Change in Reserves - Incurred Losses (U&I Part 2)	I/S ↑		50,000
Change in UPR (U&I Part 1 & 1A)	I/S ↑		10,000
<i>Unlike novation, gross reserves stay on books of transferor</i>			
Day 180 – Premium is Fully Earned (Assumes 80% Loss Ratio)			
Ceded Reinsurance Recoverable (U&I Part 2A & Sch. F)	Contra Liab ↑	8,000	
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↑		8,000
<i>To mirror the increase in unpaid losses by the transferee</i>			
Day 360 – Negative Development on Transferred Business - 3,000:			
Reinsurance Recoverable on Unpaid Losses (Sch. F)	Contra Liab ↑	3,000	
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↑		3,000
Day 540 – Reinsurer Pays the Loss @ Reported Reserves (50+8+3)			
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↓	61,000	
Ceded Reinsurance Recoverable (U&I Part 2A & Sch. F)	Contra Liab ↓		61,000

Reinsurer/Transferee			
Day 1 – Cedent transfers 50k in reserves & 10k UPR for 60,000			
Cash	Asset ↑	60,000	
Reported Losses on Reins. Assumed (U&I Part 2A & Sch. P)	Liab ↑		50,000
Unearned Premium Reserve (U&I Part 1 & 1A)	Liab ↑		10,000
Assumed Premium Written (U&I Part 1B)	I/S ↑		10,000
Change In Reserves – Incurred Losses (U&I Part 2)	I/S ↓	50,000	
Change in UPR (U&I Part 1 & 1A)	I/S ↓	10,000	
Losses Paid or Incurred (negative) (U&I Part 2 & Sch. P)	I/S ↑		50,000
Day 180 – Premium is Fully Earned (Assumes 80% Loss Ratio)			
Unearned Premium Reserve (U&I Part 1 & 1A)	Liab ↓	10,000	
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↑		8,000
Change In Reserves – Incurred Losses (U&I Part 2)	I/S ↓	8,000	
Change in UPR (U&I Part 1 & 1A)	I/S ↑		10,000
<i>To record the increase in unpaid losses by the transferee</i>			
Day 360 – Negative Development on Transferred Business -3,000:			
Change In Reserves – Incurred Losses (U&I Part 2)	I/S ↓	3,000	
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↑		3,000
Day 540 – Reinsurer Pays the Loss @ Reported Reserves (50+8+3)			
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↓	61,000	
Cash	Asset ↓		61,000

Comments:

In this second example, the portion of the runoff business that has an UPR associated with it is essentially booked as prospective reinsurance. Other elements of the example are the same except that we assumed an 80% loss ratio on the unearned portion of the business.

EXHIBIT C – ILLUSTRATION OF A REINSURANCE CONTRACT THAT IS ACCOUNTED FOR AS A DEPOSIT USING THE INTEREST METHOD

Assumptions:

Premium = \$1,000 (assumes no commissions or allowances)
 Coverage Period = 1 year
 Initial expected recoveries = \$225 per year (at end of year) for five years
 Initial Implicit rate = 4 percent*

*present value of \$225 per year for five years at 4 percent = \$1,000

At the end of Year 2, the timing of anticipated recoveries under the reinsurance contract changes. A reevaluation of the implicit interest rate produces a rate of 3.63 percent and an asset of \$640 at the end of the year.

<u>Description</u>	<u>Interest Income</u>	<u>Cash Recoveries</u>	<u>Deposit Balance</u>
Initial payment			\$1,000
Year 1 (4%)	\$ 40		\$1,040
End of Year 1		\$ (225)	\$ 815
Year 2 (4%)	\$ 33		\$ 848
End of Year 2		\$ (200)	\$ 648
Yield Adjustment	\$ (8)		\$ 640
Year 3 (3.63%)	\$ 23		\$ 663
End of Year 3		\$ (175)	\$ 488
Year 4 (3.63%)	\$ 18		\$ 506
End of Year 4		\$ (175)	\$ 331
Year 5 (3.63%)	\$ 12		\$ 343
End of Year 5		\$ (175)	\$ 168
Year 6 (3.63%)	\$ 7		\$ 175
End of Year 6		\$ (175)	\$ 0

At the inception of the contract, the ceding insurer records a deposit asset of \$ 1,000 and the assuming company, a \$1,000 deposit liability. The asset is admitted providing the conditions for credit for reinsurance are met.

At subsequent reporting dates, the deposit asset is adjusted by calculating the effective yield on the reinsurance agreement to reflect actual payments to date and expected future payments with a corresponding credit to interest income by the ceding company and interest expense by the assuming company.

At the end of year two, it is determined that the expected cash flows will differ from previous estimates, resulting in a lower effective yield on the deposit asset. The deposit asset is adjusted to the amount that would have existed at the reporting date had the new effective yield been applied from the inception of the reinsurance agreement. The adjustment is charged to interest income, i.e., as a reduction of interest income. Interest income during the remaining term of the agreement is reduced accordingly (i.e., the yield is reduced from 4.0% to 3.63%).

EXHIBIT D – ILLUSTRATION OF ASBESTOS AND POLLUTION COUNTERPARTY REPORTING EXCEPTION

SCHEDULE F – PART 3³
Aging of Ceded Reinsurance as of December 31, Current Year
(000 Omitted)

1 ID Number	2 NAIC Company Code	3 Name of Reinsurer	4 Domiciliary Jurisdiction	5 Special Code	6 Reinsurance Premiums Ceded	Reinsurance Recoverable On		
						7 Paid Losses	8 Paid LAE	9 Known Case Loss Reserves
FEIN	####	Retroactive Reinsurer X	NE	3		3,000	3,000	15,000
FEIN	####	Original Company A	US	3				5,000
Subtotal Other U.S. Authorized						3,000	3,000	20,000
AA-	####	Original Company B	UK	3		12,000	9,000	2,500
AA-	####	Original Company C	UK	3		6,000	3,000	7,500
Subtotal Other Non-U.S. Unauthorized						18,000	12,000	10,000
99999 Totals						21,000	15,000	30,000

Reinsurance Recoverable On				16 Amount in Dispute Included in Column 15	Reinsurance Payable		19 Net Amount Recoverable from Reinsurers Cols. 15 – [17 + 18]	Collateral	
10 Known Case LAE Reserves	11 IBNR Loss Reserves	12 IBNR LAE Reserves	15 Cols. 7 through 14 Totals		17 Ceded Balances Payable	18 Other Amounts Due to Reinsurers		24 Single Beneficiary Trusts Other Allowable Collateral	25 Total Funds Held Payables and Collateral
15,000	25,000 ⁴	37,500	98,500		6,000		92,500		
2,500	10,000	15,000	32,500				32,500		
17,500	35,000	52,500	131,000		6,000		125,000		
7,500	12,500	5,000	48,500				48,500	48,500	48,500
5,000	2,500	17,500	41,500				41,500	41,500	41,500
12,500	15,000	22,500	90,000				90,000	90,000	90,000
30,000	50,000	75,000	221,000		6,000		215,000	90,000	90,000

Reinsurance Recoverable on Paid Losses and Paid Loss Adjustment Expenses						
37 Current Reinsurance Recoverable on Paid Losses and Paid LAE	Overdue					43 Total Due Reinsurance Recoverable on Paid Losses and Paid LAE Cols. 37 + 42 (In total should equal Cols. 7 + 8)
	38 1 to 29 days Reinsurance Recoverable on Paid Losses and Paid LAE	39 30 to 90 days Reinsurance Recoverable on Paid Losses and Paid LAE	40 91 to 120 days Reinsurance Recoverable on Paid Losses and Paid LAE	41 Over 120 days Reinsurance Recoverable on Paid Losses and Paid LAE	42 Total Overdue Reinsurance Recoverable on Paid Losses and Paid LAE	
6,000						6,000
6,000						6,000
21,000						21,000
9,000						9,000
30,000						30,000
36,000						36,000

³ Note that unused columns have been removed for this exhibit.

⁴ This example assumes 1/2 of the original company reinsurers' unpaid recoverables are Asbestos and Pollution related.

**SUPPLEMENTAL SCHEDULE FOR REINSURANCE COUNTERPARTY
REPORTING EXCEPTION – ASBESTOS AND POLLUTION CONTRACTS
For The Year Ended December 31, 20__ (\$000 Omitted)**

1 ID Number (Original Reinsurer)	2 NAIC Company Code (Original Reinsurer)	3 Name of Reinsurer (Original Reinsurer)	4 Domiciliary Jurisdiction (Original Reinsurer)	5 IDJ Number (Retroactive Reinsurer)	6 Name of Retroactive Reinsurer Reported in Sch. F Part 3 (Retroactive Reinsurer)	Reinsurance Recoverable On				
						7 Paid Losses	8 Paid LAE	9 Unpaid Case Losses & LAE	10 IBNR Losses & LAE	11 Cols. 7+ 8+9+10 Totals
		Original Company A	US		Retroactive Reinsurer X	1,000	1,000	7,500	25,000	34,500
Subtotal Authorized						1,000	1,000	7,500	25,000	34,500
		Original Company B	UK		Retroactive Reinsurer X	1,000	1,000	10,000	17,500	29,500
		Original Company C	UK		Retroactive Reinsurer X	1,000	1,000	12,500	20,000	34,500
Subtotal Other Non-U.S. Unauthorized						2,000	2,000	22,500	37,500	64,000
9999999 Totals						3,000	3,000	30,000	62,500	98,500

Original Reinsurer Collateral			15 Amounts Approved As Other Allowed Offset Items	Reinsurance Recoverable On Paid Losses and Paid Loss Adjustment Expenses							23 Percentage Overdue	24 Percentage More Than 90 Days Overdue
12 Funds Held (Original Reinsurer)	13 Letters Of Credit (Original Reinsurer)	14 Trust Funds And Other Allowed Offset Items		16 Current	Overdue					22 Total Due		
					17 1 – 29 Days	18 30 – 90 Days	19 91 – 120 Days	20 Over 120 Days	21 Total Overdue			
-	-	-	(a) 2,000	-	-	-	-	-	2,000	-	-	
-	-	-	2,000	-	-	-	-	-	2,000	-	-	
-	-	-	29,500	2,000	-	-	-	-	2,000	-	-	
-	-	-	34,500	2,000	-	-	-	-	2,000	-	-	
-	-	-	64,000	4,000	-	-	-	-	4,000	-	-	
-	-	-	64,000 (b)	6,000	-	-	-	-	6,000	-	-	

- (a) Amount is zero because available offsets are not applied for authorized reinsurers under the credit for reinsurance model.
- (b) Annual statement Note 1 would disclose total impacts to the provision for reinsurance composed of 1) \$64,000 (impact for unauthorized/uncollateralized) plus 2) reduction to the provision for overdue.

Statement of Statutory Accounting Principles No. 63

Underwriting Pools

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	No other pronouncements
Affected by.....	No other pronouncements
Interpreted by	INT 03-02
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Disclosures.....	2
Effective Date and Transition	3
REFERENCES.....	3
Relevant Issue Papers	3

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for underwriting pools and associations.

SUMMARY CONCLUSION

2. Underwriting pools and associations can be categorized as follows: (a) involuntary, (b) voluntary, and (c) intercompany.

3. Involuntary pools represent a mechanism employed by states to provide insurance coverage to those with higher than average probability of loss who otherwise would be excluded from obtaining coverage. Reporting entities are generally required to participate in the underwriting results, including premiums, losses, expenses, and other operations of involuntary pools, based on their proportionate share of similar business written in the state. Involuntary plans are also referred to as residual market plans, involuntary risk pools, and mandatory pools.

4. Voluntary pools are similar to involuntary pools except they are not state mandated and a reporting entity participates in the pool voluntarily. In addition, voluntary pools are not limited to the provision of insurance coverage to those with higher than average probability of loss, but often are used to provide greater capacity for risks with exceptionally high levels of insurable values (e.g., aircraft, nuclear power plants, refineries, and offshore drilling platforms).

5. Intercompany pooling relates to business which is pooled among affiliated entities who are party to a pooling arrangement.^(INT 03-02)

6. Participation in a pool may be on a joint and several basis, i.e., in addition to a proportional share of losses and expenses incurred by the pool, participants will be responsible for their share of any otherwise unrecoverable obligations of other pool participants. In certain instances, one or more entities may be designated as servicing carriers for purposes of policy issuance, claims handling, and general administration of the pooled business, while in other cases a pool manager or administrator performs all of these functions and simply bills pool participants for their respective shares of all losses and expenses incurred by the pool. In either case, liabilities arising from pooled business are generally incurred on a basis similar to those associated with non-pooled business, and should therefore be treated in a manner consistent with the guidelines set forth in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*.

7. Intercompany pooling arrangements involve establishment of a conventional quota share reinsurance agreement under which all of the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares. Arrangements whereby there is one lead company that retains 100% of the pooled business and all or some of the affiliated companies have a 0% net share of the pool may qualify as intercompany pooling. In these arrangements, only the policy issuing entity has direct liability to its policyholders or claimants; other pool participants are liable as reinsurers for their share of the issuing entity's obligations. Although participants may use different assumptions (e.g., discount rates) in recording transactions, the timing of recording transactions shall be consistently applied by all participants.

8. Underwriting results relating to voluntary and involuntary pools shall be accounted for on a gross basis whereby the participant's portion of premiums, losses, expenses, and other operations of the pools are recorded separately in the financial statements rather than netted against each other. Premiums and losses shall be recorded as direct, assumed, and/or ceded as applicable. If the reporting entity is a direct writer of the business, premiums shall be recorded as directly written and accounted for in the same manner as other business which is directly written by the entity. To the extent that premium is ceded to a pool, premiums and losses shall be recorded in the same manner as any other reinsurance arrangement. A reporting entity who is a member of a pool shall record its participation in the pool as assumed business as in any other reinsurance arrangement.

9. Underwriting results relating to intercompany pools shall be accounted for and reported as described in paragraph 8. While it is acceptable that intercompany pooling transactions be settled through intercompany arrangements and accounts, intercompany pooling transactions shall be reported on a gross basis in the appropriate reinsurance accounts consistent with other direct, assumed and ceded business.

10. Equity interests in, or deposits receivable from, a pool represent cash advances to provide funding for operations of the pool. These are admitted assets and shall be recorded separately from receivables and payables related to a pool's underwriting results. Receivables and payables related to underwriting results shall be accounted for in accordance with the guidance in paragraphs 6-8. If it is probable that these receivables are uncollectible, any uncollectible amounts shall be written off against operations in the period such determination is made. If it is reasonably possible a portion of the balance is uncollectible but is not written off, disclosure requirements outlined in SSAP No. 5R shall be followed.

Disclosures

11. If a reporting entity is part of a group of affiliated entities which utilizes a pooling arrangement under which the pool participants cede substantially all of their direct and assumed business to the pool, the financial statements shall include:

- a. A description of the basic terms of the arrangement and the related accounting;

- b. Identification of the lead entity and of all affiliated entities participating in the intercompany pool (include NAIC Company Codes) and indication of their respective percentage shares of the pooled business;
 - c. Description of the lines and types of business subject to the pooling agreement;
 - d. Description of cessions to non-affiliated reinsurers of business subject to the pooling agreement, and indication of whether such cessions were prior to or subsequent to the cession of pooled business from the affiliated pool members to the lead entity;
 - e. Identification of all pool members which are parties to reinsurance agreements with non-affiliated reinsurers covering business subject to the pooling agreement and which have a contractual right of direct recovery from the non-affiliated reinsurer per the terms of such reinsurance agreements;
 - f. Explanation of any discrepancies between entries regarding pooled business on the assumed and ceded reinsurance schedules of the lead entity and corresponding entries on the assumed and ceded reinsurance schedules of other pool participants;
 - g. Description of intercompany sharing, if other than in accordance with the pool participation percentage, of the Aging of Ceded Reinsurance (Schedule F, Part 3) and the write-off of uncollectible reinsurance;
 - h. Amounts due to/from the lead entity and all affiliated entities participating in the intercompany pool as of the balance sheet date.
12. Refer to the Preamble for further discussion regarding disclosure requirements.

Effective Date and Transition

13. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 97—Underwriting Pools and Associations Including Intercompany Pools*

Statement of Statutory Accounting Principles No. 65

Property and Casualty Contracts

STATUS

Type of Issue.....	Property and Casualty
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 02-10
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
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SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for property and casualty insurance contracts. Topics not covered by this statement shall comply with the more general statutory accounting guidance.
2. Topics specific to title insurance, mortgage guaranty insurance, and financial guaranty insurance are not within the scope of this statement. These topics are addressed in *SSAP No. 57—Title Insurance*, *SSAP No. 58—Mortgage Guaranty Insurance*, and *SSAP No. 60—Financial Guaranty Insurance*.

SUMMARY CONCLUSION

3. Property and casualty insurance contracts can be written to cover insured events on the following reporting bases:
- a. Occurrence—These policies cover insured events that occur within the effective dates of the policy regardless of when they are reported to the reporting entity. Liabilities for losses on these policies shall be recorded when the insured event occurs;
 - b. Claims-made—These policies cover insured events that are reported (as defined in the policy) within the effective dates of the policy, subject to retroactive dates when applicable. Liabilities for losses on these policies shall be recorded when the event is reported to the reporting entity; and
 - c. Extended reporting—Endorsements to claims-made policies covering insured events reported after the termination of a claims-made contract but subject to the same retroactive dates where applicable. See paragraphs 7 and 8 for guidance for when premium shall be earned and losses shall be recorded.

Claims-Made Policies

4. Normally, when claims-made coverage is obtained, existing coverage is being replaced. The existing coverage may have been a claims-made policy or an occurrence policy. In either case, in an effort to reduce premium costs, the insured may request that the claims-made coverage cover only claims reported within the effective dates of the policy that occur after a specified date. This specified date is referred to as the retroactive date of the claims-made policy and eliminates duplicate coverage when converting from occurrence coverage to claims-made coverage.

5. The liability for an insured event shall be determined in accordance with *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*.

6. Extended reporting endorsements, commonly referred to as tail coverage, allow extended reporting of insured events after the termination of a claims-made contract. Extended reporting endorsements modify the exposure period of the underlying contract and can be for a defined period (e.g., six months, one year, five years) or can be for an indefinite period.

7. When a reporting entity issues an extended reporting endorsement or contract and the preceding claims-made policy terminates, the reporting entity assumes liability for unreported claims and expense. This extended reporting coverage can be issued for an indefinite period or a fixed period. For indefinite reporting periods, premium shall be fully earned and loss and expense liability associated with unreported claims shall be recognized immediately. For coverage for a fixed period, premium shall be earned over the term of the fixed period, the reporting entity shall establish an unearned premium reserve for the unexpired portion of the premium and shall record losses as reported.

8. Some claims-made policies provide extended reporting coverage at no additional charge in the event of death, disability, or retirement of a natural person insured. In such instance, a policy reserve is required to assure that premiums are not earned prematurely. The amount of the reserve should be adequate to pay for all future claims arising from these coverage features, after recognition of future premiums to be paid by current insureds for these benefits. The reserve, entitled “extended reporting endorsement policy reserve” shall be classified as a component part of the unearned premium reserve considered to run more than one year from the date of the policy.

9. When the anticipated losses, loss adjustment expenses, and maintenance costs anticipated to be reported during the extended reporting period exceed the recorded unearned premium reserve for a

claims-made policy, a premium deficiency reserve shall be recognized in accordance with *SSAP No. 53—Property and Casualty Contracts—Premiums*.

Discounting

10. With the exception of fixed and reasonably determinable payments such as those emanating from workers' compensation tabular indemnity reserves and long-term disability claims, property and casualty loss reserves shall not be discounted. No loss adjustment expense reserves shall be discounted.

11. Tabular reserves are indemnity reserves that are calculated using discounts determined with reference to actuarial tables which incorporate interest and contingencies such as mortality, remarriage, inflation, or recovery from disability applied to a reasonably determinable payment stream. Tabular reserves shall not include medical loss reserves or loss adjustment expense reserves.

12. Due to several instances in which states have prescribed or permitted practices to allow discounting on a non-tabular basis, recommended guidelines for discounting non-tabular unpaid loss and LAE are provided within Exhibit A. If a state has a prescribed or permitted practice allowing the use of discounts, or if discounting is utilized in accordance with this SSAP, financial statement disclosures are required in accordance with paragraphs 13-16.

13. In accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*, a change in the discount rate used in discounting loss reserves shall be accounted for as a change in estimate. SSAP No. 3 requires changes in estimates to be included in the statement of income in the period the change becomes known.

14. The financial statements shall disclose whether or not any of the liabilities for unpaid losses or unpaid loss adjustment expenses are discounted, including liabilities for workers' compensation. The following disclosures, for each line of business, shall be made separately:

- a. Table(s) used;
- b. Rate(s) used;
- c. The amount of discounted liability reported in the financial statement;
- d. The amount of tabular discount, by the line of business and reserve category (i.e., case and Incurred But Not Reported (IBNR));
- e. The amount of interest accretion recognized in the statement of income; and
- f. The line item(s) in the statement of income in which the interest accretion is classified.

15. If the rate(s) used to discount prior accident years' liabilities have changed from the previous financial statement or if there have been changes in other key discount assumptions such as payout patterns, the financial statements shall disclose:

- a. Amount of discounted current liabilities at current rate(s) and assumption(s) (exclude the current accident year);
- b. Amount of discounted current liabilities at previous rate(s) and assumption(s) (exclude the current accident year);
- c. Change in discounted liability due to change in interest rate(s) and assumption(s); and

- d. Amount of non-tabular discount, by line of business and reserve category (i.e., case, defense and cost containment, adjusting and other).

16. Refer to the Preamble for further discussion regarding disclosure requirements.

Structured Settlements

17. Structured settlements are periodic fixed payments to a claimant for a determinable period, or for life, for the settlement of a claim. Frequently a reporting entity will purchase an annuity to fund the future payments. Reporting entities may purchase an annuity in which the entity is the owner and payee, or an annuity in which the claimant is the payee. When annuities are purchased to fund periodic fixed payments, they shall be accounted for as follows:

- a. When the reporting entity is the owner and payee, no reduction shall be made to loss reserves. The annuity shall be recorded at its present value and reported as an other-than-invested asset. Income from the annuities shall be recorded as miscellaneous income. The present value of the annuity and the related amortization schedule shall be obtained from the issuing life insurance company at the time the annuity is purchased; and
- b. When the claimant is the payee, loss reserves shall be reduced to the extent that the annuity provides for funding of future payments. The cost of the annuities shall be recorded as paid losses.

18. Statutory accounting and Generally Accepted Accounting Principles (GAAP) are consistent for the accounting of structured settlement annuities where the reporting entity is the owner and payee, and where the claimant is the owner and payee and the reporting entity has been released from its obligation. GAAP distinguishes structured settlement annuities where the owner is the claimant and a legally enforceable release from the reporting entity's liability is obtained from those where the claimant is the owner and payee but the reporting entity has not been released from its obligation. GAAP requires the deferral of any gain resulting from the purchase of a structured settlement annuity where the claimant is the owner and payee yet the reporting entity has not been released from its obligation. Statutory accounting treats these settlements as completed transactions and considers the earnings process complete, thereby allowing for immediate gain recognition.

19. The following information regarding structured settlements shall be disclosed in the financial statements:

- a. The amount of reserves no longer carried by the reporting entity because it has purchased annuities with the claimant as payee, and the extent to which the reporting entity is contingently liable for such amounts should the issuers of the annuities fail to perform under the terms of the annuities; and
- b. The name, location, and aggregate statement value of annuities due from any life insurer to the extent that the aggregate value of those annuities equal or exceed 1% of policyholders' surplus. This disclosure shall only include those annuities for which the reporting entity has not obtained a release of liability from the claimant as a result of the purchase of an annuity. The reporting entity shall also disclose whether the life insurers are licensed in the reporting entity's state of domicile.

20. Refer to the Preamble for further discussion regarding disclosure requirements.

Policies with Coverage Periods Equal to or in Excess of Thirteen Months

21. Some property and casualty insurance contracts are written for coverage periods that equal or exceed thirteen months. These contracts may be single premium or fixed premium policies, and generally

are not subject to cancellation or premium modification by the reporting entity. The most common policies with such coverage periods are home warranty and mechanical breakdown policies. Accordingly, this guidance is primarily focused on home warranty and mechanical breakdown policies and does not apply to multiple-year contracts comprised of single-year policies, each of which have separate premiums and annual aggregate deductibles.

22. Revenues are generally not received in proportion to the level of exposure or period of exposure. In order to recognize the economic results of the contract over the contract period, a liability shall be established for the estimated future policy benefits while taking into account estimated future premiums to be received. Unearned premiums shall be recorded in accordance with paragraphs 23-33 of this statement.

23. Paragraphs 24-33 shall apply to all direct and assumed contracts or policies (“contracts”), excluding financial guaranty contracts, mortgage guaranty contracts, and surety contracts, that fulfill both of the following conditions:

- a. The policy or contract term is greater than or equal to 13 months; and
- b. The reporting entity can neither cancel the contract, nor increase the premium during the policy or contract term.

24. At any reporting date prior to the expiration of the contracts, the reporting entity is required to establish an adequate unearned premium reserve, to be reported as the unearned premium reserve. For each of the three most recent policy years, the gross (i.e., direct plus assumed) unearned premium reserve shall be no less than the largest result of the three tests described in paragraphs 27-29. For years prior to the three most recent policy years, the gross unearned premium reserve shall be no less than the larger of the aggregate result of Test 1 or the aggregate result of Test 2 or the aggregate result of Test 3 taken over all of those policy years.

25. Any reserve credit applicable for reinsurance ceded shall be appropriately reflected in the financial statements with the resulting net unearned premium reserve being established by the reporting entity.

26. The projected losses and expenses may be reduced for expected salvage and subrogation recoveries, but may not be reduced for anticipated deductible recoveries, unless the deductibles are secured by a letter of credit (LOC) or like security. Projected salvage and subrogation recoveries (net of associated expenses) shall be established based on reporting entity experience, if credible; otherwise, based on industry experience.

27. Test 1 is management’s best estimate of the amounts refundable to the contractholders at the reporting date.

28. Test 2 is the gross premium multiplied by the ratio of paragraph 28.a. to paragraph 28.b.:

- a. Projected future gross losses and expenses to be incurred during the unexpired term of the contracts; and
- b. Projected total gross losses and expenses under the contracts.

29. Test 3 is the projected future gross losses and expenses to be incurred during the unexpired term of the contracts as adjusted below, reduced by the present value of the future guaranteed gross premiums, if any.

- a. A provision for investment income is permitted in the unearned premium reserve only with respect to the projected future losses and expenses used to determine the unearned premium reserve, and not with respect to incurred but unpaid losses and expenses;
- b. A provision for investment income on projected future losses and expenses may be calculated to the expected date the loss or expense is incurred, not from the expected date of payment;
- c. The rate of interest used to calculate the provision for investment income shall be reviewed and changed as necessary at each reporting date and shall not exceed the lesser of the following two standards:
 - i. The reporting entity's future net yield to maturity on statutory invested assets as shown in Schedule D, less a 1.5% actuarial provision for adverse deviations; or
 - ii. The current yield to maturity on a United States Treasury debt instrument maturing in five (5) years as of the reporting date.
- d. The reporting entity's statutory invested assets shall be reduced by the loss and loss adjustment expense reserves on unpaid losses and expenses to calculate "available invested assets." If the available invested assets are less than the result of Test 3, as calculated above, an "invested asset shortfall" exists. In this event, the Test 3 reserve shall be recalculated with the provision for investment income based on the restricted amount of available invested assets.

30. For the purposes of Tests 2 and 3 of paragraphs 28 and 29, "expenses" shall include all incurred and anticipated expenses related to the issuance and maintenance of the policy, including loss adjustment expenses, policy issuance and maintenance expenses, commissions, and premium taxes.

31. The projected future losses and expenses are to be re-estimated for each reporting date, and the most recent estimate of these projected losses and expenses is to be used in these Tests. If a range is selected and no single point in the range is identified as being the most likely, then the midpoint of management's estimate of the range shall be used. For purposes of this statement, it is assumed that management can quantify the high end of the range. If management determines that the high end of the range cannot be quantified, then a range does not exist, and management's best estimate shall be accrued.

32. The reporting entity shall provide an Actuarial Opinion and Report in conformity with the NAIC *Annual Statement Instructions for Property and Casualty Insurers*. Exhibit A of the actuarial opinion shall include the following three items: 1) the Reserve for Direct and Assumed Unearned Premiums; 2) the Reserve for Net Unearned Premiums; and 3) any other premium reserve items on which an opinion is being expressed. If any of these three items are material, the material item(s) must also be covered in the opinion and relevant comments of the actuarial opinion.

33. The actuarial report shall include a description of the manner in which the adequacy of the amount of security for deductibles and self-insured retentions is determined. The actuarial report need not assess the credit-worthiness of the specific securities (e.g. LOC's), but the actuarial opinion must report collectibility problems if known to the actuary.

High Deductible Policies

34. Certain policies, particularly workers' compensation coverage, are available under high deductible plans. High deductible plans differ from self insurance coupled with an excess of loss policy because state laws generally require the reporting entity to fund the deductible and to periodically review the financial viability of the insured and make an assessment of the suitability of the deductible plan to the insured.

35. The liability for loss reserves shall be determined in accordance with SSAP No. 55. Because the risk of loss is present from the inception date, the reporting entity shall reserve losses throughout the policy period, not over the period after the deductible has been reached. Reserves for claims arising under high deductible plans shall be established net of the deductible, however, no reserve credit shall be permitted for any claim where any amount due from the insured has been determined to be uncollectible.

36. If the policy form requires the reporting entity to fund all claims including those under the deductible limit, the reporting entity is subject to credit risk, not underwriting risk. Reimbursement of the deductible shall be accrued and recorded as a reduction of paid losses simultaneously with the recording of the paid loss by the reporting entity.

37. If the reporting entity does not hold specific collateral for the policy, amounts accrued for reimbursement of the deductible shall be billed in accordance with the provisions of the policy or the contractual agreement and shall be aged according to the contractual due date. In the absence of a contractual due date, billing date shall be utilized for the aging requirement. Deductible recoverables that are greater than ninety days old shall be nonadmitted. However, if the reporting entity holds specific collateral for the high deductible policy, ten percent of deductible recoverable in excess of collateral specifically held and identifiable on a per policy basis, shall be reported as a nonadmitted asset in lieu of applying the aging requirement; however, to the extent that amounts in excess of the 10% are not anticipated to be collected they shall also be nonadmitted. The collateral requirements of this paragraph may be satisfied when an insured provides one collateral instrument to secure amounts owed under multiple policies, provided that the reporting entity has the contractual right to apply the collateral to the high deductible policy. Collateral obtained at a group level that is not supported by an existing pooling agreement requires a written allocation agreement among all collateral beneficiaries. The terms of such agreement must be fair and equitable. Documentation supporting any allocation of collateral among reporting entities must be maintained to allow proper calculation of the nonadmitted amounts and prohibit double counting of collateral.

38. The financial statements shall disclose the following related to high deductible policies:
- a. Gross (of high deductible) amount of loss reserves, unpaid by line of business.
 - b. The amount of reserve credit that has been recorded for high deductibles on unpaid claims and the amounts that have been billed and are recoverable on paid claims, by line of business and the total of these two numbers.
 - c. Related to the amounts that have been billed and are recoverable on paid claims,
 - i. paid recoverable amounts that are over 90 days overdue, and
 - ii. the amounts nonadmitted (per paragraph 37).
 - d. Total collateral pledged to the reporting entity related to deductible and paid recoverables:
 - i. the amount of collateral on balance sheet, and
 - ii. the amount of collateral off balance sheet.
 - e. The total amount of unsecured high deductible amounts related to unpaid claims and for paid recoverables and the total percentage that is unsecured.
 - f. Highest ten unsecured high deductible amounts by counterparty ranking. Note that the counterparty does not have to be named, just amount by counterparty 1, counterparty 2,

etc. For this purpose, a group of entities under common control shall be regarded as a single customer.

39. Unsecured High Deductible Recoverables: If the individual obligor is part of a group under the same management or control, such as a professional employer organization (PEO), list the individual obligors, each of its related group members, and the total unsecured aggregate recoverables on high deductible policies for the entire group, which are greater than 1% of capital and surplus. For this purpose, a group of entities under common control shall be regarded as a single customer.

40. Refer to the Preamble for further discussion regarding disclosure requirements.

Asbestos and Environmental Exposures

41. Asbestos exposures are defined as any loss or potential loss (including both first party and third party claims) related directly or indirectly to the manufacture, distribution, installation, use, and abatement of asbestos-containing material, excluding policies specifically written to cover these exposures. Environmental exposures are defined as any loss or potential loss, including third party claims, related directly or indirectly to the remediation of a site arising from past operations or waste disposal. Examples of environmental exposures include but are not limited to chemical waste, hazardous waste treatment, storage and disposal facilities, industrial waste disposal facilities, landfills, superfund sites, toxic waste pits, and underground storage tanks.

42. Reporting entities that are potentially exposed to asbestos and/or environmental claims shall record reserves consistently with SSAP No. 55.

43. The financial statements shall disclose the following if the reporting entity is potentially exposed to asbestos and/or environmental claims:

- a. The reserving methodology for both case and IBNR reserves;
- b. The amount paid and reserved for losses and loss adjustment expenses for asbestos and/or environmental claims, on a direct, assumed and net of reinsurance basis. Each company should report only its share of a group amount (after applying its respective pooling percentage) if the company is a member of an intercompany pooling agreement;
- c. Description of the lines of business written for which there is potential exposure of a liability due to asbestos and/or environmental claims, and the nature of the exposure(s);
- d. The following for each of the five most current calendar years¹ on both a gross and net of reinsurance basis, separately for asbestos and environmental losses (including coverage dispute costs):

Beginning reserves	\$ _____
Incurred losses and loss adjustment expenses	_____
Calendar year payments for losses and loss adjustment expenses	_____
Ending reserves	\$ _____

¹ The requirement for five years of data is only applicable to the annual statement blank. The audited statutory financial report is only required to report two years. Additionally, the audited statutory financial statement shall include items not included in the notes to the annual statement blank where the blank’s schedules and exhibits satisfy disclosure requirements that are not included in the audited statutory financial statement (i.e., Since the audited financial statements do not include Schedule P, all of the SSAP No. 55 disclosures shall be included in the audited notes to financial statements).

44. Refer to the Preamble for further discussion regarding disclosure requirements.

Excess Statutory Reserve

45. This statement eliminates the requirement to record excess statutory reserves. Excess statutory reserves do not meet the definition of a liability established in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*.

Policyholder Dividends

46. Dividends to policyholders immediately become liabilities of the reporting entity when they are declared by the board of directors and shall be recorded as a liability. Incurred policyholder dividends are reported in the statement of income.

47. The financial statements shall disclose the terms of dividend restrictions, if any. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

48. Structured settlements are addressed in *FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (FAS 113). FAS 113 is addressed in *SSAP No. 62R—Property and Casualty Reinsurance*. This statement rejects the *AICPA Audit and Accounting Guide—Audits of Property and Liability Insurance Companies*.

Effective Date and Transition

49. This statement is effective for years beginning January 1, 2001. To the extent that the requirements of paragraphs 23-33 produce a higher reserve than the reporting entity would have established through the use of their previous methodology, the reporting entity may phase in the additional reserve over a period not to exceed three years. Such a phase in period shall only be permitted if the reporting entity is able to demonstrate that it would not be operating in a hazardous financial condition and that there is not adverse risk to its insureds. The phase in shall be at least 60% of the difference between the reserve required by this statement and the reserve determined by the previous methodology during the first year, 80% in the second year, and 100% in the third year. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3. The guidance in the footnote of paragraph 43.d. was originally contained within *INT 02-10: Statutory Audit Report Notes and the Reporting Requirements Related to Disclosures Containing Multiple Year Information* and was effective June 9, 2002.

REFERENCES

Other

- *Actuarial Standard of Practice No. 20, Discounting of Property and Casualty Loss and Loss Adjustment Expense*
- *NAIC Annual Statement Instructions for Property and Casualty Insurers*

Relevant Issue Papers

- *Issue Paper No. 65—Property and Casualty Contracts*

EXHIBIT A – GUIDELINES FOR STATES WHO PRESCRIBE OR PERMIT DISCOUNTING ON A NON-TABULAR BASIS

As discussed in paragraph 10 of this statement, with the exception of fixed and reasonably determinable payments such as those emanating from workers' compensation tabular indemnity reserves and long-term disability claims, property and casualty loss reserves shall not be discounted. However, one of the most common prescribed or permitted state practices is to allow discounting of unpaid losses and unpaid loss adjustment expenses on a non-tabular basis. The recommendations in this exhibit are not requirements and therefore should only be viewed as a recommendation to those states that prescribe or permit non-tabular discounting.

Recommended Prescribed or Permitted Practice Guidelines

The state of XYZ office will permit [insert domestic companies if prescribed or insert insurance company name if prescribed] to discount its December 20XX unpaid loss (i.e., reported losses and incurred but not reported losses) and unpaid loss adjustment expense (LAE) reserves on a non-tabular basis subject to the following conditions:

1. The unpaid loss and LAE reserves shall be determined in accordance with *Actuarial Standard of Practice No. 20, Discounting of Property and Casualty Loss and Loss Adjustment Expense* (and as agreed to by an actuary) but in no event shall the rate used exceed the lesser of the following two standards:
 - a. If the reporting entity's statutory invested assets are at least equal to the total of all policyholder reserves, the reporting entity's net rate of return on statutory invested assets, less 1.5%, otherwise, the reporting entity's average net portfolio yield rate less 1.5% as indicated by dividing the net investment income earned by the average of the reporting entity's current and prior year total assets; or
 - b. The current yield to maturity on a United States Treasury debt instrument with maturities consistent with the expected payout of the liabilities.
2. Disclosure of the [insert either prescribed or permitted practice] in compliance with the requirements of the NAIC *Accounting Practices and Procedures Manual* and the *NAIC Annual Statement Instructions – Property and Casualty*, including but not limited to:

Note 1 – Summary of Significant Accounting Policies

A. Disclosure of permitted practice

- a. Disclose that the reporting entity employs a prescribed or permitted accounting practice that departs from the *Accounting Practices and Procedures Manual*; and
- b. Disclose the monetary effect on net income and statutory surplus of using the practice of discounting on a non-tabular basis rather than the NAIC statutory accounting practice of discounting fixed and reasonably determinable payments such as those emanating from workers' compensation tabular indemnity reserves and long-term disability claims.

Note 32 – Discounting of Liabilities for Unpaid Losses or Unpaid Loss Adjustment Expenses

XX. Non-tabular discounting

- a. Disclosure of whether the reporting entity is applying non-tabular discounting based upon a state prescribed or permitted practice. If permitted, provide further disclosure as to the date domiciliary state issued permitted practice and the

expiration date of such practice;

- b. Rate(s) used and the basis for the rate(s) used;
- c. Amount of non-tabular discount disclosed by line of business and reserve category (i.e., unpaid loss, incurred but not reported, defense and cost containment expense, and adjusting and other expense); and
- d. The amount of non-tabular discount reported in the statement.

Non-tabular discounting illustration:

	(1) Case	(2) IBNR	(3) Defense & Cost Containment Expense	(4) Adjusting & Other Expense
1. Homeowners/Farmowners				
2. Private Passenger Auto Liability/Medical				
3. Commercial Auto/Truck Liability/Medical				
4. Workers' Compensation				
5. Commercial Multiple Peril				
6. Medical Malpractice – Occurrence				
7. Medical Malpractice – Claims-Made				
8. Special Liability				
9. Other Liability – Occurrence				
10. Other Liability – Claims-Made				
11. Special Property				
12. Auto Physical Damage				
13. Fidelity, Surety				
14. Other (including Credit, Accident & Health)				
15. International				
16. Reinsurance Nonproportional Assumed Property				
17. Reinsurance Nonproportional Assumed Liability				
18. Reinsurance Nonproportional Assumed Financial Lines				
19. Products Liability – Occurrence				
20. Products Liability – Claims-Made				
21. Financial Guaranty/Mortgage Guaranty				
22. Total				

The rates used to discount Medical Malpractice unpaid losses at December 31, 20X2 have changed from the rates used at December 31, 20X1. At December 31, 20X2, the amount of discounted Medical Malpractice unpaid losses, excluding the current accident year, is \$ _____. Had these unpaid losses been discounted at the rates used at December 31, 20X1 the amount of discounted liabilities would be \$ _____. The reduction in the discounted liability due to the change in rates is \$ _____.

This illustration neither regulates, permits, nor prohibits the practice of discounting liabilities for unpaid losses or unpaid loss adjustment expenses.

Statement of Statutory Accounting Principles No. 66

Retrospectively Rated Contracts

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	No other pronouncements
Affected by.....	No other pronouncements
Interpreted by	INT 05-05
Relevant Appendix A Guidance	A-785

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Disclosures.....	5
Relevant Literature.....	5
Effective Date and Transition	5
REFERENCES.....	6
Other	6
Relevant Issue Papers	6

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for retrospectively rated contracts. This statement applies to property and casualty contracts, life insurance contracts, and accident and health contracts.
2. Retrospective reinsurance contracts are not within the scope of this statement. They are addressed in *SSAP No. 62R—Property and Casualty Reinsurance*.

SUMMARY CONCLUSION

3. A retrospectively rated contract is one which has the final policy premium calculated based on the loss experience of the insured during the term of the policy (including loss development after the term of the policy) and the stipulated formula set forth in the policy or a formula required by law. The periodic adjustments may involve either the payment of return premium to the insured or payment of an additional premium by the insured, or both, depending on experience. Retrospective rating features are common in certain property and casualty contracts, group life, and group accident and health contracts. Some contracts have retrospective features required by law. Contracts with retrospective rating features are referred to as loss sensitive contracts.
4. Amounts due from insureds and amounts due to insureds under retrospectively rated contracts meet the definitions of assets and liabilities as set forth in *SSAP No. 4—Assets and Nonadmitted Assets*

and *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*, respectively. Amounts due from insureds and amounts due to insureds under retrospectively rated contracts are admitted assets to the extent they conform to the requirements of this statement.

5. Initial premiums shall be recognized in accordance with *SSAP No. 51R—Life Contracts*, *SSAP No. 53—Property and Casualty Contracts—Premiums*, and *SSAP No. 54R—Individual and Group Accident and Health Contracts*.

6. Specific funds received by the prescription drug plan sponsor from either the Medicare Part D enrollee or the government as payment for standard coverage that will be subject to retrospective premium adjustments should be accounted for under this statement. These funds include ‘Direct Subsidy’, ‘Low-Income Subsidy (premium portion)’, ‘Beneficiary Premium (standard coverage portion)’, ‘Part D Payment Demonstration’ and ‘Risk Corridor Payment Adjustment’. The funds noted above have a final policy amount that is calculated based on the loss experience of the insured during the term of the policy, therefore should be treated as such. Refer to *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage* for additional information and definitions of terms specifically related to Medicare Part D business.

7. Because policy periods do not always correspond to reporting periods and because an insured’s loss experience may not be known with certainty until sometime after the policy period expires, retrospective premium adjustments shall be estimated based on the experience to date using one of the following methods:

a. Property and Casualty Contracts:

- i. Use of actuarially accepted methods in accordance with filed and approved retrospective rating plans. This includes but is not limited to the application of historical ratios of retrospective rated developments to earned standard premium to develop a ratio which is then applied to those policies for which no retrospective calculation has been recorded or for which no modification to the recorded calculation is needed. This method results in the calculation of one amount which is either a net asset or a net liability;
- ii. Reviewing each individual retrospectively rated risk, comparing known loss development (including IBNR) with that anticipated in the policy contract to arrive at the best estimate of return or additional premium earned at that point in time. This method results in the calculation of an asset or a liability for each risk. The total of all receivables shall be recorded as an asset and the total of all return premiums shall be recorded as a liability.

b. Life and Accident & Health Contracts: Reporting entities offering group coverage have extensive underwriting procedures and complex individually negotiated benefits and contracts. Due to cost and reporting deadlines, these factors make it difficult to establish an exact valuation of retrospective premium adjustments. The method used to estimate the liability shall be reasonable based on the reporting entity’s procedures and consistent among reporting periods. Common methods include a mathematical approach using a complex algorithm of the reporting entity’s underwriting rules and experience rating practices, and an aggregate or group approach.

8. Assumptions used in estimating retrospective premium adjustments shall be consistent with the assumptions made in recording other assets and liabilities necessary to reflect the underwriting results of the reporting entity such as claim and loss reserves (including IBNR) and contingent commissions. Contingent commissions and other related expenses shall be adjusted in the same period the additional or return retrospective premiums are recorded.

9. Retrospective premium adjustments are estimated for the portion of the policy period that has expired and shall be considered an immediate adjustment to premium. Additional retrospective premiums and return retrospective premiums shall be recorded as follows:

- a. Property and Casualty Reporting Entities:
 - i. Accrued additional retrospective premiums shall be recorded as a receivable with a corresponding entry made either to written premiums or as an adjustment to earned premiums. Premiums not recorded through written premium when accrued shall be recorded through written premium when billed;
 - ii. Accrued return retrospective premiums shall be recorded as part of the change in unearned premium (detailed in the underwriting and investment exhibit) liability with a corresponding entry made either to written premiums or as an adjustment to earned premiums. Premiums not recorded through written premium when accrued shall be recorded through written premium when billed;
 - iii. Ceded retrospective premium balances payable shall be recorded as liabilities, consistent with SSAP No. 62R. Ceded retrospective premiums recoverable shall be recorded as an asset. Consistent with *SSAP No. 64—Offsetting and Netting of Assets and Liabilities*, ceded retrospective premium balances payable may be deducted from ceded retrospective premiums recoverable when a legal right of setoff exists.
- b. Life and Accident and Health Reporting Entities:
 - i. Accrued additional retrospective premiums shall be recorded as an asset, accrued retrospective premiums, with a corresponding entry to premiums;
 - ii. Accrued return retrospective premiums shall be recorded as a liability, provision for experience rating refunds, with a corresponding entry to premiums.
- c. Managed Care/Accident and Health Reporting Entities
 - i. Accrued additional retrospective premiums shall be recorded as an asset, accrued retrospective premiums with a corresponding entry to premiums;
 - ii. Accrued return retrospective premiums shall be recorded as a liability, as part of Accident and Health Reserves (reserve for rate credits or experience rating refunds), with a corresponding entry to premiums.

10. The amount of accrued estimated retrospective premiums to be recorded as a nonadmitted asset for property and casualty insurers shall be determined as follows:

- a. 100% of the amount recoverable from any person for whom any agents' balances or uncollected premiums are classified as nonadmitted, and item (b), plus item (c) or (d) below. Once an insurer has elected either (c) or (d) below, a change from one to the other requires approval from the insurer's domiciliary state and such change must be disclosed in the financial statements.
- b. Retrospective premium adjustments shall be determined and billed or refunded in accordance with the policy provisions or contract provisions. If accrued additional retrospective premiums are not billed in accordance with the policy provisions or contract provisions, the accrual shall be nonadmitted.

- c. 10% of any accrued retrospective premiums not offset by retrospective return premiums, other liabilities to the same party (other than loss and loss adjustment expense reserves), or collateral, not otherwise used. Collateral shall be of the same types and quality permitted for use in connection with reinsurance (types of acceptable collateral vary from state to state) or by financial guaranty coverage issued by an insurer having an “A” or better rating from a nationally recognized rating agency. The financial guaranty coverage must allow the insured under the financial guaranty policy the same degree of access to payments under that policy as a beneficiary has under a qualified letter of credit as described in Appendix A-785. Accrued retrospectively rated premiums relating to bulk IBNR must be allocated to individual policyholder accounts prior to applying collateral by account. If the insurer is unable to allocate amounts by account, no credit may be taken for collateral.
- d. An amount calculated using the factors below for accrued retrospective premiums not offset by retrospective return premiums, other liabilities to the same party (other than loss and loss expense reserves), or collateral, not otherwise used. Collateral shall be of the same types and quality permitted for use in connection with reinsurance (types of acceptable collateral vary from state to state) or by financial guaranty coverage issued by an insurer having an “A” or better rating from a nationally recognized rating agency. The financial guaranty coverage must allow the insured under the financial guaranty policy the same degree of access to payments under that policy as a beneficiary has under a qualified letter of credit as described in Appendix A-785.

Accrued retrospectively rated premiums relating to bulk IBNR must be allocated to individual policyholder accounts prior to categorizing by Quality Rating.

Insured’s Current Quality Rating*	Insured’s Corporate Debt Equivalent to (S&P/Moody’s)**	Percentage of Retro Premium to be Nonadmitted***
1	AAA, AA, A/Aaa, Aa, A	1%
2	BBB/Baa	2%
3	BB/Ba	5%
4	B/B	10%
5	CCC, CC, C/Caa, Ca	20%
6	CI, D/C, or insured in default on debt service payments, or insured’s debt service payments are jeopardized upon filing of a bankruptcy petition	100%

* The Percentage of Retro Premium to be Nonadmitted is based upon the Insured’s Current Quality Rating (i.e., if an insured’s quality rating drops, the percentage relating to the lower quality rating is used in calculating the amount to be nonadmitted and vice versa).

** Insureds that do not have a debt rating issued by a publicly recognized rating agency are required to be rated by the NAIC’s Securities Valuation Office (SVO).

*** In the event the insured has no debt rating (either from a publicly recognized rating agency or from the SVO) the insured’s quality rating will be considered category 5 for purposes of this calculation (i.e., a factor of 20% shall be applied), unless the insurer is aware of conditions of the insured that would warrant a category 6 classification (i.e., a factor of 100%).

11. Once accrued retrospective premium is billed, the due date is governed by *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*. Life and accident and health reporting entities shall nonadmit any accrued retrospective premium that is more than 90 days due. If a reporting entity has issued more than one policy to the same insured, retrospective balances shall be netted in accordance with SSAP No. 64.

12. If, in accordance with SSAP No. 5R, it is probable that the additional retrospective premium is uncollectible, any uncollectible additional retrospective premium shall be written off against operations in the period the determination is made. If it is reasonably possible a portion of the balance in excess of the nonadmitted portion determined in accordance with paragraph 10 is not anticipated to be collected, the disclosure requirements outlined in SSAP No. 5R shall be made.

Disclosures

13. The financial statements shall disclose the method used by the reporting entity to estimate retrospective premium adjustments. The amount of net premiums written that are subject to retrospective rating features, as well as the corresponding percentage to total net premiums written, shall be disclosed. In addition, disclose whether accrued retrospective premiums are recorded through written premium or as an adjustment to earned premium.

14. The financial statements shall disclose the calculation of nonadmitted retrospective premium. If a reporting entity chooses treatment described in paragraph 10.c. or 10.d., the appropriate exhibit must be included in the Notes to Financial Statements in the annual statement. Once a reporting entity has elected either 10.c. or 10.d., a change from one to the other requires approval from the reporting entity's domiciliary state and such change must be disclosed in the financial statements.

15. The financial statements shall disclose the following amounts for medical loss ratio rebates required pursuant to the Public Health Service Act for the current reporting period year-to-date and prior reporting period year: incurred rebates, amounts paid and unpaid liabilities segregated into the following categories: individual, small group employer, large group employer and other. In addition, the impact of reinsurance assumed, ceded and net on the total medical loss ratio rebate shall be disclosed.

16. Refer to the Preamble for further discussion of the disclosure requirements.

Relevant Literature

17. This statement rejects *FASB Emerging Issues Task Force No. 93-14, Accounting for Multiple Year Retrospectively Rated Insurance Contracts* (EITF 93-14) since it applies only to multiple-year retrospectively rated contracts. The statutory principles outlined in the conclusion above are consistent with the guidance provided for accounting and retrospectively rated contracts in *FASB Statement No. 60, Accounting and Reporting by Insurance Companies* (FAS 60) and EITF 93-14, with the exception of the requirement to record certain amounts as nonadmitted. Although FAS 60 is rejected in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts* and EITF 93-14 is rejected in this statement, it is considered appropriate that the accounting for retrospectively rated contracts be consistent with those provisions of both FAS 60 and EITF 93-14 as they are consistent with the Statement of Concepts.

Effective Date and Transition

18. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

REFERENCES

Other

- *NAIC Annual Statement Instructions for Property and Casualty Insurance Companies*

Relevant Issue Papers

- *Issue Paper No. 66—Accounting for Retrospectively Rated Contracts*