

Comments Template on

Deadline
18.11.2011

Draft proposal for

Guidelines and Recommendations on Actuarial Function

Name of Association/Stakeholder: Groupe Consultatif Actuariel Européen

Please follow the following instructions for filling in the template:

- ⇒ **Do not** change the numbering in the columns "reference"
- ⇒ Please fill in your comment in the relevant row. If you have no comment on a paragraph, keep the row empty.
 - If your comment refers to multiple paragraphs, please insert your comment at the first relevant paragraph and mention in your comment to which other paragraphs this also applies.
 - If your comment refers to sub bullets/subparagraphs, please indicate this in the comment itself.

Please send the completed template to Iwona Krasniewska Iwona.Krasniewska@eiopa.europa.eu and sibylle.Schulz@bafin.de

The numbering of the paragraphs refers to **Draft proposal for Guidelines and Recommendations on Actuarial function**

Questions in the cover letter EIOPA 11-163

Question number

Answer

Q1

There will be costs, especially for smaller companies, although the application of the proportionality principle should help in this respect – with this in mind, as a minimum, proportionality and materiality should be addressed more in depth. Our understanding is that no additional reporting will result from these guidelines. The extent of additional requirements on top of level 1 and level 2 should be analysed in detail and this cannot be done at this point of time. Furthermore, it should be analysed whether these guidelines will restrict the ability of undertakings to delegate certain tasks within the group.

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Q2	Segregation of tasks (to avoid conflicts of interest) will result in additional layers within governance structures. This will result in additional costs and mean difficulties for smaller companies and increased costs for the consumer. Therefore, excess orthodoxy should be avoided here and the proportionality principle applied.
Q3	<p>The role of the actuarial function is not clear: to what extent it is reviewing/controlling and to what extent it is doing valuation. Our understanding is that the actuarial function needs to be independent, but that this does not mean it cannot perform both valuation and reviewing roles. Demands on the level of segregation should be lighter. Furthermore, the relationship between the actuarial function and the risk management function is not always clear.</p> <p>Further clarification is needed on the level of detail, for example, on the actuarial opinion to be given on underwriting or reinsurance (see 3.5.3).</p> <p>As mentioned again in the context of Q12, the situations where recommendations from the actuarial function are not taken into account should be handled. In some jurisdictions actuaries have a whistle blowing role and in some issues this might be used.</p> <p>We hope that these guidelines will be expected to be applied only when they are material and applicable (for example guidelines 21, 24 and 63). The level of detail, for example, in guideline 65, is not clear and could result in vastly different implementations across undertakings.</p> <p>The Groupe Consultatif is preparing actuarial standards in relation to reporting that could be of help here.</p>
Q4	<p>There is a balance between optimised policyholder protection and compliance costs to the industry. Good protection will always come at a cost but, on the other hand, consumers need to have their cover. It is unclear how these guidelines will influence market integration and innovation within the industry (excessive demands resulting from new tasks and documentation can create inefficiencies and restrict resources used for innovation).</p> <p>The cost and benefits will be depending on best market practice. A reference framework will allow for undertakings and others to make sure that unnecessary costs or risks are not taken. The professional organisations can help to create a best practice environment. Best practice means bench marks, exchange, peer review</p>
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Q11	Clarification of roles: interaction with the risk management function and other key functions, and relation to the administrative, management or supervisory body should be made clearer - if not within the AF then within the Guidelines on governance. There should be clarification on what the actuarial function should do if the board/management bypasses its recommendations. Guidance should be principles based: less but clearer guidance.
Q12	Guidelines on the relationships between the key functions could be beneficial – again these should be principles based as we cannot exclude the possibility that the actuarial function and risk management function are actually overlapping. Actuarial standards being produced by the Groupe Consultatif could complement these standards. Guidance on how to manage conflicts of interest between functions would also be beneficial.

Reference	Comment	resolution
General Comment	<p>In general, there is ambiguity in relation to the following important aspects:</p> <ul style="list-style-type: none"> - what is actually required for the governance structure and how the interaction between key functions and other management bodies should operate - requirements on segregation appear to be overly demanding and probably too strict in the desire to avoid conflicts of interest – in the area of conflicts of interest a difference should be made between addressing this issue among individuals and among key functions <p>Level 3 guidance should be developed in order to promote convergence and development of good practices both between undertakings and between supervisors. The development of level 3 guidance should pay particular attention to conciseness and clarity, avoid generalities, suggest concrete propositions, contain no repetitions from level 1 and level 2 measures and contain legal precision. Importantly, the level 3 guidance should avoid any inconsistencies with level 1 and level 2 measures.</p>	

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	<p>The structure of this paper differs from the structure of the Level 3 Actuarial Guidelines. This document includes detailed comments under the guidelines which are in bold. In the other document the guidelines are listed together followed by explanatory text as an appendix. Do the detailed comments in this document form part of the guidelines? If they are explanatory text, should this be clarified?</p>	
3.1.	<p>It would be better to have more principles based regulation leaving the actual organisation to the responsibility of the undertakings. It should be understood that there is no conflict of interest between coordination and calculation. It would be enough, in guideline 59, to talk of establishment of technical provisions.</p>	
3.2.	<p>The first sentence of 3.2 does not make sense and it is clearly not a complete sentence. Therefore it is impossible to comment on it at this stage. The sentence should be consulted after it has been formulated anew.</p> <p>There needs to be people with appropriate skills to make sure technical provisions are appropriately calculated and established (four-eye principle) but this should not be explicitly tied to the internal or external audit.</p> <p>When rewriting the first sentence the following changes should be made:</p> <ul style="list-style-type: none">- instead of "The undertaking could decide to have the calculation and the establishment" it should read "The ASMB could decide to have the establishment", and- instead of "once these have been independently reviewed either by the internal audit function or by an external reviewer" it should read "as long as an internal control framework exists which checks the existence and the application of the procedures" <p>For the second sentence (beginning with "In this context", with two bullet points) we think a better alternative would be: "In this context the ASMB needs to ensure conflicts of interest are adequately managed between the persons performing the calculation of the technical</p>	

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provisions and the person giving an opinion on these calculations. An adequate system of governance shall avoid that the performance of multiple tasks by individuals and business units does or is not likely to prevent the persons concerned from discharging any particular function in a sound, honest and objective manner (general governance).”

We infer that EIOPA considers that there are three activities to be completed prior to the management body setting technical provisions:

- Calculation
- Co-ordination
- Review / giving an opinion

and that the four eyes principle requires that at least two functions/sets of people should be involved in these three activities.

- The guidelines should define the activities involved and consistent terminology should be used throughout the guidelines.
- We believe that the actuarial function could be involved in any of the three activities but that the ‘four eyes’ principle should apply and undertakings should ensure that structures and/or processes are in place to provide appropriate quality assurance.
- We believe that it would be clearer if the guidance referred to the requirement for the ‘four eyes’ principle instead of referring to conflicts of interest.
- We believe that the ‘four eyes’ principle should apply not only to the calculations but also to the selection of methodologies and assumptions.
- The exact requirements should be clarified. Some of the wording in 3.2 implies that an external review is required. This appears to go beyond the requirements of the Directive and the draft Level 2 guidance.

Where a third party calculates the technical provisions, it should be stated that the actuarial guidelines should apply to this party also.

We do not support the idea that internal audit would be entitled as independent reviewer of the technical provisions. We strongly believe that the external reviewer has to respect at

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	least the same requirements as the coordination role.	
3.3.	Full segregation of duties is not a realistic requirement. It would be preferable to remove 3.3 and change 3.4 to read "The undertaking should implement arrangements to ensure that conflicts of interest..."	
3.4.	See 3.3. Furthermore, there may be problems in understanding how the proportionality principle should be applied here.	
3.5.	Reference to article 47 should be corrected to refer to Article 48. Also there is a language problem: "which imply the expression of express an opinion on the". Independence here does not mean that the actuarial function cannot be responsible for the development – instead it should mean that the same person cannot be responsible for the development and also express an opinion.	
3.6.		
3.7.	Change first "any" to "main" or to "substantial". Also "difference" could be clearer than "deviation"	
3.8.	Change "diversification effects" to "dependencies" and "complete" to "appropriate"	
3.9.	Change "sufficiency" to "appropriateness", and add ", where meaningful" after "back testing"	
3.10.	The actuarial function should ensure that the main drivers of risk and the quality of available data underlying the calculation of the technical provisions are reflected and appropriately addressed in the valuation, in the assumptions made and in the methodologies applied. - We believe that only the drivers of risk having an impact for the calculation of technical provision should be addressed by the Actuarial function. Other risks are in the responsibility	

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	<p>of the risk management function</p> <ul style="list-style-type: none">- We believe that valuation is better than valuation model because this guideline also applies to valuations without models.- We don't know what the variations apply to, what the meaning of "small" is and think the sentence is not clear enough.	
3.11.	<p>We suggest this is changed to "The actuarial function needs to understand the impact of different drivers of risk on the level..."</p>	
3.12.	<p>Change "sufficiency" to "appropriateness"</p>	
3.13.	<p>The language here is extremely difficult with too long sentences. It is difficult to understand the meaning and therefore the sentences should be split into manageable entities. Also, the last part of the second sentence lacks logic.</p> <p>The paragraph only considers long term improvements where it should also deal with short-term or immediate changes.</p>	
3.14.	<p>Omit "most" and add "and" after "data"</p>	
3.15.	<p>We propose that guideline 61 is reworded as: "The actuarial function should present an explanation, including an identification and explanation of the sources of the differences between year-end technical provisions."</p> <ul style="list-style-type: none">- It seems obvious that there will always be differences between two different years' technical provisions, thus there is no need to write "in the presence of any material differences among the estimates of technical provisions related to different years".- We think that "differences" is more precise than "deviations".- We think that "whether they are caused by internal or external factors" is redundant and should be removed.	
3.16.	<p>This paragraph is somewhat unrelated to guideline 61. In any case the word "any" should</p>	

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	be removed.	
3.17.	The wording should make it clearer that it talks, as per the guideline, of comparison between reporting years. Also the use of expert judgement should be mentioned as a method of validation of technical provisions.	
3.18.	<p>The wording appears overly negative by saying that the result of these comparisons is "an issue". It would be better to omit the three last words.</p> <p>Guideline 62 could read "The actuarial function should present an explanation of the main differences between best estimates and experience, by identifying their causes and, where relevant, propose appropriate changes in the assumptions underlying the model in order to reduce such differences"</p>	
3.19.	In a stochastic environment there will always be deviations between best estimate and experience. Furthermore, we would change "applicable" to "relevant"	
3.20.	We would add the word "material" before the word "assumption" and believe clarification should be included that the level of prudence in the assumptions should be consistent with market consistent technical provisions.	
3.21.	This whole paragraph should be deleted – why is this mentioned in relation to case-by-case approach when it should apply to all calculations?	
3.22.	This paragraph should be replaced by just saying that expert judgement is essential in all aspects of the actuarial function role and responsibilities	
3.23.	Actuarial reserves also depend on the claims handling practice. Although this could be considered as part of the underwriting policy it should be mentioned explicitly for reasons of clarity	
3.24.	It should be clarified that the opinions on the underwriting and reinsurance policies are not just annual reporting obligations and that where possible, the actuarial function should	

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	inform the management body of its opinion on any proposed material changes prior their implementation	
3.25.	<p>The following areas should be included in the list of possible aspects of the opinion on the underwriting policy:</p> <ul style="list-style-type: none"> a. Opinion on the claims handling practice. Is it consistent with the underwriting policy and the product pricing b. Opinion on the principal risk factors influencing the profitability of the business in force <p>Both aspects have a significant impact on the profitability of the business and therefore influence the calculation of reserves.</p> <p>This should be done also with respect to new products and contracts.</p>	
3.26.	For clarity, change "every single policy" to "every single contract of (re)insurance"	
3.27.	It should be made clear how the opinions sit within the overall governance structure and the roles of the different functions.	
3.28.	See 3.27	
3.29.	Many issues deal with governance and more principles based text would help with less emphasis on strict segregation of roles.	
3.30.	This should not only apply to companies with an internal model	
3.31.	The last sentence does not bring anything new and so should be deleted. Again segregation should be addressed, as well as the roles of the actuarial function and the risk management function.	
3.32.	It would be helpful if EIOPA clarified what conflicts apply. 3.34 is a useful and clear example, although review by another function may not be proportionate or practical and	

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	this requirement appears to go beyond the requirements of the Directive and level 2	
3.33.	It is difficult to understand the need for this paragraph as it does not add anything on top of level 1 and 2. It does not do much harm either. We do not understand why only insurance risk is mentioned as other risks (especially market and credit risk) would deserve mention as well.	
3.34.	Conflict of interest should be solved by the undertaking itself and "validation" would be better than "revision". This could be burdensome, especially for smaller companies	
3.35.		
3.36.	The paragraph should end "...complexity of relevant parts of the model". As regards guideline 64, instead of "express" use "provide"	
3.37.		
3.38.	We suggest replacing "prudent and sufficient reserves" by "appropriate best estimate".	
3.39.		
3.40.		
3.41.		
3.42.	Guideline 65 - The text says nothing new when compared to level 1 and level 2 so it could be omitted and replaced by "The annual report issued by the actuarial function typically would take into account appropriate guidelines and standards published by European and National actuarial bodies, if any". If the guideline is retained then "including deadlines for the overcoming of the limitations detected" should be deleted	
3.43.		
3.44.		

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3.45.		
3.46.	This should be omitted as it seems inappropriate in this context	
3.47.	Replace "less appropriate methodologies" with "less refined but more robust methodologies"	
3.48.	This and 3.49 are vague considering how they propose to address these shortcomings	
3.49.	<p>Guideline 66 - This should reduce to a normal paragraph (instead of a guideline) and changed to "The actuarial function should organise an adequate follow-up procedure in order to keep track of remedial actions taken in areas where shortcomings were observed.</p> <p>Rationale: we think that the Actuarial function should be able to say in its next report how its recommendations were taken into considerations by the ASMB. Keeping track of its recommendations and the corrections is part of the function. On the other hand, managing the remedial actions has to be organised by the ASMB</p> <p>In the context of guideline 65 and 65 it should be clarified that depending on the nature of the shortcoming the actuarial function may not be responsible for the remedial actions. The management body should therefore have overall responsibility for the remedial actions.</p>	
3.50.		
3.51.	We welcome the reference to professional organisations and would like to contribute in the area. The Groupe Consultatif has started a standard setting procedure in this area. We are also happy to continue the exchange with EIOPA and for example also to explore some additional aspects such as best practice.	