Caveats

- A personal view
- No inside track!
Key functions

The Directive Section 2: System of Governance

Four Functions:
• Compliance
• Internal Audit
• Risk Management
• Actuarial

Definition of “Actuarial Function” not obvious from its name alone.

Actuarial Function

• Definition must therefore come from:
  – Directive / Level 2 / Level 3
  – Ourselves and our firms
Actuarial Function – What do we know?

- A function is:
  - “an internal capacity to undertake practical tasks”
  - so not necessarily a separate unit.
- The four functions from Section 2 are “key functions” so:
  - fit and proper requirements
  - notification requirements for “key function holder”
  - requirements concerning outsourcing.

What does the AF have to do?

- Requirements relating to technical provisions
- Opinion on underwriting policy
- Opinion on reinsurance adequacy
- Contribute to Risk Management System (especially capital calculations and ORSA)

Clear overlap with role of (pre SII) actuarial department but neither a subset nor a superset in most cases. But nothing to stop firms taking a broader view ....
To paraphrase

• It is a requirement that certain specified tasks (relating to the valuation of and uncertainty surrounding future cash flows) are carried out by people with suitable expertise and experience.

• So where does it get confusing? …..

Independence

• How can the Actuarial Function be incorporated into the organisational structure?
• What are the requirements on independence and what restrictions are placed on this?
On the one hand...

- “The identification of a particular function does not prevent the undertaking from freely deciding how to organise that function in practice save where otherwise specified in this Directive.”
  
- “..save as regards the internal audit function, in smaller and less complex undertakings it should be possible for more than one function to be carried out by a single person or organisational unit.”
  
- More stringent requirements on the Internal Audit function.
  Article 47(2)

And...

- “Provided that the actuarial function maintains independence in its duties under the Level 1 text, in the sense that it carries them out without undue influence from other members of management and has the final power of decision, a wide variety of organisational models is possible, and each undertaking is responsible for its own internal structure.”
  
  CEIOPS response during Level 2 consultation (2009)
But...

- Elsewhere it seems less clear……

So what level of independence is necessary?

- A lower level than is required for Internal Audit
- Depends on size and complexity of undertaking.
So what level of independence is necessary?

Beyond this more difficult to tell but looks like:

- Direct access to management body (no toning down or changing findings)
- Unrestricted access to relevant information
- Not constrained, controlled or unduly influenced
- Material conflicts of interest avoided
- Segregation of AF from other Key Functions may be required (possible exception of Risk Management Function).

Some organisational structures

- AMSB
- CEO
- CFO
- CRO
- AFH
- CUO
- etc

- Finance
- Risk
- Actuarial
  - Reserving
  - Capital Modeling
  - Pricing
- Underwriting
Some organisational structures

AMSB  
CFO  
CRO  
CEO  
CUO  
etc

Finance  
Risk  
Actuarial  
Underwriting

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  - Reserving
  - AFH ???

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  - Capital Modeling

- Underwriting
  - Pricing

Separate Actuarial Function
Lloyd’s view

• “The actuarial function does not necessarily need to be a nominated person or single department; however the constitution of the actuarial function should be well defined...”
• “The actuarial function can discharge the duties with opinions being collectively provided by more than one individual.”


Organisational structures

• My view that all the above structures (and variants) could be acceptable in many organisations provided suitable standing, and conflicts managed. But what do others think?
• If the Actuarial Function is spread across different units then what does this mean for the Actuarial Function Holder?
• If the Actuarial Function Report is authored by several people (of suitable experience and expertise for their contribution), to what extent does the AFH own all the conclusions?
• Biggest issues with independence may not come with definition of AF and relationship with other key functions, but when dealing with “validation” and opinions.
Risks

• Mission creep
• Land grabs?

What to do now?

• Make sure the Actuarial Function is well defined and communicated (e.g. structure, roles)
• Check for conflicts of interest (e.g. opining on own work)
• Be clear why you believe your approach is good practice, that the AF is sufficiently independent and has appropriate standing
• Will need to revisit when updated Level 2 Implementing Measures and Level 3 Guidance are issued
• Read GCASP2 (consultation deadline 1 March 2013).
Questions or comments?

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 presenter.