

Comment #6 – 7/1/10 – 3:38 p.m.

Comments on Proposed Revision of Actuarial Standard of Practice No. 36 (Second Exposure Draft)

Section 1.2

The NAIC has instituted the requirement of a confidential actuarial opinion summary that provides more specific information about the actuary's point estimate or range. However, the wording of current ASOP exposure draft does not appear to include the issuance of the information contained in the summary as part of the scope of the ASOP.

I recommended that the scope of the ASOP be amended to include not only the statement of actuarial opinion itself, but also any reports or summaries which are based on, or provide the support for, the statement of actuarial opinion.

Suggested additional wording (in red bold) for Section 1.2:

If the actuary's statement of actuarial opinion is supported by, or is used in, other actuarial communications by the actuary, such as an actuarial opinion summary or an actuarial report, then this standard applies to the portion of such communications that relates to the actuarial statement of opinion.

Section 2.1 and 2.13

The definitions include three date definitions that are not included in the existing ASOP 36. However, the existing ASOP 36 makes reference to the CAS Statement of Principles on Loss Reserves, which includes definitions of these dates, but such reference is intended to be replaced by the wording in the ASOP. However, the definitions as provided in the Exposure Draft do not really provide any differentiation in the meaning between these two dates. The valuation date refers to transaction data used by the actuary, whereas the accounting date refers to a cutoff date for financial reporting or accounting systems. However, reality can be much more complex with respect to exactly how transactions data are processed and how various systems and manual entries are made into financial reporting systems. In practice, I have seen accounting date only used for specific financial reporting dates, typically the last day of the month for four specific quarter-end months (April 30, June 30, September 30, and December 31). However, a valuation date can be on any calendar day based on the information used to value assets or liabilities as of the end of business on that date. These dates can be the cause for confusion and litigation when they are not used appropriately. However, the definitions in the Exposure Draft are very vague and subject to various interpretations.

The only use of the accounting date and valuation date in the rest of the ASOP exposure draft is to require that the actuary identify these dates. However, there is no requirement to disclose these dates. What does identify mean with respect to these two dates? Does it simply mean to be aware of the dates? If the actuary's analyses depend on those dates, then perhaps the actuary should be consistent in how the dates are used in the actuary's data and analysis, and how the opinion is communicated with respect to the dates applicable to the intended use of the opinion.

The common definition of accounting date is fairly simple: "the date on which an accounting period ends". So why do actuaries need a different definition for accounting date?

Similarly, the valuation date is commonly defined as "Day as of which a valuator's estimate of value applies. Also called appraisal date." or "Valuation date is the specific point in time as of which the valuator's opinion of value applies (also referred to as "Effective Date" or "Appraisal Date")." So why do actuaries need a different definition for valuation date?

If the ASB believes that these date definitions should be retained in the ASOP, then they should be changed to the more common usage of the terms, as follows:

Suggested new wording (in red bold) for section 2.1:

*Accounting Date - **The date on which an accounting period ends.***

Suggested new wording (in red bold) for section 2.13:

*Valuation Date - **The date as of which the actuary's estimate applies to the opinion.***

Section 3.3(a) and (b)

This section requires the actuary to "identify" the reserve amount, the accounting date and the accounting standards. The reserve amount and accounting date seem to be really just disclosures and the ASOP should simply have them in the disclosure section rather than in this section. The reserve amount is required to be disclosed per Section 4.1 (d) of the ASOP, but the accounting date is not mentioned in the disclosures. What does identify mean in this case? Does it mean to be aware of the items, to understand them in some level of detail, or to disclose them? If only disclosure is necessary, then this should be moved to Section 4.

Section 3.3(c)

It could be onerous for the actuary to have the detailed knowledge and qualifications to determine which specific accounting standards should apply to the reserves and how such standards should be applied to the reserves. However, it is appropriate for the actuary to understand the basis of the reserves, such as might be required by specific accounting standards, and to provide an opinion that reflects such standards. Since the ASOP would not be restricted to only to cases when specific accounting standards apply, the ASOP wording should be modified to refer to the "stated basis" which may be affected by particular accounting standards.

Suggested edited wording (in red bold) for section 3.3(c):

*c. **if there are specific** accounting standards applicable to the **stated basis (per section 3.4) of the reserves (for example, US SAP, US GAAP, IFRS, etc.) , then the actuary should reflect such stated basis in developing their opinion.***

Section 3.4

The last word of this section should be changed from "reserve evaluation" to **opinion**.

Section 3.5

The first two items (a) and (b) appear to be just disclosure of the specific dates involved. There does not seem to be a reason to include these in the "Scope of the Analysis..." The review date is required to be disclosed per Section 4.1 (f) of the ASOP, but the valuation date is not

mentioned in the disclosures. The valuation date was apparently removed from the disclosures in response to comments from the first exposure draft, but it is not clear what “identify” means now? Does it mean to be aware of the dates, to understand them in some level of detail, but it is only required to disclose the review date? If only disclosure of the review date is necessary, then the valuation date requirement should be clarified.

Suggested edited wording (in red bold) for section 3.5(a):

If the actuary’s analyses and opinion depend on the valuation date, then the actuary should consistently apply that date in the actuary’s use of the data that underlies the actuary’s analysis and in the opinion with respect to the reference to the valuation date for the intended use of the opinion;

Sections 3.9, 4.1(h) and 4.2(e)

While I realize that the exposure draft is not really any different than the existing ASOP 36 with regard to the significant risk of material adverse deviation, I think the ASB is not meeting the needs of the public in the way this provision is used by many actuaries. The wording of the standard (current and proposed) results in what I see as a significant problem in the usefulness of actuarial opinions for many intended users, specifically the insurance regulators. I have heard and seen actuarial opinions where actuaries believe that a risk that is remote (trivial) is insignificant. I found a reference in accounting literature that defines “insignificant” as “having little or no importance; trivial” (paragraph 8 of Statement 97). Then if one can apply the logical antonym to conclude that any non-remote (non-trivial) risk should be considered “significant” for purposes of their actuarial opinions. I am sure that the intent of the ASOP wording is not to have every (or most) opinions issued with explanatory paragraphs.

I think that this interpretation of the word significant in the standard is not at all appropriate for many users of actuarial opinions, because it becomes merely a somewhat meaningless caveat added to many actuarial opinions. Also, it appears that the principal motivation for this interpretation is the actuary’s concerns about their liability of not declaring that there might be some risks that could turn out to be significant (and material). Consequently, they protect themselves by adding an adverse deviation explanatory paragraph as a matter of course to every opinion they issue.

This practice has the effect of then influencing other actuaries to interpret the guidance in a similar way due to concerns of not identifying some non-trivial risk that the reserves could be too low. I have seen this practice used pretty consistently by one major actuarial firm even in a case where the company had a long and consistent history of reserve redundancies emerging in their statutory annual statement reserve runoff. I do not think the ASB should restrict the freedom of actuaries to caveat their actuarial opinions, but the current practice is not a good one.

If the choice of the word “significant” for the ASOP results in an interpretation of that word as synonymous with “non-trivial” or “reasonably possible”, then perhaps the ASOP wording is not consistent with the intent of requiring the explanatory paragraph. Perhaps the need for an “explanatory paragraph regarding adverse deviations” should be changed to material adverse deviations that are within the actuary’s range of reasonable reserves, or for material adverse deviations that are less than the maximum amount that the actuary believes is reasonable. The actuary could still provide whatever caveat or limitations they feel they need, but the use of the explanatory paragraph would be restricted. If the actuary believes that there are significant

risks and uncertainties that could result in a material adverse deviation that is greater than the actuary's reasonable range, then the actuary would not use an explanatory paragraph to communicate that concern. This might cause actuaries to take a more critical look at how they set their ranges, but that should be an improvement in practice.

The suggested wording below also seems to be consistent with my understanding of how the regulators use the information provided in the actuarial opinion summary.

Suggested edited wording (in red bold) for first paragraph of Section 4.2(e):

*If the actuary believes that there are significant risks and uncertainties that could result in material adverse deviations **that are less than or equal to the maximum amount that the actuary believes is reasonable**, an explanatory paragraph should be included in the statement of opinion. (See sections 3.6 and 3.9 for guidance on evaluating materiality and adverse deviation.) **If the actuary includes an explanatory paragraph in the opinion, the actuary should disclose the maximum amount that the actuary believes is reasonable.** The explanatory paragraph should **also** contain a description of the major factors or particular conditions that the actuary believes could result in material adverse deviations.*

Sections 3.7 and 3.11(a)

The "Determination of Reasonable Provision" in 3.11(a) refers to section 3.7 with respect to what the actuary should use in their determination "when the reserve is found to be reasonable". The reasonableness standard articulated in section 3.7 is "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..." However, the ASOP exposure draft is very lacking in providing any guidance for the actuary in selecting a range except that it could include any estimate that "could be produced by an unpaid claim estimate analysis" as long as it is "consistent, in the actuary's professional judgment, with both ASOP 43 and the identified stated basis..." This is an inadequate replacement for the current ASOP 36 language in 3.6.4 "could be produced by appropriate actuarial methods or alternative sets of assumptions that the actuary judges to be reasonable." The issue is that the exposure draft only refers to the actuary's judgment concerning consistency with ASOP 43 and the stated basis, rather than the current reference to the actuary's judgment about reasonable methods and alternative sets of assumptions.

Suggested edited wording (in red bold) for Section 3.7:

*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, in the actuary's professional judgment, **considers the reasonableness of the unpaid claim estimate, and** is consistent with both ASOP No 43, Property/Casualty Unpaid Claim Estimates, and the identified stated basis of reserve presentation.*

Submitted by:

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