



AMERICAN ACADEMY *of* ACTUARIES

Comment #5 - June 30, 2010 - 3:15 p.m.

ASOP No. 36 Revision
Actuarial Standards Board
1850 M Street, Suite 300
Washington, DC 20036
Via email: comments@actuary.org

Re: Comments on the Proposed Revision of Actuarial Standard of Practice No. 36 – 2nd
Exposure Draft

Dear Actuarial Standards Board Members:

The Committee on Property Liability Financial Reporting (COPLFR) of the American Academy of Actuaries¹ appreciates this opportunity to comment on the Actuarial Standards Board's (ASB) Second Exposure Draft of proposed revisions to Actuarial Standard of Practice (ASOP) No. 36 as prepared by the Subcommittee on Reserving of the Casualty Committee of the ASB (subcommittee).

First, we have a few comments about sections of ASOP No. 36 that are being removed altogether. Then, we provide responses to the two questions from the Request for Comments section of the proposed revision to ASOP No. 36. Last, we follow up with several additional comments on the Second Exposure Draft.

Any material change in the current ASOP No. 36, such as removing a section altogether, deserves mention in the transmittal memorandum (cover letter) to the Second Exposure Draft. For example, Section 3.7.4 – Risk Transfer Requirements was removed in the Second Exposure Draft. From the ASB reviewers' comments, it appears the reason this section was removed is that the determination of risk transfer is ultimately an accounting issue outside the scope of ASOP No. 36. We offer three comments on this matter.

- The elimination of this section of the current ASOP No. 36 is worthy of mention in the cover letter in order to sensitize members to this change. We recommend the subcommittee highlight the deletion of this paragraph in the cover letter to the Proposed Revision of ASOP No. 36.

¹ The American Academy of Actuaries ("Academy") is a 16,000-member professional association whose mission is to serve the public on behalf of the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

- We understand the ASB is pursuing a separate standard of practice on the issue of risk transfer. If this contributed to the decision to remove the section from ASOP No. 36, a note to that effect would be helpful to our members.
- Even though the determination of risk transfer is an accounting issue, the American Academy of Actuaries publishes a practice note on this topic, and the issue of risk transfer on individual reinsurance contracts may be relevant to the Appointed Actuary's determination of net reserve adequacy. While actuaries are not the decision-makers as to whether sufficient risk transfer exists in a given contract, we nevertheless provide useful information to that end for the accountant's consideration.

Furthermore, the subcommittee chose to eliminate the disclosure requirement of current ASOP No. 36 section 3.8.1. (We note this was eliminated in the first exposure draft as well.) We believe this "lowers the bar" for practitioners and recommend the disclosure language from the current ASOP No. 36 be reinstated (more discussion on this point follows below). However, we also understand the subcommittee may be working to eliminate duplicative or inconsistent language between ASOPs. In particular, if it is the subcommittee's intent to keep such disclosure requirements embedded in ASOP No. 41 and not repeated throughout other ASOPs (such as ASOP No. 36), such an important change should be highlighted in the cover letter in order to avoid any confusion among practitioners.

If, however, in the unlikely event that the subcommittee's intent was to eliminate the disclosure requirement altogether, we fundamentally disagree with that decision.

The subcommittee posed two specific questions in its Request for Comments to the Second Exposure Draft:

- 1. In regards to the changes concerning reliance on another actuary's work (as described above), the new language states the opining actuary can make use of another's work under certain circumstances, as described in 3.7.2. Is this language clear and appropriate?**

We have concerns about the re-write of this section. In particular, it appears the subcommittee is obscuring the distinction between reliance on another actuary's Statement of Actuarial Opinion (SAO) for the purpose of rendering his/her own SAO and reliance on another actuary's supporting analysis as part of a Review Opinion (also known as a Second Opinion).

Review Opinions are commonly sought by regulators in connection with statutory financial exams. In their desire to minimize costs, regulators often provide the Appointed Actuary's report and ask the reviewing actuary to perform a review that does not necessarily involve independent analysis. The final work product is a formal statement of actuarial opinion that would fall under item b of Section 2.1 (Scope) – the statement of actuarial opinion is otherwise prescribed by law or regulation. Current practice is for reviewing actuaries to perform the due diligence necessary to form a second opinion on the adequacy of held loss and loss adjustment expense (LAE) reserves. The review may appear limited given a reviewing actuary's agreement with certain elements of the Appointed Actuary's work product. In such circumstances, the reviewing actuary discloses reliance on the work product in his Statement of Actuarial Opinion. Given the wording in the Second Exposure Draft, such limited reviews would appear to be in non-compliance with section 3.7.2.

- We recommend the subcommittee first recognize that these statements of actuarial opinion are commonly rendered to regulators.
- If the subcommittee's intent is to consider such opinions inconsistent with the standard, we recommend the cover letter say that, with direction to the reviewing actuary to disclose it as a deviation from the standard (set forth in Section 4.3) required by law or regulation.

Otherwise, the circular disclosure requirements of ASOP No. 36, ASOP No. 9 (Section 5.8), ASOP No. 41 (Section 3.1.6) and the Introduction to the ASOPs (Section 4.5.5) relating to reliance on another actuary's work product will cause confusion and frustration on the part of our members.

We also note the language of Section 3.7.2 past the third sentence could be made clearer, and, to that end, we suggest that the following language replace the language of Section 3.7.2 contained in the Second Exposure Draft:

3.7.2 Evaluation Based on Actuary's Use of Another's Unpaid Claims Estimate Analysis or Opinion and the Use of Supporting Analysis of Another's Opinion When Providing a Second Opinion – In the course of conducting a reserve evaluation in support of an opinion as defined by this standard, the actuary may make use of another's opinion as defined in this standard either by itself or in conjunction with the analyses supporting ~~analyses or opinions~~ the other opinion.

- An actuary may be called upon to review the opinion and supporting analyses of another actuary in order to render an opinion on the loss and loss adjustment expense reserves. (This review of the work of another actuary and an opinion given based on that review is also known as a second opinion or a review opinion.) In the circumstance of a review opinion, the actuary's process will include a review of the other actuary's analyses and may be supplemented by the actuary's own analysis of portions of the reserves. The actuary may accept portions of the other actuary's analysis as reasonable without preparing a new analysis for the particular portions of the analysis.
- An actuary may also rely upon another's opinion for the entire scope of the other's opinion. The reserves covered by the scope of the other's opinion may form a portion of the reserves opined upon by the actuary.

The actuary should understand the intended purpose of the other's opinion analyses or opinions and assess whether the ~~analyses opinion or opinions~~ portions of the supporting analysis are consistent with the stated basis of presentation of the reserves covered by the actuary's opinion. The actuary should only make use of another's opinion or supporting analyses or opinions when, in the actuary's professional judgment, it is reasonable to do so. In making this determination, the actuary should consider the following:

- The amount of ~~the~~ reserves covered by the ~~others'~~ other's opinion or the supporting analyses or opinions of the other actuary in comparison to the total reserves subject to the actuary's opinion, ~~the nature of the business, how;~~

- b. The nature of the exposure and coverage that the other’s opinion or supporting analyses considers;
- c. The way in which reasonably likely deviations from the other actuary’s opinion or supporting analyses may affect-impact the actuary’s opinion on the total reserves subject to the actuary’s opinion;
- d. The credentials of the other individual(s) that prepared the analyses or opinions~~other opinion~~.

Where, in the opinion of the actuary, the ~~others’ analyses or opinions~~ other’s opinion or portions of the supporting analyses need to be modified or expanded, the actuary should perform such analyses as necessary to render an opinion on the total reserves.

If in using the supporting analyses performed by others, the actuary reaches conclusions materially different from those in the others’ work, the actuary should, when practical, contact the producers of those analyses to discuss the differences. Where material differences exist, the issues underlying the differences should be understood by the actuary. (Note that materiality is measured relative to the actuary’s opinion, not relative to the others’ analyses.)

2. In addition, feedback is encouraged on section 3.3(c), which states the actuary should identify the accounting standards applicable for the reserve (for example, US SAP, US GAAP, IFRS, etc.). This (along with other items) was added to the draft when the term “intended measure” was removed. The subcommittee believes it is appropriate for the actuary to be aware of the applicable accounting standards when providing a reserve opinion. The subcommittee does not intend for the actuary to opine on the accounting standards themselves or on whether reserves are booked in accordance with the accounting standards. Is this language clear and appropriate?

Yes, we believe the language is clear.

We offer additional commentary beyond the two specific questions to which the subcommittee sought feedback.

In Section 2.1 (Accounting Date), we recommend eliminating the phrase “as paid,” given that financial statements record amounts both paid and unpaid.

We recommend disclosure of differences that may arise between a reviewed and reviewing actuary. We note the subcommittee chose to drop this disclosure requirement (currently required per Section 3.8.1). We recognize the standard still instructs the reviewing actuary to “understand the differences” but we believe it is important that such differences (if material) be disclosed by the reviewing actuary. If dropping the disclosure requirement were due to the current disclosure requirements of ASOP No. 41 and the subcommittee’s expectations that members should be guided by other standards as relates to all disclosures, then we recommend that intent be made clear in the cover letter.

In COPLFR's response to the First Exposure Draft of the proposed Revision to ASOP No. 36, we commented that the disclosure requirements in Section 3.4 were unduly burdensome. In particular, section 3.4e requires "the types of unpaid loss adjustment expenses covered by the reserve (for example, coverage dispute costs, defense costs, and adjusting costs)." We recognize this language is identical to that of Section 3.3(d) of ASOP No. 43 and agree that the disclosure is entirely appropriate in a report supporting a Statement of Actuarial Opinion. However, the disclosure itself belongs there (in the report) and not in the Statement of Actuarial Opinion (as defined in Section 1.2 of ASOP No. 36). The NAIC defines dozens of specific expenses as LAE. We expect the subcommittee does not intend to have the actuary disclose a complete laundry list of such but instead wants a more general description of the types of LAE covered in the opinion. We recommend the desired specificity be made clearer.

We note the references in Section 4.3 (Deviation from Standard) refer to Sections 4.2, 4.3 and 4.4 of ASOP No. 41. The current ASOP No. 41 has only sections 4.1 and 4.2. Presumably, the subcommittee is referring to Sections 4.2, 4.3, and 4.4 of the Second Exposure Draft of the proposed revision to ASOP No. 41 currently being considered by the ASB. Given that this latter document has not yet been approved, we recommend any language referring to a draft ASOP be identified as such and contain caveats to the extent the final language may not be consistent with the language of the Exposure Draft.

COPLFR appreciates the opportunity to review the proposed revision to ASOP No. 36. Please do not hesitate to contact us should you have any questions concerning our response.

Sincerely,

Joseph A. Herbers
Chairperson, COPLFR
American Academy of Actuaries