Questions for Users of Actuarial Work
General Insurance Technical Provisions and Capital

Directors are responsible for determining the technical provisions and capital requirements (currently determined under ICAS but changing to Solvency II in the next two to three years) usually on the basis of advice from an actuary. It is important that Non-Executive Directors (NEDs) understand the actuarial advice they are given and are able to engage effectively with the actuary providing that advice.

We set out below some questions which we hope will help NEDs increase their understanding of both the Provisioning and Capital adequacy processes.

Governance

The Board needs to understand the role of the actuarial team and how its responsibilities relate to other functions.

- Do you have a clear understanding of what work has been done by the actuarial team and the extent of their reliance on other functions?
- What was the impact of any changes to the allocation of responsibilities for reserving between the actuarial team and others (statisticians for example) since last year?
- Which actuarial processes have been reviewed in the past year and what were the significant issues raised and acted upon? What actions have been taken responding to issues raised by external auditors or the FSA?

Insurance risk

Insurance risk – claim frequency and severity, and the development of claims in respect of in-force business – is the main cause of uncertainty for general insurers.

- What are the material judgements behind the results? In which classes are risks greatest?
- In determining best estimate assumptions about claim frequency and severity, how much weight is attached to recent experience?
- How do actuarial assumptions take account of current underwriting practice?

Data inadequacy

A feature of many classes of general insurance is that data is incomplete. The actuary will have exercised judgement in how to compensate for data inadequacy.

- What are the material gaps in data?
- Have all data sets impacted by the gaps been identified? Have the gaps been addressed consistently in all data sets on which they impact?
- What adjustments were made to compensate for these gaps? What alternative approaches were considered, why were they rejected, and what would their impact have been?

Models and methods

Judgements about the models and methods actually used and their limitations will have a significant impact on the results.

- What alternative model methodologies were considered and then rejected (and why)?
- When were the models last reviewed and in what level of detail? What changes were considered and then rejected?
- What is the process for confirming that the models and methods used are generally accepted actuarial practice?
- How are large losses modelled?

Scenario analysis and stress testing

A key part of capital adequacy is consideration of "tail events". Models are typically developed on the basis of extensive data about events in the middle of the curve, but limited data about the tails.

- How is uncertainty in tails assessed and explained?
- What judgements have been made about correlations in tails of distributions?
- What alternative tail correlations were considered and why were they rejected? What would have been the financial implications of adopting these alternatives?

Material cash flows

Cash flows may be material for some classes of business. For example, a large catastrophe claim settlement could have a big impact on liquidity.

- Are projected cash flows reviewed regularly in sufficient detail?
- Are there peaks or troughs in cash flows as a result of potentially large individual claim settlements that might create liquidity issues?
- What liaison is there between the actuary and treasury functions on short-term cash flow? Are there other peaks or troughs in cash flows that need to be recognised and managed?

Solvency II

Current requirements for calculating provisions and determining capital adequacy are driven by existing regulation but considerable work is being performed to implement the new Solvency II regime.

- How does the actuary anticipate technical provisions and capital requirements will change on the introduction of Solvency II?
- What is the actuarial function doing to support the work of the risk function?
- Are the actuarial components of the Solvency II project on schedule and which areas have been most problematic recently?

Working with your Actuary

To ensure you get high quality actuarial work it is important that you can rely on your actuary and have an effective working relationship.

- Do you have a process in place to notify the actuary of significant events which happen after the valuation date and which might affect the funding position?
- Have you agreed the level of detail you would like to be reported? Have you agreed a format for reporting actuarial information?
- How often does your actuarial function report directly to the Board? Do you have adequate opportunity to discuss any areas of uncertainty before taking formal decisions?
- How well does your actuary explain advice?
- What quality assurance processes does your actuary use?
- Does your actuary have other interests or responsibilities which might affect their perceived objectivity, such as managing the interests of shareholders and management?
- How is your actuary's compliance with statutory requirements, BAS standards and professional standards monitored?

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