

## **GN20: Actuarial Reporting under the Lloyd's Valuation of Liabilities Rules**

### ***Classification***

Practice Standard

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

### ***Purpose***

All Lloyd's syndicates writing general insurance business are required to provide to the Council of Lloyd's each year for solvency purposes a Statement of Actuarial Opinion ("SAO") on their world-wide technical provisions, both gross and net of reinsurance. A copy of this opinion is required to be sent to the International Insurers Department ("IID") of the National Association of Insurance Commissioners ("NAIC"). For any such syndicate, the relevant Lloyd's Managing agent must appoint an actuary (the Syndicate Actuary) to provide the SAO. The purpose of GN20 is to give guidance to any Syndicate Actuary providing this SAO.

### ***Legislation or Authority***

Lloyd's Act 1982 (1982, c.14)

FSA Handbook SUP 4.6

Lloyd's Valuation of Liabilities Rules, issued annually.

### ***Application***

Members appointed by Lloyd's managing agents to provide an actuarial opinion in support of general insurance technical provisions as required by the Lloyd's Valuation of Liabilities Rules. (There are also requirements for life syndicates to obtain actuarial opinions, but these are outside the scope of this guidance note.)

### ***Author***

General Insurance Board

### ***Status***

Approved under Due Process

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## **1 Introduction**

- 1.1 This is a practice note as defined in GN50.
- 1.2 This note applies to any member instructed by a Lloyd's managing agent ("the Managing Agent") to provide such an SAO. The member must be familiar with the relevant version of the Lloyd's Valuation of Liabilities Rules and any other instructions issued by Lloyd's for this purpose. In addition, the member should have regard to any relevant detailed technical advice issued by the General Insurance Board, contained in the latest version of the Advisory Note for Actuarial Reporting under the Lloyd's Valuation of Liabilities Rules ("the Lloyd's UK Advisory Note"), which relates to the SAO. If the member has questions concerning the interpretation of the instructions issued by Lloyd's, then he or she should seek clarification from the Lloyd's Actuary.
- 1.3 A member must not sign an SAO unless he or she possesses a Certificate to provide UK Actuarial Opinions for Lloyd's Syndicates, issued by the Institute or the Faculty of Actuaries. This certificate must be valid as at the date the SAO is signed, and also at the date at which the member accepts the appointment to sign the SAO.
- 1.4 The nature of the opinion required by the Council of Lloyd's is such as to place a high level of responsibility on the Syndicate Actuary. In addition to the requirements set out in paragraph 1.3, the member must consider in relation to the Professional Conduct Standards whether he or she has sufficient experience to justify undertaking the assignment. This should include knowledge of the business procedures of Lloyd's and of types of business similar to those underwritten by the syndicate.

## **2 Purpose and Scope**

- 2.1 The SAO should, subject to paragraph 7.7 below, cover all the business of the syndicate for all years of account from 1993 to date. Separate figures are required gross and net of reinsurance for each economic entity, i.e. each open syndicate year of account, including all years that have been reinsured into it, treating as a separate entity any year of account being closed at the year end. The technical provisions to be covered by the SAO should include claims handling expenses (both allocated and unallocated) and, in the case of the net technical provisions, an allowance for reinsurance bad debts. The allowance for reinsurance bad debts should include amounts both in respect of reinsurance disputes and reinsurance insolvency. The technical

provisions should include allowance for future inflation of claims costs but should not be reduced in anticipation of future investment income on assets supporting the technical provisions. Additional contingency margins are permitted but not required. The SAO will need to be modified appropriately if there are run-off years of account.

- 2.2 The SAO is intended solely for the purpose of complying with the Lloyd's Valuation of Liabilities Rules. Unless the member otherwise agrees, reliance on the SAO for any other purpose should normally not be permitted. In particular, the SAO is not intended to be used to support a calculation of Reinsurance To Close for the syndicate, although the member may provide additional advice in this area.
- 2.3 Should the member become aware of a material cross-funding between the Unearned Premium Provision and the claims technical provisions in the course of their work, this should be commented upon in the SAO in the section labelled "Relevant Comments".
- 2.4 A specimen SAO for the combined gross and net opinions is provided in Appendix 1 to the Lloyd's Valuation of Liabilities Rules. While it is expected that this will be used as a model, modifications may be necessary to suit particular cases including any changes referred to in the Lloyd's UK Advisory Note.

### **3 Reporting Requirements**

- 3.1 The SAO must be supplemented by a separate management report ("the Report"), addressed by the member to the Managing Agent, and may be distributed to Lloyd's and the UK Supervisory Authority.
- 3.2 The purpose of the Report, which is a formal report for the purposes of GN12, is to explain the work done by the member in order to reach the opinion on the technical provisions. It is expected that, in most situations, this work would include independent calculation of the technical provisions and comparison with those established by the syndicate. In other situations, the member's work may not include independent calculation of technical provisions, but rather constitute a review of the methodology and assumptions used by someone else (e.g. the syndicate's own actuarial or other staff) in calculating the technical provisions. This practice is acceptable, provided the member signing the SAO is willing to accept personal responsibility for the opinion stated, based on the work reviewed. In these situations the Report should include an explanation of the work performed by the member signing the SAO and include details of the work performed by the other party.

## **4 Types of Opinion**

- 4.1 If the member, following discussion with the Managing Agent, believes that an SAO can be provided but only with qualifications, then the member may still prepare the SAO, using the relevant form of words contained in the Specimen SAO in Appendix 1 of the Lloyd's Valuation of Liabilities Rules, but modified to reflect the qualification, which should make clear to which figure or figures it relates. It should be recognised that in these circumstances Lloyd's may not accept the SAO and the Managing Agent may ask the member to discontinue work. Any qualifications must appear in the SAO; it is not sufficient for a qualification to appear only in the report.
- 4.2 The member may add comments to their opinion in the section labelled "Relevant Comments". It is intended that this area is used to highlight uncertainties that may have a material impact on the adequacy of technical provisions. Highlighting such uncertainties does not constitute a qualification, as the member can still produce a best estimate on which to base their opinion. It would not be unusual for syndicates that write volatile classes of business to have such additional comments in their SAOs.

## **5 Relationships**

- 5.1 The relationships between managing agents, underwriters and auditors to syndicates can be complex. The member should make clear his or her relationship with each of these parties and the extent to which he or she has used information obtained from them or relied on work undertaken by them. The member should not rely on the auditor unless there is a specific agreement for such reliance.
- 5.2 It is the responsibility of the Managing Agent to set the technical provisions. The role of the member is to provide an opinion on those technical provisions. The professional responsibilities of the member in providing the SAO override any responsibilities he or she might have as an employee or consultant.
- 5.3 The member should make clear at the outset that he or she may require frequent access to underwriters and other members of the Managing Agent's staff, and may wish to use work carried out by or for the Managing Agent, including the work of any other member who has worked for the Managing Agent as an employee or consultant. However, since the member providing the SAO must take full responsibility for the opinion stated, he or she must be satisfied as to the validity of the material used for that purpose.

## **6 Data**

- 6.1 The member should obtain assurances from the Managing Agent as to the accuracy and completeness of the data provided. The member should review all key data for reasonableness but may otherwise rely upon the Managing Agent in this respect. The member will need to amend the wording of the reference to data in the specimen SAO given in Appendix 1 of the Lloyd's Valuation of Liabilities Rules, if he or she encounters anything during the course of the work that gives rise to any material concerns with regard to the accuracy of the data, and the Managing Agent is unable to resolve these concerns satisfactorily.
- 6.2 A specimen Data Accuracy Statement (DAS) from the Managing Agent is given in Appendix 3 of the Lloyd's Valuation of Liabilities Rules. If there are any material data discrepancies or anomalies that cannot be resolved with the Managing Agent, the member should discuss them with the auditor. In some circumstances, it may be necessary to modify the wording of the specimen DAS.
- 6.3 Should the data prove to be incomplete, inaccurate, unreliable, or not as appropriate as desired, the member must consider whether the use of such imperfect data may produce material biases in the results of the investigation and make appropriate allowances. If the data are so inadequate that they cannot be used to carry out the work necessary for the SAO, even on a very conservative basis, the member must decline to provide an SAO.

## **7 Valuation Principles**

- 7.1 In order to be able to provide an SAO, the member needs to be satisfied that the technical provisions held by the syndicate are at least as large as those calculated by applying generally accepted actuarial methods and using assumptions that he or she considers reasonable in the context of the Lloyd's Valuation of Liabilities Rules.
- 7.2 The technical provisions calculated by the member for the purpose of forming the opinion must be at least as large as those implied by a "best estimate" basis without precautionary margins. If, however, the Managing Agent has set technical provisions materially higher than those indicated by such a basis, the member may still provide the SAO without qualification. In this context, the term "best estimate" is intended to represent the expected value of the distribution of possible outcomes of the unpaid liabilities. This definition is intended to clarify the concept but it will generally be impossible to apply it directly in practice. Note, however, that where the Lloyd's Valuation of Liability Rules prescribe a basis that is stronger than best estimate for certain elements of the technical provision, then the member must follow the rules in respect of those elements, without taking any offsetting benefit by adopting a weaker than best estimate basis for the other elements of the technical provision.

- 7.3 In classes which have historically shown a tendency to give rise to latent claims, the member should, in the absence of evidence to the contrary, assume continuation of that tendency, but need not allow for the emergence of major new types or classes of claims for the existence of which there is no evidence.
- 7.4 The net technical provision included in the SAO must include provision for reinsurance bad debts and claims handling expenses (both allocated and unallocated). The gross technical provision included in the SAO must also include provision for claims handling expenses (both allocated and unallocated). For each economic entity, the SAO relates to the total technical provisions including these provisions, where relevant, and does not apply to each element separately.
- 7.5 In the case of the net technical provisions, the member is required to give an opinion on the technical provisions of each economic entity, for the overall technical provisions, and separately for business denominated in US dollars and written up to 31 July 1995. In other respects, the member is not expressing an opinion on the split of the technical provisions by class, year of account or currency. These US dollar technical provisions must include appropriate provision for reinsurance bad debts. They should also include provision for claims handling expenses where such expenses are expected to be incurred in that currency.
- 7.6 If the syndicate is expected to be a net borrower, additional technical provisions may be needed to cover borrowing costs because of the need to fund claims (and other) costs in advance of premium receipts or reinsurance (or other) recoveries.
- 7.7 In some circumstances the member may be asked by the Managing Agent to provide an SAO on a subset of the technical provisions to which it is intended to apply. In most situations, this is likely to be unacceptable to Lloyd's. However, there may be specific reasons for excluding certain items from the scope of the SAO, for example contracts that are subject to ongoing dispute over coverage. The member may agree to this, as long as the exclusions are made clear in the SAO.
- 7.8 The member should be aware of the need to provide for the cost of the reinsurance protection of the liabilities covered by the opinion, irrespective of the year of account to which the relevant reinsurance premiums will be charged. For example, this could be particularly important where reinsurance is placed on the basis of losses occurring during the year of account or when policies are written for periods in excess of one year or under binding arrangements.
- 7.9 If for any particular class of business there are specific features of the exposure or the claims that significantly increase the uncertainty, beyond that which might reasonably be expected from that class of business, then a

comment to that effect should be included in the "Relevant Comments" section of the SAO and in the Report.

- 7.10 If for some or all elements of the technical provisions the member has adopted a methodology that is materially different from generally accepted actuarial methods, then reference should be made to this in the "Relevant Comments" section of the SAO and in the Report.
- 7.11 The member may be asked by the Managing Agent to carry out some of his or her work as at a valuation date prior to the SAO valuation date. In all circumstances, the member must carry out sufficient work, using data as at the SAO valuation date, in order to be satisfied that he or she can sign the SAO. In addition, the member should ascertain from the Managing Agent whether there have been any material events between the valuation date and the date of signing the SAO, and make an appropriate adjustment to the technical provisions for such events. If there is insufficient time to make such an adjustment, then the member may need to draw attention to this in the SAO.