GN5: The Prudential Supervision outside the UK of Long-Term Insurance Business

Classification
Recommended Practice

MEMBERS ARE REMINDED THAT THEY MUST ALWAYS COMPLY WITH THE PROFESSIONAL CONDUCT STANDARDS (PCS) AND THAT GUIDANCE NOTES IMPOSE ADDITIONAL REQUIREMENTS UNDER SPECIFIC CIRCUMSTANCES

Definitions
Defined terms appear in italics when used in the standard.

Board	Any governing body of an *Insurer*
Board for Actuarial Standards	The operating body of the Financial Reporting Council (the UK's independent regulator responsible for promoting confidence in corporate reporting and governance) which is responsible for setting technical actuarial standards
Insurer	The insurance company or other organisation writing *long-term insurance business* for which the actuary acts
Liabilities to policyholders	Any liability of an *insurer* to or in respect of a policyholder, including any obligation arising out of any broader regulatory requirement to treat its policyholders fairly, or to fulfil their reasonable expectations, or which otherwise creates constructive obligations
Long-term insurance business	Any insurance contingent upon human mortality or morbidity or as otherwise defined under relevant regulations or practices
PCS	Professional Conduct Standards of the Faculty of Actuaries and Institute of Actuaries
Regulator	The regulator of the *insurer* in its country of domicile

Legislation or Authority
Any applicable insurance regulations in the relevant country.

Application

Actuaries appointed to report, whether in fulfilment of a regulatory requirement or otherwise, on questions of solvency and/or other aspects of financial management to the *Boards* of, or for publication by, insurance companies or other organisations writing *long-term insurance business* which are domiciled outside the UK.

This Guidance Note does not apply to any member who carries out work otherwise within the scope of the Guidance Note, but who:

- has formally elected to be regulated by another full member of the International Actuarial Association (IAA) and not by the Faculty or the Institute of Actuaries;
- makes this clear in the relevant letter of engagement; and
- uses the professional designations of that IAA body and not of the Faculty or Institute.

The Guidance Note does not apply in any country in which a full member of the IAA provides formal guidance to its members on the subject matter of this guidance note and where the actuary reports in accordance with such guidance. Where an *insurer* publishes such a report in respect of solvency this guidance does not apply to any other published reports on financial management in respect of the same date.

Author

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Status

Approved under Due Process.

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3.1	01.12.07

1 General

1.1 This guidance should be interpreted in the context of the regulations and practice of the country(ies) in which the *insurer* is domiciled, with which an actuary to whom this guidance applies should be familiar. In this guidance note country includes any territory or dependency to which separate insurance legislation might apply.

1.2 The responsibilities of an actuary to whom this guidance applies are central to the financial soundness of the *long-term insurance business* of the *insurer* in respect of which he or she is appointed. Insurance *regulators* may also rely on the actuary to confirm that the *insurer* in respect of which he or she acts is financially sound or that it complies with regulations in other ways (e.g. certification of the method of calculation of premiums).

1.3 This guidance applies both to an actuary retained by an *insurer* to report on its solvency and/or other aspects of its financial condition for management purposes where that report is intended for the *Board* or for publication and also to an actuary retained by an *insurer* to fulfil a prudential regulatory role.

1.4 An actuary should not accept an appointment requiring him or her to determine the financial soundness of an *insurer* if he or she does not have the appropriate knowledge and practical experience relevant to the *insurer* and types of business concerned. Regulations may also specify additional requirements. Before taking up an appointment, an actuary should ensure that the relevant requirements of the *PCS* have been met including, in particular, appropriate contact with his or her immediate predecessor, if any, if this is required by the *PCS*.

1.5 An actuary to whom this guidance applies who is fulfilling a regulatory role should take all reasonable steps to ensure that the *insurer* understands when he or she is providing advice in accordance with regulations or related actuarial professional guidance, as opposed to providing advice or expressing opinion as an employee, director or external adviser, as the case may be.

1.6 An actuary should be aware of the requirement of the *PCS* relating to the inclusion in a report of an assessment of the implications for policyholders of any recommendations contained in the report.

1.7 An actuary should be objective in the performance of his or her duties and take reasonable steps to satisfy himself or herself that his or her advice is free from bias. The *PCS* provides relevant guidance on conflicts of interest.

1.8 An actuary must pay due regard to generally accepted actuarial practice. The *PCS* and professional guidance notes establish some elements of generally accepted actuarial practice. An actuary to whom this guidance applies should also consider whether there are any other practices that may be considered as generally accepted actuarial practice. Although the *Board for Actuarial Standards* restricts the application of its standards geographically, where those standards deal with matters common to situations in the country(ies) where the actuary is working, they are likely to be relevant considerations as to generally accepted actuarial practice. Where a materially different practice is adopted from one which is a generally accepted actuarial practice, the actuary should explain and justify the reasons for the practice actually adopted.

1.9 It is possible that the regulatory regime to which the *insurer* or actuary is subject may differ from the recommended practice of this Guidance Note. In this case, the actuary should consider the table below in preparing any reports:

	Reporting to the Regulator	**Reporting to the Insurer**
Regulations do not specify requirements.	In line with the practice of this Guidance Note.	In line with the practice of this Guidance Note.
Regulations specify requirements less prudent than recommended practice.	In line with the regulations (but see 2.1 below)	In line with the practice of this Guidance Note.
Regulations specify requirements more prudent than recommended practice.	In line with the regulations.	In line with the practice of this Guidance Note but also showing the regulatory position.

1.10 Each of sections 4 to 9 of this guidance applies only to an actuary required, either by regulation or by the *insurer* for which he or she acts, to carry out the activities to which reference is made in that section. They do not apply to an actuary in a role for which regulations or the *insurer* do not so require, including an actuary whose appointment or responsibility terminates on the completion of the financial condition assessment. An actuary should ensure that his or her terms of engagement are clear about whether these obligations exist or not.

2 Duties of Actuaries

2.1 Where a regulatory role is being fulfilled, the actuary should carry out the actuarial investigations specified and report in accordance with the regulations. Where the actuary believes that the regulatory basis or format materially fails to make the real financial circumstances of the *insurer* clear, the actuary should draw the attention of the *insurer* to this in a supplementary report. Where the regulations require the application of generally accepted actuarial practice, or some other generic requirement, the actuary must address these issues in the main report.

2.2 Where the actuary is reporting for management purposes within the scope of the application of this Guidance Note, he or she should report on those investigations in writing to the *insurer*, advise the *insurer* of the nature and frequency of the investigations required as a minimum to enable the financial condition of the *insurer* to be assessed and, if appropriately experienced, should offer to carry out such an investigation. The actuary should present the results in a way that demonstrates fairly the financial circumstances of the *insurer*.

2.3 All material valuation methods and assumptions should be stated.

2.4 All material risks to the solvency of the *insurer* should be identified, unless the actuary has reported these previously in a report of the type referred to in 8.1 below, or otherwise, and this information remains valid.

2.5 If the actuary considers that the report contains matters of significant concern which need to be addressed by the *insurer*, he or she should normally seek permission to present the report in person.

2.6 Where a material risk to the solvency of the *insurer* has been identified, the actuary should consider advising the *insurer* that the report, together with the other reports referred to in 2.4 above if any, or at least a specifically drafted summary of it or them, should be sent to the management or controlling body, as appropriate, of any organisation in the parental hierarchy of the *insurer* which exerts significant influence on the decisions of the *insurer.*

2.7 The actuary should bear in mind that any report required by the *regulator* which is publicly available, or which the *insurer* intends to publish, may be used by third parties, including financial advisers and actual and potential policyholders.

2.8 The actuary should consider whether to notify the *regulator* if, when he or she resigns from that role or when his or her appointment in that role is terminated or not renewed, there are circumstances concerning the cessation of the appointment which he or she thinks ought to be brought to the *regulator*'s attention. Such considerations should take into account the duty of confidentiality to the client and the extent, if any, to which legislation overrides or exempts the actuary from that duty.

2.9 If the *insurer* also carries out general insurance business or any non-insurance activities, the actuary should consider that business to the extent to which it might impact on the *long-term insurance business*. Even where the *long-term insurance business* fund and other funds are legally separated, poor performance of the other business can affect the apportionment of overheads between the businesses and the capital available outside the *long-term insurance business* fund to meet any regulatory minimum margin. Where necessary, the actuary should seek advice from an actuary with relevant experience in general insurance or, in the case of non-insurance business, a recognised expert in that business.

2.10 The actuary should advise the *insurer* if he or she believes that it may not currently be meeting *liabilities to policyholders* as they fall due or might not have done so in the past, or might in reasonably foreseeable circumstances fail to do so, either as a result of insufficient financial resources or otherwise. If the actuary believes that the *insurer* is not able to, or may not in the reasonably foreseeable future be able to, meet any minimum solvency margin required by regulation or considered appropriate by the actuary, this is a sufficient (but not necessary) condition to provide this advice.

2.11 *Liabilities to policyholders* may include obligations arising from a regulatory requirement to treat its policyholders fairly or to fulfil policyholders' reasonable expectations, including implicit liabilities created by literature, illustrations or precedent. If so, the actuary should ensure that the *insurer*'s management are aware of his or her interpretation of its obligations to treat its policyholders fairly or to fulfil their reasonable expectations which need to be taken into account. In general terms this interpretation should have regard to the broad nature of the *insurer's* practices and business plans and its approach to the treatment of policyholders both individually and (where appropriate) collectively as a group vis-à-vis shareholders.

2.12 An actuary fulfilling a regulatory role should consider whether he or she is required to inform the *regulator* without undue delay if, having first informed the *insurer* of matters envisaged in 2.10 above, the *insurer* does not take appropriate action to remedy the situation. Such considerations should take into account the duty of confidentiality to the client and the extent, if any, to which legislation overrides or exempts the actuary from that duty. The actuary should ensure that the *insurer* is aware of this professional consideration prior to informing the *regulator*.

2.13 If the actuary considers that the *insurer*'s reinsurance arrangements are inappropriate or inadequate he or she should advise the *insurer* on the modifications advisable.

2.14 The actuary should judge and decide whether the investment policy pursued by the *insurer* is inappropriate having regard to the nature and term of the *insurer*'s liabilities and to the investments available. If this is the case, the actuary should advise the *insurer* of the constraints on investment policy advisable.

2.15 The actuary should advise the *insurer* of the appropriateness of the guidelines given to the *insurer*'s investment managers regarding the use of derivative contracts and the procedures in place to monitor the *insurer*'s exposure to loss through their use. Loss can occur either through market movements or through failure of a counterparty.

2.16 The following list, which is not exhaustive, sets out the most usual items of information which are likely to be relevant to this section, particularly 2.4:

(a) the current and likely future economic, investment, and regulatory environment;

(b) the current and likely future taxation position of the *insurer*;

(c) the terms on which existing business has been, and current new business is being, written, with particular reference to all options and guarantees;

(d) the *insurer*'s policy with regard to the nature and timing of allocations of profits to policyholders and/ or shareholders;

(e) the nature, extent and availability of the *insurer*'s assets outside *the long-term insurance business* fund and of capital support from a parent;

(f) the existing investments of the *long-term insurance business* assets and the continuing investment policy including the use of derivative instruments;

(g) the extent to which assets and liabilities can not be or are not matched by term, by type and by currency;

(h) the exposure to and strength of investment and reinsurance counterparties;

(i) the systems of control which the *insurer* has established, especially those relating to operational risk;

(j) for unit-linked policies, the pricing policy for internal linked funds;

(k) the reinsurance, underwriting and (for health insurance) claims handling arrangements;

(l) the marketing plans, in particular the expected volumes and costs of sales;

(m) the current and likely future level of expenses;

(n) the current and likely future levels of mortality and morbidity; and

(o) the persistency of the business written both in the short and long term, and the terms for discontinuance.

3 The Actuarial Valuation

3.1 The actuary should take all reasonable steps to ensure that the data is accurate. If the actuary has any doubts about the accuracy of the data, reserves should be established for the risk that the actual value of the liabilities will be greater than that derived from the available data. If the potential inaccuracy is material, any certificate of solvency required to be provided to a *regulator* should be appropriately qualified.

3.2 The actuary should ensure that adequate controls are in place and documented to enable the appropriate valuation procedures to be correctly carried out and adequately recorded. The actuary should use liability valuation methods that are appropriate to the contracts in question, taking into account not only the principal benefits but also any ancillary benefits such as surrender values and any policyholder options or guarantees. When assessing the liabilities of the *insurer*, the actuary should also have due regard to any obligations arising from any regulatory requirements to treat policyholders fairly or fulfil their reasonable expectations.

3.3 Appropriate provision should be made for future expenses of administering the business existing at the date of the investigation. Allowance should be made for the possibility that preferential service agreements or outsourcing arrangements might be altered or terminated. Prudent allowance should be made for the loss of future margin as policies are made paid-up and, if the number of policies is declining or expected to decline, for the possibility of more slowly declining overhead costs. Any regulations which specify that the provisions should be sufficient in the event of closure to new business at a specified future time should be taken into account.

3.4 Assumptions about future mortality and morbidity should take into account the recent relevant credible experience and trends of the country, the industry or the *insurer*.

3.5 The value to be placed on the assets may be either the responsibility of the actuary or of the *insurer*. The actuary should, respectively, either ensure or take reasonable steps to verify that adequate controls are in place to ensure that appropriate values are placed on the assets and that any limits on exposure to individual investments, classes of investment or counterparties imposed by regulation or by the *insurer* are properly applied. If it is difficult to determine an accurate value for a material proportion of the assets, the actuary should establish reserves, if necessary, in respect of the risk of over-valuation. Similar considerations may apply to those liabilities which are not covered by the actuarial valuation itself.

3.6 The actuary should decide the rates of discount to be used in the valuation of the liabilities (reference should be made to 1.9 if the rates to be used are prescribed by regulation). Where assets are valued at current market value, the deterministic or stochastic discount factors used should be consistent with those market values. Where assets are valued on a different basis, the rates of discount should be determined consistently with that basis. In addition, due allowance should be made for the current and future taxation position of the *insurer*. Any such allowance should be consistent with any allowance made for tax relief on expenses.

3.7 The actuary will need to ensure that allowance has been made for the effect or possible effect of derivatives and other financial instruments when choosing the valuation basis. The actuary should particularly bear this in mind when choosing the basis used in the changed investment conditions envisaged in 3.11 below. The appropriate valuation interest rates should allow for the return on the assets held as adjusted to reflect economic exposure under futures contracts and contracts for differences. Consideration should also be given to the treatment of, and allowance for, financial options, particularly when close to an option date, and for options which may be liabilities.

3.8 The actuary should take account of the *insurer's* reinsurance arrangements in the valuation, including any implicit financing provision and the possibility that reinsurance contracts may lapse or prove unenforceable in certain circumstances.

3.9 The actuary should have regard to the possibility of failure of or dispute with a reinsurance, investment or financial instrument counterparty to which the *insurer* has material exposure, taking into account factors such as the financial strength and regulatory environment of the counterparty.

3.10 The actuary should ensure that adequate margins are included in the valuation assumptions or methods, including in the credit taken for any reinsurance, having regard to the actuary's own assessment of the risks inherent in the nature and conduct of the *insurer*'s business and the financial strength and regulatory environment of material counterparties.

3.11 Provision should be made for the time value of any options embedded in the liabilities. Where there is any mismatching of assets and liabilities, the actuary should also ensure that there is adequate explicit or implicit provision for reasonably foreseeable adverse movements in asset values or yields. In making this determination the actuary may accept equivalent regulatory capital requirements as fulfilling this need in lieu of making a provision.

3.12 On occasions, expenses or the return on new investments may be at a level which, if it persisted, would render it unlikely that the *insurer* would be able to meet *liabilities to policyholders*. If there are well-founded reasons for believing that these matters will change for the better in the foreseeable future, the actuary is not obliged to assume their indefinite continuation at the present level. However, the actuary should clearly state in all written reports regarding both valuation and premium bases his or her assumptions about future change in these items.

4 Ongoing Monitoring of Solvency

4.1 This section applies to an actuary who has been given the responsibility of monitoring on an ongoing basis the *insurer's* ability to continue to meet *liabilities to policyholders* in respect of *long-term insurance business* contracts as they fall due.

4.2 The actuary should ensure that he or she has sufficient information and resources to enable this task to be carried out. The actuary should request the *insurer* to provide such information and should advise the *insurer* as to the systems reasonably needed to enable it to do so. If the *insurer* is unable to supply any of the requested information, the actuary should inform the *insurer* of the consequences of this for the advice to be provided.

4.3 The information required, and the frequency of monitoring, will depend on the nature and extent of the risks to which the *insurer* is exposed and the extent of the solvency margin or other capital available. The list in paragraph 2.16 above should be taken into consideration.

4.4 Paragraphs 2.6, 2.10 and 2.12 should be applied as if they referred to the outcome of an ongoing rather than an annual assessment.

5 Premium Rates and Policy Conditions

5.1 This section applies to an actuary who is responsible for recommending premium rates.

5.2 The actuary should be satisfied that the premium rates being charged for new business are adequate, taking into account the other resources of the *insurer*. In particular they should be sufficient to enable the *insurer* in due course to meet its emerging commitments under the policies, having regard to the items listed in paragraph 2.16 above and to the extent of the *insurer*'s free assets available for this purpose.

5.3 Should premium rates be such that business is expected to be written on terms which require support from the free assets, the actuary should assess the *insurer*'s ability to continue to write business on such terms and should inform the *insurer* of this, indicating any limits on the volume of business that may prudently be accepted.

5.4 For almost all types of policy, it is impossible to be certain that a premium rate will be sufficient, because sufficiency depends on the future course of factors such as mortality, persistency, the return on investments and the *insurer's* expenses. However, techniques such as profit-testing and stochastic modelling should be used where appropriate to enable the circumstances and extent of potential insufficiency to be identified and quantified.

5.5 The actuary should pay special attention to contracts involving policyholder options, including when circumstances could arise in which the policyholder or an intermediary could gain by surrender and re-entry.

5.6 The actuary should also consider the implications for the *insurer* and for policyholders if future economic, demographic or business circumstances were to be radically different from those of today, particularly where the policy contains guarantees.

5.7 It may be that a practicable premium basis, whilst commercially justifiable, will involve significant new business strain. The actuary should be satisfied that the *insurer* will be able to set up the necessary reserves (and additional solvency margin where applicable).

5.8 Where there is a separate *long-term insurance business* fund, assets held outside it cannot automatically be assumed to be available for the purposes of paragraphs 5.2 or 5.7 above. Rather, the actuary should inform the *insurer* of any different maximum amount of new business which could be written if they were available, either for transfer into the *long-term insurance business* fund or to assist in meeting any minimum required solvency margin.

6 Exercising Discretion over Charges or Other Conditions

6.1 This section applies to an actuary who is required to exercise discretion over charges or other policy conditions, or to recommend how such discretion is exercised by the *insurer*. This may in particular arise where *insurers* have included in their policy documents a statement that certain terms will be determined by the actuary or other similar wording, or as a result of a regulatory requirement. For example, expense charges and mortality and morbidity charges may be treated in this way, as may market value adjustments to unitised with-profits contracts.

6.2 In determining such terms, or in providing advice to the *insurer* in this area, the actuary should have regard to any requirements to treat policyholders fairly or to fulfil their reasonable expectations, to any other relevant regulations (including any covering unfair contract terms) and to policyholder expectations created by literature, illustrations or precedent.

7 Unit Pricing

7.1 This section applies where an actuary is responsible for the application of unit pricing and fund charges for unit-linked and, where appropriate, unitised with-profits business.

7.2 The actuary should ensure that all discretionary elements are applied taking into account any requirements to treat policyholders fairly or to fulfil their reasonable expectations and any relevant regulations (including any covering unfair contract terms) or policyholder expectations created by literature, illustrations or precedent.

7.3 The actuary should also be satisfied that the procedures for determining:

(a) the prices at which units are allocated to or de-allocated from policies;

(b) the prices at which units are created or cancelled; and

(c) compensation where errors of a material size in unit pricing or in the allocation or de-allocation of units to policies have occurred;

are equitable to any policyholders affected either directly or indirectly and are being properly implemented. For these purposes the actuary should have regard, inter alia, to the tax position of the business and to the expected future growth or decline of the particular fund.

8 Financial Condition Reports

8.1 This section applies to an actuary responsible for preparing a 'financial condition report'.

8.2 This should be prepared in compliance with any relevant regulations or in whatever format the actuary considers necessary to ensure that the *insurer* is sufficiently well informed of the foreseeable risks which could jeopardise the *insurer's* financial condition and the extent to which they may do so.

8.3 When preparing this report, the actuary should consider whether there are risks particular to the environment to which the *insurer* is exposed. The list in paragraph 2.16 above should be considered in making this assessment. If inadequate historical data is available for the construction of financial or other models, the actuary should take care to make any necessary adjustments before using models based on data from other countries.

8.4 In particular, the actuary should advise the *insurer* of the actions that could be taken if the solvency of the *insurer* were to deteriorate, as a result of factors either within or outside the control of the *insurer*. This advice should include details of the options available as the probability of failure to meet *liabilities to policyholders* progressively increases and should also refer to the desirability of having documented plans and processes for dealing quickly and effectively with the situation were it to arise.

9 Recommendations on Allocation of Profits

9.1 This section applies to an actuary who is required by either regulation or the *insurer* to advise on or to determine the distribution or allocation of profits.

9.2 The actuary should determine, in accordance with applicable regulations if any, the excess of the assets available for the *long-term insurance business* of an *insurer* over its liabilities attributable to that business. If rights of any *long-term insurance business* policyholders to participate in profits relate only to a part of the business, the actuary should also identify separately any excess which relates to that part.

9.3 The actuary should advise the *insurer* of the extent to which it would be appropriate to transfer any excesses to shareholders or, in the case of with-profits business, distribute it between policyholders and shareholders, and, where required to do so, should make recommendations for its specific allocation.

9.4 In making recommendations in respect of any proposed allocation of profits, the actuary should carry out appropriate financial investigations including an appraisal of the relevant past experience.

9.5 In the report that includes the recommendations, the actuary should include sufficient information and discussion about each factor and about the results of any financial investigations to justify, and enable the *insurer* to judge, the appropriateness of the recommendations and for the *insurer* to understand their implications for the future course of the *insurer*'s business. In particular, the actuary should state his or her

(a) conclusions from the appraisal of the relevant experience;

(b) understanding of the *insurer*'s financial and business objectives; and

(c) assessment of the *insurer*'s ability to meet any minimum required solvency margin following the recommended allocation.

In addition, for with-profits business, the actuary should state his or her:

(d) method of use of asset share or other techniques, if any, including the way in which the recommendations are derived from those techniques;

(e) interpretation of any legal advice given to the *insurer* constraining or potentially constraining the *insurer's* discretion when allocating surplus and how this has been reflected in the recommendations;

(f) interpretation of any requirements to treat policyholders fairly or to fulfil their reasonable expectations having regard in particular to (a), (c), (d) and (e). What constitutes fair treatment may be influenced by policy literature and other publicly available information such as future benefit and by past and current distribution practice;

(g) opinion of the extent to which it is appropriate to distinguish between groups of participating policies having regard inter alia to the nature of the policies, their duration and their relevant pooled experience, and taking account of (e) and (f); and

(h) opinion of how the recommendations maintain fairness between different categories of policy or policyholder and between policyholders and the *insurer*.

The extent of information and discussion appropriate for any factor may depend upon the extent to which, if at all, the factor has been covered in a report formally presented to the *insurer* in the previous eleven months. In particular, the actuary may report in an appropriately abridged form when interim or terminal bonus rates are being reviewed during the year.

9.6 If the recommendations anticipate the results of a determination of surplus, the actuary should include in the report the estimated results of the determination and show how the recommendations can be financed.

9.7 The actuary should discuss the relationship between the recommended allocation and recent and expected future experience (economic, demographic, etc). In the case of with-profits business, the report should address bonus prospects, including terminal bonus if applicable, in different future investment scenarios. If the recommended allocation is excessive relative to the recent and expected experience (apart from any non-recurrent elements) and if the continuation of this relationship in future years could result in a material deterioration in the *insurer's* financial position, the report should indicate whether and how this could appropriately be avoided, taking any requirement to treat policyholders fairly or fulfil their reasonable expectations into account.

9.8 Where, in the opinion of the actuary, there is uncertainty regarding the extent to which the *insurer* can exercise its discretion when allocating surplus to policyholders, he or she should state in the report the nature of the uncertainty, the assumptions made with regard to the uncertainty when making the recommendations and the consequences were the uncertainty to be resolved differently.