



By email: insurance@centralbank.ie

General Insurance Supervision Division
Central Bank of Ireland
PO Box 11517
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9 December 2013

Re: Consultation Paper CP73 – Requirements for Reserving and Pricing for Non-Life Insurers and Reinsurers

Dear Sirs,

Introduction

We welcome the publication of the *Consultation Paper on the Requirements for Reserving and Pricing for Non-Life Insurers and Reinsurers* ("the CP") and the invitation to comment on its content. This submission is made on behalf of Zurich Insurance plc.

We are grateful for the opportunity to provide feedback on the proposals, and we have tried to highlight areas where in our opinion further clarification would be helpful or where alternative approaches to achieving the same objectives could be considered.

Requirements for Reserving and Pricing

We support the purposes of the Requirements, namely to provide assurance that non-life insurers and reinsurers are maintaining appropriate reserves and have appropriate governance structures in place in relation to reserving. We note that the main focus of the document is on reserving rather than pricing, and we suggest that pricing could be excluded here and considered separately in a Solvency II context.

Timing and positioning

We find it somewhat surprising these proposals are cast in a Solvency I Irish GAAP context and do not point to a transition from the current environment to Solvency II (which will in turn require an actuarial function report, covering the reserves together with other actuarial

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responsibilities). In our opinion, this initiative would be more effective if expressed in terms of the anticipated requirements of the new IFRS standards and Solvency II, as reserving and risk margins will need to be re-thought when these are formally introduced. The point is particularly evident as one tries to reconcile the different reserving requirements set out on pages 33 and 34 of the CP. We would welcome clarification on the proposed transition from these proposals to a Solvency II environment.

Reserve Risk Capital

We note that the CP does not discuss the distinction between reserve risk capital and risk margin. Clearly the purpose of reserve risk capital is to cover the risk that the booked reserves prove inadequate. To the extent that the booked reserves are higher than the Best Estimate, the reserve risk capital should be reduced accordingly. We suggest that this aspect should be considered when assessing solvency requirements.

Sequence of Submission

This submission follows the structure proposed in section 15 of the CP, and within that addresses points in the order in which they appear in the CP.

(a) Signing Actuary to be designated as a PCF role

Currently our Signing Actuary is also the Chief Actuary and therefore already a PCF. On that basis we are comfortable with the proposed requirement. However, this raises a question as to whether in future the current Signing Actuary practising certificates administered by the Society of Actuaries in Ireland will continue to be required alongside the PCF requirements.

(b) The Proposed Requirements (Appendix 1)

The Statement of Actuarial Opinion and the supporting Actuarial Report (sections 12-20)

Data

There are many references to the reserving data in the CP. We suggest it is sensible to separate assurance on the accuracy and completeness of the data from assurance of its appropriateness.

Assurance on the accuracy and completeness of data requires an audit approach with an associated concept of materiality and should be provided within the context of one of the recognised audit practice guidelines. For this reason, we believe that neither the Signing Actuary nor any Peer Reviewer should be asked to opine on accuracy and completeness, since this activity may be better performed by other professionals who have relevant expertise in this area. We suggest that responsibility for the opinion on data accuracy and completeness should vest in the Board, who may rely on the Internal Control Framework around the company's claims processes or on an audit opinion provided by either Internal Audit or the External Auditors. The implication of this is that the italicised paragraph on page 25, Appendix 2 should be retained for all companies, and that the corresponding reference should be removed from section 14. It is of course appropriate for the Signing Actuary to review the reasonableness of the data.



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Appropriateness of data is clearly an area on which the Signing Actuary or Peer Reviewer could reasonably be expected to opine. We suggest that the definition of the Reviewing Actuary on page 10 should be amended to refer to reviewing the appropriateness of the data, rather than independently checking the data.

Reserve Adequacy

CP 73 makes reference to adequacy of reserves (see for example section 12 on page 13), which is a difficult term to define. We suggest that the language of final regulations should use other forms of words, such as complying with the valuation rules mentioned in section 4.4 on page 33, where the wording is such as to be readily understandable and less open to misinterpretation.

SAO Report

Sections 19 and 20 set out various items which should be covered by the SAO Report. There seems to be considerable overlap between (and sometimes within) these two sections. A revision of sections 19 and 20 would bring about greater clarity concerning the requirements. Most of this material is already included in ASP GI-1 and ASP GI-2 issued by the Society of Actuaries in Ireland, and this raises a question of whether a reference to the actuarial guidance would suffice.

In particular, the Signing Actuary is responsible for the content of the SAO Report and so it does not seem appropriate for section 19 to state that "Companies shall ensure..."

Governance Requirements (Sections 21-29)

We note that the reconciliation of the actuarial data to the underlying claims data referred to in section 22 may take place directly or the actuarial data may be reconciled to financial data which is itself reconciled to the claims data.

Section 23 seems to imply that the External Auditor has a role in the assessment of the accuracy and completeness of the data, which is presumably in addition to the Internal Audit Assessment referred to in sections 30-33. It would be helpful to clarify the intended role of the External Auditor in this regard. Also, the reference to "technical provisions" in this section should instead be to case estimates.

Section 24 requires the Board or Audit Committee of High Impact companies to assess the External Auditor's actuary's understanding of the company and its products. We suggest that the wording should be extended to make it clear that this requirement covers all the principal individuals in the audit team including the actuary.

Section 25 is the main reference to Pricing in the CP. This is currently a very high level statement and, in the interests of a consistent industry approach, some clarification of the expected content and ownership of the Pricing Policy would be helpful. Alternatively, requirements relating to pricing could be excluded from this document and be considered separately in a Solvency II context.

Sections 27 and 28 refer to the Risk Margin and the corresponding report. In our view it would be preferable to avoid the term "Risk Margin" in this context, as it has a specific



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meaning under Solvency II, and instead refer to, say, a reserve margin for adverse development.

Section 27(c) refers to the need to satisfy accounting requirements with regard to a true and fair view. We believe there could be a potential conflict between accounting and taxation requirements for best estimate reserving and the CP 73 requirement for a risk margin to be held. Appendix 3 section 4 includes some discussion on the legal and regulatory framework, the key issue being whether adverse development can be "reasonably foreseen". We envisage that there may be considerable debate around what can be "reasonably foreseen", and hence the degree of prudence required.

Section 28 requires the Risk Margin Report to be produced within 4 months of the financial year end, whereas the timescale for the SAO Report is six months from the financial year end: we suggest that the same timescale of six months should be used for both reports. It also appears that there is potentially some overlap between the Risk Margin Report and the quantification of uncertainty included in the SAO Report, and it would make sense to align the two reports in this area.

Section 29(g) refers to the potential need for a supplementary actuarial report following a material change to the best estimate. We would expect that such instances would be very rare and that each case would need to be treated on its merits.

Internal Audit Assessment (sections 30-33)

In addition to the periodic Internal Audit assessment of the reserving process envisaged by the CP, we believe a review should also take place in any year in which significant changes to processes or systems have taken place.

We suggest that a rolling programme of assessments across the company (over two, three or five years as appropriate) may be as effective and more practical than a single assessment. For example, in our case the assessments might be done by branch on a rolling basis, combined with a periodic assessment of the process of consolidation to the ZIP level.

Peer Review (sections 34-46)

The suggestion that the peer review report for High Impact companies should include an independent calculation of the best estimate seems problematic. It imposes a greater burden of cost and management effort on such companies. More importantly, however, it will lead to confusion when best estimates differ significantly from those calculated by the Signing Actuary. A best estimate is a result of myriad small judgements made on the basis of an interpretation of reserving policy and knowledge of the business, combined with a modelling approach which is itself judgemental. We suggest that it is more helpful to seek a second opinion on the reasonableness of the judgements made and, possibly, an opinion that the Signing Actuary's best estimate lies within what the peer reviewer considers to be a reasonable range. We also suggest that the content of the peer review should be the same for all companies (although not necessarily the frequency) and that an independent calculation of a best estimate should not be required.

ZIP's current policy is to commission external reserve reviews where these add value in terms of market insights, alternative methodologies or an external perspective on portfolios subject



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to greater than usual uncertainty. We believe that a targeted risk based approach adds more value than an overall review, which would include many straightforward and uncontroversial portfolios. For a company of our size and complexity, we suggest that it would make sense to agree a rolling programme of internal and external peer reviews on a targeted basis, rather than undertake routine external reviews because of a compliance requirement.

Section 42 states that the Reviewing Actuary may not be from the same firm as the External Auditor. We do not understand the reason for this proposal, and we suggest that in fact it would be appropriate and effective for an actuary from the External Auditor to act as the Reviewing Actuary, since they will generally carry out a review as part of the audit, and the scope of this could potentially be extended to meet the peer review requirements. The appointment of an actuary from the audit firm would, of course, need to be assessed for potential conflicts on an individual case basis.

We are concerned that the requirement set out in section 46 for the Peer Review report to be presented to the Board and then submitted to the Central Bank within six months of the financial year end is likely to put pressure on the already tight timescale for producing the SAO Reports, since the implication is that these will have to be produced and made available to the Reviewing Actuary as part of the Peer Review. We would appreciate it if the Peer Review deadline could be extended to say 7 months after the financial year end.

As drafted, the CP implies that the Peer Review would take place after the year and reserves have been set, the SAO has been signed, and the SAO report drafted. However, we could see value in an alternative approach where the peer review of the actuarial estimates might be performed on the Q3 figures, so as to provide input to decisions on the booked year-end reserves – this would be similar to our current external audit approach.

Reserving Committee (section 47)

We suggest that this might be better referred to as a “Reserve Governance Committee” as companies are likely to already have “reserving committees” which may have a different remit from that suggested here.

We suggest that the committee’s oversight should relate to “claims **handling** practices” rather than “claims settlement practices”, as it should include the recording and estimation of claims as well as their settlement. We also suggest that the Committee should opine on all such changes to **determine whether** there are actual savings, as there may well be some changes which result in an acceleration of settlements but no quantifiable savings.

(c) The guidance on Best Estimate and Risk Margin (Appendix 3 sections 1 & 2)

Best Estimate

The proposed definition of Best Estimate appears generally sensible to us. However, the treatment of binary events and whether an allowance for these should be included in the Best Estimate rather than in the Risk margin may merit further consideration in order to facilitate a smooth transition to Solvency II.

The wording of the second sentence of paragraph 1.3 seems unclear, and could possibly be omitted.

Risk Margin

As already mentioned, this might be better referred to as “Reserve Margin”.

The CP does not discuss the distinction between reserve risk capital and risk margin. Clearly the purpose of reserve risk capital is to cover the risk that the booked reserves prove inadequate. To the extent that the booked reserves are higher than the Best Estimate, the reserve risk capital should be reduced accordingly. This aspect should be considered when assessing solvency requirements.

We suggest that the dynamics of the business should be factored into the risk margin calculation and that, in order to recognise the different profiles of business written by different companies, it would be entirely appropriate to allow for the time value of money in the risk margin calculation. Although paragraph 1.4 notes that the Best Estimate incorporates an implicit margin due to not discounting, this point is not currently picked up in section 2. We suggest that the Risk Margin could sensibly be calculated as the discounted reserves at the required level of prudence, minus the undiscounted Best Estimate.

Section 2 makes no reference to the time period over which any reserve deterioration might emerge, and this appears inconsistent with solvency margin considerations, particularly in view of the forthcoming Solvency II requirements. We therefore suggest that it would be better to specify a time horizon which Boards should take into account when making their assessment of the Risk Margin.

These considerations appear to us to be relevant to the legal and regulatory framework discussed in Appendix 3 Section 4. Given that the concept of “reasonably foreseen” does not appear to have been defined or tested, it would be helpful to have guidance on this

(d) Issues which should be considered by Boards when setting risk margins (Appendix 3 section 3 and Example)

A number of the points already made in response to item (c) above are also relevant here.

Paragraphs 3.7 and 3.8 indicate a degree of alignment with the forthcoming Solvency II approach and we strongly support such alignment. This reinforces the need to consider the timeframe over which any deterioration might occur and to take account of the time value of money.

The final sentence on page 37 refers to “scenarios which have been experienced in the wider market, in particular those that have led to prior company failures”. We suggest that on this point it would be desirable to have consistency between companies. We think that the Central Bank would be best placed to articulate the scenarios which have led to prior company failures, and perhaps a list of such scenarios could be provided for Boards to take into account when determining the Risk Margin.

(e) Exemptions to SAO requirements



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Section 13 suggests possible exemption from the requirement to provide an SAO for certain companies which do not write motor, liability or financial guarantee business. We suggest that it would be fairer to allow exemption from a SAO in respect of lines other than the 3 mentioned, to all companies.

Concluding Remarks

We would be happy to meet with you to elaborate on the points which we have made in this submission.

In the event that you have any questions or require further information arising from our submission, please do not hesitate to contact me.

Yours sincerely,

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