



LLOYD'S MARKET ASSOCIATION

The Actuarial Function Report

- Underwriting Policy
- Reinsurance Arrangements

A Short Practical Guide
to interpreting Solvency II requirements
for Lloyd's Managing Agents

*CALM Actuarial Function Report Working Party
April 2014*

Disclaimer

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1 Introduction

1.1 General guidance

All syndicates are required to have an effective Actuarial Function (AF) meeting the requirements set out in Article 48 of the Level 1 framework directive. The board of the managing agent will have established the composition of the AF and how the directive requirements are to be met. This note does not cover the board's wider responsibility in ensuring an adequate Actuarial Function is in place.

This note is intended to provide assistance in the interpretation of the requirements to produce opinions on underwriting policy and reinsurance arrangements, and to show how these requirements may be met in practice. As this is an evolving area, it is expected that this note will need to be updated over time.

The opinions on underwriting policy and reinsurance arrangements produced by the AF are intended to provide the board with relevant commentary from the AF perspective, which may be different to that of the underwriting or reinsurance teams, and therefore help to ensure the board is more fully informed.

Note that the term "opinion" in these instances is seen in the everyday English interpretation rather than any agreement with, or approval of, the underwriting policy, business plan or reinsurance arrangements planned or purchased.

The opinions are intended to be based on the knowledge of the AF gained through processes under its direct control or in its normal course of business, as established by the board, but do not require the AF to take on roles allocated to other functions. It does not infer the requirement to provide additional assurance of existing or planned governance controls or processes outside the direct control of the AF. Therefore the opinions are not required to include, for example, monitoring of minimum underwriting standards or the purchase of the reinsurance programme where monitoring of such activities is met by parts of the organisation outside the AF (for example, Internal Audit). However, any knowledge of issues in the design and/or execution of such controls gained in the normal operation of the AF should be considered if relevant.

If the AFR is being written by a member or members of the UK Actuarial Profession, the report should be TAS R, D, M and Insurance TAS I compliant. Where the report is being produced by other persons, their relevant professional standards may apply and should already have been considered by the board when forming the overall Actuarial Function.

1.2 Classification of guidance note

The document is classified as guidance. It is intended to provide a practical guide to Managing Agents when satisfying the "minimum" AF requirements in the areas covered. However, it does not impose any minimum standards.

1.3 Ownership

This guidance note has been written by the CALM AFR working party, with the following membership:

- Philip Archer-Lock
- Jo Atkinson
- Shamit Biswas
- Neil Bruce
- Paul Grimsey
- Tony Jordan
- Shailesh Malde
- Gary McNally
- Nigel Milner
- Kalpana Shah

Full consultation has taken place with Lloyd's Actuaries throughout the process of writing this guidance note. This document is owned and approved by CALM. It will be reviewed as considered appropriate by CALM.

2 Guidance for opinion on underwriting policy (“OoUP”)

The key considerations for the opinion on underwriting policy are:

- 2.1 Provide an analysis of whether the planned premium is sufficient to cover the planned claims and expenses, i.e. whether the combined ratio for the syndicate (as a whole) for the planned underwriting year is equal to or less than 100%, allowing for discounting if preferred. This is likely to include an analysis of profitability by line of business.
- 2.2 If the view is that the premium will not be sufficient to cover expected claims and expenses at a whole account level, consideration of alternative options should also be provided. Where investment income is a material consideration in the underwriting policy it may be appropriate to include comments on its impact.
- 2.3 Comment on the variability around the expected business plan profitability. This may refer to probabilities of adequacy from the internal model, sensitivity testing of planning assumptions or stress testing of adverse scenarios.
- 2.4 Comment on whether the business plan is consistent with the syndicate’s risk appetite statements.
- 2.5 Comment on the consistency of business plan assumptions with the estimation of technical provisions and how any changes in the underwriting policy and practice may affect the adequacy of reinsurance arrangements, if relevant.

3 Guidance for opinion on adequacy of reinsurance arrangements (“OoRA”)

The key considerations for the opinion on adequacy of reinsurance are:

- 3.1 Provide an analysis of the effectiveness of the planned reinsurance arrangements. This may refer to the syndicate’s capital requirement, volatility, exposures or other measures gross and net of the planned reinsurance. It could also highlight areas where the reinsurance arrangements do not match the gross risk.
- 3.2 The opinion on the adequacy of reinsurance arrangements needs to include commentary on how reinsurance coverage would be expected to perform in stressed situations. This could include:
 - a) Consideration of potential events relating to significant known aggregations of risk, e.g. realistic disaster scenarios
 - b) Comment on reinsurance exhaustion
 - c) Comment on credit worthiness of reinsurers
- 3.3 Comment on alternative reinsurance or risk mitigation strategies if there are issues identified with the current or proposed reinsurance programme.
- 3.4 Comment on whether the reinsurance arrangements contained within the business plan are consistent with the syndicate’s risk appetite statements to the extent that it has not already been addressed in the OoUP.
- 3.5 Comment on the effect of reinsurance on the estimation of technical provisions net of reinsurance recoverables to the extent that this has not already been addressed in the technical provisions report.

Appendix A - Cross reference to EIOPA Guideline 41

On 27 September 2013 EIOPA issued its Final Report on the Public Consultation on the Proposal for Guidance to National Competent Authorities on Solvency II Systems of Governance. This has proved useful in understanding what the requirements for drafting the opinions on underwriting and reinsurance are likely to be, given the area is still evolving. This document is available [here](#). The explanatory texts on the actuarial function are included in Section 5(II), Chapter VI, with Guideline 41 specifically relating to the opinions on underwriting and reinsurance. Guideline 41 and the accompanying explanatory texts are shown below, and the following table provides a cross reference to demonstrate that the “minimum” requirements are met:

Guideline 41 - Underwriting policy and reinsurance arrangements

In accordance with Article 48 of Solvency II Directive, national competent authorities should ensure that the undertaking requires 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.

5.147. Underwriting policy, reinsurance arrangements and technical provisions are interdependent actions according to the nature of an undertaking's business. Changes in underwriting policy and practice, for example, may not only affect the calculation of technical provisions, but also the adequacy of reinsurance arrangements. Consequently, the actuarial function is expected to identify any important interrelationships between underwriting policy, reinsurance and technical provisions when carrying out its responsibilities as described in Article 48 of Solvency II.

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

5.149. The opinion on the overall underwriting policy may include amongst others the following issues:

- a) whether the product pricing is consistent with the underwriting policy for acceptance of risks;
- b) an opinion on the principal risk factors influencing the profitability of business to be written during the next year, including the potential impact on future profitability of external factors such as inflation, legal risk, changes in business volumes and changes in the market environment;
- c) an opinion on the likely financial impact of any material planned changes in terms and conditions of contracts;
- d) the degree of variability surrounding the estimate of expected profitability; and
- e) the consistency of this degree of variability with the risk appetite of the undertaking.

5.150. Commenting on the overall underwriting policy does not require expressing views on every single policy, but rather on the undertaking's underwriting in general. The scope of the view expressed is determined by what is relevant information for the administrative, management or supervisory body in reviewing the undertaking's underwriting policies.

5.151. The opinion on the adequacy of the undertaking's reinsurance arrangements may include amongst others the following issues:

- a) the consistency of the undertaking's reinsurance arrangements with its risk appetite;
- b) the effect of reinsurance on the estimation of technical provisions net of reinsurance recoverables; and
- c) an indication of the effectiveness of the undertaking's reinsurance arrangements in mitigating the volatility of its own funds.

5.152. The opinion on the adequacy of reinsurance arrangements needs to include an assessment of how the reinsurance coverage could respond under a number of stressed scenarios. These scenarios may include situations such as the following: exposure of the undertaking's portfolio of business to catastrophic claims experience, aggregations of risks, reinsurance defaults and potential reinsurance exhaustion.

5.153. The actuarial function provides information to the administrative, management or supervisory body to enable it to take decisions concerning the underwriting policy and reinsurance arrangements. The opinions of the actuarial function on the overall underwriting policy and reinsurance arrangements need to include descriptions and examinations of other possible options.

EIOPA Explanatory text	Cross reference
5.147	Expectation that interrelationships between underwriting policy, reinsurance and technical provisions are considered - covered by OoUP (2.5) and OoRA (3.5).
5.148	Requirement to include recommendations regarding alternative strategies, when necessary - covered by OoUP (2.2) and OoRA (3.2).
5.149	<p>List of considerations that may be included in the OoUP:</p> <p>(a) Product pricing consistent with the underwriting policy - covered by OoUP (2.1). For example, an analysis of whether the plan can be supported by historical results or market benchmarks (if available) will support an opinion on whether the syndicate's pricing is consistent with the new business plan. This may also include review of rate change assumptions in the business plan.</p> <p>(b) Opinion on the principal risk factors influencing the profitability of the business plan to be written during the next year - covered by OoUP (2.3).</p> <p>(c) Consideration of financial impact of material planned changes in terms and conditions - should be part of the business plan, which is reviewed in OoUP (2.1).</p> <p>(d) Degree of variability surrounding the estimate of expected profitability - covered by OoUP (2.3).</p> <p>(e) Consistency of the degree of variability with the risk appetite of the undertaking - covered by OoUP (2.4).</p>
5.150	Commenting on the overall underwriting policy does not require expressing views on every single policy - covered by OoUP (2.1) and (2.2), where the opinion is required at whole account level, and no requirement to review pricing models.
	The scope of the view expressed is determined by what is relevant information for the administrative, management or supervisory body - this guidance does not prohibit an AF adopting a broader scope for either or both opinions if desired. This may be the result of, inter alia, the AF's opinion on what the Board would find useful or a specific request from the Board.
5.151	<p>List of considerations that may be included in the OoRA:</p> <p>(a) Consistency of the undertaking's reinsurance arrangements with its risk appetite - covered by OoRA (3.4).</p> <p>(b) Effect of reinsurance on the estimation of technical provisions net of RI - covered by OoRA (3.5).</p> <p>(c) An indication of the effectiveness of the undertaking's reinsurance arrangements in mitigating the volatility of its own funds - covered by OoRA (3.1) and (3.2).</p>
5.152	Requirement that the OoRA includes an assessment of how the reinsurance coverage could respond under a number of stressed scenarios - covered by OoRA (3.2).
5.153	The OoUP and OoRA need to include descriptions and examinations of other possible options - based on 5.148, which says 'the opinions on the underwriting policy and reinsurance arrangements include, <i>when necessary</i> , recommendations regarding appropriate strategies...' this is interpreted to mean there is a requirement to provide alternatives only if issues have been highlighted in either opinion. This is covered by OoUP (3.2) and OoRA (3.3).

Appendix B - CALM contact details

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Please address any initial questions in respect of this document to the Secretary CALM.