



The Actuarial Profession

making financial sense of the future

Response to Exposure Draft Board for Actuarial Standards

Insurance TAS

July 2010

About The Actuarial Profession

The Actuarial Profession is governed jointly by the Faculty of Actuaries in Edinburgh and the Institute of Actuaries in London, the two professional bodies for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuing 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's 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 advise 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.

The Profession also has an obligation to serve the public interest and one method by which it seeks to do so is by making informed contributions to debates on matters of public interest.

16 July 2010

The Director
Board for Actuarial Standards
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Dear Louise

BAS Exposure Draft on Technical Actuarial Standard – Insurance

Thank you for providing the Actuarial Profession with the opportunity to comment on this Exposure Draft. We set out below our observations on your proposals. The profession would welcome the opportunity to meet with the BAS to discuss further any issues raised in this letter and appendix. After that meeting has taken place we would be happy for our comments to be placed in the public domain. This letter will contain the more general points that the profession wishes to make whilst the appendix contains comments on specific points in the exposure draft. The contents of the letter and appendix are derived from comments made by the three practice areas affected by the Insurance TAS – General Insurance, Health and Care and Life Insurance.

The profession supports the need for strong governance and communication over the actuarial processes within insurance businesses in order for users of the information to understand what they are being told and the uncertainties that are identified. However the Profession has concerns that there are a number of key areas where the practical implementation of the principles, as currently worded, would not prove to be the most effective way to provide this information for the users.

Scope

An area of concern for the profession continues to be the scope of the TAS, (and in particular sections B1.3 and C1.13 – C1.15). We have highlighted below some of the areas causing concern and would be happy to discuss these in more depth, if necessary, at the meeting with the BAS referred to in the opening paragraph of this letter.

Users within an insurance company environment

As currently written, the TAS does not address the core issue that users within an insurance company environment are generally familiar with actuarial matters even when not actuaries themselves. Most users will be dealing with pricing and valuation issues on a daily basis and are familiar with issues regarding the uncertainty of assumptions or models, (see sections 2.15 – 2.22). There is concern that, for those users who are generally familiar with the issues, compliance by actuaries with the TAS, as currently worded, could lead to repetition of basic issues and would not enhance the user experience – it could even prove to be

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counterproductive or regarded as 'boiler plate'. Inclusion of a sentence in the TAS stating that minutes of meetings or presentation notes and slides would suffice as a record of a permanent nature would be very helpful.

It is accepted however, that when an individual user is new to a role then any in-depth discussions held might need to be supported not just by minutes from meetings but by more comprehensive communications such as briefings or induction courses.

If using an actuary does prove to be an ineffective way of communicating with users then users may be inclined to go to a non-actuary or an actuary who is not a member of the Institute and Faculty. In this regard we think it is important that the BAS emphasises the need for the Insurance Standard to be applied to work carried out relating to insurance business whether by an actuary or non-actuary and that you seek formal support from the FSA for this position.

Work carried out in support of an audit

We feel that it is unclear whether BAS intends work carried out in support of an audit to be within scope of the Insurance TAS or not. We think that paragraph 18(b) of the *Scope and Authority* suggests that it is not.

18 For the purposes of this definition, Reserved Work does not include:

- a) work assigned by regulations to the holder of a unique post; or*
- b) monitoring the work of another Actuary.*

but that C.1.5 of the Insurance TAS suggests that it is within scope:

*This standard shall apply to actuarial work that is performed in connection with financial statements that are intended to give a true and fair view of an **insurer's** financial position and profit or loss (or income and expenditure) other than actuarial work that is within the scope of the Pensions TAS.*

Furthermore, C.1.12 of the Insurance TAS also suggests that it is within scope

This standard shall apply to actuarial work for an auditor to support their opinion on an insurer's regulatory returns.

The latter two interpretations appear to be those intended as suggested by 2.27 of the exposure draft discussion document.

Often work in support of an audit will be a review of the work of another actuary or insurance professional and will not result in the reviewing actuary preparing their own estimates. In some circumstances, the auditor will only require a high-level review of the quality of the actuarial information supplied to them. In such circumstances we think it will not always be easy for the actuary to comply with the Insurance TAS and the generic TASs. For example,

the reviewing actuary may struggle to characterise adequately the uncertainty in the work being reviewed.

Nevertheless, we do agree that some of the disciplines proposed in the Insurance TAS and the generic TASs are helpful to reviewing actuaries. We therefore suggest that review work of this nature be explicitly excluded from scope unless the person commissioning the review (such as the auditor) requires it.

Definition of materiality

We believe that the inclusion of various areas of actuarial work within the scope of Insurance TAS has highlighted difficulties with how the current definition of materiality used throughout the standards is to be interpreted. We believe that while it is right to exclude from scope activity that will not affect decisions, we do not think that, as a matter of logic, the opposite can be assumed to be true. Many business decisions are taken that are minor in nature, and a simple cost benefit analysis would suggest that they do not merit the overlay of actuarial standards. We think that this (and the time pressures and other relevant circumstances) is part of what is intended by the phrase “*and the context in which the work is performed and reported*” in the materiality definition, however we do not think this is stated in a sufficiently transparent fashion.

We therefore suggest that the definition of materiality is amended throughout the generic and specific TASs to the following:

*Matters are **material** if they could, individually or collectively, influence the decisions to be taken by **users** of the related actuarial information. Assessing **materiality** is a matter of reasonable judgement which requires consideration of the **users** and the context in which the work is performed and reported. The context of the work includes the significance of the decision relative to the risk profile or framework of the affected entity.*

We believe this addition will also avoid the introduction of the Insurance TAS disrupting well-run firms that have an established approach to risk management.

Definition of actuarial work

At various points in Insurance TAS, the term *actuarial work* is used without definition. We feel that a natural definition of actuarial work is “work performed by an actuary”. We feel that this state of affairs presents significant difficulty to actuaries working in senior management roles such as CEOs or CFOs of business. Such individuals will have responsibility for financial statements, will not be able to use opt-outs relating to not having a veto on the decision and will often perform work in connection with financial statements. We do not believe that the intention of Insurance TAS was to include within scope the entirety of a company’s set of financial statements as a result of the professional qualifications of certain senior members of management and recommend that the definition of “actuarial work” is amended appropriately to overcome this.

Documentation

As with other BAS standards, the issues surrounding the implementation in practice of principles based regulation and what would be regarded as the correct level of documentation will continue to be an issue for discussions between the BAS and the profession.

General Principles

Assumptions

A number of points have also caused some concern in the General Principles section relating to assumptions. The specific issues are dealt with in the appendix.

It is suggested that the use of superlatives should be removed from some of the paragraphs in this section as it hinders the realistic interpretation of the requirement.

In D2.16: *Claims assumptions shall allow explicitly for potential events which would have a significant financial impact even though they might have a very low probability.*

It is suggested that the BAS follow the example of the FSA and insert the words “reasonably foreseeable” in place of ‘potential’.

Use of Judgement

Paragraph D2.2 states . *Assumptions used in, or proposed for use in, **models** shall be derived from sufficient relevant information*

However, it needs to be recognised that there are occasions when there is not sufficient information in a statistically robust manner available but actuarial advice is still helpful to users. We suggest that as long as the actuary explains the consequences of the assumptions as per TAS R then the word ‘*sufficient*’ could be deleted from the sentence.

Transitional Arrangements

The transitional arrangements need to recognise that many actuarial models have operated successfully for many years and their validity is demonstrated through comparison of actual to projected results over long periods of time. However these same models may not have been tested to modern and current standard. Transitional arrangements need to recognise that full documentation may not be required in such circumstances although the profession accepts that actuaries should explain why they are prepared to place reliance on the models they are using.

Commencement Date

This is now less than one year away and we would suggest that the BAS engages with practitioners to agree a practical timetable for its implementation. It may well be that April 2011 is feasible for reserved/required work but from an impact assessment point of view there might be an argument for aligning it with the introduction of Solvency II for other areas of work as firms will not want to divert precious resources onto this if it means they risk failing to get an internal model approved since this would cost them significantly in excess capital. In the meantime if you have any questions or would like to discuss any of these matters further, please do not hesitate to contact us as per details below:

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Yours sincerely,

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Enc - Appendix

Appendix to letter dated 16 July 2010 from The Actuarial Profession relating to Exposure Draft for Insurance TAS

Section A – no comment

Section B –see letter

Section C – see letter

Section D

D2.10 relating to aggregate reports it was felt that where the exercise was reasonably unimportant then there could be an issue as to how it relates to TAS R. Presumably the materiality clause could be extended to include this situation.

D2.14 it was felt that the second bullet point was not a good GI example.

D2.16 in addition to comments in letter it should be re-drafted to state that when setting claims assumptions the entire range of possible outcomes must be considered. Also some felt the deletion of 'explicitly' from this sentence would also help.

D2.17 could then emphasise that the items listed must not be ignored and then.

D2.18 could be deleted.

D2.20 could be deleted without any loss of meaning to D2.19.

D2.21 was felt to contain non-requirements. In group companies the assumptions would be outside of the actuary's control – if there were issues the actuary's whistle blowing duty would come into play for reserved role holders, and, in most cases, for approved persons.

D2.22 was not felt to add anything to the TAS.

D3.1 it was felt that the wording needed to be clarified in relation to "two similar exercises". It should be made clear whether this is intended to capture changes since the previous report on the same subject or a contrast with other recent exercises (or both) - should include the word "recent".

D4.5 clarification required re capital under stress tests to meet requirements (relates to principle D4.4).

D4.6 and D4.7 should add that bullets do not provide an exhaustive list, other types of common liquidity risks exist. In the sentence introducing the bullets in D4.7 "might" should be replaced by "does".

D4.9 Lots of other things could be included here. It should indicate what the information on materiality levels should be used for and in

D4.10 would prefer the words "any reasonably foreseeable circumstances" be used.

Section E

E2.1 it was felt that as worded this appeared to be asking the actuary to explain the decision of the Board relating to a change of assumptions. This would not be the case for a with-profits actuary who is not responsible for describing the rationale merely for stating if it appears reasonable.

E2.2 This appears to be a statement rather than a requirement and does not explain the meaning of E2.1. Should first bullet refer to surrender values rather than surrender penalties? The second bullet point is not built in to scenario tests.

E3.1 Unclear as to what this point is driving at; is it the impact of changes on policyholders? Does "indicate the effects" mean quantifying the impact? Suggest replacing "concerning" with "advising on" in first line.

E3.4 and E3.5 as currently written it was felt that these actions were not feasible as policyholders are referred to as a class not an individual so cannot comment on an individual's financial capability to

understand matters. A with-profits actuary would, however, need to consider the communications being sent to policyholders. There was greater concern about E3.5 than E3.4. Suggested alternative wording for these points should indicate the context in which the assumptions are given e.g. "This information is provided *on the assumption that all policyholders have been given advice by a suitably qualified adviser...*"

Section F – no comment