

A PUBLIC POLICY PRACTICE NOTE

# Statements of Actuarial Opinion On Property and Casualty Loss Reserves

2017

American Academy of Actuaries  
Committee on Property and Liability Financial Reporting



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2017

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



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The American Academy of Actuaries is a 19,000 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.

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(2017)**

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## **APPENDICES**

### **I. 2017 NAIC Instructions**

- I.1 2017 NAIC Property and Casualty SAO Instructions*
- I.2 2017 NAIC Property and Casualty AOS Instructions*
- I.3 2017 NAIC Title SAO Instructions*
- I.4 2016 NAIC Data Testing Requirement*

### **II. AOWG Regulatory Guidance**

- II.1 2017 AOWG Regulatory Guidance*
- II.2 2016 AOWG Regulatory Guidance*

### **III. Special interest topics**

- III.1 Unearned premium for Long Duration Contracts*
- III.2 Intercompany pooling*
- III.3 NAIC Guidance for Actuarial Opinions for Pools and Associations*
- III.4 Retroactive and financial reinsurance*
- III.5 Pre-paid Loss Adjustment Expense*
- III.6 Guidance for Audit Committee Members of P/C Insurers*

### **IV. SSAPs**

# 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).

## 1.1 What are practice notes?

The Academy's Guidelines for Developing Practice Notes<sup>1</sup> 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."<sup>2</sup>*

### 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 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 Property and Casualty Statement of Actuarial Opinion (SAO) and

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<sup>1</sup> Adopted by the Academy's Board of Directors in September 2006.

<sup>2</sup> Id. See <http://www.actuary.org/content/guidelines-developing-practice-notes>.

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Actuarial Opinion Summary (AOS) as required by the National Association of Insurance Commissioners (NAIC).

## 1.2.1 Discussion

Each year COPLFR is charged with the task of updating the practice note for SAOs on property and casualty loss reserves. The updates typically include discussion around changes implemented by the NAIC to the SAO Instructions (NAIC SAO Instructions). **Significant changes to this year's practice note are highlighted in yellow.**

## 1.2.2 Terms of construction

As with the Actuarial Standards of Practice (ASOPs) promulgated by the Actuarial Standards Board (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’s<sup>3</sup> needs, or that under the circumstances it would not be reasonable or practical to follow the practice.*

*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*

**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.

<sup>3</sup> Principal is defined in ASOP No. 1 as “a client or employer of the actuary”.



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*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.”<sup>4</sup>*

Additionally, this practice note uses the term “required” when the course of action is required by a particular body (e.g., the NAIC through the 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 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 Property and Casualty.”<sup>5</sup>*

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

*A: While the NAIC Instructions for Title opinions are included in [Appendix I](#), 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 Property and Casualty Annual Statement Instructions (Annual Statement Instructions) for 2017 issued by the NAIC. Actuaries may also find this information useful in preparing statements of actuarial opinion for other audiences or regulators.

### 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 any suggested improvements for future updates of this practice note. Suggestions

<sup>4</sup> Actuarial Standards Board, ASOP No. 1, *Introductory Actuarial Standard of Practice*, Section 2.1. See <http://www.actuarialstandardsboard.org/asops/introductoryactuarialstandardpractice/>.

<sup>5</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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may be sent to the current chairperson of COPLFR through the Academy's casualty policy analyst at [casualty@actuary.org](mailto: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.”<sup>6</sup>

*Appendix I* of this practice note provides the NAIC Instructions with respect to the property and casualty SAO and AOS. The NAIC Instructions for Title Insurance SAOs are also included for informational purposes only. No discussion is included.

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<sup>6</sup> American Academy of Actuaries, [Code of Professional Conduct](#), January 1, 2001, Purpose section, last paragraph.

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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 [2017 P/C Loss Reserve Law Manual](#) for guidance on these points. The 2017 P/C Loss Reserve Law Manual is available for purchase from the Academy.

Additionally, actuaries are encouraged to carefully read and consider regulatory guidance provided by the NAIC's Actuarial Opinion (C) Working Group (AOWG) of the Casualty Actuarial and Statistical (C) Task Force (CASTF) and included in Appendix II, the Statements of Principles adopted by the Casualty Actuarial Society (CAS)<sup>7</sup>, and other resources detailed in Chapter 9 of 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. The AOWG Regulatory Guidance pertains to the 2017 SAO and the AOS and supplements the NAIC Annual Statement 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. The Regulatory Guidance is not binding. References to the Regulatory Guidance are included throughout this practice note.

There are many references throughout this document to the NAIC's AOWG regulatory guidance memo. The 2017 version of this guidance was not complete in time to be incorporated into this practice note. This practice note continues to reference the 2016 regulatory guidance memo. It is our understanding based upon discussions with the AOWG that the 2016 guidance is still appropriate to consider for the 2017 SAO and AOS. The 2016 regulatory guidance memo is included in Appendix II. The 2017 regulatory guidance memo will be included in Appendix II once published.

(Editor's Note: An emergency amendment to the annual statement instructions regarding requirements for P&C writers of Long Term Care Insurance was promulgated subsequent to the preparation of this practice note. We have included that amendment in Appendix I and encourage opinion writers to read these regulatory changes.)

**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."*

<sup>7</sup> <http://www.casact.org/professionalism/standards/princip/>

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## 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 organizations<sup>8</sup> 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 Conduct<sup>9</sup> (Code), to satisfy applicable ASOPs when rendering actuarial services in the United States.”<sup>10</sup>

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 maintain the financial health of P/C insurers and to ensure that appropriate data regarding P/C insurance markets are available.”<sup>11</sup>

AOWG – According to the NAIC website, in 2017 the AOWG will: “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....

- Financial Analysis Handbook.
- Financial statement instructions.
- Regulatory guidance to appointed actuaries”<sup>12</sup>

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.”<sup>13</sup>

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.”<sup>14</sup>

## 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 Instructions pertaining to the chapter. Separate sections within the chapter

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<sup>8</sup> 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.

<sup>9</sup> These organizations adopted the Code of Professional Conduct effective January 1, 2001.

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

<sup>11</sup> [http://naic.org/cmte\\_c\\_calf.htm](http://naic.org/cmte_c_calf.htm)

<sup>12</sup> [http://naic.org/cmte\\_c\\_act\\_opin\\_wg.htm](http://naic.org/cmte_c_act_opin_wg.htm)

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

<sup>14</sup> Odomirok et al, *Financial Reporting through the Lens of a Property/Casualty Actuary* ([http://www.casact.org/library/studynotes/Odomirok-et-al\\_Financial-Reportingv4.pdf](http://www.casact.org/library/studynotes/Odomirok-et-al_Financial-Reportingv4.pdf)), CAS 2014, page 8.

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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 Instructions). As described in the NAIC Instructions,

*“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 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.”<sup>15</sup>*

[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 NAIC Data Testing Requirements. [Appendix II](#) provides the 2016 AOWG Regulatory Guidance. [Appendix III](#) contains more detailed information about specific topics that may not be common to all SAOs. [Appendix IV](#) provides the SSAPs from NAIC’s Accounting Practices and Procedures Manual deemed to be particularly applicable to actuaries signing NAIC property and casualty SAOs.

In the Annual Statement Instructions and in this practice note, the term “loss reserves” includes LAE reserves unless specified otherwise. This follows the terminology in the NAIC Instructions.

## 1.6 Changes from the 2016 practice note

COPLFR has made enhancements to the 2016 practice note based on feedback from users and a thorough review by the committee. These changes were relatively minor, and intended to provide more clarity through illustrative language, improve readability, and fix minor errors. COPLFR also reflected all changes to NAIC SAO and AOS Instructions and considered the updates to AOWG’s Regulatory Guidance document. **Significant changes to this year’s practice note are highlighted in yellow.**

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<sup>15</sup> 2017 NAIC Annual Statement Instructions Property/Casualty. Section I.1.2

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The 2017 NAIC SAO Instructions and the AOS Supplement have not had any substantive changes since 2014. However, there have been some enhancements for clarity purposes. Noteworthy changes to the NAIC Instructions for 2017 include:

- A definition has been introduced for “Company,” which has the same definition as “Insurer.”
- Section 5 has been revised to clarify that the wording under Part D is an example.
- Section 6.D has been amended to clarify that the Appointed Actuary’s comments on reinsurance collectability should address any uncertainty associated with including potentially uncollectable amounts in the estimate of ceded reserves.
- Section 6.F and Section 7.D have been revised to state that the Appointed Actuary (AA) should note if the AA has not reviewed the prior actuary’s work.
- Exhibit A has been revised under items 6 and 9 to state that additional lines are to be added as needed.
- Exhibit B has been clarified to state that expenses are loss adjustment expenses in the Actuarial Opinion. Exhibit B has been revised under item 13 to state that additional lines are to be added as needed.

## 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:

*“...specifically indicate the Appointed Actuary’s relationship to the company, qualifications for acting as Appointed Actuary, date of appointment, and specify that the appointment was made by the Board of Directors.”<sup>16</sup>*

### 2.1 Appointment of the Qualified Actuary

According to the NAIC SAO Instructions,

*“Upon initial engagement, the Qualified 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.*

*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.”<sup>17</sup>*

**FAQ: Do actuaries need to be re-appointed each year?**

A: NAIC Instructions do not necessarily require the Appointed Actuary to be re-appointed 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.

The Appointed Actuary should 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

<sup>16</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>17</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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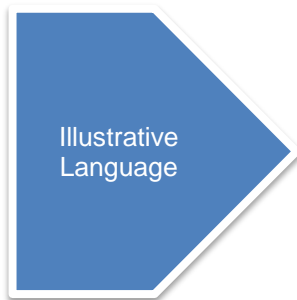
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Actuary may wish to retain materials such as minutes of the Board of Directors' meeting indicating the appointment or written confirmation by a company officer.

The term "Board of Directors" is used broadly throughout the 2017 Instructions and separately defined "to include the designated Board of Directors, its equivalent, or an appropriate committee directly reporting to the Board of Directors."<sup>18</sup> 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, Jane Actuary, am associated with ABC Consulting. I am a member of the American Academy of Actuaries and meet its qualification standards for issuing Statements of Actuarial Opinion included with NAIC Property and Casualty Annual Statements. I am a Fellow of the Casualty Actuarial Society. I was appointed by the Board of Directors of XYZ Insurance Company on November 3, 2017 to render this opinion.*

## 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 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, promulgated by the American Academy of Actuaries, and 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."<sup>19</sup>*

<sup>18</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>19</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).



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## Special Situations:

- NAIC SAO Instructions state that members of the Academy qualifying under paragraph 1A (ii) of the NAIC must attach, each year, a copy of the approval letter by the Casualty Practice Council (CPC) to the SAO.
- As set out in paragraph 3 of the NAIC SAO Instructions, insurance regulatory officials of the domiciliary state may approve individuals who do not meet the definition of Qualified Actuary in paragraph 1A (i) or (ii) to sign SAOs. In these cases, NAIC SAO Instructions state that the company must attach, each year, a letter from that official stating that the individual meets the state's requirements for rendering the SAO.

## 2.2 Qualifications

The identification paragraph contains the Appointed Actuary's statement that he or she is qualified to sign the SAO. Before taking on or renewing an Appointed Actuary assignment, actuaries are advised to review the 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, 2008 (the "US Qualification Standards")*. This practice note refers to NAIC SAOs as contemplated in Section 3 of the *US 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 – General
- MAAA, FCAS, ACAS, or fully qualified member of another IAA-member organization
  - Three years of responsible actuarial experience, defined as work that requires knowledge and skill in solving actuarial problems
  - Knowledge of the applicable law through examination or documented professional development
  - And either:
    - Have attained highest possible level of membership in an IAA full-member organization and have one year responsible actuarial

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## NAIC SAOs

### Overview of Applicable Qualification Standards

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

- 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)
  - $\geq 6$  organized
  - $\geq 3$  professionalism
  - $\leq 3$  general business
- Refer to <http://actuary.org/qualstandards/>

### U.S. Qualification Standards – Specific

In addition to the requirements of the General Qualification Standard:

- Successfully complete relevant examinations administered by the Academy or the CAS 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 basic education requirement for the specific qualification standard. This statement should be obtained before issuing an SAO.
  - 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
  - Obtain 15 CE hours per year related directly to the particular topic
  - Minimum of 6 CE hours of “organized” activities related directly to the particular topic
  - Refer to <http://actuary.org/qualstandards/>

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## NAIC SAOs

### Overview of Applicable Qualification Standards

#### NAIC

- Meet U.S. Qualification Standards' Specific Qualification Standard for NAIC SAOs
- Member in good standing of the CAS, or of the Academy (and approved as qualified by the Academy's Casualty Practice Council (CPC))
- State requirements may vary
- Refer to [NAIC Annual Statement Instructions](#) and the Academy's [2017 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
  - Refer to <http://www.casact.org/education/index.cfm?fa=ceinfo>
- 

#### Note:

- CAS CE requirements changed for Actuarial Services rendered on or after January 1, 2016, with Alternative Compliance Provisions being eliminated. The applicable requirements from the most relevant recognized organization must be followed – typically the Academy for SAOs – whether the CAS member is a member of that organization or not.
- The Actuary should be prepared to provide evidence of compliance with the relevant continuing education requirements on a timely basis. Several templates, as well as an online tool, are available from the CAS and Academy.
  - The Academy has developed and made available to its members a voluntary U.S. Qualification Standards Attestation Form, a tool which is intended to respond to regulators' concerns about transparency on actuarial qualifications necessary for signing statutory statements of opinion. The form is available to Academy members at <http://attest.actuary.org/>.
- Certification of compliance with CAS CE requirements for services to be provided in year 2018 is due by December 31, 2017.

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## 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 company 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.”*<sup>20</sup>

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.”*<sup>21</sup>

The 2016 AOWG Regulatory Guidance states *“While regulators are interested in material disagreements between the former Appointed Actuary’s final estimates and the insurer’s selection of its carried reserves, they do not expect notification on routine discussions that occur during the course of the Appointed Actuary’s work.”*<sup>22</sup>

### 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.

#### Note:

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

<sup>20</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>21</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>22</sup> 2016 AOWG Regulatory Guidance, page 3 ([Appendix II](#)).

## 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](#) as “the date (subsequent to the valuation date) through which material information known to the actuary is included in forming the reserve opinion.”<sup>23</sup>

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 should 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 can include

- Loss and LAE reserves;
- Retroactive reinsurance assumed reserves;
- Unearned premium reserves for 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.**

<sup>23</sup> 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

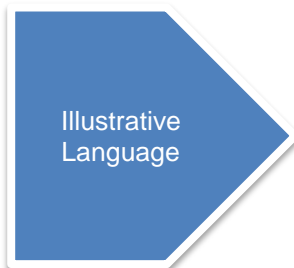
The Appointed Actuary should state that the SCOPE items included in the SAO reflect the Disclosure items (8 through 13) in Exhibit B.

### Note:

- 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, 2017. The reserves listed in Exhibit A, where applicable, include provisions for Disclosure items (disclosures 8 through 13) in Exhibit B.*

## 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:*

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- 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.”<sup>24</sup>*

## **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).

### **3.2.1 Illustrative Language**

The following language may be appropriate:



*I have reviewed the December 31, 2017 loss and loss adjustment expense reserves recorded under U.S. Statutory Accounting Principles.*

<sup>24</sup> 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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## 3.3 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.”<sup>25</sup>*

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

**A: Yes! Please see the “Definition” 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 should be provided.

### 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 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) and the Actuarial Report (section 7 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,

<sup>25</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).



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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 quota share reinsurance agreement.*  
Schedule P for the company (or companies) ceding 100 percent of its reserves shows gross reserves but zero net reserves. Paragraph 1C of the 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 entitled "*Intercompany Pooling Arrangements*", read the contract itself, and/or contact the regulator for 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 quota share reinsurance agreement. Any proportional reinsurance agreement with affiliates must be approved by the regulator as either an intercompany pooling arrangement or a quota share reinsurance agreement. The financial reporting depends on the approved filing, regardless of how a company views the contract.

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## 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.

### 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.”<sup>26</sup>*

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](#), however, we believe the two terms are conceptually similar. According to [ASOP No. 41](#):

**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.

<sup>26</sup> 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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*“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.”<sup>27</sup>*

## 3.4.2 Discussion

The 2016 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.”<sup>28</sup>*

## 3.4.3 Illustrative Language

The following language may be appropriate:



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

## 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.”<sup>29</sup>*

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

**A:** According to 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.

<sup>27</sup> Actuarial Standards Board, “ASOP No. 41, Actuarial Communications, <http://www.actuarialstandardsboard.org/asops/actuarial-communications/>, December 2010, Section 3.4.5.

<sup>28</sup> 2016 CASTF Regulatory Guidance, page 3 ([Appendix II](#)).

<sup>29</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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## 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:



*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).*

## 3.6 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.

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

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

**A: No.**

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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. Generally, prudent actuaries watch for 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 would usually be described in the Statement of Actuarial Opinion and would usually be elaborated upon in the Actuarial Report, or
  - Conclude that an actuarial opinion cannot be formed based on the available data.

### 3.6.2 Illustrative Language

The following language may be appropriate:

Illustrative  
Language

*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:

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- A. Each of the following types of data, if relied upon significantly in forming the actuarial opinion (on a net or a direct plus assumed basis), were reconciled to Schedule P, Parts 1, 1A,..., 1R (referred to collectively as Schedule P below): paid losses, incurred (case basis) losses, paid defense and cost containment expenses, incurred (case basis) defense and cost containment expenses, paid adjusting and other expenses, salvage and subrogation received, and earned premiums.
- B. The reconciliation of paid data consisted of comparing either (a) cumulative paid amounts, or (b) current calendar-year paid amounts obtained from the actuarial data to the analogous data from Schedule P, Part 1; the reconciliation of case basis reserves consisted of comparing the current year-end case basis reserves from the actuarial analysis to Schedule P, Part 1; the comparisons were completed in detail by line of business and year in which losses were incurred, to the extent that such detail was relied upon significantly and is provided in Schedule P.
- C. 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 Actuary (e.g., the case basis reserves for LAE were based on formulas that differed between the two sources.).

***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.***

## 3.7.1 Discussion

The following discussion points are relevant with respect to the Appointed Actuary's statement regarding the reconciliation of data to Schedule P:

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 can 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 can 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

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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.

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 may 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.

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10. The Actuarial Report ordinarily contains a description of the comparison performed and of any data that were relied upon significantly but could not be compared against Schedule P.
11. If, after attempting to resolve the differences, significant, unexplained differences remain between the data used by the Appointed Actuary and those shown in Schedule P, the Appointed Actuary may choose to do the following:
  - 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.

## 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.*

## 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. The Appointed Actuary provides the auditor with a list of data elements significant to the analysis in support of the SAO. However, 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.



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Note that the data testing requirement paragraph is found in the NAIC Annual Statement Instructions “Annual Audited Financial Reports” section and included in [Appendix I.4](#). A similar data testing paragraph can be found in the NAIC Annual Statement Instructions for title insurance companies.

## 3.8.1 Discussion<sup>30</sup>

As noted above, the 2017 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. For purposes of this discussion, the term “*loss reserves*” is intended to include LAE reserves and any other items within the scope of the statutory Statement of Actuarial Opinion.

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 an analysis of loss reserves if, in the Appointed Actuary’s professional judgment, the correctness of the data item or attribute in the loss reserve analysis is likely to have a material effect on the 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 ASB 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 Appointed Actuary has communicated to management and the auditor the data and attributes that he/she believes to be significant, the auditor has responsibility for considering testing such data in the statutory financial statement audit.

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

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

To satisfy the data testing requirement, Appointed Actuaries identify to management and the auditor the data that are deemed significant in the actuaries’ analysis of loss reserves. Appointed Actuaries, whether consultants or company employees, are encouraged to contact the company’s management and its auditors before beginning their loss reserve analysis. A sample letter from the Appointed Actuary to management and the audit firm is included in the illustrative language section below. While there is no requirement to this effect, written communication among the Appointed Actuary, the company’s

<sup>30</sup> 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.

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management, and the company's auditor, to be retained for a reasonable time period, may help clarify information and create a documentation trail. Although the Appointed Actuary is not required to use the sample letter, the Appointed Actuary is encouraged either to adapt the sample letter or use alternative language as appropriate to the Appointed Actuary's circumstances. The Appointed Actuary may wish to consult with legal counsel concerning the specific provisions of the NAIC's data testing requirements.

In addition, the American Institute of Certified Public Accountants (AICPA) and COPLFR strongly encourage appointed actuaries to meet with the company's management and its audit firm to discuss the data and the audit in greater depth. Actuaries may also wish to consult [ASOP No. 21](#), *Responding to or Assisting Auditors or Examiners in Connection with Financial Statements for All Practice Areas*<sup>31</sup>, regarding 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 the kind of letter an Appointed Actuary might wish to issue to company management (typically with a copy to the auditor) under the NAIC's data testing requirements. Significant data and attributes will vary depending on the circumstances of a particular assignment and may call for varying approaches to compliance with the NAIC's requirements. There is no requirement that the Appointed Actuary use this letter or any of the specific language or provisions it contains, or to identify the lines of business or attributes used as examples as significant. In fact, the Appointed Actuary is encouraged either to adapt the language of this sample to the circumstances of a particular company or to develop entirely different language if, in the Appointed Actuary's professional judgment, it is appropriate or desirable to do so. The Appointed Actuary may wish to consult with legal counsel concerning the specific provisions of the NAIC's data testing requirements.



*Dear CFO:*

*I understand that ABC CPA has been appointed to audit XYZ Insurance Company's financial statements for the year ended December 31, 2017. I understand that the NAIC Annual Statement Instructions direct insurers to require that the auditor subject the data used by the Appointed Actuary to testing procedures. As the Appointed Actuary of XYZ, I am providing this letter to communicate what data and attributes I believe to be significant to my analysis in support of the XYZ Statement of Actuarial Opinion (SAO).*

*In this letter, a data item or attribute would normally be considered to be "significant" to my analysis of loss reserves if, in my professional judgment, the correctness of the data item or attribute in the loss reserve analysis is likely to have a material effect on the opinion. Examples of "material effect" might*

<sup>31</sup> Note ASOP No. 21 was revised and reissued by the ASB in September 2016.

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*include a change in the type of opinion rendered (reasonable, qualified, redundant, deficient, or no opinion) or the presence or absence of a risk of material adverse deviation.*

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

- 1. Direct and Ceded Paid Loss and Defense and Cost Containment Expense (DCC) by reviewed line of business and by accident year, at annual evaluations as of XX/XX/2017. 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/2017. 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/2017.*
- 4. Reported Claim Counts by reviewed line of business and by accident year, at annual evaluations as of XX/XX/2017, 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/2017. 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/2017.*
- 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*

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*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, 2017, 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.

#### **3.9.2 Illustrative Language**

If the Appointed Actuary examined the assumptions and methodology underlying the Company's recorded reserves, the following wording is generally appropriate, absent any circumstances that may warrant the use of alternative language:

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Illustrative  
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, 2017, and reviewed information provided to me through XX/XX/2018 ...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 last sentence shown in the SCOPE paragraph of the NAIC SAO Instructions (above):



Illustrative  
Language

*I have examined the reserves listed in Exhibit A, as shown in the Annual Statement of the Company as prepared for filing with state regulatory officials, as of December 31, 2017, and reviewed information provided to me through XX/XX/2018...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 associated reserve amounts. The Appointed Actuary is referred to section [4.5](#) for a detailed discussion of what constitutes a qualified SAO.

## 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 and principles.*
- 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 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.”<sup>32</sup>*

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

In accordance with [ASOP No. 36](#), the Appointed Actuary will state whether the SAO is for losses and LAE combined or separately.

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.

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<sup>32</sup> 2017 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 and principles.

Management is required to record its best estimate of reserves by line of business and in total in the statutory accounts. The Appointed Actuary may wish to 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' [2017 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 [2017 P/C Loss Reserve Law Manual](#) provides a compilation of state regulatory requirements concerning property and casualty loss and LAE reserves. The Law Manual is updated annually and 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><b>A. Meet the requirements of the insurance laws of (state of domicile).</b></p> |
|--|
- B. Are computed in accordance with accepted actuarial standards and principles.*
- 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*

## 4.2 Accepted actuarial standards and principles

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 and principles.

### 4.2.1 Discussion

As discussed in section [3.9, Methodology](#), 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 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 and principles. 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 is generally 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 and principles.**
- 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 and principles.**
- 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 of [Chapter 4](#) discusses the reasonable type of SAO. Sections [4.4](#) through [4.6](#) 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.”<sup>33</sup>*

### 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 and LAE reserves and the direct-plus-assumed loss and LAE 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:** COPLFR believes that the determination of whether to issue a deficient/inadequate opinion is based upon the overall evaluation of the loss and LAE reserves as disclosed in the SCOPE paragraph. For this purpose, it may not be relevant whether the actuary believes that each subset of the reserves makes 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 and principles.

<sup>33</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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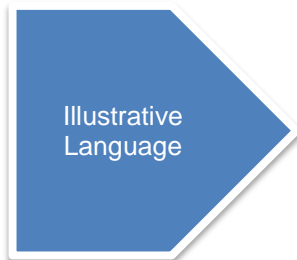
for gross reserves (direct plus assumed reserves), then the SAO would usually include language that explicitly conveys the intended category of SAO for each of the SCOPE items.

## 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 and principles.*

**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 read:

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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 and principles.*

**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.”<sup>34</sup>*

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.”<sup>35</sup>*

Further, [ASOP No. 36](#) contains specific disclosure requirements for deficient or inadequate SAOs.

### 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](#).

<sup>34</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>35</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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## 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, Property/Casualty Unpaid Claim Estimates, 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 and principles.

## 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 and principles.*

**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 amount I consider necessary to be within the range of reasonable estimates.**

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## 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.”<sup>36</sup>*

[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 reasonably estimated, or the Appointed Actuary is unable to render an opinion on those items<sup>37</sup>. 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

**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.

<sup>36</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>37</sup> Section 3.11(d) of ASOP No. 36.

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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, it is typically helpful to disclose 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 may issue an unqualified opinion even though the actuary did not review all of the reserves. Examples of these situations are as follows:

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 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 section [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, 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.

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- 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.

## 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 and principles.*
- 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*



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*issue a statement of no opinion. A statement of no opinion should include a description of the reasons why no opinion could be given.*<sup>38</sup>

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

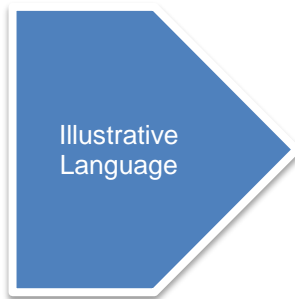
## 4.6.1 Discussion

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 are 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.

<sup>38</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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## 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);
- The amount of discount for workers' compensation loss reserves;
- Retroactive reinsurance ceded loss and LAE 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 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 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."<sup>39</sup>*

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 wish to add a statement in the OPINION paragraph, item "D" (or "E," if appropriate), such as:

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<sup>39</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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*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> under the terms of its contracts and agreements.*

## 4.8 UPR for Long Duration Contracts

The amounts recorded by the company for unearned premium reserves for Long Duration Contracts are identified in Exhibit A: SCOPE, items 7 and 8 on direct plus assumed and ceded bases, respectively. If the company has material amounts for these reserves, then the Actuary should opine on the reasonableness of the balances.

As discussed in section [4.7, Other Loss Reserve items](#), 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.

There is further discussion on disclosures for UPR for Long Duration Contracts in section [5.14, Long Duration Contracts](#), of this practice note.

### 4.8.1 Definitions

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."<sup>40</sup>*

### 4.8.2 Discussion

Unearned premium reserves related to direct and assumed 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 with fixed premiums that the insurer cannot cancel, such

<sup>40</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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as residual value contracts or directors' and officers' liability insurance. These may fall within the SCOPE of this section of the NAIC SAO Instructions.

A statutory accounting rule exists that 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 [2017 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 request disclosure of the unearned premium reserve amounts. The following entries are to be included on Exhibit A: SCOPE:

*Premium Reserves:*

*(7) Reserve for Direct and Assumed Unearned Premium for Long Duration Contracts*

*(8) Reserve for Net Unearned Premium for 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.

**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 may 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 “long duration unearned premium reserves”.
- Exhibit A, items 7 and 8 require disclosure of the amount of the reserve for unearned premium for 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 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

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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 Long Duration Contracts, the NAIC SAO Instructions require that, the SAO cover the following illustration as item (D) of the OPINION paragraph of the SAO:



*Make a reasonable provision for the unearned premium reserves for 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.

The opinion statement in 5(D), as noted in the Instructions, is usually appropriate for this situation.

### 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 [5.13, \*Extended reporting endorsements\*](#)).

### 4.9.2 Discussion

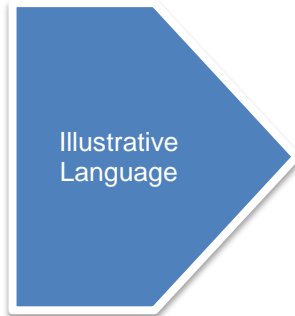
If there is any aggregation or combination of items in Exhibit A, NAIC Instructions require the opinion language to clearly identify the combined items.

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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 6, 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.*

## 4.10 Use of the work of another

According to the NAIC 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 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.<sup>41</sup>*

### 4.10.1 Discussion

Section 5 of the 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 Instructions were expanded to include the use of the work of a non-actuary, which is consistent with the phraseology in [ASOP No. 36](#).<sup>42</sup>

[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

<sup>41</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>42</sup> 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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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.

## 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 Mr. Joe Actuary, FCAS, MAAA, 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.

## 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...”<sup>43</sup>*

In addition, the NAIC SAO Instructions state the comments should include mention of 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 13) in Exhibit B. The Appointed Actuary should address the items individually and in combination when commenting on a material impact.”<sup>44</sup>*

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

- The intended users of the SAO
- The intended purpose of the SAO
- The stated basis of reserve presentation
- Whether any material assumption or method was prescribed by law
- Whether the Appointed Actuary disclaims responsibility for any material assumption or method that originated from another source

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<sup>43</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>44</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).



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The following sections discuss each of the RELEVANT COMMENT paragraphs in further detail.

## 5.1 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:

- 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;
- 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; and
- An explicit statement of whether the Appointed Actuary reasonably believes that there are significant risks or uncertainties that could result in material adverse deviation.

In this section we will discuss the materiality standard. In section [5.2](#) we will discuss major risk factors. Section [5.3](#) will round out the discussion, addressing the determination of Risk of Material Adverse Deviation.

### 5.1.1 Definitions

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

### 5.1.2 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.”<sup>45</sup>*

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<sup>45</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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

- ❑ Percentage of surplus
- ❑ Percentage of reserves
- ❑ The amount of adverse deviation that would cause 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
- ❑ Multiples of net retained risk
- ❑ Reinsurance considerations, such as levels of ceded reserves compared to surplus or concerns about solvency or collectibility of reinsurance
- ❑ The upper limit of a company's reinsurance protection on reserve development, if any

Other bases for establishing the standard may be acceptable as well.

**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".*

**Note:**

- No matter how the materiality standard is determined, ASOP No. 36, section 3.2 requires the Appointed Actuary to consider the purposes and intended uses for which the Appointed Actuary prepares the SAO.

### 5.1.3 Illustrative language

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

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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. A reduction in surplus of \$Y would result in the Company moving into the [state which RBC level, e.g., Company] Action Level.*

## 5.2 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."<sup>46</sup>*

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.

<sup>46</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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## 5.2.1 Discussion

The 2017 NAIC SAO Instructions require the Appointed Actuary to comment on the risks and other factors considered, 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:

- A&E losses
- Other emerging mass torts
- Construction defects
- Catastrophic weather events
- Exposure related to mortgage defaults
- Exposure to cyber liability
- High excess layers
- Impact of soft market conditions
- Large deductible workers' compensation claims
- Medical professional liability legislative issues
- New products or new markets
- Rapid growth in one or more lines of business or segments
- Lack of data or unexpected and unexplained changes in data
- Operational changes that are not objectively quantified
- Sudden unexplained changes in frequency or severity of reported data for a line of business or segment
- Changes in adequacy of known case reserves

The NAIC SAO Instructions direct the Appointed Actuary to address the potential that a combination of factors or particular conditions that the Appointed Actuary considers relevant could develop, increasing the entity's risk of material adverse deviation. 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.

### 5.2.2 Illustrative language

The following language may be appropriate. Note that the 2016 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; the 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 estimates of unpaid losses and loss adjustment expenses at December 31, 2017:*

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

### 5.3 Risk of Material Adverse Deviation

The NAIC SAO Instructions require the Appointed Actuary to explicitly state whether he or she 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. The previous two sections on materiality standard and major risk factors aid the Appointed Actuary in reaching this conclusion.

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## 5.3.1 Discussion

The NAIC Financial Analysis Handbook provides a Bright Line Indicator Test in regards 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 and LAE 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 a 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 2016 AOWG Regulatory Guidance includes the following:

*"When deciding if 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."<sup>47</sup>*

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

## 5.3.2 Illustrative language

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 in a situation where there is a RMAD:

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<sup>47</sup> 2016 AOWG Regulatory Guidance, page 5 ([Appendix II](#)).

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*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:



*It should be noted, however, that the company has a retroactive reinsurance contract which would serve to eliminate the impact of any 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 section [5.8](#) below.

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



*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 Company's carried reserves for losses and loss adjustment expenses and the higher end of my range of reasonable unpaid claim estimates 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.*

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## 5.4 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. The Appointed Actuary is expected to comment on this disclosure within the RELEVANT COMMENTS section of the SAO. This section provides discussion and illustrative wording around this disclosure item.

### 5.4.1 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.

The NAIC SAO Instructions require the Appointed Actuary to state whether reserves are stated net or gross of future 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.

#### 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).

The Appointed Actuary may 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*



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*that data, include an implicit provision for anticipated salvage and subrogation.*

## 5.5 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 and LAE reserves as reported in Schedule P. The Appointed Actuary is expected to comment on this disclosure within the RELEVANT COMMENTS section of the SAO. This section provides discussion and illustrative wording around this disclosure item.

### 5.5.1 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 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.

### 5.5.2 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 and in the Notes to the Financial Statements.

If the Appointed Actuary is providing an SAO for discounted loss and LAE 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.

#### 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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The Appointed Actuary may 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. 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.*

## 5.6 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 expenses for the company's share of voluntary and involuntary underwriting pools and associations' unpaid losses and expenses that are included in reserves shown on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines. The Appointed Actuary is expected to comment on this disclosure within the RELEVANT COMMENTS section of the SAO. This section provides discussion and illustrative wording around this disclosure item.

### 5.6.1 Discussion

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

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

**FAQ: What if I didn't review another's work supporting the reserve balance for an 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.**

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

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The Appointed Actuary is reminded that unless the SAO is qualified, the Appointed Actuary is generally responsible for opining on the reasonableness of the loss and LAE reserves in aggregate and may therefore consider 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.

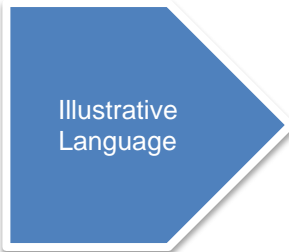
**Note:**

- The amount disclosed in item 10 of Exhibit B represents the reserve for the company's net participation in the pool, net of reinsurance purchased by the pool.

## 5.6.2 Illustrative language

The Appointed Actuary may choose 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*

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*all pools are \$XYZ. Company practice is to accrue for the reporting lag for these pools.*

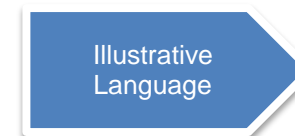
As a reminder, when the Appointed Actuary makes use of the work of another for a material portion of reserves, this needs to be disclosed in the OPINION paragraph.

## Situation 3: Immaterial pool exposure



*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. Reserve exposure with respect to pools is considered immaterial.*

## Situation 4: No adjustment for booking lag



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

## 5.7 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.

*“RELEVANT COMMENT paragraphs should describe the significance of each of the remaining Disclosure items (8 through 13) in Exhibit B. The Appointed Actuary should address the items individually and in combination when commenting on a material impact.”<sup>48</sup>*

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 5.7 may also be useful for disclosure of other possible mass torts when relevant to the disclosure of major risk factors.

<sup>48</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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## 5.7.1 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.”<sup>49</sup>

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.”<sup>50</sup>

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, Contractor’s Pollution Liability, Consultant’s Environmental Liability, and Pollution and Remediation Legal Liability.”<sup>51</sup>

**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.

## 5.7.2 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:

<sup>49</sup> SSAP 65, paragraph 41 ([Appendix IV](#)).

<sup>50</sup> SSAP 65, paragraph 41 ([Appendix IV](#)).

<sup>51</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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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.)

Generally, companies writing no commercial liability coverage, whether on a primary, excess, or assumed basis, would 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 RMAD<sup>52</sup>
- 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

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<sup>52</sup> 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 29 ([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 5.8](#) and [Appendix III.4](#).

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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.

**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.*

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

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):

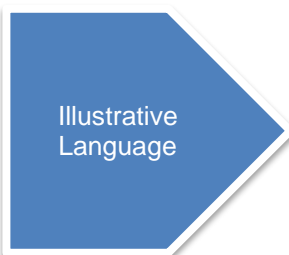
- The difficulties attendant in providing an actuarial estimate of these liabilities
- Whether these liabilities are being handled by a dedicated experienced claim/legal unit
- Any other factors the Appointed Actuary may have considered in forming his or her SAO

### 5.7.3 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*

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*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 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



*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 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 for the situation where RMAD is unlikely due to relative size:



*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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## 5.8 Retroactive reinsurance

According to the NAIC SAO Instructions,

*RELEVANT COMMENT paragraphs should address reinsurance collectability, retroactive reinsurance and financial reinsurance.*<sup>53</sup>

(Note the change in spelling of “collectability” in the Instructions).

This section discusses retroactive reinsurance, while section 5.9 covers financial reinsurance and section 5.10 covers reinsurance collectability. 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.

### 5.8.1 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.*<sup>54</sup>

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 31 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.

### 5.8.2 Discussion

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

The 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

<sup>53</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>54</sup> SSAP No. 62R ([Appendix IV](#)).

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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.

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.

For accounting purposes, the company is required to determine whether a particular contract constitutes retroactive reinsurance (e.g., loss portfolio transfer). 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 may choose to be familiar with the important aspects of the reinsurance coverage but can rely on summaries of the reinsurance coverage prepared by others, rather than reading and evaluating each contract. However, if the 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.

**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.*

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

## 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.

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## 5.8.3 Illustrative language

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

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,*

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*my evaluation as to whether a RMAD exists did consider the impact of this contract.*

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

## 5.9 Financial reinsurance

According to the NAIC SAO Instructions,

*“RELEVANT COMMENT paragraphs should address reinsurance collectability, retroactive reinsurance and financial reinsurance.”<sup>55</sup>*

This section discusses financial reinsurance, while section [5.8](#) covers retroactive reinsurance and section [5.10](#) covers reinsurance collectability.

### 5.9.1 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.”<sup>56</sup>*

### 5.9.2 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.”<sup>57</sup>

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<sup>55</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>56</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>57</sup> SSAP No. 62R, paragraph 35 ([Appendix IV](#)).

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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 assistance from actuaries, as many insurers rely on actuaries to perform the technical risk transfer 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.

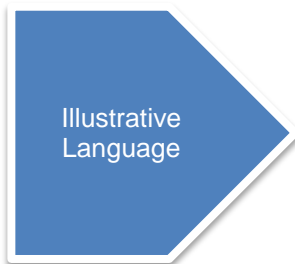
## Note:

- 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.

### 5.9.3 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. (See the section 5.8.3 for an illustration of how this might be done.)

If a contract was appropriately accounted for as financial reinsurance:

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*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.*

## 5.10 Uncollectible reinsurance

As noted in the previous section, the RELEVANT COMMENTS section of the SAO should comment on 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 Actuary's comments do not imply an opinion on the financial condition of any reinsurer."<sup>58</sup>*

### 5.10.1 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 "paid loss" in Schedule F<sup>59</sup>), 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.)

<sup>58</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>59</sup> 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 2 (Assets) contains ceded recoverable amounts on paid losses.
- 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 may choose 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 may also choose 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 (where the total recoverable from the reinsurer is over \$100,000). Beginning with year-end 2015 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 may choose 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 would also normally 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 uncollectability?

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 would ordinarily comment on large cessions to a company recently placed under regulatory control, if the Appointed Actuary has knowledge of such cessions.

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

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

The Appointed Actuary would generally 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 should also be considered.

## Note:

- Reinsurance uncollectibility can be caused 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.

### 5.10.2 Illustrative language

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

#### Situation 1: Immaterial ceded reinsurance levels



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

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

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

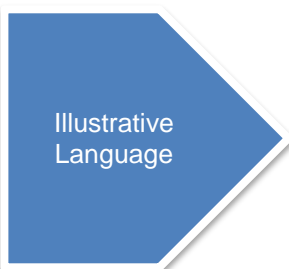
Note that even if reinsurance is with strong reinsurers, it is possible that reinsurance credits are overstated. If such credits were overstated in the past, an analysis of past uncollectible levels or of amounts currently in dispute could discover such an overstatement.

**Situation 3:** Potentially inadequate reserves for collectibility problems



*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.*

**Situation 4:** Miscellaneous – Public information



*The Company has a high portion of its reinsurance recoverable with the XYZ Corporation, whose financial difficulties have been publicized. I have reviewed the Company's exposure to this reinsurer, the ability to offset recoveries with amounts payable, and the Company's reserves for uncollectible reinsurance and found... {Note: The 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:** Miscellaneous – Public information – material ceded reserves



*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*

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*{surplus and/or reserves}. My analysis assumes that such cession will {be collectible, uncollectible, partially collectible, etc.}.*

## 5.11 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).”<sup>60</sup>*

### 5.11.1 Definitions

IRIS Test 11 One-Year Reserve Development to Surplus measures the development of net loss and LAE 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 and LAE 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 and LAE 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 between this reserve estimate and the recorded loss and LAE reserve is related to current year surplus. A calculated deficiency in recorded loss and LAE reserves of 25 percent or more is deemed to be unusual.

A link to the NAIC Insurance Regulatory Information System (IRIS) Ratios Manual is below. This manual contains calculation details along with annual statement source references for all of the IRIS Ratios.

[http://www.naic.org/documents/prod\\_serv\\_fin\\_receivership\\_uir\\_zb.pdf](http://www.naic.org/documents/prod_serv_fin_receivership_uir_zb.pdf)

### 5.11.2 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

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<sup>60</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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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](#).

### 5.11.3 Illustrative language

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



*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 wording similar to the following:

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*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.*

## 5.12 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.”<sup>61</sup>*

### 5.12.1 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.

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<sup>61</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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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.

## 5.12.2 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

Illustrative  
Language

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

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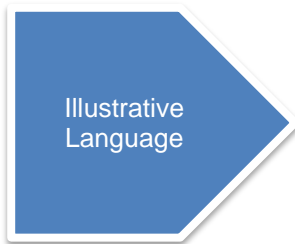
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**Situation 2:** Change made, materiality unknown



*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

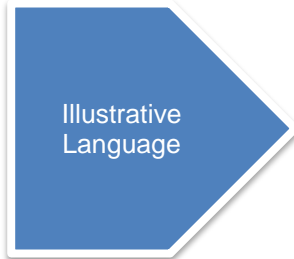


*The Appointed Actuary has changed from the prior year. A comparison of my estimates to the prior Appointed Actuary's estimates is not possible because [explain why: for example, the analysis done by the prior Appointed Actuary was performed using a different aggregation of the data]. Therefore, I am 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



*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.*

## 5.13 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).

*“RELEVANT COMMENT paragraphs should describe the significance of each of the remaining Disclosure items (8 through 13) in Exhibit B. The Appointed Actuary should address the items individually and in combination when commenting on a material impact.”<sup>62</sup>*

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

### 5.13.1 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.”<sup>63</sup>*

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.<sup>64</sup>

<sup>62</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#))

<sup>63</sup> SSAP 65, paragraph 3c ([Appendix IV](#)).

<sup>64</sup> SSAP 65, paragraph 7 ([Appendix IV](#)).



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Additionally, certain claims-made policies include provisions such as Death, Disability, or Retirement (DDR) provisions. 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,

*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...When 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 – Premiums.<sup>65</sup>*

## 5.13.2 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 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.”

<sup>65</sup> SSAP 65, paragraphs 8 and 9 ([Appendix IV](#)).

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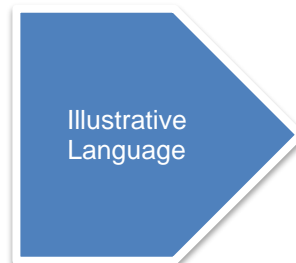
## 5.13.3 Illustrative language

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 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:



*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.*

## 5.14 Long Duration Contracts

This section addresses the situation of material levels of Long Duration Unearned Premium Reserves subject to special reporting rules in SSAP 65, and the required SAO comment on such reserves.

*If the Scope includes material Unearned Premium Reserves for Long Duration Contracts ... the Actuarial Opinion should cover the following illustration: <sup>66</sup>*

This means that if lines 7 and/or 8 of Exhibit A of the SAO include material levels of unearned premium reserves for Long Duration Contracts, the NAIC expects the Appointed Actuary to opine on the level of such Long Duration Unearned Premium Reserves.

<sup>66</sup> 2016 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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## 5.14.1 Definitions

Special rules for calculating unearned premium “shall apply to all direct and assumed contracts ... excluding financial guaranty contracts, mortgage guaranty contracts, and surety contracts, that fulfill both of the following conditions:

- a. The policy or contract 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.”<sup>67</sup>

## 5.14.2 Discussion

Note that “long duration” in this section refers only to those policies subject to the special unearned premium rules alluded to in the above definitions. More details on these special rules are provided in [Appendix III.1](#).

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

1. The company does not write Long Duration Contracts.
2. The unearned premium reserve for Long Duration Contracts is immaterial in relation to the aggregate of the loss, LAE, and long duration unearned premium reserves.
3. The long duration unearned premium reserve is material in relation to the aggregate of the loss, LAE, and long duration unearned premium reserves.

If the Appointed Actuary is unsure which of these conditions apply, he/she may analyze the disclosure of unearned premium for policies over 12 months in the Underwriting & Expense Exhibit, Part 1A, column 2. Note that that column may include both amounts subject to the SSAP 65 requirements and amounts that are exempted from those requirements; hence material values in that column may require further analysis to determine whether the SSAP 65 requirements apply.

## 5.14.3 Illustrative language

**Situation 1:** The Company does not write Long Duration Contracts (of the type specified in SSAP 65 for the special unearned premium reserve calculation).

**FAQ: Are all policies of duration over 12 months considered “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).

<sup>67</sup> SSAP 65, paragraph 23 ([Appendix IV](#)).

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When the company does not write Long Duration Contracts, the Appointed Actuary may choose to use the SAO format that makes no allusion to the long duration unearned premium reserves in the SCOPE or OPINION sections. A brief disclosure in the RELEVANT COMMENTS section of the SAO may be worded along the following lines:



*The Company does not write policies or contracts related to single or fixed premium policies with coverage periods of 13 months or greater that are non-cancellable and not subject to premium increase (excluding financial guaranty contracts, mortgage guaranty contracts, and surety contracts).*

**Situation 2:** The unearned premium reserve for Long Duration Contracts is immaterial in relation to the aggregate of the loss, LAE, and long duration unearned premium reserves. When the company writes an amount of Long Duration Contracts that develop an unearned premium reserve that is immaterial when combined with the loss and LAE 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 Long Duration Contracts subject to the SSAP 65 unearned premium reserve “three tests”, to which this opinion applies, is \_\_\_\_\_, representing \_\_\_percent of the total net unearned premium for the Company. This component of the unearned premium is not material to the Company 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.*

**Situation 3:** The unearned premium reserve for Long Duration Contracts is material in relation to the aggregate of the loss, LAE, and long duration unearned premium reserves. When the long duration contract unearned premium reserve is material, the Appointed Actuary would likely include the amounts in Exhibit A: SCOPE (items 7 and 8) and also include item (D) in the OPINION paragraph. The Appointed Actuary may choose to apply language similar to the language described in section [4.9.3](#) and may choose to include further discussion in the RELEVANT COMMENTS section.

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## 5.15 Other Items

Item 13 of Exhibit B provides a place for disclosure of “Other items on which the Appointed Actuary is providing relevant comment...”

*“RELEVANT COMMENT paragraphs should describe the significance of each of the remaining Disclosure items (8 through 13) in Exhibit B. The Appointed Actuary should address the items individually and in combination when commenting on a material impact.”<sup>68</sup>*

This means that if item 13 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 item(s) individually and within context of the other disclosure items in Exhibit B.

### 5.15.1 Discussion

Item 13 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 13, 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.

The listing of potential risk factors in section 5.2.1 of this document may provide some instances of items that could be disclosed within item 13 of Exhibit B.

### 5.15.2 Illustrative language

**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 13 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, 2017 is \$x.x million on a net of reinsurance basis and is shown as item 13 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*

<sup>68</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#))

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*\$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 13 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.*

## 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<sup>69</sup>*

**FAQ: Is an original signature required?**

*A: This depends on the requirements of each state. Suggested resources for these requirements include the [2017 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.*

<sup>69</sup> 2016 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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

**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.*



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## 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.<sup>70</sup>*

The information obtained in 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 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 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.

Disclosure 10 is the sum of voluntary and involuntary participation in underwriting pools and associations. A zero entry would be unusual for workers' compensation or automobile insurers. The Appointed Actuary may choose to show the voluntary and involuntary participation separately in the body of the SAO. Note: Refer to section 5.6 of this practice note for more information on the specifics of underwriting pools and associations.

Exhibit B would typically contain information and amounts for all of items 1 through 13, even if the company's value for an individual item is \$0. Also, if the Appointed Actuary is including a non-zero value or values in item 13, 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.

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<sup>70</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#))

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## 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.”<sup>71</sup>*

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,

*“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.”<sup>72</sup>*

<sup>71</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>72</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#))

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## 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”<sup>73</sup> 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 support) within ten (10) business days, the Appointed Actuary should proceed with the notification to the Board of Directors and the domiciliary commissioner.”<sup>74</sup>

**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.

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.

<sup>73</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>74</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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**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.”<sup>75</sup>

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<sup>75</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.2](#)).

## 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.<sup>76</sup>*

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

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<sup>76</sup> 2017 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 [2017 P/C Loss Reserve Law Manual](#) to find the state-specific due date. A non-domiciliary state may also request the AOS, but only if that state can demonstrate its ability to preserve the confidentiality of the AOS, in accordance with item 1 of the 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 should be filed separately. 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 CASTF 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) and the CAS Statements of Principles.
- 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, 2018*  
*Actuarial Opinion Summary*  
*Company: THE Insurance Company*  
*NAIC#: #####*  
*Appointed Actuary: Janet Actuary*

*I have signed the Company's Statement of Actuarial Opinion on Feb. 23, 2018. 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 (section [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.”<sup>77</sup>*

## 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.”*<sup>78</sup>
- 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.

<sup>77</sup> 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.

<sup>78</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.2](#)).



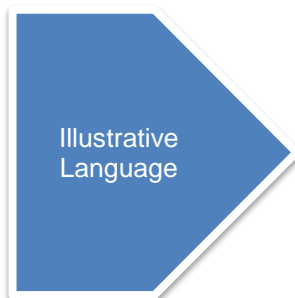
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- NAIC SAO Instructions indicate that the Actuarial Report should include detailed descriptions and calculations that support the point estimate and/or range of estimates.

## 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 would usually 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:



*During this past year, the Company evaluated its asbestos exposures using a ground-up evaluation. The ground-up evaluation considered deteriorating trends in pre-packaged bankruptcies and in reinsurance collectibility. The evaluation included input from claims, legal, and actuarial personnel. The outcome of the evaluation was an increase in the Company's net asbestos liability of \$100,000,000, thereby resulting in a one-year development of reserves that exceeds five percent of the prior year's surplus.*

NAIC AOS Instructions require "an explicit description of the reserve elements or management's decisions which were the major contributors,"<sup>79</sup> 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 (section [5.11](#)) 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:

<sup>79</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.2](#)).

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*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 was 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 was 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:



*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, 2017

**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 may be included 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*

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*request an exception from disclosure under the Freedom of Insurance Act/Laws of your state.*

## Note:

- Because the confidentiality laws differ from state to state, Appointed Actuaries are encouraged to reference the Academy's [2017 P/C Loss Reserve Law Manual](#) to assist them 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.<sup>80</sup>*

### 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 defined 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.

### 7.4.2 Illustrative language

The following language may be appropriate when a company is a 0% pool participant in an intercompany pooling arrangement:

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<sup>80</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.2](#)).

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*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 2016 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.”<sup>81</sup>*

### 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.

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.*

<sup>81</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.2](#)).

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*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.”<sup>82</sup>*

**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.”<sup>83</sup>

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<sup>82</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.2](#)).

<sup>83</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.2](#)).

## 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](#), *Actuarial Communications*, 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.<sup>84</sup>*

### 8.1 Actuarial Report requirements per the NAIC SAO Instructions

According to the NAIC 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.<sup>85</sup>*

The Instructions go on to provide a list of six bulleted items Actuarial Reports must also include. Those six bulleted items correspond to sections [8.2](#) to [8.7](#) of this chapter, respectively.

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<sup>84</sup> Actuarial Standards Board, "ASOP No. 41, *Actuarial Communications*," <http://www.actuarialstandardsboard.org/asops/actuarial-communications/>, December 2010, section 3.2.

<sup>85</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).



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## 8.1.1 Definitions

According to the NAIC 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.<sup>86</sup>*

## 8.1.2 Discussion

The requirements for the Actuarial Report per the Instructions are much more specific than those contained in [ASOP No. 41](#). The NAIC 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 [8.2](#) through [8.7](#)). Additionally, the NAIC Instructions require that the reconciliation papers in section [3.7.1 \(Reconciliation to Schedule P, Discussion\)](#) become a part of the report.

The definition of the Actuarial Report in paragraph 7 of the 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 Instructions further state that the minutes of the Board of Directors’ meeting should indicate that a presentation was made. For year-end 2016, the Instructions were expanded to 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 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 [2017 P/C Loss Reserve Law Manual](#) and relevant statutes for specific guidance.*

<sup>86</sup> 2017 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 Instructions for year-end 2017 the Actuarial Report should conclude with the signature of the Appointed Actuary and the date when the Actuarial Report was finalized **in a format consistent with what is required on 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 report was issued

The Appointed Actuary may wish to review the "Areas for Improvement" section of the 2016 AOWG Regulatory Guidance, which presents examples of what the task force considers to be weaknesses in the documentation of many Actuarial Reports.

**Note:**

- The Appointed Actuary would typically consider the requirements of the NAIC Instructions and ASOP No. 41 when developing the Actuarial Report, as well as guidance provided by the AOWG (see [2016 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 Description of Appointed Actuary's relationship to the company

The 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*

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*Actuary presents the analysis to the Board and, where applicable, to the officer(s) of the Company responsible for determining the carried reserves.*<sup>87</sup>

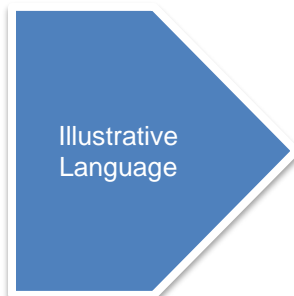
## 8.2.1 Discussion

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.

## 8.2.2 Illustrative language

The following sample wording is provided to illustrate the level of detail and nature of information intended to be included in the Report to fulfil 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.*
- *[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.*

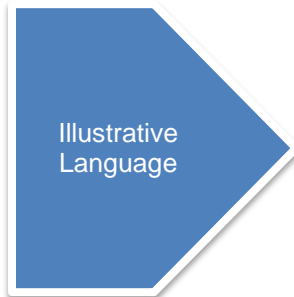
<sup>87</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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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).*

## 8.3 Exhibit comparing Appointed Actuary's conclusions to carried amounts in Annual Statement

The 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."<sup>88</sup>*

### 8.3.1 Discussion

The 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 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."<sup>89</sup>*

<sup>88</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>89</sup> 2016 CASTF Regulatory Guidance, page 6 ([Appendix II](#)).

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## 8.3.2 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

## 8.4 Reconciling and mapping data in the Actuarial Report to Schedule P

The 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.”<sup>90</sup>*

### 8.4.1 Discussion

The Schedule P reconciliation is intended to be consistent with the segmentation used in the Appointed Actuary’s analysis.

The 2016 AOWG Regulatory Guidance provides extended commentary on the topic, which the Appointed Actuary may wish to consider. The Guidance notes that regulators expect the Schedule P reconciliation to include at least a mapping of the data groupings used in the analysis to Schedule P lines of business, along with detailed reconciliation of the data at the lowest possible/practical level of segmentation. The data should be compared after minimal necessary aggregation between the analysis and/or Schedule P lines of business. 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 used in the analysis are to be included in the reconciliation:

<sup>90</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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*“The actuary should reconcile all data material to the analysis, which may include claim counts and earned premium.”<sup>91</sup>*

There are the nuances that the Appointed Actuary may decide to take into consideration with respect to the Schedule P reconciliation. For example,

- The 2016 AOWG Regulatory Guidance specifies a number of circumstances such as “mergers, acquisitions, changes in claim systems, the use of underwriting year data in the analysis”<sup>92</sup> that present challenges to Appointed Actuaries, and notes that “regulators...are holding ongoing discussions regarding expectations.”<sup>93</sup>
- The 2016 AOWG 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.”<sup>94</sup>
- 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 Instructions are explicit that material differences arising from the Schedule P reconciliation must be explained by the Appointed Actuary.

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 8.3.
- AOWG Regulatory Guidance highlights the relationship between the reconciliation performed by the Appointed Actuary, which generally entails the reconciliation 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.

## 8.5 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 Instructions also include a requirement to compare the Actuary’s estimates to the prior Actuarial Report:

<sup>91</sup> 2016 AOWG Regulatory Guidance, page 6 ([Appendix II](#)).

<sup>92</sup> 2016 AOWG Regulatory Guidance, page 6 ([Appendix II](#)).

<sup>93</sup> 2016 AOWG Regulatory Guidance, page 6 ([Appendix II](#)).

<sup>94</sup> 2016 AOWG Regulatory Guidance, page 6 ([Appendix II](#)).

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*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.*<sup>95</sup>

## 8.5.1 Discussion

The 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 Instructions to include illustration of the changes on a net basis, and on a gross basis if relevant.

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 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

**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.

<sup>95</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).



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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.

### **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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## 8.6 Extended comments on risks and uncertainties

The 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.*<sup>96</sup>

### 8.6.1 Discussion

As noted in the 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 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 2017 NAIC 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 Instructions requiring "Extended comments on trends that indicate the presence or absence of risks and uncertainties that could result in material adverse deviation,"<sup>97</sup> the Appointed Actuary may wish to comment on sources of risk and uncertainty that are not trends, such as significant, one-time events.

<sup>96</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>97</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

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## 8.7 Extended comments on unusual values for IRIS Ratio 11, 12, and/or 13

The 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.*<sup>98</sup>

### 8.7.1 Discussion

As noted in the *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.

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<sup>98</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

## 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.<sup>99</sup>*

According to the ASB, the ASOPs “identify what the actuary should consider, document, and disclose when performing an actuarial assignment.”<sup>100</sup>

While all ASOPs are binding, the following are deemed to be particularly relevant to actuaries signing NAIC property and casualty SAOs:

[ASOP No.1, Introductory Actuarial Standard of Practice](#)

[ASOP No. 20, Discounting of Property/Casualty Unpaid Claim Estimates](#)

[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](#)

[ASOP No. 38, Using Models Outside the Actuary's Area of Expertise \(Property and Casualty\)](#)

[ASOP No. 41, Actuarial Communications](#)

[ASOP No 43, Property/Casualty Unpaid Claim Estimates](#)

The above can be found at the ASB website: <http://www.actuarialstandardsboard.org/>

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<sup>99</sup> Actuarial Standards Board, ASOP No. 1, *Introductory Actuarial Standard of Practice*, <http://www.actuarialstandardsboard.org/asops/introductoryactuarialstandardpractice/>, Section 1.

<sup>100</sup> Actuarial Standards Board, ASOP No. 1, Section 1

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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, non-substantive 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.*<sup>101</sup>

There are over 100 SSAPs and they are published in the NAIC's *Accounting Practices and Procedures Manual*. COPLFR has received permission to reproduce SSAPs deemed to be particularly applicable to actuaries signing NAIC property and casualty SAOs. 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*

SSAP 116: *Claim Adjustment Expenses, Amendments to SSAP 55 - Unpaid Claims, Losses and Loss Adjustment Expenses*

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.

Note that the SSAPs are subject to change every year and have seen numerous changes since they were originally issued in 2001.

<sup>101</sup> [http://www.naic.org/cmte\\_e\\_app\\_sapwg.htm](http://www.naic.org/cmte_e_app_sapwg.htm)

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## 9.3 Available resources for opinions not covered by this practice note

While property and casualty 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 [2017 P/C Loss Reserve Law Manual](#) may also provide guidance on these points. Some examples include:

Type of opinion	Regulatory authority	Website
Bermuda opinion of the Loss Reserve Specialist	Bermuda Monetary Authority	<a href="http://www.bma.bm/SitePages/Home.aspx">http://www.bma.bm/SitePages/Home.aspx</a>
Cayman captive Statement of Actuarial Opinion	Cayman Islands Monetary Authority	<a href="http://www.cimoney.com.ky/">http://www.cimoney.com.ky/</a>
Hawaii captive Statement of Actuarial Opinion	State of Hawai'i Insurance Division, Department of Commerce & Consumer Affairs	<a href="http://cca.hawaii.gov/captive/">http://cca.hawaii.gov/captive/</a>
Vermont captive Statement of Actuarial Opinion	Vermont Department of Financial Regulation	<a href="http://www.dfr.vermont.gov/captives/annual-filing-instructions-vermont-domestic-captives">http://www.dfr.vermont.gov/captives/annual-filing-instructions-vermont-domestic-captives</a>

The Appointed Actuary may wish to contact the regulatory authority directly to obtain the specific opinion requirements.

# APPENDICES

## I. 2017 NAIC Instructions

This appendix to the practice note provides the 2017 NAIC Instructions with respect to the property and casualty 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 2016 NAIC Data Testing Requirements. No discussion is included.



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## I.1 2017 NAIC Property and Casualty 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 – Property and Casualty*.

Upon initial engagement, the Qualified 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.

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 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

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No. 36, ASOP No. 41 and ASOP No. 43, as promulgated by the Actuarial Standards Board, and Statements of Principles adopted by the Casualty Actuarial Society.

## 1A. Definitions

“Appointed Actuary” for purposes of these instructions is a Qualified Actuary appointed by the Board of Directors in accordance with Section 1 of these instructions.

“Board of Directors” for purposes of these instructions can include the designated Board of Directors, its equivalent or an appropriate committee directly reporting to the Board of Directors.

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“Qualified Actuary” is a person who 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*, promulgated by the American Academy of Actuaries, and 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 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.)

“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.

## 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

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

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## Financial Hardship Exemption

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

- (i) One percent (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.

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. Nevertheless, if a person who does not meet the definition of a Qualified Actuary has been approved by the insurance regulatory official of the domiciliary state, the Company must attach, each year, a letter from that official stating that the individual meets the state's requirements for rendering the 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.

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

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

“In forming my opinion on the loss and loss adjustment expense reserves, I relied upon data prepared by \_\_\_\_\_ (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 and principles.
- 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 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.

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

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

If the 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

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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 13) in Exhibit B. The Appointed Actuary should address the items individually and in combination when commenting on a material impact.
  - D. **Reinsurance**

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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.



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## 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.

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.

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- 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.

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8. Both the Actuarial Opinion and the Actuarial Report should conclude with the signature of the Appointed Actuary responsible for providing the Actuarial Opinion and the respective dates when the Actuarial Opinion was rendered and the Actuarial Report finalized. 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 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.

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## **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 Long Duration Contracts	\$ _____
8. Reserve for Net Unearned Premiums for Long Duration Contracts	\$ _____
9. Other Premium Reserve items on which the Appointed Actuary is expressing an Opinion (list separately, 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 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   |       |       |       |
|   |       |       | _____ |

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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)

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- |      |   |                   |
|------|---|-------------------|
| 12.1 | Amount reported as loss and loss adjustment expense reserves  | \$ _____          |
| 12.2 | Amount reported as unearned premium reserves  | \$ _____          |
| 13.  | Other items on which the Appointed Actuary is providing relevant comment (list separately, adding additional lines as needed) | \$ _____<br>_____ |

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

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## I.2 2017 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, and Statements of Principles adopted by the Casualty Actuarial Society.
3. Exemptions for filing the AOS are the same as those for filing the Statement of Actuarial Opinion.
4. The AOS contains significant proprietary information. It is expected that the AOS be held confidential; 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.



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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.

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## I.3 2017 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, and Statements of Principles adopted by the Casualty Actuarial Society.

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## 1A. Definitions

“Qualified Actuary” is a person who is either:

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

“Insurer” 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.

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## Financial Hardship Exemption

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

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

- (i) One percent (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."

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

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

- A. Meet the requirements of the insurance laws of (state of domicile).
- B. Are computed in accordance with accepted actuarial standards and principles.
- C. Make a reasonable provision for all unpaid loss and loss 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 and principles.

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,

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assumptions, or related information, then the actuary may issue a statement of no opinion. A statement of no opinion should include a description of the reasons why no opinion could be given.

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

a. Risk of Material Adverse Deviation.

The Appointed Actuary must provide specific RELEVANT COMMENT paragraphs to address the risk of material adverse deviation. The 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*, paragraph 35, 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

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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.



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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

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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)	\$ _____

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**Exhibit B: DISCLOSURES**

DATA TO BE FILED IN BOTH PRINT AND DATA CAPTURE FORMAT

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

	Last	First	Middle
1. Name of 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)	\$ _____		

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- 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) \$ \_\_\_\_\_

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## I.4 2016 NAIC Data Testing Requirement

### 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).

## II. AOWG Regulatory Guidance

### II.1 2017 AOWG Regulatory Guidance

This appendix to the practice note provides the [2017 AOWG Regulatory Guidance for the Property/Casualty Statement of Actuarial Opinion and Actuarial Opinion Summary](#).



#### **REGULATORY GUIDANCE**

**on Property and Casualty Statutory Statements of Actuarial Opinion, Actuarial Opinion Summaries, and Actuarial Reports for the Year 2017**

**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 (Working Group) of the Casualty Actuarial and Statistical (C) Task Force believes that the Statement of Actuarial Opinion (Actuarial Opinion), 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) in an effort to provide clarity and timely guidance to companies and Appointed Actuaries regarding regulatory expectations on the Actuarial Opinion, 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 Actuarial Opinion, AOS, and supporting Actuarial Report and workpapers be consistent with relevant Actuarial Standards of Practice (ASOPs).

There are no significant changes to the Instructions for 2017. The Working Group used this opportunity to make changes to this year's Regulatory Guidance document. The document has been restructured to improve readability. In addition, content that is no longer relevant has been removed, and additional information has been added in certain sections. The Working Group's goal is to keep the guidance useful and timely.

The Regulatory Guidance document is now divided into three sections: The first contains general comments; the second has comments specific to the Actuarial Opinion and Actuarial Report; and the third has comments specific to the AOS.



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## I. General comments

### A. Reconciliation between documents

If there are any differences between the values reported in the Actuarial Opinion, AOS, Actuarial Report, and Annual Statement, the Working Group expects Appointed Actuaries to include an explanation for these differences in the appropriate document (Actuarial Opinion, 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: The direct and assumed loss reserves on line 3 of the Actuarial Opinion'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 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 such as intercompany pooling arrangements; recent mergers or acquisitions; and significant changes in operations, product mix, or reinsurance arrangements.

### C. Replacement of an Appointed Actuary

The Instructions require two letters when the Board replaces an Appointed Actuary: one addressed from the insurer to the domiciliary commissioner, and one addressed from the former Appointed Actuary to the insurer. The insurer must provide both of these letters to the domiciliary commissioner.

The detailed steps are as follows:

1. Within 5 business days, the insurer shall notify its domiciliary insurance department 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 in the 24 months preceding the replacement, there were disagreements with the former Appointed Actuary. 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, in writing, request that its 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 above, 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 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.

### D. 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 the Board's minutes to specify the manner in which the Appointed Actuary presented 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 that the risks and uncertainties that underlie the exposures and the significance of the Appointed Actuary's findings

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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 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.

## E. 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 Actuarial Opinion should include the following:
  - o Description of the pool
  - o Identification of the lead company
  - o 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 should reconcile to the financial statement for that company

For intercompany pooling members with a 0% share of the pooled reserves:

- Text of the Actuarial Opinion should be similar to that of the lead company
- Exhibits A and B should reflect the 0% company's values
  - o Response to Exhibit B, Item 5 (materiality standard) should be \$0
  - o 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 Actuarial Opinion
- Information 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 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, 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.

## F. Explanation of adverse development

### 1. Comments on unusual Insurance Regulatory Information System (IRIS) ratios in the Actuarial Opinion

The Appointed Actuary is required to provide comments in the Actuarial Opinion on factors that led to unusual values for IRIS ratios 11, 12, or 13. The Working Group considers it insufficient to attribute unusual reserve development to "reserve strengthening" or "adverse development" and expects the Appointed Actuary to provide insight into the company-specific factors which caused the unusual value. Detailed documentation should be included in the Actuarial Report to support statements provided in the Actuarial Opinion.

### 2. Comments on persistent adverse development in the AOS

The Appointed Actuary is required to comment on persistent adverse development in the AOS. Comments can reflect common questions that regulators have, such as:

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

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## G. Revisions

When a material error in the Actuarial Opinion or AOS is discovered by the Appointed Actuary, the company, the regulator, or any other party, regulators expect to receive a revised Actuarial Opinion or AOS.

Regardless of the reason for the change or refiling, the company should submit the revised Actuarial Opinion in hard copy to its domiciliary state and electronically to the NAIC. The company should submit the revised AOS in hard copy to the domiciliary state but should not submit the document to the NAIC.

A revised Actuarial Opinion or AOS should clearly state that it is an amended document, contain or accompany an explanation for the revision, and include the date of revision.

## II. Comments on 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 ASOP No. 36 requirement to disclose the date through which material information known to the Appointed Actuary is included in forming the reserve opinion (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 Actuarial Opinion 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 Actuarial Opinion is signed, regulators suggest the Appointed Actuary clarify this in the Actuarial Opinion 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 Instructions say that the Appointed Actuary must provide the following information in the Actuarial Opinion:

- The person's name;
- The person's affiliation;
- The person's credential(s), if the person is an actuary; and
- 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 that 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 Actuarial Opinion 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 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 and principles) of the Opinion paragraph when they issue an Actuarial Opinion of a type other than "Reasonable."

### D. Conclusions on a net versus a direct and assumed basis

Unless the Appointed Actuary states otherwise, 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

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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 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. Regulators understand that a net versus a direct and assumed RMAD will have different meanings and, potentially, different materiality standards.

## E. Unearned premium for long duration contracts

Exhibit A, Items 7 and 8 require disclosure of the unearned premium reserve for long duration contracts, and 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. However, regulators have noted that some Actuarial Opinions include point D regardless of materiality. The Working Group expects that Appointed Actuaries will either add point D if they can and are indeed expressing an opinion on the reasonableness of this reserve and/or add a Relevant Comments paragraph about these unearned premium reserves and state whether the amounts are material or immaterial.

## F. Other premium reserve items

With regard to "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.

## G. The importance of Relevant Comments paragraphs

The Working Group considers the Relevant Comments paragraphs to be the most valuable information in the Actuarial Opinion. Relevant Comments help the regulator interpret the Actuarial Opinion 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 Risk of Material Adverse Deviation (MAD or RMAD) are particularly useful to regulators. The first two RMAD comments below respond to questions that Appointed Actuaries have posed to regulators. The second two stem from regulators' reviews of Actuarial Opinions.

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 that there are any company-specific risk factors, the Appointed Actuary should state that.
2. Mitigating factors – Regulators generally expect Appointed Actuaries to comment on significant companyspecific 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 conclusion on whether there is a significant risk of MAD.
3. Consideration of carried reserves, materiality standard, and reserve range when making RMAD 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 Actuarial Opinion 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

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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. Regulators' use of the Actuarial Report

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 can provide a foundation for efficient reserve evaluation during a statutory financial examination. This expedites the examination process and may provide cost savings to the company.

### 1. Schedule P reconciliation

The Working Group acknowledges that myriad circumstances (such as 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 that:

- 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.

- The Appointed Actuary should map the data groupings used in the analysis to Schedule P lines of business and should 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 that 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.

The Working Group draws a distinction between two types of data checks:

- The Schedule P reconciliation performed by the Appointed Actuary. The purpose of this exercise is 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 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 (for example, 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, 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.

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## 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 the majority of the analysis supporting an Actuarial Opinion may be done with data received prior to year-end and “rolled forward” to year-end. By reviewing the Actuarial Report, the 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 the 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 property/casualty lines of business, not just medical professional liability. The Schedule P Interrogatories only address extended loss and unearned premium reserves associated with medical professional liability coverage.

## 3. Scope of Exhibit B, Item 13

Regulators are cognizant that property and casualty insurers may have long term care (LTC) and other health insurance exposure. Given that LTC blocks are long duration in nature and have recently exhibited adverse experience, industry providers of this coverage are experiencing significant reserve strengthening in recent years. It would seem prudent for the Appointed Actuary to provide commentary regarding the insurer’s exposure to LTC and other health insurance segments. C

urrently, insurers may be reporting LTC liabilities as loss and loss adjustment expense reserves on Annual Statement page 3, lines 1 and 3; as unearned premium reserves/active life reserves on Annual Statement page 3, line 9; and/or as premium deficiency reserves on Annual Statement page 3, write in line. Liabilities related to health insurance coverage, particularly LTC, that are reported in the Property and Casualty Annual Statement should be identified in Exhibit B, Item 13 of the Actuarial Opinion and commented upon in the Relevant Comments paragraph.

## K. Long term care reserves

On August 9, 2017, the NAIC’s Executive (EX) Committee and Plenary adopted Actuarial Guideline LI, The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves (AG LI), requiring stand-alone asset adequacy analysis of large blocks of LTC business. The effective date of the AG LI is December 31, 2017. The AG LI states that it shall apply to a company with over 10,000 inforce lives covered by LTC insurance contracts as of the valuation date. This requirement is applicable to all life insurers having LTC business at year-end 2017. Although AG LI implicitly includes P&C insurers, the 2017 Instructions will not incorporate this requirement for Property and Casualty insurers for year-end 2017 due to the late adoption date.

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Despite this, regulators encourage P&C insurers to follow the guidance in AG LI due to the well-recognized uncertainties associated with the adequacy of LTC insurance reserves.

## III. Comments on Actuarial Opinion Summary

### A. Confidentiality

The AOS is a confidential document and 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 to avoid attaching the related Actuarial Opinion 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 that 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 of 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' Committee on Property and Liability Financial Reporting provides illustrative examples in its annual practice note "Statements of Actuarial Opinion on Property and Casualty Loss Reserves" 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.

Adopted by the Actuarial Opinion (C) Working Group on Oct. 5, 2017



**REGULATORY GUIDANCE**  
**on the Property and Casualty Actuarial Opinion Summary**  
**for the Year 2016**  
**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 (AOWG) of the Casualty Actuarial and Statistical (C) Task Force believes that the Actuarial Opinion Summary (AOS) is a valuable tool in serving the regulatory mission of protecting consumers. This Regulatory Guidance document supplements the NAIC *Annual Statement Instructions – Property/Casualty (Instructions)* in an effort to provide clarity and timely guidance to Appointed Actuaries regarding regulatory expectations on the AOS.

There are two key additions to the AOS requirements in the 2016 *Instructions*:

- Paragraph 7 requires the Appointed Actuary to explain the discrepancies if any of the values reported in the AOS do not reconcile to the values reported in the Statement of Actuarial Opinion (Actuarial Opinion) Exhibits or the Annual Statement. One situation in which a difference between the Actuarial Opinion and the AOS might arise is in the case of non-tabular discounting: The direct and assumed loss reserves on line 3 of Exhibit A come from Schedule P, Part

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1, which is gross of non-tabular discounting, while the AOS might present the direct and assumed loss reserves on a net of discounting basis.

- The *Instructions* were previously silent on required actions when the AOS is determined to be in error. Paragraph 8 of the 2016 *Instructions* states that similar requirements apply to the AOS as to the Actuarial Opinion in such a situation.

## **Form**

The AOS is intended to be a **confidential** document separate from the Actuarial Opinion. The AOWG advises the Appointed Actuary to provide the AOS to company personnel separately from the Actuarial Opinion. The AOS should be clearly labeled and identified prominently as a confidential document.

**The AOWG advises that, in order to avoid confusion, the Appointed Actuary not attach the related Actuarial Opinion to the AOS.**

Not all states have enacted the NAIC *Property and Casualty Actuarial Opinion Model Law* (#745), which requires the AOS to be filed. Nevertheless, the AOWG recommends that the Appointed Actuary prepare the AOS regardless of the domiciliary state's requirements, so that 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 AOWG advises the Appointed Actuary to work with the company in determining the requirements for each state.

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

## **Substance**

The entire substance of the AOS rests in paragraph 5. The American Academy of Actuaries' Property and Casualty Practice Note, *Statements of Actuarial Opinion on Property and Casualty Loss Reserves*, provides straightforward examples that show how the Appointed Actuary might choose to display the information required in Parts A–D of this paragraph.

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 of 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.

Regulators expect that point or range estimates reported in the AOS be clearly supported and documented in the Actuarial Report. Without clarity, the documentation fails to meet Actuarial Standards of Practice and the expectation that another actuary can evaluate the work.

Part E of paragraph 5 of the *Instructions* addresses persistent adverse development. The Appointed Actuary is in a unique position to be able to comment on the nature of this development. This section requires the Appointed Actuary to do so. Comments can reflect common questions that regulators have, such as:

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

Paragraph 6 is relevant to all pooling situations as defined in paragraph 1C of the *Instructions* for the Actuarial Opinion. For non-0% companies, regulators expect that carried values reported in the AOS can be reconciled to values reported in the Annual Statement and the Actuarial Opinion, and that actuarial estimates can be reconciled to the Actuarial Report. For 0% pooled companies, the information in the AOS should be that of the lead company.

Regulators encourage the Appointed Actuary to display values on the pooled (or consolidated) basis in addition to the statutory entity basis. This can be accomplished by displaying two tables of information.



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*Adopted by the Actuarial Opinion (C) Working Group – Aug. 18, 2016.  
Adopted by the Casualty Actuarial and Statistical (C) Task Force – Aug. 27, 2016.*

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## II.2 2016 AOWG Regulatory Guidance



### **REGULATORY GUIDANCE on Property and Casualty Statutory Statements of Actuarial Opinion for the Year 2016**

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

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 Actuarial Opinion and the supporting Actuarial Report and workpapers be consistent with appropriate Actuarial Standards of Practice (ASOPs), including, but not limited to, ASOP No. 23, *Data Quality*; ASOP No. 36, *Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves*; ASOP No. 41, *Actuarial Communications*; and ASOP No. 43, *Property/Casualty Unpaid Claim Estimates*.

If any of the values reported in the Actuarial Opinion or Actuarial Opinion Exhibits do not reconcile to the values reported in the Annual Statement, Actuarial Opinion Summary or Actuarial Report, regulators expect that Appointed Actuaries include an explanation in the respective document that justifies these differences. A robust peer-review process utilized by the Appointed Actuary should reduce reporting errors and non-reconciling items.

While the AOWG provides some illustrative language in the *Instructions*, 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 such as intercompany pooling arrangements, recent mergers or acquisitions, and significant changes in operations, product mix or reinsurance arrangements.

Several changes were made to the 2016 *Instructions*.

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

Paragraph 1 is directed to company management. There were three changes to this section in 2016:

- The notification requirements concerning the appointment of a Qualified Actuary were clarified. When a Qualified Actuary is initially appointed, the company shall notify the domiciliary commissioner. No further notice is required with respect to this person unless the Board of Directors (Board) takes action to no longer appoint or retain the actuary or the actuary no longer meets the requirements of a Qualified Actuary.
- The timeline of required actions were clarified when an actuary who was the Appointed Actuary for the immediately preceding filed Actuarial Opinion is replaced by an action of the Board.

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- The *Instructions* now require the Board’s meeting minutes to identify the manner (e.g., webinar, in-person presentation, written document) in which Appointed Actuary reported to the Board on the items within the scope of the Actuarial Opinion.

The *Instructions* require the insurer to provide a letter to the domiciliary commissioner upon the appointment of a new actuary that describes certain disagreements between the former Appointed Actuary and the insurer. Regulators understand that there may be disagreements between an 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 report may prompt the Appointed Actuary to make changes to the report. While regulators are interested in material disagreements between the former Appointed Actuary’s final estimates and the insurer’s selection of its carried reserves, they do not expect notification on routine discussions that occur during the course of the Appointed Actuary’s work.

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

- **Timely feedback** — The AOWG encourages management to seek feedback from a Qualified Actuary prior to establishing carried reserves. This allows management to make an informed decision with the benefit of actuarial analysis. It also helps prevent the difficult situation in which management is committed to a decision that results in pressure on the Appointed Actuary to “stretch” the range of reasonable reserve estimates.
- **Reporting to the Board of Directors** — The Appointed Actuary is required to report to the insurer’s Board. This may be done in a form of the Appointed Actuary’s choosing, including, but not limited to, an executive summary or PowerPoint presentation. As mentioned previously, the 2016 *Instructions* require the Board’s minutes to specify the manner in which the Appointed Actuary presented the required information to the Board. The AOWG strongly encourages the Appointed Actuary to present his or her analysis in person so that the risks and uncertainties that underlie the exposures and the significance of the 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 line 1 and line 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 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.

## **Paragraph 1A: Definitions**

The AOWG added definitions of “Appointed Actuary” and “Board of Directors” to the 2016 *Instructions*.

## **Paragraph 1B: Exemptions**

Paragraph 1B is directed to company management, describes exemption requirements and does not generally apply to the work of the Appointed Actuary.

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

This section was modified in 2014 to expand the *Instructions* to apply to all companies that operate in an intercompany pooling agreement. The *Instructions* are no longer restricted only to the 100% lead insurer and 0% pooling member situations. Regulators expanded the pooling disclosure language to provide additional clarity for readers of the Actuarial Opinion, as many pooled company Actuarial Opinions were silent on pooling arrangements.

For each company in the pool, the Appointed Actuary shall provide in the Actuarial Opinion a brief description of the pool, identify the lead insurer and list all pool members. The *Instructions* also require that the Appointed Actuary

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provide the state of domicile and the respective pooling percentage of each pool member. The Appointed Actuary may choose to provide this information in table or paragraph form; however, regulators would like to see this disclosure at the beginning of the Actuarial Opinion to ensure that the reader has a proper understanding of the contents within the Actuarial Opinion and how they relate to the subject company. Regulators recognize that the same information is required in the Notes to Financial Statements, which company management prepares.

For 0% pool members (that is, members that retain 0% of the pooled reserves), the Appointed Actuary is directed to prepare an Actuarial Opinion that reads similar to that of the lead company. This Actuarial Opinion should be filed with the Annual Statement of each of the 0% pooled companies.

Exhibit A and Exhibit B should reflect values specific to the individual company. For companies with 0% pool participation, the Appointed Actuary should prepare Exhibit A and Exhibit B of the lead company to be filed as an addendum to the 0% pooled companies' Actuarial Opinions. This will ensure proper data submission for each company in the pool, while allowing the greatest distribution of the relevant values for the pool. The *Instructions* include specific answers for the Exhibit B questions regarding the materiality standard and the risk of material adverse deviation.

Note the distinction between pooling with a 100% lead company with no retrocession and ceding 100% via a quota share reinsurance agreement. The 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.

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

Paragraph 2 includes no significant changes for 2016. It succinctly presents the four primary sections of the Actuarial Opinion.

## **Paragraph 3: Identification**

Paragraph 3 includes no significant changes for 2016.

## **Paragraph 4: Scope**

The suggested language for the Scope paragraph includes "... and reviewed information provided to me through XXX date." This is intended to capture the ASOP No. 36 requirement to disclose the date through which material information known to the Appointed Actuary is included in forming the reserve opinion (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 Actuarial Opinion 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 Actuarial Opinion is signed, regulators suggest that actuaries clarify such in the Actuarial Opinion. Suggested language may include "... and reviewed information provided to me through the date of this opinion."

Exhibit A provides a clear picture of what items are to be opined on by the Appointed Actuary. Guidance for Exhibit B disclosure items is discussed in paragraph 6.

The AOWG calls attention to two items of interest to regulators that pertain to the Scope of the Actuarial Opinion:

- **Exposure** – An Actuarial Opinion on the reasonability of the carried reserves should reflect consideration and evaluation of more than just loss history. The AOWG expects the Appointed Actuary to probe and understand the exposure associated with the company for which the Actuarial Opinion is issued.

One area of particular interest to regulators is coverage for service contracts. Due to variation in state laws, this type of product may or may not be regulated or treated as insurance. Insurance may only come into play as excess coverage for contractual liability.

- **Prepaid Loss Adjustment Expenses** – According to *Statement of Statutory Accounting Principles (SSAP)*

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*No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*, paragraph 5 of the NAIC *Accounting Practices and Procedures Manual*, the liability for unpaid loss adjustment expenses shall be established regardless of any payments made to third-party administrators (TPAs), 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 Actuarial Opinion and the Actuarial Report.

The Scope paragraph also requires disclosure of the individual upon whom the Appointed Actuary relied for preparation of the data. The 2016 *Instructions* require the Appointed Actuary to include this individual's title. The individual should be an employee of the company on which the Appointed Actuary is issuing an opinion. In some cases, the Appointed Actuary, if a senior officer of the company, may be the individual who holds this responsibility. In these cases, it is acceptable for the Appointed Actuary to identify himself or herself in this section.

The Appointed Actuary may receive data from a TPA, accounting firm or similar organization that provides service to the regulated entity. If such a relationship exists, it is informative to identify it in this section. However, any third party or firm is not the regulated entity, and regulators expect that a company official will always be identified.

## **Paragraph 5: Opinion**

Paragraph 5 is meant to be consistent with ASOP No. 36 as it relates to making use of the work of another not within the Appointed Actuary's control. Regulators expect full compliance with additional disclosure requirements pursuant to ASOP No. 36. Per ASOP No. 36, the Appointed Actuary should disclose whether he or she reviewed the other's underlying analysis and the extent of the review, including items such as the methods and assumptions used and the underlying arithmetic calculations. In most cases, this disclosure will result from the use of the work of another actuary for underwriting pools and associations.

The 2016 *Instructions* now require specific disclosures when the Appointed Actuary has made use of the work of a non-actuary for a material portion of the reserves. The Appointed Actuary must identify the non-actuary by name and affiliation, and a description of the type of analysis performed must be provided.

The AOWG expects point C (unpaid loss and loss adjustment expense reserves) and point D (unearned premium reserves for long duration contracts and/or other loss reserve items on which the Appointed Actuary is expressing an opinion) of the Opinion paragraph to be the full and complete expression of the Appointed Actuary's conclusion on the type of opinion rendered. Regulators will presume that the conclusion applies to both the net and the direct and assumed reserves. If the Appointed Actuary reaches different conclusions, the Appointed Actuary should use whatever language is appropriate to clearly convey a complete opinion. The response to Exhibit B, Item 4, should reflect the Appointed Actuary's opinion on the net reserves. The AOWG encourages the Appointed Actuary to include narrative comments to describe any differences with respect to the direct and assumed reserves.

Regulators strongly 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 and principles) of the Opinion paragraph when they issue an Actuarial Opinion of a type other than "Reasonable."

Exhibit A, Item 7 and Item 8 require disclosure of the amount of the reserve for unearned premium for long duration contracts, and the *Instructions* 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 noted that some Actuarial Opinions include paragraph (D) regardless of materiality. The AOWG expects that Appointed Actuaries will 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.

With regard to "Other Premium Reserve Items" in Exhibit A, Item 9, the Appointed Actuary should also include an explanatory paragraph about these premium reserves in Relevant Comments and state whether the amounts are material or immaterial.

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## **Paragraph 6: Relevant Comments**

The AOWG considers the Relevant Comments paragraphs to be the most valuable information in the Actuarial Opinion. Relevant Comments help the regulator interpret the Actuarial Opinion 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.

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## Risk of Material Adverse Deviation (MAD or RMAD)

Regulators continue to improve upon risk-focused procedures in both the financial analysis and financial examination areas. In accordance with this approach, regulators expect company management and the actuarial specialists employed by management to identify and discuss company-specific risk factors. The Appointed Actuary's discussion in the Actuarial Opinion is an increasingly important source of information in this regard.

Therefore, the *Instructions* were enhanced in 2014 to require the Appointed Actuary to disclose and discuss risks in the body of the Actuarial Opinion before making a conclusion on RMAD.

The *Instructions* were modified in 2014 to require the Appointed Actuary to:

- Describe the major factors, combination of factors or particular conditions underlying the risks and uncertainties that the Appointed Actuary considers relevant to the statutory entity. Examples of possible company-specific risk factors are uncertainty in the tail factors or the need to use industry benchmarks.
- Identify the materiality standard in U.S. dollars, ensuring that such is consistent with the amount shown in Exhibit B: Disclosures.
- Identify the basis for establishing this standard.
- **Explicitly** state whether he or she believes that there are significant risks and uncertainties that could result in MAD.

Note that the Appointed Actuary is asked to discuss risks whether he or she believes the company is exposed to RMAD. If the Appointed Actuary does not believe that there are ANY company-specific risk factors, the Appointed Actuary should state that.

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 conclusion on whether there is a significant risk of MAD.

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.

The type of opinion in Exhibit B, Item 4, 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 different conclusions on the net versus the direct and assumed reserves with regard to the reasonableness of the carried amounts, the materiality standard or the risk of material adverse deviation, the Appointed Actuary should include a Relevant Comments paragraph to address the differences.

With the exception of intercompany pooling members that retain a 0% share, each statutory entity is required to have a separate Actuarial Opinion 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. For pooled companies with a 0% share of the pooled reserves, the materiality standard should be \$0, and the RMAD conclusion should be "Not Applicable."

## Insurance Regulatory Information System (IRIS) Ratios

The AOWG considers it insufficient to attribute unusual reserve development to "reserve strengthening" or "adverse development" and expects relevant comments to provide reasonable insight into the company-specific factors which caused the unusual value. Detailed documentation should be included in the Actuarial Report to support statements provided in the Actuarial Opinion.

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## **Paragraph 7: The Actuarial Report**

The AOWG believes that the *Instructions* provide the best guidance to actuaries regarding the Actuarial Report and supporting documentation.

The AOWG also believes that regulators should be able to rely on the Actuarial Report as an alternative to developing their own independent estimates. A well-prepared and documented Actuarial Report that complies with ASOP No. 41 can provide a foundation for efficient reserve evaluation during a statutory financial examination. This benefits the examination process and may provide cost savings to the company.

The lettered list in paragraph 7 of the *Instructions* describes the required components of the Actuarial Report.

## **Schedule P Reconciliation**

The requirement to provide a Schedule P reconciliation is described in part C of paragraph 7. Regulators are looking for a mapping of the data groupings used in the analysis to Schedule P lines of business, along with detailed reconciliations of the data at the finest level of segmentation that is possible and practical. If the data cannot be reconciled, the reasons should be clearly documented in the Actuarial Report. The Appointed Actuary should reconcile all data material to the analysis, which may include claim counts and earned premium.

The reconciliation to Schedule P should illustrate differences between the data used in the Appointed Actuary's analysis and the amounts presented in Schedule P of the Annual Statement. The Appointed Actuary should address the reasons for any significant differences in order to reduce questions regarding data integrity.

The AOWG recognizes that company line of business definitions are often more meaningful than Annual Statement line of business definitions when completing a reserve analysis. Such differences in data classification should be addressed and clearly documented within the Actuarial Report.

Actuarial Reports display a wide variety of Schedule P reconciliation practices. Myriad circumstances (mergers, acquisitions, changes in claim systems, the use of underwriting year data in the analysis, etc.) may present reconciliation challenges to Appointed Actuaries. In recognition of these challenges, regulators and interested parties are holding ongoing discussions regarding expectations. One item of discussion is the reconciliation of paid losses. Given that development factors are generally applied to cumulative paid losses by accident year, regulators encourage Appointed Actuaries to carefully consider whether a reconciliation of incremental payments during the most recent calendar year for all accident years combined provides sufficient assurance of the integrity of the data used in the analysis.

Another item of discussion is the relationship between the reconciliation in the Actuarial Report and the reconciliations performed by the company's external auditors. Generally, the former is a check to ensure that the data in the Appointed Actuary's analysis ties to the data in Schedule P, while the latter is a check to ensure that Schedule P accurately reflects the data in the company's claims system.

## **Change in Estimates**

Part D of paragraph 7 states that the Actuarial Report must show the change in the Appointed Actuary's estimates from the prior Actuarial Report and describe factors underlying any material changes. The 2016 *Instructions* were modified to state that the exhibit or appendix should at least illustrate the changes on a net basis, but should also include the changes on a gross basis, if relevant. This requirement was previously in the Regulatory Guidance document, but not in the *Instructions*.

The AOWG expects any significant total change to be discussed; however, an explanation should also be included for any significant fluctuations among accident years or segments. The regulator is interested in seeing what the Appointed Actuary judges to have contributed to any significant changes at any level of granularity the Appointed Actuary believes is appropriate to put the current year's results in the context of the prior year's results. Therefore, the Appointed Actuary should judge at what level of aggregation the comparisons are meaningful. Further note that this exhibit or appendix is to show the change in the Appointed Actuary's estimates, not the company's. If the Appointed



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Actuary has changed from the prior year and no such comparison is practical or meaningful, the Appointed Actuary should disclose this.

## Narrative

Exhibits alone rarely convey professional conclusions and recommendations or the significance of the Appointed Actuary's opinion or findings. The Narrative section should provide clearly worded information so that readers are able to appreciate 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. Sources of assumptions should be clearly supported.

## Areas for Improvement

The AOWG has identified the following notable weaknesses in the documentation of many Actuarial Reports:

1. **Expected Loss Ratios** – When using methodologies that rely on expected loss ratios, the Appointed Actuary's analysis should incorporate 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 and/or program revisions have affected premium adequacy or inadequacy.
2. **Actuarial Judgment** – The use of this phrase in an Actuarial Report, in either the Narrative comments or in exhibit footnotes, is not considered to be sufficient explanation. A descriptive rationale is needed.
3. **Schedule P Reconciliations** – The AOWG believes that a summary reconciliation (all years and all lines combined) is an insufficient demonstration of data integrity. The risk of a lack of data integrity increases as companies cut data into finer pieces. 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. See more discussion on this topic above.
4. **Underwriting Pools and Associations** – The AOWG expects the Actuarial Report to include exhibits that support the net of ceded reinsurance amount shown in Exhibit B, Item 10, as well as a list of the pools and associations with the associated reserve amounts. If the Appointed Actuary has made use of the work of another actuary for these pools and associations, and the amounts are material to the total reserves, the Actuarial Report should include extended discussion of what the Appointed Actuary has done to review these reserves.

The AOWG recognizes that the majority of the analysis supporting an Actuarial Opinion may be done with data received prior to year-end and "rolled forward" to 12/31/20xx. By reviewing the Actuarial Report, the 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.

## **Paragraph 8: Signature**

Paragraph 8 was changed slightly in 2016 to emphasize that the Appointed Actuary must sign and date both the Actuarial Opinion and Actuarial Report.

## **Paragraph 9: Notice Regarding Errors**

Paragraph 9 of the *Instructions* was changed slightly in 2016 to clarify the timeline of required actions when the Actuarial Opinion is found to be in error. When a material error is discovered by the Appointed Actuary, the company, the regulator or any other party, regulators expect to receive a revised Actuarial Opinion. Regardless of the reason for the change or refile of an Actuarial Opinion, the company should submit the revised Actuarial Opinion document in hard copy to its domiciliary state and electronically to the NAIC. The revised Actuarial Opinion should clearly state that it is an amended filing, should contain or accompany an explanation for the revision, and should include the date of revision.

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## **Exhibit A and Exhibit B**

Note that Exhibit B, Item 12 includes extended loss and unearned premium reserves for all property/casualty lines of business, not just medical professional liability, which is addressed in the Schedule P Interrogatories.

The term “data capture format” in the *Instructions* refers to an electronic submission of the data in a format usable for computer queries. This allows for the population of an NAIC database that contains qualitative information and financial data. Appointed Actuaries should refer to the *Instructions* and prepare exhibits to assist the company in accurately completing the electronic submission.

For those companies that participate in an intercompany pooling arrangement and retain a 0% share, Exhibit A and Exhibit B of the lead company should be attached as an addendum to the PDF file and/or hard copy of the Actuarial Opinion of the 0% pool companies.

*Adopted by the Actuarial Opinion (C) Working Group – Aug. 18, 2016.*

*Adopted by the Casualty Actuarial and Statistical (C) Task Force – Aug. 27, 2016.*

## 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.”<sup>102</sup>*

The Appointed Actuary should opine on the unearned premium reserves for long duration contracts if the amount of those reserves are 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.”<sup>103</sup>*

#### 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

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<sup>102</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>103</sup> 2017 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*”.<sup>104</sup>

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.”<sup>105</sup> 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.*”<sup>106</sup> 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.*”<sup>107</sup>

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<sup>104</sup> SSAP No. 65, paragraph 21 ([Appendix IV](#)).

<sup>105</sup> SSAP No. 65, paragraph 29 ([Appendix IV](#)).

<sup>106</sup> SSAP No. 65, paragraph 26 ([Appendix IV](#)).

<sup>107</sup> 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 section [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

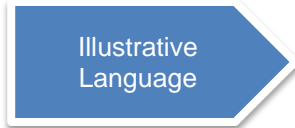
*The Company is part of an intercompany pooling agreement with other affiliates of [name of group]. Premiums and losses are allocated to the Company based on its assigned percentage of the total pool. Analysis of the reserve items identified in Exhibit A has been performed for all pool companies combined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



*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 have been 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 is reproduced 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 2017 Statement of Actuarial Opinion Instructions.

September 2010

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

Prepared by the  
Casualty Actuarial & Statistical Task Force

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

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

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

#### 1.A. Definitions

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

#### 4. SCOPE Paragraph

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

The SCOPE paragraph should indicate the accounting basis on which the entity is providing its financial information, the valuation date of data used in support of the opinion, and



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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.

# Property and Casualty Practice Note

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## Exhibits

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

### Exhibit A: SCOPE

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

Property and Casualty Practice Note

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Exhibit B: DISCLOSURES

1. Name of the Appointed Actuary Last \_\_\_\_\_ First \_\_\_\_\_ Mid \_\_\_\_\_
2. The Appointed Actuary's Relationship to the entity  
Enter E or C based upon the following:  
E if an Employee  
C if a Consultant \_\_\_\_\_
3. The Appointed Actuary is a Qualified Actuary based upon what qualification?  
Enter F, A, M, or O based upon the following:  
F if a Fellow of the Casualty Actuarial Society (FCAS)  
A if an Associate of the Casualty Actuarial Society (ACAS)  
M if not a member of the Casualty Actuarial Society, but a Member of the American Academy of Actuaries (MAAA) approved by the Casualty Practice Council, as documented with the attached approval letter.  
O for Other \_\_\_\_\_
4. Type of Opinion, as identified in the OPINION paragraph.  
Enter R, I, E, Q, or N based upon the following:  
R if Reasonable  
I if Inadequate or Deficient Provision  
E if Excessive or Redundant Provision  
Q if Qualified. Use Q when part of the OPINION is Qualified.  
N if No Opinion \_\_\_\_\_
5. Materiality Standard expressed in US dollars (Used to Answer Question #6)  
\$ \_\_\_\_\_
6. Is there a Significant Risk of Material Adverse Deviation? Yes [ ] No [ ] Not Applicable [ ]
7. Statutory Surplus \$ \_\_\_\_\_
8. Anticipated net salvage and subrogation included as a reduction to loss reserves  
\$ \_\_\_\_\_
9. Discount included as a reduction to loss reserves and loss expense reserves
- 9.1 Nontabular Discount \$ \_\_\_\_\_
- 9.2 Tabular Discount \$ \_\_\_\_\_
10. The net reserves for losses and expenses for the company's share of voluntary and involuntary underwriting pools' and associations' unpaid losses and expenses \$ XXX
11. The net reserves for losses and loss adjustment expenses that the company carries for the following liabilities\*
- 11.1 Asbestos, as disclosed in the Notes to Financial Statements \$ XXX
- 11.2 Environmental, as disclosed in the Notes to Financial Statements \$ XXX
12. The total claims made extended loss and expense reserve
- 12.1 Amount reported as loss reserves \$ XXX
- 12.2 Amount reported as unearned premium reserves \$ XXX
13. Other items on which the Appointed Actuary is providing Relevant Comment (list separately) \$ \_\_\_\_\_

\* The reserves disclosed in item 11 above, should exclude amounts relating to contracts specifically written to cover asbestos and environmental exposures. Contracts specifically

## Property and Casualty Practice Note

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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

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## III.4 Retroactive and financial reinsurance

This section provides additional detail on the topics of retroactive and financial reinsurance, beyond that discussed in sections [5.8](#) and [5.9](#) of the practice note.

According to the NAIC SAO Instructions,

*“RELEVANT COMMENT paragraphs should address reinsurance collectability, retroactive reinsurance and financial reinsurance.”<sup>108</sup>*

The reference to retroactive reinsurance relates to contracts subject to retroactive reinsurance accounting, not to retroactive reinsurance contracts subject to prospective reinsurance accounting.

### 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.”<sup>109</sup>*

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 31 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.”<sup>110</sup>*

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<sup>108</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>109</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

<sup>110</sup> 2017 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).

# Property and Casualty Practice Note

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## **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 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.

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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....”<sup>111</sup> These include cancellation provisions, loss-sensitive features and investment income potential, not just undiscounted losses that may result from that contract.

## III.5 Pre-paid 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 2016 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.”<sup>112</sup>*

**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.**

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

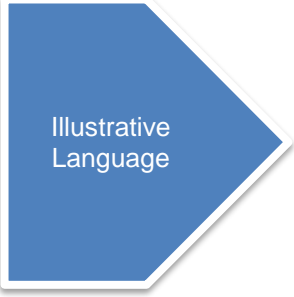
Comments on pre-paid loss adjustment expenses should be included in the SAO, if this item is material. In addition, regulators will expect an appropriate discussion of this topic in the Actuarial Report.

<sup>111</sup> SSAP No. 62R, paragraph 12 ([Appendix IV](#)).

<sup>112</sup> 2016 AOWG Regulatory Guidance, page 3 ([Appendix II](#)).

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Illustrative  
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.*



# Property and Casualty Practice Note

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### **III.6 Guidance for Audit Committee Members of P/C Insurers**

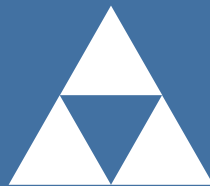
The following document was first published by COPLFR in 2007 and was updated in 2014 to assist practicing actuaries in communicating with a company's board of directors or audit committee concerning uncertainties in the process of estimating unpaid loss and loss adjustment expense claims liabilities. In response to regulatory concerns about the need for more frequent and direct communication between the Appointed Actuary and the company's board of directors, we reproduce the updated 2014 document here for the convenience of the reader. COPLFR hopes this document will serve as a reference for the Appointed Actuary when assembling materials for a presentation to a board or audit committee.

A PUBLIC POLICY OVERVIEW

# An Overview for P/C Insurers' Audit Committees: Effective Use of Actuarial Loss Reserves Expertise

*December 2014*

American Academy of Actuaries  
Committee on Property and Liability  
Financial Reporting



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# An Overview for P/C Insurers' Audit Committees: Effective Use of Actuarial Loss Reserves Expertise

*December 2014*

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



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The American Academy of Actuaries is an 18,000+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

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Revised from 2007 publication, *An Overview for Audit Committee Members of P/C Insurers: Effective Use of Actuarial Expertise*

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# A PUBLIC POLICY OVERVIEW

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## A PUBLIC POLICY OVERVIEW

*This document<sup>1</sup> 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 only estimates, not fixed known amounts. These estimates are based on the work of actuaries.

Loss reserve estimates are often subject to significant uncertainties. At times, property/casualty insurers have announced significant loss reserve increases for reasons that include but are not limited to: high growth in new business lines (where the company did not have preexisting experience), the impact of major court cases, unanticipated increases in loss trends (such as sustained higher trends in medical costs and utilization), asbestos litigation, and construction defect claims. For some companies, such loss reserve increases are large enough to impair their financial condition; for others, reported profitability is affected. Significant loss reserve decreases can also occur, e.g., due to declining auto claim frequency during a recession.

Property/casualty insurance companies’ boards of directors and audit committees have a fiduciary responsibility and regulators’ expectation for overseeing the financial reporting process. Since loss reserves are crucial to property/casualty insurers’ financial statements, audit committees and boards of directors are advised to have direct discussions 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 boards of directors and audit committee members’ appreciation for the uncertainty inherent in loss reserve estimates.

This document begins with a background on loss reserves and the roles of actuaries in setting them, followed by a discussion of oversight function considerations related to those reserves.

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<sup>1</sup> 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 reflect 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). 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.

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

### **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 expenses<sup>2</sup> (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) pursuant to policies sold, 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 far 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.

### **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 assist management in understanding underlying claim trends, the judgments and assumptions used in the analyses, and 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.

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<sup>2</sup> 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](http://www.actuarialstandardsboard.org/pdf/asops/asop043_159.pdf).

## A PUBLIC POLICY OVERVIEW

- *Audit Firms* – Often, insurance companies’ external audit firms will assign actuaries to their engagement teams. The audit firms’ actuaries evaluate the reasonableness of the recorded amounts. To assist them in this evaluation, they may develop an alternative point estimate and/or “range of reasonable estimates”<sup>3</sup> of the loss reserves. This range is usually much narrower than a range of possible outcomes, and it is intended to provide an independent view of whether the recorded loss reserve amounts are reasonable in light of the available information.
- *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 also 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. This opinion is based on specifications described by the National Association of Insurance Commissioners (NAIC), and is contained in a formal, public document called the *Statement of Actuarial Opinion* (SAO).<sup>4</sup> The SAO is an important tool used by insurance regulators to assess insurer solvency. In addition to the actuarial opinion on the reasonableness of the recorded loss reserves, the SAO contains informative disclosures regarding the factors affecting the variability of the loss reserves and the appointed actuary’s view as to whether there is a risk of “material adverse deviation”<sup>5</sup> from the recorded estimate.

### ***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 private) disclosure
- Loss reserve variability and uncertainty
- Data quality and the impact on loss reserve uncertainty
- Context of the reserves
- Ceded reinsurance
- Governance (control) structure underlying loss reserves

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<sup>3</sup> 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,” available at [http://www.actuary.org/files/range\\_sept08.4.pdf/range\\_sept08.4.pdf](http://www.actuary.org/files/range_sept08.4.pdf/range_sept08.4.pdf).

<sup>4</sup> In the United States, the SAO is prepared at the legal entity level, i.e., for each individual insurance company within a group rather than for the consolidated group of companies. (See the NAIC’s Regulatory Guidance for Annual Statement Instructions for Property/Casualty Actuarial Opinions, available at [http://www.naic.org/committees\\_c\\_catf.htm](http://www.naic.org/committees_c_catf.htm))

<sup>5</sup> The SAO instructions require the appointed actuary to disclose their materiality standard”



# A PUBLIC POLICY OVERVIEW

## **Unavoidable Use of Judgment – Input from Multiple Disciplines**

As mentioned above, loss reserves are only 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, (possibly) 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.”<sup>6</sup> 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 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:

- 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?
- 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)?
- If such changes exist, 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?

## **Extensive Public (and Private) Disclosure**

The loss reserves recorded by a U.S. property/casualty insurer are subject to extensive public and private disclosure, allowing many parties to view and potentially form their own view of the insurer’s estimates.

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<sup>6</sup> 2014 NAIC Accounting Practices & Procedures Manual – Statement of Statutory Accounting Practices (SSAP) No. 55, paragraph 10.

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The Securities and Exchange Commission (SEC) requires each publicly-traded U.S. property/casualty insurance company to include a loss reserve development table as part of its annual Form 10-K filing. This table provides a comparison of the company's consolidated loss reserves (claim liabilities) recorded at each of the past 10 year-ends to updated estimates, including the most recent estimate, of those same liabilities. Additional (largely) qualitative disclosures are also required 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, a summary of similar loss development information is provided in Schedule P, Part 2 – Summary (Schedule P) of the NAIC Statutory Annual Statement, which is filed by each individual insurance company for regulatory purposes. Schedule P shows the annual development of ultimate losses and *Defense and Cost Containment loss adjustment expense* (DCC LAE) for each of the past 10 coverage years (often referred to as “accident years”).

Both the SEC disclosures and the NAIC Schedule P filings provide 10 years of history showing the accuracy of management's loss reserve decisions over time. These schedules are used by analysts and other users<sup>7</sup> 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 to 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.

Besides the public SAO mentioned above, in which the appointed actuary is required by state law or regulation<sup>8</sup>, to opine on the reasonableness of recorded loss reserves, the appointed actuary is also required to provide a private disclosure (the Actuarial Opinion Summary, or AOS) to insurance regulators every year. The private report discloses the actuary's estimate or range of estimates relative to management's recorded loss reserve estimates, and, where applicable, the causes of recent significant adverse reserve development. The appointed actuary documents the analysis underlying the SAO and AOS in the detailed Actuarial Report<sup>9</sup>, which is made available to the insurance regulator upon request. The board or audit committee may wish to receive its own copy every year of the SAO and AOS (a relatively short document).

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<sup>7</sup> 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.”

<sup>8</sup> 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.

<sup>9</sup> The Actuarial Report is required and defined by the SAO instructions, and its purpose is to document the SAO findings.

# A PUBLIC POLICY OVERVIEW

## **Loss Reserve Variability and Uncertainty**

The management of a U.S. P/C insurer is required to include an analysis of variability and uncertainty in the loss reserve estimation process.<sup>10</sup> Actuaries are uniquely qualified to 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 in a given situation and may consider multiple reasonable assumptions regarding future conditions when applying the methods. The actuary may develop a “range of reasonable estimates”<sup>11</sup> 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 a broad range of 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 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 a significant risk to the company and that would 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 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 or the rapid unexpected inflation that led to mispricing and initial under-reserving in workers’ compensation in the late 1990s. Systemic changes can be positive as well: medical professional liability lines, in addition to experiencing rapid 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 or, for smaller companies, even 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 and low ends of the actuary’s range of reasonable estimates is material.

Members of audit committees and boards of directors should seek to understand the significant risks that threaten 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 should 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.

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<sup>10</sup> 2014 NAIC Accounting Practices & Procedures Manual, SSAP No. 55, paragraph 12: “Management ... shall include an analysis of the amount of variability in the estimate”.

<sup>11</sup> As pointed out in footnote 3, this term is also discussed in [http://www.actuary.org/files/range\\_sept08.4.pdf/range\\_sept08.4.pdf](http://www.actuary.org/files/range_sept08.4.pdf/range_sept08.4.pdf).

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## **Data Quality and the Impact on Loss Reserve Uncertainty**

The actuarial analysis process is highly 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 integrated.

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 or may hamper the efficiency of certain levels of detailed review. Limitations posed by less than perfect data may introduce new uncertainties to the estimation process.

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, the actuary is required to review the data for reasonableness and consistency<sup>12</sup>.

The actuary will have a view related to the degree of uncertainty that any data issues add to the process. The audit committee should consider making inquiries if this is a concern for a particular company.

## **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 them ask more probing questions of management and the appointed actuary regarding the recorded loss reserve and associated risks.

Information they may want to obtain from senior management and/or the appointed actuary could include:

- The breakdown of the company's loss reserves by coverage or product line.
- Recent industry trends in those product lines (with regard to profitability, underwriting, claims, and reserving issues).
- Whether there have been any recent changes in the company's experience in those lines vis-à-vis profitability, claim handling, or reserve development.
- Major risk factors in the reserving for those lines.
- Whether competitors are experiencing the same risk factors, recent changes, etc., that the company has seen.
- The causes of recent changes in reserve estimates (favorable or unfavorable).
- Whether competitors have cited similar causes.
- Questions about the reserves raised by major outside stakeholders, including regulators, rating agencies, and, where relevant, investors or investment analysts.

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<sup>12</sup> This is a requirement of both Actuarial Standard of Practice No. 23 – Data Quality, as well as the SAO instructions.

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The feedback received should be consistent with (or at least not contradictory to) information available from publicly 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 Statement of Actuarial Opinion requires the opining 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 concentrations by reinsurer
- Financial strength ratings of current reinsurers
- 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 strong 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 might want to be familiar with the extent to which these controls exist or 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 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

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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 should 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 actuary to obtain the actuary's view of the reserve committee's effectiveness and may also find value in obtaining certain summary information from the reserve committee meetings on a regular basis.

- *Internal audit.* Larger insurance companies typically 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 to provide an additional set of eyes on professional work product.
- *Report from the Appointed Actuary.* Each statutory insurer's appointed actuary is legally required to report to the board or audit committee each year on the items within the scope of the actuary's loss reserve opinion. Many of these are in-person, allowing for immediate response to questions the board/audit committee may have.

### 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 exam by the state at least once every three to five years. A review of previously-recorded loss reserves is a key part of this exam, with that review performed by either insurance departments or external actuarial consultants working on behalf of the insurance departments. As part of these exams, the state's examiners inquire about the oversight of the board and audit committees into the loss reserving process, indicating that the expectations of the regulators includes a strong awareness and involvement in oversight of the loss reserves.

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- *Replacement of Appointed Actuary.* Whenever an appointed actuary is replaced, the NAIC requires both the company and the outgoing appointed actuary to provide letters to the domiciliary state regulator discussing any disagreements over loss and LAE reserves during the last 24 months. These disagreement letters are not public information, but audit committees benefit from review of these letters whenever an appointed actuary is replaced.

### Executive Session with Actuaries

Members of boards of directors or audit committees should consider meeting in executive session with the appointed actuary and potentially other actuaries significantly involved during the reporting process. Including the audit firm actuary in the audit committee's executive session with the audit firm is also beneficial. Such executive sessions are particularly of value where management may have exercised 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 factor in a number of past insolvencies. Possible signs of undue management influence that could be identified during executive session include (in increasing order of severity):

- The actuary is not provided with comprehensive information on emerging problem areas (e.g., newer coverages with adverse experience).
- Information is provided late to the actuary, leaving inadequate time for analysis.
- The actuary is denied access to certain individuals at the company.
- Management makes clear to the actuary that his/her continued employment is contingent upon agreement with management's reserve estimates.
- The opening actuary is replaced, and the new actuary immediately agrees with management's position.

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Loss reserves are a major part of an insurer's reported balance sheet, subject to public (and private) disclosure and review, and, by their nature, require the use of judgment. As such, 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 issue brief attempts to aid in audit committees' and boards of directors' understanding of the issues and resources related to this important oversight function.