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EUROPEAN ACTUARIAL NOTE **x**

ACTUARIAL FUNCTION FOR IORP II

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PREFACE

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. It is not a European Standard of Actuarial Practice (ESAP) and is not intended to convey in any manner that it is authoritative. EANs may be issued a) 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 b) To provide non-binding guidance on an actuarial topic for which the AAE has not developed an ESAP.

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.

SECTION 1. GENERAL

1.1. Purpose

EAN 1 provides non-binding guidance to actuaries when performing the Actuarial Function (AF) in connection with Article 27 (1) of the IORP Directive.

The holder of the AF may be asked to produce a written report, actuarial function report (AFR), regarding the work he has undertaken. It may be useful for the actuary to consider how often an AFR is required taking into account how often the calculations take place, local legislative requirements and the format for documenting the contribution to risk management.

1.2. Actuarial Function Report for IORP

In performing the actuarial services, the actuary may find it useful to consider his work in light of the following principles:

- Principle 1: Comply with the IORP II Directive and relevant law and with ESAP1 which covers general actuarial practice.
- Principle 2: Carry out work which is proportionate to the nature, scale and complexity of the underlying risks of the IORP (Principle of Proportionality).
- Principle 3: Ensure consistency with the code of professional conduct of the actuarial profession and with any applicable general actuarial standards.

This document uses expressions whose precise meaning is defined in the appendix. Words and expressions which are included in the appendix are shown in bold elsewhere in the document. Headings are shown in bold whether or not they contain defined terms.

The form, structure, style, level of detail and content will need to be considered taking into account the intended users. The AFR can summarise all major tasks that have been undertaken by the AF and their results. If the AFR consists of several component reports focusing on specific content which may be provided to the Administrative, Management and Supervisory Body (AMSB) separately and at different points in time, reference can be made to this in the AFR.

The AF may wish to outline any actuarial standards that applied to the work that has been carried out and whether the work complies with those actuarial standards.

The AFR can identify the individuals responsible for its preparation and the person taking overall responsibility for its production, if applicable. The AFR can include information identifying relevant conflicts of interest and describing how they have been managed including any potential conflict of interest between the individual undertaking and any group of which it is a part.

Consideration might be given to including sufficient information, explanation and discussion about each area covered so as to enable the intended user to judge its implications. The AFR could also identify any deficiencies and give recommendations as to how such deficiencies could be remedied having regard to materiality and proportionality.

The key data used to reach the opinions expressed can be summarised. Attention could be drawn 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.

The AF may wish to discuss conclusions and recommendations with the 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.

Consideration might be given to 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.

SECTION 2. TECHNICAL PROVISIONS

Article 27 of the IORP II directive provides for an effective AF to:

- coordinate and oversee the calculation of technical provisions
- assess the appropriateness of the methodologies and underlying models used in the calculation of technical provisions and the assumptions made for this purpose
- assess the sufficiency and quality of the data used in the calculation of technical provisions
- compare the assumptions underlying the calculation of the technical provisions with the experience
- inform the AMSB of the IORP of the reliability and adequacy of the calculation of technical provisions.

The AFR could include an assessment of 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.

The AF could consider setting out the sources and degree of uncertainty in 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 remedies if possible.

The AFR can include the factors, including risk drivers and assumptions, which have a material impact on the amount of Technical Provisions. Attention might also be drawn to any material judgements made in the calculation of Technical Provisions.

A broad overview of the overall process employed in the calculation of the Technical Provisions might be included in the AFR. The AF may want to express an opinion on the adequacy and reliability of the technical provisions. There is no obligation to express an opinion under IORP II. The AF may wish to outline its conclusions regarding 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.

It may be useful to set out in the AFR the opening and closing Technical Provisions, split, to the extent possible, between best estimate and if appropriate, risk margin or equivalent. A commentary on the main items of movement in the Technical Provisions might also be considered.

The AFR could include an overview of the controls undertaken by the AF in assessing 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. The AFR could highlight the importance of storing the data in a secure environment so that it is readily available for future reference.

It may be helpful to identify any material uncertainties or limitations in the data and outline the approach taken to these in calculating the Technical Provisions. Limitations might include, but are not restricted to, the data's fitness for purpose, consistency over time, timeliness, information technology systems, availability of individual data and of historical data.

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 could be included in the AFR.

Consideration can be given to the relevant information provided by financial markets and generally available and specific data on demographic risks and explain how it is integrated into the assessment of the Technical Provisions.

An overview could be provided of the appropriateness of the methods and models used in the calculation of the Technical Provisions with regard to the main drivers of risk, the categories of membership and the way in which the IORP is being managed.

Attention could be drawn to any unusual or non-standard method 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.

Where the insufficiency of the data has prevented the application of a reliable actuarial method, the AFR could include an overview of the method(s) used to calculate Technical Provisions. The AFR could also include an assessment of the appropriateness of the approximations used in the calculations of Technical Provisions for such contracts.

The AFR could include an assessment of the appropriateness of the methods and models used in the allowance for options and guarantees included in the benefit structure. Consideration might be given to the options and guarantees underlying the insurance contracts.

The AF could indicate whether the information technology systems used for the calculation of the Technical Provisions sufficiently supports the actuarial and statistical procedures.

Where the calculation of Technical Provisions depends on multiple models, the AFR could make reference to any material differences between the results according to these models and the allowance that has been made for these differences.

Any material changes in methods from those used in the previous AFR might be disclosed and justified and the effect on the technical provisions could be quantified.

The AFR could include a description of how the appropriateness of the data and methods used to determine the assumptions underlying the Technical Provisions have been assessed.

The key assumptions underlying the calculation of the Technical Provisions could be included in the AFR and their appropriateness explained in relation to the main drivers of risk likely to affect the IORP. It may be useful to outline any material changes made to the assumptions used compared to the previous AFR. Attention might also be drawn to any material judgements made

in determining the assumptions. An overview of the process used to compare best estimates against actual experience could be included and attention drawn to any concerns the AF has in regard to the effectiveness of this process.

The AF could set out its 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 might be helpful for the AF to 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 commentary as to whether 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.

The AFR could provide 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.

SECTION 3. UNDERWRITING POLICY

Article 27 of the IORP II directive provides for an effective AF to express an opinion on the overall underwriting policy in the event of the IORP having such a policy.

An opinion on the overall underwriting policy in the event of the IORP having such a policy could be included in the AFR. It may be useful to set out how the AF has arrived at its opinion.

The AFR could explain any concerns which the AF may have as to the suitability of the overall underwriting policy. The AFR could outline the recommendations to remedy any deficiencies the AF has identified in relation to the overall underwriting policy having regard to materiality and proportionality.

The AF could assess the suitability of the overall underwriting policy in the following areas: sufficiency of premiums or contributions, environmental changes, adjustments to premiums, adverse demographic trends and interrelationships

SECTION 4. INSURANCE ARRANGEMENTS

Article 27 of the IORP II directive provides for an effective AF to express an opinion on the adequacy of insurance arrangements in the event of the IORP having such arrangements.

An opinion on the adequacy of the insurance arrangements in the event of the IORP having such arrangements could be included in the AFR. 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.

The AFR could explain any concerns which the AF may have regarding the adequacy of insurance arrangements in the event of the IORP having such arrangements. The AFR could outline recommendations to improve the insurance arrangements where the AF has identified deficiencies, including actions which might be taken to eliminate inconsistencies in insurance coverage or extend coverage of material risks.

The AFR might outline the extent to which the insurance arrangements of the IORP are not consistent with the undertaking's risk appetite, underwriting policy and technical provisions. It could also include recommendations as to how any inconsistencies could be remedied.

The AFR might incorporate the AF's comments on the credit standing of its insurance counterparties and the expected returns, if applicable, in the commentary on interrelationships.

The AFR could include 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 risk aggregations, reinsurance defaults and reinsurance exhaustion.

The AFR could include an indication of the amounts recoverable from insurance contracts and SPVs and the impact on the IORP's own funds.

Consideration might be given to the impact of reinstatements or renewal of insurance cover and the potential unavailability of insurance cover.

Commentary could be included on the effectiveness of the insurance arrangements in mitigating the volatility of the IORP's own funds.

SECTION 5. RISK MANAGEMENT

Article 27 of the IORP II directive provides for an effective AF to contribute to the effective implementation of the risk management system.

The actuary may wish to describe 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 in favour of the IORP or the members and beneficiaries.

The AFR could summarise the main findings of these activities, and in such cases provide a reference to reports from the risk management function where appropriate.

APPENDIX: DEFINITIONS

The terms below are used in this EAN.

Actuarial Function (AF): A single person or organisational unit to undertake the particular governance tasks described in Article 27 of the IORP II Directive.

Actuarial Function Report (AFR): 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.

Actuary: An individual member of one of the member associations of the Actuarial Association of Europe.

Actuarial services: Services, based upon actuarial considerations, provided to intended users that may include the rendering of advice, recommendations, findings or opinions.

Administrative, Management or Supervisory Body (AMSB): for example the Board of the IORP or the Trustees of the IORP.

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.

Data - Data means all types of quantitative and qualitative information.

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.

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).

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.

Professional judgement – The judgement of the actuary based on actuarial training and experience.

IORP II Directive: Directive (EU) 2016/2341.

Institution for Occupational Retirement Provision (IORP): 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:

- (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.

Technical Provisions: The technical provisions of an IORP calculated under the valuation principles of the IORP II Directive (Article 13) and local regulations.

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.

Special Purpose Vehicle (SPV): 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.

Underwriting: The process of defining, evaluating and pricing insurance or reinsurance risks, including the acceptance or rejection of insurance or reinsurance obligations.