



# **BOARD FOR ACTUARIAL STANDARDS**

## **EXPOSURE DRAFT: INSURANCE**

**APRIL 2010**

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# ANALYSIS OF RESPONSES

AND

# INVITATION TO COMMENT

# 1 INTRODUCTION

## CONSULTATION AND RESPONSES

- 1.1 The Board for Actuarial Standards (BAS) is responsible for setting technical actuarial standards in the UK: it is an operating body of the Financial Reporting Council (the FRC)<sup>1</sup>. In September 2009, it published a consultation paper on a Specific Technical Actuarial Standard (Specific TAS)<sup>2</sup> on insurance. During the preparation of the consultation paper we were assisted by a Working Group<sup>3</sup>.
- 1.2 The consultation period ended on 20 November 2009. A total of 28 public responses<sup>4</sup> were received (see Appendix B). A number of meetings with practitioners and other stakeholders were held including a workshop at which initial ideas were discussed. We thank all those who have contributed.

## SUMMARY

- 1.3 In drafting the proposed text of the Insurance TAS we have taken account of the comments we received in response to the consultation paper, as well as other comments that have been made to us in meetings. We have also considered the responses to our other consultations.
- 1.4 Respondents to the consultation generally agreed with the aims of the consultation paper and the proposed purpose of the Insurance TAS.
- 1.5 Respondents' views on the scope were varied. Some wanted the scope of the TAS to be restricted to Reserved Work while others agreed that a wider scope covering areas in which information is provided to assist in making a decision was appropriate.
- 1.6 We propose that there will be one TAS covering all aspects of insurance work. We consider that actuarial work in long-term and general insurance have more things in common than things that divide them. Although there are some areas of work that are specific to either long-term or general insurance the TAS will be structured so that such areas are clearly indicated.
- 1.7 Most respondents objected to the proposed requirement to show best estimates alongside prudent estimates of liabilities. These objections have been noted. The proposed text includes no such principle.

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<sup>1</sup> The Financial Reporting Council is the UK's independent regulator responsible for promoting confidence in governance and corporate reporting.

<sup>2</sup> Generic TASs apply to all work specified in the Schedule to the BAS's *Scope & Authority of Technical Standards*. Specific TASs are limited to a specific, defined context.

<sup>3</sup> Members of the working group are listed in Appendix A.

<sup>4</sup> The responses are available at <http://www.frc.org.uk/bas/publications/pub2133.html>.

- 1.8 Concerns were raised that the proposals for work related to the exercise of discretion in long-term insurance and reports to policyholders extended regulation. We consider that it is appropriate to set technical standards in this area because actuaries have a significant role in advising insurers in the exercise of this discretion.
- 1.9 A number of respondents commented that some of the principles which were proposed for the Insurance TAS could also apply to pensions and should therefore be in one of the Generic TASs. This may be so for some principles, and we intend to review the structure of the TASs when the initial set has been issued. However, we note that the fact that a principle could apply more widely than to work in insurance does not always imply that it should be so applied. Moreover, the Generic TASs apply to areas of work other than insurance and pensions, and a principle that is applicable to both these areas of work may not be applicable or desirable in other areas.
- 1.10 Respondents generally agreed with the other principles proposed in the consultation. There were many helpful suggestions on the detailed wording which we have taken into account when drafting the proposed text.
- 1.11 A common request from respondents was that examples should be provided of what is required in order to comply with this TAS. We have included examples for many of the principles proposed.
- 1.12 Section 2 covers the structure, purpose and scope of the Insurance TAS. Section 3 covers the proposed principles of the TAS. These sections summarise the comments that we received in answer to the specific questions and describe how we have responded to them. Section 4 summarises the other comments we received, and describes further proposals. Section 5 considers the transition from adopted guidance notes. Section 6 discusses the expected effects of the Insurance TAS and other TASs on insurance work. Section 7 contains our invitation to comment on the exposure draft of the Insurance TAS. The second part of this document contains the proposed text.

## **RESPONSES TO THIS CONSULTATION PAPER**

- 1.13 Details of how to respond to this paper are set out in Section 7. Comments should reach the FRC by **16 July 2010**.

## 2 STRUCTURE, PURPOSE AND SCOPE

### INTRODUCTION

- 2.1 This section considers the structure of the Insurance TAS. It also considers the purpose and scope, including the specific questions on these matters that were proposed in the consultation paper. We have included these questions in boxes with the same numbering as in the consultation paper.
- 2.2 In brief we are proposing that:
- there will be a single Insurance TAS covering both long-term and general insurance;
  - the Insurance TAS will consist of several parts, some of which will have their scope limited to work in either long-term or general insurance; and
  - the scope will extend beyond Reserved Work.

### STRUCTURE OF THE TAS

- 2.3 The first two parts of the proposed text of the Insurance TAS follow the same pattern as the Generic TASs, with Part A covering the purpose and Part B the interpretation of the TAS. As a Specific TAS, the Insurance TAS must specify its scope, and this is done in Part C.

**1 Respondents are asked to comment on the advantages and disadvantages of a single insurance TAS compared with separate TASs for long-term insurance and general insurance, with particular reference to the needs of the users of actuarial information.**

- 2.4 Most respondents favoured a single TAS. The main reasons supporting this view were:
- a belief that many of the principles should be common to all types of insurance work; and
  - a risk that some areas would either not be covered or be covered twice if there were separate TASs.
- 2.5 Some respondents argued for separate TASs. They were concerned that differences between the issues faced by actuaries working in the two types of insurance business and the methods used would mean that there would be many principles that were only relevant to one branch. This would create the potential for confusion.
- 2.6 We agree that more unites than divides actuarial work in the two fields of long-term and general insurance. There are some areas of work that are specific to either long-term or general insurance but the TAS can be structured so that those principles that apply only to particular areas of work are clearly indicated.

- 2.7 We are proposing to issue a single TAS covering all aspects of insurance work. Part D<sup>5</sup> contains the principles that apply generally to all areas of insurance work, Part E contains those principles specific to work concerning the exercise of discretion by long-term insurers and Part F contains a principle specific to work for Lloyd's syndicates writing general insurance business.

## PURPOSE

**2 Will the proposed purpose of the insurance TAS that is set out in paragraph 2.12 help to ensure that users of actuarial information can place a high degree of reliance on its relevance, transparency of assumptions, completeness and comprehensibility?**

- 2.8 Most respondents agreed with the spirit of the proposed purpose. After considering drafting suggestions from respondents we have made the purpose more concise while retaining the original concepts.
- 2.9 There was some concern that the proposed purpose did not make explicit reference to actuarial work. This is deliberate as the work within its scope is defined in Part C.
- 2.10 Some respondents were concerned that that the proposed wording placed a requirement on actuaries to make sure that sufficient information is provided to governing bodies or policyholders even if it is not within their control. Some respondents considered that policyholders are not users of actuarial information and further that it is not usually the responsibility of actuaries (with the possible exception of With-Profits Actuaries) to determine what information is given to policyholders. The wording in Part A now refers to information provided rather than specifying that it must be provided.
- 2.11 Given the responsibility of the FRC to promote confidence in corporate reporting as well as governance it has been suggested that as well as information provided to policyholders we should have considered the information needs of shareholders and other owners of insurers. We consider that their needs will be met through the production of high quality actuarial information to management and governing bodies to support the decisions they take as agents of the owners of insurers.
- 2.12 There was also a concern that the purpose imposes requirements on actuaries performing work within scope. This is not the case: the purpose sets the scene for the TAS and provides a context for interpreting the principles it contains.

## SCOPE

- 3 Do respondents agree that the areas of work listed in paragraph 4.73 should be within the scope of the insurance TAS?**
- 4 Do respondents agree that the areas of work listed in paragraph 4.74 should be within the scope of TASs on accounting or business rearrangements, rather than within the scope of the insurance TAS?**

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<sup>5</sup> References to Parts and to lettered paragraph numbers are to the proposed text of the TAS, as shown in the second part of this document.

5	<b>Do respondents agree that the areas of work listed in paragraph 4.75 should not be within the scope of the insurance TAS?</b>
6	<b>Should the areas of work listed in paragraph 4.76 be within the scope of the insurance TAS? Respondents are asked to consider the degree of reliance that users should be able to place on the actuarial information.</b>
7	<b>Is there any other work which is not mentioned above that should be within the scope of the insurance TAS?</b>

### **General observations on scope**

- 2.13 A frequent request from respondents was that the scope should be defined clearly by setting out the specific pieces of work to which the TAS applies. Part C sets out the revised proposals for scope and includes examples of pieces of work that might be included. These examples are not exhaustive and whether or not a specific piece of work falls within scope will often be a matter for judgement.
- 2.14 Most respondents provided a single reply to all the questions on scope. Opinions were divided on the work that should be in scope. Some suggested that only Reserved Work should be in scope while others suggested that all work in insurance carried out by actuaries should be in scope. The main concerns expressed over a wider scope are considered below.

### *Relationship with client*

- 2.15 In insurance, actuarial work is often performed by an in-house actuary complying with the requests of the insurer's management or the governing body. In this case, it was argued, it is for the insurer to specify the standards to which the work should be performed.
- 2.16 However, by no means all insurance work is performed by in-house actuaries and in any case we consider that the nature of the commercial relationship between the user and the actuary should not affect the quality of the work that is performed. Many of the decisions that are made based on work performed by in-house actuaries are important and sometimes they are key to the success or otherwise of an insurer.
- 2.17 Our *Scope and Authority* allows those responsible for commissioning work that is neither Reserved Work nor Required Work to instruct the actuary responsible for carrying it out to depart from specified (or all) requirements of TASs.

### *Competitive disadvantage*

- 2.18 Some respondents expressed concern that if the scope is extended beyond Reserved Work then actuaries will be placed under a competitive disadvantage. They believe that additional work will be required to demonstrate compliance with TASs. This additional work would increase the cost and potentially increase the time taken to complete the work. This would make users reluctant to use actuaries if the work could be performed by other competent experts.
- 2.19 We consider that users ask actuaries to perform work because of the competencies they bring to the performance of the work, their professionalism and prior experience of work done. Compliance with our

TASs, with their focus on the user experience, should enhance the competitive position of actuaries rather than reduce it. In addition, we do not expect compliance to add significantly to the cost of performing work – see paragraphs 6.8 to 6.11).

*Work to be performed to tight timescales*

- 2.20 Many respondents felt that compliance with TASs would not be possible for work that has to be completed in tight timescales or with inadequate data such as work connected with mergers and acquisitions.
- 2.21 However, other respondents acknowledged that this type of work is often the basis for important decisions and that it should be covered by TASs. In general, we agree. Work performed under tight deadlines is often less detailed and more approximate than other work, even though it may support very significant decisions. We consider that those relying on the work should be fully aware of its limitations. Compliance with TASs does not necessarily require work to be performed in great detail, but it does require that the limitations of the work and uncertainty attached are explained properly to the users.

*Work produced jointly with non-actuaries*

- 2.22 Several respondents had concerns about how the TAS would apply to work produced jointly by actuaries and others. Our *Scope and Authority* describes how TASs should be applied in this situation. Actuaries are required to comply with TASs only if they are responsible for the work that is within the TASs' scope. However, it is open to users to require that such work is produced in compliance with TASs whether it is performed by actuaries or not.

**Work within the scope of other TASs**

- 2.23 Some respondents thought that information supporting the preparation of financial statements (for example embedded values) should be covered by the Insurance TAS whilst others thought it should only be covered within a separate Specific TAS on information for accounts.
- 2.24 These matters were also addressed in our consultation paper on *Actuarial information used for accounts and other financial documents*. Following that consultation we decided not to issue a separate TAS on accounts, and therefore propose to include some actuarial work concerning information for accounts within the scope of the Insurance TAS. Other work, particularly work related to information on insurers' employee pension schemes, will be covered by the Pensions TAS.

**Discretion**

- 2.25 Paragraph 4.73 (f) of the consultation paper proposed that work supporting the exercise of discretion by insurers and information provided to policyholders about discretion should be within the scope of the Insurance TAS. Most respondents who expressed an opinion agreed. We consider that the exercise of discretion is important to both the insurer and its policyholders and that actuarial work supporting it should therefore be within the scope of the Insurance TAS.

- 2.26 Some respondents expressed concern over the provision of information to policyholders. They thought that in this case actuaries have no contractual obligation to policyholders and should not be required to provide information to them. This concern was based on a misunderstanding: the proposal was not to impose a requirement to report to policyholders where no such obligation already exists. We were proposing that, if there is an obligation to report to policyholders, the work should be within the scope of the Insurance TAS. If actuaries provide information to policyholders on matters concerning the exercise of discretion by an insurer, then we consider that the work should be of high quality.

#### **Work for the auditor**

- 2.27 Paragraphs 4.19 and 4.20 of the consultation paper considered the work of the Reviewing Actuary for the auditor of a long-term insurer and similar work performed for auditors of general insurers by actuaries independent of the insurer. Respondents agreed that this work should be within scope. We consider that paragraph C.1.5 brings part of the work of the auditor's actuaries within scope. Paragraph C.1.12 aims to bring actuarial work on an insurer's regulatory returns performed by the auditor's actuaries within scope as well.

#### **Pricing, product design and business planning**

- 2.28 Most respondents were against including pricing, product design and business planning work within the scope of the Insurance TAS. Most respondents' arguments supporting this view and our responses to them are described in paragraphs 2.15 to 2.22.
- 2.29 One respondent observed that often these types of work are iterative in nature and this would make it difficult to comply with the TASs without considerable replication of work and additional reports. However, we note that the concepts of component and aggregate reports introduced in TAS R enable the reporting of the results of iterations to be brief and straightforward.
- 2.30 We consider that pricing and business planning decisions are fundamental to the success of an insurer and the users making those decisions should be able to rely on the actuarial information provided to them to support those decisions. In particular, users should understand the uncertainty inherent in the information.
- 2.31 Several respondents pointed out that the actual pricing decision is a commercial one and should not be within scope. We agree: paragraph C.1.15 makes it clear that the decisions themselves are excluded.
- 2.32 One respondent argued that the work involved in business planning might include non-actuarial aspects, which would make compliance too onerous. We agree that business planning might involve a wide range of work and so paragraphs C.1.16 and C.1.17 limit the scope to the production of financial projections for an insurer's business planning and actuarial information produced for inclusion in management information used in business performance monitoring.

- 2.33 We realise that management information used in business performance monitoring might cover a wide range of matters, from the number of new policies underwritten in a period to an estimate of the margin of solvency. Much of this information might require no actuarial work. It has been pointed out that management information on the solvency of long-term insurers might be covered as it is one of the roles of the Actuarial Function Holder (AFH) to monitor and report on solvency. However, this is just part of the management information that might be prepared. Other information might include information on new business profitability or information on actual claims development against expected for general insurance business.
- 2.34 We consider that, where management information relies on actuarial work such as the results from models or the exercise of judgement in the selection of measures or assumptions, users will expect the information they are given to be relevant, comprehensible and sufficient. Users will also expect that it will contain appropriate information on risk and uncertainty. Users are then in the best position to make the appropriate decisions to manage their business successfully.

#### **Reinsurance to close for Lloyd's syndicates**

- 2.35 Most respondents were in support of including this work within the scope of the Insurance TAS.
- 2.36 We consider that actuarial information used to support the decision on the premium for reinsurance to close for a Lloyd's syndicate is relied upon in a similar way to information provided to support decisions about the amounts of technical provisions that are required.
- 2.37 One respondent believed that to include this would put an unfair burden on actuaries as they would have to be guardians of fair treatment of successive generations of capital providers. As with pricing and business planning decisions, the actual decision on the amount of the premium will not be included within the scope of the TAS.

#### **Asset-liability modelling and other investment work**

- 2.38 Respondents had differing views about the inclusion of asset-liability modelling in scope. The main objection to inclusion was that this work is often carried out, at least in part, by non-actuaries.
- 2.39 Some respondents suggested that asset-liability modelling should be included in scope only when it is used to support the assessment of regulatory capital requirements. As insurers are required by the FSA to assess the amount of regulatory capital they need, paragraph C.1.7 brings actuarial work supporting this assessment within the scope of the Insurance TAS. We consider that asset-liability modelling supporting the assessment of regulatory capital will therefore be within scope.
- 2.40 Similarly if the results of asset-liability modelling are used to determine technical provisions, to inform pricing decisions or in financial projections used in business planning then the asset-liability modelling will be within scope.

- 2.41 We consider that these cover the important uses of asset-liability modelling in insurance and are not therefore proposing to include other asset-liability modelling work within the scope of the TAS.
- 2.42 In the consultation paper we recognised that actuaries provide other investment related work for insurers including investment management, analysis and performance monitoring. Given that by no means all or even most such work is carried out by actuaries and it is not always clear what work is actuarial and what is not, we proposed not to include such investment work in the scope of the Insurance TAS. Respondents agreed with this decision.
- 2.43 It was suggested that the work of investment analysts of insurance stocks should be within scope given the reliance that owners or potential owners of these stocks might place on the analysis performed. We consider that, while some investment analysts may be actuaries, by no means all are and that information on the value and performance of insurers relevant to owners or potential owners is likely to extend beyond actuarial matters. For these reasons we do not propose to include this work within the scope of the Insurance TAS.

#### **Opining on underwriting policy and reinsurance arrangements**

- 2.44 Insurers will be required to obtain actuarial opinions on their overall underwriting policy and adequacy of reinsurance arrangements once the Solvency II directive comes into force. Under current regulation, a long-term insurer is required to have its AFH monitor the terms under which it writes new business. The AFH is required to inform management when those terms may be inadequate taking into account other available financial resources. This is Reserved Work. The requirement under the Solvency II directive extends this obligation.
- 2.45 Many respondents commented that any work related to providing these opinions should only be included within scope when it is required by regulation. However, as we have described above, aspects of this work are already Reserved Work and so will be within scope. Inclusion of work within scope does not mean that the work has to be done. It is only when the work is done that the principles in TASs D, M and R and the Insurance TAS will apply. The Solvency II directive exists and it is likely that its requirements will be implemented in the UK within the next few years. We therefore propose to include this work within scope.

#### **Insurance transformations**

- 2.46 In the consultation paper we proposed that work performed as an independent expert or for the use of an independent expert in transactions such as Part VII transfers, schemes of arrangement and estate reattributions should be within the scope of the Insurance TAS. We also issued a consultation paper on principles to be included in a Specific TAS on *Transformations* which might also cover this work. Most respondents agreed that this work should be within the scope of our TASs, but most felt that it should only be covered by one TAS. However, there was no general agreement on which TAS should cover the work. We propose that the Insurance TAS will apply to work performed in insurance transformations. Once we have considered the responses to the consultation on

*Transformations*, we shall decide whether to include additional principles in a separate Insurance and Pensions Transformations TAS or whether to include them in the Insurance TAS.

- 2.47 Some respondents observed that in many cases independent experts are users rather than providers of actuarial information. We disagree: the expert opinion is provided to users who might include the courts, the regulators and policyholders who then make decisions about the transformation based on it. We are therefore proposing that the work required to enable the opinion to be given should be within the scope of the TAS.
- 2.48 One respondent also observed that the insurers themselves might require work in support of transformations and suggested that the work should be included within scope. Long-term insurers undertaking transformations are required by regulation to obtain reports from their AFHs and, if they have one, their With-Profits Actuaries. This is Reserved Work and so will be within the scope of the Insurance TAS. However, we are also proposing that other work concerning transformations requested by insurers should be within scope.

### **Mergers and acquisitions**

- 2.49 In the consultation paper we proposed that work for any one of the parties involved in a merger or acquisition, commutation or capital raising exercise should be within the scope of the Insurance TAS. Most respondents were opposed to including this in scope. The arguments supporting this view and our responses to them are described in paragraphs 2.15 to 2.22.
- 2.50 Decisions related to mergers and acquisitions are often highly significant for the parties concerned, and actuarial information is usually an important contributor to an assessment of the value of the business being acquired. We understand that work often has to be completed in tight timescales and might rely on limited data and require use of approximate methods. It is essential then that the limitations of the work are clearly identified to the users and the uncertainty surrounding the information provided clearly conveyed.
- 2.51 We consider that it is likely that work supporting capital raising exercises, while still being subject to deadlines, will not be significantly constrained by time and lack of information. Actuarial information is likely to be important for both the issuer and the provider of capital.
- 2.52 It was suggested that reinsurance transactions should be excluded. However, reinsurance might be used to facilitate the sale or acquisition of a block of business or might be structured to increase an insurer's regulatory capital. We consider that whether a particular reinsurance transaction will be in scope will be a matter of judgement.
- 2.53 For these reasons we still propose that work for any one of the parties involved in a merger or acquisition, commutation or capital raising exercise should be within the scope of the Insurance TAS.

**Other items for scope**

- 2.54 It was suggested that the provision of a statement of actuarial opinion to a Lloyd's syndicate writing general business should be within the scope of the Insurance TAS. Lloyd's syndicates are required by regulation to obtain such an opinion and so it is Reserved Work (which we are already proposing to include within the scope).

## 3 PRINCIPLES

### INTRODUCTION

3.1 In this section we summarise the comments that we received in answer to the specific questions on the proposed principles that were posed in the consultation paper, and our reactions to them. As in section 2 we have included these questions in boxes with the same numbering as in the consultation paper. In brief, we are proposing that:

- most of the principles proposed in the consultation paper will be in the Insurance TAS, many of them in modified form;
- we are proposing not to include principles requiring explicit comparisons of discount rates with a benchmark or the quantification of any illiquidity premium component;
- we are proposing not to include a principle requiring the quantification of the level of prudence in technical provisions; and
- we are proposing not to include a principle concerning reverse stress testing.

3.2 Section 4 discusses the comments that we received that were not in answer to the specific questions that were posed in the consultation paper.

### DATA

**8 Do respondents have any comments on the proposals concerning data that are presented in section 5, especially those in paragraphs 5.18 and 5.20?**

#### Quality of data

3.3 Paragraphs 5.18 and 5.20 of the consultation paper proposed principles on improving the quality of data with a particular focus on its reliability for use as a predictor of the future.

3.4 Most respondents felt that the proposed principles were not specific to insurance and did not add anything to the principles in TASs D and M. We accept this view and we are not proposing to include any further principles on data quality which would be specific to work in insurance.

**9 Respondents are asked for their views on the actions, if any, that should be required to mitigate the effects of poor data, and in particular their views on the incorporation of margins in assumptions, and any effects that this or any other action might have on the transparency of assumptions and comprehensibility of the resulting actuarial information (paragraphs 5.19 to 5.23).**

3.5 Most respondents observed that the application of margins in assumptions to compensate for incomplete or inaccurate data is normal practice in many areas, in particular in work in long-term insurance. This issue was also raised in the feedback on the exposure draft of TAS D. TAS D requires the treatment of, or action taken for, incomplete or inaccurate data to be documented. This

allows adjustments to be made either to the data itself, the assumptions used in models or the results where data is incomplete or inaccurate. Any such adjustments need to be documented and their effects identified. Therefore, we consider that there is no need for additional principles in the Insurance TAS.

### Other principles on data

<b>10</b>	<b>Are there any other data issues which respondents believe should be covered by principles in the insurance TAS?</b>
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- 3.6 Two respondents suggested that principles be included concerning assumptions derived from sparse data or where the relationship between the assumption and the supporting data was hard to define. We consider that these are matters for judgement rather than principles. Paragraphs D.2.3 to D.2.5 address these issues.
- 3.7 Two other respondents suggested a principle on collecting a wide range of data in order to develop better models. While this may be good business practice we consider that it is not appropriate for a TAS.

### ASSUMPTIONS

<b>11</b>	<b>Do respondents have any comments on the proposals concerning assumptions that are presented in section 6, especially those in paragraphs 6.13, 6.16, 6.20, 6.22, 6.24, 6.39, 6.47, 6.57, 6.60, 6.68 and 6.79?</b>
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- 3.8 Many of the principles proposed relating to the selection of assumptions are the same as those proposed for inclusion in the Pensions TAS and the comments we have received have been very similar.

### Purpose of calculations

- 3.9 Paragraph 6.13 of the consultation paper proposed a principle that assumptions should take account of the purpose of the calculations for which they will be used. All respondents who commented on this principle supported its inclusion.

### Information used to set assumptions

- 3.10 Paragraph 6.16 of the consultation paper proposed a principle that assumptions should be justifiable from available data. A number of respondents pointed out that in some cases no data may be available and judgement will be therefore required. We agree that specific relevant and credible data may not always be available, or even exist, but our definition of data is a wide one. If judgement is used then we consider users will expect it to be based on informed opinion. If an assumption is purely a matter of speculation then it might be appropriate for it to be determined by the user. Paragraphs D.2.3 to D.2.5 address the point.
- 3.11 Paragraph 6.20 of the consultation paper proposed that assumptions should take account of any material events known to have occurred after the effective date of the data. Many respondents emphasised the need for clarity of the definition of the time period in which the material events had occurred and drew attention to issues such as post-reporting date events. We have decided not to include a specific principle on this matter, although paragraph

D.2.6 refers to the issue. TAS R requires that the reports disclose material changes or events.

### **Consistency of assumptions**

- 3.12 Paragraph 6.22 of the consultation paper proposed a principle requiring that, for work performed at regular intervals, assumptions should be changed only when justified by new data. Respondents put forward many circumstances where they believe it is appropriate to change assumptions without the need for new data, such as performing new analyses on existing data or identifying errors in previous analyses. We accept these arguments and are not proposing to include such a principle in the Insurance TAS.
- 3.13 We propose instead to include a principle requiring an explanation of the rationale for any changes and a quantification of the change in the results (paragraph D.3.1).

### **Compensating adjustments**

- 3.14 Paragraph 6.24 of the consultation paper proposed a principle that no adjustment should be made to one assumption to compensate for a shortcoming in another.
- 3.15 Respondents generally agreed with this proposal, although some were concerned that it would prevent the use of simple models in which a number of different factors which might have an influence on the outcome are represented by a single assumption. We consider that in this case there is no other assumption with a shortcoming that is being compensated for. TAS M requires the explanation of a model's limitations and their implications.

### **Illiquidity premium**

- 3.16 Paragraph 6.39 of the consultation paper proposed that any illiquidity premium included in a discount rate should be disclosed and the rationale for its selection explained. This proposal was commented on by many respondents. Some argued that there is not always an explicit allowance for an illiquidity premium, while others felt that this was just a current "hot topic" and did not merit special treatment.
- 3.17 A more popular view was that a rationale should be provided for how a discount rate as a whole has been derived. We agree: paragraph D.2.10 addresses the point.

### **Assumptions on claims**

- 3.18 Paragraph 6.47 of the consultation paper proposed that separate assumptions should be selected for current rates of mortality and for future changes to mortality rates. There was general support for this proposal, although some respondents argued there may be some current models in which this would be impossible, and others thought that there would be little gain from separate explicit assumptions.
- 3.19 It was also pointed out that the same principle applies to other areas of insurance in addition to mortality. We agree: paragraph D.2.13 addresses the point.

**Policyholder decisions**

- 3.20 Paragraphs 6.51 to 6.53 of the consultation paper considered policyholder decisions and concluded that we proposed not to include additional principles for assumptions concerning policyholder decisions as we considered that the principles in TAS R were sufficient. It has been suggested that we reconsider this decision particularly considering possible changes in policyholder behaviour that might materialise in stressed conditions.
- 3.21 TAS M requires that assumptions used in models should be consistent and provides an example which considers consistency of assumptions when considering a different scenario. We consider it would be consistent to assume different policyholder behaviours in scenarios in which policyholder options are in or out of the money.
- 3.22 We are proposing that assumptions about claim rates should be split between assumptions for base claim rates and for future changes to those rates (paragraph D.2.13). TAS R requires that aggregate reports describe the rationale for material assumptions. In most work in insurance, assumptions about claim rates are likely to be material. One rationale for assuming a change in base claim rates for future claims is a change in other factors in future periods. For example it is often the case that claims experience on personal lines general insurance business deteriorates in adverse economic conditions.
- 3.23 We are also proposing to include a principle for work that includes stressed scenarios which also uses assumptions about co-dependencies of risks to indicate the relationship between co-dependencies (paragraph D.2.21). Although it might be reasonable to assume that claim rates are independent of changes in other assumptions in normal conditions, in stressed scenarios the assumption of independence might need to change.
- 3.24 For the above reasons, we confirm our original proposal not to include specific principles concerning policyholder decisions in the Insurance TAS.

**Management discretion**

- 3.25 Paragraph 6.57 of the consultation paper proposed that assumptions about management discretion should take account of past experience and information about the insurer's intentions, particularly in stressed conditions. This proposal was supported by most respondents, who felt that future intentions should be the main focus, and that the view of the body with the power to determine future practice should be part of the information sought.
- 3.26 Some respondents pointed out that this principle applies only to long-term insurance. We agree: the point is addressed in paragraph E.2.1, which applies only to long-term insurance.

**Running costs**

- 3.27 Paragraph 6.60 of the consultation paper proposed a principle requiring the provision of a rationale for any material change in running costs and the disclosure of the impact on results of the change. Only a few respondents commented on this proposal: most of them were concerned about the treatment of inflation.

- 3.28 The consultation paper noted that running costs include the costs of marketing and sales, administration and investment management. Assumptions about running costs are significant in calculating insurance liabilities and assessing profitability. We are concerned that there is a natural bias to be optimistic about the ability of insurers to achieve reductions in running costs through greater efficiency. TAS R requires aggregate reports to describe the rationale for material assumptions. Paragraph D.2.19 extends this requirement in the case of running costs.

### **Extreme events**

- 3.29 Paragraph 6.68 of the consultation paper proposed a principle requiring explicit allowance to be made for extreme events in estimating liabilities and their variability. There was a generally favourable response to this proposal although a number of respondents suggested that it would not be appropriate in all circumstances. Some respondents observed that it is currently not usual to include such an allowance in technical provisions but recognised that it would be included in work supporting capital assessment. A number commented that they would be happy with the proposal if it was explicitly stated that the allowance could be nil.
- 3.30 Solvency II will require technical provisions to be based on a probability weighted mean of possible outcomes which will therefore include outcomes which include extreme events. The assessment of regulatory capital will require consideration of the impact of extreme events. In addition, work on pricing and producing financial projections might require consideration of the impact of extreme events.
- 3.31 We therefore consider that assumptions should allow explicitly for potential extreme events whenever assumptions about claims are required. Paragraphs D.2.16 to D.2.18 address the point.

### **Co-dependencies of risks**

- 3.32 Paragraph 6.79 of the consultation paper proposed a principle that an explicit allowance should be made for changes in the co-dependencies of risks in scenarios of high stress compared with those of low stress.
- 3.33 Many respondents expressed concern over their ability to determine how co-dependencies change in high stress scenarios. We accept this, and paragraph D.2.21 requires only that an indication of the relationship between the co-dependencies used in stressed scenarios and those in other scenarios is provided.

### **Other allowances in assumptions**

- |    |  |
|----|--|
| 12 | Do respondents have any views on whether the insurance TAS should include principles addressing: a) the allowance that should be made for cycle effects in the selection of assumptions? (paragraph 6.17); b) assumptions concerning latent claims? (paragraphs 6.61 to 6.63); c) prudential margins in assumptions used to determine insurance liabilities? (paragraphs 6.71 to 6.74); d) the communication of limitations and uncertainties in the modelling of co-dependencies? (paragraphs 6.75 to 6.78) |
|----|--|

- 3.34 There were differing views on the inclusion of an allowance for the insurance and reserving cycle. Some respondents challenged whether or not adjusting assumptions was simply a means of maintaining the cycle. One respondent believed all assumptions should be ‘cleansed’ and set on a basis which excluded any cycle effects. A popular view was that although the cycle had a strong presence in published figures it was less relevant for much other work, and that a specific principle was not required. We agree.
- 3.35 Similarly, many respondents felt that a specific principle concerning latent claims was not required. We agree, because we consider that the principle requiring claims assumptions to allow explicitly for potential events with a significant financial impact also includes the possibility of latent claims as well as catastrophe type events (see paragraphs D.2.16 to D.2.18).
- 3.36 Respondents generally supported the proposal that any prudence that is included in assumptions should be disclosed, but thought that the Insurance TAS should not prescribe any appropriate level. We agree and, while paragraph D.4.1 requires an explanation of the relationship between any prudent estimate of technical provisions and a neutral estimate of those provisions, we do not propose to include a principle on the level of prudence that should be allowed for.
- 3.37 Few respondents commented on the communication of limitations and uncertainties in modelling co-dependencies. The proposed text contains no principle explicitly addressing this issue.

#### **Assumptions that cannot be linked to models**

<b>13</b>	<b>Are respondents aware of any assumption sets used in actuarial work in insurance that cannot be linked to an underlying model? (paragraph 6.21)</b>
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- 3.38 Respondents suggested only one such assumption: the relative weighting given to the results of different models used for the same purpose. We consider that the combination of the results of a number of different models is itself a model. The principles relating to assumptions in TASs M and R will apply to the assumption about the relative weightings to be attached to the results from the base models.
- 3.39 One respondent felt that the consistency of assumptions with each other was not adequately covered in the TAS M and should be specifically mentioned in the Insurance TAS. We disagree: we consider that the principle on consistency in TAS M is sufficient.

#### **Discount rate comparator**

<b>14</b>	<b>Respondents are asked for their views on whether a standard comparator rate for discount rates would assist users’ understanding, and if so whether low risk rate should be used. (paragraphs 6.25 to 6.33)?</b>
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- 3.40 Few respondents supported the proposal for the yield on low risk assets to be presented alongside discount rates. Some pointed out the difficulties in defining the yield on a low risk asset while others felt that other information would better help users understand the derivation of discount rates and the risks of adopting those rates.

- 3.41 We agree that other information might be more helpful to users. The principle in paragraph D.2.10 lists what we consider is required.

### **Morbidity modelling**

**15 Respondents are asked for their views on the practicality of the principle concerning morbidity assumptions proposed in paragraph 6.49, and in particular whether there are any types of health insurance where its application would require disproportionate work to be performed. They are asked to explain how the use of simpler models would support the achievement of the Reliability Objective.**

- 3.42 Those respondents who commented on this issue generally felt that the proposal in paragraph 6.49 of the consultation paper would be disproportionate. Several gave examples of cases in which a Manchester Unity type approach to morbidity is used and for which it is appropriate.
- 3.43 We agree that there are some circumstances in which using a simpler model can be justified, but consider that even in those cases an approach which separately models incidence and recovery has advantages.
- 3.44 One respondent suggested that separate modelling of claims frequencies and severities should be encouraged more widely across insurance. Many actuaries working in general insurance have been modelling claims in this way for many years. We support this approach but appreciate that it may not always be proportionate. Paragraph D.3.4 addresses the point by requiring documentation of models used to project claim payments to contain suitable explanations of the treatment of claim frequencies and severities. It applies, inter alia, to morbidity modelling.

### **Other principles on assumptions**

**16 Are there any other principles on the selection of assumptions which respondents believe should be in the insurance TAS?**

- 3.45 One respondent suggested that if assumptions about policyholder behaviour are material then those assumptions should be consistent with economic assumptions and take account of policyholders' interests.
- 3.46 Paragraph D.2.13 requires separate assumptions for base claim rates and future changes to those rates. A possible cause of future changes to claim rates is a change in policyholder behaviour, which in turn could well be linked to economic conditions, particularly in stressed scenarios. TAS M requires that assumptions are consistent – we consider that taken together these principles are sufficient.

### **MODELS AND CALCULATIONS**

**17 Do respondents have any comments on the proposals concerning models and calculations that are presented in section 7, especially those in paragraphs 7.10, 7.18 and 7.23?**

### **Liquidity**

- 3.47 Paragraph 7.10 of the consultation paper proposed a principle that reports on capital assessment should discuss the liquidity risk including any

mismatching of incoming and outgoing cash flows taking account of the volatility in claims experience. All those who responded to this proposal expressed general agreement. The principle appears in paragraph D.4.6.

### **Risk and uncertainty**

- 3.48 Paragraph 7.18 of the consultation paper proposed that alternative assumptions should be applied to help evaluate the uncertainty of results.
- 3.49 Paragraph 7.23 of the consultation paper proposed a principle requiring that information on the risks being run by an insurer should include scenarios under which the ability of the firm to meet its obligations to policyholders in full would be impaired.
- 3.50 All the respondents who commented on these proposals agreed that the use of alternative assumptions or scenarios was an effective method of communicating uncertainty. However, there was some concern over the requirement to develop a specific scenario in which policyholder obligations were impaired. We consider that an effective way of enabling users to understand the effect of uncertainty is to provide them with scenarios which are likely to have a material impact on results. Paragraphs D.4.4 to D.4.5 addresses the points that were raised.

### **Other principles on models and calculations**

<b>18</b>	<b>Do respondents have any views on whether the insurance TAS should include principles addressing the treatment of: a) earned and unearned business? (paragraphs 7.24 to 7.26); b) large claims? (paragraphs 7.27 to 7.29); c) currency issues? (paragraphs 7.30 to 7.32)</b>
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- 3.51 Most respondents saw little need for principles to cover models and calculations in these areas and the few that expressed a more positive view did not propose any particular principle that they felt might be required.
- 3.52 We consider that the principles contained in TASs M and R are sufficient to address these issues and therefore propose not to include additional principles in the Insurance TAS.

<b>19</b>	<b>Are there any other principles on the selection of models and calculations which respondents believe should be in the insurance TAS?</b>
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- 3.53 One respondent commented that reinsurance should also be covered when considering liquidity. We consider that reinsurance recoveries, and their uncertainty, are one of the income items that should be included in any assessment of the mismatch between income and outgo which is covered by the principle in paragraph D. 4.6.

### **REPORTING**

<b>20</b>	<b>Do respondents have any comments on the proposals concerning reporting that are presented in section 8, especially those in paragraphs 8.10 and 8.19?</b>
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### **Monitoring assumptions against experience**

- 3.54 Paragraph 8.10 of the consultation paper proposed a principle requiring the comparison of emerging experience of with previous assumptions when selecting new assumptions for work performed regularly. Some respondents

felt that this principle was more concerned with assumptions than with reporting. Others thought that such information would often be immaterial, and that its inclusion might obscure more important information.

- 3.55 TAS R requires that an aggregate report include a comparison with an aggregate report which has previously been provided for a similar purpose. The comparison should cover assumptions and other matters. The TAS also requires a rationale for all material assumptions. We are also proposing in the Insurance TAS that assumptions used in insurance work shall be based on relevant information (paragraph D.2.2). Taken together we consider that these principles will be sufficient, and are not therefore proposing a principle that explicitly addresses emerging experience.

### **Best estimates and prudent estimates**

- 3.56 Paragraph 8.19 of the consultation paper proposed a principle that any prudent estimate of technical provisions should be accompanied by a best estimate. The change in the level of prudence from that in the previous assessment should be explained to users.
- 3.57 Few respondents supported the proposal: many, including most of the practitioners who responded, were strongly against it. Some responses, while broadly supporting the objective of ensuring that insurers have a clear understanding of the degree of prudence, had significant concerns about the details of the principle. The most common argument was that the calculation of a second estimate would result in considerable additional costs.
- 3.58 Some practitioners cast doubts on the practicality of the proposal, arguing that in many cases there is no single “best estimate”. We have noted this concern. Our proposed principle uses the term “neutral estimate”. This terminology is consistent with that used in TAS M. The definition of “neutral” in Part B of the proposed text makes it clear that there is not necessarily only a single possible neutral estimate.
- 3.59 Another concern was that providing another estimate alongside a prudent estimate would not always help the insurer, and that in some cases it would reduce clarity. In particular, some respondents argued that it would not assist the clear communication of risk and uncertainty. We agree that a neutral estimate presented in isolation might be of little use.
- 3.60 Despite these arguments we consider that it is important that users have an understanding of the prudence contained in technical provisions. When the Solvency II Directive is brought into force insurers will have to calculate the technical provisions as the sum of a best estimate and a risk margin so that this is a short term issue. For this reason, Paragraph D.4.1 just requires that users are provided with an explanation of the relationship between any prudent estimate and a neutral estimate of the technical provisions. The explanation need not require a detailed calculation requiring considerable additional work and costs to users.

**21 Do respondents have any views on whether the insurance TAS should include principles addressing: a) the contents of the With-Profits Actuary's report to policyholders? (paragraphs 8.20 to 8.21); b) the information that might be useful to the management of insurers in judging the fairness of surrender value scales? (paragraphs 8.22 to 8.24)**

**With-profits business**

- 3.61 In the consultation paper we suggested that the With-Profits Actuary should report to policyholders on the financial impact of the exercise of discretion by the insurer. All respondents on this point said that this was a matter for the regulator and not for actuarial standards. Some respondents suggested our proposals would be expensive to implement and of little value.
- 3.62 In certain long-term insurance contracts including with-profits contracts and some unit linked contracts, insurers have discretion over the addition of benefits as profits emerge or the level of charges for benefits or expenses. Actuaries have a role in advising insurers on the exercise of this discretion. Thus it is appropriate for the BAS to set technical standards in this area.
- 3.63 In paragraph E.3.1 we propose that reports on the exercise of discretion indicate the effect on policyholders. In paragraph E.3.4 we propose that the With-Profits Actuary documents the work performed which enables them to conclude that policyholders' information needs have been met by the annual report that insurers are required to provide explaining how discretion has been exercised.

**Surrender value scales**

- 3.64 Most respondents did not feel it was appropriate to include principles on surrender values. Surrender value scales are part of the commercial relationship between the insurer and its policyholders and we agree with respondents that decisions about them should not be subject to technical standards. To the extent that the insurer has discretion about the level of surrender values and uses actuarial information to support the use of its discretion the principle in paragraph E.3.1 will apply.

**22 Are there any other principles on reporting which respondents believe should be in the insurance TAS?**

- 3.65 Respondents suggested two further principles for inclusion in the Insurance TAS: a requirement for cross checks to be included in work to ensure the accuracy of results, and one for work to be completed in a timely manner so that it is relevant to the decisions to be made. We consider that the principles included in the TASs M and R cover these issues sufficiently and are proposing not to include explicit principles in the Insurance TAS.

## 4 GENERAL COMMENTS AND FURTHER PROPOSALS

### INTRODUCTION

- 4.1 In addition to the comments in answer to the specific questions posed in our consultation paper, we received a number of more general comments. Some of the comments which we have received on other consultations or in other contexts are also relevant to the development of the Insurance TAS.

### COMMON PRINCIPLES IN TECHNICAL ACTUARIAL STANDARDS

- 4.2 Several respondents commented that some of the principles proposed in the consultation paper could apply equally to other areas of work including pensions and therefore should be in a Generic TAS. We intend to review the structure of the standards when they become effective. It is possible that we will modify the structure of the standards and move principles which are common to more than one Specific TAS (such as those on assumptions) to one of the Generic TASs.
- 4.3 However, it is not necessarily the case that a principle that is capable of being applied to other areas of actuarial work should be so applied. It is possible that a principle that is proportionate in one field of work would be disproportionate in another. The Generic TASs apply to a broad range of actuarial work, and even principles that are both applicable and proportionate to work in insurance and pensions might be inapplicable or disproportionate for work in other areas. The appearance of a principle in more than one Specific TAS does not therefore imply that it should be in a Generic TAS.

### MATERIALITY AND PROPORTIONALITY

- 4.4 Some practitioners expressed their concern about the definition of materiality proposed for the insurance and other TASs. We have noted these concerns and in November 2009 we amended the definition of materiality in our *Scope & Authority* and in TAS R. We have used this amended definition in subsequent exposure drafts and TASs.
- 4.5 In brief, our definition now makes it clear that the judgement of materiality must take place within the context in which the work is performed and reported. The context includes the time at which the activities take place, so there is no element of hindsight, but does not limit it to either the time at which the work is performed or the time at which it is reported (which are not always the same). The definition also introduces an element of reasonableness into the judgement. It remains close to that used in international accounting standards.
- 4.6 There is some concern among insurance practitioners about the impact of the TASs on smaller pieces of work. Some have suggested that compliance could result in longer reports and additional costs to insurers.
- 4.7 We consider not only that actuaries (and others complying with BAS standards) should not act disproportionately, but that they should not use

BAS standards as an excuse for doing so. We consider that the best way of ensuring this is to explain that our standards should not be interpreted disproportionately (paragraph B.1.3). Practitioners will need to use their judgement to determine what approach they use to comply with each requirement of the TASs, bearing in mind the particular circumstances of the case. Most of the requirements in our TASs are expressed in terms of indications, explanations and similar terms in order to allow scope for such judgements.

- 4.8 Many practitioners recognise that our TASs should not necessarily result in longer reports being produced for smaller pieces of work but some are concerned that additional costs will arise from demonstrating compliance. We do not set any requirements for the documentation practitioners may wish to keep in order to demonstrate compliance. It is up to those who carry out work complying with our standards to determine what documentation they produce and they will no doubt consider it in the context of their existing quality control and peer review frameworks.

#### **DEFINITION OF ACTUARIAL INFORMATION**

- 4.9 Some practitioners have asked us to clarify the definition of actuarial information which is used within our standards and our *Scope & Authority*. We do not intend to define actuarial information. We consider that most actuaries and users of actuarial information know what actuarial information is when it is encountered. Part C of the proposed text includes more detailed descriptions of the work which will be within the scope of the Insurance TAS, which should help practitioners decide whether work will be within scope or not. However, it is not possible to cover all possible aspects of actuarial work and whether work is within scope will on occasion be a matter of judgement.

#### **COMMENCEMENT OF THE INSURANCE TAS**

- 4.10 We are proposing that the Insurance TAS should apply to work within its scope performed for aggregate reports completed on or after 1 April 2011. This means that it will apply to aggregate reports completed on or after 1 April 2011 and to data and models used in the preparation of aggregate reports completed on or after 1 April 2011.
- 4.11 As we intend to issue the TAS during the autumn of 2010 we consider that practitioners will have sufficient time to ensure they can comply with the standard, especially as they will have become familiar with the application of the Generic Standards.
- 4.12 We would be interested in respondents' views on the practicality of the proposed commencement date. If respondents are in favour of a later commencement date they should explain how the needs of users will be met.

## 5 TRANSITION FROM ADOPTED GUIDANCE NOTES

### INTRODUCTION

- 5.1 Our intention is that the adopted guidance notes (GNs) dealing with insurance will cease to apply when the Insurance TAS becomes effective. The consultation paper asked three questions about guidance in general and about the GNs: the responses are summarised below.

### GUIDANCE AND DETAILED RULES

**23 Do respondents believe that the insurance TAS should provide guidance on the interpretation of regulations affecting insurers or more detailed rules on the selection of assumptions and methods in order to comply with regulations? They should support their arguments by explaining how guidance or more detailed rules would assist the achievement of our Reliability Objective (paragraph 9.2).**

- 5.2 The responses to this question were mixed. A number of respondents felt that additional guidance would assist practitioners and would help to ensure that consistent approaches were adopted. Several suggested that we should give examples of possible ways of complying with the principles in the TASs.
- 5.3 Other respondents suggested that prescribing assumptions and methods conflicted with the concept of a principles-based approach and suggested that detailed guidance was not necessary. We accept this view and intend not to be prescriptive in the choice of measures, methods or assumptions.
- 5.4 We have included examples of what is required in order to comply with the TAS for many of the proposed principles.

### TRANSITION FROM ADOPTED GNS

**24 Do respondents have any comments on the proposed transitional arrangements from the adopted GNs to TASs described in section 9?**

- 5.5 Many respondents expressed concern about the withdrawal of the adopted GNs. They felt that the GNs contain much useful information and that many practitioners rely heavily on them. Life insurance practitioners were particularly concerned about the withdrawal of GNs 44 to 46 which cover capital assessment work.
- 5.6 However, there was also general agreement that it was not our role to provide assistance to practitioners or to interpret regulation, coupled with a concern that no other body would provide such guidance, particularly if it was intended to be mandatory.
- 5.7 Although we intend to withdraw the GNs their text will (as a past version of a GN) remain available.

**25 Do respondents have any views on whether matters which could be construed as technical or ethical such as those mentioned in paragraphs 9.39 and 9.44 should be included in the insurance TAS?**

5.8 There was a strong view that only technical matters should be included in TAS. However there was much disagreement on which matters were ethical, which technical and which a combination of each. We do not intend to cover matters which are ethical within the Insurance TAS.

## 6 IMPACT ASSESSMENT

### INTRODUCTION

6.1 In this section we consider the impact of the introduction of the Insurance TAS, identifying benefits to users and costs of compliance and transition.

### SUMMARY

6.2 There are 972 insurers in the UK with premium income in 2008 exceeding £160 billion and assets of almost £1,500 billion<sup>6</sup>. Actuarial input into these insurers is substantial, with over 5,000 members of the UK Actuarial Profession indicating that their primary work lies in the UK insurance sector<sup>7</sup>.

6.3 We have considered the ongoing costs of compliance with our TASs in insurance work, and have concluded that there might be a small increase in the work that actuaries perform. However, we consider that the increase will not be significant or have a material effect on the costs of actuarial work to insurers, their shareholders or policyholders. In coming to this view we assume that practitioners apply reasonable judgement, especially on materiality and proportionality.

6.4 We expect that there will be a one-off cost in making the transition to the TASs. This is primarily related to the time that will be required to ensure that existing actuarial models are compliant with the Generic TAS on *Modelling*. Rather than additional expense being incurred by insurers as a result of employing additional actuarial resources we expect that the impact will be absorbed by delaying work on other projects. We recognise that this is an opportunity cost.

6.5 We consider that the benefits outlined below justify any additional costs.

### BENEFITS

6.6 The Insurance TAS will bring a wide range of work within the scope of the Generic TASs. We have set out the benefits to users of the Generic TASs in the papers analysing the responses to previous consultations. In insurance work we consider that the Insurance TAS in conjunction with the Generic TASs will result in:

- better communication of risk and uncertainty enabling management and governing bodies of insurers to make more informed decisions;
- better understanding of the rationale underlying the selection of assumptions including claim rates and discount rates;
- greater discussion about the differences between neutral estimates and prudent estimates;
- greater focus on cash flows; and

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<sup>6</sup> UK Insurance Facts (ABI September 2009).

<sup>7</sup> Actuarial Profession membership statistics.

- greater focus on users' needs.

6.7 Practitioners are already reviewing their processes in light of the new standards and we consider that these reviews will also be of benefit to users.

### **ONGOING COSTS**

6.8 We consider that the TASs will not result in any significant additional time being spent on work related to the determination of technical provisions and the assessment of regulatory capital.

6.9 The TASs are likely to result in some additional time being required for other work. As the work on many larger exercises probably already complies with many of the principles in the TASs, we consider that there will be few additional costs measured by the additional time required to complete these larger exercises.

6.10 The additional costs of compliance measured by time required to complete the work are likely to be more significant in percentage terms for smaller exercises. Our TASs do not require disproportionate work. For smaller pieces of work they will not require much additional material to be provided. However, practitioners who wish to ensure that they can demonstrate compliance with the standards may therefore choose to document a number of the decisions they make, especially those concerning materiality and proportionality. The additional time taken to prepare this documentation will depend on the processes adopted and the detail and nature of the documentation produced.

6.11 There are some areas of work for which short reports are prepared quickly and at low cost, for example in M&A related activity or in some pricing work. This work enables a user to make a quick decision. It is possible that for such exercises compliance with the standards will result in more work being carried out requiring a brief extension of the time taken. However, this will by no means always be the case. Moreover, if the decisions to be made are important we consider that the information used should be of high quality, and in particular that users should understand any limitations in it. In these cases we consider that any additional costs will be justified.

### **TRANSITIONAL COSTS**

6.12 Transitional costs include those of training, establishing compliance processes, reviewing and documenting models and reviewing reporting needs. Practitioners and insurers will have to invest time in these areas. Insurers and actuarial firms already invest in the professional training of their staff and in reviewing processes and reports on an ongoing basis to reflect changes in the business environment in which they operate. We believe that any transitional costs in these areas might be absorbed within existing budgets.

6.13 Feedback that we received from practitioners while we were developing TAS M indicates that they are planning to expend some effort on ensuring that existing actuarial models comply with the standards likely to be required. The amount of time will vary between insurers depending on the number, age and complexity of the actuarial models that are used. We expect that the models used to determine technical provisions, to assess regulatory capital

and to determine the in force value of material blocks of life insurance business will already be compliant as they are likely to have been developed recently or to have been subject to independent scrutiny. Other older or simpler models may require additional work to ensure that documentation and checks are compliant with the standards required. However, we would expect practitioners to exercise their judgement with regard to materiality and proportionality to limit the time spent and consequent costs.

- 6.14 The work required to ensure compliance is likely to mean that resources will be diverted from other projects for which completion dates can be deferred. We recognise that this is an opportunity cost. However, we believe that this cost is likely to be small in terms of the overall costs incurred by insurers on actuarial work each year.

## 7 INVITATION TO COMMENT

### QUESTIONS

- 7.1 The BAS invites the views of those stakeholders and other parties interested in actuarial information who wish to comment on the content of this document. In particular the BAS would welcome views on the following issues:
- 1 the proposed commencement date of the Insurance TAS (paragraphs 4.10 to 4.12);
  - 2 our impact assessment and the effects that the introduction of the Insurance TAS is likely to have on actuarial information (see section 6);
  - 3 the text of the exposure draft as a means of implementing the proposals presented in this document.
- 7.2 In addition to the specific questions listed above, the BAS invites respondents' views on any other aspects of the proposed TAS. To ensure that the significance of their point is fully appreciated by the BAS, respondents are asked to indicate how their comments would address the BAS's aim of increasing the reliance that users of actuarial information can place on it.

### RESPONSES

- 7.3 For ease of handling, we prefer comments to be sent electronically to [basinsurance@frc.org.uk](mailto:basinsurance@frc.org.uk). Comments may also be sent in hard copy form to:
- The Director  
Board for Actuarial Standards  
5<sup>th</sup> Floor, Aldwych House  
71-91 Aldwych  
London  
WC2B 4HN
- 7.4 Comments should reach the FRC by **16 July 2010**.
- 7.5 All responses will be regarded as being on the public record unless confidentiality is expressly requested by the respondent. A standard confidentiality statement in an e-mail message will not be regarded as a request for non disclosure. We do not edit personal information (such as telephone numbers or email addresses) from submissions; therefore only information that you wish to publish should be submitted. If you are sending a confidential response by e-mail, please include the word "confidential" in the subject line of your e-mail.
- 7.6 We aim to publish non confidential responses on our web site within ten working days of receipt. We will publish a summary of the consultation responses, either as a separate document or as part of, or alongside, any decision.

EXPOSURE DRAFT OF  
INSURANCE TECHNICAL ACTUARIAL STANDARD

# INSURANCE TAS

**Status**

This standard (the Insurance TAS) is a Specific Technical Actuarial Standard (Specific TAS), as defined in the *Scope & Authority of Technical Standards (Scope & Authority)* of the Board for Actuarial Standards (BAS).

This standard should be read in the context of the *Scope & Authority*.

The *Scope & Authority* sets out circumstances in which material departures from this standard are permitted or required and the disclosures which are required in respect of them.

**Scope**

This standard applies to the work specified in Part C of the standard.

Wider adoption is encouraged.

**Commencement**

This standard applies to work performed for aggregate reports completed on or after 1 April 2011.

Earlier adoption is encouraged.

**Relationship with other TASs and with Guidance Notes**

This standard sets out principles to be adopted across the range of work to which it applies, as described above. Other Generic and Specific TASs may apply to work that is within the scope of this standard, setting out additional principles that should be adopted.

In the event of a conflict between this standard and a Guidance Note adopted by the BAS (as described in the *Scope & Authority*), this standard shall prevail.

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## A PURPOSE OF THE INSURANCE TAS

### A.1 PURPOSE

A.1.1 The BAS's Reliability Objective is that the **users**<sup>1</sup> for whom a piece of actuarial information was created 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.

A.1.2 The purpose of this standard is to assist the achievement of the Reliability Objective by ensuring that in the performance of work within its scope:

- information provided to managers and the governing body of an **insurer** is relevant, comprehensible and sufficient to support decisions about the business and includes information on risk and uncertainty and, if those decisions affect policyholders' benefits, on the implications for policyholders;
- information provided to policyholders is relevant, comprehensible and sufficient for its purpose; and
- calculations are carried out using **methods** and assumptions which are fit for purpose and are performed without mistakes and, if they include the projection of cash flows, the key issues that affect the cash flows' variability or discounted value are taken into account and given the appropriate weight.

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<sup>1</sup> Terms appearing in **bold** in the text are explained in the Definitions set out in Part B.

## B INTERPRETATION

### B.1 INTERPRETATION OF THE TEXT

- B.1.1 All text in this standard has equal status unless stated otherwise. Paragraphs setting out explicit principles are emphasised with boxes for convenience.
- B.1.2 The **Scope & Authority**<sup>2</sup> states that a failure to follow the principles in this standard need not be considered a departure if it does not have a **material** effect. The contents of this standard should be read in that context, even where the term **material** is not explicitly used or where the word “shall” is used.
- B.1.3 Nothing in this standard should be interpreted as requiring work to be performed that is not proportionate to the scope of the decision or assignment to which it relates and the benefit that **users** would be expected to obtain from the work.
- B.1.4 The form that is taken by any explanations, rationales, descriptions, indications or other analyses required by this standard will need to depend on the scope of the work being performed and the benefit to the **users**. The level of detail required is a matter for judgement. Unless stated otherwise, analyses may be quantitative or qualitative.
- B.1.5 Lists of examples are not intended to be exhaustive.
- B.1.6 This standard should be interpreted in the light of the purpose set out in Part A.

### B.2 DEFINITIONS

- B.2.1 Terms appearing in **bold** in the text are used with the meanings set out below. Some of the definitions are taken from the **Scope & Authority**. The definitions are used consistently in the **Scope & Authority** and other BAS standards.

**aggregate report** The set of all **component reports** relating to a piece of work within the scope of this standard. The **aggregate report** for a decision taken by a **user** in connection with work within the scope of this standard is the set of all **component reports** received by the **user** containing information **material** to that decision.

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<sup>2</sup> Paragraph 23 of the **Scope & Authority**.

<b>component report</b>	A document given to a <b>user</b> in permanent form containing <b>material</b> information which relates to work within the scope of this standard. A <b>component report</b> may be given to the <b>user</b> in hard copy or electronically. Formal written reports, draft reports, emails and presentations are examples of <b>component reports</b> . Possible contents of <b>component reports</b> include tables, charts and other diagrammatic presentations as well as or instead of text. A <b>component report</b> may form part of one or more <b>aggregate reports</b> .
<b>data</b>	Facts or information usually collected from records or from experience or observation. Examples include membership or policyholder data, claims data, asset and investment data, operating data (such as administrative or running costs), benefit definitions and policy terms and conditions.
<b>to document</b>	To record in <b>documentation</b> .
<b>documentation</b>	Records of facts, opinions, explanations of judgements and other matters. <b>Documentation</b> may be paper or electronic based. It is not necessarily provided to <b>users</b> . <b>Documentation</b> is <b>material</b> if it concerns a <b>material</b> matter.
<b>Generic TAS</b>	A Technical Actuarial Standard which applies to all work specified in the Schedule to the <b>Scope &amp; Authority</b> .
<b>implementation</b>	The formulae and algorithms of a <b>model</b> in a form that will perform the calculations required by the <b>specification</b> .  In many cases an <b>implementation</b> is a computer program, but other types of <b>implementation</b> are possible – for instance, manual calculations are often used for simple <b>models</b> .
<b>insurance transformation</b>	A change in the contract terms of a portfolio of insurance contracts or a change in the Principles of Financial Management according to which with-profits business is conducted without all the policyholders' consents.
<b>insurer</b>	A body effecting or carrying out contracts of insurance.
<b>material</b>	Matters are <b>material</b> if they could, individually or collectively, influence the decisions to be taken by <b>users</b> of the related actuarial information. Assessing <b>materiality</b> is a matter of reasonable judgement which requires consideration of the <b>users</b> and the context in which the work is performed and reported.
<b>measure</b>	The approach that is used to define how an (uncertain) asset or liability amount is quantified. Two different <b>measures</b> of the same asset or liability may produce different results.
<b>method</b>	The mechanism that is used to quantify an (uncertain) asset or liability amount. Two different <b>methods</b> of calculating the same asset or liability <b>measure</b> should produce similar results.

<b>model</b>	<p>A representation of some aspect of the world which is based on simplifying assumptions.</p> <p>A <b>model</b> is defined by a <b>specification</b> that describes the matters that should be represented and the inputs and the relationships between them, implemented through a set of mathematical formulae and algorithms, and realised by using an <b>implementation</b> to produce a set of outputs from inputs in the form of <b>data</b> and parameters.</p>
<b>neutral</b>	<p>A <b>neutral measure</b>, assumption or judgement is one that is not deliberately either optimistic or pessimistic and does not incorporate any adjustments to reflect the desired outcome. A <b>neutral</b> estimate is one that is derived using <b>neutral measures</b>, assumptions and judgements. There may be a range of <b>neutral</b> estimates, reflecting inherent uncertainty.</p>
<b>report</b>	<p>An <b>aggregate report</b> or a <b>component report</b>.</p>
<b>Scope &amp; Authority</b>	<p>The BAS's <i>Scope &amp; Authority of Technical Actuarial Standards</i>.</p>
<b>Specific TAS</b>	<p>A Technical Actuarial Standard that is not designated by the BAS as a <b>Generic TAS</b>. A <b>Specific TAS</b> is limited to a specific, defined context.</p>
<b>specification</b>	<p>A description of a <b>model</b> that describes the matters to be represented, the inputs and their interactions with each other, and the outputs to be processed.</p>
<b>users</b>	<p>Those people whose decisions a <b>report</b> is intended (at the time of writing) to assist. Those to whom the <b>report</b> is addressed, regulators and third parties for whose benefit a <b>report</b> is written are examples of possible <b>users</b>.</p>

## C SCOPE

### C.1 WORK WITHIN THE SCOPE OF THIS STANDARD

C.1.1 Work that is within the scope of this standard may also be within the scope of other BAS standards. In particular, the **Generic TASs**, including those on *Reporting Actuarial Information, Data and Modelling*, apply to all such work.

C.1.2 This standard shall apply to all Reserved Work concerning insurance business.

C.1.3 Reserved Work is defined in the **Scope & Authority**.

C.1.4 This standard also applies to some work that is not Reserved Work.

C.1.5 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.

C.1.6 The work described in paragraph C.1.5 that is within the scope of the *Pensions* TAS is preparing information on:

- an **insurer's** pension scheme(s) prepared for the purpose of complying with *International Accounting Standard 19* or *Financial Reporting Standard 17*; and
- directors' pension arrangements.

C.1.7 This standard shall apply to actuarial work that is performed to enable an **insurer** to fulfil its obligations to its regulators and to the tax authorities.

C.1.8 The work described in paragraphs C.1.5 and paragraph C.1.7 includes:

- determining an **insurer's** technical provisions;
- providing the confirmation required under the General Insurers' Technical Provisions (Appropriate Amount) (Tax) Regulations 2009;
- providing information to support the assessment of the amount of regulatory capital; and
- providing an opinion on the technical provisions of a Lloyd's syndicate writing general insurance business.

C.1.9 This standard shall apply to actuarial work that is performed to enable an **insurer** to report an embedded value to its shareholders or members.

C.1.10 The work in paragraphs C.1.5, C.1.7 and C.1.9 includes:

- providing information to support the choice of appropriate **measures** and **methods** to use;

- providing information to support the setting of assumptions; and
- making any required calculations.

C.1.11 This standard shall apply to work supporting the opinions required under article 48 of Directive 2009/138/EC (the Solvency II directive) on an **insurer's** overall underwriting policy and adequacy of reinsurance arrangements.

C.1.12 This standard shall apply to actuarial work for an auditor to support their opinion on an **insurer's** regulatory returns.

C.1.13 This standard shall apply to actuarial work that supports the pricing of insurance products.

C.1.14 The work described in paragraph C.1.13 includes:

- providing information to support the choice of appropriate **measures** and **methods** to determine premiums;
- providing information to support the setting of assumptions; and
- making the calculations to support proposed premiums.

C.1.15 The work described in paragraph C.1.13 does not include commercial decisions concerning the actual premiums charged.

C.1.16 This standard shall apply to actuarial work supporting the production of financial projections used for an **insurer's** business planning.

C.1.17 This standard shall apply to actuarial work supporting the production of management information used to monitor an **insurer's** business performance.

C.1.18 This standard shall apply to actuarial work performed in an **insurance transformation**.

C.1.19 The work described in paragraph C.1.18 includes work:

- for or as an independent expert required by a Part VII transfer or scheme of arrangement;
- for a policyholder advocate in an estate reattribution; and
- for any party to an **insurance transformation**.

C.1.20 This standard shall apply to actuarial work concerning an intended sale or purchase of an **insurer**, a sale or purchase of a block of insurance business, a commutation or a capital raising exercise; other than actuarial work related to an **insurer's** employee pension scheme(s).

C.1.21 The work in paragraph C.1.20 includes:

- supporting the assessment of the value of the business intended to be sold, purchased, commuted or securitised; and
- supporting the development or assessment of financial projections.

C.1.22 This standard shall apply to actuarial work concerning the exercise of discretion by an **insurer**.

C.1.23 The work in paragraph C.1.22 includes:

- work performed to enable an **insurer** to take decisions on the discretion to be exercised;
- providing information to the governing body of an **insurer** with with-profits long-term business on the key aspects of the discretion exercised;
- performing work for the person or persons providing an independent assessment of an **insurer's** compliance with its Principles and Practices of Financial Management;
- providing information to with-profits policyholders; and
- supporting the setting of risk or other charges for unit-linked business.

C.1.24 This standard shall apply to actuarial work supporting the determination of the premium for reinsurance to close of a Lloyd's syndicate.

## D GENERAL PRINCIPLES

### D.1 INTRODUCTION

D.1.1 This Part contains general principles relating to actuarial work in insurance that support the purpose of this standard set out in Part A. It should be interpreted as described in Part B.

#### Judgement

D.1.2 Judgements concerning the application of this standard shall be exercised in a reasoned and justifiable manner.

D.1.3 Judgement might be needed on matters such as:

- whether the work is within the scope of the Insurance TAS;
- the derivation of assumptions if there is limited **data**; and
- the selection of **models**.

### D.2 ASSUMPTIONS

#### General considerations

D.2.1 Assumptions used in, or proposed for use in, **models** shall be appropriate for the purpose of the calculations for which they are used.

D.2.2 Assumptions used in, or proposed for use in, **models** shall be derived from sufficient relevant information.

D.2.3 If there is limited relevant information from which assumptions for use in **models** might be derived, it might need to be supplemented by judgement. The **Generic TAS** on *Reporting Actuarial Information* requires the indication of any **material** uncertainty arising from a lack of information on which to base the selection of assumptions.

D.2.4 What information is sufficient is a matter for judgement and might depend on factors such as the cost of obtaining additional data and the degree of uncertainty that **users** are prepared to accept.

D.2.5 What information is relevant is a matter for judgement and might depend on factors such as the effective date of the calculations and the purpose and the nature of the calculations for which the assumptions will be used. Examples of information that might be relevant include:

- financial and economic outlooks;
- mortality and other demographic projections; and
- recent claims experience.

- D.2.6 The selection of assumptions might also take account of any **material** events which are known to have occurred after the effective date of the calculations. The **Generic TAS** on *Reporting Actuarial Information* requires that the **aggregate report** shall indicate any **material** changes or events that are known by any person responsible for the **aggregate report** to have occurred since the effective date of the **data** and other information on which it is based.
- D.2.7 The assumptions to be used for some purposes might be specified in regulations (or in some other legal document governing the work) or they might be the responsibility of a **user** or another party.
- D.2.8 The **Generic TAS** on *Reporting Actuarial Information* requires an **aggregate report** to include sufficient information to enable its **users** to judge its relevance to the decisions for which they use it. If the assumptions used are considered to be **materially** inappropriate by a person responsible for a **report**, the **report** will need to include a statement to that effect, or other explanations.

D.2.9 No adjustment shall be made to any assumption used in, or proposed for use in, a **model** to compensate for a shortcoming in an unrelated assumption.

#### **Discount rates**

D.2.10 For any discount rates used in, or proposed for use in, an exercise, **aggregate reports** shall explain:

- a) the derivation of the discount rates;
- b) the rationale for the inclusion of and the derivation of any illiquidity premium included in the discount rates;
- c) the implications of adopting the discount rates; and
- d) the cash flows that are being discounted.

D.2.11 An explanation of the derivation of discount rates might need to include matters such as:

- a comparison with low credit risk rates, such as rates based on nominal gilt or swaps yield curves published by the Bank of England;
- the return expected from the **insurer's** assets and any mismatch between the cash flows expected from the assets and the liabilities;
- a description of any **model** used to assist the setting of discount rates including the assumptions underlying it and its limitations; and
- a range of reasonable alternative discount rates.

D.2.12 An explanation of the implications of adopting particular discount rates might need to include matters such as:

- the possible effects on solvency levels;
- the possible effect on profitability of a product in a pricing exercise; and

- the impact on the assessment of value when considering the intended acquisition of a block of insurance business.

### Claim rates

D.2.13 If assumptions about claim rates are used in, or proposed for use in, an exercise there shall be separate assumptions for base claim rates and for future changes to those rates.

D.2.14 Examples of the use of assumptions about claim rates are:

- projecting annuity cash flows might use assumptions about base rates of mortality and future changes to those rates; and
- projecting household flood claims might use assumptions about base claim frequencies and future changes to those frequencies arising from climate change.

D.2.15 The assumption for future changes could be that there will be no change.

D.2.16 Claims assumptions shall allow explicitly for potential events which would have a significant financial impact even though they might have a very low probability.

D.2.17 Examples of potential events that might be considered include:

- latent claims;
- pandemics; and
- natural catastrophes.

D.2.18 The explicit allowance could be nil.

### Running costs

D.2.19 **Aggregate reports** for work that includes projections of the cost of running the business shall explain the rationale for any **material** change in the level of future running costs from the current level and the implications for the results.

D.2.20 A change in the level of running costs arising solely from inflation or a change in the volume of business might not be **material**.

### Co-dependencies of risks

D.2.21 **Aggregate reports** for work that includes stressed scenarios and uses assumptions about the co-dependencies of risks shall indicate the relationship between the co-dependencies used in the stressed scenarios and those used in other scenarios.

D.2.22 The indication might need to include a rationale for any differences between the co-dependencies used in the stressed scenarios and those used in other scenarios.

### D.3 MODELS AND CALCULATIONS

#### Changes in measures, methods or assumptions

D.3.1 **Aggregate reports** shall explain the rationale for any changes in the **measures, methods** or assumptions between two similar exercises and quantify the overall effect on results.

D.3.2 An assumption might concern the **specification** of a **model** rather than a particular numerical parameter. For example:

- if an economic parameter is linked to an index a change in the value of that index over the period might not constitute a change in assumptions. A change in the relationship between the parameter and the index or the use of a different index would be a change in assumptions; and
- in a link ratio **model** in which link ratios are automatically recalculated from period to period as new **data** is received, the change in link ratios might not constitute a change in assumptions. The use of a different **data** set to determine link ratios would be a change in assumptions.

#### Claims

D.3.3 The **Generic TAS** on *Modelling* requires the explanation of how a **model** is a satisfactory representation to be **documented**.

D.3.4 The **documentation** of **models** used to project claim payments shall explain how the **model** allows for claim frequencies and severity.

D.3.5 This explanation might need to include:

- the definition of claim frequency such as notified claims or settled claims;
- the treatment of the incidence and severity of large claims; and
- the treatment of rates of incidence of morbidity and recovery in sickness insurance.

### D.4 REPORTING

#### Prudent estimates

D.4.1 **Aggregate reports** which include a prudent estimate of the technical provisions of an **insurer** shall explain:

- a) the relationship between the prudent estimate and a **neutral** estimate of the liabilities; and
- b) any change to the relationship between the prudent and **neutral** estimates from the previous exercise, if any.

D.4.2 An explanation of the relationship between a **neutral** and a prudent estimate of the liabilities might need to include matters such as:

- presenting an approximate **neutral** estimate alongside the prudent estimate;
- comparing the assumptions underlying the **neutral** estimate with the assumptions underlying the prudent estimate and explaining the differences;
- carrying out a stochastic analysis of possible cash flows; and
- describing the level of prudence in the prudent estimate.

### **Risk and uncertainty**

D.4.3 The **Generic TAS** on *Reporting Actuarial Information* requires that for each **material** risk or uncertainty faced by an **insurer** in relation to the work being reported on, an **aggregate report** shall state the nature and significance of the risk and explain the approach taken to the risk.

D.4.4 **Aggregate reports** for work which requires projecting cash flows using **neutral measures** and assumptions shall indicate the effect of uncertainty on the cash flows by considering adverse scenarios.

D.4.5 The indication might need to include:

- providing confidence intervals or a fan chart around the projected **neutral** estimates of the cash flows;
- providing an estimate of the change in the cash flows in a stressed scenario;
- in an embedded value exercise, providing estimates of the reduction in the in force value in a range of adverse scenarios; or
- in a pricing exercise, providing a measure of the reduction in profitability expected in a range of adverse scenarios.

### **Liquidity**

D.4.6 **Aggregate reports** for work supporting the assessment of the amount of regulatory capital required by an insurer shall indicate the extent of any liquidity risk.

D.4.7 The indication might need to include:

- any mismatch between incoming and outgoing cash flows including the timing of claim payments and the related reinsurance recoveries;
- the volatility in claims experience; and
- the nature and quality of the **insurer's** assets.

## Financial statements

D.4.8 Paragraphs D.4.9 to D.4.10 apply to work supporting information provided to preparers and auditors of financial statements.

D.4.9 Information shall be sought regarding materiality levels for accounting purposes that apply to the piece of work.

D.4.10 If approximate **methods** have been used to provide actuarial information the **aggregate report** shall state any circumstances under which the information might be materially inaccurate for accounting purposes.

D.4.11 The **Generic TAS** on *Modelling* requires that the **material** limitations of models, and their implications, are explained to **users**. The **Generic TAS** on *Reporting Actuarial Information* requires that any **material** uncertainty over the accuracy of the **data** that is used is explained to **users**.

# E THE EXERCISE OF DISCRETION IN LONG-TERM INSURANCE BUSINESS

## E.1 INTRODUCTION

E.1.1 This Part applies to work concerning long-term business in which the exercise of discretion is permitted by contract. It should be interpreted as described in Part B.

E.1.2 Examples of situations in which discretion might be exercised are:

- the management of with-profits business;
- determining risk charges on unit-linked policies; and
- unit pricing.

## E.2 ASSUMPTIONS

E.2.1 **Aggregate reports** shall describe the rationale for any change in the assumptions about the way discretion is exercised in any stressed scenarios considered.

E.2.2 The ability to exercise discretion might enable an **insurer** to take action to protect the interests of continuing policyholders. Examples of such actions include:

- increasing surrender penalties if the market value of assets falls sharply; and
- postponing surrenders from or switches out of funds linked to illiquid asset classes.

## E.3 REPORTING

E.3.1 **Aggregate reports** concerning the exercise of discretion shall indicate the effects of the exercise of discretion proposed or taken on policyholders and on any with-profits estate.

E.3.2 The indication of the effects of the exercise of discretion on policyholders might need to include a description of the impact on their benefits of any change in:

- the Principles of Financial Management;
- bonus policy;
- investment policy;
- the level of charges for risk or expenses; and

- smoothing policy or asset share charges.

E.3.3 If an **insurer** exercises its discretion to use any with-profits estate as working capital to support its business plans, the indication of the effects on the estate might need to include a description of the rate of return expected and the timing of that return.

E.3.4 When reporting to policyholders on the exercise of discretion the work performed to confirm that their information needs have been taken into account shall be <b>documented</b> .
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E.3.5 **Documentation** might need to include a description of policyholders' financial capability to understand matters which affect the amount of the policy benefits they receive.

## F GENERAL INSURANCE BUSINESS WRITTEN BY LLOYD'S SYNDICATES

### F.1 INTRODUCTION

F.1.1 This Part applies to work performed for Lloyd's syndicates writing general insurance business. It should be interpreted as described in Part B.

### F.2 REPORTING

F.2.1	Work supporting the provision of an opinion confirming that the technical provisions for each syndicate year of a Lloyd's syndicate writing general insurance business are no less prudent than a best estimate of the amounts required shall be described in a document which shall include sufficient information to allow the syndicate's managing agent and the Lloyd's Actuary to understand the work performed.
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F.2.2 The document will need to be a single document in permanent form.

F.2.3 The document will need to include the information that an **aggregate report** describing the work performed would include. Part D and the **Generic TASs on Modelling and Reporting Actuarial Information** contain the principles for the information that an **aggregate report** shall provide.

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