



29 March 2019

Dear Stakeholders:

### **MARKET FEEDBACK ON ACTUARIAL OPINIONS ON EBS TECHNICAL PROVISIONS – GENERAL BUSINESS**

Following the publication of the Guidance Note (GN) “Actuary’s Opinion on EBS Technical Provisions” in May 2016, the market has for the second time submitted Actuarial Opinions (Opinions) on the Economic Balance Sheet (EBS) along with their yearly statutory submissions. Similar to previous years, the Bermuda Monetary Authority (the Authority) has now had the opportunity to analyse the Opinions submitted. With the aim of assisting the market to improve the quality of the submissions, the Authority has issued this letter to provide feedback on the main gaps identified in this year’s review. Even though the letter’s focus is to discuss the identified gaps and how these can be addressed, it also includes some high level comments on other areas.

#### **Feedback**

The Authority considers the Actuarial Opinion to be a meaningful, value-added document and an important tool in our risk-based supervisory review process. The Opinion is intended to be a document that sits between a full Actuarial Report and an attestation, with the aim of serving two key objectives:

1. An attestation that the calculation of the Technical Provisions is in line with the EBS rules as specified in Section IV of the GN “For Commercial Insurers and Insurance Groups’ Statutory Regime” of 30 November 2016
2. A document that enables the Authority to understand how insurers derive their Technical Provisions (TPs) so that the underlying working papers are only requested when the submitted documents are unclear, or a more in-depth investigation is required

Compared to the 2016 year-end submissions, the Authority noticed an improvement in the overall quality of the Actuarial Opinions received from the market and notes that many Actuaries are making efforts to consider our feedback. However, there is still a variation in the quality of the Opinions received, with some Opinions falling below expectations.

Consequently, the relevance and applicability of the feedback provided in this letter vary between Opinions, depending on their current quality as well as other factors (e.g., insurer profile). Even though our review has identified three main areas where Actuarial Opinions tended to have gaps (*Methodologies and Assumptions, Relevant Comment, Working Papers*) the following section touches on all eight parts of the Guidance:

- *Part 1 – Identification:* Opinions were in line with expectations
- *Part 2 – Scope:* Opinions were generally in line with expectations. Similar to last year, some Opinions still do not sufficiently address all the points highlighted in the Guidance (i.e., *entity information, details defining the business, material changes affecting the overall business*). Better Opinions include a discussion which is more tailored to the insurer’s risk profile and characteristics by highlighting elements specific to the insurer
- *Part 3 – Conditions and Limitations:* Opinions were generally in line with expectations. Actuaries, however, should strive to ensure that *all reasonably foreseeable conditions and limitations relevant to the determination of the TPs are included*
- *Part 4 – Expression of Opinion:* Opinions were generally in line with expectations. Actuaries are reminded to disclose both their own estimates of technical provisions (best estimate/range) and the booked. In particular, any deviations between the two estimates should be discussed, explaining the drivers and the reasoning for such differences
- *Part 5 – Summary of Methodology:* This was the main area upon which the Authority provided feedback last year. Even though we have seen improvements, we consider that further work is still needed, particularly in relation to paragraphs 54b to 54d where the desired level of detail is not always provided. The commentary below attempts to further clarify our expectations by referring to *key requirements* in the GN and provides examples of typical information that would address these requirements:
  - GN Paragraph 54b (Data) – Actuaries should ensure that all aspects of the guidance are addressed in sufficient detail so that the Opinion provides the reader with a clear view of the data integrity and process around it. Among other things, a description should be provided of the main types (e.g., claims, policy and exposure information, including any other (more bespoke) data used in the reserving process) and sources of data (e.g., discuss databases, templates and people that provide the data, including the format in which they are provided). In addition, a description of data processing steps should be provided (e.g., discuss data cleaning and adjustments performed, discuss whether the data processes are automated or manual and therefore more prone to error, discuss other relevant processes that relate to data issues and limitations, and discuss the data checks and reconciliations performed including notable results and conclusions). Finally, discuss any additional

data checks performed by the Actuary including reference of notable results and conclusions from these checks. Some Opinions have attempted to address this area by making brief affirmation statements such as ‘data has been reviewed for consistency and reasonableness’; it is expected that such statements are accompanied by more detailed descriptions of how this is achieved

- GN Paragraph 54ci (Reserving Process) – Actuaries should provide adequate detail of their reserving thought process (e.g., discuss the main reserving steps; notable considerations in the process (particularly in relation to assumptions and methodology); the main parties involved, their roles, input and interaction; notable inputs from other or consultations with experts); controls (e.g., discussion of reconciliations and other checks performed such as review of movements against previous exercise, controls for methodological consistency and transparency, any other controls in place); and validation performed or relied upon (e.g., validation of key inputs assumptions and methods, peer review and sign-off structure and results)
- GN Paragraph 54cii to 54cviii (Reserving Characteristics and Projections) – Actuaries should discuss how business/reserves are segmented in the reserving process and provide a breakdown of reserves by segment. For the main reserving segments, a brief overview of their characteristics (e.g., profile of policies and exposures, uncertainties, historical performance) should be provided, along with the discussion of the reserving methods used. The information in the Opinion should be sufficient in terms of scope and detail in order to provide the reader with a good level of understanding about how the reserves are derived. The discussion of the reserving methods used should address all the relevant and material components of the reserve projection process such as:
  - Reserving basis – Discuss whether reserving is performed on an underwriting or accident period basis, whether patterns are analysed and projected on an annual or quarterly basis, and whether attritional and large losses are reserved separately
  - Reserving models used – Reference the reserving models used whether standard (e.g., Chain Ladder, Cape Cod) or bespoke (e.g., non-triangulation models); discuss the process of selecting one model over others and their suitability in the specific circumstances
  - Selections within reserving models – Describe the selections made within the models, including discussion of the overall selection process for deriving development and earning patterns, loss ratios, trends and other key components of the model
  - Notable adjustments and considerations – Describe notable adjustments and considerations for deciding or applying the selected reserving methods such as: adjustment for seasonality, reviewing and adjusting for trends in claims handling, policy terms, exposure changes

and others

- Reserving for material bespoke elements – Describe how reserves are set for material elements which are not typically captured by the standard reserving models such as setting reserves for large losses, catastrophe events, material periodic payments or allowing for reinsurance
- Key input reserving parameters – Describe how key input parameters are derived, such as: initial expected loss ratios, trending and rate change assumptions, reliance on benchmarks and discussion of their suitability in the specific circumstances
- Additional commentary – Any further discussion around the suitability of the inputs and selections, their derivation process, any potential weaknesses, planned improvements, trends, areas of uncertainty
- GN Paragraph 54d (Expert Judgement) – This is an area that was omitted in several Opinions. All Opinions should discuss *the main areas where expert judgement is being used* (e.g., data groupings, selecting reserving models or patterns, relying on benchmarks, reserving for catastrophe losses) *and identify the most material and subjective judgements*. In identifying the most material areas for expert judgement, some narrative should be included about how materiality and subjectivity was assessed (e.g. sensitivity testing)
- GN Paragraph 54e-m (EBS Conversion) – Opinions are generally in line with expectations in this area. The Opinions that meet expectations clearly identify and discuss every step in the calculation of the Technical Provisions. They provide a clear and transparent presentation of and reasoning for the models and methodologies used (e.g., by describing the models or scenarios used to calculate ENID, Credit Risk and Risk Margin or clearly identifying the expense items forming part of the ULAE calculation) along with reference and justification for the most material input parameters and assumptions (e.g., discussing volatility factors for ENID, parameterisation of ENID scenarios, selection of default rates, loss given default and dispute assumptions for Credit Risk and loss ratio assumptions). Better Opinions provide quantification of most calculation material components and the final result of the different EBS components
- GN Paragraph 54o (Reserving Table) – Several Opinions omit to include a table with the held Technical Provisions broken down by *the name of each legal entity, business unit and/or reserving group*. Better Opinions include a step-by-step GAAP to EBS conversion, which assists the reviewer to understand the materiality of each component and assess for reasonableness.
- *Part 6 – Relevant Comment*: This part should receive particular attention and be discussed in a sufficient level of detail. Actuaries should include discussions around *material changes (GN Paragraph 55a) in the actuarial assumptions or methods employed* (e.g. changes in inputs, projection methods, selection methodology) or (GN

*Paragraph 55b) the insurer reserve risk profile (e.g., changes in policy conditions, claims handling, reserving policy, legal changes) including reference to current and potential impacts and actions relating to these changes. Additionally, this Part should include discussions of the (GN Paragraph 55d) major risk factors that could result in material adverse deviation (e.g., limited data increasing uncertainty in estimate, uncertainty in potential future material events, historical reserve underestimation) within the context of the insurer (e.g., impact on insurer, segments affected, possible outcomes and actions). Lastly, actuaries should discuss their reasoning for the materiality standard selected.*

- *Part 7 - Reliance on Opinions of other Actuaries: Whenever relying on the Opinions of others, the Actuary should ensure that they include sufficient discussion (GN Paragraph 56c) about their evaluation of the appropriateness of their reliance (e.g., experience/credentials of person relied upon, supporting processes or arrangements), provide a description of the work performed in arriving to that evaluation (e.g., annual skills review), and whether such portions of the subject TPs relied upon are likely to have a material impact on the AO regarding the total subject TPs.*
- *Part 8 – Work Papers: This part serves in providing the reader with an understanding of the work supporting the Actuary’s estimates and allows the Authority to easily identify which files and documents to request if further review is needed. Opinions are therefore expected to include a list of the key supporting working papers along with a short description next to them.*

This feedback letter is not intended to be a standalone document but should be read alongside the published Guidance. Its intention is to provide better clarity of the information the Authority is looking for and provide some examples of how some areas of the Guidance may be addressed.

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