



BOARD FOR ACTUARIAL STANDARDS

**RESPONSE TO CEIOPS ISSUES PAPER:
IMPLEMENTING MEASURES ON SYSTEM OF
GOVERNANCE**

JANUARY 2009

1 INTRODUCTION

- 1.1 The Board for Actuarial Standards (BAS) welcomes the opportunity to comment on the issues paper *Implementing Measures on System of Governance* published by the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).
- 1.2 We congratulate CEIOPS on producing this Issues Paper, which successfully provides clarity on the thinking behind the Level 2 rules, maintains a principles-based approach and avoids over-prescription. The paper reflects the crucial importance of good governance and enterprise-wide risk management within insurance firms. It will assist all insurance firms in ensuring that their governance systems are appropriate, and, as such, it should contribute to improving management of the insurance market across the EU.

WHO WE ARE

- 1.3 The BAS was established in 2006 and is responsible for setting technical actuarial standards in the UK. Its primary objective is that users of actuarial information should be able to place a high degree of reliance on the information's relevance, transparency of assumptions, completeness and comprehensibility, including the communication of any uncertainty inherent in the information. There are 14 members of the Board, seven of whom are actuaries and seven lay members representing a wide range of stakeholders. The BAS is funded by the pensions and insurance industries (45% each) and the Actuarial Profession (10%). The BAS is one of the six operating bodies of the Financial Reporting Council, which is responsible for promoting confidence in corporate reporting and governance in the UK.
- 1.4 In carrying out its work, the BAS is committed to:
- Working on the basis that well informed users are the best regulators;
 - Targeting the use of its powers, taking a proactive, risk-based and proportionate approach, and making effective use of Regulatory Impact Assessments;
 - Emphasising principles and clarity in its standard-setting; and
 - Being consultative – involving preparers, users of corporate and actuarial reports, the wider public and other regulatory organisations in its decision-making and allowing adequate time for consultation, without compromising confidentiality or its independence.
- 1.5 The BAS is independent of the UK's professional actuarial bodies, which do not set technical actuarial standards.
- 1.6 The BAS has published its *Conceptual Framework for Technical Actuarial Standards*,¹ which sets out, among other things, the objectives and characteristics that its standards will have. They will be principles-based, and directed towards ensuring that users can place a high degree of reliance on

¹ <http://www.frc.org.uk/bas/publications/index.cfm?mode=list&cID=35>

actuarial information. They will be for the benefit of the public, rather than for the protection of actuaries.

- 1.7 When it was established in 2006 the BAS adopted a number of existing actuarial standards from the Actuarial Profession, which had previously been responsible for all actuarial standards (it remains responsible for professional and ethical standards). The BAS has announced its intention of developing a completely new set of technical actuarial standards which will replace those that it adopted. The new standards are intended to be in place by the end of 2010.
- 1.8 Over the last few months, the BAS has published consultation papers setting out proposals for standards on data, modelling and reporting.² Exposure drafts and final standards covering these areas are expected to be published later in 2009. It has started work on standards on long term insurance business, general insurance and pensions, and expects to publish consultation papers and exposure drafts on these topics later in 2009.

CONTACT

- 1.9 We will be happy to discuss any points arising from our response. All queries should be addressed to

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2 KEY POINTS

- 2.1 The Issues Paper contains the first draft of CEIOPS's views concerning Level 2 implementing measures regarding the system of governance. We believe that there are number of areas in which CEIOPS should consider expanding or amending its proposed advice if it is to achieve its goals. In particular, there are a number of areas in which standards may fail to converge across the EU. Section 3 discusses some detailed points.
- 2.2 We are concerned that the role of the actuarial function will not be specified in sufficient detail. For example, there are many possible interpretations of the requirements in Article 47(1) g) and h) to express opinions on the overall underwriting policy and on the adequacy of reinsurance arrangements, and we think that the Level 2 text should indicate the aspects of the underwriting policy and reinsurance arrangements that the opinions should address. The requirement in Article 47(1) i) to contribute to the effective implementation of the risk management system is also subject to many interpretations. In addition it raises questions about the boundary (if any) between the risk management and actuarial functions. We suggest that the Level 2 text should address these issues.
- 2.3 Paragraph 6.90 states that reports on the performance of the internal model should be "tailored to the requirements of the administrative or management body, enabling its members to understand all relevant facts and the implications following from them as a solid and reliable basis for necessary decisions". We are in full support of this statement, and believe that it should be true of all reports. It is one of the primary principles on which our forthcoming standard on actuarial reporting will be based, as it is an important part of achieving our overall objective that actuarial information should be understood by its users.
- 2.4 However, paragraph 6.90 goes on to say that "The performance analysis and reporting pursuant to Article 43(5) e) should be conducted and written on an expert level." This appears to contradict the first statement, if "expert level" means "at a level intended for an expert readership". We believe that all reports, particularly the ORSA, risk and actuarial reports should be written for their users, which may well mean that they should **not** be written at a level that can be understood only by experts.
- 2.5 A report written in order to be understood by experts is unlikely to be understood by non-experts, who may well comprise the majority of the administrative or management body. We believe that the principle stated in the first part of paragraph 6.90 should be reinforced throughout the Level 2 text with no scope for ambiguity. We have serious concerns that reports written for experts will hamper the effective operation of the administrative or management body, which is responsible for the governance and management of the insurance firm.

3 SPECIFIC POINTS

- 3.1 Section 9 of the issues paper deals with Article 47 of the Directive, which covers the actuarial function. Section 6 of the paper deals with Article 43 of the Directive, which covers the risk management system. As the BAS is a setter of actuarial standards, our response deals mainly with section 9, although we also have some comments on parts of section 6. In particular, we have some concerns about possible inconsistencies between sections 6 and 9, and on the lack of specificity on the relationship between the actuarial and risk management functions.

STANDARDS

- 3.2 Paragraph 9.1 covers generally accepted actuarial standards. We note that these standards will cover everyone working in the actuarial function and not only actuaries with recognised qualifications. This extends the current scope of actuarial standards. We welcome this extension, which is consistent with our own policy of setting standards for the production of actuarial information, whether or not it is produced by actuaries.
- 3.3 The list of possible setters of actuarial standards in footnote 15 should be extended to cover independent national or international standard setters.
- 3.4 At times, duties performed within the risk management function may be actuarial in nature, or performed by actuaries, and there may be generally accepted actuarial standards that apply to such duties. In addition, there may be generally accepted risk management standards that apply to the risk management function. A reference to generally accepted risk management standards in section 6 would provide some consistency.

TASKS

- 3.5 Paragraph 9.2 states that CEIOPS considers the list of mandatory tasks for the actuarial function to be “comprehensive”. However, the listed items are not always well defined and several of them overlap with those of the risk management function. The tasks are described in less detail than section 6 provides for the risk management function. There are also some inconsistencies between the definitions and terminologies used in sections 6 and 9. We do not agree that the list is comprehensive.
- 3.6 In particular, the following definitions in section 6 (on risk management) are equally relevant to the actuarial function:
- 6.14 – 6.20 Underwriting and reserving;
 - 6.21 – 6.31 Asset-liability management;
 - 6.32 – 6.40 Investment, including derivatives and similar commitments;
 - 6.41 – 6.44 Liquidity risk management;
 - 6.45 – 6.48 Concentration risk management;
 - 6.58 – 6.64 Reinsurance and other risk mitigation techniques; and
 - 6.65 – 6.70 Credit risk.

ACTUARIAL CONTRIBUTION

- 3.7 Paragraph 9.4 expands on Article 47(1) i), the actuarial contribution to effective implementation of the risk management system referred to in Article 43, and the assessment referred to in Article 44 in the ORSA. Paragraph 9.4 states that the actuarial function should “develop the risk modelling underlying the calculation of the capital requirements”. However, Article 43(5) states that if an internal model is used to calculate the Solvency Capital Requirement, then the risk management function should be responsible for its design and implementation. These two requirements appear to be inconsistent.
- 3.8 Paragraph 9.4 also states that “depending on the complexity of the risk management system, actuarial methods may need to be applied”, but does not make it clear where the responsibility for the decision lies. We assume that it is intended that the decision should be made within the actuarial function, and that the criteria set out in paragraph 9.16 would apply.

ADEQUACY AND RELIABILITY

- 3.9 Paragraph 9.7 discusses the quality of data on which the reliability and adequacy of the calculation of technical provisions depend. We agree that the actuarial function should be responsible for assessing the quality and sufficiency of data. Our recent consultation paper on a Generic Data Standard sets out our proposals for the types of checks and analyses that might be involved, and the matters concerning data that should be included in actuarial information. We do not believe that such an assessment should include auditing the data. It would be helpful if this was clarified.
- 3.10 Paragraph 9.8 deals with the “objectivity, reasonability and verifiability of management actions” included in the calculation of technical provisions. We suggest that the effects of management actions included in the calculation of capital requirements should be subject to the same considerations.

COMPARISONS OF BEST ESTIMATES AGAINST EXPERIENCE

- 3.11 Paragraph 9.9 covers Article 47(1) d) on comparing actual experience to expected results for the technical provisions. We believe that comparisons and reconciliations are extremely useful management tools, and have proposed a similar principle for inclusion in our reporting standard.
- 3.12 We suggest that the comparison should be performed at a more detailed level than to the technical provisions as a whole. The comparison should also include a reconciliation of actual experience to that which was expected, together with an analysis of the reasons for deviation. This exercise should also include an analysis of the performance of the models that were used.
- 3.13 The actual experience will also differ from the assumptions that were used in calculating the capital requirements. We suggest that similar comparisons to those required for technical provisions would assist the management body in understanding the calculations and in managing the business. Such comparisons could be the responsibility of either the risk management or actuarial functions.
- 3.14 We note that there is no requirement to communicate the results of the comparison to the administrative or management body. We believe that the

results would assist in the effective management of insurance firms, and suggest that such a requirement be included in the Level 2 text.

ACTUARIAL OPINIONS

- 3.15 Paragraph 9.12 deals with Article 47(1) g) and h), which require the actuarial function to express opinions on the overall underwriting policy and the adequacy of the reinsurance arrangements. We believe that the Level 2 text should be more specific about which of the many possible aspects of the underwriting policy and reinsurance arrangements should be considered.
- 3.16 For example, the term “underwriting policy” could be interpreted as including any policy, process or function in the assumption and discharge of risks carried. An opinion on more or less any aspect of an insurance firm’s operation could thus be interpreted as an opinion on the overall underwriting policy. We suggest that the scope of the opinions that are required should be made more explicit. Paragraphs 6.14 – 6.20, which discuss underwriting and reserving in the context of risk management, may provide some help here.
- 3.17 Underwriting processes used by insurance firms usually provide for risks such as anti-selection by groups of customers, the consideration of possible policyholder behaviours in the light of the product design, possible behaviours of policyholders or advisers in the light of sales remuneration structures, the legal environment, and management responses. It would be impossible to list all such risks that could be covered by the opinion expressed by the actuarial function. We suggest that the Level 2 text should provide some indication of the scope of the opinion that is required without attempting to provide a comprehensive list of the matters that should be covered.
- 3.18 We suggest that an opinion on the overall underwriting policy should include a view on the adequacy of pricing (which may also affect the adequacy of technical provisions). There are a number of ways in which this could be interpreted, including sufficient on a policy by policy basis, by line of business, or sufficient given the capital resources of the firm and the anticipated levels of new business. Clarification would be helpful.
- 3.19 We also suggest that the opinion on the adequacy of reinsurance arrangements should include the adequacy of other risk management techniques which have similar effects but operate under different legal frameworks. This could be achieved through the use of a definition of reinsurance which includes Alternative Risk Transfer (ART) arrangements, as is suggested by the drafting of paragraphs 6.58 – 6.64.

REPORTING FRAMEWORKS

- 3.20 Paragraph 9.13 requires that the actuarial function produce annual written reports on the tasks that have been performed. We suggest that the reporting requirements should be consistent at least for the actuarial and risk management functions, and preferably for the other functions (compliance and internal audit) as well. We agree that a report covering shortcomings and areas of possible improvement would be of use to the administrative or management body (as required in paragraph 9.20). If a list of the tasks that have been undertaken by the actuarial function would also be useful, we suggest that a similar list of the tasks undertaken by the risk management function would be too.

CONSISTENCY

- 3.21 We suggest that the Level 2 text should aim to clarify any possible inconsistencies resulting from ambiguities in the Directive. There are several possible inconsistencies between sections 6 and 9, covering the risk management and actuarial functions respectively.
- 3.22 Paragraphs 6.14 - 6.20 refer to “reserves” and “reserving”, following article 43. Article 47 refers to “technical provisions”. (“Reserving” and related terms are also used in Articles 2, 5, 42, 105, 132, 171, 204, and 220 and in Annex IV of the Framework Directive.) We suggest that the Level 2 text should use internally consistent terminology, providing clarification of the Framework Directive where necessary. For consistency with accounting standards, “technical provisions” (and related terms) are to be preferred, unless the intention is specifically to refer to reserves in the sense in which that term is used by the IASB.
- 3.23 For consistency, the actuarial function’s responsibility to express an opinion on the overall underwriting policy should be expressed in a way that is consistent with the definition of underwriting risk given in paragraph 6.14.
- 3.24 Paragraph 6.18 states that all policies and procedures established for the underwriting and reserving should be applied by all distribution channels. We assume this means that all distribution channels have and apply policies and procedures, and not that they should all apply the same ones.