

BERMUDA MONETARY AUTHORITY

INSURANCE DEPARTMENT

GUIDANCE NOTE #4

ROLE OF THE LOSS RESERVE SPECIALIST

MARCH 2006

GUIDANCE NOTE: ROLE OF THE LOSS RESERVE SPECIALIST

Introduction

- 1 The role of the Loss Reserve Specialist is integral to the Bermuda insurance supervisory framework. The primary role of the approved Loss Reserve Specialist is to opine on the adequacy of the loss and loss expense provisions, reflected in insurers' statutory financial statements and statutory financial returns, and any other matters specified by the Bermuda Monetary Authority (the "Authority"). This opinion assists the Authority in monitoring the adequacy of loss and loss expense provisions of insurers, as at a certain date, based on information known as at the date of preparation of the opinion. This Note sets out guidance on the role of the Loss Reserve Specialist. The Guidance Notes are intended to provide information on the application of the Insurance Act and corresponding regulations.
- 2 The Authority recognizes the need for clarity as to the scope and implementation of the provisions of the Act ¹ if the regulatory system is to command the confidence of both insurers and policyholders. It seeks, therefore, to ensure that those operating in Bermuda have a good understanding of the nature of the requirements and of the Authority's approach in implementing the Act.
- 3 While the Authority aims to provide clarity as to its approach, the Guidance is not intended to be exhaustive. The Authority, through the Guidance, hereby sets out its understanding of the legal provisions affecting the appointment and the role of the Loss Reserve Specialist and provides additional information about the Authority's regulatory approach and expectations regarding these matters. ² Interpretation of statutes is ultimately a matter for the Bermuda courts. (The applicable sections of the Act are shown in brackets.) ³
- 4 Other guidelines issued by the Authority contain additional information related to the criteria and approval process for Loss Reserve Specialists.

¹ The insurance legislation is comprised of the Insurance Act 1978 (as amended by the Insurance Amendment Acts, 1981, 1983, 1985, 1995, 1998, 2001, 2002 and 2004) and the regulations promulgated under that Act (the "Regulations"). The Regulations are the Insurance Accounts Regulations 1980 (as amended by The Insurance Accounts Amendment Regulations 1981, 1985 and 1989) and the Insurance Returns and Solvency Regulations 1980 (as amended by The Insurance Returns and Solvency Amendment Regulations 1981, 1985 and 1989). References herein to the "Act" are to the Insurance Act 1978 (as amended) and the Regulations.

² The legislative summary in this Guideline is not intended to be a substitute for examining provisions of the Act. The reader is advised to refer to the legislation and not to rely on the interpretation of those provisions contained in this Guideline.

³ "IA" means the Insurance Act 1978. "IAR" means the Insurance Accounts Regulations 1980. "IRASR" refers to the Insurance Returns and Solvency Regulations 1980.

- 5 The Authority's guidance is of general application and seeks to take account of the wide diversity of institutions that may be licensed under the Act. There may be a need for revision of the Guidance Notes from time to time. Material changes in the Guidance will be published, generally through the issue of revised versions.
- 6 Guidance should be understood as reflecting the minimum standard that the Authority expects insurers to observe at all times. For references in these Guidance Notes with respect to the changes in legislation contained in the Insurance Amendment Act 2004, insurers must take immediate steps to ensure they are in compliance with the Act. In relation to other matters contained in the Guidance Notes, the Authority encourages insurers to come into compliance as soon as possible and, in any event, not later than the filing date of their statutory financial returns filed in respect to 2006 financial year-ends, or a later date as may be agreed with the Authority in a particular case.

Application

- 7 This guidance applies to all insurers registered under the Act who carry on general business, and to all Loss Reserve Specialists approved by the Authority pursuant to the Act.

Definitions

- 8 **Loss Reserve Specialist.** A Loss Reserve Specialist is a natural person approved by the Authority as qualified to provide an opinion as to the adequacy of an insurer's loss and loss expense provisions for its General Business as reported in its statutory financial statements.
- 9 **Adequate.** In the context of a Loss Reserve Specialist opining on Line 17 of Bermuda Statutory Financial Statements, means that the held reserve equals or exceeds a reasonable estimate of liabilities.

Appointment of Loss Reserve Specialist

- 10 Insurers writing general business must appoint a Loss Reserve Specialist in accordance with the Act, and have this appointment approved by the Authority. The Act sets out the specific circumstances where general business insurers are required to obtain the opinion of a Loss Reserve Specialist (see paragraphs 19 to 21) and accordingly must appoint a Loss Reserve Specialist.
- 11 Each insurer required to appoint a Loss Reserve Specialist must apply in writing to the Authority for approval of their candidate for that position. The Authority will confirm in writing its decision concerning the approval or otherwise of the insurer's candidate for Loss Reserve Specialist.

- 12 If any of the information included in the application for the Loss Reserve Specialist changes, the insurer shall provide written notice to the Authority of the changes within 14 days of the date of becoming aware of such changes (IA 8(3)).

Change in Loss Reserve Specialist

- 13 Where there is a change in the Loss Reserve Specialist, the insurer shall provide written notice to the Authority of the change and the reasons for the change within 14 days of the decision to effect such change. (IA 8(3))
- 14 Where a Loss Reserve Specialist resigns before the expiration of his or her term of office or decides not to seek to be re-appointed, and where there are circumstances connected with his resignation which he or she considers should be brought to the attention of the Authority, the Loss Reserve Specialist shall within 14 days give written notice (“resignation letter”) to the Authority of its decision and the reasons for the decision.
- 15 Where the Loss Reserve Specialist’s appointment is revoked by an insurer, and where there are circumstances connected with this revocation which the Loss Reserve Specialist considers should be brought to the attention of the Authority, the Loss Reserve Specialist shall provide the Authority with a written statement within 14 days of the circumstances and reasons why, in the Loss Reserve Specialist’s opinion, the Loss Reserve Specialist’s appointment was revoked.

Disqualification

- 16 The Authority may require that an insurer remove a person occupying the role of Loss Reserve Specialist where the Authority is satisfied that the person is no longer fit and proper for the role (IA 8B(4)). Criteria for disqualification could include, but are not limited to, where the person:
- Has failed to perform adequately and properly the functions and duties of such appointment; or,
 - No longer meets the fit & proper criteria for such an appointment.
- 17 The Authority shall not revoke its approval unless it has first notified the Loss Reserve Specialist and the insurer of its intention to do so (IA 8B(5)).

Letter of Undertaking

- 18 Any new candidate for Loss Reserve Specialist shall provide the Authority with a letter of undertaking that he or she will perform their functions in accordance with the Act and the standards of their relevant association. Where a Loss Reserve Specialist is approved pursuant to paragraphs 16 to 18 of the Guidance Note 'Fit and Proper Criteria and Approval Process for the Loss Reserve Specialist', any new candidate for Loss Reserve Specialist is expected to provide the Authority with a letter of undertaking that he or she will perform its functions in accordance with the Act.

Opinion with Statutory Financial Return

- 19 Class 2, Class 3 and Class 4 insurers shall include the opinion of a Loss Reserve Specialist, regarding the insurer's general insurance loss and loss expense provisions, with the statutory financial return. The opinion of the Loss Reserve Specialist shall be provided annually in the case of Class 3 and Class 4 insurers, and every third year in the case of Class 2 insurers. (IA 18B (1) (2))
- 20 Class 1 insurers, and Class 2 insurers who are not already required to include a loss and loss expense provision opinion with the Statutory Financial Return for the relevant year, are required to include the opinion of a Loss Reserve Specialist with their annual Statutory Financial Return (IA 18B(3)):
- a) If the gross premiums from professional liability insurance are more than 30% of the gross premium written by the insurer during the year. In such a case the insurer must obtain an opinion of a Loss Reserve Specialist on the loss and loss expense provisions relating to all professional liability insurance⁴ business. If the loss provisions for professional liability business cannot be separated from the whole amount of the loss and loss expense provisions, then the opinion of the Loss Reserve Specialist must be provided in respect of the entirety of the insurer's loss and loss expense provisions. (IA 18B(3); IAR⁵)
 - b) If in prior years the insurer wrote professional liability insurance, and if in either of the last two years during which the insurer wrote professional liability insurance, an opinion pursuant to (a) above was required. In such a case the insurer must obtain an opinion of a Loss Reserve Specialist in

⁴ "Professional liability insurance" as meaning liability insurance business where the risks, the subject of the contract of insurance, are risks of the persons insured incurring liabilities in relation to the negligence or other exercise by those persons of some professional skill.

⁵ Schedule III, Part II, Line 17

respect of the loss and loss expense provisions relating to all professional liability insurance business in every subsequent year. (IAR 6)

- c) If the insurer discounts its loss and loss expense provisions, and the insurer would not meet its general business solvency margin on an undiscounted basis. (IAR 7).⁸
- 21 The Authority, as it sees fit, may also impose a condition in the license of any insurer requiring the insurer to include the opinion of a Loss Reserve Specialist on the loss and loss expense provisions with the annual statutory financial return (IA 4(2)).

Failure to Meet Solvency Requirements

- 22 Where by reason of its total statutory capital and surplus falling to \$75,000,000 or less, a Class 4 insurer fails to meet its general business solvency margin (or has reason to believe that such a failure has occurred), it must file unaudited interim statutory financial statements, covering such period as the Authority may require, and the opinion of a Loss Reserve Specialist in relation to line 17 (the Loss and loss expense provision) of these financial statement. The unaudited interim statutory financial statements and the opinion of the Loss Reserve Specialist are to be filed within 45 days, and are to be filed with a general business solvency certificate in respect of the statements and include a report containing the particulars of the circumstances leading to the failure, the manner by which the insurer intends to rectify the failure, and the date by which the insurer intends to rectify the failure. (IA 31A (1) (2))

⁶ Schedule III, Part II, Line 17(g))

⁷ Sch III, Part II, Line 17(e)

⁸ Loss provisions may be discounted for all insurers (Class 1, 2, 3 and 4) if: both the amount of the loss provisions and the payment dates of the losses are fixed; neither the amount of the loss provisions nor the payment dates of the losses are fixed but the insurer's approved auditor is of opinion that that amount and those dates are reasonably ascertainable either in the records of the insurer itself or in those of any group of companies of which the insurer is a member; or, if the loss provisions in question were discounted on or before 31st December, 1988 in the insurer's statutory financial statements. (IA Reg, Sch III, Part II, Line 17(c))

Line 17 – Valuation of loss and loss expense provisions

- 23 Line 17, the provision for loss and loss expense in the statutory balance sheet provisions includes:
- a) An adequate amount set aside by the insurer for gross loss and loss expenses provisions, including for:
 - losses reported before, but not paid by, the date of the balance sheet,
 - losses incurred but not reported to the insurer before the last day of the relevant year, and,
 - expenses likely to be incurred in connection with the investigation, adjustment and settlement of such losses
 - b) less a reduction for an adequate amount for estimates for any amounts recoverable (“estimate for reinsurance recoverables”) under a contract of reinsurance in respect of the gross loss and loss expense provisions. (IAR, Sch III, Part II, Line 17 (a), (b))
- 24 The estimate for reinsurance recoverables is to be reduced for any amounts the collection of which, in the opinion of the insurer, is doubtful. (IAR, Sch III, Part II, Line 17 (a), (b))
- 25 The provision for loss and loss expenses may be discounted:
- a) Where both the amount of the loss provisions and the payment dates of the losses are fixed;
 - b) Where neither the amount of the loss provisions nor the payment dates of the losses are fixed but the insurer's Approved Auditor and, if applicable, the Loss Reserve Specialist is of the opinion that the amounts and dates are reasonably ascertainable; or,
 - c) Where the loss provisions in question in the insurer's Statutory Financial Statements were discounted on or before 31st December 1988, and have been discounted in each subsequent year.
- 26 Where loss provisions are discounted, as allowed, the insurer is required to establish an adequate amount for possible variations in the ultimate amount of the losses, the payment dates of the losses and the applicable interest rates. (IA Reg, Sch III, Part II, Line 17 (d))

- 27 Where the loss and loss expense provisions are discounted, the Loss Reserve Specialist is not required to provide an opinion on the rate or rates of interest used for discounting, or the possible variance in the interest rate or rates used for discounting.
- 28 The insurer is required to disclose in the notes to the Statutory Financial Statements:
- (a) The method of calculating loss and loss expense provisions and provisions for losses incurred but not reported; and,
- (b) The amount by which loss and loss expense provisions have been reduced by discounting for the time value of money, and the rates, or the range of rates, of interest used in any such discounting. (IAR, Schedule II, Part II)

Accepted Actuarial Practice

- 29 It is the responsibility of the Loss Reserve Specialist to be conversant with the requirements of the Act and its implications for the issuance of his or her opinion.
- 30 The Loss Reserve Specialist's estimate of the loss and loss expense provision,⁹ and any other matters specified by the Authority, shall be prepared in accordance with accepted actuarial practice and all applicable standards of practice of his or her relevant associations and the Act. Where any provisions of the Act differ from the standards of practice, then the Act shall prevail.

Working papers of the Loss Reserve Specialist

- 31 The Loss Reserve Specialist shall retain all relevant reports, records and documents, in either electronic or paper form, and if requested by the Authority these should be made available for review in Bermuda by the Authority or its representative. Such information should be sufficient in and of itself to enable the completion of an independent review of the opinion by another unrelated but qualified Loss Reserve Specialist.

Right to Information

- 32 An insurer must make any reasonable arrangements that are necessary to enable the Loss Reserve Specialist to complete his or her assigned responsibilities. This includes promptly complying with any and all reasonable requests for information.

⁹ Refer to line 17.

Communication of Opinion

- 33 Where there is a requirement for the opinion of a Loss Reserve Specialist, the Loss Reserve Specialist shall provide an opinion as to the adequacy of the loss and loss expense provisions (or, if applicable, the portion relating to professional liability business)¹⁰. The Loss Reserve Specialist shall further state the extent to which any instructions in the Act relating to the valuation or presentation of these loss and loss expense provisions have been complied with.
- 34 The following sets out minimum standards for the presentation, level of detail and nature of discussion to be included in the communication of the Loss Reserve Specialist opinion. The content of the report should be in eight sections, as described below:

Part 1 - Identification

This section should identify the name of the Loss Reserve Specialist and his or her full address, and the professional qualifications under which the opinion is being rendered. In addition, the Loss Reserve Specialist shall confirm that he or she is a member in good standing of all relevant associations included in the application to the Authority for his or her approval and that he or she still satisfies the fit and proper criteria, with due consideration of the nature, scale and complexity of the insurer's business.

Part 2 - Scope

This section should identify the insurer involved and the valuation date of the opinion, and provide details defining the business which is the subject of the opinion. This section should clearly identify the sections of the Insurance Act under which the provision is being provided, the relevant lines of the annual statement (or the portion thereof) for which the opinion is being given, and the date of the Statutory Financial Statements of which these lines form a part of.

Part 3 – Conditions and Limitations

In this section the Loss Reserve Specialist should provide details concerning all conditions and limitations specific to the insurer's business and circumstances. It is not necessary that the Loss Reserve Specialist state general broad statements about risks and uncertainties due to the application of accepted actuarial practice and standards.

¹⁰ Reference is to line 17 of the IAR.

Part 4 – Review and Verification of Data

In this section the Loss Reserve Specialist should describe the source and nature of any data analysed as well as the extent of his or her reliance on data or analyses prepared by others. The Loss Reserve Specialist may rely on data provided by the insurer except that the Loss Reserve Specialist should review the data for reasonableness and consistency. The extent of any reviews, or reliance on the data should be clearly stated. However, the Loss Reserve Specialist is required to state that he or she has reviewed or evaluated all data for reasonableness and consistency.

Part 5 – Expression of Opinion

The opinion should be clearly stated without restriction unless the opinion is intended to be a qualified opinion. If the loss reserve specialist issues a qualified opinion, the qualification should disclose the nature and reasons for the qualification. Where reserves have been discounted this should be stated.

Where loss and loss expense reserves are discounted, the Loss Reserve Specialist should state the amount of discount, and the rate or rates of interest used.

In addition, where loss and loss expense reserves are discounted, the Insurance Act requires that loss and loss expense reserves include “an adequate amount set aside by the insurer for possible variations in ultimate amount of losses, the payment dates of the losses, and the applicable interest rates” (IAR, Schedule III, Part I, Item 17(d)). Therefore as part of opining on Line 17 where loss and loss expense reserves are discounted, the Loss Reserve Specialist is expected to evaluate the amount set aside, and include a comment in the opinion.

The opinion paragraph should include a sentence which covers at least the points listed in the following illustration:

“In my opinion, the amounts of \$x carried in line 17 (described above) of the Company’s balance sheet:

- 1) meet the requirements of the insurance laws of Bermuda;
- 2) are computed in accordance with accepted loss reserving practice;
and

- 3) make an adequate provision for all unpaid loss and loss expense obligations of the Company under the terms of its contracts and agreements.”

Where reserves have been discounted the Loss Reserve Specialist should also state:

- 4) That an appropriate amount has been set aside for possible variations in the ultimate amount of the losses, the payment dates of the losses and the applicable interest rates.
- 5) That the amount of discount in the reserves is \$d, using rates of interest used for discounting of i% to j%

Part 6 - Relevant Comment

In this section the Loss Reserve Specialist should include comment on matters that create additional uncertainty in the loss reserves or where the amount of liability is subject to an unusual amount of variance, such as:

- where there has been a material change in the actuarial assumptions or methods employed. The Loss Reserve Specialist should describe the nature of the change and the impact of these changes on the Loss Reserve Specialist’s valuation.
- where the information provided by the company is incomplete or inadequate to complete the evaluation in accordance with accepted loss reserving standards and professional standards. The Loss Reserve Specialist should state this and describe the impact on the Loss Reserve Specialist’s evaluation.
- where the loss reserve specialist has had to select a key assumption with limited analytical support. The Loss Reserve Specialist should state this and describe the impact that the alternative selection(s) would have on the Loss Reserve Specialist’s evaluation.

Part 7 – Work Papers

This section should include a statement describing all actuarial reports, analyses and work products that have been completed, and that these same documents should be made available in Bermuda upon request. Such documents should be sufficient in and of themselves to enable the completion of an independent review of the opinion by another unrelated but qualified Loss Reserve Specialist.

Part 8 - Signature

This section should include the Loss Reserve Specialist's signature, the relevant professional designations, appointment status (i.e. officer designation, or consultant), the associated firm, and contact information including telephone number, fax number, and email.

End of Guidance Note.

If you have questions on this or other guidance from the Insurance Department please email info@bma.bm . Please put "Insurance Guidance" in the title of your email.