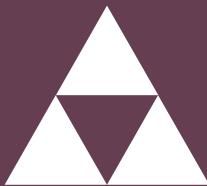


A PUBLIC POLICY PRACTICE NOTE

Statements of Actuarial Opinion on Property and Casualty Loss Reserves

2014

American Academy of Actuaries
Committee on Property and Liability Financial Reporting



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



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COPLFR wishes to express its appreciation for the contributions of Dale F. Ogden, who served as COPLFR Chairperson from 2012-14 and passed away in October after many years of service to the Academy and the actuarial profession.



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Property and Casualty Practice Note
2014

TABLE OF CONTENTS

Introduction	1
1. APPOINTMENT OF QUALIFIED ACTUARY	5
1A. Definitions	7
1B. Exemptions	7
1C. Reporting Requirements for Pooled Companies.....	8
2. CONTENT.....	10
3. IDENTIFICATION PARAGRAPH	10
4. SCOPE PARAGRAPH, EXHIBITS A AND B, AND RELIANCES	11
5. OPINION PARAGRAPH	12
6. RELEVANT COMMENT PARAGRAPHS	17
7. ACTUARIAL REPORT AND UNDERLYING WORK PAPERS.....	31
8. SIGNATURE OF ACTUARY	35
9. ERRORS IN STATEMENT OF OPINION.....	35
10. DATA IN EXHIBITS A & B IN BOTH PRINT AND DATA CAPTURE FORMAT	36
 Exhibit A: SCOPE	37
Exhibit B: DISCLOSURES.....	39
Actuarial Opinion Summary	42
 Appendices	
Appendix 1a: 2014 Statement of Actuarial Opinion Instructions (P/C).....	49
Appendix 1b: 2014 Actuarial Opinion Summary Supplement	59
Appendix 1c: 2014 Title Insurance Company Annual Statement Instructions	60
Appendix 2a: 2014 Regulatory Guidance - P/C Statutory Statements of Actuarial Opinion.....	69
Appendix 2b: 2014 Regulatory Guidance - P/C Actuarial Opinion Summary	77
Appendix 3: Frequently Asked Questions Regarding the Practice Note.....	79
Appendix 4: Miscellaneous Illustrative Wordings in Common Use	84
Appendix 5: Evaluation and Reconciliation of Data.....	87
Appendix 6: Data Testing Requirements	91

Property and Casualty Practice Note 2014

Appendix 7: Unearned Premium for Long Duration Contracts.....	101
Appendix 8: Intercompany Pooling.....	104
Appendix 9: NAIC Guidance for Actuarial Opinions for Pools and Associations.....	107
Appendix 10: Materiality Considerations (provided by CAS VFIC)	112
Appendix 11: Guidance for Audit Committee Members of P/C Insurers	122

Property and Casualty Practice Note

2014

Introduction

This practice note¹ was prepared by the Committee on Property and Liability Financial Reporting (COPLFR) of the American Academy of Actuaries (Academy). The purpose of this practice note is to provide information to actuaries on current or emerging practices in which their peers are engaged. It is intended to supplement the available actuarial literature, especially where the practices addressed are subject to evolving technology, recently adopted external requirements, or advances in actuarial science or other applicable disciplines (e.g., economics, statistics, or enterprise risk management). It is not intended to be an interpretation of the actuarial standards of practice, nor is it meant to be a codification of generally accepted or appropriate actuarial practice. Actuaries are not in any way bound to comply with this practice note or to conform their work to the practices described herein.

This practice note is intended to assist actuaries by describing practices that COPLFR believes will be commonly employed in issuing statements of actuarial opinion on loss and loss expense reserves in compliance with the Property and Casualty Annual Statement Instructions (the Instructions) for 2014 issued by the National Association of Insurance Commissioners (NAIC). Actuaries may also find this information useful in preparing statements of actuarial opinion for other audiences or regulators. However, approaches other than the ones described within this practice note may also be in common use. The information contained herein is not binding on any actuary and is not a definitive statement of what constitutes generally accepted or appropriate practice in this area. All boldface text preceding each discussion section is from NAIC materials and is reproduced with its permission. Further replication or distribution of NAIC materials without the written consent of the NAIC is strictly prohibited.

COPLFR appreciates the comments it has received since the issuance of the 2013 practice note and has incorporated a number of suggestions in this update. COPLFR also welcomes any suggested improvements for future updates of this practice note. Suggestions may be sent to the 2014 chairperson of COPLFR through the Academy's casualty policy analyst at casualty@actuary.org.

Resources

The [Code of Professional Conduct](#) (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.” Actuaries are encouraged to carefully read and consider the resources listed in the following paragraphs, in addition to the relevant NAIC instructions.

[ASOP No. 36](#)

Actuaries are reminded that [Actuarial Standard of Practice \(ASOP\) No. 36, Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves](#), applies to the material covered by this practice note. That standard is binding on all actuaries opining on P&C loss reserves. A revision of [ASOP No. 36](#) was adopted by the Actuarial Standards Board (ASB) in December 2010 and applies to all Statements of Actuarial Opinion issued on or after May 1, 2011. COPLFR encourages the actuary to be familiar with [ASOP No. 36](#), including the disclosure requirements of Sections 4.1 and 4.2, which include, but are not limited to, disclosing the following:

- The intended users of the Statement of Actuarial Opinion

¹ Substantive changes from the 2013 note are indicated by highlighting of the changed text.

Property and Casualty Practice Note 2014

- The intended purpose of the Statement of Actuarial Opinion
- The stated basis of reserve presentation
- Whether any material assumption or method was prescribed by law
- Whether the actuary disclaims responsibility for any material assumption or method that originated from another source

We note that [Appendix 10](#) of this practice note (CAS VFIC Note on Materiality and [ASOP No. 36: Considerations for the Practicing Actuary](#)) was prepared by the CAS Valuation, Finance and Investments Committee in 2000 and, therefore, does not reflect the May 1, 2011, revisions to the ASOP. The reader should focus on the intent of [Appendix 10](#)—the assessment of materiality in the context of statements of actuarial opinion—and be guided by the current version of [ASOP No. 36](#) as well as [ASOP No. 1: Introductory Actuarial Standard of Practice](#), effective for all actuarial services performed on or after June 1, 2013.

[ASOP No. 43](#)

In addition, [ASOP No. 43, Property/Casualty Unpaid Claim Estimates](#), which became effective September 1, 2007, and was updated effective May 1, 2011, contains binding guidance on many important aspects of the loss reserve estimation process. Defining the intended measure of the actuary's estimate, and actuarial considerations when relying on management's representations, are just a few items addressed in [ASOP No. 43](#). Actuaries are encouraged to carefully review and understand the requirements of [ASOP No. 43](#) and document their work product to a degree that supports compliance with this ASOP.

Other relevant ASOPs

Actuaries will also find guidance in [ASOP No. 23, Data Quality](#) and [ASOP No. 41, Actuarial Communications](#). A revision of [ASOP No. 41](#) was adopted by the ASB and became effective May 1, 2011. Additionally, [ASOP No. 9, Documentation and Disclosure in Property and Casualty Insurance Ratemaking, Loss Reserving, and Valuations](#) was repealed effective May 1, 2011. [ASOP No. 41](#) provides guidance concerning documentation and disclosures in actuarial communications.

[Qualification Standards](#)

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

Specific state requirements

Individual states may have requirements that modify or supplement the NAIC Annual Statement Instructions. NAIC codification became effective in 2001; individual states may not, however, have adopted all provisions of the Instructions as made effective by the NAIC in 2001. The actuary is

Property and Casualty Practice Note

2014

encouraged to refer to the Academy's most recent *Property/Casualty Loss Reserve Law Manual* for guidance on these points.

Other references

The Casualty Actuarial and Statistical Task Force (CASTF) of the NAIC has provided updated Regulatory Guidance for 2014 Statements of Actuarial Opinion (SAO) and Actuarial Opinion Summary (AOS) Supplement. This Regulatory Guidance supplements the NAIC Annual Statement Instructions – Property/Casualty (Instructions) in an effort to provide timely regulatory guidance and clarity to companies and Appointed Actuaries regarding regulatory expectations with respect to the Actuarial Opinion and Opinion Summary. The Regulatory Guidance is not binding. References to the Regulatory Guidance are included throughout this practice note, and the actuary is encouraged to be familiar with this document, which can be found in [Appendix 2a](#).

Organization

In the following pages, the NAIC Annual Statement Instructions related to the SAO are presented first in bold print, section by section.

Next, where COPLFR considered it appropriate, a description of possible practice related to the particular section of the Instructions follows.

Finally, illustrative wording is presented in italics if applicable. The illustrative wording was prepared to cover a variety of common situations but does not cover all possible circumstances; actuaries choosing to consider similar language should carefully adapt it as necessary or appropriate. The actuary should not use the illustrative wording provided herein as a substitute for language that is more appropriate in a given situation. In fact, the actuary may choose not to use the illustrative language at all. The individual actuary is responsible for ensuring that the language used in the SAO accurately represents the actuary's view or understanding of each specific situation.

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

Changes from the 2013 Practice Note

Substantive changes from the 2013 practice note are indicated by highlighting of the changed text.

1. The 2014 NAIC Statement of Actuarial Opinion (SAO) Instructions and the Actuarial Opinion Summary (AOS) Supplement have changed since 2013. The noteworthy changes in the Instructions are discussed throughout this practice note and include:

- a) Replacement of "category of opinion" with "type of opinion" and the addition of the word "substantive" before "wording of the opinion" in the list of types of disagreements that the insurer is required to report to its domiciliary commissioner when there is a change in Appointed Actuary.

Further, when such disagreements exist, the Instructions state that the letter from the

Property and Casualty Practice Note 2014

insurer to the commissioner should include a description of the disagreement and the nature of its resolution (or the fact that it was not resolved).

- b) Expansion of the disclosure and reporting requirements of intercompany pooling to apply to all companies operating under such arrangements, as opposed to only those in which there is a one hundred percent (100%) lead company with zero percent (0%) members.
- c) Inclusion of the word “adjustment” in Item C of the OPINION paragraph in the Instructions: *“Make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements.”*
“Loss Adjustment Expense” was also added to the headings for items 1 through 6 of Exhibit A (Scope) of the Instructions.
- d) Inclusion of “*Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion*” to Item D of the OPINION paragraph of the Instructions.
- e) Clarification that disclosure is required if the actuary has made use of another’s analysis or opinion for a *material* portion of the reserves.
- f) Movement of the actuary’s discussion on risk factors in the RELEVANT COMMENT(S) paragraphs to precede the actuary’s conclusion as to whether or not significant risks could result in material adverse deviation.

2. The CASTF updated its Regulatory Guidance for 2014 Statements of Actuarial Opinion ([Appendix 2a](#)).

Electronic Filing

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

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

Statements of Actuarial Opinion on P&C Loss Reserves as of Dec. 31, 2014

APPOINTMENT OF QUALIFIED ACTUARY

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

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

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

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

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

The Appointed Actuary must report to the Board of Directors or the Audit Committee each year on the items within the scope of the Actuarial Opinion. The Actuarial Opinion and the Actuarial Report must be made available to the Board of Directors. The minutes of the Board of Directors should indicate that the Appointed Actuary has presented such information to the

Property and Casualty Practice Note
2014

Board of Directors or the Audit Committee and that the Actuarial Opinion and Actuarial Report were made available. A separate Actuarial Opinion is required for each company filing an Annual Statement. When there is an affiliated company pooling arrangement, one Actuarial Report for the aggregate pool is sufficient, but there must be addendums to the Actuarial Report to cover non-pooled reserves for individual companies.

The Statement of Actuarial Opinion and the supporting Actuarial Report and workpapers, should be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including but not limited to ASOPs [23](#), [36](#), [41](#), and [43](#), as promulgated by the Actuarial Standards Board, and Statements of Principles adopted by the Casualty Actuarial Society.

DISCUSSION – THE APPOINTED ACTUARY:

The Instructions require the appointed actuary to be a Qualified Actuary as defined in Section 1.A. of the Instructions. Therefore, the appointed actuary must be an individual, not a firm.

The actuary may be appointed for one or more subsequent year-ends at the same time. If one actuary is appointed in November 2013 for the December 2013 opinion, without mention of subsequent year-ends, and a different actuary is appointed in November 2014 for the December 2014 opinion, notification to the commissioner is required by the Instructions.

The 2012 Instructions expanded the types of disagreements that an insurer is required to report to the insurance department when there is a change in Appointed Actuary, and the 2014 Instructions clarified this. First, the reference to disagreements regarding the “category of opinion issued” was modified to refer to “type of opinion issued,” to make the language consistent with that of [ASOP No. 36](#). In addition, reference to disagreements over the “wording of the opinion” was modified to be limited to disagreements over the “substantive wording of the opinion.” Finally, in situations where there is disagreement between the insurer and Appointed Actuary, the 2014 Instructions require a description of the disagreement and the nature of its resolution (or the fact that it was not resolved) in the insurer’s letter to the domiciliary commissioner.

The report to the board of directors may be an oral report, the full Actuarial Report defined in Section 1A. of the Instructions, or a summary of the Actuarial Report (e.g., an executive summary). According to the Instructions, in the event that an oral report or executive summary report is presented to the board, the full Actuarial Report must still be made available to the board upon request. The report must cover the items in the scope of the SAO, and it is generally appropriate for it to include discussion of each item in the SCOPE, OPINION, and RELEVANT COMMENT sections of the SAO (Sections 4 through 6, and Exhibits A and B of the Instructions) and to convey clearly the findings given in the SAO. The report usually provides more discussion than the SAO itself. An oral report may be desirable (although it is not required) to give the board an opportunity to ask questions of the appointed actuary and to help improve the board’s understanding of the reserves and their importance. Section 1A. states that the “Appointed Actuary should present the findings to the Board of Directors in a manner deemed suitable for such audience.”

[Appendix 2a](#) of this practice note includes the regulators’ discussion of this presentation.

Property and Casualty Practice Note
2014

1A. Definitions

“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.

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

“Actuarial Report” means a document or other presentation, prepared as a formal means of conveying 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 that documents the analysis underlying the opinion. The required content of the 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 thirteen months and (2) the insurer can neither cancel nor increase the premium during the contract term.

DISCUSSION – ACTUARIAL REPORT:

The above definition of “Actuarial Report” is more detailed than the definition contained in [ASOP No. 41, Actuarial Communications](#). The NAIC requirements for the Actuarial Report are further described in Section 7 of the Instructions.

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.

Property and Casualty Practice Note
2014

Exemption for Small Companies

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

Exemption for Insurers under Supervision or Conservatorship

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

Exemption for Nature of Business

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

Financial Hardship Exemption

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

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

1C. Reporting Requirements for Pooled Companies

The following paragraphs apply to companies that are members of an intercompany pooling arrangement.

For each company in the pool, the actuary shall include a description of the pool, identification of the lead company and a listing of all companies in the pool, 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 each company.

Property and Casualty Practice Note

2014

The following paragraph applies to companies that have a 0% share of the pool (no reported Schedule P data). The company shall submit an 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 response to question 5 should be \$0 and the response 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).

DISCUSSION – INTERCOMPANY POOLING ARRANGEMENTS

In both the Opinion paragraph and the Actuarial Report, the appropriate treatment of intercompany pooling arrangements may cause confusion. In addition to the discussion below, pooling is discussed in [Appendix 8](#) as well as the CASTF Regulatory Guidance attached as [Appendix 2a](#). The reader is referred in particular to the CASTF Regulatory Guidance related to pooling arrangements in the Opinion paragraph (Section 1C) and the Report (Section 7).

Section 1C was expanded in 2014 to apply to all companies that operate in an intercompany pooling agreement. Companies participating in intercompany pooling arrangements, regardless of their participation percentage, are required to include a description of the pool, identification of the lead company, and a listing of all companies in the pool, 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, reflecting their share. Companies having a zero percent (0%) 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.

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.

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

1. *An intercompany pooling agreement applies, the lead company retains 100 percent of the pooled business, and the other pool participants each retain 0 percent.* Schedule P for the lead company will contain the total gross and net reserves for the pool. The gross and net reserves in Schedule P for the other companies will be zero. Paragraph 1C of the Statement of Actuarial Opinion Instructions and paragraph 6 of the Actuarial Opinion Summary (AOS) Instructions apply.
2. *An intercompany pooling agreement applies, more than one pool participant retains a share of the pooled business, and other pool participants each retain 0 percent.* Schedule P, for each company that retains a non-zero share of the pooled business, will show its share of the gross and

Property and Casualty Practice Note

2014

net reserves. The gross and net reserves in Schedule P for the other companies will be zero. Paragraph 1C of the Statement of Actuarial Opinion Instructions and paragraph 6 of the 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 SAO Instructions and paragraph 6 of the AOS Instructions do not apply.

If questions exist as to whether Section 1C applies, refer to the Financial Statement Note entitled, “Intercompany Pooling Arrangements,” read the contract itself, and/or contact your state regulator. The actuary may refer to [Appendix 8](#) of this practice note for more information.

CONTENT

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.**

IDENTIFICATION PARAGRAPH

3. **The IDENTIFICATION paragraph should specifically indicate the Appointed Actuary’s relationship to the company, qualifications for acting as appointed actuary, date of appointment, and specify that the appointment was made by the Board of Directors, or its equivalent, or by a committee of the Board.**

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

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

DISCUSSION – QUALIFIED ACTUARY:

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

Property and Casualty Practice Note 2014

Changes were made to the *CAS Syllabus of Basic Education* in 2011, such that the examination requirements for Associateship may not cover all of the basic education requirements required by the Instructions to issue a Statement of Actuarial Opinion. See “Requirements for ACAs to Issue NAIC PC Opinions Clarified for the 2011 CAS Syllabus,” by Mary Frances Miller and David Menning, at <http://www.casact.org/newsletter/index.cfm?fa=viewart&id=5789>, which was published in the August 2009 *Actuarial Review*.

SCOPE PARAGRAPH, EXHIBITS A AND B, AND RELIANCES

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

“I have examined the actuarial assumptions and methods used in determining reserves listed in Exhibit A, as shown in the Annual Statement of the Company as prepared for filing with state regulatory officials, as of December 31, 20__, and reviewed information provided to me through XXX date.”

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

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

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

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

DISCUSSION – DATA:

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

Detailed descriptions of possible practice concerning the evaluation and reconciliation of data are provided in [Appendix 5](#). Further information regarding data testing requirements and the interaction between the actuary and the company’s external auditor is provided in [Appendix 6](#).

[ASOP No. 36](#) was revised effective May 1, 2011, and one of the resulting requirements for Statements of Actuarial Opinion is to explicitly identify the review date, if it differs from the date the opinion is signed. 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.

Property and Casualty Practice Note 2014

The 2014 CASTF Regulatory Guidance, which can be found in [Appendix 2a](#), notes that when the actuary is silent regarding the review date, this can indicate either a review date that is the same as the date the opinion is signed or that the actuary overlooked this disclosure requirement. In instances in which the actuary's review date is the same date that the opinion is signed, regulators suggest actuaries clarify that in the opinion. Such language may include, "...and reviewed information provided to me through the date of this opinion."

DISCUSSION – METHODOLOGY:

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

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

ILLUSTRATIVE WORDING – METHODOLOGY:

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

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

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

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

If there is some segment of the associated reserve amounts for which the actuary is not giving an opinion, such qualification may be stated here. This would be a qualified opinion in accordance with [ASOP No. 36](#), which requires the actuary to indicate the segment of business and the associated reserve amounts. The actuary is referred to [Appendix 3](#) for a detailed discussion of what constitutes a qualified opinion.

OPINION PARAGRAPH

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).

Property and Casualty Practice Note
2014

- 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 Opinion should cover the following illustration:

- 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 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-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

Property and Casualty Practice Note

2014

issue a qualified Statement of Actuarial Opinion. The 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 actuary is not required to issue a qualified opinion if the actuary reasonably believes that the item or items in question are not likely to be material.

- e. **No Opinion.** The actuary's ability to give an opinion is dependent upon data, analyses, assumptions, and related information that are sufficient to support a conclusion. If the actuary cannot reach a conclusion due to deficiencies or limitations in the data, analyses, assumptions, or related information, then the actuary may issue a statement of no opinion. A statement of no opinion should include a description of the reasons why no opinion could be given.

DISCUSSION – THE OPINION:

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

[ASOP No. 36](#), Section 3.7, states that 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 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.

[ASOP No. 36](#) contains specific disclosure requirements for deficient or inadequate opinions, redundant or excessive opinions, qualified opinions, and situations in which no opinion can be formed. [Appendix 3](#) contains further relevant information.

If the actuary reaches different conclusions regarding the SCOPE items, e.g., the determination of a reasonable provision for net reserves versus a determination of a redundant provision for gross reserves (direct plus assumed reserves), then the opinion would usually include language that explicitly conveys the intended category of opinion for each of the SCOPE items.

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

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

Property and Casualty Practice Note 2014

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

If the SCOPE includes material unearned premium reserves for extended losses and expenses, as a write-in item in the Exhibit A SCOPE, line 9, or Other Loss 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 extended losses and expenses of the company and/or <insert other loss reserve item(s) on which the Appointed Actuary is expressing an Opinion> under the terms of its contracts and agreements.”

The opinion statement in 5(D), as noted in the Instructions or as suggested above, is usually appropriate when the actuary is opining on unearned premium reserves for extended losses and expenses or Other Loss Reserve items, as separately identified in Exhibit A: SCOPE.

For further information on the appropriate treatment of Unearned Premium for Long Duration Contracts and Other Premium Reserves, please refer to [Appendix 7](#) as well as the 2013 CASTF Regulatory Guidance, included in [Appendix 2a](#). Other Loss Reserve items may include a specific loss reserve item for which an Opinion is required by state regulation, or the accrual for Death, Disability, or Retirement (DDR) provisions if recorded as a loss reserve.

Section 5(A) requires an opinion that the reserves meet the requirements of the insurance laws of the state of domicile. In most jurisdictions, these laws may be interpreted to include statutory accounting requirements. Thus, to comply with insurance law, reserves ordinarily represent management’s best estimate.

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

Section 5 of the Instructions also requires that, if an actuary has made use of the work of another actuary for a material portion of the reserves, he or she must provide that other actuary’s name and affiliation in the opinion. [ASOP No. 36](#) takes this disclosure requirement several steps further. [ASOP No. 36](#) states that the actuary should make use of another’s² supporting analyses or opinions only when it is reasonable to do so. According to section 3.7.2, in determining whether it is reasonable to make use of the work of another, the appointed actuary should consider the following:

² The NAIC Instructions refer to making use of “another actuary.” However, ASOP No. 36 does not specify that “another” is “another actuary.” According to page 5 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.”

Property and Casualty Practice Note

2014

- 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, after these considerations, the actuary determines that it is reasonable to make use of the work of another without performing any independent analysis, and the actuary makes use of 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.

DISCUSSION – DEFICIENT OR REDUNDANT PROVISION:

Note that [ASOP No. 36](#), sections 4.2.b and 4.2.c require disclosure of the amount by which the inadequate reserve differs from the minimum amount the actuary believes is reasonable, or that redundant reserves exceed the maximum amount the actuary believes is reasonable. Effective year-end 2014, NAIC instructions were revised to be made consistent with this requirement, as highlighted above.

ILLUSTRATIVE WORDING – DEFICIENT OR REDUNDANT PROVISION:

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

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

DISCUSSION – QUALIFIED OPINION:

Note that [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 amount, if disclosed by the reporting entity. The 2014 NAIC Instructions were revised to include this requirement.

Further, [ASOP No. 36](#) states that, if the amounts for such items are not disclosed by the entity, the actuary should disclose that the reserve includes unknown amounts for such items.

The actuary should also disclose whether the reserve amount makes a reasonable provision for the liabilities associated with the specified reserves, except for the item or items to which the qualification(s) relate(s). The qualified opinion must be properly disclosed in Exhibit B.4.

Property and Casualty Practice Note
2014

ILLUSTRATIVE WORDING – QUALIFIED OPINION:

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

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 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.

RELEVANT COMMENT PARAGRAPHS

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

- a. Risk of Material Adverse Deviation.

The Appointed Actuary must provide specific RELEVANT COMMENT paragraphs to address the risk of material adverse deviation. The actuary must identify the materiality standard and the basis for establishing this standard. The materiality standard must also be disclosed in \$US in Exhibit B: Disclosures. The 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 actuary required to include an exhaustive list of all potential sources of risks and uncertainties. The actuary should explicitly state whether or not he or she reasonably believes that there are significant risks and uncertainties that could result in material adverse deviation. This determination is also disclosed in Exhibit B.

- b. Other Disclosures in Exhibit B

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

Property and Casualty Practice Note
2014

c. **Reinsurance**

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

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

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

d. **IRIS Ratios**

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

e. **Methods and Assumptions**

If there has been any significant change in the actuarial assumptions and/or methods from those previously employed, that change should be described in a **RELEVANT COMMENT** paragraph. If the actuary is unable to review the work of the prior Appointed Actuary, then the actuary should disclose this.

DISCUSSION – RISK OF MATERIAL ADVERSE DEVIATION:

The Instructions require the actuary to include **RELEVANT COMMENT** paragraphs that specifically address material adverse deviation. These paragraphs would contain the following:

- a) The amount of adverse deviation in \$US that the actuary judges to be material with respect to the SAO (i.e., materiality standard disclosed in Exhibit B) and an explanation as to how that amount was determined;
- b) A description of the major factors or particular conditions underlying the significant risks or uncertainties that the actuary considers relevant to the statutory entity; and

Property and Casualty Practice Note 2014

- c) An explicit statement as to whether the actuary reasonably believes that there are significant risks or uncertainties that could result in material adverse deviation.

The Materiality Standard

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

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

Other standards may be acceptable as well.

No matter how the materiality standard is determined, ASOP No. 36, paragraph 3.4 requires the actuary to consider the purposes and intended uses for which the actuary prepares the statement of actuarial opinion.

Major Risk Factors or Considerations Underlying the Significant Risks and Uncertainties

The NAIC's 2014 Statement of Actuarial Opinion Instructions require the 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 asbestos and environmental losses from a personal lines company. The list below is meant to provide some suggestions for the types of risk factors and underlying loss exposures for which comment may be appropriate:

- Asbestos and environmental losses
- Construction defects
- Catastrophic weather events
- Exposure related to mortgage defaults
- 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

Property and Casualty Practice Note 2014

- 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 actuary may refer to the sections of [ASOP No. 36](#) that pertain to Significant Risks and Uncertainties (section 4.2.e) and Materiality (section 3.6) for further guidance about the explanatory paragraph. The regulators further expect the Actuarial Report to address the risk factors identified in the SAO, with descriptions of alternate outcomes that could result in adverse development in excess of the materiality threshold.

The Instructions direct the actuary to address the potential that a combination of factors or particular conditions that the actuary considers relevant could develop, increasing the entity's risk of material adverse deviation (RMAD). 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 in 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 upwards in policy limits and attachment points sold, along with a reduction in reinsurance protection purchased

ILLUSTRATIVE WORDING – RISK OF MATERIAL ADVERSE DEVIATION

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

I 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.

If the company is subject to Risk Based Capital (RBC) reporting requirements, the NAIC Financial Analysis Handbook suggests that, if ten percent (10%) of the insurer's net loss and loss adjustment expense (LAE) reserves is greater than the difference between the Total Adjusted Capital and the Company Action Level capital, then there is a presumption of a risk of material adverse deviation. (The actuary may also wish to consider this situation in the selection of the materiality standard.) In this situation, the Appointed Actuary may consider describing in the explanatory paragraph why he/she does not feel there is an RMAD, if that is the conclusion.

Property and Casualty Practice Note 2014

In addition, the Regulatory Guidance for 2014 includes the following: “When considering significant risks and concluding 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 actuary should support the conclusion.”

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

DISCUSSION – ADDITIONAL RELEVANT COMMENTS:

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

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

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

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

DISCUSSION – CHANGE IN METHODS AND ASSUMPTIONS:

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

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

According to the Instructions, when an opining actuary is changing assumptions and/or methods from the prior year, and the impact of the change is not known, the 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 newly 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 actuary to always copy a predecessor’s methodology. However, the newly appointed actuary may choose to become familiar with his or her predecessor’s basic methodology and conclusions. If the changes in assumptions, procedures or methods are likely to have a material impact on unpaid claim estimates, the new actuary may choose to note the difference(s) in the SAO.

Property and Casualty Practice Note 2014

ASOP No. 36 requires disclosure of instances in which the actuary is unable to review the prior actuary's work. In this event, according to section 4.2.a, the actuary should disclose that the prior assumptions, procedures and methods are unknown.

ILLUSTRATIVE WORDING: CHANGE IN METHODS AND ASSUMPTIONS:

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

1. Material change due to distortions affecting old method

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

2. Change made, materiality unknown

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

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

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

4. Unable to review the work of the prior Appointed Actuary

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

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

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

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

Property and Casualty Practice Note 2014

If the actuary is providing an SAO for discounted loss and loss adjustment expense reserves, the 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 as to whether discounting is allowed. Further, inquiry can be made as to whether the state insurance regulator has allowed the company to discount reserves by authorizing a permitted practice.

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

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

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

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

1. Are pool reserves material?
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 actuary's opinion, or some combination of the above?
3. If there is a lag in the booking of pool losses, does the company accrue for this or not? Are premiums treated similarly? Are these items material?

[Appendix 9](#) contains further guidance, including commentary from the CASTF regarding actuarial opinions for pools and associations.

ILLUSTRATIVE WORDING – POOLS AND ASSOCIATIONS:

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

1. Material reserves; adjustment for booking lag
The company participates in a number of voluntary and involuntary pooling arrangements. The booked reserves and earned premiums for some pools reflect losses incurred and premiums earned by the pools through various dates prior to year-end. Company practice is to record the loss and loss adjustment expense reserves reported to it by the pools with accrual for any reporting lag.
2. Material reserves; independent review of significant pools or made use of pool actuarial opinion; balance of non-reviewed reserves immaterial; adjustment for lag

Property and Casualty Practice Note

2014

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

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

3. Immaterial pool exposure

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

4. No adjustment for booking lag

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

The actuary is reminded that unless the SAO is qualified, the actuary is generally responsible for opining on the reasonability of the entire loss and loss adjustment reserves and may therefore consider clearly stating his/her level of review of and use of others' opinions for any material reserves related to pools, and/or explaining their immateriality.

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

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

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

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

Property and Casualty Practice Note 2014

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

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

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

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

- a. Whether the actuary believes that the ultimate liability is actuarially estimable
- b. The difficulties attendant in providing an actuarial estimate of these liabilities
- c. Whether these liabilities are being handled by a dedicated experienced claim/legal unit
- d. Any other factors the actuary may have considered in forming his or her opinion

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

ILLUSTRATIVE WORDING – ASBESTOS AND ENVIRONMENTAL LIABILITY:

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

Situation (1):

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

Property and Casualty Practice Note
2014

Situation (2):

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

Samples of possible additional wording follow.

Sample 1

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

Sample 2

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

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

The scope of the actuary's opinion includes the amount of extended loss and expense reserves reported in Exhibit B, Disclosure 12. The actuary is reminded that the relevant comment, as well as the corresponding entries in Exhibit A and Exhibit B, Disclosure 12 should include all of the company's extended loss and expense reserves, not just the Medical Professional Liability portion of these reserves.

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

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

Property and Casualty Practice Note 2014

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

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

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

The company writes extended loss and expense contracts on claims-made professional liability policies, which provide 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 accrual for these contracts is recorded as loss reserves, the actuary may choose to use wording similar to the following:

The Company writes extended loss and expense contracts on claims-made professional liability policies, which provide 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.

DISCUSSION – OTHER DISCLOSURES – [ASOP NO. 36](#)

The Exhibit B disclosures discussed above are required by the Instructions. In addition to these disclosures, COPLFR encourages the 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 Statement of Actuarial Opinion
- The intended purpose of the Statement of Actuarial Opinion
- The stated basis of reserve presentation
- Whether any material assumption or method was prescribed by law
- Whether the actuary disclaims responsibility for any material assumption or method that originated from another source

DISCUSSION – RETROACTIVE REINSURANCE/FINANCIAL REINSURANCE:

Comment on this item is always required by the Statement of Actuarial Opinion Instructions.

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

Property and Casualty Practice Note 2014

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

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

The actuary may choose to be familiar with the important aspects of the reinsurance coverage but can rely on summaries of the reinsurance coverage prepared by others, rather than reading and evaluating each contract. However, if the actuary is aware of a determination that he or she believes to be clearly incorrect, the actuary ordinarily 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 actuary's opinion.

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

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

ILLUSTRATIVE WORDING – RETROACTIVE REINSURANCE/FINANCIAL REINSURANCE:

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

If there are no contracts of these types:

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

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

Property and Casualty Practice Note 2014

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

DISCUSSION – REINSURANCE:

Uncollectability of ceded unpaid loss and loss adjustment expenses will generally have an effect of the future development of reserves as well as surplus. NAIC requires commentary on reinsurance collectability.

The 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.

If any issues are raised by the above considerations, the actuary may choose to provide some discussion as to amounts already set up to cover this risk (e.g., uncollectible reinsurance reserve, Schedule F penalty). The actuary would also normally consider the effects of any existing collateral. If the amounts already set up are deemed by the actuary to be inadequate, the actuary may choose to indicate how the shortfall is being treated in the reserve opinion. For example, is the shortage in these amounts being added to the otherwise indicated 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 Instructions provide that the actuary's comments are to reflect any such information of which the actuary is aware. For example, the actuary would ordinarily comment on large cessions to a company recently placed under regulatory control, if the actuary has knowledge of such cessions.

In some cases, other parties may already perform the above analysis. When the opining actuary is relying on other parties for the reinsurance collectability analysis, it is generally prudent 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.

ILLUSTRATIVE WORDING – REINSURANCE:

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

1. Immaterial ceded reinsurance levels

Use of ceded reinsurance is minimal, resulting in an immaterial risk of reinsurance uncollectability relative to loss and loss adjustment expense reserves and surplus.

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

Property and Casualty Practice Note 2014

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

3. Potentially inadequate reserves for collectability 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, including amounts shown on the Liabilities, Surplus and Other Funds page, Provision for reinsurance, account for \$YY million of this amount, with no provision made for the remaining \$[XX-YY] million. In forming my opinion of the net reserves, I have recognized this \$[XX-YY] million as uncollectible.

4. Miscellaneous – Public information

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

The actuary would generally consider whether potential uncollectible cessions create risks and uncertainties to be disclosed and contribute to risk of material adverse deviation.

DISCUSSION – IRIS RATIOS:

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

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

ILLUSTRATIVE WORDING – IRIS RATIOS:

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

Property and Casualty Practice Note 2014

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

or

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

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

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

ACTUARIAL REPORT AND UNDERLYING WORK PAPERS

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

The Actuarial Report should be consistent with the documentation and disclosure requirements of [ASOP No. 41](#). 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 Report must also include:

- **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 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 which ties to the Annual Statement and compares the Actuary's conclusions to the carried amounts consistent with the segmentation of exposure or**

Property and Casualty Practice Note
2014

liability groupings used in the analysis. The Actuary's conclusions include the Actuary's point estimate(s), range(s) of reasonable estimates, or both.

- **An exhibit that reconciles and maps the data used by the Actuary, consistent with the segmentation of exposure or liability groupings used in their analysis to the Annual Statement Schedule P line of business reporting.**
- **An exhibit or appendix showing the change in the Actuary's estimates from the prior Actuarial Report, including extended discussion of factors underlying any material changes. If the actuary is unable to review the work of the prior Appointed Actuary, then the 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 unusual IRIS ratios for One-Year Reserve Development to Surplus, Two-Year Reserve Development to Surplus, or Estimated Current Reserve Deficiency to Surplus, and how these factors were addressed in prior and current analyses.**

DISCUSSION – ACTUARIAL REPORT:

The above requirements for the Actuarial Report are much more specific than those contained in [ASOP No. 41, Actuarial Communications](#), which was revised effective May 1, 2011. Section 3.2 of [ASOP No. 41](#) includes, but is not limited to, the following guidance:

1. An Actuarial Report may comprise one or several documents (in which case the report may be in several different formats). Where an Actuarial Report for a specific intended user comprises multiple documents, the actuary should communicate which documents comprise the report.
2. 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 actuarial work as presented in the Actuarial Report.

The NAIC Instructions require the Actuarial Report to show the analysis, from the basic data to the conclusions, and the Instructions require the Actuarial Report to contain all the items listed in Section 7. The Instructions also require that the Actuarial Report be available for review in a timely fashion. Additionally, they require that the reconciliation papers discussed above in the Discussion – Data section and in [Appendix 5](#) become a part of the report. The actuary may wish to consider both [ASOP No. 41](#) and the CASTF Regulatory Guidance in [Appendix 2a](#) when developing the Actuarial Report.

The definition of the Actuarial Report in paragraph 7 of the Instructions was recently modified to include company boards of directors as part of the intended audience. This change was made 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 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.

Property and Casualty Practice Note 2014

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

The 2012 Instructions included significant new requirements related to the information that must be included in the Actuarial Report. Each of these new requirements is discussed below.

DISCUSSION – APPOINTED ACTUARY'S RELATIONSHIP TO THE COMPANY:

The 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.

ILLUSTRATIVE WORDING – APPOINTED ACTUARY'S RELATIONSHIP TO THE COMPANY:

The following sample wording is provided to illustrate the level of detail and nature of information intended to be included in the Report to fulfill each element of this requirement. Please note that these examples are not meant to represent all potential situations.

- The Appointed Actuary's relationship to the Company:
 - *I am the Chief Actuary of the Company.*
 - *I am an independent consultant to the Company.*
 - *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.*
 - *I establish a range of reasonable reserve estimates. Company management selects the carried reserves based on my range of reasonable reserve estimates.*
 - *My role is to evaluate the reasonableness of the carried reserves. I do not explicitly advise management or the board of directors in the reserve setting process.*
- How and when the Appointed Actuary presents the analysis to the board:
 - *This report was prepared for the board of directors of the Company.*
 - *[Optional addition: A summary of the findings of my analysis was presented to the board of directors on (Date).]*
 - *[Optional addition: The results of my analysis have been shared with (Individual, Title) of the Company. (Individual) has primary responsibility at the Company for establishing the carried reserves.]*

Property and Casualty Practice Note
2014

DISCUSSION – COMPARISON OF ACTUARY’S CONCLUSIONS TO THE CARRIED AMOUNTS:

The Instructions require the Actuarial Report to include an exhibit that ties to the Annual Statement and compares the actuary’s conclusions to the carried amounts. This exhibit is to be consistent with the segmentation used in the actuary’s analysis and clarifies that the conclusions include the actuary’s point estimate(s), range(s) of reasonable estimates, or both. COPLFR interprets this to mean that the carried amounts may need to be compared to the actuary’s conclusions at the lowest possible/practical level of aggregation, based on the segmentation of exposure in the Appointed Actuary’s Report as compared to the segmentation of exposure in Schedule P.

DISCUSSION – SCHEDULE P RECONCILIATION:

The 2013 Instructions included the requirement that the Schedule P reconciliation be consistent with the segmentation used in the actuary’s analysis. The 2014 CASTF Regulatory 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 Regulatory Guidance further notes that, if the reconciliation cannot be performed, the reasons should be noted in the Report. All data elements used in the analysis are to be included in the reconciliation. For further discussion, please see [Appendix 5](#) and the CASTF Regulatory Guidance, included as [Appendix 2a](#).

DISCUSSION – CHANGE IN ESTIMATES:

The Instructions require the actuary to include in the Actuarial Report an exhibit that summarizes changes in the Appointed Actuary’s estimates from the prior analysis, with extended discussion of significant factors underlying the changes. These requirements seem to be intended to apply to the change in the Appointed Actuary’s prior period estimates since the previous Actuarial Report.

If the actuary estimated ultimate amounts (losses and/or loss adjustment expenses) 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 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 estimated ultimate amounts would be calculated as the incremental paid amounts plus the change in the estimated unpaid amounts between Actuarial Reports, again for prior periods.

Based on the 2014 CASTF Regulatory Guidance and the requirements in the Instructions, the actuary is encouraged to consider the following:

- The changes in estimates are intended to be discussed on both a net and a gross basis;
- The changes include significant fluctuations in the aggregate estimates, estimates by reviewed segment, and estimates by loss year;
- The level of detail used to describe the significant factors underlying material changes in estimates is left to the discretion of the actuary; and

Property and Casualty Practice Note 2014

- The amount of change that constitutes a significant amount is left to the 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 Statement of Actuarial Opinion.

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:

- 1) Exhibit(s) and discussion related to material changes in point estimates from the prior year (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 material changes in the range of estimates from the prior year (if a range is included in the Actuarial Report), if meaningful and practical, including discussion of any material expansion or contraction of the range relative to the prior year.

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.

For specific instruction, please see the 2014 CASTF Regulatory Guidance, included as [Appendix 2a](#).

SIGNATURE OF ACTUARY

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

Signature of actuary
Printed name of actuary
Employer's name
Address of actuary
Telephone number of actuary
Email address of actuary
Date opinion was rendered

ERRORS IN STATEMENT OF OPINION

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**

Property and Casualty Practice Note
2014

or not issued solely because of data or information concerning events subsequent to the balance sheet date or because actual results differ from those projected.

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

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

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

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

DISCUSSION – SECTIONS 8 AND 9:

The NAIC Instructions and the CASTF Regulatory Guidance include information on reissuing Statements of Actuarial Opinion when the Appointed Actuary determines 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. This includes instruction on timing, format, and content of the revised submission. There are other situations in which the Statement of Actuarial Opinion may need to be revised and reissued. An example of such a situation is a request from a regulator for expanded wording in the Opinion. In these situations, the actuary may wish to discuss the timing/format/content of the revised Opinion with the regulator in consultation and conjunction with the company to which the Opinion relates.

DATA IN EXHIBITS A & B IN BOTH PRINT AND DATA CAPTURE FORMAT

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

DISCUSSION – SECTION 10:

Property and Casualty Practice Note
2014

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

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 opinion.

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. Reserve for Unpaid Losses (Liabilities, Surplus and Other Funds page, Col 1, Line 1)	\$ _____
2. Reserve for Unpaid Loss Adjustment Expenses (Liabilities, Surplus and Other Funds page, Col 1, Line 3)	\$ _____
3. Reserve for Unpaid Losses – Direct and Assumed (Should equal Schedule P, Part 1, Totals from Cols. 13 and 15, Line 12 * 1000)	\$ _____
4. Reserve for Unpaid Loss Adjustment Expenses – Direct and Assumed (Should equal Schedule P, Part 1, Totals from Cols. 17, 19 and 21, Line 12 * 1000)	\$ _____
5. The Page 3 write-in item reserve, "Retroactive Reinsurance Reserve Assumed"	\$ _____
6. Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion (list separately)	\$ _____

<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)	\$ _____

DISCUSSION – EXHIBIT A: SCOPE

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

DISCUSSION – RETROACTIVE REINSURANCE RESERVE:

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

Property and Casualty Practice Note
2014

DISCUSSION – PREMIUM RESERVES FOR LONG-DURATION CONTRACTS:

[Appendix 7](#) provides guidance on this requirement.

Property and Casualty Practice Note
2014

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 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 US 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, 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) | \$ _____ |

Property and Casualty Practice Note
2014

- 9. Discount included as a reduction to loss reserves and loss 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 expenses for the company's share of voluntary and involuntary underwriting pools' and associations' unpaid losses and expenses that are included in reserves shown on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines.** \$ _____
- 11. The net reserves for losses and loss adjustment expenses that the company carries for the following liabilities included on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines. *** \$ _____
- 11.1 Asbestos, as disclosed in the Notes to Financial Statements (Notes, Line 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 expense reserve (Greater than or equal to Schedule P Interrogatories).**
- 12.1 Amount reported as loss reserves \$ _____
- 12.2 Amount reported as unearned premium reserves \$ _____
- 13. Other items on which the Appointed Actuary is providing Relevant Comment (list separately)** \$ _____

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

Property and Casualty Practice Note
2014

DISCUSSION – DISCLOSURE ITEMS:

The actuary is required by the NAIC to prepare Exhibit B in the exact format shown in the Statement of Actuarial Opinion Instructions with no items deleted and write-in lines not inserted.

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

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

Regulators expect the answer to item 6 to be consistent with the disclosure in the Relevant Comments of the SAO as to whether there are significant risks or uncertainties that could result in material adverse deviation.

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

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

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

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

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

Property and Casualty Practice Note
2014

Actuarial Opinion Summary as of Dec. 31, 2014

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

Actuarial Opinion Summary Supplement

- 1. For all companies that are required by their domiciliary state to submit a confidential document entitled Actuarial Opinion Summary (AOS), such document shall be filed with the domiciliary state 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 they are able to preserve the confidentiality of the document.**
- 2. The AOS should be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including but not limited to ASOPs [23](#), [41](#) and [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 and is not intended for public inspection. The AOS should not be filed with the NAIC and should be kept separate from any copy of the Statement of Actuarial Opinion in order to maintain confidentiality of the AOS. The AOS can contain a statement that refers to the Statement of Actuarial Opinion and the date of that opinion.**

DISCUSSION – FILING THE AOS:

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

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

- 5. The AOS should be signed and dated by the Appointed Actuary who signed the Statement of Actuarial Opinion and 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;**

Property and Casualty Practice Note
2014

- 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; and**
- 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 surplus, as measured by Schedule P, Part 2 Summary, in at least three of the past five calendar years, include explicit description of the reserve elements or management decisions which were the major contributors.**

DISCUSSION – ACTUARIAL OPINION SUMMARY:

The AOS requires the actuary to disclose, on a gross and net basis, the actuary's point estimate and/or the actuary's range, and compare this to the carried reserves. Paragraph 3.7 of [ASOP No. 36](#) states that a reserve should be considered reasonable if it is within a range of estimates that could be produced by an unpaid claim analysis that is, in the actuary's professional judgment, consistent with both [ASOP No. 43](#) and the identified stated basis of reserve presentation. The Actuarial Report normally includes detailed descriptions and calculations that support the point estimate and/or range of estimates.

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

Items 5 (A) through 5 (D) in the Instructions above 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 actuary's analysis (i.e., if an 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 one-year development has been adverse by at least five percent in at least three of the last five calendar years, the AOS also requires explicit discussion of reserve elements and/or management decisions to which such adverse development can be attributed. Each year's one-year development, on a net basis, is compared to the prior period's surplus, and a ratio is developed. The one-year development test is the same calculation as that which underlies the IRIS ratio regarding One-Year Reserve Development to Surplus. The calculation of the company's one-year reserve development to surplus for each of the prior five years is disclosed in the five-year historical exhibit of the company's Annual Statement.

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

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

Property and Casualty Practice Note 2014

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

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

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

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

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

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

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

OR

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

Content of the Actuarial Opinion Summary

The AOS is due by March 15, and it is to be submitted by the company (see [Appendix 8](#) for comments on intercompany pooling) separately from its Annual Statement and the SAO. Because it is sent separately from the opinion, the actuary may wish to consider including some basic information along with the AOS. Sample wording is presented below:

Property and Casualty Practice Note
2014

Date: March 13, 2015

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, 2015. These two documents are closely linked; the Actuarial Opinion Summary is an extension of the Statement of Actuarial Opinion. Therefore, all limitations, caveats, and reliances in the Statement of Actuarial Opinion should also be applied to the Actuarial Opinion Summary. Moreover, it is my understanding that, consistent with the Annual Statement Instructions, the Actuarial Opinion Summary will be kept confidential by state regulators and is not intended for public inspection, subject to applicable law.

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

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

Property and Casualty Practice Note
2014

SAMPLE FORMAT FOR THE AOS
[Name] Insurance Company
December 31, 2014

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

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

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

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

Sample # 3: If actuary provides both range and point estimate:

	Net Reserves			Gross Reserves		
	Low	Point	High	Low	Point	High
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 actuary provides a qualified opinion – point estimate without a range:

	Net Reserves			Gross Reserves		
	Lo	Point	High	Low	Point	High
A Actuary's range of estimates	NA		NA	NA		NA
B Actuary's point estimate		9,500			10,000	
C Company carried reserves - TOTAL		10,000			11,000	
1					0	
C Company carried reserves - portion excluded by opinion		1,000			1,500	
2 excluded by opinion					0	
C Company carried reserves covered by opinion		9,000			9,500	
3 opinion						
D Difference between company carried and		(500)			(500)	

Property and Casualty Practice Note 2014

actuary's estimate (C3-B)

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

[Signature]

Name of Actuary

Date

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

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

6. **The AOS for pooled companies (as referenced in paragraph 1C of the instructions for the Statement of Actuarial Opinion) shall include a statement that the company is a xx% pool participant. For non-0% companies, 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.**

DISCUSSION – SECTION 6:

Consistent with changes to the SAO Instructions, Paragraph 6 has been modified to require the AOS to include the participation percentage for companies participating in an intercompany pooling agreement, as defined in paragraph 1C of the Instructions for the SAO. For those companies whose participation percentage is zero, the information provided in paragraph 5 of the AOS should be that of the lead company.

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

DISCUSSION – SECTION 7:

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

DISCUSSION – ERRORS IN THE ACTUARIAL OPINION SUMMARY:

The 2014 CASTF Regulatory Guidance, included as [Appendix 2a](#), discusses regulatory expectations in cases where an error in the Summary is discovered by the Appointed Actuary, the company, or the regulator. The revised Summary should be submitted only to the regulator within ten business days,

Property and Casualty Practice Note
2014

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

Property and Casualty Practice Note
2014

Appendix 1a

2014 STATEMENT OF ACTUARIAL OPINION INSTRUCTIONS

ACTUARIAL OPINION

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

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

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

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

If an actuary who was the Appointed Actuary for the immediately preceding filed Actuarial Opinion is replaced by an action of the Board of Directors, the insurer shall within five (5) business days notify the Insurance Department of the state of domicile of this event. The insurer shall also furnish the domiciliary commissioner with a separate letter within ten (10) business days of the above notification stating whether in the twenty four (24) months preceding such event there were any disagreements with the former Appointed Actuary regarding the content of the opinion on matters of the risk of material adverse deviation, required disclosures, scopes, procedure, 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 disagreement and the nature of its resolution (or that it was not resolved). The insurer shall also in writing request such former actuary to furnish a letter addressed to the insurer stating whether the actuary agrees with the statements contained in the insurer’s letter and, if not, stating the reasons for which he 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 Statement of Actuarial Opinion and the supporting Actuarial Report and Workpapers, should be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including, but not limited to, 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.

Property and Casualty Practice Note

2014

1A. Definitions

“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” 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, 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 that documents the analysis underlying the opinion. The required content of the 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 thirteen months; and (2) the insurer can neither cancel nor increase the premium during the contract term.

1B. Exemptions

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

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

Exemption for Small Companies

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

Exemption for Insurers under Supervision or Conservatorship

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

Exemption for Nature of Business

Property and Casualty Practice Note

2014

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

Financial Hardship Exemption

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

- (i) One percent (1%) of the insurer's capital and surplus reflected in the insurer's latest quarterly statement for the calendar year for that 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 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 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 responses to question 5 should be \$0 and to question 6 should be "not applicable." Exhibits A and Exhibits 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 Statement of Actuarial Opinion must consist of an IDENTIFICATION paragraph identifying the Appointed Actuary; a SCOPE paragraph identifying the subjects on which an opinion is to be expressed and describing the scope of the actuary's work; an OPINION paragraph expressing his or her opinion with respect to such subjects; and one or more additional RELEVANT COMMENTS paragraphs. These four Sections must be clearly designated.
3. The IDENTIFICATION paragraph should specifically indicate the Appointed Actuary's relationship to the company, qualifications for acting as Appointed Actuary, date of appointment, and specify that the appointment was made by the Board of Directors, or its equivalent, or by a committee of the Board.

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

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

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

"I have examined the actuarial assumptions and methods used in determining reserves listed in Exhibit A, as shown in the Annual Statement of the Company as prepared for filing with state regulatory officials, as of December 31, 20__, and reviewed information provided to me through XXX date."

Property and Casualty Practice Note

2014

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

The Appointed Actuary should state that the items in the SCOPE, on which he or she is expressing an opinion, reflect the Loss Reserve Disclosure items (8 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 _____ (name, affiliation and relation to company). I evaluated that data for reasonableness and consistency. I also reconciled that data to Schedule P, Part 1 of the company’s current Annual Statement. In other respects, my examination included such review of the actuarial assumptions and methods used and such tests of the calculations as I considered necessary.”

5. The OPINION paragraph should include a sentence that at least covers the points listed in the following illustration:
“In my opinion, the amounts carried in Exhibit A on account of the items identified:

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

- 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 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.

Property and Casualty Practice Note 2014

- 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 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 actuary is not required to issue a qualified opinion if the actuary reasonably believes that the item (or items) in question are not likely to be material.
 - e. **No Opinion.** The actuary's ability to give an opinion is dependent upon data, analyses, assumptions, and related information that are sufficient to support a conclusion. If the actuary cannot reach a conclusion due to deficiencies or limitations in the data, analyses, assumptions, or related information, then the actuary may issue a statement of no opinion. A statement of no opinion should include a description of the reasons why no opinion could be given.
6. The Appointed Actuary must provide RELEVANT COMMENT paragraphs to address the following topics of regulatory importance.
- a. Risk of Material Adverse Deviation

The Appointed Actuary must provide specific RELEVANT COMMENT paragraphs to address the risk of material adverse deviation. The actuary must identify the materiality standard and the basis for establishing this standard. The materiality standard must also be disclosed in U.S. dollars in Exhibit B: Disclosures. The 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 actuary required to include an exhaustive list of all potential sources of risks and uncertainties. The actuary should explicitly state whether or not he or she reasonably believes that there are significant risks and uncertainties that could result in material adverse deviation. 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 in Exhibit B. The actuary should address the items individually and in combination when commenting on a material impact.
 - c. Reinsurance

RELEVANT COMMENT paragraphs should address retroactive reinsurance, financial reinsurance and reinsurance collectibility. Before commenting on reinsurance collectibility, the actuary should solicit information from management on any actual collectibility problems, review ratings given to reinsurers by a recognized rating service, and examine Schedule F for the current year for indications of regulatory action or reinsurance recoverable on paid losses over 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 actuary's comments do not imply an opinion on the financial condition of any reinsurer.

Property and Casualty Practice Note

2014

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.

d. IRIS Ratios

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

e. Methods and Assumptions

If there has been any significant change in the actuarial assumptions and/or methods from those previously employed, that change should be described in a RELEVANT COMMENT paragraph. If the actuary is unable to review the work of the prior Appointed Actuary, then the 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 Report be held confidential and is not intended for public inspection. The Report must be available by May 1 of the year following the year-end for which the Opinion was rendered or within two (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 Report must also include:

- 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 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 Actuary's conclusions to the carried amounts consistent with the segmentation of exposure or liability groupings used in the analysis. The Actuary's conclusions include the Actuary's point estimate(s), range(s) of reasonable estimates or both.
- An exhibit that reconciles and maps the data used by the Actuary, consistent with the segmentation of exposure or liability groupings used in their analysis, to the Annual Statement Schedule P line of business reporting.

Property and Casualty Practice Note 2014

- An exhibit or appendix showing the change in the Actuary's estimates from the prior Actuarial Report, including extended discussion of factors underlying any material changes. If the actuary is unable to review the work of the prior Appointed Actuary, then the 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 unusual IRIS ratios for One-Year Reserve Development to Surplus, Two-Year Reserve Development to Surplus, or Estimated Current Reserve Deficiency to Surplus, and how these factors were addressed in prior and current analyses.
8. The statement should conclude with the signature of the Appointed Actuary responsible for providing the Actuarial Opinion and the date when the Opinion was rendered. The signature and date should appear in the following format:

Signature of actuary
Printed name of actuary
Employer's name
Address of actuary
Telephone number of actuary
Email address of actuary
Date opinion was rendered

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

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

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

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

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

Property and Casualty Practice Note 2014

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

Exhibit A: SCOPE **DATA TO BE FILED IN BOTH PRINT AND DATA CAPTURE FORMATS**

Loss and Loss Adjustment Expense Reserves:

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

Premium Reserves:

- | | |
|--|----------|
| 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 2014

Exhibit B: DISCLOSURES

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 | _____ |
| 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, 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 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. | \$_____ |

**Property and Casualty Practice Note
2014**

10. The net reserves for losses and expenses for the company's share of voluntary and involuntary underwriting pools' and associations' unpaid losses and expenses that are included in reserves shown on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines. \$ _____
11. The net reserves for losses and loss adjustment expenses that the company carries for the following liabilities included on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines. *
- 11.1 Asbestos, as disclosed in the Notes to Financial Statements (Notes, Line 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 expense reserve (Greater than or equal to Schedule P Interrogatories).
- 12.1 Amount reported as loss reserves \$ _____
- 12.2 Amount reported as unearned premium reserves \$ _____
13. Other items on which the Appointed Actuary is providing relevant comment (list separately) \$ _____
- * The reserves disclosed in item 11 above, should exclude amounts relating to contracts specifically written to cover asbestos and environmental exposures. Contracts specifically written to cover these exposures include Environmental Impairment Liability (post 1986), Asbestos Abatement, Pollution Legal Liability, Contractor's Pollution Liability, Consultant's Environmental Liability, and Pollution and Remediation Legal Liability.

Property and Casualty Practice Note
2014

Appendix 1b

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 fifteen days of request, but no earlier than March 15, provided that the requesting state can demonstrate, through the existence of law or some similar means, that they are able to preserve the confidentiality of the document.
2. The AOS should be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including but not limited to 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 and is not intended for public inspection. The AOS should not be filed with the NAIC and should be kept separate from any copy of the Statement of Actuarial Opinion in order to maintain confidentiality of the AOS. The AOS can contain a statement that refers to the Statement of Actuarial Opinion and the date of that opinion.
5. The AOS should be signed and dated by the Appointed Actuary who signed the Statement of Actuarial Opinion and 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 surplus as measured by Schedule P, Part 2 Summary in at least three of the past five (5) calendar years, include explicit description of the reserve elements or management decisions which were the major contributors.
6. The AOS for pooled companies (as referenced in paragraph 1C of the instructions for the Statement of Actuarial Opinion) shall include a statement that the company is a xx% pool participant. For non-0% companies, 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. No Appointed Actuary shall be liable in any manner to any person for any statement made in connection with the above paragraphs if such statement is made in a good faith effort to comply with the above paragraphs.

Property and Casualty Practice Note
2014

Appendix 1c

2014 Title Insurance Company Annual Statement Instructions

ACTUARIAL OPINION

1. There is to be included or attached to Page 1 of the Annual Statement, the statement of a Qualified Actuary, entitled “Statement of Actuarial Opinion,” setting forth his or her opinion relating to reserves specified in the SCOPE paragraph. The Actuarial Opinion, both the narrative and **required** exhibits, shall be in the format of and contain the information required by this section 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 reporting entity shall within five (5) business days notify the Insurance Department of the state of domicile of this event. The insurer shall also furnish the domiciliary commissioner with a separate letter within ten (10) business days of the above notification stating whether in the twenty-four (24) months preceding such event there were any disagreements with the former Appointed Actuary regarding the content of the opinion on matters of the risk of material adverse deviation, required disclosures, scopes, procedure, 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 reporting entity shall also request in writing such former actuary to furnish a letter addressed to the entity stating whether the actuary agrees with the statements contained in the entity’s letter and, if not, stating the reasons for which he or she does not agree; and the reporting entity shall furnish such responsive letter from the former actuary to the domiciliary commissioner together with its own.

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

The Statement of Actuarial Opinion and the supporting Actuarial Report and Workpapers, should be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including but not limited to 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.

Property and Casualty Practice Note

2014

1A. Definitions

“Qualified Actuary” is a person who is either:

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

“Insurer” means 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 that documents the analysis underlying the opinion. The expected content of the 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

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

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

Exemption for Small Companies

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

Exemption for Insurers under Supervision or Conservatorship

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

Exemption for Nature of Business

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

Property and Casualty Practice Note

2014

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 specifically indicate the appointed actuary's relationship to the company, qualifications for acting as Appointed Actuary, date of appointment, and specify that the appointment was made by the Board of Directors (or its equivalent) or by a committee of the Board.

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

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

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

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

Property and Casualty Practice Note 2014

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, assumptions, or related information, then the

Property and Casualty Practice Note

2014

actuary may issue a statement of no opinion. A statement of no opinion should include a description of the reasons why no opinion could be given.

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

- a. Risk of Material Adverse Deviation.

The Appointed Actuary must provide specific RELEVANT COMMENT paragraphs to address the risk of material adverse deviation. The actuary must identify the materiality standard and the basis for establishing this standard 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 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 actuary required to include an exhaustive list of all potential sources of risks and uncertainties. The actuary should explicitly state whether or not he or she reasonably believes that there are significant risks and uncertainties that could result in material adverse deviation. 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 in Exhibit B. The actuary should address the items individually and in combination when commenting on a material impact.

- c. Reinsurance

RELEVANT COMMENT paragraphs should address retroactive reinsurance, financial reinsurance and reinsurance collectibility. Before commenting on reinsurance collectibility, the actuary should solicit information from management on any actual collectibility problems, review ratings given to reinsurers by a recognized rating service, and examine Schedule F for the current year for indications of regulatory action or reinsurance recoverable on paid losses over 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 actuary's comments do not imply an opinion on the financial condition of any reinsurer.

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

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

- d. Reserve Development

If the company 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 Surplus to be greater than 20%, the actuary must include RELEVANT COMMENT on the factors that led to the exceptional reserve development.

- e. Methods and Assumptions

Property and Casualty Practice Note 2014

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 actuary is unable to review the work of the prior Appointed Actuary, then the 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 report be held confidential and not intended for public inspection. The Report must be available by May 1 of the year following the year-end for which the Opinion was rendered or within two (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 Report must also include:

- 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 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 Actuary's conclusions to the carried amounts consistent with the segmentation of exposure or liability groupings used in the analysis. The Actuary's conclusions include the Actuary's point estimate(s), range(s) of reasonable estimates or both.
 - An exhibit that reconciles and maps the data used by the Actuary, consistent with the segmentation of exposure or liability groupings used in their analysis, to the Annual Statement Schedule P.
 - An exhibit or appendix showing the change in the Actuary's estimates from the prior Actuarial Report, including extended discussion of factors underlying any material changes. If the actuary is unable to review the work of the prior Appointed Actuary, then the 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 6d, and how these factors were addressed in prior and current analyses.
8. The statement should conclude with the signature of the Appointed Actuary responsible for providing the Actuarial Opinion and the date when the Opinion was rendered. The signature and date should appear in the following format:

Signature of actuary
Printed name of actuary
Employer's name
Address of actuary
Telephone number of actuary
Email address of actuary
Date opinion was rendered

Property and Casualty Practice Note 2014

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

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

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

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

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

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

STATEMENT OF ACTUARIAL OPINION

Exhibit A: SCOPE DATA TO BE FILED IN BOTH PRINT AND DATA CAPTURE FORMAT

LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES:	<u>Amount</u>
1. Reserve for Unpaid Losses and Loss Adjustment Expenses (Schedule P, Part 1, Total Column 24 or 34 if discounting is allowable under state law)	\$ _____
2. Reserve for 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)	\$ _____

Property and Casualty Practice Note

2014

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	\$ _____		
8. Known claims reserve (Liability Page, Line 1)	\$ _____		
9. Statutory premium reserve (Liability Page, Line 2)	\$ _____		
10. Aggregate of other reserves required by law (Liability Page, Line 3)	\$ _____		
11. Supplemental reserve (Liability Page, Line 4)	\$ _____		
12. Anticipated net salvage and subrogation included as a reduction to loss reserves as reported in Schedule P	\$ _____		

**Property and Casualty Practice Note
2014**

- | | |
|---|----------|
| 13. Discount included as a reduction to loss reserves and loss expense reserves as reported in Schedule P | \$ _____ |
| 14. Other items on which the Appointed Actuary is providing relevant comment (list separately) | \$ _____ |

Property and Casualty Practice Note
2014

Appendix 2a

Adopted September 9, 2014



**REGULATORY GUIDANCE
On Property and Casualty Statutory Statements of Actuarial Opinion
For the Year 2014**

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

The Casualty Actuarial and Statistical (C) Task Force (CASTF) of the NAIC believes that the Statement of Actuarial Opinion (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 with respect to the Opinion.

An Appointed Actuary has a responsibility to know and understand both the *Instructions* and the expectations of regulators. One expectation of regulators clearly presented in the *Instructions* is that the Opinion and the supporting Actuarial Report and workpapers should be consistent with appropriate Actuarial Standards of Practice (ASOP), including, *but not limited to*, ASOPs Nos. 23, 36, 41 and 43.

The CASTF consciously tries to avoid illustrative language in the *Instructions* and encourages all actuaries to use whatever language they feel is appropriate to clearly convey their opinion *and* thought processes in reaching conclusions on a company with reference to specific characteristics of that company in both the Opinion and the supporting Actuarial Report. Specific characteristics include relevant background information about the company, such as intercompany pooling percentages, recent mergers or acquisitions, significant changes in operations, product mix, reinsurance arrangements, etc.

Several changes were made to the 2014 *Instructions*.

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

Paragraph 1 is directed to company management and was changed slightly in 2014 and 2012 as it relates to disclosure of disagreements with a prior Appointed Actuary. Regulators expanded on the types of disagreements that an insurer is required to report to the Insurance Department when there is a change in Appointed Actuary. Two additional types, “type of opinion issued” and “substantive wording of the opinion,” were added and clarified. When such disagreements occur, regulators now request that a description of the disagreement and the nature of its resolution, or non-resolution, be included in the letter to the Insurance Department. Finally, the paragraph was amended to include a reference to ASOP No. 43.

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

- **Timely feedback** — The CASTF encourages management to seek feedback from a “qualified actuary” *prior to* management’s decision on establishing carried reserves. This allows management to make an informed decision with the benefit of actuarial analysis. It also helps to avoid a difficult situation in which management is committed to a decision that results in pressure on the actuary to “stretch” the range of reasonable reserve estimates.
- **Reporting to the Board of Directors or Audit Committee** — The actuary is required to report to the Board of Directors (Board). This may be done in a form of the actuary’s choosing, including, but not limited to, an executive summary or PowerPoint presentation. The entire Actuarial Report must still be made available to the Board upon request. The CASTF strongly encourages the Appointed Actuary to present his or her analysis in person so that

Property and Casualty Practice Note

2014

the risks and uncertainties that underlie the exposures and the significance of the actuary's findings can be adequately conveyed and discussed. As the actuarial profession makes advances in reserve methodology, such as stochastic simulation, a single deterministic indication would not be appropriate for many companies.

While management is limited to single values on lines 1 and 3 of the Liability Page, the Board should be made aware of the actuary's opinion regarding the risk of material adverse deviation, the sources of risk and what amount of adverse deviation the actuary judges to be material.

Paragraph 1A: Definitions

In 2011, the definition of the Actuarial Report was modified to include the Board of Directors as part of the intended audience in order to be consistent with Paragraph 1, which states that the Actuarial Report should be made available to the Board. In 2012, language was added to emphasize that this change in definition was not intended to change the content of the Actuarial Report as described in Paragraph 7. The actuary may still choose to present findings to the Board in any manner deemed suitable to such audience.

Paragraph 1B: Exemptions

Paragraph 1B is directed to company management, defines exemption requirements and does not generally apply to the work of appointed actuaries.

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.

For each company in the pool, the Appointed Actuary shall provide in the Opinion a brief description of the pool, identify the lead insurer and list all pool members. The *Instructions* also require that the actuary provide the state of domicile and the respective pooling percentage with each pool member. The 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 Opinion to ensure the reader has a proper understanding of the contents within the 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. Changes were made to provide additional clarity for readers of the Opinion, as many pooled company Opinions were silent on pooling arrangements.

In situations where there is an intercompany pooling agreement in which a member of the pool retains 0%, the Appointed Actuary is directed to prepare an Opinion that reads similar to that of the lead company ("pooled Opinion"), which is to be filed with the Annual Statement of each of the 0% pooled companies.

Exhibits A and B should reflect values specific to the individual company. For companies with 0% pool participation, the actuary should prepare Exhibits A and B of the lead company to be filed as an addendum to the 0% pooled companies Opinions. This will allow for proper data submission for each company in the pool while accommodating the greatest distribution of the relevant values for the pool. The *Instructions* include specific answers for the Exhibit B questions regarding materiality and the risk of material adverse deviation. Note the distinction between pooling with a 100% lead company with no retrocession and ceding 100% via a quota share agreement. 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 their operating platform.

Paragraph 2: Structure of the Opinion

Paragraph 2 is unchanged for 2014. It succinctly presents the four primary sections of the Opinion.

Property and Casualty Practice Note

2014

Paragraph 3: Identification

Paragraph 3 is unchanged for 2014.

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 (within the scope) the date through which material information known to the actuary is included in forming the reserve opinion (review date), if it differs from the date the Opinion is signed. However, when the actuary is silent regarding the review date, this can indicate either a review date the same as the date the opinion is signed or that the actuary overlooked this disclosure requirement. In instances where the actuary's review date is the same date the opinion is signed, regulators suggest actuaries clarify such in the 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 actuary. Guidance for Exhibit B disclosure items is discussed in Paragraph 6.

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

1. **Exposure** - An Opinion on the reasonability of the carried reserves should reflect consideration and evaluation of more than just loss history. The CASTF expects the actuary to probe and understand the exposure associated with the company for which the Opinion is issued. Areas of particular interest to regulators include:
 - Coverage for Service Contracts: Due to wide variation in state laws, this type of product may or may not be regulated or treated as insurance. Insurance may only come into play as excess coverage for contractual liability.
 - Economic Conditions: With the current strains on the economy, regulators expect the Appointed Actuary of a company that faces such risks to attempt to quantify those risks in the analysis. Mere disclaimers are insufficient.
2. **Prepaid loss adjustment expenses** - According to SSAP 55, Paragraph 5 of the NAIC's *Accounting Practices 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.

The Scope paragraph also requires disclosure of the individual upon whom the Appointed Actuary relied for preparation of the data. In some cases, the Appointed Actuary, if a senior officer of the company, may be the individual who holds this responsibility. In these cases, it is acceptable for the actuary to identify himself/herself in this section. Regulators expect the Appointed Actuary's disclosure to always include the senior official(s) of the regulated entity responsible for integrity of the data.

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.

Property and Casualty Practice Note

2014

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 actuary. Regulators expect full compliance with additional disclosure requirements pursuant to ASOP No. 36. If material, the actuary should disclose if they have made use of the work of another actuary. Further, 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 CASTF expects points C (unpaid loss and loss adjustment expense reserves) and 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 will apply to both the Net and the Direct and Assumed reserves. If the actuary reaches different conclusions, the actuary should use whatever language is appropriate to clearly convey a complete opinion, but the actuary should prepare the response to Exhibit B, Item 4, to reflect the opinion on the Net reserves. The CASTF encourages the actuary to further include narrative comments to describe any differences with respect to the Direct and Assumed reserves.

The CASTF has outlined additional requirements for actuaries writing Opinions that fall into the Deficient/Inadequate, Redundant/Excessive or Qualified Opinion categories. In the Deficient/Inadequate situation, the actuary should disclose the minimum amount that the actuary believes is reasonable. Similarly, the actuary should disclose the maximum amount the actuary believes is reasonable for a Redundant/Excessive provision. Finally, regulators ask for additional information about Qualified Opinions, related to the item(s) to which the qualification relates, the reason(s) for qualification, and amounts, if disclosed by the company.

Exhibit A, Items 7 and 8 require disclosure of the amount of the reserve for unearned premium for long duration contracts, and the *Instructions* further require the 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 Opinions include paragraph (D) regardless of materiality. The CASTF expects that actuaries either add paragraph (D) if they can and are indeed expressing an opinion on the reasonableness of this reserve and/or add an explanatory paragraph about these unearned premium reserves in Relevant Comments and state whether the amounts are material or immaterial. With regard to "Other Premium Reserve items" in Exhibit A, Item 9, the actuary should also include an explanatory paragraph about these premium reserves in Relevant Comments and state whether the amounts are material or immaterial.

Paragraph 6: Relevant Comments

The CASTF considers the relevant comments of the Appointed Actuary to be the most valuable information in the Opinion. Relevant comments provide the context for the regulator to interpret the Opinion and to understand the actuary's reasoning and judgment. In addition to the required Relevant Comments, reinsurance with affiliates, mergers or acquisitions, long duration contracts, other premium reserves, catastrophe impact or risk, and other items the Appointed Actuary feels are relevant provide important information for the regulator.

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 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 Opinion before making a statement and conclusion on RMAD.

The latest version of the *Instructions*, as modified in 2014, requires the Appointed Actuary to:

Property and Casualty Practice Note 2014

- 1) Identify the materiality standard in U.S. dollars, ensuring that such is consistent with the amount shown in Exhibit B: Disclosures.
- 2) Identify the basis, or rationale, for establishing this standard.
- 3) Describe the major factors, combination of factors or particular conditions underlying the significant risks and uncertainties that the actuary considers relevant to the statutory entity.
- 4) **Explicitly** state whether he or she believes that those significant risks and uncertainties could result in RMAD.

Note that Item 3 now precedes Item 4; the Appointed Actuary is asked to discuss risks whether or not he or she believes the company is exposed to RMAD.

With the exception of intercompany pooling members that retain a 0% share, each statutory entity is required to have a separate 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 those companies submitting a pooled Opinion (i.e., 0% pool companies only), the materiality standard should be \$0, and the RMAD conclusion should be “Not Applicable,” as per the *Instructions*.

If the actuary does not consider there to be ANY specific or unique risk factors to this company, the actuary should say that. If the risks have mitigated by certain company actions, those explanations will also be helpful.

The *Instructions* state that the RMAD explanatory paragraph should not include general broad statements about unspecified risks and uncertainties that could apply to nearly all companies in any situation. When considering the inclusion of risk disclosures in the Opinion, the actuary should take into account the likelihood of the event occurring. Risks and uncertainties may include items such as the uncertainty in the tail factors or the need to use industry benchmarks.

When considering significant risks and concluding 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 actuary should support the conclusion.

IRIS Ratios

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

Methods and Assumptions

The *Instructions* were modified in 2014 to recognize that when there is a change in Appointed Actuary, the newly Appointed Actuary may not be able to review the work of the prior actuary. If the Appointed Actuary has changed from the prior year and finds that no such comparison to methods and/or assumptions is practical or meaningful, the actuary should make such a disclosure.

Paragraph 7: The Actuarial Report

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

The *Instructions* were recently revised to require the Actuarial Report to include additional components. The first four bullets were added recently; the latter two bullets have been requirements of the *Instructions* for many years.

Property and Casualty Practice Note 2014

- A description of the Appointed Actuary's relationship to the company with clear presentation of the actuary's role in advising the Board and/or management regarding the carried reserves. The Actuarial Report should identify how and when the Appointed Actuary presents the analysis to the Board and, where applicable, to the officer(s) of the company responsible for determining the carried reserves;
- An exhibit that ties to the Annual Statement and compares the actuary's conclusions to the carried amounts consistent with the segmentation of exposure or liability groupings used in the analysis. The actuary's conclusions include the actuary's point estimate(s), range(s) of reasonable estimates or both;
- An exhibit that reconciles and maps the data used by the actuary, consistent with the segmentation of exposure or liability groupings used in their analysis, to the Annual Statement Schedule P line of business reporting;
- An exhibit or appendix showing the change in the actuary's estimates from the prior Actuarial Report, including extended discussion of factors underlying any material changes;
- 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 unusual IRIS ratios for One-Year Development to Surplus, Two-Year Reserve Development to Surplus or Estimated Current Reserve Deficiency to Surplus, and how these factors were addressed in prior and current analyses.

With regard to the first bullet, the CASTF believes that the American Academy of Actuary's Property/Casualty Practice Note, *Statements of Actuarial Opinion on Property and Casualty Loss Reserves*, provides germane sample illustrative wording covering regulators' expectations with regard to this disclosure.

The second bullet replaced the previous language: "An exhibit which ties to the Annual Statement and compares the actuary's conclusions to the carried amounts." The Actuarial Opinion Summary already provides this information at the highest level of aggregation; this information should still be presented in the Actuarial Report. However, the language added in 2012 was intended to capture the comparisons at a more detailed level consistent with how the reserves were analyzed, to the extent these comparisons are possible.

The third bullet further clarifies the requirement for a Schedule P reconciliation and replaces the previous language: "Documentation of the required reconciliation from the data used for analysis to the Annual Statement Schedule P." Regulators are at least 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 actuary should reconcile all data elements to the extent used in the analysis such as claim counts and earned premium.

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

The fourth bullet was added in response to the recommendation by the Casualty Actuarial Society's Task Force on Actuarial Credibility in an effort to improve the transparency of disclosures in actuarial work. 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. The CASTF 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 actuary feels is appropriate to put the current year's results in the context of the prior year's results. Thus, the actuary should judge at what level of aggregation the comparisons are meaningful. Further

Property and Casualty Practice Note

2014

note that this exhibit or appendix is to show the change in the actuary's estimates, not the company's. If the Appointed Actuary has changed from the prior year and no such comparison is practical or meaningful, the actuary should make a disclosure consistent with that reported in the Opinion.

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

1. **Expected Loss Ratios.** When using methodologies that rely on expected loss ratios, particularly in a long-tailed line or new business segment, the CASTF expects the documentation to include recognition of pricing and underwriting information in the recent years, loss costs and loss inflation. Historical loss ratio indications have little value if rate actions, credit adjustments or program revisions have affected premium adequacy or inadequacy.
2. **Actuarial Judgment.** The use of this phrase in an Actuarial Report, in either the narrative comments or in exhibit footnotes, is not considered to be proper explanation. A descriptive rationale is needed.
3. **Schedule P Reconciliation.** The CASTF believes that a summary reconciliation (all years and all lines combined) is an insufficient demonstration of data integrity. The risk of lack of data integrity is increased as companies cut data into finer pieces. A reconciliation should include enough detail to reflect the segmentation of exposure or liability groupings structure used in the reserve analysis, the accident years of loss activity and the methods used by the actuary. See more discussion on this topic above.
4. **Underwriting Pools and Associations.** The CASTF expects the Actuarial Report to include exhibits that reconcile with the net amount shown in Exhibit B Item 10, including a reconciliation to Schedule F or discussion if the amount cannot be reconciled to Schedule F, as well as a list of the pools and associations with the associated reserve amounts. If the 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. Ideally, the regulators would also like to see support for pools and associations on a direct and assumed basis so differences from net to gross can be understood.

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

The CASTF believes that regulators should be able to rely on the Actuarial Report as an alternative to developing their own independent estimates. A well-prepared and documented Actuarial Report that is consistent with the spirit of ASOP No. 41 can provide a foundation for efficient reserve evaluation within a statutory financial examination. This provides benefits to the examination process and potential cost-savings to the company.

Paragraph 8: Signature

Paragraph 8 is unchanged for 2014.

Paragraph 9: Notice Regarding Errors

Paragraph 9 of the *Instructions* outlines the requirements of company management to provide corrected actuarial documents to the domiciliary regulator when data errors occur. When an error is discovered by the Appointed Actuary, the company or the regulator, regulators expect to see a revised Opinion. Regardless of the reason for the change or re-filing of an Opinion, the revised Opinion document should be submitted in hard copy and electronically within 10 business days. The revised Opinion should clearly state that it is an amended filing, should contain or accompany an explanation for the revision, and should include the revised date.

Property and Casualty Practice Note

2014

Exhibits A and B

Note that Exhibit B, Item 12 includes extended loss and expense reserves for all P&C lines of business, not just Medical Professional Liability, which is addressed in the Schedule P Interrogatory.

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 mechanical queries on demographic information and financial data. Appointed Actuaries should refer to the *Instructions* and prepare exhibits to assist the company in accurately populating the electronic submission.

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

Property and Casualty Practice Note
2014

Appendix 2b

Adopted September 9, 2014



REGULATORY GUIDANCE On the Property and Casualty Actuarial Opinion Summary For the Year 2014

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

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

Changes were made to Paragraph 6 of the 2014 *Instructions*, related to intercompany pooling.

Form

The Summary is intended to be a **confidential** document separate from the Statement of Actuarial Opinion (Opinion). The CASTF advises the Appointed Actuary to provide the Summary to his or her company separately from the Opinion. The Summary should be clearly labeled and identified prominently as a confidential document.

The CASTF advises that, in order to avoid confusion, the Appointed Actuary should not attach the related Opinion to the Summary.

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

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

Regulators expect that when the Appointed Actuary, the company or the regulator discovers an error in the Summary, the revised Summary document be submitted only to the regulator within 10 business days. The revised Summary should clearly state it is an amended document, should contain or accompany an explanation for the revision, and should include the revised date.

Substance

The entire substance of the Summary rests in Paragraph 5. The required information for Parts A–D of Paragraph 5 is highlighted by the straightforward examples provided in the Summary section of the American Academy of Actuary's Property/Casualty Practice Note, *Statements of Actuarial Opinion on Property and Casualty Loss Reserves*.

The content of the Summary should reflect the analysis performed by the Appointed Actuary, because the Summary is a synopsis of the conclusions drawn in the Actuarial Report. Therefore, all of the actuary's calculated estimates, including actuarial central estimates and ranges, are to be presented in the Summary consistent with estimates presented in the Actuarial Report.

Property and Casualty Practice Note

2014

Regulators expect that point or range estimates reported in the Summary 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 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 Opinion and provides more relevant information to the domiciliary regulator of the pooled companies. For non-0% companies, regulators expect that carried values reported in the Summary can be tied back to values reported in the Annual Statement and the Opinion, and that actuarial estimates can be tied back to the Actuarial Report.

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.

For 0% pooled companies, the information should be that of the lead company.

Property and Casualty Practice Note
2014

Appendix 3

Frequently Asked Questions Regarding the Practice Note

QUESTION 1:

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

DISCUSSION 1:

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

Materiality is further discussed in [Appendix 10](#).

QUESTION 2:

When is a carried reserve reasonable?

DISCUSSION 2:

[ASOP No. 36](#), Section 3.7 states that 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 professional judgment, consistent with both [ASOP No. 43, Property/Casualty Unpaid Claim Estimates](#), and the identified stated basis of reserve presentation.

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

The actuary will be guided by [ASOP No. 36](#).

QUESTION 3:

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

Property and Casualty Practice Note
2014

DISCUSSION 3:

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

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

QUESTION 4:

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

DISCUSSION 4:

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

QUESTION 5:

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

DISCUSSION 5:

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

Property and Casualty Practice Note 2014

reflect information such as the number of open claims, dollars of total case loss reserves, and types of policies written. The use of such professional judgment does not necessarily require a qualified opinion. With this in mind, there are a number of possible situations that may arise, including:

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

Situation 2: An actuary reviews a quantitative analysis performed by another 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.

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

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

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

QUESTION 6:

Pursuant to [ASOP No. 36](#), effective May 1, 2011, there is a significant change with respect to how actuaries can make use of the work of another actuary. Within this context, how would the opining actuary treat pools when an opinion is provided by another actuary on behalf of the pool?

DISCUSSION 6:

The actuary would typically respond in one of three ways:

1. The actuary may conclude that such reserves are likely to be immaterial or that the potential variability of the pool's reserves would not affect the actuary's conclusion on the total reserve and

Property and Casualty Practice Note

2014

would respond as in Situation 1 (Question 5) above. In this instance, there is no need to qualify the opinion.

2. The actuary may make use of the work of the pool actuary and make such disclosures as necessary in accordance with ASOP Nos. [36](#), [41](#), and the Instructions. In this instance, there is no need to qualify the opinion.
3. The actuary may qualify the opinion to exclude this business.

QUESTION 7:

What is a clean opinion?

DISCUSSION 7:

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

QUESTION 8:

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

DISCUSSION 8:

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

QUESTION 9:

What constitutes pre-paid loss adjustment expense as discussed in [SSAP 55, paragraph 5](#) of the NAIC *Accounting Practices and Procedures Manual*, and why does a company still need to record a liability for unpaid loss adjustment expenses if it has “pre-paid” such expenses?

Property and Casualty Practice Note
2014

DISCUSSION 9:

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

According to **SSAP 55, paragraph 5** of the NAIC *Accounting Practices and Procedures Manual*, the liability for unpaid loss adjustment expenses should be established regardless of any such pre-payments.

QUESTION 10:

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

DISCUSSION 10:

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

Property and Casualty Practice Note
2014

Appendix 4

Miscellaneous Illustrative Wordings in Common Use

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

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

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

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

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

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

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

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

Property and Casualty Practice Note
2014

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

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

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

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

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

Opinions have included language to indicate the intended audience:

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

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

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

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

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

Property and Casualty Practice Note
2014

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

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

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

1. New company—opinion formed

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

2. New company—no opinion formed

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

Appendix 5 **Evaluation and Reconciliation of Data** **(Section 4 of Opinion Instructions)**

“I evaluated the data for reasonableness and consistency.”

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

NOTE:

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

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

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

Property and Casualty Practice Note
2014

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

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

This sentence normally means the following:

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

DISCUSSION:

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

Property and Casualty Practice Note 2014

and associations and other business), then the data relied upon can be aggregated to the level shown in Schedule P. Similarly, if the actuary chooses to combine some Schedule P lines of business for purposes of the actuarial study, then the Schedule P data can be aggregated as needed for comparison.

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

**Property and Casualty Practice Note
2014**

then, in forming the opinion on year-end reserves, the actuary would typically compare the actual year-end data against expected year-end values based on the earlier evaluation. The actual year-end values would typically still be reconciled to Schedule P.

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

Property and Casualty Practice Note
2014

Appendix 6

Data Testing Requirements

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

Note that the data testing requirement paragraph, included in this Appendix as Attachment 1, is found in the NAIC P&C Annual Statement Instructions “Annual Audited Financial Reports.” Beginning in 2013, a similar data testing paragraph can also be found in the NAIC Annual Statement Instructions for title insurance companies.

Data Testing Requirement in 2014 P/C Annual Statement Instructions: Guidance for Actuaries Signing Statements of Actuarial Opinions on Loss and Loss Expense Reserves

As noted above, the 2014 NAIC Instructions include a data testing paragraph in the Annual Audited Financial Reports section. This statutory guidance is included as Attachment 1 and referred to as “the data testing requirement” in this document. The Annual Statement Instructions further address the auditor’s review of data used by the Appointed Actuary. For purposes of this letter, the term “loss reserves” is intended to include loss adjustment expense reserves and any other items within the scope of the statutory Statement of Actuarial Opinion.

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

This communication by the American Academy of Actuaries Committee on Property and Liability Financial Reporting (COPLFR) is intended to provide advisory, non-binding guidance to the actuarial community and help describe the respective roles of management, the actuary and the auditor in fulfilling this requirement. *This communication is not an Actuarial Standard of*

Property and Casualty Practice Note 2014

Practice. It has not been adopted by the Actuarial Standards Board (ASB) and is not binding on any actuary.

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

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

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

Attachment 3 is a list of questions and answers that may be useful to you as you work through this process with companies and their auditors. Actuaries may also wish to consult Actuarial Standard of Practice ([ASOP No. 23](#)) regarding the nature and boundaries of the actuary’s responsibilities regarding data quality.

COPLFR generated this document after discussions with the AICPA, the NAIC/AICPA Working Group and the NAIC Casualty Actuarial Task Force. Actuaries are not normally trained to define or specify audit procedures and therefore we look to insurance companies and their auditors as having the ultimate responsibility for determining how to comply with the data

Property and Casualty Practice Note 2014

testing requirement. Questions about the data testing requirement as it relates to specific companies should be directed to the companies' domiciliary regulators.

Attachment 1

Data Testing Requirement (from 2014 P&C Annual Statement Instructions Page 19, “Annual Audited Financial Reports”)

The reporting entity shall require the independent certified public accountant to subject the current Schedule P – Part 1 (excluding those amounts related to bulk and IBNR reserves and claim counts) to the auditing procedures applied in the audit of the current statutory financial statements to determine whether Schedule P – Part 1 is fairly stated in all material respects in relation to the basic statutory financial statements taken as a whole. It is expected that the auditing procedures applied by the independent CPA to the claim loss and loss adjustment expense data from which Schedule P – Part 1 is prepared would be applied to activity that occurred in the current calendar year (e.g., tests of payments on claims for all accident years that were paid during the current calendar year). [Refer to American Institute of Certified Public Accountants Statement of Position 92-8.]

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

Property and Casualty Practice Note
2014

Attachment 2

Sample Letter to Company Management (Copy to Auditor)

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

Mr. CFO
XYZ Insurance Company

Dear Mr. CFO:

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

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

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

1. Direct and Ceded Paid Loss and Defense and Cost Containment Expense (DCC) by reviewed line of business and by accident year, at annual evaluations as of XX/XX/201X. 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/201X. For Workers' Compensation, this data is

Property and Casualty Practice Note 2014

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

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

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

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

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

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

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

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

Property and Casualty Practice Note
2014

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

Yours truly,
Ms. Actuary

cc: Mr. Partner, ABC CPA

Property and Casualty Practice Note
2014

Attachment 3

Answers to Frequently Asked Questions

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

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

Answer:

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

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

Answer:

- Not all data identified by the Appointed Actuary as significant will be tested by the auditor, and not all data will be tested each year. This is a matter of auditor judgment and depends on the auditor's assessment of materiality and other considerations.

Property and Casualty Practice Note 2014

- The Appointed Actuary is relying on management for the fair presentation of the data. The Appointed Actuary is not required to follow up with the auditor as to what data has been tested, or to disclose such information in the opinion or report.

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

Answer:

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

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

Answer:

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

Property and Casualty Practice Note 2014

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

Answer:

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

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

Answer:

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

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

Answer:

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

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

Answer:

- As soon as practicable, the Appointed Actuary discusses the change with management and the auditor.

Property and Casualty Practice Note 2014

- The actuary should not be limited in the use of various methods or data by the original list of “significant” data.

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

Answer:

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

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

Answer:

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

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

Answer:

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

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

Answer:

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

Appendix 7

Unearned Premium for Long Duration Contracts

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

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

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

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

OPINION LANGUAGE:

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

The Section 4 and Exhibit A: SCOPE (Items 7 and 8) Instructions request disclosure of the unearned premium reserve 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*

Property and Casualty Practice Note 2014

(subset of the Underwriting and Investment Exhibit Recapitulation of All Premiums, Total Reserve for Unearned Premiums)

- (8) *Reserve for Net Unearned Premium for Long Duration Contracts*
(subset of the Liabilities, Surplus and Other Funds page, Unearned Premiums line)
- (9) *Other Premium Reserve items on which the Appointed Actuary is expressing an opinion*

Further, the NAIC Instructions require that, if the Scope of the opinion includes material unearned premium reserves for long duration contracts, the opinion cover the following illustration as item (D) of the OPINION section of the opinion:

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

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

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

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

The NAIC Instructions do not require disclosure of these amounts in the opinion. Descriptions of the review procedures performed, including application of the three tests and the associated assumptions as appropriate, are included in the Actuarial Report supporting the opinion. However, the actuary may wish to state in the opinion that the three tests were performed or provide further discussion in the RELEVANT COMMENTS section.

ILLUSTRATIVE WORDING:

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

1. The company writes no long duration contracts,

Property and Casualty Practice Note
2014

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

Situation 1 The company writes no long duration contracts.

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

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

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

When the company writes an amount of long duration contracts that develop an unearned premium reserve that is immaterial when combined with the loss and loss adjustment expense reserves, the opining actuary 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 opinion may be worded along the following lines:

Total net unearned premium for the company as recorded on the Liabilities, Surplus and Other Funds page, Unearned premiums line of the Annual Statement is \$_____. The unearned premium for long duration contracts, to which this opinion applies, is ___, representing ___ percent of the total net unearned premium for the company. This component of the unearned premium is not material to the company when combined with the loss and loss adjustment expense reserves and 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, loss-adjustment expense, and long duration unearned premium reserves.

When the long duration contract unearned premium reserve is material, the actuary would likely include the amounts in Exhibit A: SCOPE (Items 7 and 8) and also include item (D) in the OPINION paragraph. The actuary may choose to apply language similar to the language described in the portion of this section labeled Opinion Language and may choose to include further discussion in the RELEVANT COMMENTS section.

Property and Casualty Practice Note
2014

Appendix 8

Intercompany Pooling

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

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

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

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

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

Section 1C of the 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.

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

Property and Casualty Practice Note 2014

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. 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.

or

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

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.

- 2 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. 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.

- 3 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.

Property and Casualty Practice Note 2014

The Actuarial Opinion Summary and Intercompany Pooling:

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. Also according to the AOS Instructions, for those companies whose participation percentage is zero percent, the information provided for paragraph 5 should be that of the lead company.

Appendix 9

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 2014 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 whether this

Property and Casualty Practice Note 2014

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 2014

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

Loss Reserves:

- | | <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) | \$ _____ |

Premium Reserves:

- | | |
|--|----------|
| 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
2014

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) \$ _____

Property and Casualty Practice Note 2014

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

Property and Casualty Practice Note
2014

Appendix 10

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

Note: This document was prepared by the Valuation, Finance, and Investments Committee in 2000 and, therefore, has not been updated to reflect the revisions made to ASOP No. 36 effective May 1, 2011.

Introduction

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

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

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

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

1. **Materiality and ASOP No. 36:** Discusses the use of the concept of materiality in ASOP No. 36, highlighting its impact on decisions made by the actuary in the course of preparing a SAO.
2. **Materiality in Accounting Contexts:** Reviews the concept of materiality in accounting contexts, including both regulatory and Securities Exchange Commission (SEC) financial reporting. This discussion is not intended to be

112

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Appendix 10
Materiality Considerations (Provided by CAS VFIC)

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Property and Casualty Practice Note 2014

guidance for the actuary, since an actuary's issues and concerns are not in general the same as those of accountants. Instead, this review is provided to enrich the discussion of potential issues with regard to materiality.

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

Discusses qualitative and quantitative concepts the actuary may wish to consider while coming to a professional judgment on materiality in the context of ASOP No. 36. Although certain quantitative measures can be suggested for consideration in certain circumstances, no formulaic approach to a quantitative materiality standard can be developed.

Several caveats are in order at this point:

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

Materiality and ASOP No. 36

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

Property and Casualty Practice Note 2014

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

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

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

Again, please note that VFIC has not reproduced [ASOP No. 36](#) in this note. Actuaries should read that document in conjunction with this one.

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

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

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

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

Specific considerations listed in Section 3.5 are the following:

Property and Casualty Practice Note 2014

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

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

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

Section 4.5 Changes in Opining Actuary's Assumptions, Procedures, or Methods:
“If a change occurs in the opining actuary's assumptions, procedures, or methods from those previously employed in providing an opinion on the entity's reserves, and if the actuary believes that the change is likely to have a **material** effect on the results of the actuary's reserve analysis, then the actuary should disclose the nature of the change. If the actuary can not make a judgment as to whether the change is likely to have a **material** effect on the results of the actuary's reserve analysis, the actuary should disclose that there has been a change in actuarial assumptions,

Property and Casualty Practice Note 2014

procedures, or methods, the effect of which is unknown. No disclosure is required unless the actuary believes that the changes are likely to have a ***material*** effect on the results of the actuary's reserve analysis."

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

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

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

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

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

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

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

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

Property and Casualty Practice Note 2014

Materiality in Accounting Contexts

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

A. NAIC Accounting Practices and Procedures Manual

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

In narrowing the definition, the following considerations are discussed:

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

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

B. SEC Staff Accounting Bulletin No. 99

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

Property and Casualty Practice Note 2014

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

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

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

- There should not be exclusive reliance on a percentage or numerical threshold to determine something is material or not.
- The use of a percentage or numerical threshold may provide the basis for a preliminary assumption regarding materiality.
- A matter is material if there is a substantial likelihood that a reasonable person would consider it important.
- Both "quantitative" and "qualitative" factors should be considered in assessing an item's materiality. Experienced human judgment is necessary and appropriate.

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

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

- whether the misstatement arises from an item capable of precise measurement or

Property and Casualty Practice Note 2014

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

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

Materiality, Statements of Actuarial Opinion, and [ASOP No. 36](#)

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

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

Property and Casualty Practice Note 2014

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

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

A. SAOs Filed with Statutory Annual Statements

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

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

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

- Absolute magnitude of item that represents a correction or a different result if reviewing the work of others.
- Absolute magnitude of item for which data are not available or are incomplete.
- Ratio of item to reserves or statutory surplus.
- Impact of item on IRIS ratios.
- Impact of item on risk-based capital results.

Property and Casualty Practice Note 2014

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

SAOs Prepared for Other Purposes

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

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

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

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

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

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Property and Casualty Practice Note
2014

Appendix 11

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.

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

This document³ 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

³ 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.

Property and Casualty Practice Note 2014

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.

Property and Casualty Practice Note 2014

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 expenses⁴ (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

⁴ 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.

Property and Casualty Practice Note 2014

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.

- *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”⁵ 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).⁶ 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”⁷ from the recorded estimate.

Oversight Function Considerations – Loss Reserve Estimates

⁵ 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.

⁶ 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)

⁷ The SAO instructions require the appointed actuary to disclose their materiality standard”

Property and Casualty Practice Note 2014

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

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.”⁸ This estimation process is often led by actuaries and requires the input of others from multiple disciplines. Those providing input typically include the claims department, legal counsel, underwriting, and relevant business units, with the final decision on the estimate to book being the responsibility of company management. That said, actuarial input is vital to management’s process, as the actuarial estimates typically consider and incorporate input from all involved disciplines.

Members of audit committees and boards of directors benefit from understanding the significant judgments and assumptions incorporated into the loss reserve estimates that are made by management and by the actuary. The significance of this understanding can extend beyond loss reserves, as the findings or observations that inform those judgments may also 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

⁸ 2014 NAIC Accounting Practices & Procedures Manual – Statement of Statutory Accounting Practices (SSAP) No. 55, paragraph 10.

Property and Casualty Practice Note 2014

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.

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

Property and Casualty Practice Note 2014

analysts and other users⁹ 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 regulation¹⁰, 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 Report¹¹, 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).

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.¹² 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"¹³ of loss reserves based on various combinations of these methods and assumptions. This range is typically developed by the Appointed Actuary

⁹ 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."

¹⁰ 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.

¹¹ The Actuarial Report is required and defined by the SAO instructions, and its purpose is to document the SAO findings.

¹² 2014 NAIC Accounting Practices & Procedures Manual, SSAP No. 55, paragraph 12: "Management ... shall include an analysis of the amount of variability in the estimate."

¹³ 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.

Property and Casualty Practice Note 2014

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.

Property and Casualty Practice Note 2014

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 consistency¹⁴.

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.

¹⁴ This is a requirement of both Actuarial Standard of Practice No. 23 – Data Quality, as well as the SAO instructions.

Property and Casualty Practice Note 2014

- 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.

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

Property and Casualty Practice Note 2014

reserving and pricing roles. The perspectives provided by the pricing and reserving functions are often different, with the pricing function focusing on the profitability of current and future business. By contrast, the reserving function focuses on the potential outcomes connected with business written in the past (sometimes even in markets that the company has since left). As such, the reserving function acts to some extent as an early warning test or report card on past pricing and/or underwriting performance. This creates a potential conflict of interest when the same people perform both functions. Where resources do not allow separate staffing of these two functions, audit committee members should be aware of the potential conflict of interest that arises from the same people performing both functions.

- *Use of reserve committees.* Some insurance companies have reserve committees or an equivalent oversight management group, often organized at one or more management segment level(s) (e.g., legal entity, line of business, region). The committee might include the segment's executive management, the segment's internal reserving actuary or actuarial consultant, and heads of key operating functions (e.g., claims, underwriting, marketing).

Having a reserve committee does not ensure objectivity, and members of audit committees and boards of directors may wish to inquire further to determine its effectiveness. The extent to which a reserve committee improves objectivity is partly a function of the quality and efforts of the reserve committee members. Members of audit committees and boards of directors 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.

Property and Casualty Practice Note 2014

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.
- *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.

Property and Casualty Practice Note 2014

- Management makes clear to the actuary that his/her continued employment is contingent upon agreement with management's reserve estimates.
- The opining 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.