



The Actuarial Profession  
making financial sense of the future

Expert judgement on expert judgement  
Michael Ashcroft, Roger Austin, Peter Scolley  
(on behalf of Solvency & Capital Management Research Group)

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## Introduction

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- We are members of the Professions' Solvency & Capital Management Research Group.
- We have chosen Expert Judgement (EJ) as our focus for this year due to it being identified as a common issue across the industry with limited insights available to date.
- In September we carried out a survey of UK Life insurers, the results of which have been used to inform this talk.

## The Agenda for Today

| Section                 | Speaker          |
|-------------------------|------------------|
| Background              | Michael Ashcroft |
| EJ Survey               | Michael Ashcroft |
| EJ Scope                | Roger Austin     |
| EJ Governance           | Roger Austin     |
| EJ Framework Specifics  | Peter Scolley    |
| Independent Expert View | Peter Scolley    |
| Summary                 | Michael Ashcroft |
| Questions               |                  |

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## Background

### EJ before SII

- The idea of expert judgement in Insurance is not new:
  - Independent Expert reports for transactions/court cases;
  - Evidence for reporting/audit;
  - AFH/WPA opinions;
  - TAS standards;...
- The requirement for recognised experts is also common in other professions – medical consultants, legal experts,....
- Expertise is a hot topic in social science.

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## Background

### “Definition” of an expert

- The current draft of the Level 2 text says that expert judgements should be based on the expertise of persons with *relevant knowledge*, *expertise*, and *understanding of the risks* inherent in the insurance/reinsurance business.
- “Expert - you will know one when you see one”.
- An **expert** is someone widely recognized as a *reliable* source of *technique* or *skill* whose faculty for judging or deciding rightly, justly, or wisely is *accorded authority and status by their peers or the public* in a specific well-distinguished domain. An expert can be, by virtue of *credential, training, education, profession, publication* or *experience*, believed to have special knowledge of a subject beyond that of the average person, sufficient that others may *officially* (and *legally*) rely upon the individual's *opinion*.

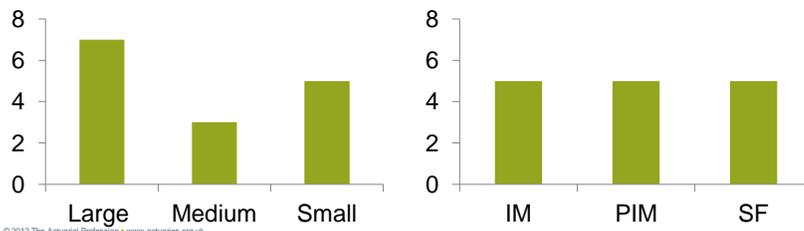
## Background

### SII regulations

- Solvency II Framework Principles (or “Level 1”):
  - Directive 2009/138/EC, Articles 121, 124 and 125.
- Solvency II Implementing Measures (or “Level 2”):
  - Draft Level 2 (October 2011).
- Solvency II Guidance (or “Level 3”):
  - Draft Level 3 (March 2011).
- Recent IMAP feedback from the FSA.

## EJ Survey

- Research group created a survey covering:
  - General concerns around EJ;
  - Expectations of scope of EJ;
  - Expectations of evidencing requirements for EJ.
- 15 responses received from a wide range of UK Insurance companies.



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## EJ Survey

### What are the issues for companies?

- General consensus of a lack of clarity on detailed requirements / expectations of the regulators.
- Agreeing on the scope of EJ.
- EJ Framework.
- Producing and managing the documentation required.
- Ensuring sufficient validation and challenge of EJ.
- Ensuring consistency of the treatment of EJ across the business.

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## EJ Scope

- Draft Level 2 Text makes clear that EJ goes beyond SCR:
  - Technical provisions;
  - Asset valuation;
  - Valuation of (non-technical provisions) liabilities;
  - Own funds;
  - MCR.
- So EJ applies to Standard Formula firms too.

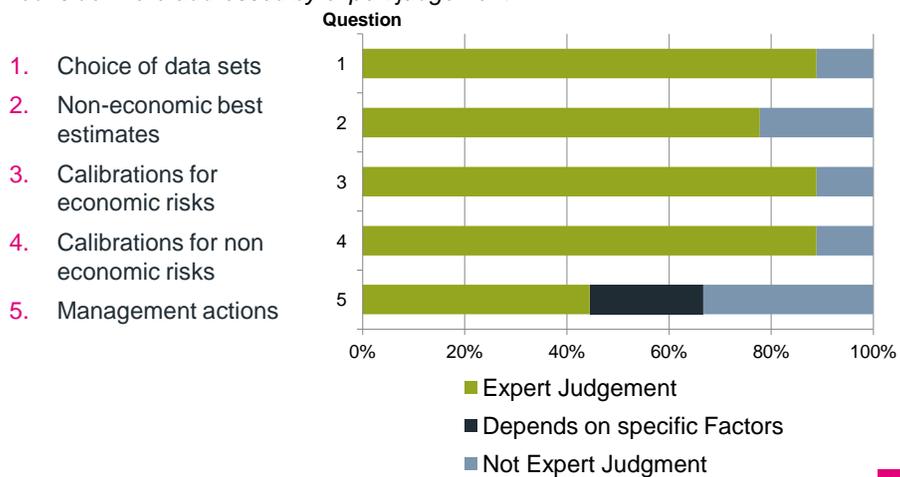
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## EJ Scope

### Survey – company expectations

*In the context of your model validation, which of the following areas did you consider were addressed by expert judgement?*

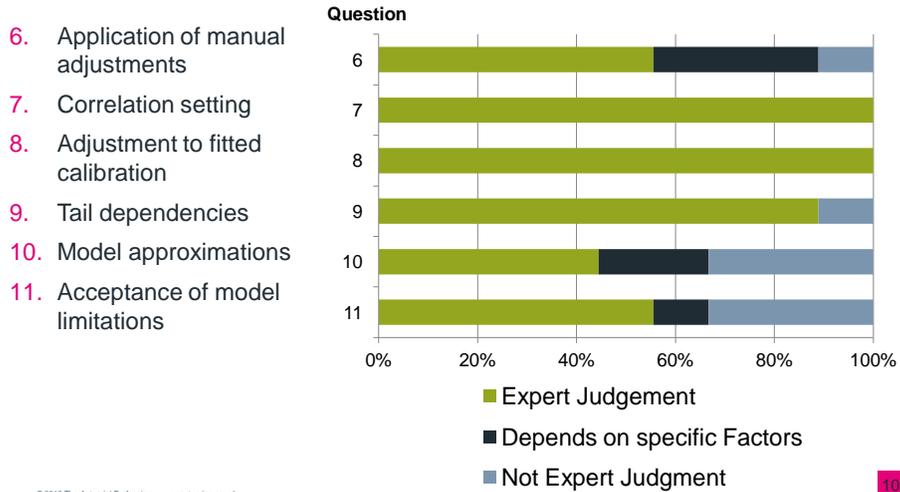


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## EJ Scope

### Survey – company expectations



## EJ Scope

### Methodology

- Some debate over whether methodology is included.
- Level 2 text requires firms to “choose assumptions on the issues covered”.
- In practice, this distinction may not be important...
  - Regulator needs reassurance that balance sheet items are appropriately calculated:
    - Will entail explaining why the methodology is appropriate; AND explaining why the assumptions are appropriate;
    - Both aspects have to be covered off in the documentation.

## EJ Governance

### Governance framework

- Robust governance framework is critical.
- Materiality and proportionality are highly relevant.
- Framework should include EJ, materiality and proportionality.
- May have formal policies for each, or combine with others.
- EJ is not just relevant for the internal model.
- *Level 3 Guidance*
  - *tight governance framework (guideline 2), good communication that includes limits and uncertainties of expert judgement (guideline 3) and thorough documentation (guideline 4). Validation also has a role to play, for example in the maintenance of a track record (guideline 5).*

## EJ Governance

### Governance framework ctd...

- EJ policy could cover:
  - Scope, definitions (EJ and expert), metrics.
  - Process for assessing (potential) expert judgements.
  - Documentation required:
    - Having regard to materiality and proportionality policies.
  - Consistency:
  - Appropriate validation and challenge.

## EJ Governance

### EJ assessment process

- Clear (practically-focused) process:
  - Is the judgement considered an “Expert Judgement”?
  - Initial materiality assessment (to assess level of proportionality to apply).
  - Context of judgement: why is it needed and how it will be used?
  - Does the expert have relevant knowledge, understanding of the subject and adequate experience?
  - Identification of potential sources of information relevant to the judgement.

## EJ Governance

### EJ assessment process ctd...

- Clear (practically-focused) process ctd...
  - Identification of key drivers underlying judgement.
  - Guidance around:
    - Avoiding potential bias;
    - Assessment of plausible range;
    - Robustness of analytics supporting the judgement;
    - Conducting a sensitivity / scenario analysis.
  - Reassessment of materiality in light of sensitivity assessment.
  - Documentation.

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## EJ Governance

### EJ documentation

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- Should be proportionate to materiality of EJ.
- EJ register?
- Template to capture necessary information.
- Sources of information used to inform judgement (including market practice), and how they are used.
- Key drivers upon which the judgement depends.
- Related judgements.
- Plausible range of acceptable judgements.
- Sensitivity assessment on relevant metrics.

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## EJ Governance

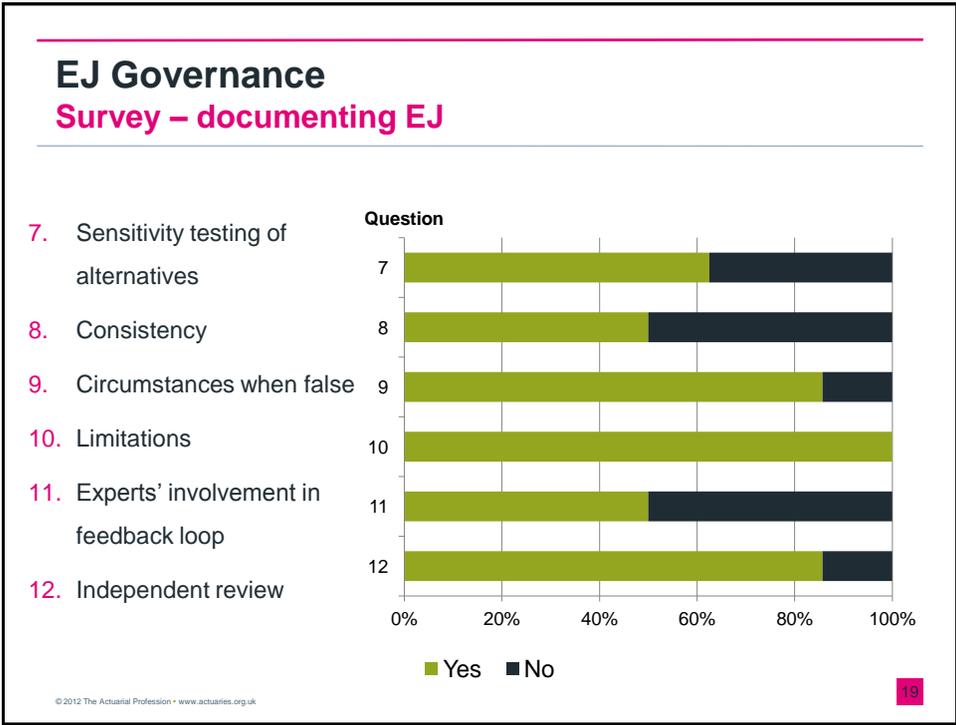
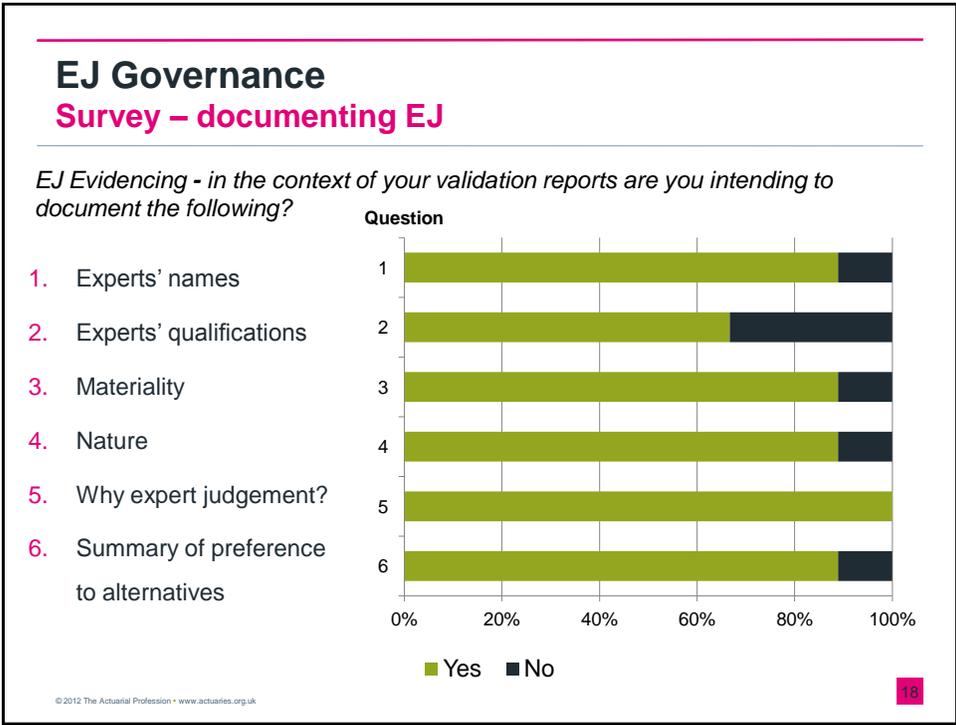
### EJ documentation ctd...

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- Date of judgement.
- Name and title of expert (where “expert” may be an individual, or a committee).
- Credibility of expert.
- Validation and challenge process applied to judgement.
- Scheduled date by which EJ must be reviewed.
- Key limitations, and triggers for non-scheduled review.

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## EJ Framework Specifics

### Assessing materiality

- Consider: potential for error; impact on results; impact on use to which results are put.
- There are several possible approaches to assessing materiality. These could include:
  - Ranges of assumptions e.g. 10<sup>th</sup> percentile, 90<sup>th</sup> percentile;
  - Sensitivity of TPs/SCR to a specified change in the assumption e.g. +/- 10%;
  - Impact of scenarios;
  - Sum at risk approach;
  - Qualitative assessment.

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## EJ Framework Specifics

### Consistency

- Need to consider consistency:
  - With other judgements;
  - With similar assumptions;
  - With similar risks;
  - Over time;
  - Across business units;
  - Across regions.

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## EJ Framework Specifics

### Achieving consistency

- Achieving consistency – key elements might include:
  - Consistent process in deciding on EJ;
  - Grouping similar areas of judgement and monitoring them using common drivers;
  - Judgements are changed only when there is a compelling reason to do so (e.g. new data);
  - Consistent story across the judgements;
  - Just one person making all the judgements (unrealistic!);
  - Committee reviews of judgements;
  - Validation;
  - EJ Register.

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## EJ Framework Specifics

### Validating judgements

#### How do you gain comfort on the judgement made?

- Accept that no judgement will be “right”.
- Strong governance/process.
- Important to have a strong justification.
- Good documentation.
- Avoid changes in judgements without good reason.
- Consistency.
- Being in line with the industry does not necessarily provide sufficient comfort in its own right. Need to ensure that you are able to back it up and are aware of the financial impact and impact on policyholders.
- Feedback loop (ensuring EJ not used out of context).
- Backtesting / tracking experience / trends.

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## Independent Expert View

- Current Independent Expert opinions:
  - are a very public display of actuarial work;
  - require a high standard of actuarial work.
- Key points:
  - Requirements to be an expert;
  - Be clear about scope of work;
  - Information on which opinions are based;
  - Explanation of assumptions and uncertainty;
  - Differences in opinions.

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## Summary

- Applies to all aspects of Solvency II balance sheet (for both SF and IM firms) not just Internal Model assumptions.
- Development of a robust process/governance is vital.
- Ensure sufficient and proportional challenge and validation.
- Ensure there is clear ownership.
- Materiality and proportionality considerations are key.
- Need to ensure consistency across the framework.
- Clear (and proportional) documentation strategy.
- Feedback loop.
- Practical management – EJ register, drivers etc...
- Next steps...

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## Questions or comments?

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Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenters.

[Michael.Ashcroft@kpmg.co.uk](mailto:Michael.Ashcroft@kpmg.co.uk)

[Roger.Austin@aprllp.com](mailto:Roger.Austin@aprllp.com)

[Pscolley@deloitte.co.uk](mailto:Pscolley@deloitte.co.uk)

