EUROPEAN STANDARD OF ACTUARIAL PRACTICE 2 (ESAP2)
ACTUARIAL FUNCTION REPORT UNDER DIRECTIVE 2009/138/EC

FINAL MODEL STANDARD including issuer considerations and reference to regulatory requirements

Date: 16 April 2021 <exposure draft>

Sources being used for regulatory requirements cited:

1. **Level 1 (L1): DIRECTIVE 2009/138/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), 25.11.2009 ("Solvency II Directive") and amendments published in 2011/89/EU, 2012/23/EU, 2013/23/EU, 2013/58/EU, 2014/51/EU, 2016/2341/EU, 2017/2402/EU, 2018/843/EU and 2019/2177/EU**
2. **Level 2 (L2): Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) and amendments published in Commission Delegated Regulations 2016/467/EU, 2016/2283/EU, 2017/669/EU, 2017/1542/EU, 2018/1221/EU, 2019/981/EU, 2019/1865/EU, 2020/442/EU and 2020/988/EU**
3. **Level 3 (L3-SoG): EIOPA – BoS – 14/253 "Final Report on Public Consultation No. 14/017 on Guidelines on system of governance", 28 January 2015**

Other sources used:

4. **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 and Revision approved by the General Assembly of the Actuarial Association of Europe on 11 October 2019**
5. **AAE Glossary : Glossary of defined terms used in European Standards of Actuarial Practice, approved by the General Assembly of the Actuarial Association of Europe on 11 October 2019**

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Editorial remarks:

- **This Document in tabular format consists of three columns:**
  - **The first column represents the text of the model standard ESAP2 presented for approval by the General Assembly.**
  - **The second column cites relevant law and regulation.**
  - **The third column includes issuer considerations and comments, as well as an allocation of the standard text to the four principles underpinning the model standard as stated in the Basis for Conclusions document issued 31 May 2013.**
- **Defined terms are formatted as bold text whereas these are formatted with a** dotted blue underline text **in the main ESAP2 document.**
- **This version has been changed compared to the model standard ESAP2 approved by the General Assembly on 31 January 2016:**
  - **Account has been taken of comments received on model standard ESAP2.**
  - **Changes in the Solvency II Directive and the Solvency II Delegated Regulation published after the approval of ESAP2 have been assessed and where appropriate reflected in the new version of ESAP2.**
  - **Definitions included in ESAP2 have been removed from ESAP2 and reference to the AAE Glossary for definitions have been included. The AAE Glossary has been extended with definitions that were included in ESAP2 but not in the AAE Glossary. Inconsistencies between definitions in ESAP2 and the AAE Glossary have been solved in the AAE Glossary.**

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
	Preface		
	This European Standard of Actuarial Practice (ESAP) is a model for actuarial standard-setting bodies to consider. The Actuarial Association of Europe (**AAE**) encourages relevant actuarial standard-setting bodies to maintain a standard or set of standards that is substantially consistent with this ESAP to the extent that the content of this ESAP is appropriate for **actuaries** in their jurisdiction. This can be achieved in many ways, including: • adopting this ESAP as a standard with only the modifications in the Drafting Notes; • customising this ESAP by revising the text of the ESAP to the extent deemed appropriate by the standard-setting body, while ensuring that the resulting standard or set of standards is substantially consistent with this ESAP; • endorsing this ESAP by declaring that this ESAP is appropriate for use in certain clearly defined circumstances; • modifying existing standards to obtain substantial consistency with this ESAP; or • confirming that existing standards are already substantially consistent with this ESAP. A standard or set of standards that is promulgated by a standard-setting body is considered to be substantially		

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	consistent with this ESAP if: • there are no material gaps in the standard(s) in respect of the principles set out in this ESAP; and • the standard or set of standards does not contradict this ESAP. If an actuarial standard-setting body wishes to adopt or endorse this ESAP, it is essential to ensure that existing standards are substantially consistent with ESAP1 as this ESAP relies upon ESAP1 in many respects. Likewise, any customisation of this ESAP, or modification of existing standards to obtain substantial consistency with this ESAP, should recognise the important fact that this ESAP relies upon ESAP1 in many respects. If this ESAP is translated for the purposes of adoption, the adopting body should select three verbs that embody the concepts of “must”, “should”, and “may”, as described in paragraph 1.5.1 Language of this ESAP, even if such verbs are not the literal translation of “must”, “should”, and “may”. This ESAP uses various terms whose specific meanings are defined in the document “Glossary of defined terms used in European Standards of Actuarial Practice” (the **AAE** Glossary). This ESAP is binding upon an **actuary** only if so directed by the **actuary’s** standard-setting body or if the **actuary** states that some or all of the **work** has been performed in compliance with this ESAP (e.g., if the **actuary** is directed by the **principal** to comply with this ESAP). This ESAP was originally adopted by the **AAE** General		

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	Assembly on 31 January 2016. This revision was adopted by the **AAE** General Assembly on <XX Month YYYY>.		
	[Drafting Notes: when an actuarial standard-setting organisation adopts this standard it should: 1. Replace "ESAP" throughout the document with the local standard name, if applicable; 2. Modify references to ESAP1 in paragraphs 1.2.2 and 2.1.2.3 to point to the local standard(s) that are substantially consistent with ESAP1, rather than referring to ESAP1 directly, if appropriate; 3. Choose the appropriate phrase and date for insertion in paragraph 1.7.1; 4. Review this standard for, and resolve, any conflicts with the local law and code of professional conduct; and 5. Delete this preface (including these drafting notes and the reference in the Table of Contents) and the footnote associated with paragraph 1.7.1]		
Section 1.	*General*		
1.1.	*Purpose*		
1.1.1	This ESAP provides guidance to **actuaries** when issuing an **Actuarial Function Report** (**AFR**) in connection with an **undertaking**'s compliance with the reporting requirements in Article 48 (1) of the **Solvency II Directive** and in paragraph 8 of Article 272 of the Commission delegated regulation on Solvency II.	**L1 - Article 48 (1):** "Insurance and reinsurance undertakings shall provide for an effective actuarial function to: ... (e) inform the administrative, management or supervisory body of the reliability and adequacy of the calculation of technical provisions; ... (g) express an opinion on the overall underwriting policy; (h) express an opinion on the adequacy of	Solvency II regulation requires undertakings and groups to set up an effective actuarial function to undertake the tasks which are listed in L1 Article 48 (1). The actuarial function shall produce a written report about the function's work and its results to be submitted to the administrative, management or supervisory body, at least annually.

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		reinsurance arrangements; ...” **L2 – 272 (8):** “The actuarial function shall produce a written report to be submitted to the administrative, management or supervisory body, at least annually. The report shall document all tasks that have been undertaken by the actuarial function and their results, and shall clearly identify any deficiencies and give recommendations as to how such deficiencies should be remedied.”	
1.1.2	The purpose of this ESAP is that the **intended users** of the **AFR** should be able to place a high degree of reliance on the **AFR**, its relevance, transparency of assumptions, completeness and comprehensibility, including the **communication** of any uncertainty inherent in the results stated in the **AFR**. In particular it does this by ensuring that the **AFR** - includes sufficient information to enable **intended users** to judge the relevance of the contents of the **AFR**; - includes sufficient information to enable **intended users** to understand the implications of the contents of the **AFR**; and - such information is presented in a clear and comprehensible manner.		Purpose as set out in “Proposal for the Groupe Consultatif to develop a model standard on the actuarial function holder report under the Solvency II Directive (GCASP2)”, 30.9.2011
1.1.3	This standard will contribute to ensuring consistent, efficient and effective practices within the **Actuarial Function** (**AF**) across **undertakings** in the European Union concerning the preparation of the **AFR**. This will strengthen and contribute towards harmonised and consistent application of EU legislation.		Purpose as set out in “Proposal for the Groupe Consultatif to develop a model standard on the actuarial function holder report under the Solvency II Directive (GCASP2)”, 30.9.2011

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
1.2	*Scope*		
1.2.1	This ESAP applies to **actuaries** performing **actuarial services** when issuing an **AFR** in connection with an **undertaking's** compliance with Article 48 (1) of the **Solvency II Directive** and paragraph 8 of Article 272 of the Commission delegated regulation (EU) 2015/35.	c.f. 1.1.1 **L2 - 268 (3):** "The persons performing a function shall promptly report any major problem in their area of responsibility to the administrative, management or supervisory body."	An actuary who provides these services may be acting in one of several capacities, such as an employee, officer or director of the principal, or be external to the principal. Reporting promptly, as referred to in L2 - 268 (3), is not formally within the scope of this ESAP but depending on the matter which is to be reported some guidance may nevertheless be relevant.
1.3	*Underlying Principles*		
1.3.1	This ESAP is based on four principles, which should be borne in mind in any assessment of compliance with this ESAP.		These principles have been stated in a similar way in the Basis for Conclusions document issued 31 May 2013 by the Groupe Consultatif. The third column of this document includes an allocation of the standard text to the four principles underpinning the working draft.
1.3.2	**Principle 1**: **Actuarial services** related to the **AFR** must be carried out consistently with Solvency II regulations and guidelines.		This principle addresses compliance with Solvency II regulation.
1.3.3	**Principle 2**: **Actuarial services** related to the **AFR** should be carried out in a way which is proportional to the nature, scale and complexity of the underlying risks of the **undertaking**. (Principle of Proportionality).	**L2 – 56 (1):** "Insurance and reinsurance undertakings shall use methods to calculate technical provisions which are proportionate to the nature, scale and complexity of the risks underlying their insurance and reinsurance obligations."	ESAP1 1.5.2 "Nothing in an ESAP should be interpreted as requiring work to be performed that is not proportionate to the scope of the decision or the assignment to which it relates and the benefit that intended users would be expected to obtain from the

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			work (Principle of Proportionality).” L2 regulation does not explicitly apply the principle of proportionality to reporting. This principle emphasizes the importance of the principle of proportionality also for the work of the AF and for the AFR. In particular statements made as part of ESAP2 need to be seen under this principle.
1.3.4	**Principle 3**: **Actuarial services** related to the **AFR** should be consistent with the code of professional conduct of the actuarial profession and with any applicable general actuarial standards.		This principle requires in particular compliance with ESAP1.
1.3.5	**Principle 4**: The **AFR** should be structured according to the needs of the **intended users**, in particular the **Administrative, Management or Supervisory Body** (**AMSB**).	**L3 – SoG Guideline 39 – Monitoring and reporting:** “The undertaking should establish monitoring and reporting mechanisms within the internal control system which provide the AMSB with the relevant information for the decision-making processes.”	The AF should consider the preference of the undertaking's AMSB on the depth of reporting and on the potential inclusion of additional topics in the AFR. The acceptance of the AFR and any recommendations depends on meeting the expectations of the key stakeholder. In particular this standard does not prevent items or tasks appearing in the AFR which are not specifically referred to in this standard. The tasks assigned to the AF and the related reporting (AFR) can be understood as part of the monitoring and reporting mechanisms mentioned in L3 – SoG Guideline 39, which states that information provided to the AMSB should be relevant

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			to its decision-making.
1.4	*Relationship to ESAP1*		
1.4.1	Insofar as possible, this ESAP does not repeat guidance already provided in ESAP1. Any **actuary** who asserts compliance with this ESAP (as a model standard) must also comply with ESAP1. References in ESAP1 to "this ESAP" should be interpreted as applying equally to this ESAP2, where appropriate.		The content of ESAP1, approved by the General Assembly of the AAE on 3 October 2014, is almost identical to ISAP 1, approved as a model standard by the International Actuarial Association (IAA) on 18 November 2012. ESAP2 refers to actuarial function reporting, whilst ESAP1 refers to general actuarial practice, and is therefore more general. The 'Actuarial Function Report – AFR' in ESAP2 is more specific than the 'Report' addressed in ESAP1. ESAP2 can be regarded as a 'Practice-Specific Standard' using the terminology of ESAP1 1.2.2.
1.4.2	A failure to follow the principles in this standard need not be considered a departure if it does not have a **material** effect. The contents of this standard should be read in that context, even where the term **material** is not explicitly used or where the word "must" is used.		
1.5	*Language*		
1.5.1.	Some of the language used in all ESAPs is intended to be interpreted in a very specific way in the context of a decision of the **actuary**. In particular, the following words are to be understood to have the meanings indicated: • "must" means that the indicated action is mandatory and failure to follow the indicated action will constitute a failure to comply with this ESAP, unless the departure is due to a conflict with law (ESAP1 1.3.1) or code of professional conduct (ESAP1 1.3.2). • "should" (or "shall") means that, under normal		This text is identical to the one used in ESAP1 1.6.1.

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	circumstances, the **actuary** is expected to follow the indicated action, unless the departure is due to a conflict with law (ESAP1 1.3.1) or code of professional conduct (ESAP1 1.3.2). However, in all other cases, if following the indicated action would produce a result that would be inappropriate or would potentially mislead the **intended users** of the **actuarial services**, the **actuary** should depart from that guidance and disclose that fact and provide the reason for not following the indicated action as described in ESAP1 1.3.3. • "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. • "any" (as in e.g. "any report") means all such items if they exist, while acknowledging they may not exist. Such a reference does not give rise to a requirement to create such an item.		
1.5.2	This ESAP uses various terms whose precise meanings are defined in the **AAE** Glossary. These terms are highlighted in the text with a dashed underscore and in blue (e.g. **actuary**).		
1.6	*Cross-references*		
1.6.1	This ESAP refers to the content of the **Solvency II Directive** and the Commission Delegated Regulation (EU) 2015/35 supplementing the **Solvency II Directive**, both as amended as per the approval date of this ESAP. If the **Solvency II Directive** or the Commission Delegated Regulation (EU) 2015/35 is subsequently amended, restated, revoked, or replaced after this date, the **actuary**		ESAP2 is a standard on specific actuarial services following the Solvency II Directive and its associated Commission Delegated Regulation. The latest amendment of the Solvency II Directive reflected in ESAP2 is per Directive 2019/2177/EU (18 December 2019, published 27 December 2019). The

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	should apply the principles in this ESAP to the extent they remain relevant.		latest amendment of the Commission Delegated Regulation (EU) 2015/35 reflected in ESAP2 is per Commission Delegated Regulation 2020/988/EU (12 March 2020, published 10 July 2020).
1.7	*Effective Date*		
1.7.1.	This standard applies to **actuarial services** relating to an **Actuarial Function Report** performed after [Date[1]].		
~~*Section 2.*~~	~~*Definitions*~~		
	~~The terms below are defined for use in this ESAP.~~	~~None~~	~~Definitions of terms which are used within their common meaning in this ESAP are not included in the Definitions section.~~ Section 2 "Definitions" is removed from ESAP2 as all definitions are included in the AAE Glossary. The ESAP2 Preface has been extended with wording similar to ESAP1: This ESAP uses various terms whose specific meanings are defined in the document "Glossary of defined terms used in European Standards of Actuarial Practice" (the AAE Glossary).
~~2.1~~	~~**Actuarial Function (AF**): An administrative capacity to undertake the particular governance tasks described in Article 48 of the **Solvency II Directive**.~~	~~**L1 - 48.1:** c.f. 1.1.1.~~ ~~**L1 - 13 (29):**~~ ~~"'function', within a system of governance, means an internal capacity to undertake practical tasks; a system of governance includes the risk management function, the compliance function, the internal audit~~	

[1] Date to be inserted by standard-setter adopting or endorsing this ESAP

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		~~function and the actuarial function"~~	
~~2.2~~	~~**Actuarial Function Report (AFR):** The **report** from the **Actuarial Function** to the **AMSB** in accordance with Article 48 of the **Solvency II Directive** and associated regulations, standards and guidelines. The **AFR** may consist of multiple components, and these components may be issued at different dates.~~	~~c.f. 3.1.1.~~	
~~2.3~~	~~**Actuary**: An individual member of one of the member associations of the Actuarial Association of Europe.~~		~~This definition refers to such actuaries to which this Model Standard applies when implemented by member associations of the AAE. However it is suggested that actuaries who are members of other actuarial associations or other professionals performing actuarial work in the context of this ESAP consider complying with this ESAP.~~
~~2.4~~	~~**Actuarial services:** Services, based upon actuarial considerations, provided to **intended users** that may include the rendering of advice, recommendations, findings or opinions.~~		~~ESAP1 definition~~
~~2.5~~	~~**AF: Actuarial Function**~~		
~~2.6~~	~~**AFR: Actuarial Function Report**~~		
~~2.7~~	~~**AMSB**: Administrative, management or supervisory body.~~	~~**L1 – 257:**~~ ~~*"Administrative, management or supervisory body of insurance holding companies*~~ ~~Member States shall require that all persons who effectively run the insurance holding company are fit and proper to perform their duties."~~	~~This term is widely used in the Level 1 regulation without being formally defined. An implicit definition is given in Level 1 Articles 40 and 257.~~
~~2.8~~	~~**Conflict of interest**: Occurs when an individual or organisation is involved in multiple interests, one of~~		

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	~~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.~~		
~~2.9~~	~~**Data** – Data means all types of quantitative and qualitative information.~~		
~~2.10~~	~~**Intended user**: Any legal or natural person (usually including the principal) whom the **actuary** intends, at the time the **actuary** performs the **actuarial services**, to use the report.~~		~~ESAP1 definition~~
~~2.11~~	~~**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**).~~		
~~2.12~~	~~**Model**: A simplified representation of some aspect of the world. A **model** is defined by a specification which 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 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**.~~		
~~2.13~~	~~**Professional judgement** – The judgement of the actuary based on actuarial training and experience.~~		
~~2.14~~	~~**Solvency II Directive**: Directive 2009/138/EC.~~		
~~2.15~~	~~**Special Purpose Vehicle (SPV):** A **special purpose vehicle** means any undertaking, whether incorporated or not, other than an existing insurance or reinsurance **undertaking**, which assumes risks from insurance or reinsurance **undertakings** and which fully funds its~~	**L1 - 13 (26)**	

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	~~exposure to such risks through the proceeds of a debt issuance or any other financing mechanism where the repayment rights of the providers of such debt or financing mechanism are subordinated to the reinsurance obligations of such an undertaking.~~		
~~2.16~~	~~**Technical Provisions**: The **technical provisions** of an **undertaking** calculated under the valuation principles of the **Solvency II Directive** (Articles 75 to 86).~~		
~~2.17~~	~~**Undertaking**: An insurance or reinsurance **undertaking** which has received authorisation to carry out the business of insurance or reinsurance in accordance with Article 14 of the **Solvency II Directive.**~~		
~~2.18~~	~~**Underwriting**: The process of defining, evaluating and pricing insurance or reinsurance risks, including the acceptance or rejection of insurance or reinsurance obligations.~~		
Section 2.	*Appropriate Practices*		
2.1	*General principles*		
2.1.1	**The Actuarial Function Report and its core parts**		
2.1.1.1	The **Actuarial Function** (**AF**) must produce a written **report** (the **Actuarial Function Report (AFR)**) to be submitted to the **Administrative, Management or Supervisory Body** (**AMSB**), at least annually. The **actuary** should consider that the **intended user** is the **AMSB** but may also include other functions of the **undertaking** or any related **undertaking** and the relevant supervisory authorities.	**L2 - 272 (8):** "The actuarial function shall produce a written report to be submitted to the administrative, management or supervisory body, at least annually. The report shall document all tasks that have been undertaken by the actuarial function and their results, and shall clearly identify any deficiencies and give recommendations as to how such deficiencies should be remedied."	• ***Principle 1*** • Higher frequency may be considered upon request from the AMSB. The AFR should be revisited if exceptional events occur and trigger a need for update. • L2 uses "shall". The draft ESAP has selected "must" rather than "should" because of the force of the L2 text. For efficiency reasons it is allowed to build up the AFR in separate components (c.f. ESAP1 3.2.4). The AFR may consist of two or more component

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			reports each of which contributes to the compliance of the aggregate report with this standard. This standard does not require that any single component report on its own complies fully unless it is also an aggregate report. This will allow to have the sections on more static contents (like the ones referring to product background and capital frameworks) separated from dynamic contents (results; adequacy levels; capital requirements). It also permits having sections that are common to multiple legal entities drafted only once. Any executive summary must be in one component only.
2.1.1.2	The **AFR** should have a form, structure, style, level of detail and content which is appropriate to the particular circumstances, taking into account the **intended users**. This may lead to an **AFR** consisting of several component **reports** focusing on specific content which may be provided to the **AMSB** separately and at different points of time.		• This requirement is necessary to comply with ESAP1 3.1.1. • ***Principle 4*** • It is common practice to provide an Executive Summary. This Executive Summary is the obvious place to summarize the tasks undertaken (elements of report) and the concerns / deficiencies / recommendations (conclusions). • Each component report may have its own executive summary, presenting the procedures performed and the significant findings and recommendations. A cover note may be issued on top, providing an

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			overview of the various component reports and their main outcomes. • The focus of the L2 text is on the requirements to provide detail on deficiencies. This paragraph of ESAP2 - refers to all most important conclusions, irrespective of being a positive, negative or neutral message.
2.1.1.3	The **AFR** should: (a) state which Actuarial Standards apply to the **work** that has been carried out and whether the **work** complies with those Actuarial Standards; (b) state which Actuarial Standards apply to the **AFR** and whether the **AFR** complies with those Actuarial Standards; and (c) give particulars of any **material** departures from the Actuarial Standards referred to in (a) and (b) above.		• ***Principle 3*** • It is useful to provide assurance to the AMSB that the AFR and related actuarial work complies with actuarial standards.
2.1.2	**The Actuarial Function**		
2.1.2.1	The **AFR** must document a summary of all major tasks that have been undertaken by the **AF** and their results.	c.f. 2.1.1.	• ***Principle 1*** • The documentation of all tasks may be given in a separate component report which is delivered once to the AMSB and to which the annual report refers only provided there are no changes of the tasks.
2.1.2.2	The **AFR** should set 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.	**L2 – 268 (1):** "Insurance and reinsurance undertakings shall incorporate the functions and the associated reporting lines into the organisational structure in a way which	• ***Principle 1*** • In formulating professional conclusions and opinions, the AF should be objective and free from influence that may compromise the function's ability

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		ensures that each function is free from influences that may compromise the function's ability to undertake its duties in an objective, fair and independent manner. Each function shall operate under the ultimate responsibility of, and report to the administrative, management or supervisory body and shall, where appropriate, cooperate with the other functions in carrying out their roles." **L3 – SoG Guideline 46:** "The undertaking should take appropriate measures to address the potential conflicts of interests, if the undertaking decides to add additional tasks or activities to the tasks and activities of the actuarial function."	to undertake its duties in an objective, fair and independent manner. • A related requirement is part of the AAE's Code of Professional Conduct (Principle 4: "An actuary shall not allow bias, conflict of interest or the undue influence of others to override professional judgement") • ***Principle 4*** • This gives transparency in disclosing potential conflicts and reliance on other parties.
2.1.2.3	In applying 2.3 and 3.2.3.f of ESAP1 the **AF** should disclose any **material** reliance on other persons' work and how the **AF** gained assurance on the reliability of the other persons' work.		• ***Principle 4*** • Regarding 'Reliance on Others' ESAP1 2.3 states appropriate practices. • "other person's work" is also used as terminology in the definition of "work" in the AAE Glossary. Note that "work" in "other persons' work" does not have the meaning of "work" as defined in the AAE Glossary.
2.1.2.4	The **AFR** must identify the individuals responsible for writing the **AFR**, and, if applicable, the person taking overall responsibility for its production.		• ***Principle 4*** • This is to support transparency and accountability, especially in cases where the AFR consists of components which have been written at different points of time or by different

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			individuals • Cf. ESAP1 3.2.3.
2.1.2.5	The **AFR** may provide information to demonstrate that each of the contributors to the **AFR**, and, if applicable, the individual taking overall responsibility for the **AFR**, has the relevant knowledge and experience to fulfil the role.	**L2 – 273 (1):** "Insurance and reinsurance undertakings shall establish, implement and maintain documented policies and adequate procedures to ensure that all persons who effectively run the undertaking or have other key functions are at all times fit and proper within the meaning of Article 42 of Directive 2009/138/EC." **L2 – 273 (2):** "The assessment of whether a person is fit shall include an assessment of the person's professional and formal qualifications, knowledge and relevant experience within the insurance sector, other financial sectors or other businesses and shall take into account the respective duties allocated to that person and, where relevant, the insurance, financial, accounting, actuarial and management skills of the person."	• ***Principle 1*** • The (key) individuals involved in preparing the AFR fulfil a key position as referred to in L2 – 273 (1) and are therefore subject to the assurance procedures required by L2 – 273 (2). If the assurance procedures are otherwise made transparent, there may not be any need to include related information in the AFR.
2.1.3	**<u>Content of the Actuarial Function Report</u>**		
2.1.3.1	The **AFR** must clearly identify any deficiencies and give recommendations as to how such deficiencies should be remedied having regard to **materiality** and proportionality.	**L2 - 272 (8):** "… and shall clearly identify any deficiencies and give recommendations as to how such deficiencies should be remedied."	• ***Principle 1*** • The identification of deficiencies is an output of the AF's assessment in relation to each of the areas covered in the AFR. It is a matter of professional judgement for the AF as to the measure(s) used, whether quantitative

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
			or qualitative, in assessing a potential deficiency and the basis for the AF's findings may be made clear in the AFR. Commentary in relation to the absence of deficiencies may also be appropriate. • The regulation requires any deficiency to be identified. To serve the needs of the intended users such deficiencies which are considered not to be significant may be stated in a separate component report of the AFR.
2.1.3.2	The **AFR** should include sufficient information and discussion about each area covered so as to enable the **AMSB** to judge its implications.		• ***Principle 4*** • It is best practice to support conclusions and recommendations.
2.1.3.3	The **AFR** should summarise the key **data** used to reach the **opinions** expressed and should draw attention to any **material** areas of uncertainty and their sources, and also to any **material professional judgement** made in the assessments by the **AF**.		• ***Principle 4*** • This requirement does not require a comprehensive overview of all internal and external source data used, but a sufficient reference to internal and external source data with additional detail on how known issues with data have been treated. • "Normal" uncertainties, like market volatilities, may be stated in a component report which is produced once and deals with such uncertainties in a comprehensive way. • In this case the annual AFR may focus on uncertainties which need the special attention of the AMSB.

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
2.1.4	**Feedback on the Actuarial Function Report**		
2.1.4.1	The **AF** should discuss its conclusions and recommendations with management when finalizing the **AFR**. After submission of an **AFR** to the **AMSB**, the **AF** should seek feedback from the **AMSB** on the contents of the **AFR** and should have regard to that feedback when preparing future **AFR**s.		• ***Principle 4*** • This is common practice, not only for reports prepared by actuaries, but also for reports prepared by internal and external auditors.
2.1.4.2	Details of whether recommendations in the **AFR** have been accepted and, if so, on progress towards implementation, should be summarised in the next **AFR**.		• ***Principle 4*** • This is also common practice.
2.2	*Technical Provisions*		
2.2.1	Conclusions on adequacy and reliability of Technical Provisions		*Term 'Reliability' added*
2.2.1.1	The **AFR** must clearly state the conclusions of the **AF** with regard to its analysis of the adequacy and reliability of the **Technical Provisions**. The conclusions should include any concerns the **AF** has in this regard and identify **material** shortcomings or deficiencies, with recommendations as to how these could be remedied.	**L1 - 48.1(e):** "Inform the administrative, management or supervisory body of the reliability and adequacy of the calculation of technical provisions;" **L2 – 272 (5):** "…Information submitted to the administrative, management or supervisory body on the calculation of the technical provisions shall at least include a reasoned analysis on the reliability and adequacy of their calculation … …The actuarial function shall clearly state and explain any concerns it may have concerning the adequacy of technical provisions."	• ***Principle 1*** • The L1 text requires the Actuarial Function to give opinions on the overall underwriting policy and the adequacy of the reinsurance arrangements of the undertaking, while the term 'opinion' is not explicitly used in the context of technical provisions. It is not clear if a different meaning is intended by the regulation. When drafting ESAP2 we did not see any different meaning but decided to retain the different wording used by the regulation. • Where the AFR concludes that the Technical Provisions are either inadequate or unreliable, a summary of the key concerns and recommendations should be included

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
			in the conclusion. • It should be noted that considerations related to technical provisions in this part should also reflect the calculation of the recoverables from reinsurance contracts and SPVs. • A reasoned analysis as mentioned in L2 – 272 (5) should as a minimum include the topics dealt with in 2.2.2 – 2.2.9 of this ESAP2. • In special cases some additional topics may have to be considered.
2.2.1.2	The **AFR** should include the results of an assessment whether the **Technical Provisions** have been calculated in accordance with Articles 75 to 86 of the **Solvency II Directive** and advise if any changes are necessary in order to achieve compliance.	**L2 – 272 (1):** "In coordinating the calculation of the technical provisions, the actuarial function shall include all of the following tasks: (a) apply methodologies and procedures to assess the sufficiency of technical provisions and to ensure that their calculation is consistent with the requirements set out in Articles 75 to 86 of Directive 2009/138/EC;" **L3 - SoG Guideline 47 - Coordination of the calculation of technical provisions:** The undertaking should require the actuarial function to identify any inconsistency with the requirements set out in Articles 76 to Article 86 of Solvency II for the calculation of technical provisions and propose corrections as appropriate. The undertaking should require the	• ***Principle 1***

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
		actuarial function to explain any material effect of changes in data, methodologies or assumptions between valuation dates on the amount of technical provisions."	
2.2.1.3	The **AFR** must clearly state 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** should explain the potential sources of uncertainty and, where appropriate, illustrate uncertainty by reference to possible scenarios.	**L2 – 272 (1):** "In coordinating the calculation of the technical provisions, the actuarial function shall include all of the following tasks: … (b) assess the uncertainty associated with the estimates made in the calculation of technical provisions;" **L2 – 272 (5):** "Information submitted to the administrative, management or supervisory body on the calculation of the technical provisions shall ...include... the sources and the degree of uncertainty of the estimate of the technical provisions …"	• ***Principle 1***
2.2.2.	Important information about Technical Provisions		
2.2.2.1	The **AF** should ensure 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**.		• ***Principle 4***
2.2.2.2	In particular the **AFR** should draw attention to any **material** judgements made in the identification of the boundary of insurance or reinsurance contracts and in the calculation of **Technical Provisions**.		• ***Principles 1 and 4***
2.2.3	Disclosure of opening and closing Technical Provisions		
2.2.3.1	The **AFR** should disclose the opening and closing **Technical Provisions**, split, to the extent possible,		• ***Principle 4*** • Provides audit trail to prior reports,

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
	between best estimate and risk margin. A commentary on the impact on the Own Funds of the main items of movement of **Technical Provisions** should be provided.		and other presentations of technical provisions • The AFR may include 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.
2.2.4	Co-ordination of process		• This topic deals with one of the tasks of the AF explicitly mentioned in L1 regulation.
2.2.4.1	The **AFR** should include a broad overview of the overall process employed in respect of the calculation of the **Technical Provisions**.	**L1 - 48.1(a):** "Insurance and reinsurance undertakings shall provide for an effective actuarial function to: (a) coordinate the calculation of technical provisions."	• ***Principle 1*** • This should include a description of the key responsibilities and tasks, the review and sign-off process and how potential conflicts of interest have been managed (Also addressed in section 2.1 of this ESAP2) • If there is a process description available to the intended users, the AFR may refer to it.
2.2.5	Sufficiency and quality of data		• This topic deals with one of the tasks of the AF explicitly mentioned in L1 regulation. • ESAP1 2.5 deals with data quality. In case of potential conflicts between ESAP1 and ESAP2, ESAP1 requirements are explicitly superseded by ESAP2

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
			according to ESAP1 1.2.1
2.2.5.1	The **AFR** must include an overview of the controls surrounding 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.	**L1 - 48.1(c):** "Insurance and reinsurance undertakings shall provide for an effective actuarial function to: ... (c) assess the sufficiency and quality of the data used in the calculation of technical provisions" **L2 – 272 (1):** "In coordinating the calculation of the technical provisions, the actuarial function shall include all of the following tasks: … (c) ensure that any limitations of data used to calculate technical provisions are properly dealt with" **L3 – SoG – Guideline 48 – Data Quality:** "The undertaking should require the actuarial function to assess the consistency of the internal and external data used in the calculation of technical provisions against the data quality standards as set in Solvency II. Where relevant, the actuarial function provides recommendations on internal procedures to improve data quality so as to ensure that the undertaking is in a position to comply with the Solvency II framework."	• ***Principle 1***
2.2.5.2	The **AFR** must identify any **material** uncertainties or		• ***Principle 1***

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
	limitations in the **data** and outline 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 policy and claims **data** and of historical **data**.		
2.2.5.3	The **AFR** should give an overview of the business covered by the **Technical Provisions**, the split of **data** into homogeneous risk groups and how this split has been assessed for appropriateness in relation to the underlying risks of the **undertaking**.	**L2 – 272 (1):** "In coordinating the calculation of the technical provisions, the actuarial function shall include all of the following tasks: … (e) ensure that homogeneous risk groups of insurance and reinsurance obligations are identified for an appropriate assessment of the underlying risks;"	• ***Principle 1***
2.2.5.4	The **AFR** should consider relevant information provided by financial markets and generally available **data** on **underwriting** risks and explain how it is integrated into the assessment of the **Technical Provisions**.	**L2 – 272 (1):** "In coordinating the calculation of the technical provisions, the actuarial function shall include all of the following tasks: … (f) consider relevant information provided by financial markets and generally available data on underwriting risks and ensure that it is integrated into the assessment of technical provisions;"	• ***Principle 1***
2.2.5.5	The **AFR** should disclose any concern the **AF** has on the documentation describing the process of the collection of **data** and analysis of its quality and other information that relates to the calculation of **Technical Provisions**, including any concern the **AF** has on the directory of the **data** used in the calculation of the **Technical Provisions.**	**L2 – 265 (1):** "Insurance and reinsurance undertakings shall document the following processes: (a) the collection of data and analysis of its quality and other information that relates to the calculation of	• ***Principle 1***

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
		technical provisions;" …. **L2 – 265 (2):** "For the purposes of point (a) of paragraph 1, the documentation shall include: (a) a directory of the data used in the calculation of the technical provisions, specifying their source, characteristics and usage; (b) the specification for the collection, processing and application of data referred to in Article 19(3)(e); (c) where data are not used consistently over time in the calculation of technical provisions, a description of the inconsistent use and its justification."	
2.2.6	<u>Methods and models</u>		• This topic deals with one of the tasks of the AF explicitly mentioned in L1 regulation. • ESAP1 2.6 – 2.8 deal with methodology. In cases where methodology is prescribed either by Solvency II regulation or authorities, ESAP1 2.8 should be followed.
2.2.6.1	The **AFR** must provide an overview about how the appropriateness of the methods and **models** used in the calculation of the **Technical Provisions** has been assessed with regard to the main drivers of risk, the lines of business of the **undertaking** and the way in which the business is being managed.	**L1 - 48.1 (b):** "Insurance and reinsurance undertakings shall provide for an effective actuarial function to: ... (b) ensure the appropriateness of the methodologies and underlying models used …. in the calculation of technical	• ***Principle 1*** • Where appropriate, the AFR may include a broad overview of the cash inflows and outflows being taken into account in the calculation of Technical Provisions (e.g. major types of premiums, claims, expenses), the time horizon of the projections (e.g. to a

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
		provisions;" **L2 – 272 (2):** "The actuarial function shall assess whether the methodologies and assumptions used in the calculation of the technical provisions are appropriate for the specific lines of business of the undertaking and for the way the business is managed, having regard to the available data." **L3 – SoG – Guideline 49 – Testing against experience:** "The undertaking should ensure that the actuarial function reports any material deviations from actual experience to the best estimate to the AMSB. The report should investigate the causes of the deviations and, where applicable, propose changes in the assumptions and modifications to the valuation model in order to improve the best estimate calculation."	specific term or date) and the main projection steps (e.g. data , assumptions, models, output, review). The unit of measurement applying to any graphical or numerical presentations should be clear.
2.2.6.2	The **AFR** should draw 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.		• ***Principle 1***
2.2.6.3	The **AFR** should include, where appropriate, an overview of the methods used to calculate **Technical Provisions** in respect of contracts where the insufficiency of the **data** has prevented the application of a reliable actuarial method, specifically those cases referred to in Article 82 of the **Solvency II Directive**. The **AFR** should include an	**L1 - 48.1 (f):** "Insurance and reinsurance undertakings shall provide for an effective actuarial function to: (f) oversee the calculation of technical provisions in the cases set out in Article 82;"	• ***Principle 1***

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
	assessment of the appropriateness of the approximations used in the calculations of **Technical Provisions** for such contracts.	**L1 - 82:** "Member States shall ensure that insurance and reinsurance undertakings have internal processes and procedures in place to ensure the appropriateness, completeness and accuracy of the data used in the calculation of their technical provisions. Where, in specific circumstances, insurance and reinsurance undertakings have insufficient data of appropriate quality to apply a reliable actuarial method to a set or subset of their insurance and reinsurance obligations, or amounts recoverable from reinsurance contracts and special purpose vehicles, appropriate approximations, including case-by-case approaches, may be used in the calculation of the best estimate." **L2 – 272 (1):** **"**In coordinating the calculation of the technical provisions, the actuarial function shall include all of the following tasks: … (d) ensure that the most appropriate approximations for the purposes of calculating the best estimate are used in cases referred to in Article 82 of Directive 2009/138/EC; "	
2.2.6.4	The **AFR** must include an assessment of the appropriateness of the methods and **models** used in the	**L2 – 272 (1):** "In coordinating the calculation of the	• ***Principle 1*** • The main AFR may state only the

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
	calculation of options and guarantees included in insurance or reinsurance contracts and in the valuation of these options and guarantees in the **Technical Provisions**.	technical provisions, the actuarial function shall include all of the following tasks: .... (h) ensure that an appropriate assessment is provided of options and guarantees included in insurance and reinsurance contracts."	results of such an assessment. The detailed results and typical areas of dispute may be provided in a component report • Contractual options or guarantee should be appropriately reflected in the technical provisions. This requires two steps: 1) identification and quantification of the options and guarantees, and 2) valuation of these options and guarantees.
2.2.6.5	The **AFR** should indicate if the **AF** assesses that the information technology systems used for the calculation of **Technical Provisions** do not sufficiently support the actuarial and statistical procedures.	**L2 – 272 (3):** "The actuarial function shall assess whether the information technology systems used in the calculation of technical provisions sufficiently support the actuarial and statistical procedures."	• ***Principle 1***
2.2.6.6	Where the calculation of **Technical Provisions** depends on multiple methods or **models**, the **AFR** should make reference to any **material** differences between the results according to these methods or **models** and what allowance has been made for these differences.		• ***Principle 4*** An example of this might be where one model is used to calculate the best estimate element of Technical Provisions and a different model is used to calculate the capital requirements for the risk margin element of Technical Provisions.
2.2.6.7	The **AFR** should disclose and justify any **material** changes in methods or models from those used in the previous **AFR** and quantify the effect on the **Technical Provisions**.	**L2 – 272 (1):** "In coordinating the calculation of the technical provisions, the actuarial function shall include all of the following tasks: … (g) compare and justify any material differences in the calculation of technical provisions from year to year; "	• ***Principle 1***
2.2.7	<u>Assumptions</u>		• This topic deals with one of the tasks of

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
			the AF explicitly mentioned in L1 regulation. • ESAP1 3.6 - 3.8 deal with assumptions. In cases where assumptions are prescribed either by Solvency II regulation or by authorities ESAP1 3.8 should be followed.
2.2.7.1	The **AFR** must include a description of how the appropriateness of the **data** and methods used to determine the assumptions underlying the **Technical Provisions** have been assessed.	**L1 - 48.1 (b):** "Insurance and reinsurance undertakings shall provide for an effective actuarial function to: .... (b) ensure the appropriateness of ….. the assumptions made in the calculation of technical provisions;"	• ***Principle 1***
2.2.7.2	The **AFR** should 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 insurance or reinsurance obligations of the **undertaking**.		• ***Principle 4***
2.2.7.3	The **AFR** should disclose any **material** changes made to the assumptions used compared to the previous **AFR**.		• ***Principle 4***
2.2.7.4	The **AFR** should disclose its assessment of the appropriateness of **material** judgements made in the determination of assumptions. These may include, but are not restricted to, assumptions or interpretations made in relation to the following: • contractual options and guarantees; • policyholder behaviour; • future management actions; • amounts recoverable from counterparties; • areas of future discretion exercised by the	The topics listed in the ESAP text are specifically mentioned in the Level 2 requirements: **L2 – 23** (Future management actions) **L2 – 24, 25** (Future discretionary benefits) **L2 – 26** (Policyholder behaviour) **L2 – 32** (Contractual options and guarantees) **L2 – 41** (General provisions on Recoverables from reinsurance and special	• ***Principle 1*** • *We have abstained from citing the voluminous full text in column 2.*

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
	undertaking which might impact its insurance or reinsurance obligations; and • obligations which might exist over and above contractual obligations.	purpose vehicles)	
2.2.8	<u>Comparing best estimates against experience</u>		• This topic deals with one of the tasks of the AF explicitly mentioned in L1 regulation.
2.2.8.1	The **AFR** should include an overview of the process used to compare best estimates against actual experience and must draw attention to any concerns the **AF** has in regard to the effectiveness of this process.	**L1–4 48.1 (d):** "Insurance and reinsurance undertakings shall provide for an effective actuarial function to: .... (d) compare best estimates against experience;"	• ***Principle 1***
2.2.8.2	The **AFR** should disclose the findings of the **AF**'s review of the quality of past best estimates and the conclusions 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, the **AFR** should draw attention to those areas where actual experience has deviated in a **material** way from the assumptions made and provide a commentary in this regard. 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** should disclose any **material** judgements when such a distinction is made.	**L2 – 272 (4):** "The actuarial function shall, when comparing best estimates against experience, review the quality of past best estimates and use the insights gained from this assessment to improve the quality of current calculations. The comparison of best estimates against experience shall include comparisons between observed values and the estimates underlying the calculation of the best estimate, in order to draw conclusions on the appropriateness, accuracy and completeness of the data and assumptions used as well as on the methodologies applied in their calculation." **L3 – SoG – Guideline 49 – Testing against**	• ***Principle 1***

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
		experience: "The undertaking should ensure that the actuarial function reports any material deviations from actual experience to the best estimate to the AMSB. The report should investigate the causes of the deviations and, where applicable, propose changes in the assumptions and modifications to the valuation model in order to improve the best estimate calculation."	
2.2.9.	Sensitivity analysis		
2.2.9.1	The **AFR** must report 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**.	**L2 – 272 (5):** "Information submitted to the administrative, management or supervisory body on the calculation of the technical provisions shall include at least a reasoned analysis on the reliability and adequacy of their calculation and on the sources and the degree of uncertainty of the estimate of the technical provisions. That reasoned analysis shall be supported by a sensitivity analysis that includes an investigation of the sensitivity of the technical provisions to each of the major risks underlying the obligations which are covered in the technical provisions. The actuarial function shall clearly state and explain any concerns it may have concerning the adequacy of technical provisions.	• ***Principle 1***
2.3	*Opinion on underwriting policy*		

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
2.3.1	Opinion on the overall underwriting policy of the undertaking		
2.3.1.1	The **AFR** must express an **opinion** on the overall **underwriting** policy of the **undertaking**.	**L1 - 48.1(g):** "Insurance and reinsurance undertakings shall provide for an effective actuarial function to …… express an opinion on the overall underwriting policy." **L2 – 272 (6):** "Regarding the underwriting policy, the opinion to be expressed by the actuarial function in accordance with Article 48(1)(g) of Directive 2009/138/EC shall at least include conclusions regarding the following considerations: (a) sufficiency of the premiums to be earned to cover future claims and expenses, notably taking into consideration the underlying risks (including underwriting risks), and the impact of options and guarantees included in insurance and reinsurance contracts on the sufficiency of premiums; (b) the effect of inflation, legal risk, change in the composition of the undertaking's portfolio, and of systems which adjust the premiums policy-holders pay upwards or downwards depending on their claims history (bonus-malus systems) or similar systems, implemented in specific homogeneous risk groups; (c) the progressive tendency of a portfolio	• ***Principle 1*** • This is one of the tasks of the AF explicitly mentioned in the Solvency II Directive. The Directive does not specify the meaning of 'opinion'. It may be seen as a statement summarizing the key findings of the AF's work, that identifies deficiencies and gives recommendations as to how such deficiencies should be remedied. • The opinion shall refer to both the underwriting policy and its implementation. • The underwriting policy may be one comprehensive document or may be contained in several separate documents.

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
		of insurance contracts to attract or retain insured persons with a higher risk profile (anti-selection).	
2.3.1.2	The **AFR** should set out how the **AF** has arrived at its **opinion** on the overall **underwriting** policy of the **undertaking.**	c.f. 2.1.1.	• The AFR may include an overview of the overall process related to underwriting policy to support the discussion of the AF's conclusions. 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.
2.3.1.3	The **AFR** should explain any concerns which the **AF** may have as to the suitability of the overall **underwriting** policy.	c.f. 2.1.1. **L1 - 44.1 Risk management:** "Insurance and reinsurance undertakings shall have in place an effective risk-management system comprising strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report, on a continuous basis the risks, … **L1 - 44.2 Risk management:** "… The risk-management system shall cover at least the following areas: (a) underwriting and reserving; … The written policy on risk management referred to in Article 41(3) shall comprise policies relating to points (a) to (f) of the second subparagraph of this paragraph."	• ***Principle 1*** • To comply with L1 Articles 41 and 44 the undertaking should formulate written policies on underwriting within their Risk Management policies. • We expect that these written policies will cover the main part if not the total of the overall underwriting policy as mentioned in the L1 text. • The Solvency II regulation does not explicitly specify criteria of suitability of the overall underwriting policy. • In special cases some additional topics may have to be considered.

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
2.3.1.4	The **AFR** should outline the recommendations to remedy any deficiencies the **AF** has identified in relation to the overall **underwriting** policy having regard to **materiality** and proportionality.	c.f. 2.1.1.	• ***Principle 1***
2.3.2	Areas of consideration		
2.3.2.1	An assessment of the suitability of the overall **underwriting** policy should at least include the areas set out in 2.3.3 to 2.3.7.	**L2 – 272 (6)** **<L2 requirement** as specified below>	• ***Principle 1***
2.3.3	Sufficiency of premiums		
2.3.3.1	The **AFR** must conclude whether the premiums are expected to be sufficient in the light of the operation of the overall **underwriting** policy. The assessment must take into consideration the impact of the underlying risks (including **underwriting** risks) to which the business is exposed and the impact on the sufficiency of premiums of options and guarantees included in insurance and reinsurance contracts.	**L2 – 272 (6):** "Regarding the underwriting policy, the opinion to be expressed by the actuarial function in accordance with Article 48(1)(g) of Directive 2009/138/EC shall at least include conclusions regarding the following considerations: (a) sufficiency of the premiums to be earned to cover future claims and expenses, notably taking into consideration the underlying risks (including underwriting risks), and the impact of options and guarantees included in insurance and reinsurance contracts on the sufficiency of premiums;" ….	• ***Principle 1*** • The requirement includes consideration of all kinds of premiums being relevant for current solvency assessment. This would include also future premiums which need to be included in premium risk assessments or premium reserves. • 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. This assessment may be linked in to the ORSA process and the assessment of Technical Provisions. • The AFR may 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). • The AFR may summarise the major

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ESAP2 Reference	1. ESAP2 Standard statements and definitions	2. Regulatory requirements	3. Explanation of considerations made by issuer
			risks which may affect future experience.
2.3.4	Environmental Changes		
2.3.4.1	The **AFR** should describe the external environmental factors which have the potential to influence the profitability of new business including renewals. These factors might include inflation, legal risk and changes in the market in which the **undertaking** operates affecting business volumes and business mix.	**L2 – 272 (6):** "Regarding the underwriting policy, the opinion to be expressed by the actuarial function in accordance with Article 48(1)(g) of Directive 2009/138/EC shall at least include conclusions regarding the following considerations: ... (b) the effect of inflation, legal risk, change in the composition of the undertaking's portfolio, …"	• ***Principle 1*** • Such changes could include, but are not limited to, changes in inflation, the impact of legal risks, a change in the composition of the undertaking's portfolio, the impact of epidemics and advances in medical care or technology.
2.3.5	Adjustments to Premiums		
2.3.5.1	For products where premiums may be adjusted in response to experience, the **AFR** must comment on the effect of systems which adjust the premiums policyholders pay upwards or downwards depending on their claims history (bonus-malus systems) or similar systems, implemented in specific homogeneous risk groups.	**L2 – 272 (6)** "Regarding the underwriting policy, the opinion to be expressed by the actuarial function in accordance with Article 48(1)(g) of Directive 2009/138/EC shall at least include conclusions regarding the following considerations: ..... (b) the effect of … systems which adjust the premiums policy-holders pay upwards or downwards depending on their claims history (bonus-malus systems) or similar systems, implemented in specific homogeneous risk groups;"	• ***Principle 1***
2.3.6	Anti-selection		
2.3.6.1	The **AFR** must include the **AF'**s conclusions concerning anti-selection risks within the **undertaking**'s portfolio of	**L2 – 272 (6)** "Regarding the underwriting policy, the	• ***Principle 1***

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	contracts if these risks might have an adverse impact on the **Technical Provisions** or sufficiency of premiums. The **AFR** should outline the **AF**'s recommendations for improvements to the **underwriting** policy which might mitigate these risks.	opinion to be expressed by the actuarial function in accordance with Article 48(1)(g) of Directive 2009/138/EC shall at least include conclusions regarding the following considerations:
		.....
		(c) the progressive tendency of a portfolio of insurance contracts to attract or retain insured persons with a higher risk profile (anti-selection).
			Anti-selection risk can occur where the average profile of the risks underwritten differs materially and adversely from the assumptions made about the risks in the pricing basis. This could be because of more adverse risks self-selecting themselves, because there is a flaw in the underwriting procedure or because better risks are incentivised to take out different contracts, which leave an adverse residual.
			
			• 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.

2.3.7	Interrelationships		
2.3.7.1	The **AFR** should outline the extent to which the overall **underwriting** policy of the **undertaking** is not consistent with other relevant policies of the **undertaking**.	c.f. 2.3.7.2	• ***Principle 1***
2.3.7.2	This should at least include an assessment of the consistency with the risk appetite and the reinsurance arrangements of the **undertaking** and with the **underwriting** risks that the **undertaking** reflects in the calculation of the **Technical Provisions**.	**L3 – SoG – Guideline 50 – Underwriting policy and reinsurance arrangements:** "The undertaking should require the actuarial function, when providing its opinion on the underwriting policy and the reinsurance arrangements, to take into	• ***Principle 1*** • The AFR may include an assessment of whether the underwriting policy is consistent with the approach to product pricing used by the undertaking

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		consideration the interrelations between these and the technical provisions."	• The AFR may include an assessment of the main 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 factors, inflation, legal risk and changes in the market environment, etc.). • 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 undertaking. • The AFR may include an assessment of the likely variability surrounding the estimate of expected profitability of the business.
2.4	*Opinion on reinsurance arrangements*		
2.4.1	Opinion on the adequacy of reinsurance arrangements	**L1 - 23.1 Scheme of operations** "… (c) "the guiding principles as to reinsurance and to retrocession" which the reinsurance undertaking proposes to make with ceding undertakings;"	
2.4.1.1	The **AFR** must express an **opinion** on the adequacy of the reinsurance arrangements.	**L1 - 48.1 Actuarial function:** "Insurance and reinsurance undertakings shall provide for an effective actuarial function to: … (h) express an opinion on the adequacy of reinsurance arrangements;"	• ***Principle 1*** • This is one of the tasks of the AF explicitly mentioned in the Solvency II Directive. The Directive does not specify the meaning of 'opinion'. It may be seen as a statement summarising the key findings of the AF's work, that identifies deficiencies and gives

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		L3 – SoG – Guideline 46 – Tasks of the actuarial function: "The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should require that the actuarial function gives an opinion on the reinsurance policy and the reinsurance program for the group as a whole."	recommendations as to how such deficiencies should be remedied. • This task has also to be performed at group level, where appropriate. • The term 'reinsurance arrangement' as used in the Solvency II directive refers to contracts mitigating the risks of the undertaking or group which in particular excludes reinsurance business written by the undertaking or group. • L3 – SoG – Guideline 46 refers to the 'reinsurance policy' and the 'reinsurance program'.
2.4.1.2	The **AFR** should explain any concerns which the **AF** may have concerning the adequacy of the reinsurance arrangements.	**L1 - 44.1 Risk management:** "Insurance and reinsurance undertakings shall have in place an effective risk-management system comprising strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report, on a continuous basis the risks, … **L1 - 44.2 Risk management:** "… The risk-management system shall cover at least the following areas: (a) underwriting and reserving; … (f) reinsurance and other risk-mitigation techniques. The written policy on risk management	• The Solvency II regulation does not explicitly specify criteria of adequacy of reinsurance arrangements. • To comply with L1 Articles 41 and 44 the undertaking should formulate written policies on reinsurance and other risk-mitigation techniques within their Risk Management policies. • The adequacy of reinsurance arrangements may, as a minimum, be assessed against these policies.

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		referred to in Article 41(3) shall comprise policies relating to points (a) to (f) of the second subparagraph of this paragraph."	
2.4.1.3	If the **AF** identifies deficiencies the **AFR** should outline recommendations to improve the reinsurance arrangements, including actions which might be taken to: • eliminate inconsistencies in reinsurance coverage; • reduce the risk of non-performance by reinsurance counterparties; and • extend coverage of **material** risks.	c.f. 2.1.1.	• ***Principle 1***
2.4.1.4	The **AFR** should set out how the **AF** has arrived at its **opinion**.		• ***Principle 4*** • It may be considered whether to include an overview of any areas in the AFR where additional work was required during the financial period, for example in assessing reinsurance adequacy on Technical Provisions 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. • The AFR may also include a commentary on the impact of any disputes with reinsurance undertakings. • The AFR may also include an overview of (material) reinsurance contracts and any Special Purpose Vehicle (SPV) used as part of the overall reinsurance strategy of the undertaking when

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			appropriate. • The AFR may disclose the impact of reinsurance arrangements on the undertaking's balance sheet at the opening and closing reporting date. The AFR may 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 may be provided if appropriate. • The AFR may include a description of relevant additional services provided by reinsurance undertakings, for example assistance with business plans, product development, underwriting guidelines, claims management and policy administration. • Where relevant, the AFR may disclose the extent to which the requirements set out in the Regulations in respect of Special Purpose Vehicles have been adhered to. **(L2 – 211 –** Risk-Mitigation techniques using reinsurance contracts or special purpose vehicles)
2.4.2	Interrelationships		
2.4.2.1	The **AFR** should outline the extent to which the reinsurance arrangements of the **undertaking** are not consistent with the **undertaking**'s: • risk appetite; • **underwriting** policy; and	**L2 – 272 (7):** "Regarding the overall reinsurance arrangements, the opinion to be expressed by the actuarial function in accordance with Article 48(1)(h) of Directive	• ***Principle 1*** • Consistency of reinsurance arrangements with the underwriting policy and consistency of reinsurance arrangements with the underwriting

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	• **underwriting** risk, and include recommendations as to how any inconsistencies should be remedied.	2009/138/EC shall include analysis on the adequacy of the following: (a) the undertaking's risk profile and underwriting policy;…" **L3 – SoG – Guideline 20 – Underwriting and reserving risk management policy:** "In its risk management policy, the undertaking should cover at least the following with regard to underwriting and reserving risk: … e) how, in the process of designing a new insurance product and the premium calculation, the undertaking takes account of reinsurance or other risk mitigation techniques." **L3 – SoG – Guideline 50 – Underwriting policy and reinsurance arrangements:** "The undertaking should require the actuarial function, when providing its opinion on the underwriting policy and the reinsurance arrangements, to take into consideration the interrelations between these and the technical provisions."	risk are separate items as "underwriting risk" is linked to the actual portfolio of insurance obligations. The AFR should discuss inconsistencies between the underwriting risks covered in the reinsurance arrangements and the underwriting risk profile of the portfolio of insurance obligations.
2.4.2.2	The commentary on interrelationships should incorporate the **AF**'s assessment of the credit standing of reinsurance counterparties, including the assessment whether the **undertaking** needs to produce and use its own internal credit assessment of one or more of the reinsurance counterparties.	**L2 – 272 (7):** "Regarding the overall reinsurance arrangements, the opinion to be expressed by the actuarial function in accordance with Article 48(1)(h) of Directive 2009/138/EC shall include analysis on the adequacy of the following:	• ***Principle 1***

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		… (b) reinsurance providers taking into account their credit standing**;…"** **L2 – 4 (5):** "Where an item is part of the larger or more complex exposures of the insurance or reinsurance undertaking, the undertaking shall produce its own internal credit assessment of the item and allocate it to one of the seven steps in a credit quality assessment scale. Where the own internal credit assessment generates a lower capital requirement than the one generated by the credit assessments available from nominated ECAIs, then the own internal credit assessment shall not be taken into account for the purposes of this Regulation."	
2.4.3	<u>Effectiveness of reinsurance arrangements</u>	**L3 – SoG – Guideline 22 – Reinsurance and other risk-mitigation techniques:** "In the risk management policy the undertaking should cover at least the following with regard to reinsurance and other risk mitigation techniques: …. c) procedures for assessing the effective risk transfer and consideration of basis risk; …."	• ***Principle 4*** • The understanding taken from the L3 – SoG – Guideline 22 is that the term 'reinsurance arrangements' is intended to include other risk mitigation techniques whose substance is similar to reinsurance. In particular, this would include the use of SPVs for risk mitigation purposes. • It is not specified in L1 regulation if adequacy of reinsurance necessarily includes effectiveness, which would clarify the question if related work has to be performed by the AF or not.

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			• In any case the undertaking will have to assess the effectiveness of all risk-mitigation contracts in particular reinsurance arrangements (c.f. L3 – SoG – Guideline 22). In cases where the undertaking assigns this task to the AF, the AFR may cover related reporting to the AMSB as well. In cases where work is done by another function the AFR may refer to the documentation provided by this function. The role of the AF needs to be described in the AFR in this case.
2.4.3.1	The **AFR** should include assessments of how the reinsurance arrangements, including any special purpose vehicles, might respond in a number of stressed scenarios or refer to where this is considered in the ORSA. The scenarios might include: • catastrophic claims experience; • risk aggregations; • reinsurance defaults; and • reinsurance exhaustion.		• ***Principle 4***
2.4.3.2	The assessments should include indications of: • the amounts recoverable from reinsurance contracts and special purpose vehicles; and • the impact on the **undertaking**'s own funds.	**L2 – 272 (7):** "Regarding the overall reinsurance arrangements, the opinion to be expressed by the actuarial function in accordance with Article 48(1)(h) of Directive 2009/138/EC shall include analysis on the adequacy of the following: … (d) the calculation of the amounts recoverable from reinsurance contracts and special purpose vehicles."	• ***Principle 1***

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2.4.3.3	The assessments should consider, if appropriate, the impact of reinstatements or renewal of reinsurance cover and the potential unavailability of reinsurance cover.	**L2 – 272 (7):** "Regarding the overall reinsurance arrangements, the opinion to be expressed by the actuarial function in accordance with Article 48(1)(h) of Directive 2009/138/EC shall include analysis on the adequacy of the following: … (c) the expected cover under stress scenarios in relation to the underwriting policy;	• ***Principle 1***
2.4.3.4	The **AFR** might include an assessment of the effectiveness of the reinsurance arrangements in mitigating the volatility of the **undertaking**'s own funds.		• ***Principle 4*** • If appropriate the AFR may explain any concerns the AF might have as to the appropriateness of the overall processes employed in respect to reinsurance arrangements to protect the financial strength of the undertaking.
2.5	*Contribution to risk management*		
2.5.1	The **AFR** should 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 should cover the contribution of the **AF** to the risk modelling underlying the calculation of the capital requirements, including contribution to the modelling of the loss-absorbing capacity of deferred taxes. It should also cover the contribution that the **AF** has made with regard to the assessment of the expected profit included in future premiums (EPIFP). Other examples might include the role of the **AF** and its contribution in relation to the internal model, the identification of **material** deviations in the company's risk	**L1 - Article 48(1)(i)** "Insurance and reinsurance undertakings shall provide for an effective actuarial function to: … (i) contribute to the effective implementation of the risk-management system referred to in Article 44, 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 to the assessment	• ***Principle 1*** • L2 – 308 (7) requires that such a description should be part of the Regular Supervisory Reporting, which may be referred to in the AFR. • L2 – 260(1)(h)(ii) requires that the actuarial function or the risk management function is the relevant key function involved in the projection of future taxable income and the calculation of the loss-absorbing capacity of deferred taxes.

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	profile from the assumptions underlying the standard formula and the contribution of the **AF** to the ORSA process, including its views in relation to the stress- and scenario-testing undertaken.	referred to in Article 45. **L2 – 260 (1)(h)** "(ii) involvement of the relevant key functions in the selection and assessment of methods and assumptions to demonstrate the amount and recoverability of the loss-absorbing capacity of deferred taxes, how the outcome of that assessment is reported to the administrative, management or supervisory body, including the assessment of the underlying assumptions applied for the projection of future taxable profit for the purposes of Articles 15 and 207, and an explanation of any concerns about those assumptions, which shall be carried out in each case by either the actuarial function or the risk management function." **L2 – 295 (5)** With regard to liquidity risk, the solvency and financial condition report shall include the total amount of the expected profit included in future premiums as calculated in accordance with Article 260(2). **L2 – 260 (2)** The expected profit included in future premiums shall be calculated as the difference between the technical provisions without a risk margin calculated in accordance with Article 77 of that Directive and a calculation of the technical	• L2 – 272 (7) requires that the actuarial function includes an analysis of the undertaking's risk profile. This is drafted in the context of assessing the overall reinsurance arrangements, hence also means such an assessment needs to take place if no reinsurance arrangements are in place to conform that not having reinsurance is appropriate. • From L3 – SoG – Guideline 51 one may take it that EIOPA expects the AF to be involved within their domain of expertise if the undertaking is using an internal model.

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		provisions without a risk margin under the assumption that the premiums relating to existing insurance and reinsurance contracts that are expected to be received in the future are not received for any reason other than the insured event having occurred, regardless of the legal or contractual rights of the policyholder to discontinue the policy. **L2 – 308 (7):** With regard to the actuarial function the regular supervisory report shall include an overview of the activities undertaken by the actuarial function in each of its areas of responsibility during the reporting period, describing how the actuarial function contributes to the effective implementation of the undertaking's risk management system. **L3 – SoG – Guideline 51 – The actuarial function of an undertaking using an internal model:** "The undertaking should require the actuarial function to contribute to specifying which risks within their domain of expertise are covered by the internal model. The actuarial function should also contribute to how dependencies between these risks and dependencies between these risks and other risks are derived. This	

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		contribution is based on a technical analysis and should reflect the experience and expertise of the function."	
2.5.2	The **AFR** may summarise the main findings of these activities, and in such cases should provide appropriate reference to reporting from the risk management function.	**L2 - 272 (8):** "The actuarial function shall produce a written report to be submitted to the administrative, management or supervisory body, at least annually. The report shall document all tasks that have been undertaken by the actuarial functions and their results, and shall clearly identify any deficiencies and give recommendations as to how such deficiencies should be remedied."	• ***Principle 1*** • Usually risk management related findings would be included in the reporting of the risk management function. • The AFR may include additional findings which the AF likes to bring to the attention to the AMSB. • In cases where the AF wishes to give specific recommendations reporting in the AFR is required.

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