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The Use of Reliance in Actuarial Opinions

by Frank S. Irish

When appointed actuaries of life companies file their annual statement reserve opinions, it is quite normal for those opinions to state reliance on others for various inputs that were used in the work. It is important to properly utilize reliance and to recognize the limits on how much reliance is allowed to appointed actuaries.

The Need for Reliance

On the one hand, reliance is a way for appointed actuaries to avoid the impossible burden of taking responsibility for everything in the company that might have a bearing on the formation of reserve opinions. It is quite normal for other company employees to prepare the required listings of inforce, the listings of assets for cash flow testing and, quite frequently, the projection of asset cash flows under various scenarios.

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Appointed actuaries may claim reliance on these other people. In Actuarial Standard of Practice (ASOP) No. 22 (the revised edition of which became effective on April 15, 2002), this is spelled out quite clearly. The relevant paragraph is section 4.3, which reads as follows:

> Reliance on Others for Data, Projections and Supporting Analysis – The actuary may rely on data, projections and supporting analysis supplied by others. In doing so, the actuary should disclose both the fact and the extent of such reliance. Such disclosure may be prescribed in applicable law. The accuracy and comprehensiveness of data, projections and supporting analysis supplied by others are the responsibility of those who supply the data, projections and supporting analysis. When practicable, the actuary should review the data, projections and supporting analysis for reasonableness and consistency, and disclose such a review. For further guidance, the actuary is directed to ASOP No. 23, *Data Quality*.

Note that the standard suggests that the "reasonableness and consistency" of the information should be reviewed by the appointed actuary where practicable, but does not place the burden for complete accuracy on the appointed actuary. And when there is this kind of reliance, it should be disclosed. Although the standard does not explicitly say where this disclosure should be made, there is no doubt that the disclosure should be in the statement of actuarial opinion filed with the state. When the standard says that, "Such disclosure may be prescribed in applicable law," the obvious reference is to the *Actuarial Opinion and Memorandum Regulation* (AOMR). The model AOMR not only requires such disclosure in the statement of opinion but even suggests language to be used in reporting reliance.

Limitations on Reliance

On the other hand, appointed actuaries should not rely completely on others in forming their opinions. Thus, if we go on to Section 4.4 of ASOP 22, we read:

> "Opinions of Other Actuaries – When more than one actuary contributes to forming an opinion, supporting memoranda from the other actuaries may be included in the actuary's memorandum. The actuary should review the contributions of these other actuaries. The actuary should then form an overall opinion without claiming reliance on the opinions of other actuaries. The use of the work product of other actuaries should be described in the supporting memorandum."

A clear distinction should be recognized between the permissive language of Section 4.3, which allows the actuary to rely on "data, projections and supporting analysis supplied by others," and the language of section 4.4, which says that the actuary should not rely on "the opinions of other actuaries." The distinction may be a very fine one, but it is important.

An example illustrates this distinction. It often happens that the opinions of other actuaries, who are not the appointed actuary, are very authoritative and dependable. Typically, appointed actuaries in companies that have a variety of products face the problem of knowing less about those products than actuaries who spend all their time on one product. The product line actuary is far better equipped for the analysis. The nature of the products, the choice of conservative assumptions and the choice of cells to model, are all very much dependent on a detailed knowledge of the product. In such cases, the product line actuaries may do the projections and supporting analysis, and even bring the work all the way to the point where the opinion is obvious. Nonetheless, the appointed actuary may not simply reference the opinion of another actuary, but must review the work of the other actuary and form an independent opinion. The intensity of that review is a matter left to the judgment of the appointed actuary.

As it is the appointed actuary who has to take the ultimate responsibility for forming an opinion, the appointed actuary should usually be involved in the processes that go on in the product lines. At the very least, the appointed actuary should do enough to understand the process so that the opinion can be rendered knowledgeably, without complete reliance on the opinion of the product line actuary. More than that, the appointed actuary usually brings to the process a broader knowledge of how asset adequacy testing is done and can advise on modeling methods, lapse rate responsiveness to modeled conditions and the like. In the end, the appointed actuary should have a sound basis for feeling that the testing was appropriate and supports the opinion that is being given to the state.

As a corollary, it is usually assumed that the responsibility for the opinion cannot be divided; that is, that there should only be one appointed actuary per company. The actuarial standard of practice has little to say on this point, but the model regulation and the Standard Valuation Law seem to imply that there should only be one. (For example, they refer to ". . . the opinion of a qualified actuary . . ." and to " . . . the opinion of an Appointed Actuary . . . .") But it is beyond the scope of this article to interpret the law. Let us simply state that actuaries should be aware of this issue, and be sure of their ground if there is any implication that the opinion is anything other than the responsibility of the one appointed actuary. For example, if the filing consists of the opinions of several product line actuaries stapled together for submission to the state, one might expect questions to be raised.

Reinsurance raises some sticky questions in this regard. The appointed actuary of the ceding company should not rely completely on the reinsurer for reserve adjustments. It is the net liability that is important, and it is that liability for which the appointed actuary of the ceding company is responsible. Actuarial Standard of Practice No. 11 sets forth the basic principles of this matter.

SUMMARY

In the end, appointed actuaries must determine the degree to which they rely on others to do their work. But they should take care to rely on others only where law, regulation and/or standards of practice say it is appropriate to do so. Furthermore, they must disclose their reliance in the proper form and in the proper place. Note that, in addition to the statement of opinion, the supporting actuarial memorandum should also contain disclosures of reliance, probably in greater detail than in the opinion itself. All such disclosures should respect the distinction between "forming an opinion," which is wholly within the discretion of the appointed actuary, and "data, projections and supporting analysis," which may be carried out by others.

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