

GN43: The Role of the Appropriate Actuary

Classification

Practice Standard

MEMBERS ARE REMINDED THAT THEY MUST ALWAYS COMPLY WITH THE PROFESSIONAL CONDUCT STANDARDS (PCS) AND THAT GUIDANCE NOTES IMPOSE ADDITIONAL REQUIREMENTS UNDER SPECIFIC CIRCUMSTANCES

Purpose

This Guidance Note sets out the duties of the appropriate actuary as defined in SUP 4.4 and gives guidance on how to fulfil them. It details generally accepted actuarial practice in regard to this function.

Definitions

Defined terms appear in italics when used in the standard.

Reference	Definition
appropriate actuary	A Fellow of the Faculty of Actuaries or of the Institute of Actuaries appointed by a friendly society in accordance with SUP 4.4.1R of the <i>FSA Handbook of Rules and Guidance</i>
firm	A friendly society writing long-term insurance business in respect of which the <i>appropriate actuary</i> is appointed
FSA	Financial Services Authority
governing body	The board of directors or committee of management of the friendly society to which the <i>appropriate actuary</i> is appointed.
PCS	Professional Conduct Standards of the Faculty of Actuaries and Institute of Actuaries

The following terms have the meanings given to them in the *FSA Handbook of Rules and Guidance*:

with-profits business

with-profits insurance business

In addition, the following abbreviations are used for sections of the *FSA Handbook of Rules and Guidance*:

COB	Conduct of Business
IPRU(FSOC)	Interim prudential sourcebook for friendly societies

SUP	Supervision manual
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Legislation or Authority

The Financial Services and Markets Act 2000
The *FSA Handbook of Rules and Guidance* (the “*FSA Handbook*”)
The Financial Services and Markets Act 2000 (Communications by Actuaries) Regulations 2003 (the “*Regulations*”)

Application

Appropriate Actuaries of UK authorised friendly societies writing long-term insurance business.

Author

Life Board

Status

Approved under Due Process

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1.0 31.12.04

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2.0 01.06.06

1 General

1.1 In this standard, requirements of legislation or of *FSA* rules and guidance are specifically referred to as such. Any other guidance is that provided additionally by the profession. The inclusion of summarised references to, or quotations from, particular provisions of the *FSA Handbook* is not a substitute for referring to the *FSA Handbook*.

1.2 GN39 and GN8 are also applicable to *appropriate actuaries* when carrying out their duties.

2 The appointment as *appropriate actuary*

2.1 With effect from 30 December 2006, the *appropriate actuary* must hold a practising certificate, which must cover *with-profits insurance business* if such business is written by the *firm*.

2.2 When accepting an appointment as *appropriate actuary*, the actuary must ensure that he or she has the right to present a report to the *firm’s governing body* in person, should he or she deem the report sufficiently important.

2.3 The *appropriate actuary* must ensure that he or she has sufficient information and resources to enable the necessary investigations to be carried out. This applies both at the time of the appointment and thereafter.

3 Duties of *appropriate actuaries*

- 3.1 Actuaries to whom this standard applies have a duty under *FSA* rules to carry out the actuarial investigations in accordance with the rules in Appendix 5 of IPRU(FSOC) and applicable professional guidance, to report on those investigations, to prepare an abstract for publication of the report in the form specified and to provide the certificate or statement required (as appropriate), qualified if necessary.
- 3.2 Before completing the abstract of the report of any investigation, the *appropriate actuary* must report in writing to the *governing body* on the results and implications of that investigation. Both in the report and in the abstract, the *appropriate actuary* must present the results in a way that demonstrates, subject to the constraints of the regulatory valuation basis, the correct underlying position of the *firm*. All material valuation methods and assumptions must be stated. All material risks to the solvency of the *firm* must be disclosed unless the *appropriate actuary* has reported these previously, and this information remains valid. Where the *appropriate actuary* believes that the regulatory basis or format materially fails to make the real financial circumstances of the *firm* clear to the *governing body*, the report must draw attention to this, explaining the differences, unless this has recently been done or will shortly be done in a separate formal report by the *appropriate actuary* to the *governing body*.
- 3.3 If an *appropriate actuary* considers that the report contains matters of concern which need to be addressed by the *governing body*, he or she should normally seek permission to present the report in person.
- 3.4 The *appropriate actuary* should bear in mind that the abstract and the certificate will be used by third parties, including the *FSA*, financial advisers and actual and potential policyholders.
- 3.5 When listing in the certificate the professional guidance with which he or she has complied, the *appropriate actuary* (except when completing Form FSC4) must include GN39, GN43, and GN8. The certificate must state the effective dates of these GNs.
- 3.6 *Appropriate actuaries* are required by SUP 4.5.9R to notify the *FSA* without delay when they resign or their appointment is terminated or not renewed. They are also required to notify the *FSA* without delay of any matters concerning the cessation of their appointment which they think ought to be brought to its attention, or that there is no such matter. However, such appointments are only for a specific valuation. In particular, there is no ongoing responsibility to monitor solvency.
- 3.7 The *appropriate actuary* may be asked to perform other duties not covered by his or her appointment, for example the annual certification of financial condition (Form FSC4). If he or she did not perform the previous triennial

investigation, he or she should liaise with the *appropriate actuary* who did so, where possible.

4 The actuarial investigation for long-term business

- 4.1 The *appropriate actuary* must take all reasonable steps to ensure that the data is accurate. If the *appropriate actuary* has any doubts about the accuracy of the data, reserves must be established for the risk that the actual value of the liabilities will be greater than that derived from the available data. If the potential inaccuracy is material, the certificate required to be provided (see paragraph 3.1 above) must be appropriately qualified.
- 4.2 The *appropriate actuary* must seek to ensure that adequate systems controls are in place and fully documented to enable the appropriate valuation procedures to be correctly carried out and adequately recorded. The *appropriate actuary* must use liability valuation methods that are appropriate to the contracts in question, taking into account not only the principal benefits but also any ancillary benefits such as surrender values and any policyholder options or guarantees. When assessing the liabilities of the *firm*, the *appropriate actuary* must also have due regard to the *FSA*'s requirement to treat policyholders fairly.
- 4.3 Appropriate provision must be made for future expenses of administering the business existing at the date of the investigation. This provision must not be less than that which would be required if the *firm* were to be closed to new business one year after the valuation date. It must also have regard, amongst other factors, to the possibility that preferential service agreements or outsourcing arrangements might be altered or terminated. Prudent allowance must be made for the loss of future margin as policies are made paid-up and, if the number of policies is declining or expected to decline, for the possibility of more slowly declining overhead costs. Further guidance can be found in GN8. The *appropriate actuary* may take into account the powers of a friendly society to dissolve.
- 4.4 Assumptions about future mortality and morbidity must take into account recent relevant experience and trends of the industry and, if credible, of the *firm*.
- 4.5 The value to be placed on the assets is the responsibility of the *governing body*. However, the *appropriate actuary* must take reasonable steps to verify that adequate systems controls are in place to ensure that appropriate values are placed on the assets; in particular, that any limits on exposure to individual investments, classes of investment or counterparties imposed by *FSA* rules are properly applied. If the actuary believes that the systems and controls may not be adequate, he or she must draw this to the attention of the *governing body* and, if necessary, establish reserves in respect of the risk of over-valuation.
- 4.6 The *appropriate actuary* must decide the rates of interest to be used in the valuation of the liabilities. Due allowance must be made for the current and future taxation position of the *firm*. Any such allowance must be consistent with any allowance made for tax relief on expenses.

- 4.7 The *appropriate actuary* must take account of the *firm's* reinsurance arrangements in the valuation, including the possibility that reinsurance contracts may lapse or prove unenforceable in certain circumstances.
- 4.8 The *appropriate actuary* must have regard to the possibility of a failure of or a dispute regarding a reinsurance, an investment or a financial instrument counterparty to which the *firm* has material exposure.
- 4.9 The *appropriate actuary* must be satisfied that, in each of the assumptions, the margins in any valuation of the liabilities, including any margins required by *FSA* rules, are adequate having regard to his or her own assessment of the risks inherent in the nature and conduct of the *firm's* business. In this context the *appropriate actuary* should also consider the financial strength and regulatory environment of relevant counterparties.
- 4.10 Where there is any mismatching of assets and liabilities, the *appropriate actuary* must ensure that there is adequate explicit or implicit provision for reasonably foreseeable adverse movements in asset values or yields.

5 Recommendations on allocation of profits

- 5.1 When carrying out the required investigations under IPRU(FSOC) 5.2, the *appropriate actuary* is required to determine in accordance with any applicable valuation regulations any excess of the assets maintained in respect of its insurance business over its liabilities attributable to that business. If rights of any policyholders to participate in profits relate to a part of such a fund, the *appropriate actuary* must also identify separately any excess which relates to that part.
- 5.2 The *appropriate actuary* must advise the *governing body* on the extent to which it would be appropriate to distribute any excesses to policyholders and must make recommendations for its specific allocation.
- 5.3 In making recommendations in respect of any proposed allocation of profits, the *appropriate actuary* must carry out appropriate financial investigations including an appraisal of the relevant past experience.
- 5.4 In the report that includes the recommendations, the *appropriate actuary* must include sufficient information and discussion about each factor and about the results of any financial investigations to justify, and enable the *governing body* to judge, the appropriateness of the recommendations and for the *governing body* to understand their implications for the future course of the *firm's* business. In particular, the *appropriate actuary* must state his or her:
- (a) conclusions from the appraisal of the relevant experience including, if asset share techniques are used, the way in which the recommendations are derived from those techniques;
 - (b) understanding of the *firm's* financial and business objectives;

- (c) assessment of the *firm's* ability to meet its minimum required solvency margin following the recommended allocation;
- (d) interpretation of legal advice given to the *firm* constraining or potentially constraining the *governing body's* discretion when allocating surplus and how this has been reflected in the recommendations;
- (e) interpretation of what is required to treat policyholders fairly having regard in particular to (a), (c) and (d). Such requirements are influenced by policy literature and other publicly available information such as own-charge illustrations and by past and current distribution practice;
- (f) opinion of the extent to which it is appropriate to distinguish between groups of participating policies having regard inter alia to the nature of the policies, their duration and their relevant pooled experience, and taking account of (d) and (e);
- (g) opinion of how the recommendations maintain fairness between different categories of policy or policyholder; and
- (h) assessment of whether or not the firm has an excess surplus as defined in COB 6.12.58R and his or her recommendations for dealing with the situation.

The extent of information and discussion appropriate for any factor will depend upon the extent to which, if at all, the factor has been covered in a report formally presented to the *governing body* in the previous 2 years. In particular, the *appropriate actuary* may report in an abridged form when interim or terminal bonus rates are being reviewed.

- 5.5 If the recommendations anticipate the results of a determination of surplus, the *appropriate actuary* must include in the report the estimated results of the determination and show how the recommendations can be financed.
- 5.6 The *appropriate actuary* must discuss the relationship between the recommended allocation and recent and expected future experience (economic, demographic, etc). In the case of *with-profits business*, the report must address bonus prospects, including final bonus, in different future investment scenarios. If the recommended allocation is excessive relative to the recent and expected experience (apart from any non-recurrent elements) and if the continuation of this relationship in future years could result in a material deterioration in the *firm's* financial position, the report must indicate whether and how this could appropriately be avoided, taking into account the *FSA's* requirement to treat policyholders fairly.
- 5.7 Where, in the opinion of the *appropriate actuary*, there is uncertainty regarding the extent to which the *governing body* can exercise its discretion when allocating surplus, he or she must state in the report the nature of the uncertainty, the assumptions made with regard to the uncertainty when making

the recommendations and the consequences were the uncertainty to be resolved differently.