Institute and Faculty of Actuaries

Risk Outlook

by the Risk Outlook Working Party of the Regulation Board

December 2016

Contents

1. Introduction, objectives and audience

1. On behalf of the Institute and Faculty of Actuaries (**IFoA**), we are pleased to introduce this "Risk Outlook" paper. The paper provides an analysis of areas of risk to the public, as relevant to actuaries and their work.

2. The Risk Outlook was prepared, prior to the UK referendum on leaving the European Union ("**Brexit**"). The outcome of that vote will have far-reaching consequences so, as the situation develops, we will attend carefully to developments and the implications for the Risk Outlook.

3. The IFoA is the UK's only chartered professional body dedicated to educating, developing and regulating actuaries and is based both in the UK and internationally. Our object is, in the public interest, to advance all matters relevant to actuarial science and its application and to regulate and promote the actuarial profession. Our regulatory activity is overseen, insofar as relating to the UK, by the Financial Reporting Council (**FRC**).

4. The IFoA, through its Regulation Board, undertook a project to identify, prioritise, and where appropriate, publicise risks to the public interest which arise in connection with actuarial activity. The overall purpose of the project was threefold:

    4.1. to bring relevant risks to the attention of Members and our wider stakeholder community;

    4.2. to inform the IFoA's regulatory strategy and the prioritisation of our regulatory work; and

    4.3. to contribute to the IFoA's assessment and management of its own risk.

5. The IFoA carried out this work in a manner consistent with our Refreshed Regulatory Policy Statement and Regulatory Strategy, which requires that our regulatory regime is transparent, proportionate, accountable, consistent and targeted.[1] Assessing relevant public interest risks, in terms of probability and impact, helps to ensure that our regulatory activities are appropriately prioritised and resourced.

6. In pursuit of those regulatory objectives, the IFoA established a Risk Outlook Working Party (the **Working Party**) in 2015. The Working Party arranged a number of sessions with the IFoA's Practice Boards and with Regional Communities during 2015/2016 to obtain Members' views on risks to the public interest as relevant to actuarial activity.

7. The Regulation Board reviewed the Working Party's results and agreed that some identified risks should be brought specifically to the attention of the wider membership. This will be done by way of a periodic communication to be known as a "Risk Alert". The first two Risk Alerts were published on 30 June 2016 (Commutation Factors) and on 4 July 2016 (General Insurance Reserving). These Risk Alerts were issued to Members who had identified themselves as pensions or general insurance actuaries respectively. They have also been

[1] https://www.actuaries.org.uk/upholding-standards/our-role-regulator

drawn to all Members' attention via the IFoA's Regulatory Newsletter and published on our website.

8. The Regulation Board has also undertaken a broader analysis to consider the wider results of the information gathering exercise undertaken and set out some possible means of mitigation. This paper (the '**Risk Outlook**') sets out that analysis.

9. We are grateful for the care and attention shown by our Members during the information gathering process. We hope that the regulatory community, our Members and other interested stakeholders find this paper useful in raising awareness, and stimulating discussion and consideration, of some of the public interest risks relevant to actuaries and their work. We will use this analysis to help ensure that the IFoA's own regulatory approach is appropriately targeted and proportionate.[2]

Desmond Hudson
Chair (lay) of the Regulation Board of the Institute and Faculty of Actuaries

and

Andy Rear
Chair of the Risk Outlook Working Party

[2] https://www.actuaries.org.uk/upholding-standards/our-role-regulator/regulatory-strategy

2. Background: risk work undertaken by the Joint Forum on Actuarial Regulation

2.1. In 2013, the FRC, the IFoA, the Pensions Regulator (**tPR**), the Financial Conduct Authority (**FCA**) and the Prudential Regulation Authority (**PRA**) established the Joint Forum on Actuarial Regulation (**JFAR**). JFAR's objectives include the identification and consideration of the appropriate response to risks to the UK public interest to which actuarial work is relevant.

2.2. In October 2014, the FRC published a discussion paper entitled "Joint Forum on Actuarial Regulation: a risk perspective" (the "**Risk Perspective**").[3] This paper was designed both to stimulate debate regarding how to identify the UK public interest risks which affect actuaries and their work, and then to raise awareness of these risks and related potential mitigants. Twelve high level risks were identified in the Risk Perspective.

2.3. In July 2015, the FRC, on behalf of the JFAR, produced a feedback statement on the Risk Perspective ("**Feedback Statement**")[4] which set out the JFAR's relevant future programme of work. The JFAR identified three particular areas for action. As a result, thematic work has been conducted in relation to the following:

2.3.1. Defined Benefit to Defined Contribution pension scheme transfers;

2.3.2. Group Think; and

2.3.3. Reserving in the General Insurance industry.

2.4. Further detail regarding this thematic work can be found in the JFAR's updated Risk Perspective issued by the FRC, which is due to be published in Quarter 4 of 2016.

2.5. The role of the JFAR is focused on high level issues relating to the identification and analysis of public interest risk to which actuarial work is relevant and which has a cross-sectoral, but UK specific, relevance. The Risk Perspective findings, however, provided an invaluable starting point from which we have drawn in producing this paper.

2.6. The Working Party considered whether to use the Risk Perspective twelve risk categories[5] to analyse the information gathered. After consideration, the Working Party decided to apply a different categorisation to the risks identified by our Members in recognition of the fact that the Risk Perspective was naturally more focused on technical categories of UK cross-regulatory risk. The IFoA's role as a professional regulatory body is wider, extending to a wider range of ethical and professional issues, and to risks facing our Members working in a wide variety of sectors and roles. Accordingly, the Working Party settled on eight high level, broad, cross-sectoral risk categories. Those categories are:

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[3] https://frc.org.uk/Our-Work/Publications/Actuarial-Policy-Team/Discussion-Paper-JFAR-a-risk-perspective-(October-File.pdf

[4] https://www.frc.org.uk/Our-Work/Publications/Actuarial-Policy-Team/Feedback-Statement-Joint-Forum-on-Actuarial-Regul.pdf

[5] The eight JFAR risk categories are modelling; group think/inappropriate commercial pressure; understanding of risk and return; product design and distribution; financial reporting; general insurance reserving; liability management of defined benefit pension schemes; changes in the external environment; economic outlook – impact on pension schemes; economic outlook – impact on insurers; competitive pressure on insurers; and rapid change in the pensions market.

2.6.1. Personal qualities;

2.6.2. Skills relevance;

2.6.3. International;

2.6.4. Communication;

2.6.5. Failure to speak out;

2.6.6. Regulation;

2.6.7. Commercial issues and pressures; and

2.6.8. External environment.

2.7. We have mapped the risks which our Members identified across the twelve high-level risks identified in the JFAR Risk Perspective to ensure that the relationship between the respective risks is clear.

3. Summary and analysis of the results of our information gathering exercise

3.1. The next section of this Risk Outlook presents a summary and an analysis of the possible public interest risks identified.

3.2. The information gathering exercise described in **Appendix 1** elicited approximately 300 identified risks from our Members. Views were taken from over 500 Members who attended our sessions. Some Members reported the same risks and not all Members provided feedback during the sessions. Certain risks appeared across a number of practice areas and were not practice-specific.

3.3. The Working Party reviewed the information and agreed that the risks identified fell into eight high level categories. An analysis of those categories and possible risks is below. We have included specific comments made by our Members, where appropriate. A range of potential mitigants to these risks is discussed in sections 4 and 5 of this paper.

3.3.1. Personal Qualities

Descriptor of identified risk: Actuaries or users/employers fail to recognise the extent and limits of actuaries' skills.

This was a frequently cited risk that arose across most practice areas, with Members reflecting an impression that the wider public does not have a detailed knowledge of the work that actuaries do and, in particular, may not understand the contribution that actuaries can and do make to society as experts in qualitative risk.

Members also identified a risk that some actuaries might go beyond the boundaries of their skill set. If actuaries exceed their levels of competence this could leave the user confused but not willing or able to take action against the actuary's advice. Acting outside of one's skill set could lead, for example, to taking inappropriate risks with new products.

3.3.2. Skills Relevance

Descriptor of identified risk: Actuaries do not keep their knowledge and/or understanding of new methodologies up to date.

Again, this was a risk which was identified across all practice areas, with a number of different strands. Members expressed concerns that there was a risk that the actuarial profession could not keep up with newer developments, such as Big Data, cyber risks or climate change. This was suggested, for example, to have the potential to have negative impact on reserving if cyber risks and other data developments were not understood correctly. Additionally, it was suggested that failure to keep up with technological advances or new methodologies might lead to actuaries being "left behind" as new ideas emerge. This would result in actuaries being unable to provide the best advice.

A number of practice areas reported risks in relation to the use of models – ranging from a poor understanding of models to excessive reliance on models. Concerns were expressed that perhaps the use of actuarial models in the retail distribution of investments and pension products might lead to the wrong customer outcome being achieved, due to poor positioning or oversight of these models (including in relation to the nascent 'robo-advice' market). Some mentioned that there could be a risk that actuaries do not exercise enough professional judgement – instead relying on the models to undertake their work i.e. "actuaries using 'machines' not 'tools' leading to a loss of judgement and understanding".

Other Members identified a risk that the continuing professional development undertaken could be insufficient, which could have consequences for the users of actuarial services. Conversely, one Member suggested that actuaries were moving too quickly as regards new methodologies and that there was a "loss of traditional knowledge" which may adversely impact users.

A further view expressed by quite a number of actuaries involved concerns around 'group think' and herding behaviour. It was suggested that failure to keep skills up to date could also be linked to the tendency for actuaries to use the same model, potentially for a long period of time - the "everyone is doing it so it must be right" approach – without assessing advances in technologies or changes in the regulatory or business environment.

3.3.3. International

Descriptor of identified risk: Actuaries, their employers and users of actuarial services operate differently and to different standards depending on where they are located.

Some Members in a few of the practice areas, particularly Health & Care and General Insurance, expressed the view that there was a risk that Members outside the UK might not operate to the same standard as Members within the UK. A related risk relevant to employer size and structures was also raised. Differences in regulatory environments around the world were also noted as a concern, with Members having different responsibilities depending on where they are located or for different work instructions.

3.3.4. Communication

Descriptor of identified risk: Actuaries fail to communicate sometimes complex solutions to problems in a way in which users can understand.

A few practice areas reported a risk that actuaries do not communicate appropriately with the users of actuarial work or with other professionals with whom they may need to work. An example was that of medical professionals in the Health & Care sector who may use specific medical terminology which is not sufficiently understood by actuaries and which could have an impact on the assumptions the actuary uses.

Another example was the risk that Pension Scheme actuaries fail to provide technical advice to trustees in a manner which was appropriate to their level of knowledge.

Other risks identified included investment risks being poorly understood or explained, for example, projections, costs or the existence of an information asymmetry between actuaries and the users of actuarial work. It is relevant to note here that our Members must comply with relevant standards and the Actuaries' Code, which requires communication to be clear, effective, timely and appropriate to its audience.

3.3.5. Failure to speak up

Descriptor of identified risk: Actuaries fail to speak up on issues of importance.

This risk was identified by a large number of the practice areas. Two particular themes emerged: first, that actuaries might not speak up on issues of importance to the public (for example, immigration, regulation, housing) and second, that actuaries might not speak up when they observe behaviours which conflict with ethical or technical standards incumbent on Members. The first risk was not categorised by the Working Party as one with a regulatory focus as it concerns wider sociological, philosophical and political concerns and beliefs. The second risk, the challenge of speaking up, involves a multi-faceted approach by Members, the IFoA and employers of actuaries to encourage people to speak up and raise concerns, particularly where there are contrary pressures (including commercial ones) not to do so. The working environment of actuaries and the culture within the profession are key considerations in addressing this risk, as profiled by the introduction of the Quality Assurance Scheme (**QAS**) to assist employers in developing and reinforcing a positive working culture.

3.3.6. Regulation

Descriptor of identified risk: Overly complex regulation of actuaries can lead to negative outcomes, including an environment or culture of conformity rather than one which fosters appropriate use of professional judgement.

This risk was raised by almost all of the practice areas, with a strong additional theme that over-regulation can lead to a lack of transparency. It was suggested by some that too much regulation in the UK could lead to insurance companies moving assets offshore to less regulated environments.

By 'over-regulation', the Working Party understood our Members to refer to the risk of too much UK and international regulation and too many regulators regulating in the same area. This was of particular concern to General Insurance, Pensions and Life actuaries. Solvency II provided a particular example where the unwinding or simplification of that regulation could potentially benefit users of actuarial services.

Separately, it was felt that overly-prescriptive legislation can lead to increased costs for users of actuarial services; for example, where "regulations require a certain level of capital, this means products could be more costly and people don't purchase them".

A key theme that arose was linked to the possibility of herding or group think behaviours due to the complex nature of the regulatory environment. This could lead to an environment where Members operate on the same basis simply 'because everyone else is doing it', without applying thought as to whether it is appropriate to the circumstances. Critical and considered professional judgements may not then necessarily be made. The JFAR has identified this as a risk and we published a thematic review on "Group Think" in 2016.[6]

[6] https://www.actuaries.org.uk/news-and-insights/media-centre/media-releases-and-statements/review-group-think-finds-organisational-culture-has-largest-impact-behaviour

3.3.7. Commercial Issues or Pressures

Descriptor of identified risk: Actuaries are subject to commercial pressures which are a threat to the appropriate exercise of professional judgement.

A few common themes arose in relation to this risk which was raised by most of the Members we spoke to. First, Members noted the risk that actuaries might advise users to utilise inappropriate investment vehicles in order to satisfy commercial pressures arising from either the user and/or the actuary's firm or employer. It was agreed that junior actuaries might come under particular pressure to confirm business decisions with which they may not agree.

Rapid changes in the UK pensions market in light of the new pensions freedoms regime, were also identified as a risk, for example. While Members are skilled at adapting to evolving and changing markets, this risk reflects the inevitability that rapid and frequent change will have an uncertainty attached and recognises the responsibility on actuaries to keep their life long learning up-to-date and new skills relevant.

3.3.8. External Environment

Descriptor of identified risk: Actuaries are affected by changes in the external environment.

A good example of this is technological change. The risk identified by our review in this context is that their professional understanding and, therefore, their capacity for appropriate objective judgements, is diminished if actuaries do not place sufficient emphasis on keeping abreast of such changes.

Most practice areas identified that actuaries' work can be affected by changes in the external environment, which could result in risks being passed on to the public if actuaries fail to adapt to these changes. For example, "Brexit" could have a substantial impact on actuaries and the advice that they give to their users – for example, if Solvency II were to be unwound to any extent and how might this affect the actuarial regime and the advice that actuaries provide to their employers?

This risk is clearly not specific to actuaries. Some feedback did, however, suggest some specific examples relevant to the actuarial profession. A few Members noted that a failure by actuaries to understand changes to the external environment, such as "dramatic improvements to health and longevity" due to unpredicted medical advances could have an adverse effect on assumptions used by actuaries in providing advice. Similarly, an over-reliance on very sophisticated software might also affect actuarial assumptions.

4. Analysis of specific risks identified- ‘Risk Alerts’

4.1. Following the conclusion of the review, we decided that some of the risks identified through the analysis of the information gathering exercise should be brought to the attention of our membership by way of a communication to be known as a ‘Risk Alert’. These Risk Alerts are, therefore, one of the key outputs of this work. However, they are not the only output.

4.2. The Risk Alerts highlight a particular concern, in order to raise awareness amongst our Members as well as wider stakeholders and if appropriate suggest possible mitigants. The target audience for a Risk Alert may range from the entirety of our membership to a small subset, depending on the subject matter. Risk Alerts will, in addition, be published on the IFoA’s website for wider consumption. The Working Party sought to focus on the more significant risks based on their own knowledge and experience, but drawing critically upon the views expressed during the information gathering exercise. It may be that a small subset is acutely affected by a particular risk at a particular time. With this in mind, the selection of potential Risk Alert topics should not be seen as based on any attempt at a scientific or quantitative analysis of the identified risk, but more as reflecting a considered and informed practitioner view.

4.3. The Working Party will liaise with relevant IFoA Practice Boards in relation to the content of Risk Alerts to ensure that they are fit for purpose.

4.4. We will consider whether a Risk Alert topic should lead to:

4.4.1. no further action being taken, other than to issue the Risk Alert, being of itself sufficient to raise awareness of the issue (subject to ongoing monitoring and review) and thereby, address the underlying concern;

4.4.2. educational or CPD material; or

4.4.3. necessary and proportionate regulatory intervention.

The first of the Risk Alerts was on Commutation Factors in the context of Defined Benefit pension schemes, followed by an Alert highlighting the risks around under-reserving in the General Insurance market. These were published on 30 June and 4 July 2016 respectively and copies are contained in Appendices 2 and 3 to this paper.

4.5. As risks develop or change, future Risk Alerts will be issued to raise and address concerns quickly and appropriately.

4.6. A number of topics were identified as being of importance, but which could more usefully be brought to Members’ attention through a route other than a Risk Alert. For example, as noted earlier, the issue of cyber risk arose. Nonetheless, the Working Party was of the opinion that, at the moment, there is already widespread awareness and activity by other stakeholders and interested parties to address this risk. Additionally, the difficulties experienced by small firms and sole practitioners due to “over-regulation” and/or the failure of regulators to act proportionately in their regulation of such firms/Members, was also identified as a broader risk of which we aim to take account across all of our regulatory activity.

5. Other mitigants to identified risks: professional culture and the QAS

5.1. The Working Party's view is that an overarching mitigant in relation to many of the risks identified relates to the presence or otherwise of a positive culture within organisations. Encouraging and fostering such a culture requires a multi-faceted approach with varying input from different people and stakeholders.

5.2. Regulators and the professionals they regulate, in addition to educational systems with a commitment to ethics, need collectively to ensure that professionals can develop the right skill sets to serve and protect the public. This starts with the individual professional and the acceptance and development of professional self-responsibility, but is also fostered by the working environment in which they operate.

5.3. The working environment clearly exerts great influence on the behaviour and formation of those who work within organisations. The working environment can be described as a set of identifiable shared values or beliefs that guide the thinking and behaviours of the members of the organisation. Such an environment can have a positive influence i.e. it offers direction and stability but, equally, it can be constraining if it does not move with the times. Whilst many organisations will have core values which touch on similar philosophical concepts such as integrity, trust etc, the environment of each organisation can be quite different. The working environment plays a key role in ensuring that actuaries (and all professionals) are appropriately supported in relation to both professional and technical issues and that they feel encouraged to carry out their work with confidence.

5.4. The Working Party has concluded that one of the most effective ways to mitigate risks to the public arising from actuarial work is through the reinforcement of a positive and professional working environment in organisations and in the culture of the actuarial profession as a whole. Professional working practices can be reflected in the organisation's or profession's behaviour - for example, newly qualified actuaries being habitually encouraged by other Members in their organisations to follow ethical practices, such as speaking up where appropriate.

5.5. The IFoA's recently launched QAS was developed with this in mind. The QAS recognises the importance of the working environment in enabling Members to fulfil their professional responsibilities and to produce high quality actuarial work. The objectives of the QAS include:

5.5.1. the promotion of effective quality assurance at an organisational level, which indirectly impacts on the quality of actuarial work for users of actuarial services; and

5.5.2. the promotion of confidence in the work of actuaries; and

5.5.3. the establishment of a mechanism by which to identify proactively issues affecting the quality of actuarial work.

5.6. The QAS looks at whether an organisation is meeting a range of outcomes, all of which have been identified as being relevant to cultivating an environment that is conducive to high quality actuarial work. The outcomes relate to the following topics:

5.6.1. quality assurance (including work review);

5.6.2. conflicts of interest;

5.6.3. the development and training of Members;

5.6.4. speaking up about issues that cause concern; and

5.6.5. relationships with users of actuarial work, including engagement, communication and the handling and resolution of concerns raised.

5.7. In order to achieve the QAS accreditation, organisations must demonstrate, by way of independent assessment, that appropriate policies and procedures are applied, appropriately documented and, most importantly, embedded within the organisation's working environment and culture. As evidenced in our information gathering exercise, the external environment can have a substantial impact on actuaries' work and it is also expected that QAS accredited organisations have policies and procedures which are dynamic and capable of responding to such changes.

5.8. The reinforcement of professionalism within the profession and the working environment of actuaries is a key strand of the IFoA's Regulatory Strategy and will inform the IFoA's future regulatory work to promote both the quality of actuarial work and thereby the strong reputation of the actuarial profession.

6. Future work on public interest risk

6.1. Risks are not static. As such, the IFoA is committed to undertaking periodic reviews of the risk environment following liaison with practitioners through our Practice Boards, conferences and broader stakeholder engagement. This will be a continuous process rather than one following a specific (and probably artificial) timetable.

Relevance to the IFoA's Regulatory Strategy

6.2. There is a core link between these initiatives and the Regulation Board's work programme, objectives and regulatory standard setting. The IFoA is firmly of the belief that regulation is not the cure all for systemic risks. However, in some circumstances regulation is at least part of the solution. We fully recognise though that, for other risks, publication of communications, topical papers, education and CPD events sometimes may be just as, if not more, effective and proportionate in raising awareness of those risks and in their appropriate mitigation. Equally, it may be that it will be appropriate to withdraw, amend or replace regulatory standards where the risk they are intended to address becomes less significant.

Do you have any comments?

6.3. We welcome any comments or feedback on this Risk Outlook from our interested readers. Any comments should be directed to:

Regulation
The Institute and Faculty of Actuaries
Level 2, Exchange Crescent
7 Conference Square
Edinburgh
EH3 8RA

or regulation@actuaries.org.uk

Appendix 1: How did we conduct our information gathering exercise?

1. During 2015 and early 2016, the Working Party spoke in depth with the:

   - Actuarial regional communities in Belfast, Birmingham, Manchester, Basingstoke, Edinburgh, York and Glasgow.

   - IFoA's Practice Boards: Finance and Investment Board, General Insurance Board, Health and Care Board, Life Board, Pensions Board, Resource and Environment Board and Risk Management Board;

   - IFoA's Education Board;

   - IFoA's Regulation Board; and

   - IFoA's Disciplinary Board.

2. Informative discussion of the public interest risks relevant to actuarial activity also took place at the IFoA's 2015 General Insurance Research Organising Committee ("**GIRO**"), with the Association of Consulting Actuaries Smaller Firms' group and the Chinese Actuarial Network UK.

3. The question asked at each of the discussions was: "what are the risks to the public interest which are relevant to actuarial activity?" Overall, the Working Party discussed this issue with over 500 actuaries. The discussions were both subjective and qualitative and were conducted under the Chatham House Rule to encourage free-flowing debate. Accordingly, this Risk Outlook does not provide a detailed list of responses; rather, we have provided examples of common themes that came to our attention and have included some (unattributed) comments from our Members to provide colour to illustrate some of the identified risks.

4. The information gathering exercise and this Risk Outlook have, for practical reasons, focussed on UK risks in the first instance. A substantial proportion of our Members are based overseas and so we will consider how to include, in a second phase of this work, risks facing the public outside the UK.

5. We are immensely grateful to everybody who has taken the time to contribute to the project to date.

Appendix 2: Risk Alert: commutation factors

RISK ALERT
Commutation Factors

KEY MESSAGE
Commutation Factors should be kept under regular review. When this does not happen, factors typically appear unlikely to offer fair value for members.

What are Risk Alerts?

A series of email alerts drawing members' attention to specific issues where the IFoA asks members to think carefully about the consequences of actions they are taking.

The information in the Risk Alert is non mandatory guidance which we publish to protect the public interest.

This Alert is relevant for the following members

Actuaries advising Trustees of Defined Benefit (DB) Schemes; and
Actuaries advising sponsors of DB schemes.

Subject matter

This Risk Alert recognises that responsibility for setting commutation factors may lie with different stakeholders in a pension scheme. Members may find the 2006 publication from the profession's Member Options Working Party provides helpful information on this topic.

In general, an actuary's advice to the client has always included discussion of, or recommendations for, appropriate commutation factors. The continuing improvements in longevity and falls in yields over the last decade have emphasised the importance to trustees, sponsors and particularly members of keeping commutation factors current.

Typically, it is the Scheme Actuary who advises on factors, but this is not always the case. The note is therefore relevant for all actuaries who have a role in providing advice to the decision maker on factors.

Considerations for actuaries

1. Consider the frequency of providing advice about commutation factors. Actuaries should be aware of trends in market conditions that could affect commutation factors.

2. Consider the timing of advice about commutation factors. For example, where the Technical Provisions include an allowance for commutation that is based on current factors Scheme Actuaries should consider including commutation factor advice as part of their initial funding valuation advice, rather than defer advice until after the conclusion of the valuation.

3. Communicate clearly to the client the consequences of changing, or retaining, commutation factors.

4. Consider the consistency of commutation factors with Cash Equivalent Transfer Values, particularly for members close to retirement age.

5. Record advice provided, particularly if the client decides to use alternative commutation factors.

6. Consider the impact of the Pensions Technical Actuarial Standard when providing advice on commutation factors.

Further information and support

Actuaries who have specific professional questions or concerns should contact the Professional Support Service.

Appendix 3: Risk Alert: General Insurance Reserving

RISK ALERT
General Insurance Reserving

KEY MESSAGE
Fluctuating market conditions, not just linked with the risks of Brexit, but also the underlying trends of over-capacity and pricing pressures, increase the risk that reserves are understated. General Insurance reserving actuaries should be aware of the cyclical nature of market conditions, the current position within this cycle and the need to take this

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The information in the Risk Alert is non mandatory guidance which we publish to protect the public interest.

This Alert is relevant for the following members:

Chief Actuaries
General Insurance Reserving Actuaries General Insurance Pricing Actuaries
General Insurance Capital Modelling Actuaries
Actuaries appointed to General Insurance Boards (including Non-Executives) Actuaries appointed as General Insurance Chief Risk Officers.

Subject matter

Current market conditions are challenging across a number of lines of general insurance business. For these lines, the cyclical nature of the insurance market and the current position within the cycle has led to:

- Prolonged and significant rate reductions
- Weakening of terms and conditions; and
- Relaxation of underwriting selection criteria.

Although these conditions mean that the reserve releases seen over recent years are unlikely to be sustainable long term, the management of firms may take an alternative view, and this may lead to increased pressure on actuaries to reduce reserving estimates, especially on longer tailed lines of business.

The reserve strengthening and resulting insolvency of several general insurance companies in the late 1980s and 1990s, following a period of under-reserving, provides a precedent for understanding the impact of the insurance cycle. These events should act as a prompt for reserving actuaries to reflect on the implications of unanticipated events in today's market.

The existence of a reserving cycle is well documented; however there is a risk that reserving actuaries do not recognise, or adequately allow for, 'cycle effects'.

General insurance actuaries should also refer to the recent speech by Chris Moulder of the PRA in which he referred to the current soft market conditions.

Considerations for actuaries

1. Consider the impact of the cyclical nature of the insurance market. Actuaries should reflect on the consequences of under-reserving as experienced in the 1990s.
2. Communicate the impact of the insurance cycle to Boards. Actuaries should also consider the understanding of these issues by Board members.
3. Do not allow reserving bases to be unduly weakened in the face of any commercial pressures to reduce reserves.
4. Review the suitability of current reserving techniques and methodologies. This review should examine any potential over-reliance on particular forms of data (such as case estimates over claim payments for example). It should also be informed by scenario analyses investigating the impact of alternative reasonable choices in parameters and methods.
5. Understand how current pricing decisions could impact reserves.
6. Communicate any increased down-side risks in reserving outcomes, and how these have been appropriately reflected in the reserve estimates.

Potential consequences

If claims reserves are insufficient, firms may face:

- Calls to raise additional capital
- Restrictions on writing new business; and/or
- Insolvency in extreme cases; in some cases leading to non payment or underpayment of valid claims.

Further information and support

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