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Prudential Regulation Authority

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Dear Chief Actuary

### **General insurance Actuarial Function Reports**

This letter to Chief Actuaries<sup>1</sup> of general insurers is intended to be part of an ongoing dialogue between the PRA and the Chief Actuary community. We encourage you to share this letter with your board, and we welcome your thoughts and feedback.

The purpose of this letter is to provide comments following our review of Actuarial Function Reports (AFRs) and to:

- Set out the areas where we think that Solvency II requirements are not always being met.
- Share our findings on emerging good practice in AFRs.
- Share our observations on how firms' actuarial functions can be more engaged with the firm's board and the firm's risk management.

The Chief Actuary makes an important contribution to the board's decision-making processes. The requirements of the actuarial function<sup>2</sup> make it well placed to look widely across underwriting, reserving and reinsurance, and provide effective analysis and advice to help the board navigate the issues arising from the insurance market and external environment. Accordingly, effective engagement with the Chief Actuary community is important to us.

The key messages of this letter are that firms' actuarial functions can enhance the contribution they are making to their firm's systems of governance, particularly in the areas of:

- Engaging with the board so that the actuarial function is better seen as a key part of the firm's systems of governance.
- Producing AFRs for the board<sup>3</sup> that get key messages across in order to support the board's decision making.
- Expressing opinions in AFRs that are supported by clear rationale and are of value to stakeholders.
- Providing evidence in AFRs that the actuarial function is meeting Solvency II guidelines relating to the validation of technical provisions.<sup>4</sup>

We have reviewed AFRs from a number of general insurance firms over the last year. The focus of our reviews was on whether the Solvency II requirements were met and whether findings were communicated effectively to the board. We are providing specific feedback to individual firms following our reviews. I have already met several Chief Actuaries from these firms, last year, and will be meeting more throughout this year to discuss their experiences, the challenges they face, and how the actuarial function can best support the board.

### ***General feedback***

Overall, we have observed some good examples of analysis being discussed with boards. However, many firms have areas where improvement is needed to be fully compliant with Solvency II and to ensure the actuarial function work drives improvements across all relevant areas.

The PRA's primary focus is on the requirement that the actuarial function is effective in carrying out its tasks. It is therefore down to the firms to decide how to structure their actuarial function and how to ensure the necessary level of objectivity and independence.<sup>5</sup>

A key point is that the AFR is a report for the board and not the PRA, although we may request a copy of the report. While Solvency II requirements should of course be met, we do not see the AFR as a tick-box or compliance report. The better reports we have seen are those that address the requirements with the level of analysis appropriate to the materiality and complexity of the areas in question. They also clearly communicate the key issues and recommendations to the board. The more effective actuarial function processes demonstrate good board engagement and a feedback loop where recommendations to remedy deficiencies identified in the AFR<sup>6</sup> are followed up.

The AFR informs the board of the reliability and adequacy of technical provisions and is therefore key to the board fulfilling its responsibility of managing the insurer prudently as set out in the PRA approach document.<sup>7</sup> We consider that the underwriting and reinsurance opinions expressed in the AFR can provide valuable, independent insights into the ongoing and future viability of the business and that a fit for purpose AFR will help the board to discharge its responsibilities.

Our particular observations from reviewing AFRs include:

- Some AFRs have not clearly stated an opinion where required by Solvency II and have focused instead on process, or stating what has been reviewed. The better AFRs provide clear and informative opinions, with appropriate criteria for assessment, and recommendations have a clear rationale. This, in any case, is required by the Financial Reporting Council's Technical Actuarial Standard TAS100.<sup>8</sup> This standard applies to all technical actuarial work.
- It is not always clear how much reliance the board can place on conclusions within the AFR. For example, many reports have not clearly explained the level of independence in the work or any conflicts of interest; also in some AFRs there is insufficient information on how conclusions have been reached and the alternative approaches and recommendations considered by the actuarial function.
- Recommendations and deficiencies are not always highlighted clearly for the board. It is a requirement of Solvency II to highlight deficiencies, with recommendations for remediation.<sup>9</sup> We view this as an important part of a firm's governance process.
- There was a wide variety in the length of AFRs we have reviewed. Reports should consider the audience, ensure key messages are clear from the executive summary, and contain sufficient supporting analysis. Where underlying analysis is carried out elsewhere, we consider that it would be useful for the board if key points are highlighted in the AFR and underlying reports are signposted and available. There is no need to reproduce the contents of other reports in full.

- We have seen a number of reports that do not cover the role the actuarial function plays in risk management, including both the capital calculations and the own risk and solvency assessment.<sup>10</sup>

### ***Technical provisions***

This is an area where the required statements of adequacy and reliability are clearly stated in most reports we have seen. However, we have found areas where many AFRs did not address fully the requirements relating to technical provisions<sup>11</sup> including:

- While most reports do clearly inform the board of the reliability and adequacy of the calculation of technical provisions, this is not always backed up by the level of analysis required. Without this, it can be unclear from the report the extent to which the board can rely on the work carried out. As mentioned in the previous section, signposting to underlying reports is beneficial.
- The extent of validation of technical provisions (and evidence that the actuarial function has ensured the validation is appropriately designed) is not evident in many AFRs. While validation of technical provisions may be documented elsewhere, it is important that the board can see evidence of this validation within the AFR to understand the reliance it can place on the statement of adequacy. This is an area where we consider signposting and summarising key findings is particularly important; in addition highlighting the level of independence is beneficial to the board.
- A comparison and justification of any material differences in the calculation of technical provisions from year to year.
- A comparison of best estimates against experience<sup>12</sup> for the premium provision and for the claims provision parts of the best estimate (often only the claims provision, and not the premium provision, has been compared against experience in the AFR), together with sufficient commentary on the appropriateness, accuracy and completeness of the data and assumptions used as well as on the methodologies applied in the calculation of best estimates.
- An analysis and explanation of the degree of uncertainty in the estimates of the technical provisions.
- An investigation of the sensitivity of the technical provisions to each of the major risks underlying the obligations which are covered in the technical provisions.
- Ensuring that any limitations of data used to calculate technical provisions are properly considered.

### ***Opinion on the overall underwriting policy***

We have observed that in some opinions on the overall underwriting policy, it was unclear whether some of the requirements<sup>13</sup> had been given full consideration including the:

- Sufficiency of premiums. Often we only saw an assessment that combined ratios were on target to meet those in the business plan, whereas better reports contained meaningful analysis to support their conclusions. Some actuarial functions calculated their own independent estimates of future claims and expenses to compare to the plans. Others reviewed the plan and provided an opinion while some firms merely tracked performance against the plan. In our view this latter approach is unlikely to provide sufficient analysis to support the required opinion.
- Effect of inflation.
- Change in composition of the firm's portfolio.
- Risk of anti-selection.

The better reports we have seen demonstrated how the factors above had been assessed – a basic statement of compliance is unlikely to give the board the information it needs. If these areas had not been assessed the board should be informed of the reason and the materiality involved. Any other areas

that have a material impact on premiums should be covered, eg planned changes in terms and conditions. Where the actuarial function's view on loss ratios differs from the business plan, we consider that an assessment of the differences would be of use to the board, particularly in setting the context for future decision making on reserving.

### ***Opinion on adequacy of reinsurance arrangements***

This is an area where many firms have significant relevant work already in place to evaluate the reinsurance programmes and their impact on the risk profile. In particular, we consider that AFRs that draw together a comprehensive overview of the reinsurance arrangements would be useful for the board.

Other observations from our reviews so far include:

- In some AFRs the analysis written in the report has been disproportionately limited compared to the materiality and complexity of the risk profile and reinsurance programme.
- The expected cover under stress scenarios in relation to the underwriting policy<sup>14</sup> were not always covered sufficiently. Some firms tested a range of reinsurance coverage options that, while useful, did not evaluate the adequacy of the selected reinsurance in different situations (such as reinsurers in stressed conditions or exhaustion of the reinsurance programme). Better reports included an analysis of the implication of stress test results and recommended actions or mitigants.
- The opinion did not always cover all applicable reinsurance types, including group-wide reinsurance covers where the effect on the entity in stressed scenarios should be analysed.

If you would like to discuss the content of this letter, please speak to your usual supervisory contact in the first instance.

Yours sincerely



<sup>1</sup> Persons responsible for discharging firms' Chief Actuary function (ie the function of having responsibility for the actuarial function – see rule 7.1 of the 'Insurance – Senior Insurance Management Functions' Part of the PRA Rulebook).

<sup>2</sup> Rule 6.1(1) of the 'Conditions Governing Business' Part of the PRA Rulebook, and Delegated Regulation (EU) 2015/35 Article 272.

<sup>3</sup> Delegated Regulation (EU) 2015/35 Article 272(8).

<sup>4</sup> EIOPA Guidelines on valuation of technical provisions ([eiopa.europa.eu/Publications/Guidelines/TP\\_Final\\_document\\_EN.pdf](http://eiopa.europa.eu/Publications/Guidelines/TP_Final_document_EN.pdf)): Introduction paragraph 1.6 sets out that the actuarial function should carry out the coordinating and validating task; Section 5: Validation Guidelines 83 to 87.

<sup>5</sup> Delegated Regulation (EU) 2015/35 Articles 258(1)(g) and (k), 258(5) and 268(1).

<sup>6</sup> Delegated Regulation (EU) 2015/35 Article 272(8).

<sup>7</sup> 'The PRA's approach to insurance supervision', March 2016: [www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/approach/insurance-approach-2016.pdf](http://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/approach/insurance-approach-2016.pdf) (in particular paragraphs 81, 121, 123, 126).

<sup>8</sup> FRC's TAS100: [frc.org.uk/getattachment/b8d05ac7-2953-4248-90ae-685f9bcd95bd/TAS-100-Principles-for-Technical-Actuarial-Work-Dec-2016.pdf](http://frc.org.uk/getattachment/b8d05ac7-2953-4248-90ae-685f9bcd95bd/TAS-100-Principles-for-Technical-Actuarial-Work-Dec-2016.pdf).

<sup>9</sup> Delegated Regulation (EU) 2015/35 Article 272(8).

<sup>10</sup> Conditions Governing Business / 6.1 (1)(i).

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- <sup>11</sup> In addition to Conditions Governing Business / 6.1(1)(a) to (f) we draw Chief Actuaries' attention to Delegated Regulation (EU) 2015/35 Articles 264 and 272, and the EIOPA Guidelines on the valuation of technical provisions in particular: Introduction paragraph 1.6 and guidelines 3 to 6, 8 to 12, 14, 16, 44, 83 to 87; and the EIOPA Guidelines on system of governance ([eiopa.europa.eu/GuidelinesSII/EIOPA-BoS-14-253\\_GL%20on%20system%20of%20governance.pdf](http://eiopa.europa.eu/GuidelinesSII/EIOPA-BoS-14-253_GL%20on%20system%20of%20governance.pdf)) section 9 : Actuarial function.
- <sup>12</sup> Rule 6.1(1)(d) of the 'Conditions Governing Business' Part of the PRA Rulebook.
- <sup>13</sup> Delegated Regulation (EU) 2015/35 Article 272(6).
- <sup>14</sup> Delegated Regulation (EU) 2015/35 Article 272(7)(c).