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Session 22OF
Appointed Actuary Forum

Moderator: Lori H. Helge

Panelists: Frank Longo
Jim Van Elsen
Robert Guth

Summary: A panel of appointed actuaries, with the help of substantial audience participation, shares its perspectives and practical experience in fulfilling the duties and responsibilities of the appointed actuary.

MS. LORI H. HELGE: You will be asking the questions today, not us. The front row is a safe place to be, so come in and have a seat.

Let me introduce everybody. On our panel we have Frank Longo. Frank is the appointed actuary for Union Fidelity Life Insurance Company and Illinois Life Insurance Company, one of several insurance companies owned by General Electric Company. The company had about $1 billion of assets at year-end 2003. He is also appointed actuary for Heritage Life Insurance Company, a small life company with admitted assets of $50 million, and chief actuary, although not appointed actuary, of Heritage Casualty Insurance Company. This is a property casualty company with $100 million of assets. Frank is an FSA and a member of the Academy and the CFA Institute.

Then we have Jim Van Elsen in the middle. Jim is president and founder of Van Elsen Consulting. He's been heavily involved in XXX illustration regulations, 2000 CSO, new Actuarial Opinion and Memorandum Regulation (AOMR), et cetera. He is the former chief actuary of several small life insurance companies and now is appointed actuary for several companies. Jim is also the publisher of *Van Elsen Reports.*

Note: The chart(s) referred to in the text can be found at the end of the manuscript.

On the far end we have Bob Guth. Bob is appointed actuary of Mennonite Mutual Aid Association, a fraternal benefit society with admitted assets of $284 million. He has life, health and annuity business under his care. He is also appointed actuary of MMA Insurance Company, a small life company with admitted assets of $15 million. Bob has also been a participant in the life working group that is addressing the revisions for 1995 practice notes appointed actuary practice. He can give us a lot more information on some of the topics that were covered at lunchtime.

I am Lori Helge. I have been with Tillinghast for six years now and spent two of my years with that company in the cash-flow testing area. I serve as appointed actuary for two companies. One has about $888 million in reserve and is a closed block of single-premium immediate-annuity subcontracts lottery business. It has the unique feature of having a cash-flow testing reserve, although it sounds like that is not so unique anymore. The second company has $500,000 in reserve, a closed block of mortgage term. Both are domiciled in only one state and it happens to be the same state, so my exposure is a bit limited in that respect. As a side note, I also chair the Finance Examination Committee.

Today, we are here to answer your questions. The Appointed Actuary Forum, otherwise known as "Stump the Actuaries," can be what you want to make of it. We have presented a simple outline, and we hope that the questions can follow in this outline. To the extent that they do not, we can also circle back around at the end. For the time being, we will try to stick to the outline and the topics of the questions. If you do not have any questions for us, we have some questions of our own. However, we have a full house and hope they will keep on coming.

The first area that we will cover is responsibilities of the appointed actuary, including qualifications and continuing education. This might be a good time to get into the new standard on qualifications, if you like. Would anybody like to be first with any questions in this area?

FROM THE FLOOR: On qualification standards, I have a question for the group. Have any of you ever considered accepting an appointment as appointed actuary but then reviewed the qualification standards and concluded that you are not qualified? Has anybody ever faced that? You know you are obligated to turn down an appointed actuary position if you are not qualified. I wondered whether anybody has ever had a situation where that happened. Maybe the answer is no, but it is worth asking.

MR. ROBERT J. LOMBARDI: I have a corollary to your situation, Frank, which is succession planning. We wanted to groom someone to become an appointed actuary, so we had to follow a series of steps, which included the four-day or five-day seminar in Washington, D.C. It required about a two-year plan to get him ready.

MS. DONNA R. CLAIRE: I would like to follow up on what he said. Nobody in the Valuation Actuary Symposium has mentioned that yet, but basically FSA 2000 and later does not have the basic qualifications as mentioned at lunch. Before 2000 it depends on what examinations you have taken. You have to have been examined on certain things, such as U.S. regulatory topics, which are not under the new SOA requirements. For anybody in 2000 and later, it is hoped that you are not filing a blue, yellow or orange annual statement.

UNIDENTIFIED SPEAKER: Unless you have taken other education.

MS. HELGE: Are there any other questions? We should talk about the annual requirements. This is what you have to do every year, like managing the process, data gathering, relying on others, mechanics and past criteria. Tell us what you think.

MR. CLIFFORD A. LANGE: I am a chief analytics officer. I am in the process of interviewing three finalists for an appointed actuary position. One of the candidates mentioned to me that two of our competitors, whom I will not name, even though they have a large number of actuaries, have made a choice to have outside consulting firms do the appointed actuary opinions to present presumably more of an air of objectivity or a larger body behind the opinion rather than just one actuary who might be in-house. I wanted to ask the experts on the panel and the group if there were any data on whether this is an anecdote or whether there is some movement toward more companies going to outside firms, either their auditors or another firm's, for that opinion, even though there maybe many in-house actuaries who do meet the qualification requirements.

MS. HELGE: Jim and I think that is a great idea.

MR. JIM VAN ELSEN: I have seen some interactions with public accounting firms where they have viewed the work I do as superior to having the in-house actuary do it, and they have a different view of the amount of work. I have always been confused by that because, with the same level of experience and the same level of work, you would expect the in-house actuary's work to be received just as well. However, there seems to be something going on in the accounting world that somehow views us as more independent. Quite frankly, the average consulting actuary in some ways is less independent, sometimes. I am confused by why that is happening. I used to work for a company, as well, and served as an appointed actuary there. Personally, if I could do it inside and had the resources to do it inside, I would rather work inside, unless the board absolutely insisted it be done outside, but that is just my opinion.

FROM THE FLOOR: I thought the Blue Cross/Blue Shield association required it.

MS. HELGE: The Blue Cross/Blue Shield Association, you said, requires it.

MR. ROLAND A. ROSE: I had assumed that there would be a conflict of interest as far as the external auditor taking on the appointed actuary role.

MS. HELGE: In both Jim's case and mine, that would not apply because our firms are independent of the external auditors. Certainly with Sarbanes-Oxley, that would seem to be an issue.

MR. ROBERT GUTH: I was going to say the same thing. I talked with an external auditor, maybe a year ago, and he told me that many of his client companies where they had provided the appointed actuary role had switched taking it in-house about the same time as Sarbanes-Oxley was in that.

MS. HELGE: I should add that of the two companies where I served as actuary, one did not have any direct staff, although there is some indirect staff that could do it. Part of the reason it wants some of the independent actuaries, I guess, is the confidence of having a separate name on the paper. The other company has no actuaries on staff to do the work.

MR. GUTH: The other thing I see happening in dealing with the board of directors of the companies I have worked with is that sometimes the guy from outside is in a better position to be candid about what the company needs to do. The in-house person in many ways is looking over something that his boss did or that he did. Sometimes I can definitely see some judgment of having the person from the outside. Of course, that same thing could be obtained by good peer review within the internal work. I have some clients where my role is to review the work of the appointed actuary, and in my mind that accomplishes much the same thing.

UNIDENTIFIED SPEAKER: One question we had was how often do appointed actuaries receive a peer review?

MS. HELGE: Can we have a show of hands? Is there anyone here whose company has the peer review every year, say a peer review by an independent actuary? Every two years? Every three years? We have one hand for one year, one hand for two years. How about never? Is that everybody else? Hardly ever?

UNIDENTIFIED SPEAKER: We do it about every five years.

MS. HELGE: One question that we had in advance falls in this category. It is a fairly specific question, so I will read it verbatim and then let some of the panel discuss the answer. Assume your blue-blank company buys a shell. Assume it is not quite a shell, but the seller reinsures all existing business 100 percent. Assume the seller is an A+-rated life and A&H Company. The first part of the question is, how does an appointed actuary address the reinsured business in the statement of actuarial opinion? Does the appointed actuary need a reliance letter from the seller's appointed actuary? How is the reinsured business addressed in the actuarial memorandum in support of the opinion? Does it need to be addressed in the memorandum given that there is no liability on page 3? Finally, would any of these answers change if the seller were something less than a solid company? Say for example that they have lost money for three years running.

UNIDENTIFIED SPEAKER: I think I would start with looking at Actuarial Standard of Practice No. 7 (*ASOP No. 7*). Let me read from *ASOP No. 7*. "The actuary should consider whether reinsurance receivables will be collectable when due, and any terms, conditions, or other aspects that may be reasonably expected to have a material impact on the cash flows." Later in *ASOP No. 7*, the documentation section states that "the characteristics of any reinsurance agreement and how they were reflected in the analysis should be documented in the memorandum." That would tend to speak to a couple portions of this question. Also, in the 2004 survey of appointed actuaries that we heard about at lunch, about 80 percent of the respondents modeled reinsurance when it is material. Of those who model reinsurance, about half model at the sell level, a few at the plan level, and maybe about a fifth at the aggregate level.

Some other aspects of that include whether a reliance letter is needed. I would look at the reinsurance agreement, analyze it and decide from the face of the agreement if I can figure out what I need to know. Maybe one needs some further information, or maybe you can form an opinion just on the basis of that agreement.

As to whether the reinsurance business should be addressed in the memorandum, I think *ASOP No. 7* speaks to that.

MS. HELGE: I have one thing to add about the reliance letter because this question has come up within our firm. If you have an appointed actuary or somebody who is doing the review of another block, to what extent can you have the appointed actuary rely on them? You still have to come to your own conclusion. Even if you get a reliance letter from the other company's appointed actuary, you still need to come to your own conclusions and do your own review. When you say "reliance letter," you need to understand exactly what you are relying on and what you cannot rely on.

UNIDENTIFIED SPEAKER: Can I can add a comment on this? I guess I look at reinsurance much like everything else you are looking at. When you do your analysis, you tend to evaluate risks. You should be familiar with the risks that are associated with this reinsurance contract. You need to evaluate it much like you would anything else. In particular, if there is a situation where there is potentially a peer company, you need to be considering how that treaty would unwind and what the impact would be on your company.

At these times the company starts considering how it should mediate this potential problem. If you have identified a potential seriously negative event in the future, the company should attempt to do something at that point in time to mediate that.

If that means recapturing it, even maybe recapturing it at a loss, you are doing something to get that business to a safe place.

This is part of how you use this work to benefit the company. When you have determined that something is a problem, management needs to act on it. This is not just cut-and-dry.

MR. CLARK A. RAMSEY: I think the discussion about reinsurance perhaps should take into account whether you are dealing with an indemnity reinsurance agreement or an assumption reinsurance agreement. Under assumption reinsurance, of course, the discussion would have presumably been much shorter and easier. Just as another technical fine point, the question was not specific, but some of the answers also may be different if you were dealing with the modified coinsurance agreement instead of a coinsurance agreement. If there were no reserve credit being taken, the issues obviously would be a little different. These are some clarifications.

MS. HELGE: Thank you.

MR. ROD L. BUBKE: One of the questions that I wondered about at lunch today was the level of review on data, or when you got a letter of reliance. I would like to hear the panel's opinion on how much review needs to be done on reinsurance assumed on the data that you receive, especially if it is a significant block of business.

MR. FRANK LONGO: I think it is up to the actuary to determine how much of a review is necessary to allow himself or herself to get comfortable rendering the opinion. At the company for which I have been the appointed actuary, we have several reliance statements that are passed back and forth between different divisions of the company that administer blocks of business that are either assumed or ceded in different directions under my company. I feel that it is my responsibility in some cases, if the process is straightforward and if the amount is not material, that I can accept the reliance statement just as is. If it is a material block and if there are some aspects of the business that make it tricky or more complicated, it is up to me to make a decision on how deep I need to go. I think the responsibility finally rests with the appointed actuary to determine his own level of comfort.

FROM THE FLOOR: I have a comment on the reinsurance. You may want to look at the state laws. I know in Washington with reinsurance credit, and you either take 100 percent of the reinsurance credit or you take none. There is a question about whether or not that reinsurance contract is going to be paid under the agreement. You may get zero on it. Fortunately what happens is that in Washington the commissioner will make that determination. I will just write him a letter and make that determination. That was my comment.

I have a question on reliance and others. We have quite a few collateralized mortgage obligations (CMOs) in asset-backed securities. We send our model down to the Centers for Medicare and Medicaid Services (CMS). It models those for us. I check them over to see if they are reasonable, but I am not an expert on CMOs and I have to get into the model. It is impossible for an actuary to go through and do that kind of work, I think. We are now going through our triennial examination, and I put a reliance on CMS in my opinion. However, I did not attach a statement, and Washington is requesting a statement. When I went back to CMS, it acted as if no one had ever done this before. I wonder whether other states are doing the same thing, how people are addressing this if they rely on somebody to model their bonds, and whether they get the statement with that or are accepting responsibility for how they did the model?

MR. VAN ELSEN: This is an area that I deal with a lot. Like you, I am ill equipped to model many of the sophisticated securities that are out there. I have tried and have not been overly comfortable with the results. I do rely on many instances on investment advisors. I provide the scenarios. They feed me back the projected cash flows from them. In every instance, I get a signed statement from that advisor that I include in my report and my opinion. If you are going to rely on something, you need to have the statement from that other person. I think that needs to be one for one.

MR. BOB GUTH: I take a different tack. This may not add comfort, though. I am a graduate of the investment track of the FSA curriculum, so I took examinations that dealt with CMOs and other such issues. With modeling if I use software where some of the material is in the software—it comes from a pricing service—in the actuarial memorandum I have a section where I describe assumptions that I have found in its documentation of what it does. I have maybe two or three pages of assumptions. It goes pretty deep in terms of what it all describes. It is at a level where an investment person would have a reasonable idea of the methods that are being used. Then I do not get a reliance statement, because I am basically looking over the models myself and taking personal responsibility for them. Again, that comes with my particular education, that I took examinations in the investment track. It worked well.

MR. LONGO: I have a modest amount of investment background. I was in an investment/actuarial type of role for 10 years, and I have a chartered financial analyst designation. However, I get a reliance statement from the investment team at my company that produces asset cash flows that are used in our asset adequacy analysis. At our company, since we have many divisions, we have a situation where our corporate actuarial area secures information from our investment team and distributes it to the different business units. This includes recommended language for actuarial memoranda that describe the asset-related activities that were used to produce asset cash flows. In my case, I tailor it a little bit to my particular memorandum, but we are dependent on a reliance statement from the investment officer who is responsible for producing those asset-related items.

MS. HELGE: Just out of curiosity, to wrap up the answer to that question, is there anybody here who obtains a reliance statement from an outside vendor such as CMS, just to counter that we have been asked for that before argument?

MR. PATRICK D. STUDLEY: I am the appointed actuary of Metropolitan Life. Since our demutualization, we have restructured a lot of our subsidiaries and various affiliates. For the most part, those affiliates are under the holding company and not under Metropolitan Life Insurance Company (MLIC). They have their own appointed actuaries. Many of them work under my supervision. Each one of them can independently give its own actuarial opinion and require its own work. Since a large chunk of what goes on in the whole enterprise is coming from MLIC, to what extent do you think that the appointed actuary at the largest affiliate should be concerned about what goes on in those other affiliates when in a strong sense each is independent?

MS. HELGE: Frank, this sounds pretty similar to your situation.

MR. LONGO: I am not sure if I understand the question totally. At our company, the strongly held view is that the appointed actuary who is rendering an opinion for a legal entity needs to be knowledgeable about and responsible for all the elements that go into that opinion. Maybe you need to elaborate just a bit.

MR. STUDLEY: Our work with the asset adequacy analysis is on the assets and liabilities. I am expressing an opinion on MLIC, and these other insurance companies have their own assets and liabilities and their own asset adequacy analysis going on. In some sense, then, it is independent. It happens to all be owned by one holding company. However, that is not a statutory structure that matters. They all have their own blue books, of course. What is your opinion about the extent that the work in one affiliate should be concerned about what is going on in what I would call, in a literal sense, an unrelated affiliate?

MR. LONGO: I would think that as the lead appointed actuary, you might have a desire for there to be consistency of approaches. It might not make a lot of sense, business wise, to have widely divergent approaches to development of information that leads up to the rendering of an opinion. However, I would say that the appointed actuary for the individual legal entities, from our point of view, is the final statutory authority for that legal entity and has that ownership.

MS. HELGE: Another thing that comes to mind is perhaps even consistency and assumptions in default rates. I assume that you have one team of investment personnel who are investing for all the companies. I guess if I were looking at it, I would expect the assumptions on the asset side to be fairly consistent. Assumption of other products might vary widely depending on the market and pricing. I guess that is what comes to mind. You might want consistency in language. One thing that we do within Tillinghast is to produce boilerplate language every year. We start with that language and modify it for our own uses. What you ultimately end up with are memoranda for each of the companies that look similar but that obviously reference the specifics of each of those companies. That might be something to work for.

I think, Frank, you mentioned too that boilerplate is prepared at the top and then you do with it what you need to do.

MR. LONGO: Yes, but the conundrum is that the individual actuary is rendering an opinion, and an opinion is personal, so there is judgment involved. We might be in the same organization and have similar characteristics to our respective blocks of business, but it is a personal independent opinion.

MR. STUDLEY: But you agree the issue would be different if the ownership structure was that those smaller affiliates were all owned by the insurance company? Then they can do something, if they are big enough, that could cause the insolvency of the parent. Since it is not a parent relationship, does that change?

MR. LONGO: Part of your analysis needs to take into account relative risk of these subsidiaries. If their potential insolvency would have virtually no impact on the big company, you can safely ignore it. On the other hand, if it was a wholly owned subsidiary, it would have an impact, and you should be a little more concerned. When someone working for you is doing that opinion, the situation is a little different. You obtain some of the responsibility through the supervision, and presumably things are being done according to your standards anyway. That person still has to give his opinion, but it is unlikely he would do it in a manner inconsistent with what you would want.

MR. THOMAS A. BICKERSTAFF: I think in a multicompany setting, there has to be a fairly high degree of consistency among all of the scenarios and the assumptions that go into it. For example, you cannot have a high degree of credibility in the results if one company within your structure is using a set of interest rates that are 300 basis points higher than another company within the same total company environment. Likewise, I think if you have comparable products, lapse assumptions have to be fairly consistent across the body of companies that you are testing. I think when you have more than one company within a total structure, you have to ensure that the assumptions that are going into the overall testing have a high degree of consistency.

MR. JERRY F. ENOCH: I would like to address something that was discussed a minute ago, and maybe I am mistaken, but when we were talking about what happens when one statutory entity owns another statutory entity, and whether the results of the owner were dependent upon the results of the subsidiary, as I recall, what we are relying on is the adequacy of the reserves of the major company. Whatever is happening in that subsidiary might affect the surplus of the owner company but would not affect the reserves. If I am misunderstanding something, set me straight, but that is my recollection.

MR. GUTH: It depends where in your analysis you allocate that particular asset. If it is allocated to surplus, you are right; it does not have an impact. If a portion of it is directed toward a line of business, it would be different.

FROM THE FLOOR: What In a situation of having negative cash flows and the need to borrow to cover some of those and setting assumptions, what has an impact on the situation we are talking about here? You are still setting up a reserve. It is not surplus, but you would have to make some assumptions about the level, which you have to go to the markets to borrow if you have negative cash flows in any situation.

MS. HELGE: Are there any other questions in this area?

UNIDENTIFIED SPEAKER: Maybe past criteria; we should see whether anybody has questions about the criteria used for performing.

MS. HELGE: I am surprised nobody has asked about that. Maybe they covered it too well at lunch.

MR. GUTH: I might comment on that because I think it is difficult to say that we should all be using the same past criteria. It will depend on the nature of your company. Certainly the book value is of importance. That is what ultimately determines the solvency of your companies. However, the market values cannot always be ignored. Again, it depends on your situation, whether you are vulnerable to a run on the market. If you are upside-down severely through market values, you can be a lot more concerned about that. I do some market for some premade companies, and we know people will not die quickly enough to take advantage of it, but it has a different impact on a company like that. It may affect negatively what they invest. You have to look at these things and determine what constitutes the real risk to the company if you have a severe write-down on market value. If there is a significant negative impact, it is something you need to be considering and trying to mitigate.

FROM THE FLOOR: I was curious about past criteria and whether you have a present value of surplus or you accumulate to a certain level of surplus. The average was 100 scenarios. What quartile or percentile are people using?

MS. HELGE: In terms of what percentage of scenarios, how many people are at 75 percent or less? At 75 percent to 80 percent? What about 80 percent to 85 percent; 85 percent to 90 percent; 90 percent to 95 percent; and 95 percent to 100 percent? There are a few hands in each range.

FROM THE FLOOR: I have a follow-up comment on that question. It depends on how you define the scenarios. The test is you need to pass moderately adverse scenarios. If you have a set of scenarios, you probably can have a higher percentage of a failure rate. If all your scenarios are all designed to be moderately adverse, you probably need a 100 percent pass rate or pretty close to it. To have a number thrown around it depends on how you define them.

UNIDENTIFIED SPEAKER: I do not use a specific percentage.

MS. HELGE: Let me read the following question: "Since regulators are included as part of the intended audience, supporting documentation should be made available to the regulator upon request." The response is that the committee disagrees. The question is, what does an appointed actuary do when a regulator requests supporting documentation in the absence of any state regulation requiring documentation be made available? I believe Bob is all prepared to answer this.

MR. GUTH: I looked at *ASOP No. 41* after we received that question. The committee disagreed because it felt that this was more of a regulatory or a legal question than an actuarial question. It did not feel it applied. It made sense to me. It did not feel it was appropriate to try to define what regulations should be saying when that is the issue. I felt like my response to that would be, if there is a request from a regulator for supporting documentation, the appointed actuary works for the board of directors of the company. The board is essentially the principal for whom you are doing the work.

The work product belongs to the company in that sense. If a regulator asks for documentation, I think you look at that request, you talk with whoever the relevant people are within the company, and if everybody agrees, you release the information as requested. You need the consent of the company, essentially, and the cooperation of the company. If you have a situation where for some reason the company does not want the information released, you consult an attorney for your own advice about that conflict of interest because the regulator also expects some responsibility from appointed actuary. The regulator is asking, and the company is not agreeing. You talk with an attorney.

I do not know that I have ever received a request. What I experience in Indiana is that when requests come to our company, they have always been addressed to the company officer who is responsible for the financial statement. Then the company officer comes to me and gets what is needed. A regulator working in that way will not cause legal trouble.

MS. HELGE: Any questions in this area?

FROM THE FLOOR: The phrase "to the best of my knowledge and belief," as I remember it, appears in the standard language of the actuarial opinion memorandum regulation only once, and the same for New York Web-126. We tend to use it rather liberally, and we have had some comments on the subject, especially with respect to the standard reserves as opposed to asset adequacy testing. For example, "To the best of my knowledge and belief, we meet the reserve requirements of this state," or "To the best of my knowledge and belief, we meet the requirements in the aggregate for other states." There are other places where I have seen it used in other people's actuarial opinions. Could we get some comments on the use of the words "to the best of my knowledge and belief?"

MR. VAN ELSEN: I use it every chance I can. New York has recently taken a hard line on when you can, and it is limited. I am not sure I am totally comfortable with their position, but there is not much I can do about it. I will tell you that I use it liberally as you do, and New York is the only jurisdiction I have had difficulty with.

MS. HELGE: Here's another question we received: Should the regulatory summary, the executive summary, be sent to all states we do business in or only as states request it?

MR. GUTH: I have had a hard time finding out what is expected there. My state had adopted the new AOMR last year, so I needed to deal with this. Every state prepares a set of instructions for how the NAIC statement is handled. It is usually on the state's Web site, and the person who handles your annual statements would know how to get them for each state. In some of those, a specific statement says what to do about the Risk Assessment Information System (RAIS). In a few cases, maybe when states adopt it the first time or the first year, they might not get around to putting it in there. You might have to call them or check it out. I have tried to review that for each state and then respond accordingly. It takes a lot of work to do that, but we hope that from year to year it will not vary a great deal.

FROM THE FLOOR: I do not know the question, but I will answer that one. You are talking about the memorandum as opposed to the opinion.

MS. HELGE: The question said the executive summary to the memorandum.

FROM THE FLOOR: We have always taken the position that, if someone asks for it, we give it to them; otherwise, we do not. In the past, we have given it only because we have always done it, and there is no direct request. We have pulled them back to see what happens, and usually the state does not get back to us. My question, if I may change the subject, has to do with the new AOMR. During the deliberations of the new AOMR, there were a lot of discussions of small companies and the problems requiring asset adequacy analysis for all companies you know would provide. Certainly I want to get the thoughts of people who are considered appointed actuaries for small companies.

<INAUDIBLE END OF TAPE> actuaries for small companies to talk about whether those problems did come to fruition or have they gained any benefit? Has the cost been prohibitive? I would like just to get their thoughts.

UNIDENTIFIED SPEAKER: I will just mention that in my case we had two small companies last year where we felt the need to do asset adequacy testing for the first time. However, recalling that the adequacy testing can be fulfilled by methods other than cash-flow testing, we chose to use a gross premium valuation technique and satisfied ourselves that we were fulfilling the requirements. It required some extra work and required writing another memorandum, but it was relatively simple. Therefore, we did not make it into a big deal. That is just one person's experience.

MR. GUTH: I was one of the prime resistors to the new AOMR, and so I am the one they are complaining to. There are certainly a good number of companies that are not up to speed on what they are going to need to do yet. I do not think this has played out yet. Unfortunately most of those companies have nobody at this meeting. They typically are companies that have no actuarial staff.

FROM THE FLOOR: I am a consulting actuary. Jim just described my entire practice. A lot of my clients are small to very small companies, and several of them got caught this year. They happened to get licensed in a second state, maybe New Mexico or Indiana, and had to do asset adequacy for the first time. The impact was they had to spend a lot of money. They did not have a choice about it. That is the big thing. Although Jim has fought it for a long time, there is not any other recourse. You do the best you can to do the work as efficiently as possible. The fact of the matter is, you have to do it. That is what we tried to avoid, but we were unsuccessful.

UNIDENTIFIED SPEAKER: Were you able to use some of the alternative methods?

FROM THE FLOOR: We were for certain of the other clients, depending upon the type, because I have some credit life companies that have short time horizons. I was able to do some other things like gross premium evaluations and that sort of thing. With other ones, you look at the business and said, "We have no choice other than to do cash-flow testing." I told them how much it cost, and after I poured water on their faces, they said, "Okay." The fact of the matter is, there are not a lot of alternatives unless they are in some short-term, noninterest-sensitive business.

MS. HELGE: The AOMR is a whole topic on its own, and we are definitely coming around to it. Do we have any other questions in the area of work product? How about qualified opinion?

UNIDENTIFIED SPEAKER: I was just going to ask that. What goes into a qualified opinion?

MR. GUTH: In the survey, that question was asked, and we did not have enough time at noon to see the answers. There were five or six choices given in the survey. Let me read some of those. First is only when the analysis indicates that a reserve deficiency exists and additional reserves are not established. Sixty-five percent of the respondents felt that was a qualified opinion. Sixty-four percent felt the reserves for certain items are in question because they cannot be reasonably estimated and are material, which means a third did not think it was a qualified opinion. The opinion is based on incomplete data analysis or assumptions, even though the results indicate reserves are adequate. Fifty-six percent thought that was a qualified opinion. Significant advances have taken place since December 31 that may have a material impact from the results. Forty-nine percent thought that was a qualified opinion. Thirty-nine percent thought only when the actuary is unable to form an opinion for whatever reason. The reserves meet the minimum requirements of the state of domicile, but do not meet the minimum requirements of the state of filing, and no additional reserves are set out. Thirty-two percent thought that was a qualified opinion. Adequacy depends on the continuation of an assumption or event that the actuary is not qualified to judge, such as continuation of a reinsurance treaty. Twenty-nine percent thought that was a qualified opinion. Whenever additional reserves are established for whatever reason, only 6 percent thought that was a qualified opinion.

There is a lot of variety of understanding about what it means.

MS. HELGE: Can you tell us the right answer, Bob?

MR. GUTH: The right answer is what the actuary gives his opinion on.

FROM THE FLOOR: Was the survey sent to everybody or to appointed actuaries? There are certain things that appointed actuaries would probably not say.

MR. GUTH: This survey was sent to appointed actuaries and to certain society lists where it was asked of the person who works for the company on the actuarial opinion answer, person to person.

MS. HELGE: I hope they did not hand it down to the intern.

MR. MARTIN A. CLAIRE: With regard to opinions, we have been discussing this at our company. With regard to the 2001 CSO, our impression is it could turn out that 2005 will come around, not all the states will have passed the 2001 CSO, and we want to issue a 2001 CSO product. The idea of qualified opinions or alternate opinions is one thing that our controller's department pointed out to us. For a lot of states, we do not mail in an opinion. They say, "We are just going to grab the opinion you have on the NAIC Web site." We are kicking around that, if a state does not pass the 2001 CSO, how do we flag its attention that the reserves were set up? We are not sure what direction we will go. Initially people have wondered if you wanted to have varying opinions in varying states, can you send in your regular blue book and then send in a little letter and, by the way, change those two numbers to the 1980 CSO? However, they were commenting that for a lot of states, we are not sending them a blue book directly. They are just grabbing the NAIC statement. We just send them a separate letter saying, "Increase what you are reading on the Web site by $10 million in the reserves and decrease the surplus by $10 million."

MR. GUTH: When you send a statement to the NAIC, do you use the computation standards?

MR. CLAIRE: We use state of domicile, with any codification making it in wherever you are supposed to expose codification.

MR. GUTH: My sense was that the way that things were becoming automated, it was somewhat less flexible than it used to be. I think that is what you were describing.

MS. HELGE: Yes.

UNIDENTIFIED SPEAKER: You are also describing a situation where soon what is mandatory in some states will be prohibited in others.

MR. CLAIRE: I have a follow-up question. Does the opinion have language that says you meet the minimum standards in all states?

UNIDENTIFIED SPEAKER: In the state in which it has been filed.

UNIDENTIFIED SPEAKER: Then you would not be able to say it meets in all states except for…

UNIDENTIFIED SPEAKER: You can always change the wording of the opinion. It is your opinion. That could be yes, except for the following five states that have not passed the 2001 CSO.

UNIDENTIFIED SPEAKER: It also depends on whether the new AOMR has been adopted by a state, and it has elected certain provisions, that you can use the reliance on the domestic state. It will get convoluted before we get to the end of this.

MR. GUTH: I suppose where you write in the state of filing, you could put in parentheses the name of the state you intend, such as your domicile state. In that case, any state reading it might realize you were referring to that state and maybe not its state. This is if you are only sending one copy to the NAIC and are concerned that other states might be reading it where it is not appropriate.

MR. JOHN C. KNAUSS: The state of New York asks for several additional tests and requirements over and above our domicile state and most other states. What do most companies do for their memorandum? Do they prepare a separate New York memorandum? Do they put it all in the same memorandum, even though it is not applicable to those states, or must they supplement? I am curious to hear what other companies do with that.

MS. HELGE: We can take comment if you want or we can even raise hands. Do people prepare one memorandum and just include the New York information? Does anybody prepare a separate New York memorandum? You have about a 50-50 split.

MR KNAUSS: The reason I ask as a follow-up is that there was the New York A&H Regulation 56. It said specifically in state memorandums that it complies to New York Regulation 56. What does the regulator in Pennsylvania care about New York Regulation 56? That is why I asked.

MS. HELGE: It looks like people are fairly evenly split on what they are doing. What about objections from states? Have any of you seen objections lately like you were talking about?

UNIDENTIFIED SPEAKER: I got objections recently from two states about the fact that there is some confusion about reliance statements. At our company we had a practice, and I made a reference to this before, where there are blocks of business administered in different business units, and those blocks of business were in various other legal entities. For example I had a legal entity that had blocks of business that were administered elsewhere. We had a practice of the actuary who was responsible for doing the valuation for that block and would send a reliance statement to the appointed actuary for the legal entity. The difficulty that we had and the challenge that arose was that these internal reliance statements had language in them that made them look like opinions. They were not literally opinions because the actuary was not rendering an opinion about the adequacy of reserves in light of the assets. The actuary was merely making a statement about the fact that the reserves were accurate and that the blocks of business that were valued were complete and accurate.

Anyway, in our case both New York and Illinois objected to that because it gave the appearance that the top level opining actuary was relying on opinions of other actuaries. In fact it was made clear that that was not what was intended or was desired. We have to take some steps to modify that, and we are in the process of doing so.

UNIDENTIFIED SPEAKER: When I needed to give an opinion like that to a reinsurer, I think I have wording in it that specifically says this is not an opinion where the assets are being considered in relation to the reserves. This is a way of making it clearer.

MR. VAN ELSEN: This is not exactly your question. I run into objections from the independent auditors. In some ways I regard their comments as good peer review. If they have good comments I try to incorporate them into what I do. There have been a few situations where I totally disagree with what they are asking me to do.

That is where I draw the line because it is still my opinion, and I am the one who must be comfortable with it. I will do the work that they ask and provide it to them, but it will not become part of my report. I am seeing that with increased frequency. What seems to be happening is that the public firms have these standards of what they expect to see in the memorandums, and I am not sure they are well-thought out.

MS. HELGE: I definitely saw increased interest from the external auditors this past year. Are there any other questions on this topic? We will move on to the new AOMR. Maybe we can focus questions around the new AOMR first. Probably the most obvious thing is, if we can go through a quick review of what states have implemented it, who is affected for year-end 2004? Bob.

MR. GUTH: For persons who went to the first session, I think it was in the handout. I was not at that session. I was at the second session. This is what I did about a week ago. My company is cost-conscious, and so I did a Google search on the Web where I looked for actuarial opinion and memorandum as an entire set of words together with regulatory asset adequacy issue summary. I figured if I had a document that had all those words in it, I was close to what I wanted. I had about 50 hits. As I looked through those, I found all 10 states that were listed. It seems like that might be a reliable way one can update a little later in the year.

Iowa and Colorado adopted for 2004, as well as Alabama, Rhode Island, North Carolina and North Dakota. I had a hit for Alaska, and I think some state had said it was in the process, but the document that I saw I had an effective date on it, or it was getting close, I suspect. At least that raises the question to check. Those will be some states to check, and there maybe others that are coming along.

There was also something on Kentucky's instructions. As I understand, it had not adopted it as such. Its instructions say that the opinion submitted should conform to the NAIC AOMR, which would mean the new one. There might be other states where that is the case, and I am not aware.

MS. HELGE: Does anybody have any questions on this topic? I know a lot of sessions have been talking about the new AOMR, so it is probably old news by now, being at the end of the first day.

How about differences in reliance statements? I think we have touched on that. Bob, is there anything that you want to add?

MR. GUTH: Yes. There were more differences about reliance statements than I think I had initially expected. At one point, I took the new AOMR and the old and read what it said carefully. One of the sets of words that popped out concerning reliance statements was about a precise identification of the items being relied on. One consulting company was saying to me, "Your reliance statement is too specific. You ought to make it less specific so you are not taking responsibility for things that you did not accidentally mean to." The new AOMR wants a precise identification of what is being relied on. That is a difference from what was previously the case.

MS. HELGE: How about aggregation? That might be a good topic to talk about. I know it was touched on a bit at lunch. How did things change after the new AOMR? What are some of the considerations that might go into making a decision on how to handle aggregation?

UNIDENTIFIED SPEAKER: The wording about aggregation is a little bit different if you compare the two. I did not know all of the legislative history or what went into why it was changed. In the new AOMR, there are some sections about aggregation that are completely missing. In one place it talks about aggregate reserve and in another place it talks about aggregate surplus. That is a hint that aggregation is still okay, but it does not directly say that aggregation is okay. Some states want particular lines of business to pass, so the meaning of the use of aggregation is a little bit different. It seems like the new AOMR perhaps allows for the fact that states may have different expectations about it. I would say that it is important to read the rules carefully. Read the AOMR of the state you are concerned with carefully if it is a new one.

Also, even in the old AOMR, aggregation was not automatic. For example, you could aggregate results if you were satisfied that the results were developed under consistent economic scenarios and if the business was subject to mutually independent risks. There were some caveats in aggregation, even in the older AOMR.

MR. FRANK M. AMRINE: I would like to go back to actuarial memorandum and the concept of actuarial communications. I sent this convoluted message to the panel, and I will try to bail it out with something a little simpler. In actuarial communications they talk about actuarial reports and documentation of actuarial communications. All actuarial communications are not actuarial reports, but when I read *ASOP No. 41*, it talks about documentation. When you put a communication together with the documentation required for the communication, you now have a report. At least you have exactly the same amount of work as required for a report. What does the panel think about that?

UNIDENTIFIED SPEAKER: In the case of appointed actuary work, I think I try to put all of the relevant documentation into the actuarial memorandum. That constitutes the necessary report. I may have some additional documentation, but I try to get the major documentation into the actuarial memorandum itself, which makes a pretty good sized document. I got a doctorate degree using fewer words.

UNIDENTIFIED SPEAKER: My tendency is to include relevantly full documentation in my actuarial memorandum. That makes it pretty big. Was your original question more along the lines of whether or not a particular response to a regulator was indicated or should be provided under certain circumstances? Was it something along those lines?

FROM THE FLOOR: We got to that eventually. That was the end point. This goes back to something the panel spoke about earlier. Once we sent in the actuarial memorandum, the regulator requested all the documentation, all the work, all the assumptions on the basis, and it was in the request from the regulator that this was an actuarial communication, and it was required to have all of this information. That is when I dug around and came to the conclusion that the regulator was trying to turn the memorandum into an actuarial report, where the AOMR is fairly specific about what goes into the memorandum. To my mind, that does not rise to the level of an actuarial report, whereas regulator appeared to equate the two.

UNIDENTIFIED SPEAKER: I am not familiar all of a sudden with what an actuarial report is. I would have thought that an actuarial memorandum would be an example of a report. Are you thinking that the regulator is thinking that an actuarial report is a super set of a memorandum that gives the regulator broader power?

FROM THE FLOOR: *ASOP No. 41* has a definitive statement as to what an actuarial report is.

UNIDENTIFIED SPEAKER: I do not remember.

FROM THE FLOOR: It is everything you have. If you were a consulting actuary, which I never have been, in my opinion virtually everything that the consultant does would have to be a report.

MS. HELGE: I was going to say the memorandum side, put together, is pretty detailed. It was what Frank and Bob described, with an extensive discussion of assumptions and documentation of assumptions. You could not necessarily rebuild the whole model from it. You would not necessarily have full inventory, where it lays out all the assumptions.

UNIDENTIFIED SPEAKER: Another actuary reviewing it should be able to make some determination of whether or not the work was appropriate.

MS. HELGE: Right. Is there anything else? Go back down to that last page. Here we have a list of resources for appointed actuaries, and these are also on the document that was posted to the Web site, the "presentation" for this session. With the exception of the Web site address AAA practice notes, these are good sources of resources. The exposure draft, the last item, was discussed at lunch, but we put that in there before we knew it was going to be discussed at lunch. These are places to go when you do have questions, places where you can turn. As I said, the AAA practice notes are being rewritten, but if you want to see the current sets, all 14 of them are all right there at that Web site address. They were also on the core finance examination a few years ago, for what that is worth.

UNIDENTIFIED SPEAKER: You missed an important resource.

MS. HELGE: Consultants?

UNIDENTIFIED SPEAKER: Consultants. I do not understand how you missed that.

MS. HELGE: You are not supposed to market while you are here. For that matter, there are other actuaries at other firms. No colleagues in general obviously.

UNIDENTIFIED SPEAKER: Another resource that might be good to add to that list would be the "Life and Health Valuation All Manual" that is published by the Academy.