KPMG response to Consultation Paper CP73

Requirements for Reserving and Pricing for Non Life Insurers and Reinsurers

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Introduction

KPMG welcomes the opportunity to respond to the Central Bank of Ireland's ("CBI") Consultation Paper 73 ("CP73"), "Requirements for Reserving and Pricing for Non-Life Insurers and Reinsurers". We support the CBI in its aims to strengthen its supervisory oversight in the areas of reserving and pricing practices in insurers and in particular that appropriate levels of reserves are maintained by non-life insurers and reinsurers.

KPMG is a leading provider of professional services in Ireland. We work with clients in all sectors of Irish business, including many of the leading insurers and reinsurers, providing a range of Audit, Tax and Advisory services. Our insurance practice is involved in both professional and industry bodies and take an active role in pursuing regulatory, accounting and tax issues affecting the industry. We believe we are well placed to comment on CP73.

Our response is structured as:

- Executive Summary.
- Key observations.
- Detailed points principally regarding clarifications required and drafting points in Appendix1.

We would be delighted to discuss our response with the CBI. Related contact details are set out in Appendix 2.

Executive Summary

The key points arising from our review of CP73 are as follows:

- We consider the CP73 requirements as being appropriate and necessary for High Impact companies i.e. principally domestic non life insurers. We consider that there should not be significant effort for most High Impact companies to comply with these requirements.
- We consider that the proposed requirements should enable Medium High Impact companies to adopt the proposed requirements on a 'comply or explain' basis to reflect the specific circumstances of the entities. There is a reasonable argument to be made that Medium Low entities should fall out of the proposed requirements due to the nature of their business, e.g. reinsurance or due to nature and profile of their claims reserves. Entities should be encouraged to consider many of the proposed requirements as best practice (including through Dear CEO letters or guidelines) though without the statutory prescription, thereby giving operational flexibility and discretion to the Board of Directors. We believe that Low Impact companies should be out of scope of the proposed requirements.
- Our approach takes account of how international (re)insurers perceive the level of prescription in the proposed requirements and the additional costs that will arise from complying.
- We do not consider that mandating the Signing Actuary as a PCF meets a reasonable interpretation of (or the spirit or intent of) the Central Bank Reform Act, 2010 whereby "*.....a pre-approval controlled function... if the function is one by which a person may*

exercise a significant influence on the conduct of a regulated financial service provider's affairs". Moreover, CP73 requires the Signing Actuary to act independently of the company. The classification of the role as a PCF and the requirement for a degree of independence may not be mutually exclusive, but in our view they are not entirely compatible. Based on the above, we would suggest that the PCF requirement be removed from the requirements.

- We consider the restriction in relation to the Signing Actuary role for non High Risk entities and peer review of all entities by an actuary from the external audit firm to be restrictive and without merit for all entities. There is a trade off between cost and efficiency for the CBI receiving assurance from multiple parties examining actuarial reserves. We believe that the CBI should be receptive to companies' own choice of Signing Actuary (for Medium High/ Low Impact companies)/ peer reviewer (for all entities) rather than introducing restrictions in this area.
- We recommend further clarification on how CP73 may or may not transition into Solvency II so that entities can plan accordingly.
- Identification of possible data issues, both within the CBI and by Board of Directors of High Impact companies, could be enhanced by the collection and benchmarking of claims and reserving data.
- In line with the Dear CEO letter to High Impact companies dated 22 February 2013 the member of executive management with responsibility for claims or the relevant PCF could produce a report supporting the Data Accuracy Statement and in addition formally report to the audit committee/ Board of Directors around accuracy of case estimates.

KPMG

Key observations

Scope of proposed requirements / Interaction with PRISM

While we note that the impact ratings from PRISM are reflected in certain requirements of CP73, we believe that this application of PRISM ratings highlights a more fundamental question, i.e. should the proposed requirements apply to Medium High and Medium Low Impact companies as currently envisaged? We consider that most of the requirements of CP73 are appropriate and necessary for High and Ultra-High Impact companies[1]. We consider the mandatory application of these proposed requirements to all other firms to be excessive.

The approach taken in CP73, whereby certain proposed requirements (e.g. peer review) apply to Medium High and Medium Low Impact companies less frequently than to High Impact companies may be inappropriate or unnecessary for many lower impact companies. We acknowledge that it is not practical for PRISM to classify firms to more granular level e.g. that might reflect higher or lower reserving risk or reserve volatility, therefore, given this challenge, we suggest that the requirements should be less prescriptive particularly for Medium High and Medium Low Impact companies.

We propose that Medium High Impact companies comply with the proposed requirements on a 'comply or explain' basis to reflect the specific circumstances of the entities e.g. how Signing Actuary role is delivered, how peer review is delivered, and the role of Risk function in assessing claims processes and risk margin. The Board of Directors would document how compliance has been achieved. We recognise the challenges for the supervisor with a 'comply or explain' framework as it does require the supervisor to assess and challenge what is being done and not being done.

There is a reasonable argument to be made that Medium Low Impact companies should fall out of the proposed requirements due to the nature of their business e.g. reinsurance, or due to the nature and profile of their claims reserves. Entities should be encouraged to consider many of the proposed requirements as best practice (including through Dear CEO letters or guidelines) though without the statutory prescription, thereby giving operational flexibility and discretion to the Board of Directors.

Furthermore, we believe that Low Impact companies should be out of scope of the proposed requirements.

To supplement this (with regard to Medium High and Medium Low Impact companies) we believe that a more focussed approach should apply as and when required. The CBI's supervisory toolkit, which includes significant powers through its Fitness and Probity regime and by way of powers granted under the Central Bank (Supervision and Enforcement) Act 2013, should enable it to address any concerns in the actuarial and reserving areas on a case-by-case basis.

[1] An alternative categorisation or definition of scope is the insurance / reinsurance classification; however we support the use of PRISM ratings as a means of defining scope in the knowledge that in general, large domestic insurers are rated High Impact, while reinsurance companies are usually a lower rating.

Clarity of proposals

We note that CP73 applies to non life (domestic and international) insurers, non life reinsurers and life reinsurers. As the requirements do not apply equally to all, though the references throughout CP73 are ambiguous, we would like to see three separate documents dealing with each sector specifically (and possibly four in the case of composite reinsurers if there are differences between life and non life reinsurance). This will make it easier for entities to fully understand their respective requirements when confirming compliance annually.

Potential improvements to achieve the regulatory aim

In our discussions internally and with our clients, the perception is that CP73 is designed to ensure there is not another failure of a domestic non-life insurance entity. It is not clear to us that CP73 will prevent a further failure. We have given thought to how the proposed requirements for High Impact companies could be enhanced to reduce this risk further without imposing a significant burden on lower impact companies.

For non life insurers, one of the largest reserve balances is outstanding claims where historically there has been limited supervisory scrutiny of booked estimates. The scrutiny of claim estimates being carried out by personnel from claims, finance as well as actuarial. We consider two areas of risk not adequately covered by CP73: subjectivity in setting case estimates and timely recognition of claims.

- Improved focus on case estimates could be achieved by requiring more formal reporting to the audit committee/ Board of Directors around case estimates. This could be performed by the member of executive management with responsibility for claims or the relevant PCF and be supported by a report setting out how they are satisfied with the accuracy of claims data provided to the Signing Actuary and may also form part of the regulatory return to the CBI.
- Issues with underlying claims data / case reserving for High Impact companies could be identified through collection and benchmarking of claims information from market participants e.g. frequencies and severities across lines of business and within various claims bands; actual vs expected development and prior year ultimate loss development triangles would assist in the identification of reserve adequacy issues. Results of benchmarking could also be made available to the Signing Actuary, the executive with responsibility for claims and the Board of Directors to assist them with their responsibilities.

We recommend that the Data Accuracy Statement be supplemented with the above analysis to reinforce the reserve adequacy assessment.

Transition to Solvency II

We note that since the issue of CP73, significant clarity has now been brought to the Solvency II project in terms of its implementation in 1 January 2016 and the technical basis for the calculation of Best Estimate liabilities with the finalisation of the Long Term Guarantee package. We see many areas of overlap between the purpose of the consultation/proposed requirements with EIOPA's Proposal for Guidelines on the System of Governance which we understand CBI will adopt in preparation for Solvency II. However, there are significant areas of conflict, or at best super-equivalence, with the proposed approach.

In particular, within the proposed requirements, the role of the Signing Actuary and the requirements attaching to the SAO and related report have been used as a vehicle to absorb many aspects of preparation (for example in respect of data) without regard to the role of Signing Actuary and attaching responsibilities not being present in Solvency I currently or Solvency II.

Furthermore, the preparatory requirements are principles based, proportionate and not subject to enforcement action, which seems to be at odds with the proposals which has a statutory footing and includes the threat of enforcement. In this regard it is worth reiterating that the aims of maximum harmonisation as envisaged by the Solvency II regime and in preparation for Solvency II will not be advanced by introducing such requirements.

As the industry transitions to Solvency II through 2014 and 2015 it will be important to avoid creating uncertainty on how the CBI's proposed requirements will transition into Solvency II post 1 January 2016. In particular: does the Actuarial Function Holder need to be an employee of a High Impact company; will the CBI make peer review mandatory under Solvency II – will this be a peer review of the annual AFH and/or ORSA reports; will re-calculations be required in any such peer review under Solvency II; will High Impact companies be required to produce annual Risk Margin reports or its possible equivalent. We would welcome further clarity on the CBI's thoughts on these aspects. We also believe that these are matters that should be discussed at an EIOPA level in the context of Solvency II.

Best Estimate and Risk Margin

We agree with the additional focus on risk and uncertainty. However, we consider the use of the term Risk Margin to be confusing particularly in the lead into Solvency II where the same term which has wider understanding and more general acceptance. We also note that the definition of Best Estimate is inconsistent with the Solvency II definition e.g. under Solvency II binary events are included in the Best Estimate and discounting is permitted. During the preparatory phase, with parallel running of Solvency I and Solvency II technical provisions, the use of the term Risk Margin and inconsistencies in the Best Estimate definition will cause confusion. We believe this to be unnecessary and extremely unhelpful.

Given the preparatory period to 1 January 2016 and significant work to develop and embed Pillar 1 technical provisions including risk margin, we would recommend that entities be permitted to disclose the equivalent Solvency II technical provisions and identify differences to the booked position under Solvency I. This would permit greater understanding of the Solvency II position and facilitate the discussion and challenge of solvency figures. This would supplement existing analysis of uncertainty which is included in current SAO reporting.

Signing Actuary as PCF

CP73 increases the level of responsibility on the Signing Actuary to provide assurance in relation to reserve adequacy and to assist the Board of Directors in its running of the company. We also note that the Signing Actuary role would be considered a PCF.

While we recognise the importance of the role, we would question whether it meets a reasonable interpretation of (or the spirit or intent of) the Central Bank Reform Act, 2010 whereby "*.....a* *pre-approval controlled function... if the function is one by which a person may exercise a significant influence on the conduct of a regulated financial service provider's affairs".*

Moreover, CP73 requires the Signing Actuary to act independently of the company. We note that this could be challenging for an employee in a High Risk entity without further guidance on what is meant by independence.

We recognise that the Appointed Actuary system is viewed as having worked well for direct life insurance companies in Ireland. Therefore, it is reasonable that the CBI should look to enhance the Signing Actuary role and assign more responsibility to the Signing Actuary for non life insurers. A key barrier to this working effectively for non life insurers is that there is no bifurcation of actuarial reserve calculations for accounting and regulatory purposes; the Appointed Actuary in a direct life company sets regulatory reserves on a basis which is typically significantly different to that used for accounting purposes. We believe that the independence and strength of the Appointed Actuary role is supported by the separate set of regulations when setting regulatory reserves which is not a feature for the Signing Actuary in non life entities.

Therefore, we consider that the classification of the role as a PCF and the requirement for a degree of independence may not be mutually exclusive, but in our view they are not entirely compatible. Based on the above, we would suggest that the PCF requirement be removed from the proposed requirements. We consider that professional qualifications, CPD requirements and the practising certificate regime address any perceived risks in this area.

Statutory auditor

As statutory auditors, we do not agree with the requirement that the Signing Actuary cannot be an actuary from the external audit firm for companies which are not High Impact under PRISM. As highlighted earlier, we consider many of the proposed requirements to be appropriate for domestic non life insurance companies including this restriction. However we do not believe the restriction is appropriate for reinsurance, captive and international insurance.

While there is a school of thought that separation of the Signing Actuary role from the external audit firm provides a more robust outcome, as auditors, our experience is that this is not the case. We are strongly of the view that the statutory auditor has significantly greater visibility and oversight and can challenge more rigorously the work of an actuarial colleague than he/she may be able to achieve in discussion with a third party. We firmly believe that the proposed restriction will not provide a better overall outcome for the company or the supervisor.

Other points to note include:

- Many Groups with subsidiaries in different jurisdictions (including Ireland) mandate the external auditor to coordinate the certification of reserves for Group reporting, for local statutory reporting and where required for regulatory certifications. A move to disallow this practice in one jurisdiction is an unnecessary hindrance for Groups.

- It is worth pointing out that it is not necessarily the case that the statutory audit partner in an audit firm will require a full reserve re-projection for an audit client if the Signing Actuary is external to the audit client, for Medium High/ Low Impact companies. In many cases, reliance can be placed on the external party acting as Signing Actuary and appropriate audit evidence can be gained through enquiry and review of the work of the Signing Actuary. It is important to understand that the level of audit work is determined by an assessment of the risks of material misstatement of the account balances being audited e.g. claims reserves, IBNR, funds withheld etc. It is at the discretion of the statutory auditor how they involve specialists, including actuaries, in arriving at their audit opinion. Therefore this may not achieve the aim of the CBI under CP73.

- Our experience where we are permitted (under auditor independence rules and clients requirements) to act as Signing Actuary in addition to the statutory auditor role is that the overall quality of reserve adequacy assessment is enhanced through closer working relationships across the audit team and improved visibility of issues around data and claims.

Role of Signing Actuary and peer reviewer

We consider the restriction in relation to the Signing Actuary role for non High Risk entities and peer review of all entities by an actuary from the external audit firm to be restrictive and without merit for all entities.

There is a trade off between cost and efficiency for the CBI receiving assurance from multiple parties examining actuarial reserves. We believe that the CBI should be receptive to companies' own choice of Signing Actuary/ peer reviewer rather than introducing restrictions in this area.

As noted above in the section on statutory auditors, our experience does not suggest that restrictions on the selection of Signing Actuary/ peer reviewer would produce a better overall outcome. Professional standards are applied with equal force to work and relationships within firms as are applied to third party relationships.

We note that actuaries can interpret peer review in many ways so further guidance should be provided on the scope of work expected by the CBI. We note that for High Impact companies a full recalculation is required. Indeed for many non life entities, this would be the typical approach to peer review. However, for life reinsurance companies, it would be impractical and costly to require a full recalculation so typically a focus on assumptions, methodologies, analysis of surplus and sensitivities would be more appropriate. We recommend that the requirements should accommodate the different approaches and the CBI sets out its expectations in this regard.

Finally, we would raise the need for explicit guidance on the prescription for peer review noting that in most cases the conditions would only take effect after coming into force of Solvency II and changes to the current regime thus potentially making them redundant.

Role of internal audit

We consider the requirement for an assessment of the reserving process to be reasonable. Further guidance may be required so that internal audit functions could understand the CBI's expectations in this area. It is likely that actuarial expertise will be required to supplement the internal audit function in these tasks. We note that this potentially introduces another actuarial party to the reserving process.

SAO report

We support the CBI's proposed reporting requirements.

We believe that it would be useful if the CBI sets out its observations on SAO reports on an annual basis. Such reporting can supplement the additional requirements and we believe that this would lead to an improvement in quality.

Focus on Pricing

CP73 is titled "Consultation on Requirements for Reserving and Pricing for Non-Life Insurers and Reinsurers". However, CP73 mainly addresses reserving processes. If there is a concern on pricing governance, processes and practices, then we believe that this would be better addressed in a separate CP or Dear CEO letter. Such an approach would allow the CBI to more clearly articulate and focus their concerns on pricing.

We would have concerns if the CBI were to become more prescriptive around pricing particularly in the international insurance and reinsurance sectors where entities will want freedom to make commercial pricing and capital allocation decisions consistent with their risk appetite and corporate strategy.

Comparison to other jurisdictions in terms of actuarial oversight

Based on our analysis of the proposed requirements on the roles of the actuary in relation to reserve adequacy over actuarial reserves with those in other jurisdictions including UK, Lloyds, Australia, Bermuda, Canada and the US, the scope and prescriptive nature of the proposed requirements would surpass those in place in these jurisdictions, other than possibly Australia where they might be viewed as on par. Where there is limited public interest (e.g. subsidiaries of global reinsurers), the CBI should appropriately consider the impact of the proposed requirements on the international insurance sector in Ireland.

Reporting deadlines

We note the Risk Margin Report shall be produced within 4 months of financial year end. This may not be possible as statutory returns are required by 30 April and companies may be making changes to this date.

We note that the Peer Review report is to be submitted to the Board of Directors no later than 6 months after the financial year end. This may not be possible as the SAO report is within scope of the peer review and it can be submitted up to 2 months after signing the opinion.

Overall we would recommend that the Board of Directors be provided with the above key reports in time for 30 April year ends.

Data

We have included some summary extracts below outlining the requirements of the various stakeholders in relation to data – and we believe the area of data to be critical to effective assurance on reserve adequacy. In general the checks that various parties are required to carry out are not clear. Guidance should be developed regarding data checks that are expected to be performed; this would also ensure consistency across companies.

We would be happy to discuss more generally the role of external audit on data and what we would typically expect to see and check from a best practice perspective.

Signing Actuary

"The Signing Actuary is required to perform reasonable checks on the data to test its accuracy and completeness."

The scope of data checks that the Signing Actuary should perform is not clear, for example does data consistency include consistency of case estimation philosophy?

It is important to ensure that the requirements are not based on unrealistic expectations regarding the actuarial areas of expertise.

As noted above where we act as Signing Actuary in addition to the statutory auditor role reserve adequacy assessment is enhanced through claims data checks which are performed and which we have visibility of.

Reviewing Actuary

"He/she is required to independently check the data provided by the company for this purpose."

The scope of data checks that the Reviewing Actuary should perform is not clear e.g. does this go beyond reconciliation to accounting / system information which the company and Board of Directors respectively have responsibility for. Should a sample of individual claim files be reviewed to reconcile case estimates to supporting information / to validate judgement of claims handlers? What reliance can be placed on company experts e.g. claims and IT functions?

Internal Audit Assessment

"Includes a review of the process around the preparation and submission of the data provided to the Signing Actuary. The purpose of this assessment is to provide reasonable assurance that the data is accurate and complete."

The scope of this review is not clear e.g. does the review strictly relate to the data flows through to booked reserves? Does it include some actuarial element or review of case estimates back to supporting information etc?

We recommend that further guidance be provided to elaborate on the CBI expectations as regards data.

Appendix 1

Drafting observations

We believe that the following sections of the consultation paper, which were either unclear to us or may be open to interpretation, would benefit from more detail and further explanation.

Paragraph 3

It is not clear whether or not the initial approval of all Signing Actuaries could be a significant undertaking for the CBI. Is grandfathering envisaged? Further guidance may need to be provided on the fitness and probity assessment e.g. the current Society of Actuaries practicing certificate regime to act as Signing Actuary differentiates in certain cases by certain lines of business, by domestic/ international and insurance/ reinsurance.

Paragraph 4

How will these requirements compare to the existing Signing Cert requirements?

What requirements will apply to Reviewing Actuary e.g. required to be a Fellow and member of SAI, required to hold a practicing certificate.

Appendix 1, Paragraph 9

For High Impact companies can the Chief Actuary and the Signing Actuary be the same person? Paragraph 47 implies that they can be.

Appendix 1, Paragraph 11

Some clarification is required:

- When does counting of the nine year period start from?
- Can the new Signing Actuary be from the same firm?

Appendix 1, Paragraph 12

The aim of the SAO is to provide a warning to the CBI should the reserves be inadequate in the Signing Actuary's opinion.

Is the CBI's definition of inadequate meant to mean that booked reserves are less than the Signing Actuary's Best Estimate or less than a Best Estimate and appropriate Risk Margin?

Appendix 1, Paragraph 19

Suggest re-wording from *"Companies shall ensure"* to remove reference to companies in relation to the SAO report content.

Appendix 1, Paragraph 19 part c.

Does *"approach"* cover methods used to derive ultimate losses or does it extend more widely for example: data segmentation, triangle construction, treatment of large losses, large loss thresholds etc.

Appendix 1, Paragraph 23

In this context are technical provisions case estimates?

Appendix 1, Paragraph 27 part e.

The Board of Directors for all entities that the proposed requirements apply to needs to consider the Risk Margin Report, paragraph 28 however states that this report is only required for High Impact companies.

Appendix 1, Paragraph 28 part c.

Does this cover the process starting from the Best Estimate to the booked reserve i.e. the booking process or does it include the full reserving process including the actuarial Best Estimate.

Appendix 1, Paragraph 28 part d.

We note where management disagree with the actuarial Best Estimate this may place pressure on the internal Signing Actuary to converge towards the management view, otherwise the management overlay / adjustment forms part of the Risk Margin as currently defined. We note that in this example an external Signing Actuary can more easily act with independence and freedom from commercial pressures than an in-house Signing Actuary.

Appendix 1 – Paragraphs 34-46 General comments

We recommend a pragmatic and flexible approach is taken to peer review as a one size fits all approach may not be suitable given the range of companies in scope.

It is not clear if peer review can be performed using Q3 data with a roll-forward to Q4. A detailed review at Q3 with Q4 roll-forward is effective because it can inform the year end booking and help ensure no surprises at year end.

For large Groups phased reviews should be considered. This would reduce the strain on capacity both for companies and actuarial service providers.

For larger entities the services of more than one actuary may be required.

If the information in the report underlying the SAO does not contain enough information for the Reviewing Actuary to form an assessment will supporting information be made available? Could this then lead into intellectual property issues?

Full re-calculation of the Best Estimate may not be value adding. A risk based review focusing on the material segments or sources of risk would reduce unnecessary inefficiency in the peer review process. Non – material segments could instead be tested rather than independently re-projected. In addition we consider that a review of the methodologies, assumptions and key judgements rather than a full recalculation of Best Estimate can be as effective and in some cases more effective.

We note that the Reviewing Actuary cannot be from the same firm as the external auditor. This exclusion is not clear as they can demonstrate independence. We note this requirement is inconsistent with other jurisdictions.

Appendix 1, Paragraph 36 part e.

This suggests the Reviewing Actuary of Medium High Impact companies should assess the governance around the production of the Risk Margin Report. The definitions section suggests that the Risk Margin Report is required for High Impact companies only and hence would not apply to Medium High Impact companies.

Appendix 1 – Paragraph 47

The CRO may be responsible for the Risk Margin Report and the CBI may therefore consider him/her as a member of the reserving committee.

Appendix 3 General comments

We note that the components of the Best Estimate and Risk Margin are prescribed. Based on our experience companies take different approaches based on their Reserving Policy e.g. some include allowance for possible but not yet published legislation in the Best Estimate and others in the margin. While consistency would make comparison easier for the CBI it may cause inconsistencies for Group reporting whereby the Group Reserving Policy definition of Best Estimate may differ from the CP 73 definition.

We recommend changing "Risk Margin" to an alternative such as "Margin for Uncertainty" due to possible confusion with the Solvency II risk margin.

CP 73 suggests that the components of the booked reserves are Best Estimate and Risk Margin for uncertainty, where the margin for uncertainty is built up based on explicit components such as statistical uncertainty and changes in claims environment etc.

In some cases management disagree with the actuarial Best Estimate e.g. they may feel that it does not allow sufficiently for all possible outcomes, for example, claims initiatives. A management adjustment or overlay to the actuarial Best Estimate may be applied. In this instance the "Risk Margin" as currently defined would include management adjustments. In this case the explicit enumeration of the Risk Margin required as part of the Risk Margin Report would include management adjustments. This may place pressure on internal Signing Actuaries to converge towards management views. We note that in this example an external Signing Actuary can more easily act with independence and freedom from commercial pressures than an in-house Signing Actuary.

Appendix 3 Paragraph 1.10

Expert judgement particularly around operational changes, underwriting and rating action not present in historic data is often applied when carrying out reserve reviews and this should be moved from explanatory text and included in the guidelines.

Appendix 3 Paragraph 1.7

Any pessimistic bias in the Best Estimate will be apparent in actual vs. expected analysis and should be addressed accordingly. The exclusion of optimistic factors may reflect favourable development that may not be expected to be repeated going forward e.g. period following introduction of IB.

Appendix 2

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