To: Judy Weaver, Chair, Financial Analysis Research and Development (E) Working Group
From: Richard Piazza, Chair, Casualty Actuarial and Statistical (C) Task Force
Date: _______, 2014
Re: Response to Referral Regarding Proposed Changes to Certain Reserving IRIS Ratios

1. As requested in the Financial Analysis Research & Development Working Group (FARD)’s Sept. 27, 2013 referral, the Casualty Actuarial and Statistical (C) Task Force studied the proposed revisions to the following IRIS Ratios: P/C Reserve Ratio 11 – one-year Reserve Development to Policyholders’ Surplus, P/C Reserve Ratio 12 – Two-year Reserve Development to Policyholders’ Surplus and P/C Reserve Ratio 13 – Estimated Current Reserve Deficiency to Policyholders’ Surplus.

2. The Task Force verified that the proposed formulas are accurate given the accompanying proposed description of the formulas. The Task Force supports these formulas.

3. We note that additional accuracy could be achieved in the formulas but that would require creating additional reporting on the blank. For example, given that the currently proposed formulas require use of two annual statements to calculate the change in A&O and pooling changes would only be reflected in the most recent annual statement’s Schedule P, the A&O development would be incorrect when there are pooling changes. If we required A&O development to be reported in Schedule P, and therefore adjusted for pooling changes, we could improve the accuracy of the formula. Another option that would be more accurate is to use the Statement of Income to calculate development (which we referred to as the “Texas formula”), but we would need to revise Note 32 “Discounting of Liabilities for Unpaid Losses or Unpaid Loss Adjustment Expenses” and have the tabular and nontabular discounts submitted electronically. If you would like to pursue one of these other options, we could assist with development of specific reporting needs.

4. The Task Force determined that the ranges for the usual/unusual values could be adjusted by a couple of percentage points. Given that the ranges are generally rounded to the nearest 5% and the current definition for unusual values seems significant even with A&O included, the current upper bounds could continue to be used for these calculations. Some actuaries have suggested that the IRIS ratios’ usual/unusual values should be modified from their fixed percentages to vary depending on recent experience (e.g. low interest rates, etc.). Given that would be beyond the scope of your current referral, please let us know if you wish for us to further investigate that possibility.

5. Lastly, you asked the Task Force to ensure there is consistency between the revised formulas and related NAIC documents. The following are inconsistencies we identified:

A. Annual Statement Blank:
   - Five-Year Historical Data: The current descriptions of development are the same as the current titles for the IRIS ratios, describing the data in the exhibit as being development for loss and all loss expenses when those are not accurate descriptions. The Five-Year Historical Data development should say the development is for loss and DCC expenses (rather than all loss expenses). This reporting should be consistent with the IRIS reporting. [Also note that a
change in the IRIS ratios will distort the history in the Five-Year Historical Data development reporting unless you require restatement for the past few years.]

B. Annual Statement Instructions:

- Actuarial Opinion Summary Supplement: Current wording regarding development is as follows: “Where there has been one-year adverse development in excess of 5% of surplus as measured by Schedule P, Part 2 Summary in at least three of the past five calendar years, include explicit description of the reserve elements or management decisions which were the major contributors.” Consideration should be given to refer directly to the IRIS ratios, similar to the wording in the Statement of Actuarial Opinion Instructions.

C. Financial Analysis Handbook:

- Similar changes made to the Actuarial Opinion Summary Supplement would need to be made in the Analyst Reference Guide and the Supplemental Procedures (referring to the IRIS ratio rather than referring to Schedule P, Part 2).
- Similar changes made to the IRIS ratios’ formulas would need to be made to the Supplemental Procedures. Presently the procedures describe the IRIS ratio, referencing Schedule P, Part 2.

D. Financial Analysis Solvency Tools Scoring System (Regulator Only): the Property/Casualty scoring system ratios would need to be adjusted for consistency.

6. We found no inconsistencies between the currently proposed IRIS formulas and the following NAIC documents: Schedule P and the Statement of Actuarial Opinion instruction. With or without the changes to the IRIS ratio calculations, we do not recommend any changes to the Schedule P, Part 2 loss development triangles and subsequent development calculations. This is because the A&O expenses are not accurately allocated to accident years and thus, could distort the triangles for their use in reserve sufficiency calculations.

7. We suggest you weigh the inconsistencies and additional issues against the value of the IRIS ratio changes to add A&O expenses. Our Task Force has mixed reaction as to whether the status quo is preferable, with some strong opinions that the change is unnecessary. We have data showing the impact of adding A&O expenses if you wish to see the research.

8. If you have any further questions, please contact me (RPiazza@naic.org) or NAIC staff Kris DeFrain (kdefrain@naic.org).

cc: Wei Chuang (LA)
Kris DeFrain (NAIC)

Adopted by the Actuarial IRIS 11-13 (C) Subgroup on June 5, 2014.

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