ACTUARIAL SOCIETY OF SOUTH AFRICA

APN 106 / 403: HEAD OF ACTUARIAL FUNCTION FOR SOUTH AFRICAN INSURERS

Classification

This Advisory Practice Note (APN) provides guidance for *Heads of Actuarial Function*, including *Members* who support or review this function or who act in a similar capacity, of South African life and non-life *Insurers*.

Abstract

The *Head of Actuarial Function* is responsible for expressing an opinion to the *Board* on specified actuarial matters within an *Insurer*, as well as providing advice to the *Board* on actuarial issues. These duties are described in this practice note and guidance is given on their application.

Purpose

The purpose of this APN is to provide guidance on the statutory duties and professional responsibilities of the *Head of Actuarial Function*, and those *Members* who support or review this function or who act in a similar capacity, for South African *Insurers*.

Legislation or Authority

Insurance Act (18 of 2017); and the Actuarial Society of South Africa.

Application

This APN applies to *Heads of Actuarial Function* who perform their duties in terms of the Insurance Act (18 of 2017) including *Members* who support or review this function or who act in a similar capacity. Additionally, *Members* responsible for the underlying work, on which the *Head of Actuarial Function* relies, should duly consider this practice note.

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Status

APN 106

Version 1	Effective from 1 July 2000
Version 2	Effective from 1 January 2004
Version 3	Effective from 1 July 2005
Version 4	Effective from 1 January 2012
Version 5	Effective from 31 December 2012
Version 6	Effective from 31 August 2018
Version 7	Effective from 1 December 2022

APN 403

Version 1	Effective from 31 August 2018
Version 2	Effective from 1 December 2022

Definitions

Act	Insurance Act (18 of 2017), including relevant amendments, Prudential Standards, regulations, *Prudential Authority* directives and guidance notes.
ASSA	Actuarial Society of South Africa.
Board	The term *Board* refers to the full *Board* of the *Insurer*, or a duly appointed committee thereof.
Control Function	A function, as defined in the *Act*, which forms part of an *Insurer*'s governance framework.
Distribution	A Distribution to shareholders as defined in the Companies Act (71 of 2008), which includes dividends.
Economic Capital	Economic Capital is an internal risk-based assessment of the capital required by an *Insurer* to withstand a loss in economic value over a specified time period, with a specific confidence level, calibrated to the risk appetite of the *Insurer*.
Eligible Own Funds	As defined in the *Act*.
Financial Sector Conduct Authority	Means the authority established in terms of the Financial Sector Regulation Act (9 of 2017).
Head of Actuarial Function	A Fellow of ASSA appointed by an *Insurer* in terms of the *Act* as the head of the actuarial *Control Function*.
Insurer	The insurance company (including mutual societies) writing life or non-life insurance business (as defined in the *Act*) in respect of which the *Head of Actuarial Function* is appointed.
MCR	The minimum capital requirement of the *Insurer* as determined in terms of the *Act*.
Member or Members	A member of ASSA as defined in the Code of Professional Conduct, or a member of another recognised actuarial association to whom this APN applies.
ORSA	Own Risk and Solvency Assessment required in terms of the *Act*.
Principles and Practices of Financial Management	Principles and Practices of Financial Management that are applied in the management of Discretionary Participation *Products*.
Product or *Products*	Any products written using the *Insurer*'s licence.
Prudential Authority	Means the authority established in terms of the Financial Sector Regulation Act (9 of 2017).

Prudential Supervision Reporting	Refers to results calculated for prudential supervision purposes as determined in terms of the *Act*, including any such results in the *ORSA* report.
Public Interest	Benefiting the general public or a large class of persons. Not something which only benefits one person or a small number of people at the expense of the general public.
Published Reporting	Refers to results prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board, and published in the annual financial statements.
Reasonable Benefit Expectations	The reasonable expectations of policyholders regarding future premiums, charges and benefits, based on the *Insurer's* marketing literature, communications to the policyholder and initial sales representations. For life insurance business, please also refer to the appendix: policyholder reasonable expectations – considerations for life *Insurers*.
SCR	The solvency capital requirement of the *Insurer* as determined in terms of the *Act*.
Solvency Capital Ratio	The ratio of the *Eligible Own Funds* to the *SCR* of the *Insurer* as calculated in the *Prudential Supervision Reporting*.
Technical Provisions	Insurance liabilities as determined in terms of the *Act.*

Sections

1. Introduction

1.1. This APN applies to both the *Head of Actuarial Function* and *Members* who support or review the *Head of Actuarial Function*, or *Members* who act in a similar capacity. Additionally, *Members* responsible for the underlying work, on which the *Head of Actuarial Function* relies, should duly consider this practice note.

1.2. The *Head of Actuarial Function* is responsible for expressing an opinion to the *Board* on specified actuarial matters within an *Insurer*, as well as providing advice to the *Board* on actuarial issues. Depending on the nature, scale and complexity of the *Insurer*, this work may comprise a range of activities that can be delegated to *Members* acting in support of, and who are accountable to, the *Head of Actuarial Function*. However, the reporting function, and in particular when providing opinions or advice to the *Board*, would be expected to be performed by one person, being the duly appointed *Head of Actuarial Function*.

1.3. Therefore, where reference in this practice note is made to the duties and responsibilities of the *Head of Actuarial Function*, this shall by extension also apply to *Members* who support or review the *Head of Actuarial Function* or *Members* who act in a similar capacity.

1.4. This APN covers both life and non-life *Insurers*. Some points may be more or less relevant to the one or the other kind of *Insurer*. In only a limited number of cases is a distinction between the two kinds of *Insurer* drawn in this APN. The *Head of Actuarial Function* should exercise their professional judgement in deciding which points are relevant for the *Insurer* they are advising, and which matters are deserving of more attention, bearing in mind the requirements of the *Act*.

2. Responsibilities of the *Head of Actuarial Function*

2.1. This APN makes reference to statutory duties which arise in terms of the *Act*, as well as professional responsibilities which stem from *ASSA*.

Statutory duties

2.2. Requirements relevant to the *Head of Actuarial Function*'s statutory duties are set out in the Prudential Standards under the *Act*. The rest of this APN provides more detailed guidance, where deemed necessary or desirable, for *Heads of Actuarial Function* in fulfilling the statutory duties. Where no guidance corresponding to the *Act* is provided in this APN, the *Head of Actuarial Function* is expected to apply their own professional judgement, or to discuss with the *Prudential Authority* or an appropriate senior *Member*.

2.3. The *Head of Actuarial Function* should be familiar with the requirements of the *Act*.

2.4. In particular, the *Head of Actuarial Function's* attention is drawn to the following obligations contained in GOI 3:

a) 'segregation of duties' in section 10.6;
b) 'independence' in section 10.7; and
c) 'whistle blowing' in section 10.10.

Professional responsibilities

2.5. The *Head of Actuarial Function* is reminded of their responsibilities under *ASSA*'s Code of Professional Conduct.

2.6. The essence of a profession lies in upholding its standards, technical and ethical, in the *Public Interest*. A *Head of Actuarial Function* who becomes doubtful as to the proper course of action to adopt in relation to a potentially significant problem is strongly advised to seek help and advice through the President or President-Elect of *ASSA*, or the *Prudential Authority* or the *Financial Sector Conduct Authority* as the case may be.

2.7. The *Head of Actuarial Function* should at all times act in recognition of the prominent role that the *Head of Actuarial Function* plays in the financial position of the insurance business of the *Insurers* in respect of which they are appointed, and the reliance that the *Board* places on the *Head of Actuarial Function*.

2.8. The *Head of Actuarial Function* should take reasonable steps to ensure access to:

a) the *Board* at appropriate times;
b) relevant committees or forums where actuarial matters, such as contained in this APN, are discussed;
c) all relevant information necessary for the fulfilment of their duties.

The *Board* is ultimately responsible for ensuring such access as per sections 10.7 and 10.9 of GOI 3.

2.9. The *Head of Actuarial Function* should take reasonable steps to attend any meeting where the *Head of Actuarial Function*'s own report is discussed, so that the *Head of Actuarial Function* may identify and address any areas of misunderstanding or concern that may arise.

2.10. The *Head of Actuarial Function* should bear in mind that depending on the purpose for which the *Head of Actuarial Function*'s report has been prepared, the report might be used by third parties.

2.11. The *Head of Actuarial Function* should take all reasonable steps to ensure that the *Board* understands when the *Head of Actuarial Function* is providing advice in accordance with statute (including Prudential Standards and regulations) or actuarial professional guidance, as opposed to providing advice or expressing opinion as an employee, director or external adviser, as the case may be.

2.12. The *Head of Actuarial Function* should pay due regard to generally accepted actuarial best practice including SAPs and APNs issued by *ASSA*. SAPs and APNs establish some elements of generally accepted actuarial best practice. The *Head of Actuarial Function* should also consider whether there are any other practices that may be considered as generally accepted actuarial best practice.

2.13. Where necessary and appropriate (for example assessing adequacy and effectiveness of controls, or maintaining risk registers), the *Head of Actuarial Function* may place reliance on the work of other *Control Function*s or on appropriate third party providers. The *Head of Actuarial Function* should clearly disclose when and where such reliances have been placed.

2.14. The *Act* does not require the *Head of Actuarial Function* to provide an opinion on Treating Customers Fairly (TCF). However, the *Head of Actuarial Function* may be exposed to market conduct and TCF matters in the performance of their duties. In doing so, the *Head of Actuarial Function* should be mindful of TCF and where they become aware of material TCF or market conduct risks or breaches, they should report these matters to senior management or the *Board* as appropriate.

<u>Reporting requirements</u>

2.15. The *Head of Actuarial Function* must provide regular reports to the *Board* on matters relating to their duties.

2.16. Such reporting can be a single overall report covering all the necessary requirements, or it can be made up of individual component reports completed at suitable points in the *Head of Actuarial Function's* work cycle. The intention is not to duplicate other reports presented to the *Board*. However, the *Head of Actuarial Function* should ensure that all the required tasks are reported on in some appropriate way at some stage.

2.17. The report should be produced at least annually or more frequently as the *Board* requires. Alternatively components of the annual report may be produced as and when required.

3. Appointment and termination

3.1. A *Member* must not accept an appointment as a *Head of Actuarial Function* if the *Member* does not have the appropriate knowledge and practical experience relevant to the *Insurer* and types of business concerned. Additionally, in order to be appointed as a *Head of Actuarial Function*, *ASSA* requires its *Members* to possess a life (for life insurance licences) or short-term (for non-life insurance licence) practising certificate relevant to the lines of business of the *Insurer*, and to ensure that they have met the relevant requirements of the Code of Professional Conduct and of Continuing Professional Development of *ASSA*. These requirements apply at initial appointment and continuously for the duration of the appointment.

3.2. A potential *Head of Actuarial Function* has a professional duty to consult with the present *Head of Actuarial Function* to determine if there are any professional reasons why the appointment should not be accepted. Permission from the *Insurer* to consult with the present *Head of Actuarial Function* should be obtained first. If the *Insurer* withholds such permission, it would be a material factor in deciding whether or not to accept the appointment.

3.3. Any *Member* has a duty to the profession. The *Member*'s responsibility to the *Insurer* must be consistent with this. The *Head of Actuarial Function*, however, is in a special situation in that the *Head of Actuarial Function* is being appointed and remunerated by the *Insurer*, while at the same time having responsibilities and obligations to the *Board* under the *Act*. These responsibilities may be in conflict from time to time and it would be important for any material conflict to be resolved via discussions with the *Insurer* and/or the *Prudential Authority* or *Financial Sector Conduct Authority* as the case may be.

3.4. Upon appointment, and where deemed necessary thereafter, the *Head of Actuarial Function* should inform the *Board* of the *Head of Actuarial Function*'s responsibilities in terms of this APN and the *Act*.

3.5. Under the *Act*, a *Head of Actuarial Function* who resigns or whose appointment has been terminated, must at the request of the *Prudential Authority*, notify the *Prudential Authority* in writing of any matter relating to the affairs of that *Insurer* or controlling company of which the *Head of Actuarial Function* became aware in the performance of the *Head of Actuarial Function*'s role, responsibilities, duties or functions, and which may prejudice the ability of the *Insurer* or controlling company to comply with the *Act*.

4. Opinion on adequacy of *Technical Provisions*, *MCR* and *SCR*

4.1. The *Head of Actuarial Function* must provide the *Board* with an opinion on the adequacy and reliability of the *Technical Provisions, MCR* and *SCR*. The objective of the opinion is to inform the *Board* that these calculations are accurate and that the assumptions are appropriate and are suitable to the *Insurer*, relative to the risks faced by the *Insurer*, *Products* sold, external environment, etc.

4.2. The opinion provided on the adequacy and reliability of the results should include an assessment as to whether the results have been calculated in accordance with the *Act*, with *ASSA* standards and with generally accepted actuarial best practice. The *Head of Actuarial Function* should advise the *Board* if any changes are needed to achieve compliance.

4.3. The *Head of Actuarial Function* should clearly state and explain any material concerns as to the adequacy of the *Technical Provisions, MCR* and *SCR*. This refers to the uncertainty about the ultimate outcome and the circumstances that might lead to the ultimate outcome deviating significantly from the assumptions underlying the *Technical Provisions, MCR* and *SCR*. The report should disclose how the *Head of Actuarial Function* has assessed the adequacy of the *Technical Provisions, MCR* and *SCR*. This should include disclosure of those factors, including risk drivers and assumptions made, which in the opinion of the *Head of Actuarial Function* have a material impact on the *Technical Provisions, MCR* or *SCR*, and, in particular, any material judgements made in the calculations.

4.4. The report should raise any issues that require the attention of the *Board*, particularly any material areas of uncertainty.

4.5. The *Head of Actuarial Function* should review, and sign-off where required, the relevant returns (quantitative and qualitative) to the *Prudential Authority*.

<u>Data</u>

4.6. "Data" refers to any data that is used in the calculations. The *Head of Actuarial Function* should be satisfied that the data used in the calculations are materially correct and complete to satisfy the objective that the calculation results are accurate. The *Head of Actuarial Function* should make clear what reliance has been made in making this assessment.

4.7. If the *Head of Actuarial Function* has doubts about the material correctness and completeness of, or is aware of any limitations in, the data used then the report should disclose this and the expected impact on the results or the reliability of the estimates. Such limitations might include its fitness for purpose, consistency over time, timeliness, or availability of relevant data. It should describe any approaches used to mitigate such shortcomings and disclose the nature and amount of any material adjustments made to the *Technical Provisions, MCR* or *SCR* in this regard. The *Head of Actuarial Function* should make a recommendation that such shortcomings are investigated and resolved.

4.8. The *Head of Actuarial Function* should be satisfied that appropriate data controls are incorporated into the valuation process, for example (where relevant):

a) Reconciliation to administration systems;
b) Reconciliation of movements over the period;
c) Reconciliation of data changes through the data cleaning process;
d) Reconciliation of data into and out of the models; and
e) Reconciliation of data to accounts (such as premiums and claims).

Assumptions

4.9. The assumptions used in the calculations can have a significant impact on the results. The assumptions are subject to a range of possible values all of which could be considered reasonable. The *Head of Actuarial Function* should consider whether the key assumptions, including the credit taken for any reinsurance or other forms of risk transfer or for management actions, are reasonable having regard to the *Head of Actuarial Function*'s own assessment of the risks inherent in the nature and conduct of the *Insurer*'s business and the financial strength of relevant counterparties.

4.10. In assessing the reasonability of the assumptions, the *Head of Actuarial Function* might consider the following actions, for example (where relevant):

a) Confirm that the assumptions used are in line with the agreed methodologies;
b) Discuss the sources, quality and credibility of the data used in setting assumptions;
c) Review any experience analysis performed to support the assumptions;
d) Review the approach/policy for setting assumptions;
e) Review the use of judgement in deriving the assumptions;
f) Review the assumptions which are outside the control of the *Insurer*, for example where dictated by external considerations. This could include elements such as inflation, exchange rate movements, litigation leading to delays in claim settlements, etc.;
g) Review the key assumptions underlying the calculations and explain their appropriateness in relation to the main drivers of risk likely to affect the (re)insurance obligations of the company;
h) Highlight those assumptions considered to exhibit a high degree of uncertainty and which have a material impact on the *Technical Provisions, MCR* or *SCR*;
i) Review the sensitivity of the results to changes in the key assumptions; and
j) Review stochastic reserving estimates that inform variability of the levels of technical provisions.

4.11. The *Head of Actuarial Function* should disclose any material changes made to the key assumptions used compared to the previous report, the impact of the key assumption changes, and any material changes in the sensitivity of individual key assumptions.

4.12. The *Head of Actuarial Function* should document any specific issues in relation to the assumptions which the *Head of Actuarial Function* considers should be brought to the attention of the *Board* – for example (where relevant):

a) Allowances for contractual options and guarantees and policyholder behaviour;
b) An assessment of how reasonable and verifiable the assumptions are in relation to future management actions;
c) The assumptions made in respect of amounts recoverable from counterparties, for example in respect of outward reinsurance, and the likelihood of such recoveries;
d) The interpretation taken by the *Head of Actuarial Function* in respect of any areas of discretion exercised by the company which might impact on its future (re)insurance obligations; and
e) The impact of specific management actions or undertakings that have a material impact on the assumptions, for example where management undertakes to cut expenses or increase volumes.

Methodologies and models

4.13. For methodologies not prescribed by the Prudential Standards the *Head of Actuarial Function* should review the methodologies used in the *Prudential Supervision Reporting* and why such methods were chosen, and explain how their appropriateness has been assessed with regard to the specific lines of business of the *Insurer* and the way in which it is being managed.

4.14. For methodologies prescribed by the Prudential Standards the *Head of Actuarial Function* should confirm that these are applied as prescribed.

4.15. Examples of items that could be considered in reviewing the methodologies are as follows (where relevant):

a) Descriptions of the nature of the cash flows being quantified, including the units, the time horizon and the projection steps;
b) Confirmation that the methodology used is suitable to the nature, scale and complexity of the business;
c) Descriptions of the methodology used, any shortcomings and future developments;
d) For life insurance, descriptions of how the methodology provides for policyholders' *Reasonable Benefit Expectations*, which should be interpreted in conjunction with the appendix: policyholder reasonable expectations – considerations for life *Insurers*; and
e) Descriptions of how any known future events are allowed for.

4.16. The *Head of Actuarial Function* should review any material changes in methods from those used in the previous report and the impact thereof. The *Head of Actuarial Function* should pay attention to any material non-standard techniques which have been used. The *Head of Actuarial Function* should also review any judgements made in relation to the definition and application of contract boundaries which have a material impact on the amount of the *Technical Provisions* or *SCR* held.

4.17. The *Head of Actuarial Function* should review the methodologies and assumptions used to do the calculations in cases where the data is insufficient and has prevented the application of a standard or prescribed actuarial method. The *Head of Actuarial Function* should comment on the appropriateness of the approach used for such situations, any limitations imposed by the techniques used and the additional resulting uncertainty. The *Head of Actuarial Function* might consider the following example items for this purpose (where relevant):

a) Why such approximations were used (e.g. insufficient data, materiality, model issues, etc.);
b) When the approximation will be removed and a formal model used (for some types of approximation);
c) Why the approximation is suitable;
d) The methodology used for the approximation;
e) The models used for the approximation;
f) The assumptions used for the approximation; and
g) The likely impact on the accuracy of the overall results.

4.18. The *Head of Actuarial Function* should review the models used in the calculations, highlighting any shortcomings, simplifications and approximations in the models used.

4.19. In assessing the models the *Head of Actuarial Function* should consider the control environment such as:

a) Sufficient user documentation to mitigate key person risk;
b) Controls over model storage and versions;

c) Controls used for model changes and checks performed; and
d) Controls incorporated into the use of the models.

Analyses of changes

4.20. The *Head of Actuarial Function* should compare expected results, and the assumptions underlying those estimates, against actual experience (e.g. experience analysis; analyses of surplus/changes in the *Technical Provisions, MCR* and *SCR*; trends in the *Solvency Capital Ratio* over time). The report should discuss instances where actual experience has deviated from the assumptions made in a material way, including explanations of these deviations. The report should distinguish between deviations which are judged to arise from volatility of the underlying experience and those which are viewed as impacting on the appropriateness of the data, methods or assumptions used. The report should disclose the conclusions from the process of comparing best estimates against actual experience, specifically in relation to the quality of previous estimates and any changes recommended in relation to the data, methods or assumptions used in the calculation of *Technical Provisions, MCR* or *SCR*.

SCR using (partial) internal models or insurer-specific parameters

4.21. For full or partial internal models, or the use of insurer-specific parameters, the relevant Prudential Standards define extensive reviews which need to be completed. Where the *Head of Actuarial Function* places reliance on a third party for the review of any approved model, this should be stated.

5. Review of financial position

5.1. The *Head of Actuarial Function* should evaluate and provide advice to the *Board* on the *Insurer*'s financial position, including the impact of any proposed allocation of profits, or shareholder *Distribution*. In any such report, the *Head of Actuarial Function* should present the results in a way that demonstrates the correct underlying position of the *Insurer*. All material valuation methods and assumptions should be stated. All material risks to the solvency and liquidity of the *Insurer* should be highlighted and explained to the *Board* unless these are reported elsewhere to the *Board* and this information remains valid.

5.2. The report presented to the *Board* should include *Published Reporting* and *Prudential Supervision Reporting* figures, and in particular, the *Solvency Capital Ratio* and a commentary on this ratio. The commentary should include an explanation for any significant changes (over time) in the ratio relative to previously reported figures, and its level relative to the risk appetite. Recommendations may also be included as to how the ratio can be improved if the ratio is considered to be at an unsatisfactory level. The extent and effect of any management action assumed in arriving at the *Solvency Capital Ratio* should be clearly explained.

5.3. The *Head of Actuarial Function* should consider the extent to which adequate systems of control are in place, appropriately documented, and regularly reviewed to enable appropriate valuation procedures to be correctly carried out and adequately recorded, to the extent that this is not already covered by the reviews in section 4 above.

5.4. The value to be placed on the assets is the responsibility of the *Board*. However, the *Head of Actuarial Function* should consider the extent to which adequate systems of control are in place to ensure that appropriate values are placed on the assets; in particular, that any adjustments to assets for *Prudential Supervision Reporting* are properly applied. If the *Head of Actuarial Function* considers that the systems of control are not adequate, the *Head of Actuarial Function* should draw this to the attention of the *Board* and, if necessary, recommend reserves in respect of the risk of over-valuation.

5.5. The *Head of Actuarial Function* should consider the liabilities, the corresponding assets, and their interrelationship, and be satisfied as to the resilience of the financial position of the *Insurer* in all reasonably foreseeable circumstances which might affect that position. This may include off-balance sheet items and contingent liabilities. Where there is any mismatching of assets and liabilities, the *Head of Actuarial Function* should consider the extent to which there is adequate provision in the value of the liabilities or in the *SCR* (avoiding double-counting) for reasonably foreseeable adverse movements in asset values or yields or policyholder behaviour.

5.6. In considering the robustness of the current or future financial position, or in monitoring the risks (see 5.9 and 5.12 below), the *Head of Actuarial Function* should consider the appropriateness of the stress testing performed (scenarios, stress tests and reverse stress tests) as well as the results of the stress tests and the implications for the business.

5.7. Where liabilities or *Economic Capital* are calculated using alternative methods for purposes other than *Prudential Supervision Reporting* (for example for internal, accounting or tax purposes), the *Head of Actuarial Function* should review an explanation of the differences between the various bases and results, and should advise the *Board* accordingly.

5.8. In providing advice to the *Board* where an *Economic Capital* model is used, the *Head of Actuarial Function* should also provide advice on the suitability of the *Economic Capital* model to the business. This may entail a full review of the *Economic Capital* methodology, data, assumptions, model, etc., as well as a consideration of the differences compared to the *SCR*.

Future solvency / ORSA Report

5.9. The *Head of Actuarial Function* should evaluate and provide advice to the *Board* on the future solvency of the *Insurer*. This can be done via an *ORSA* report or via alternative reporting that allows the *Head of Actuarial Function* to be satisfied with the future solvency of the *Insurer*. This report should include a summary of the results of the projections and commentary from the *Head of Actuarial Function* on matters such as the following (where relevant):

a) The capital requirements over the business planning horizon (allowing for the business plans) and the impact of the firm's capital management policy on the business;
b) The consequent impact of the capital requirements on the solvency position of the company;
c) The impact of any planned/expected *Distributions* or capital injections;
d) The key risks which may affect the projections and any actions which may need to be taken;
e) Any key or unusual features of the projections which imply future actions may be required (e.g. a tranche of business that matures in a particular period, reinvestment of assets in future, the impact of a new product launch, etc.);
f) Actions that could be taken if the solvency of the *Insurer* were to deteriorate;
g) Whether the *Insurer* does not, or may not, have sufficient financial resources to meet liabilities to policyholders as they fall due (keeping in mind policyholders' *Reasonable Benefit Expectations*) or, if the *Insurer* currently has sufficient resources but might, in reasonably foreseeable circumstances, not continue to have them;
h) Whether the I*nsurer* is or may be writing new business on inadequate terms;
i) The interaction between the business plan and future solvency; and
j) The results of stress and scenario tests.

5.10. The *Head of Actuarial Function* should confirm that the starting points for the *ORSA* projections are the *Technical Provisions* and *SCR* which have been calculated as at the valuation date (i.e. that the starting point is consistent with the *Prudential Supervision Reporting* balance sheet at that date). Some approximations or a roll forward methodology may be used if the *ORSA* starting point is different to the most recent valuation date, in which case the *Head of Actuarial Function* should review the roll forward methodology to ensure it is suitable and aligned to the projection methodology.

5.11. The possibility of insolvency, or intervention by the *Prudential Authority* on the grounds of the *Insurer* being unable to meet its *Technical Provisions, MCR* or *SCR*, may arise from a wide range of factors, some of which are within the control of the *Insurer* and some not. To the extent that they are under the control of the *Insurer*, the *Head of Actuarial Function* should assess the limits within which the *Insurer* should act and should advise the *Board* of the necessity for these limits. The *Head of Actuarial Function* should also consider all external factors outside the control of the *Insurer*, which could reasonably be foreseen to lead to insolvency, and should advise the *Board* on actions the *Head of Actuarial Function* considers necessary to protect the solvency of the *Insurer*.

Risk monitoring as part of the ORSA

5.12. The *Head of Actuarial Function* should assist and support the *ORSA* process in the identification and monitoring of the risks run by the *Insurer* to the extent that they may materially impact the *Insurer*'s ability to meet policyholder liabilities as they fall due (including policyholders' *Reasonable Benefit Expectations* in the case of life *Insurers*).

5.13. The *Head of Actuarial Function* should have regard to all aspects likely to affect the financial position of the *Insurer* materially in respect of its insurance business including the possible effect of any contingent liabilities should they crystallise. The information required, and the frequency of monitoring, will depend on the nature of the business carried out by the *Insurer*. The following list, which is not exhaustive, sets out the most common items of information which could be considered to monitor risks, particularly those of a financial nature. The *Head of Actuarial Function* should apply judgement to decide which items to consider and the frequency with which they should be monitored, and advise the *Board* appropriately. While the *Head of Actuarial Function* must ensure they are aware of and consider this information, it is not typically the responsibility of the *Head of Actuarial Function* to compile and report on the majority of this information:

a) the terms and conditions on which existing business has been written, and current new business is being written, with particular reference to all options and guarantees;
b) the existing investments of the insurance business and the continuing investment and asset-liability management policies, including the use of derivative instruments and the extent to which assets and liabilities are matched by term, by type and by currency;
c) the marketing plans, in particular the expected volumes and costs of sales;
d) the persistency of the business written both in the short and long term, and the terms for discontinuance;
e) for unit-linked policies, the pricing policy for internal linked funds;
f) the current and likely future level of expenses;
g) the current and likely future levels of mortality and morbidity for life *Insurers*;
h) for non-life *Insurers*, the expected frequency and severity of claims, claims ratios, catastrophe losses, cashback benefits, and the relevant rating factors;
i) the reinsurance and other forms of risk transfer arrangements;
j) the underwriting and associated claims handling arrangements;
k) the *Insurer's* policy in regard to the nature and timing of allocations of profits to policyholders and/ or shareholders;
l) the current and likely future taxation position of the *Insurer*;
m) the nature, extent and availability of the *Insurer's* surplus funds or capital;
n) the allocation of capital between business classes and the relevant cost of capital;
o) actual risk metrics relative to the *Insurer's* stated risk appetite, particularly with regard to underwriting and market risks; and
p) the systems of control which the *Insurer* has established, especially those relating to operational risk.

5.14. Where the *Insurer* uses the standardised formula to assess its risks, the *Head of Actuarial Function* should evaluate and provide advice to the *Board* on why that regulatory capital model is an accurate reflection of the *Insurer's* own risk profile, taking into account the *Board*-approved risk appetite (and related risk limits), and business strategy. Both qualitative and quantitative assessments can be used for this purpose. The following factors (where relevant) may be useful in making this assessment:

a) For each type of risk, the extent to which the *Insurer's* risk profile is expected to differ from the industry profile that would have been used to calibrate the standardised formula;
b) Consideration of material non-standard features of the *Insurer* (such as contained in: *Product* terms or guarantees; investments; capital structure; reinsurance arrangements, and so forth);
c) The significance of each risk type in the overall risk profile and *SCR*, with greater focus being placed on more significant risks;
d) The need to include allowance for additional risks that may not have been included in the standardised formula and the materiality of such risks on the overall capital requirements;
e) The results of stress tests that indicate higher or lower sensitivity to risks modelled in the *SCR*; and
f) The availability of internal and external data or models to validate the calibration of the *SCR*.

6. Shareholder *Distributions*

6.1. In terms of the *Act*, an *Insurer* shall not declare or pay a dividend if the *Insurer* fails or is likely to fail to maintain a financially sound condition (as determined in accordance with the *Act*). A dividend is one form of *Distribution*. The *Head of Actuarial Function* should consider all *Distributions*.

6.2. The *Head of Actuarial Function* should advise the *Board* on the impact of any proposed or actual *Distribution*. In this evaluation, the *Head of Actuarial Function* should consider the impact of the *Distribution* on the *Insurer*'s current *Solvency Capital Ratio* and on the *Insurer*'s ability to maintain a financially sound condition for the foreseeable future after the *Distribution*. The *Head of Actuarial Function* should also consider the impact of the *Distribution* on the liquidity of the *Insurer* and its ability to meet its obligations as they fall due. Where possible, the *Head of Actuarial Function* should express these views in writing to the *Board*.

6.3. The *Head of Actuarial Function* should advise the *Board* whether *Distributions* would result in a current or projected solvency position which may fall short of the *Insurer*'s minimum or target capital as stated in the company's capital management policies or risk appetite.

7. Opinion on stipulated policies

7.1. The *Head of Actuarial Function* is required to express an opinion on the appropriateness of the following policies of the *Insurer*:

a) Asset-liability management;
b) Underwriting; and
c) Reinsurance and other forms of risk transfer.

7.2. The *Head of Actuarial Function* must regularly review these policies and related matters and report on this to the *Board*. The frequency of reporting to the *Board* should be as required by the *Board* (typically on an annual basis, or when there are significant changes to the business).

7.3. In reviewing the policies, the *Head of Actuarial Function* should consider:

a) The requirements set out in the Prudential Standards;
b) The coverage of the policies, taking into account the nature, size and complexity of the *Insurer*;
c) Whether all areas relevant to the particular policy have been properly and consistently addressed in the policy; and
d) The policies in the context of the *Insurer*'s overall risk management framework.

7.4. The *Head of Actuarial Function* should assess whether the policies in question pursued by the *Insurer* are, or could become, inappropriate having regard to the current and expected future nature of the *Insurer*'s business. If this is the case, the *Head of Actuarial Function* should advise the *Board* of the changes to policy, and possibly short-term constraints on business, necessary to protect the financial position of the *Insurer*.

7.5. The *Head of Actuarial Function* is not expected to monitor the implementation of, and compliance with, the particular policies. This monitoring is more suited to other *Control Functions*.

<u>Asset-liability management</u>

7.6. The *Head of Actuarial Function* should consider the need for and extent to which the asset-liability management policy should consider (where relevant) matters such as:

a) Definitions of types of risk covered in the policy in the context of the *Insurer*'s own risk taxonomy;
b) Measurement of risk exposure taking into account the *Insurer*'s own risk appetite metrics;
c) Sources of asset-liability management exposures;
d) Principles and requirements for investment mandates;
e) Setting and monitoring of risk limits;
f) Reporting of risk monitoring process, particularly any breaches;
g) Operational structures and responsible committees and persons; and
h) Asset-liability management requirements for *Product* approval and pricing.

7.7. When considering the sources of asset-liability management exposure, the *Head of Actuarial* Function should consider all potential sources across the balance sheet, for example (where relevant):

a) Shareholder funds backing the *SCR*, the *Economic Capital*, and funds in excess of these requirements;
b) Subsidiaries of the *Insurer*;

c) Non-profit guaranteed policyholder liabilities;
d) Embedded financial options and guarantees;
e) With-profit policyholder liabilities;
f) Asset-liability management risk exposures affected by interactions with other risk types (e.g. insurance risk); and
g) Contingent liabilities and the emergence thereof.

Underwriting

7.8. The *Head of Actuarial Function* should consider the interaction between the underwriting policy, *Product* design, pricing, claims management and client expectations. In doing so, the *Head of Actuarial Function* should be mindful of the possibility that underwriting may take place at inception, during the life of a contract or at claims stage – and that the underwriting at these various stages should be consistent for a particular *Product* set.

Reinsurance and other forms of risk transfer arrangements

7.9. In addition to expressing an opinion on the appropriateness of the *Insurer's* reinsurance and other forms of risk transfer policy, the *Head of Actuarial Function* is required to express an opinion on the adequacy of the reinsurance and other forms of risk transfer arrangements. Reinsurance arrangements refers, for example, to the actual reinsurance treaties, structures, levels and reinsurers in place at a particular point in time.

7.10. In assessing the adequacy of reinsurance and other forms of risk transfer arrangements, the *Head of Actuarial Function* should review the arrangements in-force at the time of the review, as well as proposed arrangements over the coming year. The following should be considered (where relevant):

a) Whether the arrangements are consistent with the reinsurance and other forms of risk transfer policy, as well as the *Act*;
b) Whether the reinsurance or risk transfer programme is adequate to support the objectives of the business as defined in the business strategy, business plan/forecast, risk appetite and broader risk management;
c) The expected effect of the arrangements on current and future solvency;
d) Whether the data used for reinsurance or risk transfer purposes are of sufficient quality and fit for purpose;
e) Whether sufficient reinsurance has been placed by considering the sufficiency of the programme in terms of:
    i. Appropriateness of the programme to manage the risk of various large catastrophic events;
    ii. Capacity and retention of the programme;
    iii. Risks, perils, geographic accumulations;
    iv. Results of the stress and scenario tests;
f) Analysis of the historical use and outcomes of the reinsurance or risk transfer programme;
g) Identification of any limitations or gaps in the reinsurance or risk transfer programme;
h) Consideration of alternative reinsurance or risk transfer structures;
i) The credit-worthiness of reinsurers and the spread of reinsurers;
j) The process for assessing, selecting and placing reinsurance; and
k) Review of the models used to assess the sufficiency and appropriateness of reinsurance or risk transfer arrangements.

8. Review of *Product* design, premium rates and policy conditions

8.1. The *Head of Actuarial Function* should evaluate and provide advice to the *Board* on the actuarial soundness of product development and design, including the terms and conditions of insurance contracts; premiums; insurance obligations and other values; and the estimation of the capital required to underwrite the product. This should be done for new *Products* and for material changes to existing *Products*, including pricing reviews. This may be done via the *Product* approval process if this approval is performed by the *Head of Actuarial Function,* or via the pricing review process. In other instances, the *Head of Actuarial Function* could separately report to the *Board* on the *Head of Actuarial Function*'s opinion on the actuarial soundness of product development, pricing and design.

8.2. For new products, the *Head of Actuarial Function* should assess whether the product design and premium rates align with the *Insurer*'s business strategy, risk appetite, profitability criteria, and relevant policies (such as investment / asset-liability management, underwriting and reinsurance amongst others).

8.3. The *Head of Actuarial Function* should provide an opinion on whether the premium rates being charged for new or renewal business are appropriate and consistent with the requirements of the *Act*. In particular the *Head of Actuarial Function* should consider whether the rates are expected to be sufficient to enable the *Insurer* in due course to meet its emerging commitments under the policies, having regard to the items listed below (where relevant):

a) the terms and conditions on which existing business has been written, and current new business is being written, with particular reference to all options and guarantees;
b) the existing investments of the insurance business and the continuing investment and asset-liability management policies, including the use of derivative instruments and the extent to which assets and liabilities are matched by term, nature and currency;
c) the marketing plans, in particular the expected volumes and costs of sales;
d) the persistency of the business written both in the short and long term, and the terms for discontinuance;
e) for unit-linked policies, the pricing policy for internal linked funds;
f) the current and likely future level of expenses, including brokerage if applicable;
g) the current and likely future levels of mortality and morbidity for life *Insurers*;
h) For non-life *Insurers*, the expected frequency and severity of claims, claims ratios, catastrophe losses, cashback benefits, and the relevant rating factors;
i) the reinsurance and other forms of risk transfer arrangements;
j) the underwriting and associated claims handling arrangements;
k) the *Insurer's* policy in regard to the nature and timing of allocations of profits to policyholders and/ or shareholders;
l) the current and likely future taxation position of the *Insurer*;
m) the nature, extent and availability of the *Insurer's* surplus funds or capital;
n) the allocation of capital between business classes and the relevant cost of capital;
o) the appropriateness of the data and assumptions used for pricing purposes;
p) the historical adequacy of premiums and an assessment of the sufficiency in aggregate and by line of business;
q) the suitability of the methodology used for any predictive models;
r) the reasonability of modelling results and validations;
s) premium rates for similar products;
t) any relevant competitor information;
u) consideration of changes in economic conditions and the general external environment (for example economic, regulatory, legal); and

v) the results of techniques such as profit-testing, business plan projections, sensitivity tests and stochastic modelling.

8.4. The *Head of Actuarial Function* should highlight that it is impossible to be certain that a premium rate will be sufficient in all circumstances, because sufficiency depends on the future course of factors such as business volumes, claims experience, mortality, persistency, the return on investments and the *Insurer*'s expenses. The assumptions underlying these items are critical and the *Head of Actuarial Function* should provide an opinion on the appropriateness of the key assumptions.

8.5. When reviewing rates the *Head of Actuarial Function* should pay special attention to contracts involving policyholder options, including when circumstances could arise in which the policyholder or an intermediary could gain by surrender and re-entry.

8.6. When reviewing rates the *Head of Actuarial Function* should also consider the implications for the *Insurer* and for policyholders if future economic, demographic or business circumstances were to be materially different from those of today, particularly where the policy contains guarantees.

8.7. It may be that a premium basis, whilst commercially justifiable, will involve significant new business strain or high initial expenses. The *Head of Actuarial Function* should provide an opinion on whether the *Insurer* will have sufficient *Eligible Own Funds* to cover the necessary *SCR*, having regard to expected volumes of new business and the extent of the new business strain.

8.8. Should premium rates be such that business is expected to be written on terms which require ongoing support from the surplus funds or capital, the *Head of Actuarial Function* should assess the *Insurer*'s ability to continue to write business on such terms and must inform the *Board* of this, indicating any limits on the volume of business that may prudently be accepted.

8.9. It is not considered practical for the *Board* to also sign-off on each new *Product* or pricing review. However, the *Head of Actuarial Function* should advise the *Board* of new *Products* which have very different (or significantly larger) risks relative to existing *Products*.

8.10. When reviewing a new *Product*, the *Head of Actuarial Function* should look at proposed key marketing material and *Product* contracts, and consider whether what is shown in the marketing material and contracts is consistent with the terms of the *Head of Actuarial Function*'s review. Any material inconsistencies should be highlighted and recommendations made for changes.

9. Life insurance *Products*

Applicable to life *Insurers* only

9.1. In all the new *Product* reviews that the *Head of Actuarial Function* carries out, the *Head of Actuarial Function* should consider policyholders' *Reasonable Benefit Expectations*. In particular, the *Head of Actuarial Function* should consider policyholders' *Reasonable Benefit Expectations* with regard to:

a) The level of surrender values (and any penalties);
b) The level of bonuses declared (and the split between vested and non-vested bonuses); and
c) The level of fees, expense charges and risk charges.

9.2. The *Head of Actuarial Function* should also consider policyholders' *Reasonable Benefit Expectations* with regard to the above every time any of the above changes materially. *Reasonable Benefit Expectations* should not only be considered for discretionary participating business but also for linked business and reviewable risk premium business.

9.3. In addition, the *Head of Actuarial Function* should consider other relevant statutes when reviewing bonuses, reviewing premium rates and policy conditions, and when considering policyholders' *Reasonable Benefit Expectations*.

9.4. Obligations to policyholders include the need to treat customers fairly, taking into consideration policyholders' *Reasonable Benefit Expectations* in general, as well as the *Insurer*'s *Principles and Practices of Financial Management* where applicable. The *Head of Actuarial Function* should inform the *Insurer* of the *Head of Actuarial Function*'s interpretation of the *Insurer*'s policyholders' *Reasonable Benefit Expectations*. In general terms this interpretation should have regard to the broad nature of the *Insurer*'s practices and business plans and its approach to the treatment of policyholders both individually and (where appropriate) collectively as a group vis-à-vis shareholders. When a material change is likely to take place in the *Insurer*'s business plans, practices or other circumstances, the *Head of Actuarial Function* should inform the *Insurer* of the implications for fairness and the *Reasonable Benefit Expectations* of its policyholders.

9.5. Some *Insurers* may include in their policy documents a statement that certain terms or charges will be determined by the actuary or other similar wording. For example, expense charges and mortality and morbidity charges may be treated in this way, as may market value adjustments to smoothed bonus contracts. In reviewing such terms, or in providing advice to the *Insurer* in this area, the *Head of Actuarial Function* should have regard to policyholders' *Reasonable Benefit Expectations*.

9.6. The *Head of Actuarial Function* should be satisfied that all discretionary elements of unit pricing and fund charges are applied in a manner that is consistent with policyholders' *Reasonable Benefit Expectations* as well as the *Insurer*'s *Principles and Practices of Financial Management* where applicable. For these purposes the *Head of Actuarial Function* should have regard, inter alia, to the tax position of the business and to the expected future growth or decline of the particular fund.

9.7. As part of the *Product* design and policy conditions approval process, the *Head of Actuarial* Function should be satisfied that surrender values, if applicable, meet any legislated minimum requirements.

9.8. Where a distinction is made between the premiums, benefits or other values of different policies, the *Head of Actuarial Function* should be satisfied that the distinction is actuarially justified.

9.9. Clearly it is impractical to express an opinion on the actuarial soundness of each individual premium rate for group business. However, the *Head of Actuarial Function* should review and express an opinion on the actuarial soundness of the group rating basis and methodology.

10. Non-life insurance *Products*

Applicable to non-life *Insurers* only

10.1. The approach to considering the actuarial soundness of products and premium rates will vary between *Insurers*, classes of business and *Products*, depending on the nature, scale and complexity of the underlying business and rating approaches. In many cases it may not be feasible or possible to review the underlying technical rating models in detail. However, the *Head of Actuarial Function* may still be able to obtain the desired level of comfort by considering qualitative and/or quantitative aspects such as:

a) The development of actual underwriting experience as compared to that anticipated or targeted in the pricing approach. This could also include consideration of deviation from technical rates (for example through discretionary discounts) and whether outcomes can be clearly and objectively explained.
b) The distribution of and trends in resultant loss ratios, for example by class of business, product, underwriting period, geographical region, policy duration, etc.
c) The process and associated controls underlying the rating approach. For example relating to data, allowance for unique or pertinent product features, incorporation and testing of expert judgement etc.
d) The process for monitoring and, where appropriate, reacting to underwriting experience.
e) The approach to revisiting and updating technical rating frameworks and models, including documented processes, roles & responsibilities, controls and governance. This may include consideration of whether the insurer has a formalised process for periodically reviewing the ongoing appropriateness of rating models.
f) The controls and governance around implementing proposed rates. For example governance regarding the level of management oversight, peer review and *Board* approval required for implementing rates (whether new or existing business).
g) The pricing strategy and incorporation of metrics such as targeted loss ratios, underwriting margins, return on capital, solvency levels, etc. This would typically differentiate between new and renewal business. Furthermore the consistency of selected key metrics with the insurer's risk appetite should be considered.
h) Considering movements key outputs of models following changes to assumptions or model structure.
i) Where rates are significantly driven by expert judgment (e.g. large, unique corporate risks), consideration should be given to how the selected rates were objectively tested, benchmarked or validated prior to adoption.
j) Whether the rating approach gives due consideration to nature and levels of reinsurance in place.

11. Review of profit allocations

Applicable to life *Insurers* only

11.1. The *Head of Actuarial Function* should evaluate and provide advice to the *Board* on the awarding of bonuses to policyholders. This should be done for final bonus declarations and for material changes to interim bonus rates. This may be done via the bonus recommendation process described below if this recommendation is made by the *Head of Actuarial Function*. In other instances, the *Head of Actuarial Function* should report separately to the *Board* and provide an opinion on the awarding of bonuses to policyholders.

11.2. The *Head of Actuarial Function* should review the calculation of any excess of the assets maintained in respect of the *Insurer*'s life business over its liabilities attributable to that business. If rights of any life business policyholders to participate in profits relate to a part of such a fund, any excess that relates to that part should be reviewed to determine whether it is in accordance with the applicable *Principles and Practices of Financial Management*.

11.3. The *Head of Actuarial Function* should advise the *Board* on the extent to which it would be appropriate to distribute any excess of assets over liabilities to policyholders or transfer it to shareholders and to make recommendations for its specific allocation in accordance with the applicable *Principles and Practices of Financial Management*.

11.4. In reviewing recommendations in respect of any proposed allocation of profits the *Head of Actuarial Function* should consider, among others, the factors listed in paragraph 5.13 above (where relevant), and should carry out appropriate financial reviews including an appraisal of the relevant past experience.

11.5. In the report that includes the recommendations, the *Head of Actuarial Function* should ensure that there is sufficient information and discussion about each factor and about the results of any financial reviews to justify, and enable the *Board* to judge, the appropriateness of the recommendations and for the *Board* to understand their implications for the future course of the *Insurer*'s business. Typically the report would state (where relevant) the *Head of Actuarial Function*'s:

a) conclusions from the appraisal of the relevant experience including, if asset share techniques are used, the way in which the recommendations are derived from those techniques;
b) understanding of the *Insurer's* financial and business objectives;
c) assessment of the *Insurer's* ability to cover its *SCR* with sufficient *Eligible Own Funds* following the recommended allocation of surplus;
d) interpretation of legal advice given to the *Insurer* constraining or potentially constraining the *Board's* discretion when allocating surplus and how this has been reflected in the recommendations;
e) interpretation of policyholders' *Reasonable Benefit Expectations*. Such expectations are influenced by the *Principles and Practices of Financial Management, by* policy and marketing literature and other publicly available information, and by past and current bonus declarations.
f) opinion of the extent to which it is appropriate to distinguish between groups of participating policies having regard inter alia to the nature of the policies, their duration and their relevant pooled experience, and taking account of (d) and (e) above; and
g) opinion of how the recommendations maintain fairness between different categories of policy or policyholder and between policyholders and the *Insurer*.

11.6. The extent of information and discussion appropriate for any factor in 11.5 above will depend upon the extent to which, if at all, the factor has been covered in a report formally presented to the *Board* in the previous eleven months. In particular, the *Head of Actuarial Function* may report in an appropriately abridged form when interim or terminal bonus rates are being reviewed during the year.

11.7. If the recommendations anticipate the results of a determination of surplus (e.g. a declaration is proposed prior to the finalisation of results), the report should include the estimated results of the determination and state the nature of the estimation.

11.8. The *Head of Actuarial Function* should review the relationship between the recommended allocation and recent and expected future experience (economic, demographic, etc.). In the case of with-profits or smoothed-bonus business, the report should address bonus prospects, including terminal, final or non-vesting bonuses given the current level of the bonus stabilisation reserve. If the recommended allocation is excessive relative to the recent and expected experience (apart from any non-recurrent elements) and if the continuation of this relationship in future years could result in a material deterioration in the bonus stabilisation reserve, the report should indicate whether and how this could appropriately be avoided, taking policyholders' *Reasonable Benefit Expectations* into account.

11.9. Where, in the opinion of the *Head of Actuarial Function*, there is uncertainty regarding the extent to which the *Board* can exercise its discretion when allocating surplus, the *Head of Actuarial Function* should ensure that the report states the nature of the uncertainty, the assumptions made with regard to the uncertainty when making the recommendations and the consequences were the uncertainty to be resolved differently.

11.10. The affordability of bonuses and the adequacy of the bonus stabilisation reserve should be reviewed at least annually. A report should be made available to the *Board* covering these issues. This may be done in conjunction with the report covering the review of the financial position of the *Insurer* (see paragraphs 5.1 to 5.8 above).

11.11. In cases where bonuses are declared frequently during the year (for example, monthly), a written report is not required every time the bonus changes as long as the methodology followed and the *Head of Actuarial Function*'s opinion thereon is provided to the *Board* on at least an annual basis.

11.12. In the event of the *Board* approving higher or lower bonus rates than those reviewed by the *Head of Actuarial Function*, then the *Head of Actuarial Function* should inform the *Board* of the expected impact of the deviation, for example:

a) The impact the deviation has on the financial position of the company;
b) The impact the deviation has on the future policyholders' *Reasonable Benefits Expectations*; and
c) How the declaration relates to current policyholders' *Reasonable Benefits Expectations*.

11.13. If requested by the *Board*, the *Head of Actuarial Function* should provide an opinion on the *Principles and Practices of Financial Management* or material changes to these. This opinion would typically consider the implications for the items listed in paragraph 11.5 above.

12. Transfers of business and other significant transactions

12.1. The *Head of Actuarial Function* must provide the *Board* with an opinion on the soundness of any transfer of business or other significant transaction, as set out in the *Act*. Such transactions comprise: transfers of business; disposal of all or a greater part of the assets of the *Insurer*; amalgamation or merger; scheme of arrangement; or compromise with creditors.

12.2. The *Head of Actuarial Function* should consider the potential conflicts of interest that may arise in such situations, and should manage these conflicts appropriately. For example, material conflicts must be fully disclosed to all *Boards* involved and in all reports produced (refer to *ASSA*'s Code of Professional Conduct). Where in doubt, the *Head of Actuarial Function* is advised to seek appropriate professional guidance.

12.3. The *Head of Actuarial Function* should take all reasonable steps to ensure that they have sufficient time and information to provide the required opinion. Where this is not fully possible, the report may require appropriate qualification.

12.4. For the purposes of the required opinion, "soundness" may be defined as the ability to maintain post-transaction a financially sound condition on the *Prudential Supervision Reporting* basis, as determined in accordance with the *Act*. This does not preclude the *Head of Actuarial Function* from advising the *Board* on the likely effects on other bases or results (such as *Published Reporting* or *Economic Capital* for example).

12.5. In forming the opinion, the *Head of Actuarial Function* should consider the guidance in sections 4 to 6 above, mutatis mutandis. In particular, the likely effects on future solvency should be considered.

12.6. The work done may overlap with that of an out-of-cycle *ORSA* which is triggered as a result of the proposed transaction. However, the *Head of Actuarial Function* must provide a separate report on their opinion.

12.7. In addition to providing an opinion on the soundness of the transfer or transaction, the *Head of Actuarial Function* should also consider advising the *Board* of the likely effects of the transfer or transaction on current and future policyholders of the *Insurer*. The guidance in sections 8 to 10 above may have relevance in this regard. For example, in the case of a transfer, consideration should be given to whether any group of policyholders, both transferring and remaining, might be disadvantaged by the transfer. In such cases, the *Head of Actuarial Function* may provide recommendations to the *Board* on the fair treatment of policyholders of the *Insurer*.

12.8. In preparing the report, the *Head of Actuarial Function* must bear in mind that such a report could be made available to various stakeholders. In particular, a report is required as part of the application to the *Prudential Authority*. The *Head of Actuarial Function* should consider preparing separate reports for separate stakeholders where this is deemed necessary.

12.9. While not an independent actuary, as contemplated in APN 108, the *Head of Actuarial Function* should have regard to the guidance in APN 108 where relevant and appropriate. Additionally, where relevant, the *Head of Actuarial Function* may consider the guidance in APN 109. APN108 and APN109 are currently written for life *Insurers* but may have relevance to non-life *Insurers*.

Appendix: Policyholder reasonable expectations – considerations for life *Insurers*

The principles in this appendix are copied from section 2.5 of SAP104 version 10. Any terms used in this appendix are from SAP104 version 10 rather than from this APN.

1. The reasonable expectations of policyholders cannot be defined in watertight terms. They will depend upon, inter alia, the type of product, the insurer's historically established practices, the manner in which benefits are quoted and presented to policyholders and expectations created by marketing material.

2. An overriding principle is that in the calculation of the liabilities, account needs to be taken of those expectations that in the actuary's opinion should influence the long-term insurer when deciding on future distributions of surplus.

3. In order to encourage consistent interpretation of policyholder reasonable expectations, the following guidelines are provided:

    a) Policyholders expect all contractual benefits to be paid and obligations to be met.
    b) Holders of market-related policies expect to participate in the unsmoothed investment performance of the underlying asset portfolio. For this purpose market-related policies are defined as those where the end benefits are held out as being linked to the value of an asset portfolio, either explicitly or implicitly.
    c) Holders of smoothed bonus policies expect to participate in the smoothed investment performance of the underlying asset portfolio as described in marketing literature.
    d) In the absence of anything to the contrary, holders of with-profit and smoothed bonus policies (as described in marketing literature) expect over the medium term (three to five years) to receive an equitable share of the investment performance and, where applicable, other profits and losses that are earmarked for policyholders by the insurer.
    e) The insurer may have made specific and clear announcements or taken action to change previously created expectations.
        i. The actuary will need to consider what expectations have been created and whether the insurer has taken clear action to change any previously held expectations to determine which expectations need to be taken into account in the valuation.
        ii. The following are some of the specific ways in which expectations are frequently created:
            - Where there is a history of maintaining bonus rates or strong smoothing of bonus rates over a sustained period, policyholders will expect that the same approach will apply in the future, given a continuation of past and current circumstances.
            - The illustration of future values assuming the maintenance of bonus rates creates an expectation that those rates will be maintained, given a continuation of past and current circumstances.
    f) In the case of reversionary bonus policies, it is not acceptable to discount future benefits at high interest rates without allowing for the corresponding bonuses that could be supported under such conditions.
        i. If the actuary considers that policyholder expectations have been created in respect of projected values or bonus rate maintenance, to the extent that the long-term insurer would need to take cognisance thereof in future surplus distributions, the full maintenance of the implied bonus rate must be assumed. If the actuary considers that no such expectations have been created, the full maintenance of the level of bonus rates that may reasonably be expected under conditions consistent with the investment return assumptions may be assumed.

ii. The full amount of non-vested bonuses that have already accumulated or would be paid out on death, must always be valued. In addition, depending upon circumstances, future additions to such bonuses need to be assumed at levels consistent with investment return assumptions (for example, where the amount of bonus depends on a scale that is related to duration).