ACTUARIAL ASSOCIATION OF EUROPE

ESAP2 Review Task Force

Exposure drafts of ESAP2 and AAE Glossary

Exposure Drafts AAE Glossary and ESAP2

- As per the Due Process for the Development of European Standards of Actuarial Practice, ESAPs should be reviewed at least every five years to ensure that they are still up-to-date, relevant and meet the needs of users of actuarial services and of actuaries. The Actuarial Standards Subcommittee (ASSC) of the Professionalism Committee conducts such reviews. As ESAP2 on the Actuarial Function Report has been approved in 2016, the ASSC has formed the ESAP2 Review Task Force to perform the first review on ESAP2.
- The scope of the ESAP2 Review Task Force includes incorporating the ESAP2 definitions into the Glossary of Defined Terms used in European Actuarial Standards ("AAE Glossary"), as approved in 2019.
- This document presents the main changes in the AAE Glossary and ESAP2. For a comprehensive overview of the changes, please see the Exposure drafts.

AAE Glossary (2021) – Exposure draft

GLOSSARY OF DEFINED TERMS USED IN
EUROPEAN STANDARDS OF ACTUARIAL PRACTICE

Key changes compared to AAE Glossary (2019)

AAE Glossary (2021) – Introduction text

2019 This glossary is the single repository of all defined terms used in European Standard of Actuarial Practice 1 (ESAP1). It is not an ESAP and has no authority of its own. Defined terms are indicated in ESAP1 in blue text with a dotted blue underline (e.g. **defined term**).

2021 This glossary is the single repository of all defined terms used in European Standards of Actuarial Practice (ESAPs). The glossary is not an ESAP and has no authority of its own. Defined terms are indicated in ESAPs in blue text with a dotted blue underline (e.g. **defined term**). As per the approval date of this glossary, the ESAP1 and ESAP2 texts have been updated to refer to this glossary.

AAE Glossary (2021) – Defined Terms, no changes

- The following defined terms have remained unchanged:
  - AAE
  - Accepted Actuarial Practice
  - Actuarial Services
  - Actuary
  - Adoption Date *
  - Communication
  - Data
  - Intended User
  - Law
  - Model
  - Model Governance
  - Model Risk
  - Opinion
  - Principal
  - Professional Judgement
  - Report
  - Subsequent Event
  - Work

* In the definition “this ESAP” has become “the ESAP” to reflect that the AAE Glossary now applies to more than one ESAP

AAE Glossary (2021) – new Defined Terms

- The following defined terms have been transferred from ESAP2 (2016):
  - Actuarial Function
  - AF *
  - Actuarial Function Report
  - AFR *
  - Administrative, Management or Supervisory Body
  - AMSB *
  - Conflict of interest
  - Material
  - Solvency II Directive
  - Technical Provisions
  - Undertaking
  - Underwriting

* The definitions of the acronyms AF, AFR and AMSB have been combined with the corresponding Defined Terms

- The definitions for Actuarial Function, Actuarial Function Report, Technical Provisions and Undertaking are linked to the Solvency II Directive and need modification if they should apply to the IORP II Directive in the future as well.

ESAP2 (2021) – Exposure draft

EUROPEAN STANDARD OF ACTUARIAL PRACTICE 2 (ESAP2)

ACTUARIAL FUNCTION REPORT UNDER DIRECTIVE 2009/138/EC

Key changes compared to ESAP2 (2016)

ESAP2 – Scope

2016 (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.

(1.2.2) ESAP2 assumes that **actuaries** will also comply with ESAP 1, approved as a model standard by the AAE on 3 October 2014.

2021 (1.2.1) no changes

(1.2.2) removed

Notes

- ESAP2 (2021) has a new article 1.4.1 replacing the former article 1.2.2 (see next page).

ESAP2 – Relationship with ESAP1

2016 (1.2.2) ESAP2 assumes that **actuaries** will also comply with ESAP 1, approved as a model standard by the AAE on 3 October 2014.

2021 (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.

Notes

- New title of section 1.4 is "Relationship with ESAP1" (was "Materiality"). Former article 1.4.1 has been renumbered into 1.4.2.
- The requirement to comply with ESAP1 has changed from "assumes … will also comply" to "must also comply". This wording is aligned with ESAP3.

ESAP2 – Language

2016 (1.5.1) Description of the meaning of “must”, “should” and “may”.

2021 (1.5.1) Description of the meaning of “must”, “should”, “may” and “any”, with meaning of “must” and “should” aligned with ESAP1 description and meaning of “any” taken over from ESAP1. Repeating the ESAP1 text on language is deliberate to ensure clear understanding of the ESAP2 articles.

2016 (1.5.2) This document uses various expressions whose precise meaning is defined in section 2. Words and expressions which are included in section 2 are shown in **bold** elsewhere in the document. Headings are shown in bold whether or not they contain defined terms.

2021 (1.5.2) This ESAP uses various terms whose precise meaning are defined in the **AAE** Glossary. These terms are highlighted in the text with a dashed underscore and in blue (e.g. **actuary**).

ESAP2 – Changes in cross-references

2016 (1.6.1) Generic text on cross-references.

2021 (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** should apply the principles in this ESAP to the extent they remain relevant.

Notes

- The requirement has been detailed by mentioning the key documents ESAP2 is referring to, i.e. the SII Directive and the SII Delegated Regulation.
- The new text is analogous to the cross-references text in ESAP3.

ESAP2 – Defined Terms

2016 (2.1 – 2.18) Defined Terms and their definitions

2021 (no article) All Defined Terms are included in the Glossary of Defined Terms used in European Standards of Actuarial Practice (AAE Glossary (2021)).

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1) AAE Glossary already has the same definition: Actuary, Actuarial services, Data, Professional Judgement
2) AAE Glossary already has almost the same definition: Intended user, Model
3) Defined Terms moved to AAE Glossary: Actuarial Function, Actuarial Function Report, AF, AFR, AMSB, Conflict of interest, Material (and materiality), Solvency II, Technical Provisions, Undertaking, Underwriting
4) No longer a Defined Term: Special Purpose Vehicle (SPV)
5) Now marked in ESAP2 as Defined Term: AAE, Communication, Opinion, Report, Work

ESAP2 – renumbering General Principles

2016 (3.1) Section 3.1 on General Principles has 13 articles. These are grouped under four headers using 3.1.1 – 3.1.13 as numbering.

2021 (2.1) Section 2.1 on General Principles is split into 4 subsections 2.1.1 – 2.1.4. The first article in each subsection has number 2.1.x.1.

- 2.1.1 = The Actuarial Function Report and its core parts
- 2.1.2 = The Actuarial Function
- 2.1.3 = Content of the Actuarial Function Report
- 2.1.4 = Feedback on the Actuarial Function Report

Notes

- The four subsections of section 3.1 in ESAP2 (2016) were numbered inconsistently with the numbering in subsections 3.2 – 3.5 (now 2.2 – 2.5).

ESAP2 – Other persons' work

2016 (3.1.6) In applying 3.3 and 4.2.3.f of ESAP 1 the **AF** should disclose any material reliance on other work and how the **AF** gained assurance on the reliability of the other work.

2021 (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.

Notes

- "other work" has been changed into "other persons' work" to align with the definition of defined term "work" in the AAE Glossary.
- "work" in "other persons' work" is intentionally not marked as a defined term.
- references to ESAP1 have been updated.

ESAP2 – Consistently use “AFR”

2016 (3.1.12) … the **AF** should seek feedback from the **AMSB** on the contents of the report and should have regard to that feedback when preparing future reports.

2021 (2.1.12) … 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.

Notes

- There is no reason to use “report” when referring to an AFR.

ESAP2 – Judgements on contract boundary

2016 (3.2.2.2) In particular the **AFR** should draw attention to any **material** judgements made in the calculation of **Technical Provisions**.

2021 (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**.

Notes

- Discussions on the topic "contract boundary" are not unusual, primarily as there is not a clear objective definition of contract boundary.
- The outcomes of contract boundary discussions are relevant in calculating the amount of Technical Provisions.
- It is therefore appropriate to reflect this in the text of article 2.2.2.2.

ESAP2 – Data collection and Directory of data

2016 --

2021 (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**.

Notes

- Articles 265.1 / 265.2 of the SII Delegated Regulation set requirements on the documentation of the data collection process, including the data directory.
- As article 265 is about Technical Provisions, and as data is getting more and more attention from several stakeholders, the AFR should mention the AF views on the documentation of data underlying the Technical Provisions.

ESAP2 – Valuation of options and guarantees

2016 (3.2.6.4) The **AFR** must include an assessment of the appropriateness of the methods and **models** used in the calculation of options and guarantees included in insurance or reinsurance contracts.

2021 (2.2.6.4) The **AFR** must include an assessment of the appropriateness of the methods and **models** used in the calculation of options and guarantees included in insurance or reinsurance contracts and in the valuation of these options and guarantees in the **Technical Provisions**.

Notes

- Contractual options or guarantee should be appropriately reflected in the technical provisions. This requires: 1) identification and quantification of options and guarantees; 2) valuation of these options and guarantees.
- ESAP2 (2016) could be interpreted to only cover the first step.

ESAP2 – Model changes

2016 (3.2.6.7) The **AFR** should disclose and justify any **material** changes in methods from those used in the previous **AFR** and quantify the effect on the **Technical Provisions**.

2021 (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**.

Notes

- This change reflects common actuarial practice to report the impact of model changes separately in the movement analysis of the technical provisions.
- Such model changes could be driven by methodology changes.
- But they can also be the result of solving errors, addressing existing model limitations, etc. without changes in the underlying methodology.

ESAP2 – Reinsurance link to in-force portfolio

2016 (3.4.2.1) The **AFR** should outline the extent to which the reinsurance arrangements of the **undertaking** are not consistent with the **undertaking**'s … **Technical Provisions** …

2021 (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 … **underwriting** risk …

Notes

- SII requires that the AF expresses an opinion on the **adequacy** of reinsurance arrangements, i.e. how these fit to (gross) risks in the portfolio. That is better covered by linking to underwriting risk (SCR) than to Technical Provisions.
- The AF opinion on the **valuation** of reinsurance arrangements is in scope of the AF opinion on Technical Provisions (this is linked to SII Directive Article 81).

ESAP2 – Own credit assessment of reinsurers

2016 (3.4.2.2) The commentary on interrelationships should incorporate the **AF**'s assessment of the credit standing of reinsurance counterparties.

2021 (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.

Notes

- The extended text is to explicitly indicate that there are situations in which the undertaking should produce and use its own internal credit assessment. Consequently, the AF should consider this in the assessment.
- Article 4.5 of the SII Delegated Regulation provides the regulatory background.

ESAP2 – AF contribution to LAC DT modelling

2016 (3.5.1) … contribution of the **AF** to the risk modelling underlying the calculation of the capital requirements …

2021 (2.5.1) … 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 …

Notes

- Commission Delegated Regulation 2019/89: LAC DT added as risk management area, including potential AF role, in SII Delegated Regulation, article 260.1.h.
- "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 … which shall be carried out in each case by either the actuarial function or the risk management function."

ESAP2 – AF contribution to EPIFP

2016 (3.5.1) … contribution of the **AF** to the risk modelling underlying the calculation of the capital requirements …

2021 (2.5.1) … contribution of the **AF** to the risk modelling underlying the calculation of the capital requirements … 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) …

Notes

- The EPIFP is positioned as part of liquidity risk management and tiering of own funds, and therefore is a potential AF contribution to risk management.
- The calculation of EPIFP has similarities with the calculation of the best estimate component of technical provisions. See SII Delegated Regulation article 260.2 and Guidelines 76, 77 on the valuation of technical provisions.

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