

GN1(ROI): ACTUARIES AND LONG-TERM INSURANCE BUSINESS

Classification (see APC)

This Guidance Note is classified in relation to the code of professional conduct as *mandatory*.

Scope

Republic of Ireland. Worldwide business of Republic of Ireland supervised long-term insurers.

Application

Appointed Actuaries and other actuaries who are directors or senior employees of long-term insurance companies or companies which control long-term insurance companies.

Legislation or Authority

This Guidance Note is written with specific reference to actuaries appointed in terms of the Insurance Act 1989. Actuaries responsible for long-term insurance business written by bodies other than those supervised under the Act are expected to follow the same principles.

First issued

April 1995.

Latest revision

April 1995.

A. THE APPOINTED ACTUARY

1 Introduction

- 1.1 The responsibilities of actuaries who are appointed in terms of Section 34 of the Insurance Act 1989 are central to the financial soundness of the long-term insurance business of their companies. The reputation of the profession, therefore, depends in no small measure on the proper discharge of these responsibilities. It is incumbent upon all Appointed Actuaries to ensure, so far as is within their authority, that the long-term business of the company is operated on sound financial lines and with regard to its policyholders' reasonable expectations.
- 1.2 The essence of a profession lies in upholding its standards, technical and ethical, in the public interest. Any Appointed Actuary who becomes doubtful as to the proper course to adopt in relation to a potentially significant problem is strongly advised to seek help and advice through the Professional Guidance Committee.

2. Considerations affecting the position of Appointed Actuaries

- 2.1 Any actuary, before accepting appointment as an Appointed Actuary, must consider most carefully in the light of individual previous experience and work whether acceptance would be in line with proper professional behaviour and standards. No actuary should act as Appointed Actuary if that individual does not have the appropriate knowledge and practical experience relevant to the company concerned. There may be exceptional circumstances where this need not apply, but in such cases appropriate arrangements must be made for the Appointed Actuary to have recourse on a professional and formal basis to an actuary who has such knowledge and experience.

- 2.2 A potential Appointed Actuary who has not already worked in close touch with the present Appointed Actuary has a professional duty to consult that individual (if this is possible) to discover whether there are any professional reasons why the appointment should not be accepted. The prospective client should be informed of such consultation and their permission sought. If such permission were withheld it would be a material factor which would be relevant to the prospective appointee's decision as to the propriety of accepting the appointment. The Appointed Actuary must have a right of direct access to the board of directors of the company and have access to all relevant information so that the full range of duties can be carried out satisfactorily. This must be explicit from the inception of the new appointment. Where there is a group structure, the Appointed Actuary should bear in mind the possible implications and ensure right of direct access to the relevant decision making bodies.
- 2.3 Where an individual's financial interests in an insurance company by their nature and size are or become such that a material conflict of interest would, in the normal course of events, arise or seem to arise (or where a material conflict arises for some other reason), an actuary should not accept the position of Appointed Actuary or continue in it as the case may be. If temporarily in a special situation a material conflict of interest arose, or would seem to arise, the Appointed Actuary before making a report should first ask the company to obtain a report from an actuary who has no conflict of interest.

3. Extent of the Appointed Actuary's Responsibility

- 3.1 The profession's rules of conduct make it clear that every actuary acting in a professional capacity, whether remunerated by salary or fee, has a duty to the profession and an individual's responsibility to the client must be consistent with this. The Appointed Actuary is, however, in a special position:

- (a) being appointed and remunerated by the company, and at the same time
- (b) having responsibilities and obligations to the Department of Enterprise and Employment by reason of certain statutory duties, which arise from the Department's supervisory functions aimed at the protection of policyholders.

- 3.2 It is seldom that these two aspects of the appointment conflict in a material way. If they do, however, the company must be informed by the Appointed Actuary if the individual is of the view that:

- (a) a course of action is being, or is proposed to be, followed by the company, or
- (b) a situation has arisen, perhaps outside the control of the company,

which creates a material risk that the long-term fund may be insufficient to cover its liabilities or the company may fail to meet its obligations under the law in relation to its long-term business. It is also the Appointed Actuary's duty:

- (i) if the company persists in following such a course of action under 3.2(a), or
- (ii) if the company fails to remedy the situation in 3.2(b) and does not report this fact to the Department of Enterprise and Employment,

to advise the Department after so informing the company. *

* This duty applies, notwithstanding paragraph 7 of the Memorandum on Professional Conduct of the Society.

- 3.3 It is part of the Appointed Actuary's continuing responsibility to advise the company of the Appointed Actuary's interpretation of its policyholders' reasonable expectations. In general terms this interpretation should have regard to the broad nature of the company and its approach to the treatment of policyholders both individually and (where appropriate) collectively as a group vis-à-vis shareholders. When a significant change is likely to take place, the Appointed Actuary should take all reasonable steps to ensure that the company appreciates the implications for the reasonable expectations of its policyholders. It is also incumbent upon the Appointed Actuary to take all reasonable steps to ensure that the company's incoming policyholders should not be misled as to their expectations.

For with-profits business the bonus rates declared by the company are fundamental to policyholders' reasonable expectations and the issues that the Appointed Actuary must take account of in this regard are set out in paragraph 8.3. For unit-linked business, the prices used to allocate units to policies and to cancel units from policies and the processes by which, and the prices at which, new units are created and existing units are cancelled in unit funds are fundamental to policyholders' reasonable expectations. Accordingly, the Appointed Actuary must be satisfied that:

- (i) the prices at which units are allocated to policies and at which units are cancelled from policies are determined in a manner that is equitable to the policyholders involved; and
- (ii) (a) where units are being created in a unit fund, the prices at which such units are created are equitable to the continuing policyholders linked to that fund; and
(b) where units are being cancelled in a unit fund, the prices at which such units are cancelled are equitable to the continuing policyholders linked to that fund.

For these purposes, the Appointed Actuary will have regard to the value of the assets of the unit fund, the tax position of the unit fund and any other matters the Appointed Actuary considers relevant.

- 3.4 The Appointed Actuary, as such, has no executive authority within the company (even though the Appointed Actuary may also, in another capacity, have an executive position and authority). The responsibility for company decisions must, both in law and in practice, rest with the board of directors. The Appointed Actuary's duty is to advise the company on those matters relevant to the Appointed Actuary's statutory duties. Having regard to the paramount importance of this advice in the context of long-term business, the Appointed Actuary must continue to have a right of direct access to the Board of Directors.

4. The duties of the Appointed Actuary

- 4.1 The statutory responsibility of the Appointed Actuary as required under Article 15 of the European Communities (Life Assurance) Framework Regulations 1994 is to carry out, from time to time, and to report on an investigation into the financial condition of the office, including a valuation of its long-term liabilities. The Appointed Actuary must certify that, inter alia, GN1(ROI) and GN8(ROI) have been complied with. Although, as a statutory requirement, an investigation is to be made only at specific intervals, the profession regards it as the Appointed Actuary's duty to take all reasonable steps to ensure that the Appointed Actuary is, at all times, satisfied that in any investigation the long-term fund would be sufficient and the company would be able to satisfy any obligation to which it is subject by virtue of the European Communities (Life Assurance) Framework Regulations 1994.

- 4.1.1 More precisely, Article 15 makes it the statutory responsibility of the Appointed Actuary to determine in accordance with any applicable valuation regulations any excess of the assets representing a long-term fund over its liabilities. The Appointed Actuary must also identify separately any excess which relates to a part of such a fund if there are policyholders with a right to participate in profits which also relates to that part. The company is permitted by Section 15 of the Insurance Act 1989 to make transfers of assets representing its long-term funds to the extent that they have been shown by a recent Article 15 investigation (or an

investigation made in pursuance of a requirement imposed under Section 16 or 17 of the Insurance Act 1989) to exceed the amount of the liabilities. It is the Appointed Actuary's professional responsibility to advise the company on the extent to which it would be appropriate to distribute any excess to policyholders or transfer it to shareholders and to make recommendations for its specific allocation.

- 4.1.2 It is the duty of the Appointed Actuary to take all reasonable steps to ensure that the company's constitution or authorised procedures are or will be such that it will not make or undertake to make a specific allocation of profit in a long-term fund (whether to policyholders, shareholders or both) before the directors have obtained from the Appointed Actuary and duly considered a written report containing the Appointed Actuary's observations and recommendations on the subject.
- 4.2 The Appointed Actuary must have regard to all aspects likely to affect the financial position of the company in respect of its long-term business including the possible effect of any contingent liabilities should they crystallise. Although the following list is not exhaustive the financial position is particularly affected by:
- (a) the premium rates on which existing business has been, and current new business is being, written;
 - (b) the nature of the contracts in force and currently being sold, with particular reference to all options and guarantees;
 - (c) the existing investments and continuing investment policy including the use of derivative instruments;
 - (d) the marketing plans, in particular the expected volumes and costs of sales;
 - (e) the current and likely future level of expenses;
 - (f) the extent of the company's free estate;
 - (g) the reinsurance arrangements;
 - (h) the company's policy in regard to the nature and timing of allocations of profits to policyholders and/or shareholders; and
 - (i) the current and likely future taxation position of the company.
- 4.3 Information on the above items and any other relevant information should be made available to the Appointed Actuary so that the actuary is able to carry out the necessary financial investigations, to be satisfied as to the continuing financial state of the company and to sign the relevant certificates. A prospective Appointed Actuary must make sure that the necessity for such information is fully understood by the company, and that suitable arrangements are made to ensure that this information is forthcoming. If sufficient information is not available to ensure compliance with GN1(ROI) and GN8(ROI), the Appointed Actuary will need to qualify the certificate.

5. Premium Rates and Policy Conditions

- 5.1 A prime responsibility must lie with the Appointed Actuary to be satisfied that the premium rates being charged for new business are appropriate. That is to say they should be sufficient to enable the company in due course to meet its emerging liabilities, having regard to the items listed in 4.2 above, not least the extent of the company's free estate.
- 5.2 Paragraph 4(2) of Annex IV of the European Communities (Life Assurance) Framework Regulations 1994 requires the Appointed Actuary to include, in the certificate to be completed by the Appointed Actuary under Article 32(b) of those Regulations, a statement that premiums being charged for new business are sufficient, on reasonable actuarial assumptions, to enable the company to meet all its commitments and, in particular, to establish adequate technical reserves. Should premium rates be such that business is expected to be written on terms which require support from the free assets, the Appointed Actuary will need to consider the company's ability to continue to write business on such terms and will need to inform the directors of the ability of the company's financial resources to withstand the writing of business on such terms.

- 5.3 The statement that a premium rate will be sufficient cannot in fact be an absolute statement - it is inevitably a probability statement because it depends on such future events as mortality, the return on investments, and the expenses. The adequacy or otherwise of premium rates cannot, therefore, be other than a matter of judgement. It is the responsibility of the actuary to exercise this judgement.
- 5.4 The required judgement will, of course, need to be based on the use of sound techniques. Attention may be specially drawn to the complex questions of tax relief and allowances for a new company, adequacy of provision for expenses, and contracts involving various options, including guaranteed surrender values, particularly if financial conditions could arise in which the policyholder could gain by surrender and re-entry.
- 5.5 It may be that a practicable premium basis, whilst commercially justifiable, will involve significant new business strain. The actuary must be satisfied that the company will be able to set up the necessary reserve and solvency margin, and must indicate any limits on the volume of business that may prudently be accepted.
- 5.6 The shareholders' assets in a proprietary office will be taken into account by the Appointed Actuary. However, it cannot automatically be assumed that they are equivalent to free reserves held as part of the long-term fund because they can be used for other than long-term business.

6. Actuarial Investigations

- 6.1 The Appointed Actuary must be satisfied in relation to the existing business. To do so the Appointed Actuary must consider the liabilities, the corresponding assets, and their interrelationship, and be satisfied as to the resilience of the financial position of the company in all reasonably foreseeable circumstances which might affect that position.
- 6.2 The Appointed Actuary should take all reasonable steps to ensure that the data is accurate and if the Appointed Actuary has any doubts management must be asked to provide written assurance as to the correctness and completeness of the data. The Appointed Actuary should be satisfied that the appropriate valuation procedures have been correctly carried out and adequately documented.
- 6.3 The Appointed Actuary must use liability valuation methods that are appropriate to the contracts in question, taking into account not only the principal benefits but any ancillary benefits such as surrender and paid-up values and any options. When assessing the liabilities of the long-term business of the company the Appointed Actuary must also have regard to policyholders' reasonable expectations.
- 6.4 Appropriate provision must be made for future expenses of continuing the existing business. This provision must not be less than that which would be required if the company were to be closed to new business; it must also have regard, amongst other factors, to the possibility that preferential service agreements might be altered or terminated.
- 6.5 Subject to any statutory regulations, the responsibility for investment policy rests with the directors of the company, as also does the decision as to the value to be placed on the assets in any balance sheet.
- 6.6 The Appointed Actuary must decide the rates of interest to be used in the valuation of the liabilities. These are affected by the Appointed Actuary's estimates of the likely future proceeds of the existing assets and of the rate at which future investment will be possible. In relation to the existing assets, the Appointed Actuary must assess the nature of the portfolio and consider what rate of return, capital and income is likely to be realised over the future period relevant to the liabilities. In addition, due allowance must be made for the current and future taxation position of the company. Any such allowance must be consistent with any allowance made for tax relief on expenses. Judgement on these factors rests with the Appointed Actuary who must decide the basis of the valuation of the liabilities. The Appointed Actuary will need to be aware of the possible effects of derivative instruments used by the company when

choosing the valuation basis (including the basis used in the changed investment conditions envisaged under Article 3 of Annex IV of the European Communities (Life Assurance) Framework Regulations 1994). The appropriate valuation interest rates should allow for the return on the assets held as adjusted to reflect economic exposure under future contracts and contracts for differences. Consideration should be given to the situation with options, particularly when close to the option date.

- 6.7 The Appointed Actuary must also pay regard to the relationship between the term of the assets and that of the corresponding liabilities. The importance of this will vary widely from one situation to another, but experience suggests that this can be an area of particular danger.
- 6.8 At one extreme, for example, for a company with a large portfolio of long-established with-profit business, and where the company is transacting (and seems likely to continue to transact) a steady volume of new business which is small in relation to the existing business, the possibility of insolvency arising from mismatching of assets and liabilities may be minimal.
- 6.9 At the other extreme, for a company transacting a volume of non-profit new business which is very large in relation to the existing portfolio and which has only a small free estate, matching of asset proceeds to liability outgo may be critical to solvency. The dangers are increased if there are alternative guarantees or options which could, in certain circumstances, require a different distribution of assets by term.
- 6.10 The Appointed Actuary must judge and decide whether the investment policy pursued by the directors is, or could become, inappropriate having regard to the nature and term of the company's liabilities. If this is the case, the Appointed Actuary must advise the company of the constraints on investment policy necessary to protect the position of policyholders.
- 6.11 The Appointed Actuary must advise the company that appropriate guidelines should be given to the company's investment managers regarding the use of derivative contracts and that appropriate procedures should be in place to monitor the company's exposure to loss through their use. Loss can occur either through market movements or through failure of a counterparty.
- 6.12 The nature of the company's reinsurance arrangements including any financing provision implicit therein should be taken into account in the Appointed Actuary's valuation. If the Appointed Actuary considers these arrangements are inappropriate or inadequate the Appointed Actuary should advise the company on the modifications necessary to protect the position of the policyholders. The Appointed Actuary should also have regard to the possibility of failure of a reinsurer or the possibility that reinsurance contracts may lapse or prove unenforceable in certain circumstances.
- 6.13 The Appointed Actuary must be satisfied that, in each of the assumptions, the margins in any published valuation of the liabilities, including any margins required by statute, are adequate having regard to the Appointed Actuary's own assessment of the risks inherent in the nature and conduct of the company's business.

7. Insolvency

- 7.1 It is apparent from the foregoing that most of the problems with which the Appointed Actuary is concerned are not capable of precise assessment but are, rather, matters of judgement. In some circumstances, this judgement may appropriately be based on the actuary's estimates of the most probable outcome - perhaps, for example, in relation to bonus distribution. If, however, judgement is required in a matter which may affect the solvency of the company, much more rigorous standards must be applied. (Two such contrasting situations are exemplified in 6.8 and 6.9).
- 7.2 The possibility of insolvency, or intervention by the Minister for Enterprise and Employment on the grounds of the company being unable to fulfil the reasonable expectations of its policyholders, may arise from factors, some of which are within the control of the company and some not. To the extent that they are under the control of the company, it is the Appointed

Actuary's duty to assess the limits within which the company must act and to advise the company of the necessity for these limits.

- 7.3 The Appointed Actuary must consider all external factors outside the control of the company which could lead to insolvency and must then take whatever action the Appointed Actuary considers necessary. The profession requires that any Appointed Actuary should pay the most scrupulous regard to prudent judgement in these matters.

8. Written reports

- 8.1 The Appointed Actuary is required as part of the actuary's statutory duties to report to the Department of Enterprise and Employment in a prescribed form on actuarial investigations carried out under Article 15 of the European Communities (Life Assurance) Framework Regulations 1994. It is the Appointed Actuary's professional duty first to report in writing to the directors on the results and implications of any such investigation, whether or not an allocation of profits is involved. In the Article 15 Report to the Department of Enterprise and Employment, the Appointed Actuary should use best endeavours to ensure the financial condition is presented in a way that demonstrates the true underlying position of the company and that the financial condition is not distorted by any undisclosed valuation methods or assumptions.

- 8.2 If the Appointed Actuary has reason to believe that the company plans to announce or otherwise undertake to make a specific allocation of profits to policyholders and/or shareholders in anticipation of the results of an Article 15 investigation (notwithstanding that, to comply with Section 15(2) of the Insurance Act 1989, confirmation that the investigation shows a sufficient excess of assets over liabilities must precede an actual transfer of assets out of the long-term fund), the Appointed Actuary must take all reasonable steps to ensure that the directors will be in a position to consider a suitable written actuarial report on the subject before the announcement is due to be made or the undertaking given.

- 8.3 In reporting on and making recommendations in respect of any proposed allocation of profits the Appointed Actuary must consider the factors listed in paragraph 4.2 above and any others personally thought to be significant, and must carry out appropriate financial investigations including an appraisal of the relevant experience. The Appointed Actuary must include in the report such information and discussion about each factor, and about the results of any financial investigations, as may be necessary to enable the directors to judge the appropriateness of the allocation and understand its implications for the future conduct of the company's long-term business. In particular, but without prejudice to the generality of this requirement:

- 8.3.1 If the report anticipates the results of an Article 15 investigation the Appointed Actuary must indicate and discuss how in the context of statutory requirements the allocation will be financed.

- 8.3.2 The relationship between the proposed allocation and the relevant experience must be discussed and an indication given as to whether in the Appointed Actuary's opinion the continuance of a distribution policy which, in its relationship to relevant experience, was consistent with the allocation now proposed (excluding any component of the allocation that will be declared to be non-recurring) could lead in due course to an unsatisfactory position. If so, the Appointed Actuary must explain how this could appropriately be avoided.

- 8.3.3 In the case of with-profit business the Actuary's comments under 8.3.2 must cover bonus prospects, with particular reference to the projected development of outgo on and asset cover for unreserved terminal bonus and the like in different investment scenarios.

- 8.3.4 The Appointed Actuary must justify any recommendations regarding the allocation and its consequences (if any) for the conduct of the company's business by reference as appropriate to the actuary's

- (a) appraisal of the relevant experience;

- (b) understanding of the company's financial and business objectives;
 - (c) assessment of the company's continuing ability to meet its statutory solvency requirements;
 - (d) interpretation of the reasonable expectations of the company's policyholders having regard to (a), (b) and (c). The Appointed Actuary should assume that among the conditions for the fulfilment of those expectations are:
 - (i) that, in the recognition and allocation of profits in accordance with the company's terms of participation and its policy in respect of the matters referred to in 4.2(h) above, groups of participating policies are appropriately and equitably distinguished having regard inter alia to the terms of the policies, their duration and their relevant pooled experience, and
 - (ii) that the company conducts its affairs, including its new business and investment strategies, with due regard for its financial resources.
- 8.4 If in the Appointed Actuary's opinion issues required to be covered in a written report to the directors were fully dealt with in a comparable report made within the preceding eleven months and duly discussed by the board, the Appointed Actuary may report in an appropriately abridged form, as for example when interim or terminal bonus rates are being reviewed during the year.
- 8.5 If a parent of the company reserves the right to approve or vary decisions on matters which are required by this section to be covered in a report by the Appointed Actuary to the company's directors, the Appointed Actuary must take all reasonable steps to ensure that any such report is made available at an appropriate time to the relevant authorities within that parent.

B. THE ACTUARY AS A DIRECTOR OR IN ANY OTHER POSITION OF AUTHORITY IN RELATION TO AN INSURANCE COMPANY

9. Internal

- 9.1 It is clearly in the public interest that actuaries should be available to act as directors of insurance companies and companies which control insurance companies, particularly those transacting long-term insurance, where by their professional training they are especially fitted to make a useful contribution. Any such actuaries should, however, recognise that the public, and their fellow directors, will assume that they are satisfied as to the way in which the affairs of the insurance company are likely to be conducted whilst they are members of the board. It is appropriate for such actuaries to make suitable enquiries before accepting appointments as directors.
- 9.2 A common situation is for the Appointed Actuary also to hold a managerial appointment or (whether an employee or not) to be invited to join the board. On occasions the Appointed Actuary will be expressing views as a member of the management or as one director among many; at other times the actuary will be advising the board as the Appointed Actuary. All reasonable steps must be taken to ensure that the other members of the management or the other directors, as the case may be, recognise in what capacity the actuary is expressing these views.
- 9.3 A professional responsibility is owed to the Appointed Actuary by any other actuary who is a director. Such individuals can be of great use both to the board and to the Appointed Actuary in assisting the board to a full understanding of actuarial issues. They have a professional responsibility to ensure that their actions or absence of action do not in any way diminish the status of the Appointed Actuary.
- 9.4 A similar responsibility is owed to the Appointed Actuary by any other actuaries who are in a managerial or other position of authority in the company or in a parent company. In particular,

although their responsibilities may be such as to require them to enter into discussions with the Appointed Actuary on matters which impinge on the latter's professional responsibility, they should at all times take care to respect the status of the Appointed Actuary.

10. External

- 10.1 There will be circumstances in which a member who is external to a particular insurance company is asked by the company or someone with a legitimate interest in the company to express an opinion on a valuation carried out by the Appointed Actuary or on a report the Appointed Actuary has made to the company in the context of the Appointed Actuary's statutory or professional responsibilities.
- 10.2 Any members engaged in such assignments should bear in mind that, while there is room for differences of opinion in relation to actuarial advice and judgement, they should at all times take care to respect the status of the Appointed Actuary. However, this does not prevent them from making properly reasoned comments on the work of the Appointed Actuary if they feel it is appropriate or necessary to do so. *

* Members will note the connection between this paragraph and paragraph 17 of the Memorandum on Professional Conduct of the Society.