



Society of Actuaries in Ireland

ACTUARIAL STANDARD OF PRACTICE LA-2

ACTUARIAL FINANCIAL CONDITION REPORTS

Classification

Mandatory

MEMBERS ARE REMINDED THAT THEY MUST ALWAYS COMPLY WITH THE CODE OF PROFESSIONAL CONDUCT AND THAT ACTUARIAL STANDARDS OF PRACTICE IMPOSE ADDITIONAL REQUIREMENTS UNDER SPECIFIC CIRCUMSTANCES.

Legislation or Authority

Guidelines issued by the Central Bank of Ireland requiring Actuarial Financial Condition Reports from life assurance companies

Application

Appointed Actuaries appointed pursuant to Section 34 of the Insurance Act 1989

Version	Effective from
1.0	03.09.1997
2.0	08.02.2006
2.1	30.12.2006
2.2	01.11.2010
2.3	30.12.2011

Definitions

“*ASP*” means Actuarial Standard of Practice

“*the Board*” means the Board of the Company

“*the Company*” means the life assurance company in respect of which the Appointed Actuary is appointed

“*the Guidelines*” means the guidelines issued by the Central Bank of Ireland requiring Actuarial Financial Condition Reports from life assurance companies

“*Report*” means Actuarial Financial Condition Report

“*should normally*” indicates that members of the Society to whom this ASP applies must comply with a particular requirement or prohibition, unless the circumstances are such that the requirement or prohibition is inappropriate and non-compliance is consistent with the standards of behaviour, integrity, competence and professional judgement which other members or the public might reasonably expect of a member

“*the Society*” means the Society of Actuaries in Ireland

1 Introduction

- 1.1 The Guidelines stipulate that each authorised life assurance company must prepare and submit a Report to its Board and to the Central Bank of Ireland once every three years, but the Central Bank of Ireland has the right to prescribe a more frequent reporting schedule in particular cases.
- 1.2 The Guidelines require Reports to be prepared in accordance with guidance provided by the Society. This ASP constitutes the guidance relating to Reports provided by the Society referred to in the Guidelines.
- 1.3 The purpose of preparing a Report is to identify plausible threats to satisfactory financial condition, actions that lessen the likelihood of those threats, and actions that would mitigate a threat if it materialised. As such, a Report serves a critical governance function by enabling the Board and management of the Company concerned to focus on its future risk profile and on the risk management options available.
- 1.4 An Appointed Actuary must not sign a Report unless he or she possesses a Practising Certificate of a type appropriate to the relevant appointment as an Appointed Actuary.
- 1.5 Reports may be produced more frequently than is required by the Central Bank of Ireland. Where a Report is produced that is not required to be submitted to the Central Bank of Ireland, and provided there has been a period of financial stability, both externally and within the company, the Report may be truncated to avoid undue repetition of information provided previously. If, however, there are changes either in the company itself or externally the relevant parts of the Report may need to be updated as necessary.
- 1.6 The Appointed Actuary need not comply with any part of this ASP that is clearly inappropriate to the company in question, but a complete explanation of all such departures must be given.

2 The Report

- 2.1 The Report must be addressed to the Board. The Report must be signed by the Appointed Actuary and the date of signing must be provided.
- 2.2 The Report must state that it has been prepared in accordance with ASP LA-2 current at the date the Report is signed. Any departures from ASP LA-2 must be explained. If the Report is intended to satisfy the requirements of the Guidelines, the Report must state that this is the case and must confirm that the Appointed Actuary signing the Report holds a current Appointed Actuary Certificate of the appropriate type (see paragraph 1.4).
- 2.3 The Appointed Actuary must ensure that the Report is clear and appropriate to the circumstances and its expected audience, including readers beyond those to whom the Report is actually addressed. The Appointed Actuary must therefore ensure that the Report is written in appropriate terms so that its readers will be able to understand its basic assumptions, conclusions and recommendations. An executive summary or overview drawing attention to important issues should normally be included.

- 2.4 The level of detail to be provided in the Report will depend on the size and complexity of the company's operations and considerations of materiality. Where information, if misstated or omitted, would cause the results or opinions of the Appointed Actuary to be misleading to users of the Report, then that information would be considered material. Whether something is material or not will always be a matter requiring the exercise of judgement by the Appointed Actuary.
- 2.5 The Report must include:
- 2.5.1 A statement of the purpose of the Report.
- 2.5.2 A statement of the extent, if any, to which the Report falls short of its stated purpose. The Appointed Actuary must draw attention to any restrictions to the scope or detail of the analysis and give an opinion as to their importance and relevance to the company.
- 2.5.3 An introductory section briefly describing the current operational structure, market positioning and distribution strategy of the company and its recent performance against its business plan. This requirement may be met alternatively by appending a separate report that includes comparable information.
- 2.5.4 The Appointed Actuary's conclusions and recommendations (see Section 6).
- 2.6 The Report must include solvency projections (see Section 3) and must describe:
- 2.6.1 The methods and assumptions that have been used, distinguishing between:
- (i) those assumptions which are important and those which are less so;
 - (ii) those which are within the Company's control and those which are dictated by external circumstances; and
 - (iii) those that might reasonably be relied on as having a stable trend, those that may be highly uncertain, and those that need to be placed in the context of historical experience and any changes anticipated in the light of different operating methods now used by the company.
- 2.6.1 The Report should normally state how the assumptions adopted compare with recent experience, and provide explanations where assumptions differ significantly from that experience.
- 2.6.2 Any changes made to the methods or assumptions used in the last similar Report.
- 2.6.3 Any particular financial characteristics of existing or current new business that may require special consideration.
- 2.6.4 The special characteristics of the company in terms of the way in which they may affect its development and future prospects. It is helpful to draw attention to any such characteristics and be clear about the importance of both the absolute position of any particular characteristic and, where possible and relevant, the relative position when compared with other companies.

- 2.7 The Report must indicate how the following issues, if applicable, have been addressed:
- 2.7.1 Any unusual features of existing business, current new business or proposed product development.
 - 2.7.2 Any financially significant reinsurance arrangements and any possible options contained within them.
 - 2.7.3. The effects of any known or planned changes in the Company's method of operation or structure.
 - 2.7.4 Any use made by the Company of derivatives, where potentially financially significant, and their purpose.
 - 2.7.5 Post Balance Sheet events - some comment on experience and events since the end of the financial year to which the Report relates will almost always be required.
- 2.8 The Appointed Actuary must review any outputs from the Company's risk management process, and, based on this information and his or her own knowledge of the Company's operations, comment in the Report on operational and other risks that may have a significant financial impact on the Company.

3 Dynamic solvency testing

- 3.1 Dynamic solvency testing should normally be used to assess the ability of the company to withstand changes in both the external economic environment and the particular experience of the Company. It involves projecting the Company's financial position forward and then varying the important assumptions to establish the sensitivity of the Company's financial condition to changes in that particular assumption or assumptions.
- 3.2 Projections for the base scenario (see Section 4.5) should normally be carried out over a period of five years. The Appointed Actuary must consider whether it is appropriate to use a longer projection period, having regard to the nature of the business and to the fact that the full effects of some risks become apparent only over a long period. The Appointed Actuary must consider in performing sensitivity and scenario testing (see Section 4) whether a point-in-time stress provides sufficient information or whether it is necessary to perform a projection to identify adverse impacts in the longer term.
- 3.3 The projections must include actuarial valuations at the end of each year of the projection period of the Company's assets and liabilities and the resultant statutory solvency position of the Company.
- 3.4 Subject to paragraphs 3.5 and 3.6 the actuarial valuations of assets and liabilities for this purpose should normally have regard to both the requirements of prevailing relevant legislation and the expected form and timing of future legislation governing the determination of statutory solvency, insofar as is reasonably foreseeable.
- 3.5 Appointed Actuaries must exercise judgement if incorporating future legislation into solvency projections. In particular, Appointed Actuaries must have regard to proportionality when considering the uncertainty in future legislation and the status of related systems in development.

- 3.6 Ultimately the Appointed Actuary is required to produce a document for the Board that is fit for the purposes outlined in paragraph 1.3. Therefore the Appointed Actuary should normally make reference to impending legislative changes and so give the Board a relevant picture of the medium-term financial condition of the company, subject to the considerations outlined in paragraph 3.8. The Appointed Actuary must consider whether it is sufficient to provide information on the impending legislative changes as a point-in-time stress or whether projections would be appropriate in the particular circumstances of the Company.
- 3.7 A solvency projection or stress based on proposed legislation could reveal a significantly different financial outcome to one based on current legislation. If the financial outcome based on proposed legislation is materially worse than the outcome based on current legislation, the Appointed Actuary must make reference to both sets of results.
- 3.8 Given the uncertainty in relation to future legislation, the Appointed Actuary must clearly state the assumptions and methodologies used in respect of this legislation. If the models used in the solvency calculations based on proposed legislation are still under development, the Appointed Actuary must highlight whether any potentially material deficiencies could exist that may impact on the overall results of the Report. Where the Appointed Actuary has not been involved in the development of the model used in the solvency calculations based on proposed legislation, the Appointed Actuary must be satisfied that the model is fit for purpose. In instances where the Appointed Actuary has placed reliance on the model output, this must be explicitly stated in the Report.
- 3.9 There may be instances where a separate report has been prepared which considers the solvency projections allowing for future legislation. In these instances it is acceptable for the Appointed Actuary to refer to this report to avoid any duplication of work. Where the Appointed Actuary has not prepared that report, the Appointed Actuary must be satisfied that the information contained within that report is fit for purpose. In instances where the Appointed Actuary has placed reliance on another report, this must be explicitly stated in the (Actuarial Financial Condition) Report and this other report must be attached as an appendix to the Report.

4 Sensitivity and scenario testing

- 4.1 For the appraisal of many risks, the projections can be on a deterministic basis. However, stochastic techniques can be used to identify additional risks and might be considered depending on the circumstances and nature of the company. Stochastic techniques may also be valuable in comparing the relative level of probability of adverse circumstances occurring.
- 4.2 Testing groups of assumptions which are assumed to change in a related way is sometimes described as "scenario testing", whereas varying individual assumptions independently is referred to as "sensitivity testing". Stochastic modelling will normally incorporate the scenario concept by assuming specific statistical relationships between variables such as inflation and investment returns.
- 4.3 Certain assumptions, in particular those which are a consequence of the economic environment, are best treated as a group. The Company's ability to withstand a period of inflation or recession, rising or falling stock markets, increasing market sizes or increasing competitiveness, should normally be investigated using coherent sets of assumptions.

- 4.4 The projections or point-in-time stresses must include a base scenario and several plausible adverse scenarios. Each scenario must take into account not only in-force policies but also the policies assumed to be sold during the projection period (where applicable).
- 4.5 The base scenario is a realistic set of assumptions used to forecast the company's financial position over the projection period. Normally, the base scenario will be consistent with the Company's business plan, unless those assumptions are so inconsistent or unrealistic that the resulting report would be misleading. The Appointed Actuary must report any material inconsistency between the base scenario and the business plan.
- 4.6 A plausible adverse scenario is a set of adverse, but plausible, assumptions about matters to which the Company's financial condition is sensitive. Plausible adverse scenarios will vary between companies and may vary over time for a particular company.
- 4.7 Plausible adverse scenarios should normally include plausible combinations of adverse developments in different factors as well as adverse developments in individual factors. In constructing plausible adverse scenarios, the Appointed Actuary should normally consider the potential impact of policyholder behaviour in adverse conditions.
- 4.8 Variations in the following assumptions must be tested, unless there are specific reasons (which must be stated in the Report) not to do so:
- (i) future investment conditions;
 - (ii) levels of new business, where this is being written;
 - (iii) mortality and morbidity;
 - (iv) expenses;
 - (v) exercising of options by policyholders; and
 - (vi) persistency.
- 4.9 The Appointed Actuary must consider whether it is appropriate to test variations in other financial or demographic assumptions or features, including the following:
- (i) allocation of profits and/or special distributions of carried forward surplus to policyholders and/or shareholders;
 - (ii) taxation;
 - (iii) concentrations of assets in particular risk areas;
 - (iv) use of derivatives;
 - (v) assets containing unusual provisions which may be susceptible to particular risks;
 - (vi) sources of new business which have unusual characteristics;
 - (vii) the effect in different scenarios of options and guarantees in the insurance liabilities;

- (viii) exercising of options by the Company;
- (ix) effects of asset risks;
- (x) risk of reinsurer default;
- (xi) currency exchange rates; and
- (xii) agreements with third party providers of services.

This list is not exhaustive, and the Appointed Actuary must consider other risks which are likely to materially impact on the Company's financial stability.

- 4.10 The Appointed Actuary does not need to comment on each of the items outlined in paragraph 4.9 in the report. However, if any of the items tested in paragraph 4.9 represent material risks to the Company's projected solvency position, the Appointed Actuary must comment on these in the Report.

5. Comparison with previous report

- 5.1 If the Report is to be submitted to the Central Bank of Ireland, it must include a comparison of actual outcomes, calculated using current legislation, over the period since the last report submitted to the Central Bank of Ireland with the scenarios set out in that previous report.
- 5.2 If the Report includes projections that allow for proposed legislative changes, the Appointed Actuary is not required to provide a comparison of actual outcomes, calculated using the proposed legislative changes, over the period since the last report submitted to the Central Bank of Ireland with the scenarios set out in that previous report

6. Conclusions and recommendations

- 6.1 The Report must include appropriate commentary on the solvency projections, including the Appointed Actuary's conclusions as to the key risks and issues facing the Company. The Appointed Actuary must also consider whether it is appropriate to include comment on the results in the context of any Risk Appetite Statements adopted by the Board.
- 6.2 The Appointed Actuary must identify the possible implications of the key risks and issues for the Company and, where these implications are adverse, the Appointed Actuary must propose recommendations designed to address the issues.
- 6.3 Where a solvency projection or stress is based on proposed legislation the Appointed Actuary must highlight any material differences between these results and the equivalent results based on current legislation which may impact on the conclusions drawn by the Board.

EXPLANATORY NOTE
ACTUARIAL STANDARD OF PRACTICE LA-2, VERSION 2.3

This Explanatory Note does not form part of the ASP.

Version 2.3 reflects changes incorporated following a review of version 2.2 in the light of Solvency II.

The following sections are new/amended;

- Section 2.8,
- Section 3,
- Sections 4.4, 4.9 and 4.10,
- Section 5,
- Section 6.

ASP LA-2 continues to be relevant for Companies and Appointed Actuaries operating under the Solvency I regime. It is retained for this purpose only and will be discontinued after a period.