

GN20: Actuarial Reporting Under the Lloyd's Valuation of Liabilities Rules

Classification

Practice Standard

Legislation or Authority

Lloyd's Act 1982 (1982, c.14)

Insurance Companies Act 1982 (1982, c.50). Section 83 (5) (b).

Lloyd's of London. Solvency and reporting byelaw.

(Byelaw No 13 of 1990, 5 December 1990).

Lloyd's of London.

Lloyd's Valuation of Liabilities Rules, issued yearly on 31 December.

Application

Actuaries appointed by Lloyd's managing agents to provide an actuarial opinion in support of general insurance solvency reserves as required by the Lloyd's Valuation of Liabilities Rules. (There are also requirements for life syndicates to obtain actuarial opinions, but these are outside the scope of this guidance note.) This guidance note also applies to Fellows of the Casualty Actuarial Society who are also affiliates of the Institute of Actuaries.

Author

General Insurance Board

Status

Approved under Fast Track.

Required to complete due process by May 1999.

<i>Version</i>	<i>Effective from</i>
1.0	01.02.94
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4.0	01.12.97

1 Introduction

- 1.1 Lloyd's syndicates writing general insurance business are required to provide to the Council of Lloyd's each year for solvency purposes a Statement of Actuarial Opinion (SAO) on their worldwide reserves, both gross and net of reinsurance.

- 1.2 This note applies to any actuary instructed by a Lloyd's managing agent to provide such an SAO. The actuary must be familiar with the latest version of Valuation of the Liabilities Rules and any other instructions issued by Lloyd's for this purpose.
- 1.3 The nature of the opinions required by the Council of Lloyd's is such as to place a high level of responsibility on the profession. An actuary who is asked to provide an SAO must consider carefully, in relation to the Memorandum on Professional Conduct, whether his or her experience of the business procedures of Lloyd's and of estimating reserves for types of business similar to those underwritten by the syndicate is sufficient to justify undertaking the assignment.
- 1.4 A Specimen SAO for the combined gross and net opinions is provided in Appendix 1 to this note. While it is expected that this will be used as a model, modifications may be necessary to suit particular cases.

2 Reporting Requirements

- 2.1 The SAO should cover all the business of the syndicate for all years of account from 1993 to date. Separate figures are required gross and net of reinsurance for each economic entity, ie open syndicate years of account, including all years that have been reinsured into them, treating as a separate entity any year of account being closed at the year end. The reserves to be covered by the SAO should include allocated claims handling expenses but exclude unallocated claims handling expenses. The reserves should include allowance for future inflation of claims costs but should not be reduced in anticipation of future investment income on assets supporting the reserves. Additional contingency margins are permitted but not required. The adequacy of the provision for reinsurance bad debts is outside the scope of the SAO. The SAO will need to be appropriately modified if there are Run-Off years of account.
- 2.2 The SAOs should be supplemented by a separate management report ('the Report'), addressed by the actuary to the managing agent. The Report should state for whom it is intended and the extent, if any, to which it may be distributed to third parties other than Lloyd's and the Insurance Supervisory Body.
- 2.3 The purpose of the Report is to explain the work done by the actuary in order to reach the opinion on the reserves. It is

expected that, in most situations, this work would include independent estimation of the reserves and comparison with those established by the syndicate. In these situations the Report should conform to GN12. In other situations, the actuary's work may not include independent estimation of reserves, but rather constitute a review of the methodology and assumptions used by someone else (eg the syndicate's own actuarial or other staff) in estimating the reserves. This practice is acceptable, provided the actuary 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 actuary signing the SAO and include details of the work performed by the other party.

- 2.4 The actuary should make clear the purpose of the Report and that it should not be used for purposes for which it is not intended. In particular, if it is not suitable or intended to provide support for calculation of the Reinsurance to Close, then this should be made clear.
- 2.5 The Report should be comprehensive. Together with the files, it should be sufficient to allow any other suitably experienced actuary to form a view as to the appropriateness or otherwise of the work carried out. Another actuary should be able, by referring to the Report and files, to reproduce the reserves without access to the signing actuary. The Report alone need not be in the detail to allow another actuary to reproduce the reserves, but it should be in sufficient detail for another actuary to be satisfied that sufficient work has been done to enable the original actuary to sign the SAO. In particular, if there are any material incongruous results or subjective judgements, the Report should make clear what the actuary has done in order to be satisfied that it was proper to sign the SAO.
- 2.6 If the actuary believes that an SAO can be provided but only with qualifications, then the actuary may still prepare the SAO, using the relevant form of words contained in Appendix 1, but modified to reflect the qualification, which should make clear to which figure or figures it relates. In this case, the actuary should also prepare the separate Report. It should be recognised that in these circumstances Lloyd's may not accept the SAO and the managing agent may ask the actuary to discontinue his work. Any qualifications must appear in the SAO: it is not sufficient for a qualification to appear only in the report.

3 Relationships

- 3.1 The relationships between managing agents, underwriters and auditors to syndicates can be complex. The actuary 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.
- 3.2 It is the responsibility of the managing agent to set the reserves. The role of the actuary is to provide an opinion on those reserves. The professional responsibilities of the actuary in providing the SAO override any responsibilities he or she might have as an employee or consultant.
- 3.3 The actuary should make clear at the outset that he or she may require frequent access to underwriters and other members of the staff, and may wish to use work carried out by or for the managing agent, including the work of any other actuary who has worked for the managing agent as an employee or consultant. However, since the actuary providing the SAO must take full responsibility, he or she must be satisfied as to the validity of the material used for that purpose.
- 3.4 Although the actuary is required to submit a detailed report to the managing agent, he or she is not required to communicate formally with the board or other governing body in respect of the provision of the SAO.
- 3.5 The SAO is intended solely for the purpose of complying with Lloyd's Valuation of Liabilities Rules. Unless the actuary otherwise agrees, reliance on the SAO for any other purpose should normally not be permitted.

4 Data

- 4.1 Although the actuary is not required to ensure that the data he or she uses have been audited, he or she should obtain assurances from the managing agent as to the accuracy and completeness of that information. A specimen letter from the managing agent is given in Appendix 2. However, if there are any material discrepancies or anomalies which cannot be resolved with the managing agent, the actuary should discuss them with the auditor.
- 4.2 Should the data prove to be incomplete, inaccurate, unreliable, or not as appropriate as desired, the actuary should 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 actuary should decline to provide an SAO.

5 Valuation Principles

- 5.1 In order to be able to provide an SAO, the actuary needs to be satisfied that the reserves 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.
- 5.2 It has been agreed by Lloyd's and the DTI that the reserves calculated by the actuary for the purpose of forming the opinion should be on a 'best estimate' basis without precautionary margins. If however, the managing agent has set reserves materially higher than those indicated by such a basis, the actuary 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: it will generally be impossible to apply it directly in practice. In classes which have historically shown a tendency to give rise to latent claims, the actuary should, without evidence to the contrary, assume continuation of that trend, but need not assume recurrence of major latent claims such as US asbestos or pollution.
- 5.3 The SAOs cover open and hence immature years. In some cases the available historical data may be insufficient to enable the actuary to use conventional projection techniques. Benchmarking and methods such as the Bornhuetter-Ferguson method are generally accepted actuarial techniques although the actuary would need to have sufficient information to be satisfied that the benchmarks were reasonable for the business written. Alternative approaches might include obtaining a detailed understanding of the differences between the business included in the benchmark and the business written, and making appropriate adjustments. If the actuary has sufficient doubts as to the suitability of the benchmarks (eg if only some broad whole account data are available and the relative proportions of property and liability business are not clear), he or she should amend the wording of the SAO appropriately.

- 5.4 In the case of the net reserves, the actuary is required to give an opinion on the reasonableness of the reserves of each economic entity for business denominated in Canadian dollars and for business denominated in US dollars and written up to 31 July 1995. In other respects, the actuary is not expressing an opinion on the split of the reserves by class, year of account or currency. These Canadian and US dollar reserves may include provision for unallocated claims handling expenses, and should include an appropriate provision for reinsurance bad debts. The opinion thus includes a reliance on the managing agent's estimates of these provisions. If there is no business in either category, or if the actuary has reviewed the provisions, the relevant sentence should be deleted.
- 5.5 The net solvency reserve included in the SAO should exclude any provision for reinsurance bad debts, as estimated and reported by the managing agent. If there are any overall differences in the split of the reserve as calculated by the actuary when compared with the reserve established by the managing agent, then there may need to be a consequent adjustment to the bad debt reserve. In these circumstances, the actuary should draw this to the attention of the managing agent. In some cases the statistics provided by the managing agent may allow for the effect of non-recoveries arising out of reinsurance bad debts. This may lead to some over-estimation if bad debts are provided for in full separately. Provided the actuary is satisfied that the separate bad debt provision does make a full provision, the implicit allowance may be estimated and removed in forming the opinion. Since future premiums are also being projected and the actuary would normally take credit for this in the opinion, it is important that the actuary verifies that any required bad debt provision for this element is made. This latter point would also apply to the gross reserves.
- 5.6 Under Lloyd's Valuation of Liabilities Rules, discounting is not allowed when calculating reserves for solvency purposes. However, additional reserves may be needed to cover borrowing costs if the syndicate is expected to be a net borrower because of the need to fund claims (and other) costs in advance of premium receipts or reinsurance (or other) recoveries.
- 5.7 In some circumstances the actuary may be asked by the managing agent to provide an SAO on a subset of the reserves to which it is intended to apply. In most situations, this is likely to be unacceptable to Lloyd's. However, there may be specific reasons for excluding certain items from the scope of the SAO (eg contracts that are subject to ongoing dispute over coverage

etc.) and the actuary may agree to this, as long as the exclusions are made clear in the SAO (immediately above the table of reserves given in the opinion).

- 5.8 Since the opinion covers all relevant liabilities at the year end the actuary should be aware of the need to provide for the cost of the insurance protection of the liabilities covered by the opinion, irrespective of the year of account to which the relevant reinsurance premiums will be charged. This could be particularly important where reinsurance is placed on the basis of losses occurring during the year of account and when policies are written for periods in excess of one year or under binding arrangements.
- 5.9 If there are specific features of the business or the claims that significantly increase the uncertainty, beyond that which a reader of the accounts would reasonably expect, then a comment to that effect should be included in the opinion. In any event, the actuary should, as far as reasonably practical, quantify the level of uncertainty in the Report.

Appendix 1: Opinion on Solvency Reserves

To: Council of Lloyd's

Statement of Actuarial Opinion - Syndicate KLM

Identification

I, ABC, am an actuary employed by XYZ [the Managing Agent.] I am a Fellow of the Faculty / Institute of Actuaries with experience of claims reserving.

Or

I, ABC, am associated with the Firm of GHI Consulting Actuaries who have been retained by XYZ [the Managing Agent.] I am a Fellow of [the Casualty Actuarial Society and a member of the] Faculty / Institute of Actuaries with experience of claims reserving.

Scope

I have examined the reserves listed below for the underwriting years 1993 to 1997 of Syndicate KLM as at 31st December 1997, as reported in lines 1 and 3, 7 and 9 of Form SR16, 'Analysis of Reserves', submitted by the Managing Agent. I have also reviewed lines 7 and 8 of the same form.

The reserves are the responsibility of the Managing Agent; my responsibility is to express an opinion on those reserves based on my review.

	1997	1996	1995
Total gross reserves			
Reserves net of reinsurance			
CAN dollar			
LATF			

The above reserves for indemnity and allocated claims handling expense are net of salvage and subrogation and are not discounted for the time value of money. They also include provision for future claims arising from unexpired periods of risk, and are net of anticipated future premiums (net of acquisition expenses) on past and current business. To the extent that credit has been taken for

reinsurance in the net reserves, it is assumed to be valid and collectible.

I have relied upon data prepared by the responsible employees of the Managing Agent. This data has not been checked by myself [nor, as far as I am aware, by the syndicate auditor.] I have also relied on the provisions for claims expenses and for reinsurance bad debts, as estimated by the responsible employees of the Managing Agent, for the purpose of forming my opinion on the Canadian dollar and LATF figures above. In other respects my examination included such review of the methods and assumptions used and such tests of the calculations made as I considered necessary.

Additional Comments

Other comments at the discretion of the Actuary.

These additional comments do not constitute a qualification of my opinion.

Variability

In evaluating whether the reserves make a reasonable provision for unpaid claims and claims expenses, it is necessary to project future premium, claim and claim handling expense payments. Actual future premium, claims and claim handling expenses will not develop exactly as projected and may, in fact, vary significantly from the projections. Further, in most classes of business, the scope for adverse development exceeds the scope for favourable development. In particular, although I have made what I believe to be a reasonable allowance for the risk of adverse development, I have not anticipated the emergence of major new types or classes of claims.

Opinion

In my opinion, subject to the above comments [and except for the qualifications stated below], the reserves identified above comply with the Lloyd's Valuation of Liabilities Rules and each is no less than the expected future cost of the corresponding claims and allocated claims handling expenses net of anticipated future premiums for which Syndicate KLM was liable at 31 December 1997.

Qualifications on Opinion

Other comments at the discretion of the Actuary

An actuarial report, supporting the findings expressed in this statement of opinion, has been [will be] provided to the Managing Agent.

This statement of opinion is solely for the use of, and to be relied upon only by, the Managing Agent, the Syndicate auditors, the Council of Lloyd's and their auditors for the purpose of compliance with the Valuation of Liabilities Rules.

Signed:

Name:
Fellow of the Faculty / Institute of Actuaries

Date:

Address:

Appendix 2: Data Accuracy Statement

I, , ,
Name Title

hereby affirm that the listings and summaries of claims data (including indemnity and expense amounts)

regarding as at.....
Syndicate XYZ Valuation Date

and other relevant data and information provided to

.....
Actuary's name and firm

were prepared under my direction and, to the best of my knowledge and belief, are accurate and complete [except where advised otherwise].

Signed:.....Date: