



**The Actuarial Profession**

making financial sense of the future

## **Consultation Response**

# **Groupe Consultatif Actuariel Européen**

GC Actuarial Standard of Practice 2 (GC ASP2) Exposure Draft

Actuarial Function Report under Directive 2009/138/EC

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1 March 2013

## **About the Institute and Faculty of Actuaries**

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Michael Lucas  
Secretary-General  
Groupe Consultatif Actuariel Européen  
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1 March 2013

Dear Michael

**GC Actuarial Standard of Practice 2 (GC ASP2) Exposure Draft Actuarial Function Report under Directive 2009/138/EC**

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to this consultation. We have consulted extensively with our members over the last few months through our volunteer channels and by open forums held in London and Edinburgh to encapsulate fully, the cross-practice views of members operating within the Life Insurance, General Insurance, and Health & Care practice areas.

We are supportive of the intent behind this exposure draft. It is important that reporting – both in terms of scope and practice – is consistent (if not necessarily identical) across Europe, in the general application of EU legislation and particularly once Solvency II comes into effect. We anticipate (although this will be determined by the Financial Reporting Council) that the UK's reporting structure will be broadly compliant with GC ASP2, therefore requiring less alteration to practice within the UK than may be the case for other countries. Consequently, our response is primarily from this perspective of European consistency, as well as in consideration of UK actuaries operating outside the UK or on non-UK clients.

Against that context, we do however have some concerns regarding both the scope and structure of the draft standard. I set out our key concerns below and include our detailed drafting comments and suggested amendments in the Appendix.

**1. Principles-based, targeted and proportionate**

The IFoA and Financial Reporting Council have implemented a principles-based framework in the UK. This approach has been built in part upon the foundation of Technical Actuarial Standard (TAS) R – Reporting Actuarial Information. We welcome the Groupe Consultatif's (Groupe's) similar commitment to a principles-based approach, but are concerned that the draft as framed veers away from this approach, becoming perhaps unnecessarily granular in the level of detail it intends to prescribe.

The standard needs to be outcomes-focused in serving the interests of the users regarding their reliance on the report; its relevance; transparency; and comprehensibility, at a high level. Unnecessary prescription may act counter to this in generating a disproportionate regulatory burden, and the Groupe needs to be careful to balance the requirements of best practice and harmonisation without obscuring the true message being relayed by the Actuarial Function (AF). It is important that the positive contribution to good decision making that actuaries can make is conveyed within an Actuarial Function Report (AFR) of a balanced length, which displays their professional skills along with clear delivery of the AFR's capital adequacy focus.

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As Solvency II has been further delayed, and the regulation is therefore not yet fully known, actuaries are concerned that any further guidance is not disproportionate in adding to the prescriptive nature of the requirements placed upon them, and in particular that additional disproportionate or unnecessary requirements beyond what is required by legislation are not imposed.

## **2. Mandatory provisions**

The style of the standard leads to a lack of clarity, in certain instances, as to which provisions are mandatory and which are 'desirable' in a best practice scenario. One easy way of resolving this would be for the provisions to be clearly linked back to the original regulation (Directive, Level 2 or Level 3) giving rise to the requirement. This amendment would then also resolve any perceived inconsistencies between the Groupe's attribution of a mandatory provision in the exposure draft as compared to the requirements stipulated by the regulations.

We recognise the role the Groupe Consultatif has to play in this area of actuarial reporting. There would be substantial value should a summary of all Solvency II requirements from the Directive and Level 2 and 3 guidance be contained in one document. The Groupe could play a valuable role here in highlighting the expectations of actuaries by providing such a summary which could then form the foundation of GC ASP2 instead. A tabular format would work well for this purpose by collating all requirements for Solvency II, including a clarification of the provision the requirement derives from and the level of compulsion attaching to it, and also leaving scope for the Groupe to then add the best practice considerations. This would serve the dual purpose of providing certainty of the minimum standard report that would comply with regulations, and its ease of use would fulfil the Groupe's aims of improving standards in localities without existing standards and encouraging non-actuaries (and new entrants to the insurance sector) to adopt GC ASP2 principles.

As a minimum, the clarity of the standard would, we think, be improved if the mandatory provisions were more clearly distinguished, and perhaps separated from a presentational perspective, from those provisions which are non-mandatory or helpful guidance. One practical way of operating this would be to have a best practice / guidance section or Annex. Alternatively, this information could be contained in a separate document of educational material. This would have the dual positive result of simplifying the standard and ensuring the main purpose is not rendered opaque.

## **3. Reliance and responsibility**

There may be some elements which are already dealt with within another area of a company, rather than by the AF, such as the reinsurance, underwriting and risk management functions (and our specific concerns are addressed within the Appendix). To include such functions to the extent envisaged by the guidance within the AFR could create a duplication of process and reporting, which would incur unnecessary costs, with the added potential for conflicting communications, for the industry and users. Within the UK feedback suggests this is a concern, particularly within the General Insurance practice area. For example, actuaries would not necessarily have visibility over each underwriting decision. This requires them to rely on the appropriate behaviour and decisions of other areas. The standard should acknowledge, in some way, this lack of ownership by providing a framework for reliance on subsidiary reports.

The further concern, with the expectation that an individual fulfilling the AF need not be a qualified actuary who is automatically required to comply with the GC ASP2 and other actuarial principles, is that an actuary responsible for opining on the adequacy of the technical provisions (or on any other function of the AF) may be the only professional providing an opinion in the AFR. Should negative events transpire, there is potential perhaps for increased reputational risk and unrewarded culpability to be attached to this individual and their profession.

## **4. Timing**

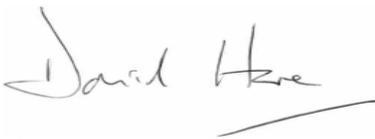
Solvency II has recently been postponed and UK regulators have advised that the earliest workable implementation date is now likely to be 31 December 2015. Clearly, it will be impossible to finalise this guidance, which is dependent upon principal regulation, unless and until that regulation is also finalised. Whilst we can appreciate the desirability of cohesion across Europe with regards to actuarial practice and actuarial remit this

clearly needs to be effected at the appropriate times so that interested parties are suitably engaged in the process and to ensure relevant correspondence with the finalised substance of the principal regulation.

The IFoA therefore queries whether this consultation exercise will achieve its purpose of delivering a cogent and considered set of guidance. Further consultations are likely to be required once the regulatory provision is finalised. The IFoA will continue to support the Groupe in its development of guidance, however, we would welcome reassurance that there will be opportunity for further real and substantive input once the parameters and implications of Solvency II have crystallised.

We trust our comments are of value and we look forward to working closely with the Groupe Consultatif in relation to the further development of this important initiative. If you have any questions in relation to this response, please contact Helena Dumycz, Policy Manager at the Institute and Faculty of Actuaries, on 020 7632 2118 or [helena.dumycz@actuaries.org.uk](mailto:helena.dumycz@actuaries.org.uk).

Yours sincerely,

A handwritten signature in black ink that reads "David Hare". The signature is written in a cursive style with a long horizontal stroke extending to the right.

David Hare  
President-elect  
The Institute and Faculty of Actuaries

## Appendix

### Detailed drafting comments for GC Actuarial Standard of Practice 2

#### 1. Preface

- 1.1. Point 2 of the Preface refers to the use of the terms 'must', 'should' and 'may' in respect of application of the provisions of the standard. We would like to see an approach that encourages actuaries to comply with the standard; however, if they elect not to follow certain elements, they would be allowed to explain the reason behind their departure.

#### 2. Section 2. Definitions

- 2.1. Assumptions are defined as 'Values of parameters assumed for use in models'. However, assumptions can relate not only to the selection of values for parameters but also to the selection of models themselves, in that models are simplified representations of reality and how these are specified in terms of which drivers are selected for inclusion also requires judgment.
- 2.2. Intended User includes third parties for whose benefit a report is written. There is a difference between those parties to whom an actuary has a duty (of care) and parties who may find the report of interest but to whom the actuary does not have a formal duty. Can this distinction be made?
- 2.3. Opinion is defined as 'A statement summarising the key findings of the actuary's work'. However, there are instances where an opinion made needs to be tightly defined, for example, certification of the adequacy of the technical provisions. There are also instances where looser wording, perhaps providing commentary, is also appropriate, such as consideration of the reinsurance arrangements. We would suggest that the level of certainty attaching to the statement of an opinion is clarified throughout GC ASP2 or an alternative word is found where the situation requires a weaker (or a more certain) statement.
- 2.4. Reporting Actuary – This term does not appear to be included within Solvency II regulations. The standard is not particularly clear on the scope of this role with the majority of the functions within the guidance being carried out by the 'Actuarial Function' and little working reference to the Reporting Actuary.

#### 3. Section 3.1. General Principles

- 3.1. Generally, we would suggest that there is not an overreliance on using the Executive Summary to provide clarity for the report, as this may encourage the report to become increasingly verbose which could lead to a disguising of its most valuable points.
- 3.2. Provisions 3.1.5 and 3.1.6 require a conclusion to be expressed on the underwriting and reinsurance policies, yet provisions 3.3 and 3.4 require an opinion. Can this inconsistency be addressed? In addition, provision 3.1.5 refers to the underwriting policy and section 3.3 and provision 3.1.6 refers to the reinsurance policy and section 3.4. These references to sections 3.3 and 3.4 are incorrect and should be swapped over.
- 3.3. Provision 3.1.7 refers to the AF being independent with respect to its opinion; however, there is no clarity of what the Groupe intend by this term 'independent'. This may be an area where the Groupe could valuably add further considerations.
- 3.4. Provision 3.1.8 requires a summary of all major tasks undertaken by the AF to be documented; however, there is no definition of the term 'major' within the standard. Can an element of materiality be included in this provision?
- 3.5. Provision 3.1.9 requires any deficiencies to be identified; however, it is unclear what specifically this is addressing. The linking of the provisions in the standard back to the Directive or Level 2 or 3 guidance would help to clarify this provision. Additionally, the requirement for 'any' deficiency to be addressed is a broad one; we would welcome a consideration of the materiality of the deficiency to be included here.
- 3.6. Provisions 3.1.12 and 3.1.13 require identification of all individuals responsible for having written the report, identification of any person with overall responsibility for the report and demonstration of the relevant skills and experience of the aforementioned parties. We feel that the 'all individuals' element is

somewhat excessive. It is likely to relate to a large team of individuals of varying levels of experience and qualification carrying out specific functions; the constitution of which having potentially varied during the production process through company exits and workflow restructuring. A small number of specific individuals will take overall responsibility for certain sections (or the entirety) of the AFR, depending upon corporate structure. We feel it is sufficient assurance for these individuals only to be encompassed by these provisions. Additionally, there is no reference to the Reporting Actuary in these provisions – should reference to that role be included here?

- 3.7. Provision 3.1.14 requires the main responsibilities and tasks of the AF to be documented including those not required by Solvency II. We are unclear why items outside of Solvency II are referred to in this area and would question if this is fulfilling the same requirement as provision 3.1.8.
- 3.8. Provision 3.1.15 requires the provision of details of any approved person relationship. Reference to the appropriate segregation of duties should be made in this provision.
- 3.9. Provision 3.1.18 requires a blanket setting out of the data used to reach the opinions expressed in the report. A materiality or proportionality reference should be included for the statement of the data used to avoid lengthy lists being reported.

#### **4. Section 3.2. Technical Provisions**

- 4.1. Provision 3.2.1.1 mandates the expression of an opinion on the adequacy and reliability of the Technical Provisions. Article 48 of the Directive requires a statement on the reliability and adequacy of the calculation of the technical provisions. This clarification should be added.
- 4.2. Provision 3.2.1.3 relates to the sufficiency of the technical provisions and particularly the degree of uncertainty regarding the ultimate outcome. Technical Provisions under Solvency II are calculated applying a 'best-estimate' basis. This provision appears to presume a greater level of certainty than best-estimate technical provisions would allow for.
- 4.3. There is a requirement in provision 3.2.2.2 that all factors with a material impact on the amount of technical provisions must be made clear. Where this sensitivity has been clarified in previous reports then it is only the factors particularly appropriate for this AFR that need to be stated. To continue reiterating the known potential for variance, which has had immaterial impact this time may reduce the comprehensibility of the report, which is contrary to provision 1.1.2.
- 4.4. Provision 3.2.7.5 relates to the AF raising particular issues in respect of assumptions that need to be brought to the user's attention. The usual scenario is one where the AF has control over the assumptions applied. However, there could be instances where the AF is coordinating the calculation of technical provisions on assumptions they would not necessarily agree with in their entirety. The standard should make clear the appropriate course of action for the AF in such a scenario, for example: clarify in the report where the assumptions underlying the calculations are, in their opinion, unsuitable and highlight the potential consequences of that selection.
- 4.5. Provision 3.2.8.1 mandates the regular comparison of actual experience against best estimates (and the assumptions underlying those estimates). It would be more appropriate to compare actual experience with the appropriate distribution functions.
- 4.6. Provision 3.2.8.2 requires a separation of the experience analysis between volatility of the experience and experience impacting the appropriateness of the data, method or assumptions. This is a prescriptive requirement and the actuary should have professional freedom to determine which elements of the deviations are the most appropriate to draw attention to.

#### **5. Section 3.3. Opinion on the adequacy of reinsurance arrangements**

- 5.1. Provision 3.3.1.3 should clarify what the term 'inconsistency' specifically relates to and also provide a framework to define an improvement, for example, a reduction in the reinsurer's profit, minimum capital usage.
- 5.2. The relevance of sub-section 3.3.4. Overview of the overall process employed in respect to reinsurance arrangements to the purpose of the AFR is unclear as this is not required by the Directive and appears to be an extension of scope. Additionally, it is already carried out under different functions within an insurance company so would be a duplication should the AF also carry out this role.

- 5.3. Provision 3.3.6.1 requires the AF to judge the adherence of the company to regulations regarding special purpose vehicles. We do not feel it is usual for this to fall with the remit of the AF, although the Actuaries' Code may place an obligation onto our members to report malpractice or a breach of regulation. Clarity regarding the type of special purpose vehicle being referred to would be welcome. Could the Groupe explain their intention as to which vehicles are intended to be covered by this provision?
- 5.4. The detail within sub-section 3.3.7 Consistency [of the reinsurance arrangements] with other policies of the undertaking appears to be an example of best practice considerations for the AF; however, its inclusion in the AFR to this level of detail may obscure the key messages of the AFR. Limitation to, and consistency with, the Level 3 guidance may be better here.
- 5.5. The detail within sub-section 3.3.8 Effectiveness of reinsurance arrangements also appears to be an example of best practice, and whilst the Directive requires the AF to provide an opinion on the adequacy of the reinsurance arrangements the elements in this sub-section are phrased more as a list of items to be considered.
- 5.6. Provision 3.3.9.1 does not appear to be a materially different requirement to provision 3.3.8.1. In particular, it is unclear how this provision links back to the regulatory text as this requires the AF to consider the credit position of the reinsuring entity yet GC ASP2 may include reference to the volatility of both the insurer and the reinsurer. Is this the intention?

## **6. Section 3.4. Opinion on underwriting policy**

- 6.1. The underwriting process is different in the Life Insurance and Non-Life Insurance areas. We would welcome some guidance on the Groupe's intention behind this section. In particular, provision 3.4.1.3 requires the underwriting policy to include the actual operation of the underwriting policy and the procedures affecting it. This is contrary to market practice in the General Insurance area as the checking of the actual operation of the underwriting policy would usually be carried out by a different function (underwriting management or Internal Audit for example). Actuaries would not usually be involved due to some skill-set mismatch and resource and cost constraints.
- 6.2. Provision 3.4.6.4 states that the AFR should summarise the major risks which may affect the future experience of premium sufficiency. This is already carried out within another function of a company so would be a duplication if the AF were required to also carry this out. Additionally, the conclusion as to whether premiums will be sufficient, required by provision 3.4.6.1, will already have fulfilled the requirements for the AF.
- 6.3. Provision 3.4.7.1 requires a summary of the impact of changes in the external environment on the underwriting policy. This wording is rather wide, in particular the list of items that could be included, and may result, in some instances, in a lengthy all encompassing generic statement that adds no significant value to the user's particular situation.
- 6.4. Sub-section 3.4.8 Adjustments to Premiums appears to be a creep in scope over Solvency II as it mandates that any decisions to adjust premiums in response to experience or decisions to ignore experience and leave premiums unadjusted must be summarised in the AFR. We suggest that these items be removed from the standard or the level of compulsion clarified.
- 6.5. Sub-section 3.4.9 Anti-selection requires the AF to assess if underwriting processes have been effective at managing anti-selection. This appears to go beyond the Directive and Level 2 and 3 guidance and could place actuaries into a role they do not have the necessary skills for.

## **7. Section 3.5. Contribution to risk management**

- 7.1. This section may duplicate the Risk Management function of a company, so it may be deemed unnecessary by a company to have the AF involved on the same issue. How does the Groupe envisage this potential overlap being managed?