

EUROPEAN ACTUARIAL NOTE 1 (EAN1)

ACTUARIAL FUNCTION FOR IORPs II UNDER DIRECTIVE (EU) 2016/2341

DRAFT NOTE including issuer considerations and reference to regulatory requirements

Date: DAY MONTH 2018

Sources being used for regulatory requirements cited:

1. Level 1 (L1): DIRECTIVE (EU) 2016/2341 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs)

Other sources used:

2. ESAP1: European Standard of Actuarial Practice 1 – General Actuarial Practice, approved as a model standard by the General Assembly of the Actuarial Association of Europe on 3 October 2014

EAN1 Reference	1. EAN1 statements and definitions
	Preface
	<p>A European Actuarial Note (EAN) is an educational document on an actuarial subject that has been adopted by the Actuarial Association of Europe (AAE) in order to advance the understanding of the subject by readers of the EAN including actuaries and others, who use or rely upon the work of actuaries.</p> <p>It is not a European Standard of Practice (ESAP) and is not intended to convey in any manner that it is authoritative. EANs may be issued:</p> <ul style="list-style-type: none"> • to assist actuaries in complying with an ESAP, for example by offering practical examples of ways in which actuaries might implement an ESAP in the course of their work, or • to provide non-binding guidance on an actuarial topic for which the AAE has not developed an ESAP. <p>Because an EAN is not intended to be authoritative, its language will be chosen carefully. It will not contain words such as 'should'. Rather, its style will be descriptive or will convey meaning by the use of examples of actual practice, without suggesting that these examples are comprehensive.</p>
Section 1.	<u>General</u>
1.1.	<u>Purpose</u>
	<p>This European Actuarial Note 1 provides non-binding guidance to actuaries when issuing an Actuarial Function Report in connection with Article 27 (1) of the IORP Directive.</p> <p>It may be useful for the actuary to consider how often an Actuarial Function Report is required taking into account how often the calculations take place, local legislative requirements and the format for documenting the contribution to risk management.</p>
1.2	<u>Scope</u>
	<p>Actuaries performing actuarial services when issuing an Actuarial Function Report in connection with Article 27 (1) of the IORP II Directive.</p> <p>EAN 1 relies on the premise that actuaries will comply with ESAP 1 (or equivalent).</p>

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1.3	Underlying Principles
	<p>In performing the actuarial services, the actuary may find it useful to consider his work in light of the following four principles:</p> <p><u>Principle 1:</u> Comply with the IORP II Directive and relevant law.</p> <p><u>Principle 2:</u> Carry out work which is proportional to the nature, scale and complexity of the underlying risks of the IORP (Principle of Proportionality).</p> <p><u>Principle 3:</u> Ensure consistency with the code of professional conduct of the actuarial profession and with any applicable general actuarial standards.</p> <p><u>Principle 4:</u> Structure the Actuarial Function Report according to the needs of the intended users, in particular the Administrative, Management or Supervisory Body</p>
1.4	Language
	This document uses expressions whose precise meaning is defined in section 2. Words and expressions which are included in section 2 are shown in bold elsewhere in the document. Headings are shown in bold whether or not they contain defined terms.
1.5	Cross references
	When this note refers to the content of another document, the reference relates to the referenced document as it is effective on the adoption date as shown on the cover page of this EAN. The referenced document may be amended, restated, revoked or replaced after the adoption date. In such a case, the actuary may wish to consider the extent the modification is applicable and appropriate to the guidance in this EAN.
1.6	Effective Date
	This EAN is recommended to be considered for actuarial services relating to an Actuarial Function Report with an effective date after [Date ¹].

¹ Date to be inserted by AAE

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Section 2.	Definitions and abbreviations
	The terms below are defined for use in this EAN.
2.0	Abbreviations: These are used after the definitions section. AF: Actuarial Function AFR: Actuarial Function Report AMSB: Administrative, Management or Supervisory body IORP: Institution for Occupational Retirement Provision
2.1	Actuarial Function: A single person or organisational unit to undertake the particular governance tasks described in Article 27 of the IORP II Directive.
2.2	Actuarial Function Report: The report from the Actuarial Function to the administrative, management or supervisory body in connection with Article 27 of the IORP II Directive and associated regulations, standards and guidelines.
2.3	Actuary: An individual member of one of the member associations of the Actuarial Association of Europe.
2.4	Actuarial services: Services, based upon actuarial considerations, provided to intended users that may include the rendering of advice, recommendations, findings or opinions.
2.5	Administrative, Management or Supervisory body: AMSB
2.6	Conflict of interest: Occurs when an individual or organisation is involved in multiple interests, one of which could possibly corrupt the motivation for an act in the other or result in work which is not, or is not perceived to be, objective and impartial.
2.7	Data - Data means all types of quantitative and qualitative information.
2.8	Intended user: Any legal or natural person (usually including the party who engages the provider of actuarial services - the client or the employer of the actuary) whom the actuary intends, at the time the actuary performs the actuarial services, to use the communication from the AF, typically in report form.
2.9	Material: Matters are material if they could, individually or collectively, influence the decisions to be taken by intended users on the basis of the relevant information given. Assessing whether something is material is a matter of reasonable judgement which recommends consideration of the intended users and the context in which the work is performed and reported (similarly materiality).

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2.10	Model: A simplified representation of some aspect of the world. A model is defined by a specification which describes the matters represented and the inputs and the relationships between them, implemented through a set of mathematical formulae and algorithms, and realized by using an implementation to produce a set of outputs from inputs in the form of data and assumptions, usually involving judgement of the actuary.
2.11	Professional judgement – The judgement of the actuary based on actuarial training and experience.
2.12	IORP II Directive: Directive (EU) 2016/2341.
2.13	Institution for Occupational Retirement Provision: This means an institution, irrespective of its legal form, operating on a funded basis, established separately from any sponsoring undertaking or trade for the purpose of providing retirement benefits in the context of an occupational activity on the basis of an agreement or a contract agreed: <ul style="list-style-type: none"> (a) Individually or collectively between the employer(s) and the employee(s) or their respective representatives, or (b) With self-employed persons, individually or collectively, in compliance with the law of the home and host Member States, and which carries out activities directly arising therefrom.
2.14	Technical Provisions: The technical provisions of an IORP calculated under the valuation principles of the IORP II Directive (Article 13) and local regulations.
2.15	Sponsoring Undertaking: any undertaking or other body, regardless of whether it includes or consists of one or more legal or natural persons, which acts as an employer or in a self-employed capacity or any combination thereof and which offers a pension scheme or pays contributions to an IORP.
2.16	Special Purpose Vehicle: This means any entity other than the IORP which assumes risks from insurance and which funds its exposure to such risks through other financing mechanisms.
2.17	Underwriting: The process of defining, evaluating and pricing insurance or reinsurance risks, including the acceptance or rejection of insurance or reinsurance obligations.

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Section 3.	<u>Appropriate Practices</u>
3.1	<u>General principles</u>
	<u>THE ACTUARIAL FUNCTION REPORT - CORE PARTS, CONTENT & FEEDBACK</u>
	<p>When the holder of the AF produces a written report (the AFR) to be submitted to the AMSB, at least every three years, the holder of the AF is encouraged to consider that the intended user is the AMSB and tailor the content appropriately and in accordance with ESAP1.</p> <p>The actuary may wish to consider the following when preparing the report:-</p> <ul style="list-style-type: none"> • using a form, structure, style, level of detail and content which is appropriate to the particular circumstances, taking into account the intended users. If an AFR consists of several component reports focusing on specific content which may be provided to the AMSB separately and at different points of time, the AF may wish to consider ensuring proper documentation and disclosure according to ESAP1. • stating which actuarial standards (e.g. international, European or local) apply to the work that has been carried out and whether the work complies with those actuarial standards, if applicable. • documenting a summary of all major tasks that have been undertaken by the AF and their results. • setting out information identifying relevant conflicts of interest and describing how they have been managed including any potential conflicts of interest between the individual undertaking and any group of which it is a part. • identifying the individuals responsible for writing the AFR, and, if applicable, the person taking overall responsibility for its production. • identifying any deficiencies and give recommendations as to how such deficiencies could be remedied having regard to materiality and proportionality. • including sufficient information, explanation and discussion about each area covered so as to enable the AMSB as the intended user to judge its implications. • summarising the key data used to reach the opinions expressed and drawing attention to any material areas of uncertainty and deficiency and their sources and any adjustments that have been made, and also to any material professional judgement made in the assessments by the AF. This is especially important if the AMSB is taking action based on that key data. • discussing conclusions and recommendations with AMSB on finalizing the AFR. The AF could document any relevant aspect that arises after the signing of the AFR. After submission of an AFR to the AMSB, the AF could seek feedback from the AMSB on the contents of the AFR and have regard to that feedback when preparing future reports. • documenting promptly the details of what recommendations in the AFR have been accepted and rejected and need to be summarised in the next AFR. Progress towards implementation could also be documented and significant implications outlined.

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3.2	<u>Technical Provisions</u>
	<p>The actuary may wish to consider the following when preparing the report:-</p> <ul style="list-style-type: none"> • stating the conclusions of the AF with regard to its analysis of the adequacy and reliability of the Technical Provisions. The conclusions could include any concerns the AF has in this regard and identify material shortcomings or deficiencies, with recommendations as to how these could be remedied. • expressing an opinion on the adequacy and reliability of the technical provisions to the extent that the AF feels it is appropriate to do so. There is no obligation to express an opinion under IORP II. • including the results of an assessment as to the extent to which the Technical Provisions have been calculated in accordance with local regulations and advise if any changes are necessary in order to achieve compliance. • stating the sources and degree of uncertainty the AF has assessed in relation to the estimates made in the calculation of the Technical Provisions. The AFR could explain the potential sources of uncertainty and, where appropriate, illustrate uncertainty by reference to possible scenarios and remedy them if possible. • ensuring that the factors which have a material impact on the amount of Technical Provisions, including risk drivers and assumptions, are made clear in the AFR. • drawing attention to any material judgements made in the calculation of Technical Provisions. • disclosing in the AFR the opening and closing Technical Provisions, split, to the extent possible, between best estimate and if appropriate, risk margin or equivalent. • providing a commentary on the main items of movement on the impact on the Own Funds and of the main items of movement of Technical Provisions, where appropriate. • including a broad overview of the overall process employed in respect of the calculation of the Technical Provisions. • including an overview of the controls surrounding the assessment undertaken by the AF of the data used in the calculation of Technical Provisions and an explanation of how the AF is comfortable that the data is appropriate, accurate, reliable and complete • identifying any material uncertainties or limitations in the data and outlines the approach taken to these in the context of the calculation of Technical Provisions. Limitations might include, but are not restricted to, its fitness for purpose, consistency over time, timeliness, information technology systems, availability of individual data and of historical data. • giving an overview of the different benefit structures covered by the Technical Provisions, the split of data into meaningful groups and how this split has been assessed for appropriateness in relation to the underlying risks of the undertaking. • the relevant information provided by financial markets and generally available and specific data on demographic risks and explaining how it is integrated into the assessment of the Technical Provisions. • providing an overview about how the appropriateness of the methods and models used in the calculation of the Technical Provisions have been assessed with regard to the main drivers of risk, the categories of membership and the way in which the IORP is being managed.

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	<ul style="list-style-type: none"> • drawing attention to any unusual or non-standard method not within usual market practice which has been used to calculate Technical Provisions, including a description of the rationale for the choice of method and if no unusual methods have been used, noting that only standard methods have been used. • including, where appropriate, an overview of the methods used to calculate Technical Provisions where the insufficiency of the data has prevented the application of a reliable actuarial method. The AFR could also include an assessment of the appropriateness of the approximations used in the calculations of Technical Provisions for such contracts. • including an assessment of the appropriateness of the methods and models used in the allowance for options and guarantees included in the benefit structure. It is generally accepted and good practice that consideration be given to the options and guarantees underlying the insurance contracts. • indicating whether the AF assesses that the information technology systems used for the calculation of the Technical Provisions do not sufficiently support the actuarial and statistical procedures. • where the calculation of Technical Provisions depends on multiple models, making reference to any material differences between the results according to these models and the allowance that has been made for these differences. • disclosing and justifying any material changes in methods from those used in the previous AFR and quantifying the effect on the technical provisions. • including a description of how the appropriateness of the data and methods used to determine the assumptions underlying the Technical Provisions have been assessed. It is important to store the data in a secure environment so that it is readily available for future reference. • disclosing the key assumptions underlying the calculation of the Technical Provisions and explaining their appropriateness in relation to the main drivers of risk likely to affect the IORP. • disclosing any material changes made to the assumptions used compared to the previous AFR. • disclosing the appropriateness of material judgements made in determining the assumptions. • including an overview of the process used to compare best estimates against actual experience and drawing attention to any concerns the AF has in regard to the effectiveness of this process. • disclosing the findings of the AF's review of the quality of past best estimates and the conclusions drawn from this in relation to the appropriateness of data, methods or assumptions used in the calculation of the Technical Provisions. In reviewing the quality of past estimates, it is good practice that the AFR draw attention to those areas where actual experience has deviated in a material way from the assumptions made including an analysis of the financial impact and provide a commentary in this regard. This could include if the sources of the deviations are caused by internal or external factors. It may assist understanding if this commentary distinguishes between deviations which are judged to arise from volatility of the underlying experience and those which are viewed as relevant to the appropriateness of the data, methods or assumptions used. The AFR could disclose any material judgements when such a distinction is made. • reporting on the results of an analysis of the sensitivity of the Technical Provisions to each of the major risks underlying the obligations which are covered in the Technical Provisions.

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3.3	<u>Opinion on underwriting policy</u>
	<p>The actuary may wish to consider the following when preparing the report:-</p> <ul style="list-style-type: none"> • expressing an opinion on the overall underwriting policy in the event of the IORP having such a policy. • setting out how the AF has arrived at its opinion on the overall underwriting policy of the IORP. • explaining any concerns which the AF may have as to the suitability of the overall underwriting policy. • outlining the recommendations to remedy any deficiencies the AF has identified in relation to the overall underwriting policy having regard to materiality and proportionality. • assessing the suitability of the overall underwriting policy including the areas set out below. <ul style="list-style-type: none"> ○ Sufficiency of premiums or contributions ○ Environmental changes ○ Adjustments to premiums ○ Adverse demographic trends ○ Interrelationships
3.4	<u>Opinion on insurance arrangements</u>
	<p>The actuary may wish to consider the following when preparing the report:-</p> <ul style="list-style-type: none"> • expressing an opinion on the adequacy of the insurance arrangements. It would be appropriate if there is knowledge available that reference is made to it but it is not expected that the AF would reference beyond common public knowledge. It would typically not include an assessment of the insurer. • explaining any concerns which the AF may have concerning the adequacy of insurance arrangements in the event of the IORP having such arrangements. • outlining recommendations to improve the insurance arrangements where the AF has identified deficiencies, including actions which might be taken to: <ul style="list-style-type: none"> • eliminate inconsistencies in insurance coverage; • extend coverage of material risks • outlining the extent to which the insurance arrangements of the IORP are not consistent with the undertaking's: <ul style="list-style-type: none"> • risk appetite; • underwriting policy; and • technical provisions, and including recommendations as to how any inconsistencies could be remedied. • incorporating the AF's comments on the credit standing of its insurance counterparties and the expected returns, if applicable, in the commentary on interrelationships.

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	<ul style="list-style-type: none"> including an assessment of how the insurance arrangements, including any SPVs, might respond in a number of stressed scenarios or referring to where this is considered in the Own Risk Assessment. The scenarios might include: <ul style="list-style-type: none"> risk aggregations; reinsurance defaults; and reinsurance exhaustion. including an indication of: <ul style="list-style-type: none"> the amounts recoverable from insurance contracts and SPVs; and the impact on the IORP's own funds. considering, if appropriate, the impact of reinstatements or renewal of insurance cover and the potential unavailability of insurance cover. including a commentary of the effectiveness of the insurance arrangements in mitigating the volatility of the IORP's own funds.
3.5	<u>Contribution to risk management</u>
3.5.1	<p>The actuary may wish to consider the following when preparing the report:-</p> <ul style="list-style-type: none"> describing the areas where the AF has made a material contribution to the implementation of the risk management system and the work performed. In particular, this could cover the contribution of the AF to the risk modelling underlying the calculation of the technical provisions and any recommendations for the risk management system. Other examples might include the role of the AF and its contribution to the Own Risk Assessment process, including its views in relation to the stress- and scenario-testing undertaken, as well as to the assessment of the overall funding needs of the IORP, especially when a recovery plan is necessary, where applicable; the assessment of the risks to members and beneficiaries relating to the paying out of their retirement benefits and the effectiveness of any remedial action taking into account, where applicable the qualitative assessment of the mechanisms protecting retirement benefits, including as applicable, guarantees, covenants or any other type of financial support by the sponsoring undertaking, insurance or reinsurance by an undertaking covered in favour of the IORP or the members and beneficiaries. summarising the main findings of these activities, and in such cases providing a reference to reports from the risk management function where appropriate