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RE: REG-2017-00018

We commend the California Insurance Commissioner and Department of Insurance for their effort to protect California workers by decreasing the risk of insurer insolvency via new regulations concerning workers' compensation high-deductible policies. The American Academy of Actuaries[1] Committee on Property and Liability Financial Reporting has several comments and recommendations relating to the impact on annual statement schedules, implementation impact, and credit risk relating to the proposed regulation.

Impact on Annual Statement Schedules

Section (a)(1) of the proposed regulation defines that an insurer shall report uncollateralized *Deductible Ultimate Receivables* as "a loss in its Financial Statements." We assume the proposed regulation and Initial Statement of Reasons are using "loss" in broad terms as an impact to the insurer's income statement rather than the more specific definition of underwriting loss and expense. We have two distinct recommendations for how this "loss" would flow through financial statements:

- Separate the *Deductible Ultimate Receivables* into the *Deductible Recoverable*[2] and the *Deductible Loss Reserve* for reporting purposes; and

[1]The American Academy of Actuaries is a 19,000 member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

[2] This letter defines the term "deductible recoverable" using the terms in the regulation as *Deductible Ultimate Receivables* less *Deductible Loss Reserves*.

- Use write-in line items on the financial statements to record the "loss," maintaining the underwriting loss and expenses in the financial statements on a net of deductible basis regardless of collateralization.[3]

These recommendations would result in the "loss" being recognized by the insurer; increase transparency in the financial statements by delineating credit risk and underwriting risk; be largely consistent with existing statutory accounting principles on high-deductible policies included in Statement of Statutory Accounting Principles (SSAP) 65; be similar to the accounting treatment regarding insurer's credit risk related to the reimbursement of losses ceded to reinsurers; and avoid a multitude of downstream impacts on various loss schedules in the insurer annual statements if the "loss" were to be recorded through underwriting loss and expenses (e.g., distortion to development patterns in the National Association of Insurance Commissioners (NAIC) Schedule P, changes to risk-based capital results, etc.).

Specific recommendations for the two components for reporting purposes are included below:

<u>Deductible Recoverable</u>

We recommend the non-collateralized *Deductible Recoverable* be reported as a non-admitted asset (assuming credit risk requirements are not met). This presentation would be largely consistent with the existing statutory accounting principles on high-deductible policies included in SSAP 65. Per SSAP 65, the *Deductible Recoverable* "shall be accrued and recorded as a reduction of paid losses simultaneously with the recording of the paid loss…" SSAP 65 further defines situations where the accrual will be either partially or fully reflected as non-admitted to reflect the credit risk of potential non-reimbursement.

<u>Deductible Loss Reserves</u>

We recommend insurers report the uncollateralized *Deductible Loss Reserves* as a write-in liability on the balance sheet. This approach would be similar to the accounting treatment regarding the credit risk related to the reimbursement of losses ceded to reinsurers. In that case, the reported loss reserves are on a net basis while the Provision for Reinsurance Liability line item on the balance sheet is utilized to prevent surplus benefit from amounts ceded to certain reinsurers. Further, segregating the credit risk from uncollateralized *Deductible Loss Reserves* from underwriting losses will result in greater transparency for the issue at hand.

Implementation Impact

Insurers that do not already obtain the collateral and security requirements specified in the regulation may be able to adopt processes to rectify this for high-deductible policies they write in the future. However, these insurers would likely have more difficulty obtaining sufficient collateral for policies previously written that may still have significant *Deductible Loss Reserves*.

[3] Note that there would be no reserve credit for any amount due from the insured that has been determined to be uncollectible, which at that point have essentially been transferred from a credit risk to an underwriting risk.

Thus, the implementation of this regulation, if applied retrospectively, could result in a potentially significant financial impact for certain insurers to which they may have little to no recourse.

Credit Risk

Subdivision (c) of the proposed regulation discusses credit risk requirements, stating credit rating and minimum capital amounts for an insurer to be exempt from reporting uncollateralized *Deductible Ultimate Receivables* as a loss. While we recognize the enhanced focus of a tailored regulatory system to take into account different risk profiles of insurers, the long tail of workers' compensation claims complicates the issue of which insurers are at risk of potential insolvency. The length of time an insurer will have *Deductible Ultimate Receivables* outstanding can extend many years after an underlying workers' compensation policy is written.

Thank you for the opportunity to share our thoughts on this matter with the California Department of Insurance. If you have any questions or would like to discuss this in more detail, please contact Marc Rosenberg, the Academy's senior casualty policy analyst, at rosenberg@actuary.org or 202-785-7865.

Sincerely,

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Chairperson
Committee on Property and Liability Financial Reporting