

APS G2: ACTUARIAL REPORTING FOR LLOYD'S SYNDICATES WRITING US BUSINESS

Author: General Insurance Practice Executive Committee

Status: Approved under the Standards Approval Process

Version: 1.0, effective from 15 December 2010

To be reviewed: No later than 15 December 2011

Purpose: Lloyd's syndicates authorised by the **IID** to write surplus lines insurance in the US are required to provide to the **IID** a **Solvency SAO** and a **SAO** on the technical provisions gross of reinsurance in their Surplus Lines Trust Fund. In addition, the **NYID** requires **Trust Fund SAOs**. The structure is shown in the **Lloyd's US Advisory Note**. The purpose of APS G2 is to give guidance to any member providing the **Solvency SAO** or the **Trust Fund SAOs**.

Authority: **NAIC – IID** and **NYID** regulators

Target Audience: Members appointed by **Managing Agents** to provide actuarial opinions required by the **IID** of the **NAIC** or by the **NYID** for Lloyd's syndicates writing relevant US insurance or reinsurance business.

Application and status:

All Members of the Institute and Faculty of Actuaries (the Actuarial Profession) are required to comply with this Standard in their professional lives, whether or not they are engaged in actuarial work. Where there is uncertainty as to whether an activity forms part of a Member's professional life for the purposes of the application of this Standard, then it should be regarded as such a part.

All sections of this Standard are mandatory.

Any failure by a Member to comply with the Actuaries' Code, or with any other guidance, standards, advice, memorandum or statement on professional conduct, practice or duties which may be published by the Actuarial Profession or the Board for Actuarial Standards (BAS) may be liable to consideration under the Actuarial Profession's Disciplinary Scheme (the Disciplinary Scheme). A material breach of the Actuaries' Code, Actuarial Profession Standards or BAS' Technical Actuarial Standards (TASs) is of itself a ground for referral under the Disciplinary Scheme and would amount to strong prima facie evidence of Misconduct, as defined at Rule 1.6 of the Disciplinary Scheme.

1. Introduction

- 1.1. The member must be familiar with the relevant version of any instructions issued by the **IID**, **NYID** or Lloyd's for this purpose. In addition, the member should have regard to any relevant detailed technical guidance issued by the General Insurance Professional Executive Committee, contained in the latest version of the **Lloyd's US Advisory Note**. If the member has questions concerning the interpretation of the instructions issued by Lloyd's, then he or she should seek clarification from the Lloyd's Actuary.
- 1.2. The nature of the opinions required by the **IID/NYID** is such as to place a high level of responsibility on the member. The member must consider in relation to the Actuaries' Code whether he or she has sufficient experience to justify undertaking the assignment. This should include knowledge of the business procedures of Lloyd's and of types of business similar to those underwritten by the syndicate.

2. Purpose and Scope

- 2.1. The **Solvency SAO** should, subject to paragraph 7.8 below, cover all the business of the syndicate for all years of account from 1993 to date, whereas the **Trust Fund SAOs** should, subject to paragraph 7.8 below, cover business incepting on or after 1 August 1995. Separate figures are required for each economic entity, i.e. each open syndicate year of account, including all years that have been reinsured into it, treating as a separate entity any year of account being closed at the year end. The **Solvency SAO** should include claims handling expenses both allocated and unallocated together with an allowance for reinsurance bad debts. The allowance for reinsurance bad debts should include amounts both in respect of reinsurance disputes and reinsurance insolvency. The **Trust Fund SAOs** should include allocated claims handling expenses. The technical provisions should include allowance for future inflation of claims costs but should not be reduced in anticipation of future investment income on assets supporting the provisions. Additional contingency margins are permitted but not required. The **SAOs** will need to be modified appropriately if there are run-off years of account.
- 2.2. The **SAOs** are intended solely for the purpose of complying with the Lloyd's US regulatory requirements. Unless the member otherwise agrees, reliance on the **SAOs** for any other purpose should normally not be permitted.
- 2.3. Should the member become aware of a material cross-funding between the unearned premium provision and the claims technical provisions in the course of their work, this should be commented upon in the **SAO** in the section labelled "Relevant Comments".

- 2.4. Specimen **SAOs** for the opinions are provided in the appendices to the **Lloyd's Valuation of Liabilities Rules**. While it is expected that these will be used as models, modifications may be necessary to suit particular cases including any changes referred to in the **Lloyd's US Advisory Note**.

3. Reporting Requirements

- 3.1. The **SAO** must be supplemented by a **Report**. Its purpose is to explain the work done by the member in order to reach the opinion on the technical provisions.
- 3.2. It is expected that, in most situations, this work would include independent calculation of the technical provisions and comparison with those established by the syndicate. In other situations, the member's work may not include independent calculation of technical provisions, but rather constitute a review of the methodology and assumptions used by someone else (e.g. the syndicate's own actuarial or other staff) in calculating the technical provisions. This practice is acceptable, provided the member signing the **SAO** is willing to accept personal responsibility for the opinion stated, based on the work reviewed. In these situations, the **Report** should include an explanation of the work performed by the member signing the **SAO** and include details of the work performed by the other party.

4. Types of Opinion

- 4.1. If the member, following discussion with the **Managing Agent**, believes that a **SAO** can be provided but only with qualifications, then the member may still prepare the **SAO**, using the relevant form of words contained in the specimen **SAOs** in the appendices to the **Lloyd's Valuation of Liabilities Rules**, but modified to reflect the qualification, which should make clear to which figure or figures it relates. It should be recognised that in these circumstances the relevant authorities (i.e. the **IID**, **NYID** or **Lloyd's**) may not accept the **SAO** and the **Managing Agent** may ask the member to discontinue work. Any qualifications must appear in the **SAO**; it is not sufficient for a qualification to appear only in the report.
- 4.2. The member may add comments to their opinion in the section labelled "Relevant Comments". It is intended that this area is used to highlight uncertainties that may have a material impact on the adequacy of technical provisions. Highlighting such uncertainties does not constitute a qualification, as the member can still produce a best estimate on which to base their opinion. It would not be unusual for syndicates that write volatile classes of business to have such additional comments in their **SAOs**.

5. Relationships

- 5.1. The relationships between **Managing Agents**, underwriters and auditors to syndicates can be complex. The member should make clear his or her relationship with each of these parties and the extent to which he or she has used information obtained from them or relied on work undertaken by them. The member should not rely on the auditor unless there is a specific agreement for such reliance.
- 5.2. It is the responsibility of the **Managing Agent** to set the technical provisions. The role of the member is to provide an opinion on those technical provisions. The professional

responsibilities of the member in providing the **SAO** override any responsibilities he or she might have as an employee or consultant.

- 5.3. The member should make clear at the outset that he or she may require frequent access to underwriters and other members of the **Managing Agent's** staff, and may wish to use work carried out by or for the **Managing Agent**, including the work of any other member who has worked for the **Managing Agent** as an employee or consultant. However, since the member providing the **SAO** must take full responsibility for the opinion stated, he or she must be satisfied as to the validity of the material used for that purpose.

6. Data

- 6.1. The member should obtain assurances from the **Managing Agent** as to the accuracy and completeness of the data provided. The member should review all key data for reasonableness but may otherwise rely upon the **Managing Agent** in this respect. The member will need to amend the wording of the reference to data in the specimen **SAOs** given in the appendices to the **Lloyd's Valuation of Liabilities Rules**, if he or she encounters anything during the course of the work that gives rise to any material concerns with regard to the accuracy of the data, and the **Managing Agent** is unable to resolve these concerns satisfactorily.
- 6.2. A specimen **DAS** is given in the appendices to the **Lloyd's Valuation of Liabilities Rules**. If there are any material data discrepancies or anomalies that cannot be resolved with the **Managing Agent**, the member should discuss them with the auditor. In some circumstances, it may be necessary to modify the wording of the specimen **DAS**.
- 6.3. Should the data prove to be incomplete, inaccurate, unreliable, or not as appropriate as desired, the member must consider whether the use of such imperfect data may produce material biases in the results of the investigation and make appropriate allowances. If the data are so inadequate that they cannot be used to carry out the work necessary for the **SAO**, even on a very conservative basis, the member must decline to provide an **SAO**.
- 6.4. For the **Trust Fund SAOs**, the member is required to verify that the data presented by the **Managing Agent** in Schedule P of the annual return to the **NYID** reconcile with the Trust Fund data used by him or her for the purpose of preparing the **Trust Fund SAOs**. Appropriate wording is included in the specimen **SAO** in the appendices to the **Lloyd's Valuation of Liabilities Rules**. If the timescale is such that the member is unable to see the final version of the schedule before he or she signs the **SAOs**, then he or she should obtain a draft of this schedule prior to signing, and an undertaking from the **Managing Agent** that there will be no changes between the draft and the final version. In these circumstances the appropriate paragraph in the **SAO** should be amended to: -
- "I have verified that the data contained in a final draft of Schedule P reconcile with the Trust Fund data used for the purpose of preparing this SAO [except for immaterial differences, possibly due to rounding]/(except for rounding differences)]. [The Managing Agent] has confirmed that there was/will be no change to Schedule P before submission".*
- 6.5. If the **Managing Agent** advises the member of any changes, then he or she will need to consider the effect on the calculations, and whether the **SAOs** need to be amended and re-issued.

7. Valuation Principles

- 7.1. In order to be able to provide a **SAO**, the member needs to be satisfied that the technical provisions held by the syndicate are at least as large as those calculated by applying generally accepted actuarial methods and using assumptions that he or she considers reasonable in the context of the **Lloyd's Valuation of Liabilities Rules** (for the **Solvency SAO**) or the basis agreed with regulators referred to in paragraphs 7.3 and 7.6 (for the **Trust Fund SAOs**).
- 7.2. The technical provisions calculated by the member for the purpose of forming the opinion must be at least as large as those implied by a "best estimate" basis without precautionary margins. If, however, the **Managing Agent** has set technical provisions materially higher than those indicated by such a basis, the member may still provide the **SAO** without qualification. In this context, the term "best estimate" is intended to represent the expected value of the distribution of possible outcomes of the unpaid liabilities. This definition is intended to clarify the concept but it will generally be impossible to apply it directly in practice. Note, however, that where the Lloyd's Valuation of Liability Rules prescribe a basis that is stronger than best estimate for certain elements of the technical provision, then the member must follow the rules in respect of those elements, without taking any offsetting benefit by adopting a weaker than best estimate basis for the other elements of the technical provision.
- 7.3. In the case of the **Trust Fund SAOs**, the "best estimate" basis may need to be modified to take account of the basis agreed with the regulators, which is summarised in the **Lloyd's US Advisory Note**.
- 7.4. In classes which have historically shown a tendency to give rise to latent claims, the member should, in the absence of evidence to the contrary, assume continuation of that tendency, but need not allow for the emergence of major new types or classes of claims for the existence of which there is no evidence.
- 7.5. The technical provisions included in the **Solvency SAO** must include provision for reinsurance bad debts and claims handling expenses (both allocated and unallocated) in the currencies where such expenses are expected to be incurred. The **Trust Fund SAOs** must include provision for allocated claims handling expenses. For each economic entity, the **SAO** relates to the total technical provisions including these provisions, where relevant, and does not apply to each element separately.
- 7.6. The **Solvency SAO** refers to technical provision conforming to UK insurance regulations and therefore UK accounting principles will apply. The Trust Fund and the **NYID** version of the Surplus Lines Trust Fund SAOs refer to technical provisions being consistent with the "Modified UK Basis, as agreed with the **NYID**" and the member should therefore be familiar with that basis, as described in the **Lloyd's US Advisory Note**.
- 7.7. If the syndicate is expected to be a net borrower, additional technical provisions may be needed to cover borrowing costs because of the need to fund claims (and other) costs in advance of premium receipts or reinsurance (or other) recoveries.
- 7.8. In some circumstances the member may be asked by the **Managing Agent** to provide an **SAO** on a subset of the technical provisions to which it is intended to apply. In most situations, this is likely to be unacceptable to the relevant authorities (i.e. the **IID**, **NYID** or Lloyd's). However,

there may be specific reasons for excluding certain items from the scope of the **SAO**, for example contracts that are subject to ongoing dispute over coverage. The member may agree to this, as long as the exclusions are made clear in the **SAO**.

- 7.9. For the **Solvency SAO**, the member should be aware of the need to provide for the cost of the reinsurance protection of the liabilities covered by the opinion, irrespective of the year of account to which the relevant reinsurance premiums will be charged. For example, this could be particularly important where reinsurance is placed on the basis of losses occurring during the year of account or when policies are written for periods in excess of one year or under binding arrangements.
- 7.10. If for any particular class of business there are specific features of the exposure or the claims that significantly increase the uncertainty, beyond that which might reasonably be expected from that class of business, then a comment to that effect should be included in the "Relevant Comments" section of the **SAO** and in the **Report**.
- 7.11. If for some or all elements of the technical provisions the member has adopted a methodology that is materially different from generally accepted actuarial methods, then reference should be made to this in the "Relevant Comments" section of the **SAO** and in the **Report**.
- 7.12. The member may be asked by the **Managing Agent** to carry out some of his or her work as at a valuation date prior to the **SAO** valuation date. In all circumstances, the member must carry out sufficient work, using data as at the **SAO** valuation date, in order to be satisfied that he or she can sign the **SAO**. In addition, the member should ascertain from the **Managing Agent** whether there have been any material events between the valuation date and the date of signing the **SAO**, and make an appropriate adjustment to the technical provisions for such events. If there is insufficient time to make such an adjustment, then the member may need to draw attention to this in the **SAO**.

8. Definitions

Term	Definition
DAS	Data Accuracy Statement produced by the Managing Agent
IID	International Insurers Department
Lloyd's US Advisory Note	Advisory Note on Lloyd's US Opinions issued by the General Insurance Practice Executive Committee
Lloyd's Valuation of Liabilities Rules	Valuation of Liabilities Rules for Lloyd's Solvency Purposes, issued annually
Managing Agent	Lloyd's managing agent
NYID	New York Insurance Department
NAIC	National Association of Insurance Commissioners
Report	The separate management report which supplements the SAO which is addressed by the member to the Managing Agent and may be distributed to Lloyd's and the US regulators.
SAO	Statement of Actuarial Opinion
Solvency SAO	SAO on worldwide technical provisions both gross and net of reinsurance.
Trust Fund SAOs	SAOs in respect of technical provisions gross of reinsurance for the Surplus Lines Trust fund and the Credit for Reinsurance Trust Fund