

# Property and Casualty Practice Note

2019

## 5.2.2 Discussion

According to the NAIC SAO Instructions,

*“The Appointed Actuary must identify the materiality standard and the basis for establishing this standard. The materiality standard must also be disclosed in U.S. dollars in Exhibit B: Disclosures.”<sup>51</sup>*

Examples of possible considerations in the choice of a materiality standard are:

- Percentage of surplus
- Percentage of reserves
- The amount of adverse deviation that would cause surplus to fall below minimum capital requirements
- The amount of adverse deviation that would cause Risk-Based Capital (RBC) to fall to the next action level
- Multiples of net retained risk
- Reinsurance considerations, such as levels of ceded reserves compared to surplus or concerns about solvency or collectibility of reinsurance
- The upper limit of a company’s reinsurance protection on reserve development, if any

Other bases for establishing the standard may be appropriate as well.

The NAIC Financial Analysis Handbook provides a Bright Line Indicator Test in regard to the Risk of Material Adverse Deviation for those companies subject to RBC reporting requirements. If the Appointed Actuary does not address material adverse deviation, yet ten percent (10%) of the company’s net loss reserves is greater than the difference between the Total Adjusted Capital and the company Action Level capital, then comments from the Appointed Actuary should be pursued by the Financial Analyst. In situations where the test is triggered, the Appointed Actuary may consider disclosing why he/she does not feel there is a RMAD, if that is the conclusion. The Appointed Actuary may also wish to consider this test in the selection of the materiality standard.

**FAQ: If a company is a 0% pool participant, what is the company’s materiality standard?**

*A: According to the NAIC Instructions, a 0% pool participant should enter a materiality standard of zero dollars for Question 5 on Exhibit B of the SAO. Furthermore, the response to Question 6 of Exhibit B regarding whether there are significant risks that could result in material adverse deviation should be “not applicable”.*

**FAQ: What percentage of SAOs concludes an RMAD exists?**

*A: Approximately one-third of SAOs reach this conclusion.*

<sup>51</sup> 2019 NAIC Annual Statement Instructions Property/Casualty ([Appendix I.1](#)).