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Ask the Actuary: Year-End Actuarial Analyses

Actuarial analyses project outstanding liabilities used by company management in establishing financial statement loss reserves at fiscal year-end. For RRGs and other insurers, the year-end analysis also supports regulatory filings, including the NAIC Statement of Actuarial Opinion (SAO). While self-insurers and captives may not have the same regulatory requirements, many of the SAO items below are also considered during their actuarial analyses. Additionally, the issues touched upon by these items are of interest to auditors and should be considered by management when assessing the program's financial position.

Q: Besides loss and loss expense reserves, what are some other important items to be aware of in the SAO?

Risk of Material Adverse Deviation – In order to assist regulators in identifying potential problems, actuaries are required to discuss significant risks or uncertainties that could result in material adverse deviation of the loss reserves (i.e., significant upward adjustments). The amount considered to be material is chosen by the actuary, based on company-specific factors such as type of business written, capitalization level, geographic spread of risk, or coverage limits provided.

Premium Deficiency Reserve – If an unearned premium reserve must be established at fiscal year-end because, for example, the company's fiscal year and policy year do not coincide, the actuary must review the adequacy of that unearned premium reserve using current data to determine whether a premium deficiency reserve is needed. A premium deficiency reserve is required when losses are expected to exceed premiums/ funding for the remainder of the unexpired policies. This creates an additional liability amount that needs to be reflected on the company's financial statements.

Reinsurance Collectability – The actuary should consider ceded amounts with troubled reinsurers (e.g., those in liquidation or rehabilitation) or ceded amounts in dispute and discuss the ramifications of such amounts if they are significant relative to net reserves and surplus. However, the actuary may only have access to a limited amount of information with which to review and comment on the financial condition of reinsurers.

Risk-Based Capital (RBC) Calculations & Financial Ratio (IRIS) results – These are RRG and insurer-specific calculations that are provided to the actuary for review. The risk-based capital formula attempts to measure the amount of capital/surplus needed to absorb the many types of risk that insurance companies are exposed to, such as asset, credit, underwriting, reserving, and premium risk. The IRIS ratios are a predecessor to the RBC calculations and are used to raise red flags related to items such as rate of premium growth, investment yield, changes in surplus, and loss reserve development. The actuary should review these amounts and provide comment when appropriate.

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