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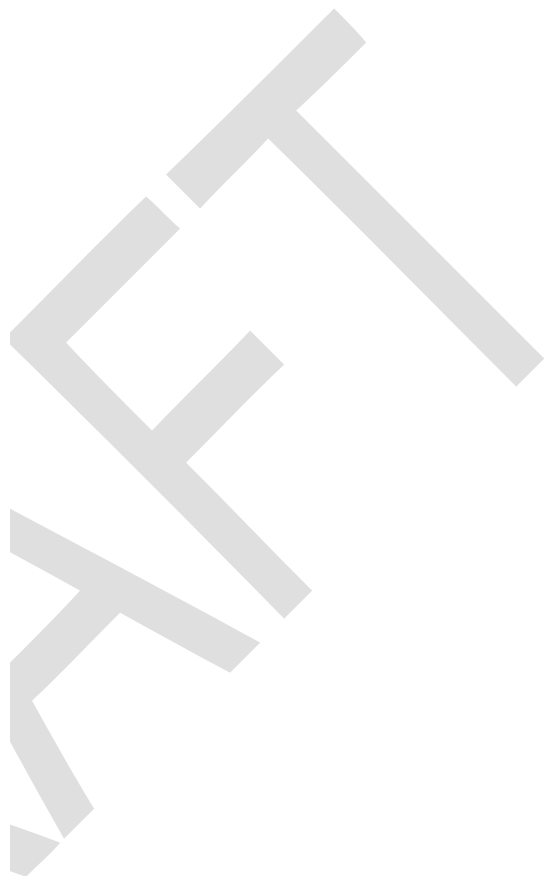
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**EXPOSURE DRAFT OF
GROUPE CONSULTATIF
ACTUARIAL STANDARD OF PRACTICE 2
(GCASP 2)**

ACTUARIAL FUNCTION REPORT
UNDER DIRECTIVE 2009/138/EC
(The “Solvency II Directive”)

This document

- was approved on 14 September 2012 by the Standards Project Team of the Groupe Consultatif
- for distribution to membres titulaires, membres suppléants and representatives on the Standards, Freedoms and Professionalism and Insurance Committees



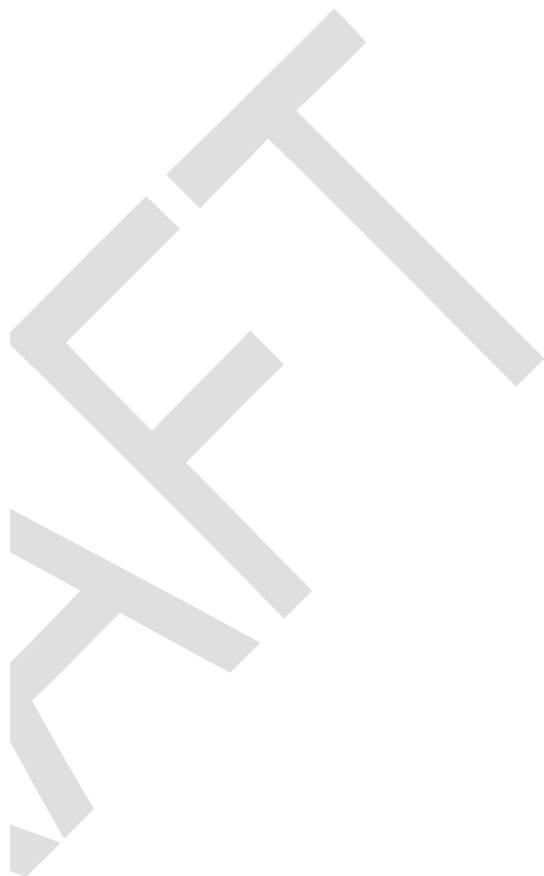
Introduction 1

1. *[Introduction 1 should be deleted when a standard setting organization adopts this standard.]*
2. This GROUPE CONSULTATIF ACTUARIAL STANDARD OF PRACTICE (GCASP) is a model standard for member organizations and other standard setting bodies to consider adopting. This GCASP is not binding upon an **actuary** unless the **actuary** states that some or all of the work has been performed in compliance with this GCASP or an association of which the actuary is a member adopts it (or a modification of it) as a mandatory standard of practice.
3. The GROUPE CONSULTATIF ACTUARIEL EUROPÉEN (GC) encourages member organizations and other relevant standard setting bodies to consider adopting this GCASP as a standard with or without modification, or to endorse this GCASP as a standard. Such an adopted standard (rather than this GCASP) is binding on those **actuaries** who are subject to such body's standards, except as otherwise directed by such body (for example with respect to cross-border work).
4. When the standard is translated, the adopting body should select three verbs that embody the concepts of "must", "should", and "may", even if such verbs are not the literal translation of "must", "should", and "may".

Introduction 2

Language

5. Some of the language used in this GCASP is intended to be interpreted in a very specific way in the context of a decision of the actuary. In particular, the following verbs are to be understood to convey the actions or reactions indicated:
 - "must" means that the indicated action is mandatory and failure to follow the indicated action will constitute a departure from this GCASP.
 - "should" (or "shall") means that, under normal circumstances, the actuary is expected to follow the indicated action, unless to do so would produce a result that would be inappropriate or would potentially mislead the intended users of the actuarial services. If the indicated action is not followed, the actuary should disclose that fact and provide the reason for not following the indicated action.
 - "may" means that the indicated action is not required, nor even necessarily expected, but in certain circumstances is an appropriate activity, possibly among other alternatives. Note that "might" is not used as a synonym for "may", but rather with its normal meaning.
6. This document uses various expressions whose precise meaning is defined in section 2.
7. This GCASP was adopted by the General Assembly of the GC..... on [month year].



Section 1. Purpose, Scope, Cross References and Effective Date

Purpose

- 1.1. Groupe Consultatif Actuarial Standard of Practice 2 (GCASP2) provides guidance to actuaries when issuing an **Actuarial Function Report (AFR)** in connection with an insurance undertaking's compliance with the **Solvency II Directive**. The purpose of GCASP2 is that the **intended users** for the **AFR** should be able to place a high degree of reliance on the report, its relevance, transparency of assumptions, completeness and comprehensibility, including the communication of any uncertainty inherent in the results stated in the report.
- 1.2. This standard will contribute to ensure consistent, efficient and effective practices within the **Actuarial Function (AF)** across insurance and reinsurance undertakings in the European Union concerning the preparation of their **AFR**. This will strengthen and contribute towards harmonised and consistent application of EU legislation.

Scope

- 1.3. This **GCASP** applies to **actuaries** performing **professional services** when issuing an **AFR** in connection with an **undertaking's** compliance with the **Solvency II Directive**. An **actuary** who provides these **professional services** may be acting in one of several capacities such as an employee, officer, director of the **principal**, or be external to the principal.
- 1.4. Laws or regulations may also impose obligations upon an **actuary**. Compliance with binding requirements of law or regulation that conflict with this standard shall not be considered to be a deviation from the standard.
- 1.5. This standard will assist the achievement of this objective by ensuring that in the **AFR**
 - sufficient information is included to enable intended users to judge the relevance of the contents of the **AFR**;
 - sufficient information is included to enable intended users to understand the implications of the contents of the **AFR**; and
 - information is presented in a clear and comprehensible manner.
- 1.6. Nothing in this standard should be taken to imply a requirement to depart from statutory provisions deriving from the **Solvency II Directive**, the **Omnibus II Directive**, the regulations issued by the **EU-Commission** or the **standards and guidelines** issued by **EIOPA** or other statutory or legal requirements under the applicable jurisdiction.. It should be read in the context of these statutory provisions. The scope of this standard could be affected by any amendments to statutory provisions issued after the issuance of this standard.
- 1.7. GCASP2 assumes that actuaries will also comply with **ISAP 1¹**, issued by the **International Actuarial Association (IAA)** on [date] and with **GCASP1** issued by the Groupe Consultatif on [date]

Cross references

- 1.8. When this standard refers to the provisions of other documents, the reference includes the referenced documents as they exist on the adoption date as shown on the cover page. The referenced documents may be amended, restated or replaced after the adoption date. If any amended, restated or replacement document

¹ The IAA is currently working parallel to the GC on its ISAP 1. The IASSC of the IAA is recommending to the Executive Committee the adoption of the ISAP1 General Actuarial Practice without a re-exposure implementing a number of amendments based on the comments received. (September 2012)

differs materially from the originally referenced document, the actuary should consider the extent to which it is applicable and appropriate to the guidance in this standard.

Effective Date

- 1.9. This standard applies **to professional services** related to an **Actuarial Function Report** completed after 31 December 2013.

Section 2. Definitions

Terms appearing in **bold** in the text are used with the meanings set out below. The definitions are used consistently in Groupe Consultatif Actuarial Standards of Practice (GCASP).

Actuarial Function (AF): An administrative resource to undertake the particular governance tasks described in Article 48 of the **Solvency II Directive**.

Actuarial function report (AFR): The report from the **Actuarial Function** to the **AMSB** in accordance with article 48 of the **Solvency 2 Directive** and associated **regulations, standards and guidelines**.

Actuary: An individual member of a professional association of actuaries which is a full member of the Groupe Consultatif Actuariel Européen.

AF: Actuarial Function

AFR: Actuarial Function Report

AMSB: Administrative, management or supervisory body.

Anti-Selection: The progressive tendency of a portfolio of insurance contracts to attract or retain insured risks with a higher risk profile

Approved Person: An individual approved by a regulator to hold a **controlled function** within an insurance or reinsurance undertaking.

Assumptions: Values of parameters assumed for use in models.

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..

Continuing Professional Development (CPD): The continuous acquisition of knowledge, keeping up-to-date with changes in the regulatory environment and familiarising oneself with relevant material, both technical and professional, throughout one's professional life. Member Associations of the Groupe Consultatif may lay down specific requirements to be fulfilled in relation to Continuing Professional Development (CPD).

Controlled function: a function, relating to the carrying on of a regulated activity by an authorised person or a firm²

Data: 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.

To document: To record in documentation.

Documentation: Records of facts, opinions, explanations of judgements and other matters. Documentation may be paper or electronic based. It is not necessarily provided to intended users but should be available to any reviewer. Documentation is material if it concerns a material matter.

EIOPA: The **European Insurance and Occupational Pensions Authority** is a European Union financial regulatory institution that replaced the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).

EU-Commission: The executive body of the European Union.

² In UK controlled functions are specified, under section 59 of the Act (Approval for particular arrangements), in the table of controlled functions., In Germany there is a controlled function « Verantwortlicher Aktuar nach §11 VAG»

GCASP1: Groupe Consultatif Actuarial Standard of Practice 1: Quality of Actuarial Work under the **Solvency II Directive**.

IAA: The International Actuarial Association is the worldwide association of professional actuarial associations and individual actuaries.

Insurance business: The business of effecting or carrying out contracts of insurance.

Insurance undertaking: A direct life or non-life insurance undertaking which has received authorisation to carry out insurance business in accordance with Article 14 of the **Solvency II Directive**.

Intended user: Any legal or natural person (usually including the principal) whom the actuary intends to use the work product at the time the actuary provides professional services. Here intended users are those people whose decisions a report is intended (at the time of writing) to assist. Examples of possible users are those to whom the report is addressed, regulators and third parties for whose benefit a report is written.

ISAP : International Standard of Actuarial Practice issued by the IAA.

Material: Matters are material if they could, individually or collectively, influence the decisions to be taken by intended users of the related information given. Assessing materiality is a matter of reasonable judgement which recommends consideration of the intended users and the context in which the work is performed and reported.

Measure: The approach that is used to define how an (uncertain) asset or liability amount is quantified. Two different measures of the same asset or liability may produce different results.

Method: The mechanism that is used to quantify an (uncertain) asset or liability amount, when a **measure** has been specified.

Model: A simplified representation of some aspect of the world. A model is defined by a specification 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 implementation to produce a set of outputs from inputs in the form of data and parameters.

Omnibus II Directive: Directive 2012/???/EC

Opinion: A statement summarising the key findings of the **actuary's** work.

Policy: A statement of principles or rules setting out how an undertaking intends to act in specific circumstances. It is normally approved and adopted by the AMSB of the undertaking. For the purposes of the actuarial function's opinion in relation to an undertaking's underwriting policy, this is interpreted to include the actual operation of the underwriting policy and the processes and procedures which give effect to this.

Principal: The party who has the right to provide direction to the provider of professional services. The principal will usually be the client or the employer of the actuary.

Professional services: Services provided to a principal, which may include the rendering of advice, recommendations, findings or opinions based upon actuarial considerations.

Proportionate: At an appropriate level of detail and complexity.

Regulations: Level 2 measures (reference) issued by the European Commission under powers contained within the Solvency II Directive.

Reinsurance arrangement: Reinsurance contracts and any Special Purpose Vehicle ("SPV") and other risk mitigating contracts used as part of the overall reinsurance policy of the undertaking.

Reinsurance undertaking: An insurance undertaking which has received authorisation to carry out the business of reinsurance in accordance with Article 14 of the **Solvency II Directive**.

Report: An actuary's communication presenting the results of professional services.

Reporting Actuary: An actuary appointed by an insurance or reinsurance undertaking to produce the actuarial function report or parts of it.

Solvency II Directive: Directive 2009/138/EC.

Solvency II principles: The provisions contained in the **Solvency II Directive** and the associated **standards and guidelines**.

Specification: A description of a model that describes the matters to be represented, the inputs and their interactions with each other, and the outputs to be produced.

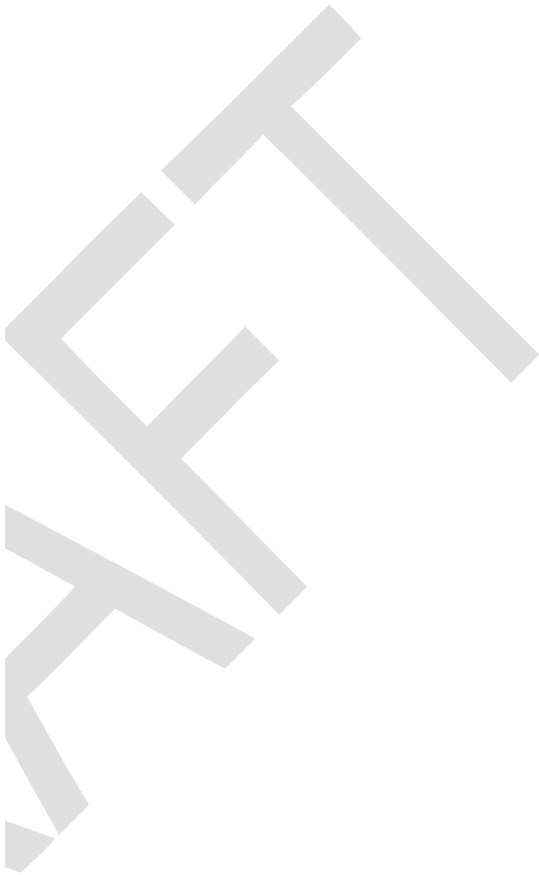
Standards and guidelines: Binding (Level 2 or level 3) standards and non-binding guidelines issued by EIOPA under powers given by the Omnibus II Directive

Technical Provisions: The technical provisions of an undertaking calculated under the valuation principles of the **Solvency II Directive** (Articles 75 to 85)

Undertaking: An **insurance** or **reinsurance undertaking**

Underwriting: The process of defining, evaluating and pricing (re)insurance risks, including the acceptance or rejection of the obligation to pay or indemnify the insured under a contract of (re)insurance.

Work product: The totality of the professional services provided by an actuary to intended users including any opinion or report, as well as any supporting calculations and documentation.



Section 3. Appropriate Practices

3.1 General principles

- 3.1.1 The **AF** must produce a written report (the **Actuarial Function Report**) to be submitted to the administrative, management or supervisory body (**AMSB**), at least annually.
- 3.1.2 The **AFR** must express a conclusion from the **AF** on the adequacy and reliability of the **Technical Provisions** as per section 3.2 of this standard. Where the **AFR** concludes that the **Technical Provisions** are either inadequate or unreliable, a summary of the key areas of concerns and recommendations should be included in the conclusion.
- 3.1.3 The **AFR** must express a conclusion on the **underwriting policy** as per section 3.3 of this standard and whether it reflects and is consistent with the risk appetite of the company. Where any shortcomings are identified, a summary of the key areas of concerns and recommendations should be included in the conclusion.
- 3.1.4 The **AFR** must express a conclusion on the reinsurance **policy** as per section 3.4 of this standard and whether it reflects and is consistent with the risk appetite of the company. Where any shortcomings are identified, a summary of the key areas of concerns and recommendations should be included in the conclusion.
- 3.1.5 In forming and formulating its own professional conclusions, the **AF** should be objective and free from influence of other functions or the **AMSB** and provide its opinion in an independent fashion.
- 3.1.6 The **AFR** must document all tasks that have been undertaken by the **AF** and their results.
- 3.1.7 The **AFR** must clearly identify any deficiencies and give recommendations as to how such deficiencies should be remedied.
- 3.1.8 The level of detail of the **AFR** should be dependent on nature, scale and complexity of the underlying risks of the undertaking. (Principle of Proportionality)
- 3.1.9 The **AFR** should include sufficient information and discussion about each area covered so as to enable the **AMSB** to judge its implications.
- 3.1.10 The **AFR must** identify the individuals responsible for writing the report and if applicable the person taking overall responsibility for the production of the **AFR**.
- 3.1.11 The **AFR** should provide information to demonstrate that each of the writers of the **AFR** and if applicable the person taking overall responsibility for the **AFR** has the relevant knowledge and experience to fulfil the role.
- 3.1.12 The **AFR** should include a description of the main responsibilities and tasks of the **AF**, including such which are not required by the **Solvency II principles**.
- 3.1.13 The **AFR** should also provide details of any **approved person** relationship the **Reporting Actuary** may have with regulators.
- 3.1.14 The **AF** should consider the preference of the undertaking's **AMSB** on depth of reporting and on the potential inclusion of additional topics in the **AFR**. This standard does not prevent items or tasks appearing in the **AFR** which are not specifically referred to in this standard.
- 3.1.15 The **AFR** must set out information in relation to how relevant **conflicts of interest** have been managed.
- 3.1.16 The **AFR** should set out the data used to reach the opinions expressed and should draw attention to any material areas of uncertainty and their sources, and also any material judgements made in the assessments

by the **Actuarial Function**.

- 3.1.17 The **AF** should disclose any material reliance on other work and how the **AF** gained assurance on the reliability of the other work.
- 3.1.18 The **AF** should seek feedback on the contents from the **AMSB** after submission of an **AFR**.
- 3.1.19 Details of whether recommendations in the **AFR** have been adapted, and, if so, on progress towards implementation should be summarised in the next **AFR**.
- 3.1.20 The **AFR** may explicitly state compliance with this standard.

3.2 Technical Provisions

3.2.1 Conclusion on adequacy of Technical Provisions

- 3.2.1.1 The **AFR** must express an opinion from the **AF** on the adequacy and reliability of the **Technical Provisions**.
- 3.2.1.2 The opinion should include the results of an assessment whether the **Technical Provisions** have been calculated in accordance with Articles 76 to 85 of the **Solvency II Directive** and advise if any changes are necessary in order to achieve compliance.
- 3.2.1.3 The **AFR** must clearly state and explain any concerns the **AF** may have as to the sufficiency of the **Technical Provisions**, in particular the degree of uncertainty about the ultimate outcome and the circumstances that might lead to the outcome deviating significantly from the **Technical Provisions** made.

3.2.2 Important information about Technical Provisions

- 3.2.2.1 The **AFR** should disclose how the **AF** has assessed the sufficiency of technical provisions.
- 3.2.2.2 The **AF** must ensure that all factors, including risk drivers and assumptions made, which have material impact on the amount of **Technical Provisions** are made clear in the **AFR**.
- 3.2.2.3 In particular the **AFR** must draw attention to any material judgements made in the calculation of **Technical Provisions**.
- 3.2.2.4 The **AFR** must draw attention to any issues in relation to the **Technical Provisions** that require the special consideration of the **AMSB**.
- 3.2.2.5 In particular the **AFR** must draw attention to any material areas of uncertainty and their sources related to the calculation of **Technical Provisions**.
- 3.2.2.6 To comply with 3.1.9 of this standard the information and discussion related to **Technical Provisions** the **AFR** must as a minimum include considerations of the **AF** with regard to the issues addressed in 3.2.3 to 3.2.8.

3.2.3 Disclosure of opening and closing Technical Provisions

- 3.2.3.1 The **AFR** must disclose the opening and closing **Technical Provisions**, split, to the extent possible between best estimate and risk margin.
- 3.2.3.2 The **AFR** must disclose a reconciliation of **Technical Provisions** which shows a breakdown of the change over the reporting period including, where appropriate, the impact of new business, the impact of actual experience diverging from any assumptions made, the effect of any model changes, the effect of assumption changes and the amount of any unexplained movements. A commentary on the main items of movement should be provided.

3.2.4 Co-ordination of process

- 3.2.4.1 The **AFR** must include an overview of the overall process employed in respect of the calculation of the **Technical Provisions**. This should include a description of the key responsibilities and tasks, the review and sign-off process and how **conflicts of interest** have been managed.
- 3.2.4.2 The **AFR** must contain a clear description of any shortcomings identified in the overall process and the recommendations of the **AF** in respect of these.

3.2.5 Sufficiency and quality of data

- 3.2.5.1 The **AFR** must provide an overview of the review undertaken by the **AF** of the data used to perform the calculation of **Technical Provisions**. This should include an assessment of the internal processes and procedures in place in relation to the accuracy and completeness of the data used. The **AFR** should make it clear what reliances have been made by the **AF** in making this assessment.
- 3.2.5.2 The **AFR** should include an assessment of the appropriateness of the data for the use to which it is being put, disclosing any interpretations made of the data which are considered as material.
- 3.2.5.3 The **AFR** should describe any limitations in the data that have materially added to the uncertainty of the results or reliability of estimates. Such limitations might include its fitness for purpose, consistency over time, timeliness, information technology systems, availability of individual policy data and of historical data. The **AFR** should outline how these limitations have been addressed in relation to the calculation of **Technical Provisions**, for example if any adjustments were made to the data.
- 3.2.5.4 If the **AF** has doubts about the material correctness and completeness of the data used, then the **AFR** must disclose this. It should describe any approaches used to mitigate such shortcomings and disclose the nature and amount of any adjustments made to the **Technical Provisions** in this regard. The **AF** must provide its recommendation on how to overcome such shortcomings to the **AMSB**.

3.2.6 Methodologies and models

- 3.2.6.1 The **AFR** must provide a description of the methods used in the calculation of the **Technical Provisions**, an explanation of why such methods were chosen and how their appropriateness has been assessed with regard to the specific lines of business of the undertaking and the way in which it is being managed. The **AFR** should also disclose how the appropriateness of methods has been judged not only in relation to the principal benefits specified under contracts written by the undertaking but also any ancillary benefits, including options and guarantees.
- 3.2.6.2 The **AFR** should indicate the nature of the cash inflows and outflows being quantified, including the unit, the time horizon of any projection and the projection steps.
- 3.2.6.3 The **AFR** should give an overview and assessment of any models and information technology systems used in the calculation of **Technical Provisions**, highlighting any shortcomings.
- 3.2.6.4 Where the **Technical Provisions** depend on additional models, for example that used to calculate the capital requirements used in the cost-of-capital calculation for the risk margin, the **AFR** should make reference to any material differences between the models and what allowance has been made in respect of these.
- 3.2.6.5 The **AFR** should disclose and justify any material changes in methodologies from those used in the previous **AFR**.
- 3.2.6.6 The **AFR** should draw attention to any unusual or non-standard techniques which have been used.
- 3.2.6.7 The **AFR** should give an overview of the business covered, the split of data into homogeneous risk groups and how this split has been assessed for appropriateness.

- 3.2.6.8 The **AFR** should also disclose any judgements made in relation to the definition of contract boundaries which have a material impact on the amount of **Technical Provisions**.
- 3.2.6.9 The **AFR** must disclose, where appropriate, the methodology used to calculate **Technical Provisions** in respect of contracts where insufficient data has prevented the application of a standard actuarial method, specifically those cases referred to in Article 82 of the Solvency II Directive. The **AFR** should comment on the approach used for such contracts, any limitations imposed by the techniques used and additional resulting uncertainty.

3.2.7 Assumptions

- 3.2.7.1 The **AFR** must include a description of the methodology used to determine the assumptions underlying the **Technical Provisions**. This should include a description of the data, and its source, relied upon for this purpose.
- 3.2.7.2 The **AFR** must disclose any significant judgements made in the determination of assumptions, including any approximations used. Where appropriate, a sensitivity analysis should be included. The **AFR** should also indicate those assumptions which are outside the control of the undertaking, for example, where dictated by external considerations.
- 3.2.7.3 The **AFR** must disclose the key assumptions underlying the calculation of the technical provisions and explain their appropriateness in relation to the main drivers of risk likely to affect the (re)insurance receivables of the company. The **AFR** should highlight those assumptions considered to exhibit a high degree of uncertainty. The sensitivity of the **Technical Provisions** to the main drivers should also be shown.
- 3.2.7.4 The **AFR** should disclose any material changes made to the assumptions used compared to the previous **AFR** and any material change to the sensitivity of individual assumptions.
- 3.2.7.5 The **AFR** should mention any particular issues in relation to the assumptions which the **AF** feels should be brought to the attention of the **AMSB**. These may include, but are not restricted to, the following:
- The appropriateness of any allowance made in respect of contractual options and guarantees and policyholder behaviour.
 - How reasonable and verifiable the assumptions are in relation to future management actions.
 - The assumptions made in respect of amounts recoverable from counterparties, for example, in respect of outward reinsurance and the likelihood of such recoveries.
 - The interpretation taken by the **AF** in the calculation of **Technical Provisions** in respect of any areas of discretion exercised by the company which might impact on its future (re)insurance obligations to customers.
 - The interpretation taken by the **AF** where uncertainty exists in relation to any obligations which might exist over and above contractual obligations.

3.2.8 Comparing best estimates against experience

- 3.2.8.1 The **AFR** must disclose and comment on the processes and procedures in place that enable best estimates, and the assumptions underlying those estimates, to be regularly compared against actual experience.
- 3.2.8.2 The **AFR** should draw attention to those areas where actual experience has materially deviated from assumptions made, and provide a justification for these deviations. In doing so, the **AFR** should distinguish between deviations which are judged to arise from volatility of the underlying experience and those which are viewed as impacting on the appropriateness of the data, methodologies or assumptions used.

- 3.2.8.3 The **AFR** must disclose the **AF**'s conclusions from the process of comparing best estimates against actual experience, specifically in relation to the quality of previous estimates and any changes recommended in relation to the data, methodologies or assumptions used in the calculation of Technical Provisions.

3.3 Opinion on adequacy of reinsurance arrangements

3.3.1 Conclusion on the adequacy of reinsurance arrangements

- 3.3.1.1 The **AFR** must express an opinion from the **AF** on the adequacy the reinsurance arrangements.
- 3.3.1.2 The **AFR** should explain any concerns the **AF** may have as to the adequacy of the reinsurance arrangements.
- 3.3.1.3 The **AFR** should outline recommendations of the **AF** to improve the **reinsurance arrangements** where there is inconsistency and a risk of non-performance.

3.3.2 Important information about reinsurance arrangements

- 3.3.2.1 The **AFR** should set out how the **AF** has arrived at its opinion.
- 3.3.2.2 The **AFR** should include an overview of any areas where additional work was required during the financial period, for example in assessing reinsurance adequacy on reserves where commutation has taken place. For example, the impact of reinsurance arrangements in the event of significant claims or events and their interaction with the remaining reinsurance cover.
- 3.3.2.3 The **AFR** should include a commentary on the impact of any disputes with the reinsurers.

3.3.3 Overview of reinsurance arrangements

- 3.3.3.1 The **AFR** should include an overview of (material) reinsurance contracts and any Special Purpose Vehicle ("SPV") used as part of the overall reinsurance strategy of the undertaking.
- 3.3.3.2 The **AFR** should disclose the impact of **reinsurance arrangements** on the undertaking's balance sheet at the opening and closing reporting date. The **AFR** should disclose a breakdown of the change over the reporting period including the impact of new **reinsurance arrangements**. A commentary on the main items of movement should be provided.

3.3.4 Overview of the overall process employed in respect to reinsurance arrangements

- 3.3.4.1 The **AFR** should include an overview of the overall process employed in respect **of reinsurance arrangements**.
- 3.3.4.2 This should include a description of the key responsibilities and tasks, the review and sign-off process and how conflicts of interest have been managed.
- 3.3.4.3 This may include a description of relevant additional services provided by reinsurance undertakings, for example assistance with business plans, product development, underwriting guidelines, claims management, policy administration.
- 3.3.4.4 The **AFR** should explain any concerns the **AF** may have as to the appropriateness of these processes.

3.3.5 Areas of adequacy of reinsurance arrangements

- 3.3.5.1 The adequacy of reinsurance arrangements should include consideration on the issues addressed in 3.3.6. to 3.3.9.

3.3.6 Compliance with Solvency II principles

- 3.3.6.1 When undertakings use SPVs, the **AFR** should disclose the extent to which the requirements and guidelines set out in Level 2 Advice on Special Purpose Vehicles have been adhered to.

3.3.7 Consistency with other policies of the undertaking

- 3.3.7.1 The **AFR** should outline the extent to which the **reinsurance arrangements** of the undertaking are consistent with other policies of the undertaking.
- 3.3.7.2 As minimum this should include an assessment of consistency with the risk appetite, the **underwriting policy** and the proceedings related to **Technical Provisions** of the undertaking as per 3.3.7.3 to 3.3.7.5
- 3.3.7.3 The **AFR** should make references to the **reinsurance arrangements** as outlined in the risk management policy of the undertaking referred to in Article 44(2) of the Solvency II Directive, including an assessment of the consistency of the undertaking's **reinsurance arrangements** with its risk appetite.
- 3.3.7.4 The **AFR** should make references to the overall underwriting policy of the **undertaking** including an assessment of the consistency of the undertaking's **reinsurance arrangements** with the overall underwriting policy.
- 3.3.7.5 The **AFR** should make references to the treatment and effect of reinsurance on the estimation of net technical provisions.

3.3.8 Effectiveness of reinsurance arrangements

- 3.3.8.1 The **AFR** should outline the extent to which the reinsurance arrangements support the ability of the undertaking to remain solvent in stressed scenarios.
- 3.3.8.2 The **AFR** may include an outline of a scenario under which the cover of the reinsurance arrangement is exhausted, including an assessment of the likelihood that reinsurance cover will be exhausted and under which circumstances such scenario might arise.
- 3.3.8.3 The **AFR** may include a calculation of the amounts recoverable from reinsurance contracts and special purpose vehicles in stressed scenarios and an assessment of the impacts on the undertaking's solvency.
- 3.3.8.4 The **AFR** should include an assessment of the ability of reinsurers and SPV's to be able to fulfil their liabilities in a stressed environment.

3.3.9 Impact of reinsurance arrangements on the undertaking's financial strength.

- 3.3.9.1 The **AFR** should include an assessment of the effect of reinsurance arrangements on the volatility of the undertaking's financial strength.

3.4 Opinion on underwriting policy

3.4.1 Conclusion on the adequacy of the overall underwriting policy

- 3.4.1.1 The **AF** must prepare an opinion on the overall underwriting policy of the undertaking.
- 3.4.1.2 The **AFR** must include the results of the **AF**'s assessment whether the underwriting policy itself is suitable, and has been followed in writing business over the period and provides an overall conclusion in respect of the suitability of the underwriting policy.
- 3.4.1.3 The **AFR** should explain any concerns the **AF** may have as to the suitability of the overall underwriting policy.
- 3.4.1.4 The **AFR** should outline recommendations to improve the overall underwriting policy, where appropriate.

3.4.2 Important information about the overall underwriting policy

3.4.2.1 The **AFR** should set out the basis for the **AF**'s opinion.

3.4.3 Overview of overall underwriting policy

3.4.3.1 The **AFR** may include an overview of the overall underwriting policy to support the discussion of the **AF**'s conclusions.

3.4.4 Overview of the overall process in respect to underwriting

3.4.4.1 The **AF** may include an overview of the overall process related to underwriting policy to support the discussion of the **AF**'s conclusions.

3.4.4.2 This may include a description of the key responsibilities and tasks, the review and sign-off process and how conflicts of interest have been managed.

3.4.5 Areas of consideration

3.4.5.1 The **AFR** must as a minimum include conclusions regarding the issues addressed in 3.4.6. to 3.4.10.

3.4.5.2 The **AFR** may include considerations in other areas where the **AF** believes it is necessary to support the **AF**'s conclusions on the overall underwriting policy. Additional guidance is given in 3.4.11.

3.4.6 Sufficiency of premiums

3.4.6.1 The **AFR** must conclude whether the premiums are expected to be sufficient in light of the operation of the underwriting policy. This assessment may be performed using the calculations supporting the Technical Provisions and may be supplemented, for example, by a comparison of pricing bases to the current experience.

3.4.6.2 This assessment must take into consideration of the impact of the underlying risks (including underwriting risks) that the business is exposed to, and the impact of options and guarantees included in insurance and reinsurance contracts on the sufficiency of premiums. This assessment should be linked into the ORSA process and the assessment of **Technical Provisions**.

3.4.6.3 The **AFR** should state the process that has been followed and indicate any material differences in the experience analysis compared to assumptions used in the wider business (for example, in the business planning and underwriting processes).

3.4.6.4 The **AFR** should summarise the major risks which may affect future experience.

3.4.6.5 The **AFR** must assess whether the profitability and volatility of the business plans are within the insurer's risk appetite and make any other relevant comments on the inter-relationship between the plan and the risk appetite.

3.4.7 External environment

3.4.7.1 The impact of changes in the external environment on the underwriting policy should be summarised, along with recommendations to manage any risks. Such changes could include, but not limited to inflationary changes, the impact of legal risks, a change in the composition of the undertaking's portfolio, the impact of epidemics, advances in medical care or technology.

3.4.8 Adjustments to Premiums

3.4.8.1 For products where premiums may be adjusted in response to experience, the **AFR** must summarise any instances where premiums have been adjusted and the reasons for these adjustments.

3.4.8.2 Where premiums have not been adjusted in response to emerging experience (e.g. for competitive reasons), the **AFR** must summarise the reasons for this and provide an assessment of the impact of this decision.

3.4.9 Anti-selection

3.4.9.1 The **AFR** must assess whether the underwriting process and controls used to manage the risk of anti-selection have been effective. The **AFR** should include an assessment of the likelihood of any anti-selection in particular product classes and recommendations to manage this risk.

3.4.9.2 In respect of anti-selection, the **AFR** may include:

- A summary of the experience analysis performed
- Any trends observed in the experience analysis; and
- An assessment of the composition of the in force business against the assumptions made in the pricing process

3.4.10 Consistency with other policies of the undertaking

3.4.10.1 The **AFR** should outline the extent to which the overall underwriting policy of the undertaking is consistent with other policies of the undertaking.

3.4.10.2 As minimum this should include an assessment of the consistency with the risk appetite, the **reinsurance arrangements** and **Technical Provisions** of the undertaking.

3.4.11 Additional information

3.4.11.1 The information listed in 3.4.11.3 to 3.4.11.6 may be included in the **AFR** where the **AF** believes it is necessary to support the **AF**'s conclusions on the overall underwriting policy.

3.4.11.2 This list is not intended to be exhaustive and the **AF** may include any additional information necessary to support its conclusions on the overall underwriting policy.

3.4.11.3 The **AFR** may include an assessment of whether the underwriting policy is consistent with the approach to product pricing used by the company.

3.4.11.4 The **AFR** may include an assessment of the principal risk factors influencing the profitability of business to be written during the next year, including the potential impact on future profitability of external factors (for example: economic, inflation, legal risk and changes in the market environment etc.).

3.4.11.5 The **AFR** may include an assessment of the likely financial impact of any material planned changes in terms and conditions of the products sold by the company.

3.4.11.6 The **AFR** may include an assessment of the likely variability surrounding the estimate of expected profitability of the business.

3.5 Contribution to risk management

3.5.1 The **AFR** should list the key areas where the **AF** has contributed to the implementation of the risk management system as required by Article 48 (i), in particular with respect to the risk modelling underlying the calculation of the capital requirements set out in Chapter VI, Sections 4 and 5, and the assessment referred to in Article 45.

3.5.2 The **AFR** should summarise the main findings of these activities and, in particular, list recommendations for future improvements.

3.5.3 In particular any material risks that have not been covered by the risk management system should be highlighted.

3.5.4 Where an insurance or reinsurance **undertaking** has an approved internal model, the **AFR** should indicate any inconsistencies between the **Technical Provisions**, the **reinsurance arrangements** and the overall underwriting policy and related assumptions and values in the internal model.



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Explanatory Note from GCASP2 Drafting Team (DT)

30 August 2012

1. Purpose

Reference

The main purpose of this document is supporting the discussion of the Draft with stakeholders and individuals.

2. References

Whenever necessary we will refer explicitly to the relevant parts of the draft standard. The respective numbering of the standard is given on the right hand side.

3. Starting conditions

1. Principles based Standard
2. No conflict or overlap with an IAA standard (including the current state of the ISAP 1), unless there are specific circumstances in EU which justify the differences
3. Exclusively focussing on tasks of the Actuarial Function mentioned in the SII Directive or in related Level 2 or 3 guidance
4. Closely linked to related Directive and relevant EIOPA Guidance
5. Starting with structure of ISAP1
6. Focussed on the needs of the main recipient of the report (= Management)
7. Focussed on the report and the information/opinions given therein, which means that we should address issues/tasks to be dealt with, but NOT on how these are dealt with.
8. Needs to fit to all (re-)insurance business models and portfolios

4. Structure of the Standard

ISAP1 has been used as a starting point for the structure of the GCASP2. However there was need for adjustments.

5. General Considerations of the DT

5.1 Should standard prescribe a structure for the AFR?

The DT had a working structure in mind, which is more or less given by the structure of the standard itself, but the standard won't prescribe a structure for the AFR.

This should allow flexibility for actuaries to adopt an approach that is appropriate to

their company. On the other hand, the standard will include minimum contents (per approach used in ISAP 1) to help maintain consistency and the minimum requirements of SII.

5.2 Should the standard also apply to actuaries employed by auditors or supervisors?

No, the standard shall apply only to the reporting actuaries. However audit or supervisory actuaries need to be aware of it and its content when working with AFR in their respective roles (but not as reporting actuaries.)

5.3 Should the standard also apply to actuaries who are not members of an actuarial association and to non-actuaries responsible for the AFR?

GCASP2 cannot be binding¹ on non-actuaries. A potential solution would be enforcement by EIOPA and/or national supervisory authorities.

5.4 Potential risk that standard gets overly prescriptive

The DT is aware that there is such risk. However at least regarding technical provisions the Directive itself is already prescriptive. There was need to balance between just giving broad principles and a level of detail giving guidance to reporting actuaries.

5.5. Usage of “must”, “should” and “may” in GCASP2

While a general interpretation of these terms is given in the introductory part of the standard, the DT has tried to indicate the binding level as given by the Solvency II regulation as follows:

- “Must” is appropriate for topics required in the Directive or L2/L3 guidance.
- “Should” is appropriate for topics mentioned therein, but not as a requirement
- “May” is appropriate either when the Directive or L2/L3 guidance states “may” or it is a recommendation made by the GC.

An exemption from this rule is the requirement made in 3.1.10 that the individual responsible for writing the AFR must be identified in the AF, which is not explicitly required under S II regulation.

3.1.10

6. Tasks of Actuarial Function

3.1.14

According to Level 2 guidance given by the EU commission the AFR shall document all tasks that have been undertaken by the actuarial function and their results.

The list of tasks given in the Solvency II directive does not, however, preclude the allocation of further duties to the actuarial function as the administrative, management or supervisory body sees fit, provided this does not compromise the proper segregation of duties within the undertaking.²

GCASP 2 relates only to those tasks of the actuarial function which are explicitly mentioned in the Solvency II directive. However the standard would not prevent items/tasks appearing in the report which are not specifically referred in the standard.

¹ It needs to be noted here that GCASP2 is not binding even for actuaries unless it is adopted by a member association or an actuary declares it as binding (c.f. 2. Introduction 1.)

² CEIOPS” Advice for Level 2 Implementing Measures on Solvency II: System of Governance (former Consultation Paper 33) October 2009 – 3.295

Reasoning: The allocation of tasks to the AF is left to the individual companies, such that the AF potentially performs additional tasks not listed in Article 48 of the directive. In case that the AMSB expects the AF to include reporting related to these tasks the standard should not be preventive.

6.1 Shall the standard suggest a list of tasks and/or topics to be considered?

- The standard would not require an exhaustive listing of all tasks to be performed.
- A minimum list is given by the standard including all topics explicitly mentioned in the directive or binding L2/L3 regulation.
- Possibly a non-exhaustive list of tasks could be given in the commentary to the standard.

7. Documentation of Tasks

3.1.6

3.1.14

Solvency II regulation requires the documentation of all tasks the AF has performed to fulfil its duties. This may interfere with the AMSB's preference of depth of reporting. There is the possibility that the AFR may be made up of a number of sub-reports, which should be then referenced in the main final report.

8. Approved Person

3.1.13

In some jurisdictions there are requirements that insurance undertakings have to name individuals ("Approved Person") who have to take regulated and activities ("Controlled functions") specified in the applicable insurance laws.

In UK controlled functions are specified under section 59 of the Act (Approval for particular arrangements) in the table of controlled functions. In Germany there is a controlled function « Verantwortlicher Aktuar » required in the German insurance law (§11 VAG).

The standard requires disclosure if there are Approved Persons within the AF.

9. Conflicts of Interest

3.1.15

3.2.4.1

The AFR must set out information in relation to how conflicts of interest have been managed. This would normally contain a list of potential conflicts of interest and commentary on how these have been mitigated including discussion of any particular issues arising. For example, there should be a commentary in relation to how an appropriate segregation of duties has been achieved between actuaries carrying out the underlying tasks and decisions of the areas commented upon in the AFR, such as technical provisions, reinsurance and underwriting, and those actuaries responsible for the AFR itself. A further example relates to any potential conflicts of interest that might arise as a result of a reporting actuary's remuneration structure, particularly variable elements.

10. Actuarial Function perspective

3.3

3.4

The skills and experience of the Actuarial Function can provide a different perspective from underwriters or reinsurance teams. This perspective, when communicated to the administrative, management or supervisory body, will help ensure it is fully informed. The opinions on the underwriting policy and reinsurance arrangements include, when necessary, recommendations regarding the most appropriate strategies to be followed by the undertaking in this matter.

11. Interrelationships	3.2
	3.3
	3.4

Underwriting policy, reinsurance arrangements and technical provisions are interdependent according to the nature of an undertaking's business. Changes in underwriting policy and practice, for example, may not only affect the calculation of technical provisions, but also the adequacy of reinsurance arrangements.

12 Target Audience of AFR	3.1.14
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The report should focus on the needs of the Board of Directors (AMSB) as referred to in the S II directive. The Actuarial Function Report should therefore not normally repeat detailed information provided in other reports, but instead cross reference them where necessary.

13 Assessment of the sufficiency of TP	3.2.2.1.
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The AFR should disclose how the AF has assessed the sufficiency of technical provisions. This could be done for example by means of back-testing, sensitivity testing, a comparison of actual and expected experience or other analyses.

14 Assessment of reinsurance processes	3.3.4.4.
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Solvency II does not require the AF to assess these processes. In the DT view the AFR should nevertheless explain any concerns the AF may have as to the appropriateness of these processes.

The level of sophistication for these processes and procedures should be proportionate to the nature, scale and complexity of the undertaking's risks and to the capabilities of the undertaking to manage and control the risk management techniques used.

Processes and procedures in selecting the appropriate reinsurance arrangement could be the following:

- a) Identification of the level of risk transfer appropriate to the undertaking's approach to risk;
- b) Types of reinsurance arrangements that are most appropriate to limit risks to the undertaking's insurance risk profile;
- c) Principles for the selection of reinsurance counterparties;
- d) Procedures for assessing the creditworthiness and diversification of reinsurance counterparties;
- e) Procedures for assessing the effective risk transfer;
- f) Concentration limits for credit risk exposure to reinsurance counterparties and appropriate systems for monitoring these exposures; and
- g) Liquidity management to deal with any timing mismatch between claims' payments and reinsurance recoveries.

15 Level 2 requirements and guidelines on Advice on Special Purpose Vehicles	3.3.6.1
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The standard refers to Level 2 requirements which are given below.

- a) The fully funded requirement shall be actively monitored by the undertaking through its system of governance;
- b) Any remaining risk from the SPV shall be fully taken into account in the

undertaking through its risk management system and also taken into account within the calculation of its regulatory capital requirements.

16 Risk management policy of the undertaking referred to in Article 44(2) of the Solvency II Directive **3.3.7.1**

In the risk management policy the undertaking should consider at least the following with regard to reinsurance and other risk mitigation techniques:

- a) Identification of the level of risk transfer appropriate to the undertaking's defined risk limits and which kind of reinsurance arrangements are most appropriate considering the undertaking's risk profile;
- b) Principles for the selection of reinsurance counterparties and procedures for assessing and monitoring the creditworthiness and diversification of reinsurance counterparties;
- c) Procedures for assessing the effective risk transfer;
- d) Liquidity management to deal with any timing mismatch between claims' payments and reinsurance recoveries; and
- e) Procedures for ensuring that policyholders continue to receive benefits in line with aims and of objectives originally communicated to them.

17 Opinion on underwriting policy **3.4**

The AFR should not comment on every single policy, but rather on the undertaking's underwriting in general (that is, the overall process followed, checks and controls used to manage the risks that are being underwritten as well as operational risks arising from inappropriate underwriting).

18 How long should an AFR be?

The DT has discussed how long the report will potentially be in the starting phase of the drafting.

Considering the draft standard having almost 20 pages the resulting report may be quite long, contradicting the intention of serving the needs of the AMSB.

However one needs to note that everything needs to be considered but not all of them need to be reported on (e.g. due to materiality).

19 Relationships to other reports required under Solvency II

The current version of the standard does not consider potential relationships of the AFR to other reports under Solvency II, for example ORSA reporting.

20 Relationship between GCASP2 and ISAP1

GCASP2 includes some generic principles, which the DT expects to be covered also under the forthcoming ISAP1, which is currently under discussion by the IAA. The drafting of GCASP2 has been started using the structure of ISAP1. The DT regards it highly probable that there will be overlapping and less probable that there will be inconsistencies between both standards. A later version of GCASP2 may avoid any duplication.