

Comments Template on CEIOPS-CP xx Draft proposal for Level 3 Guidance on the System of Governance		Deadline 18.03.2011 12:00 CET
Name of Company:	Groupe Consultatif Actuariel Europeen	
Disclosure comments:	of CEIOPS will make all comments available on its website, except where respondents specifically request that their comments remain confidential. Please indicate if your comments should be treated as confidential:	Confidential/Public
<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ Do not change the numbering in the column "reference". ⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a paragraph, keep the row <u>empty</u>. ⇒ Our IT tool does not allow processing of comments which do not refer to the specific paragraph numbers below. <ul style="list-style-type: none"> ○ If your comment refers to multiple paragraphs, please insert your comment at the first relevant paragraph and mention in your comment to which other paragraphs this also applies. ○ If your comment refers to sub bullets/subparagraphs, please indicate this in the comment itself. <p>Please send the completed template, <u>in Word Format</u>, to secretariat@ceiops.eu. Our IT tool does not allow processing of any other formats.</p> <p>The numbering of the paragraphs refers to Consultation Paper No. 83 (CEIOPS-CP-83/10).</p>		
Reference	Comment	
General Comment	Groupe Consultatif generally welcomes this paper as useful guidance to firms and supervisors which is written in practical terms at about the right level of detail. The paper is substantially silent on the place of external auditors within the governance system – is this to be the subject of a separate paper?	

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2.2.		
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2.5.	<p>The actuarial function (AF) interacts with a number of different functions and roles (the undertaking, the risk management function, the compliance function, the internal audit function, the general management, the external auditor, the public).</p> <p>The interpretation of independence can be different in function of the different tasks. Given the different impact of each of these tasks and the corresponding place of the AF in the organisation, the independency objective will lead to different issues:</p> <p>Operational involvement or not External or internal</p> <p>Article SG10(12) of Chapter X of the Level 2 regulations (Working document EIOPC/SEG/IM1/2009/REV1 of 27 January 2010 Draft Commission Document on System of Governance), in referring to the Actuarial Function required under Article 48 of Directive 2009/138/EC, states that "The persons involved in the actuarial function must have a sufficient level of operational independence". This operational independence and how it might be safeguarded and communicated is discussed below.</p> <p>Operational independence, in the context of the work of the actuarial function, might be described as the ability to analyse and to make relevant decisions (within the areas of competence of the function set out in Article 48) without being unduly or inappropriately controlled, constrained or influenced by the management or Board of the company or by any other function. Operational independence is compromised if there is any form of pressure on the persons carrying out the actuarial function to make a particular decision on the data, methods, assumptions, or results of their work.</p>	

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Clearly this does not mean that the actuarial function should carry out its work in isolation, since, in order to carry out the task in an effective manner, those performing the actuarial function will need to consult widely with others within the company and still others outside of the company (including the external auditors). However, in order to maintain operational independence the actuarial function should retain ultimate responsibility for deciding how to interpret the data, what assumptions and models to use, how the work should be carried out and what conclusions should be drawn.

Operational independence is a question of thought and process and does not necessarily prejudge matters of location, employment status or reporting structures. However, in order to express an opinion on work carried out by others, as is implicit in the requirements of Article 48(g) and (h) in relation to the overall underwriting policy and the adequacy of reinsurance arrangements, the actuarial function should preferably stand outside the parts of the firm and the reporting structures where the decisions on underwriting policy and reinsurance are first taken.

Operational independence implies objectivity, which in turn means taking decisions based objectively on the available data, relevant collateral information and all the circumstances of the case, whilst ignoring irrelevant considerations. The actuarial function should be able to take into account different views, including those of other technical experts and the firm's management, and come to conclusions which are not inappropriately biased towards any particular position advocated by those consulted, but which represent the objective professional judgement of those carrying out the actuarial function, having taken into account all relevant considerations.

There should be an obligation on the insurer to have in place sufficient safeguards to prevent undue influence with respect to the performance of the relevant duties and responsibilities for any functions which are required to have operational independence. The insurer should have adequate policies and procedures to ensure that this is demonstrably the case.

Operational independence should be supported by ensuring that appraisal and remuneration decisions in respect of the actuarial function are taken by or are transparent to non-executive Directors.

Prerequisites for operational independence

In order to carry out any of the tasks set out in Article 48 with a sufficient level of operational independence, the actuarial function will need to have a deep knowledge and understanding of the firm and its business and the operational freedom to ask questions of whomsoever questions need to be

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asked, to collect information from inside and outside the firm and to form their own judgements about the responses.

In order to form an objective and independent view in coordinating and overseeing the calculation of technical provisions, the actuarial function will need to understand well the factors influencing the data and the probable evolution of liabilities under the contracts for which technical provisions are to be determined.

In order to express an operationally independent opinion on the overall underwriting policy, the actuarial function will need to have a deep knowledge of the products issued by the firm and the nature of the risks underwritten, as well as unrestricted access to all the information required. The actuarial function will need to understand well the underwriting and pricing processes and the potential implications of the risk classification adopted for future claims experience under the contracts.

In order to express an operationally independent opinion on the adequacy of reinsurance arrangements, those performing the actuarial function will need to have a deep knowledge of the nature of the risks underwritten by the firm, both currently and in the past, and hence the potential exposure to large claims, to aggregations of claims and generally to adverse experience. The actuarial function will also need to have unrestricted access to the details of the firm's reinsurance program, the negotiations preceding the conclusion of reinsurance treaties, and full information about the financial strength of the reinsurers used and the risk that one or more of them may be unable or unwilling to pay claims in full and in a timely fashion.

Operational independence of the actuarial function implies a thorough knowledge of management thinking, analysis and strategy, but without an obligation slavishly to follow management directions where this might conflict with professional judgement or threaten independence. It involves the exercise of professional judgement, informed by education, experience and ethical standards, and the ability to analyse all relevant aspects of the situation objectively in order to come to a conclusion.

Operational independence of the actuarial function implies the ability to present ideas and results directly to the Board and to express directly to the Board any concerns about management actions, data management or procedures which, in the opinion of those performing the actuarial function, might limit or distort objectivity in data collection, analysis or calculation.

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2.12.	<p>Guideline 12 talks of fitness. The actuarial profession sees a need for standards to make it more practicable to evaluate the fitness.</p> <p>The aims of a standard-setting process within the Groupe Consultatif might be summarised as follows:</p> <p>To establish, review and maintain professional and other standards to support the carrying out of actuarial activities in relation to Solvency II, with a view, in the public interest, of promoting high quality actuarial practice and convergence of practice between actuaries in the member states of the EU.</p> <p>To ensure that standards serve the needs of users of actuarial information, in particular the management and Boards of insurance undertakings, and give confidence to financial supervisors, policyholders, shareholders and other stakeholders that actuarial work under Solvency II has been carried out by competent persons in a way which is objective, transparent, without conflict of interest, consistently over time and from company to company, regardless of geographical location within the EU.</p> <p>To supplement at a greater level of technical detail the Level 1 and Level 2 measures relating to Solvency II, in line with the principles set out therein, so that the standards can be more easily revised and updated to accommodate changing circumstances.</p> <p>To involve all stakeholders in an effective, open, transparent and responsive consultation process, so as to achieve the greatest possible stakeholder buy-in to the standards which are put in place.</p> <p>To assist all actuaries within the EU to be able to operate within a common professional framework for Solvency II.</p>	

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To promote and support the role of actuaries in a wide range of activities under Solvency II.

The current draft of Article SG10(1) of Chapter X of the Level 2 measures states that "CEIOPS shall adopt, following a period of public consultation, European actuarial guidelines on technical issues, taking into account the standards set in national and international actuarial associations" The recitals to Chapter X expand on the guidelines concept by stating that "European actuarial guidelines include principles and rules on methodologies, data reconciliations, assumptions and reporting that are used and produced by the actuarial function."

The Groupe Consultatif has suggested some modifications to these texts, in particular to propose that 'adopt' should be replaced by 'endorse' and that a modified version of the text of the recital be incorporated in Article SG10(1). We would also suggest that the Level 2 text reference exclusively to technical standards is not entirely faithful to the Level 1 text, where explicit reference is made to 'professional and other standards'. It is likely that the Level 2 text will undergo further changes before it is finally adopted.

The Groupe Consultatif broadly supports the Commission proposal, although we believe that international actuarial associations should be given a stronger role in the development of technical standards for the actuarial function than suggested, as this will help to ensure that they are appropriate and proportionate for the function. Relevant actuarial standards will in any case be developed by the actuarial profession (or specific standard-setting bodies for the actuarial profession that may exist in some countries), both at the international and national level, subject to a due process which will involve appropriate consultation with the insurance industry and with those affected by the work of the actuarial function, such as policyholders and regulators.

As expressed by IAIS, in its guidelines, "the use of actuaries as part of a supervisory model" guidance paper, approved in Singapore on 3 October 2003, Conclusion #13: "The nature of the professional associations should influence the supervisor's dependence on a responsible actuary. For instance, where professional codes of conduct, standards of practice and disciplinary procedures are in place, the supervisor may place greater reliance on these persons. The professional associations can also provide a forum for development of technical aspects of the actuarial role. In any event, the supervisor has a role to ensure that practices are adequate and subject to review."

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Some relevant standards are already in place at national level. EIOPA should have an obligation to build on such national and international standards, as would be expected for International Financial Reporting Standards, and not just 'take them into account', inter alia to avoid the potential for conflict with professional standards.

Some of the required guidelines are expected to be developed by the International Actuarial Association (IAA), which has established a standard-setting structure with a view to preparing generic actuarial standards for international usage, as well as specific standards for use in connection with the implementation of IFRS4 (revised). The guidelines which are more specific to the tasks of the actuarial function under Article 48 will be developed by the Groupe Consultatif under an agreement which is in place with the IAA to ensure coordination and avoid potentially conflicting standards. Both the IAA and the Groupe Consultatif will prepare standards under a rigorous due process, involving consultation not only with actuarial associations and firms but also with representatives of affected stakeholders, including EIOPA (and, in the case of IAA due process, the International Association of Insurance Supervisors and the International Accounting Standards Board).

Because of their professional independence, the IAA and the Groupe Consultatif are best placed to develop guidelines which are proportionate for all types of undertakings and to take into account the practical experience of actuaries in carrying out the tasks required under the actuarial function. Oversight and eventual adoption of standards by EIOPA will ensure that the standards contribute to efficient and harmonised supervision.

Given the extent of discretion required in setting the Solvency II balance sheet, actuarial experience and professional integrity will be vital. We believe that it is essential for actuarial guidelines to include professional and ethical guidelines, as well as guidelines which are purely technical in nature. The dividing line is in any case not entirely clear-cut. We suggest that it would be appropriate to amend the wording in paragraph 1 of the Level 2 measures (Article 262 SG10) to refer explicitly to "actuarial guidelines on technical, professional and ethical issues". This would also align the description more closely with that in Article 48(2) of the Solvency II Directive.

In our paper presented to CEIOPS in September 2009 we recommended as follows:

"The Groupe recommends that both public interest standards and technical standards should be formulated, in order to ensure high quality protection of policyholders and to facilitate convergence of professional practice throughout the European Union. These standards would be applicable both for

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actuaries and for others who may be appointed to carry out the actuarial function, and would have relevance to other actuarial responsibilities in the undertakings.

Public interest standards should include:

- qualification standards
- ethical standards
- governance standards
- communication standards

The Groupe recommends that qualification standards should include requirements for a specified minimum level of education, relevant practical experience and mandatory continuing education....

Ethical standards should cover matters such as competence, integrity, objectivity, confidentiality and avoidance of conflicts.

Governance standards should include the relationship with senior management and with the Board of the undertaking, cooperation in dealings with other internal functions and with external parties, checking and quality control of work, speaking up in case of serious concerns and protection for those who do speak up.

Communication standards might cover matters such as explanation of the purpose and scope of any report, comprehensibility, completeness, transparency, independence and accountability....

Technical implementation standards should provide broad principles on different aspects of carrying out the actuarial function. The aim should be to increase consistency of professional practice and contribute towards harmonisation and convergence of practice for all types and sizes of undertakings in the EU. They should ensure a high level of protection for policyholders, whilst not inhibiting development and innovation in the market.

Principles which might be included in the technical implementation standards include consistency, transparency and accountability, reproducibility and credibility."

Fuller argumentation of the need for public interest standards is contained within our September 2009 paper. The essential rationale is to protect the public and those who will rely upon the work of the actuarial function by ensuring that those carrying out the actuarial function are appropriately educated,

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	experienced and up-to-date to perform the tasks required of them, and that they carry out those tasks with integrity and objectivity. The standards should also provide guidelines relating to communications from the actuarial function and relationships with other functions and with senior management within the firm.	
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2.14.	We are uneasy that there is an implication that once established as fit and proper initially, this is deemed to continue indefinitely until some event which justifies a different conclusion. We suggest that modern good practice would supplement with some requirement on the person concerned – for example to submit an annual confirmation of professional development activity and ethical compliance.	
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2.25.	We do not understand the reference to an undertaking possibly issuing assets.	
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2.32.	Rather than require monitoring of changes in credit ratings, it may be better to monitor credit quality as reflected in either agency rating, spread or both.	
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2.42.	We agree although it may be helpful to distinguish between management (executive) and supervisory (non-executive) in that it is good practice for internal audit to communicate directly with the latter.	
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2.44.	The reference to 'informing the supervisor' is not clear. The Directive refers only to the supervisory body. We have no objection to introducing a requirement to inform the supervisor of certain matters, although this may require careful consideration of appropriate legal context.	
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2.51.	"...It should also ensure that the model is stable enough to withstand small variations introduced" is somewhat ambiguous. It might be here that a nonlinear process is monitored just to show the dangers of the thing. Should the model or pursuing such business be forbidden? Also one might ask whether models are allowed to be stable to withstand large variations.	
2.52.	'as between one year and another' may be less ambiguous than 'related to different years'	
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2.56.	It would be helpful for EIOPA to clarify how the expectations of the actuarial function will apply to non-EEA business. In particular there are a number of countries outside Europe which do not have a tradition of market consistent balance sheets and the actuarial function may perform a different role from that envisaged within Europe. It would seem odd (and perhaps impractical) to impose the requirements such as those in Guideline 56 in such countries Some flexibility may also be desirable where a non EEA requires substantial actuarial reporting but that does not align with requirements under Solvency II	
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2.60.	Whether the service provider is itself a supervised insurer may also be relevant.	
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3.31.	The reference to fitness and propriety of all persons working within a key function may need elaboration. A reference to sound recruitment practices might be helpful.	
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3.34.	"... the service provider need to possess a sufficient degree of knowledge, experience and professional qualification" – we certainly do not disagree with this but isn't this even more than what is required when outsourcing is not used?	
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3.56.	See comment on 2.14	
3.57.	In (a) it could be helpful to suggest at least that prior notification is preferable.	
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3.125.		
3.126.	It may be helpful to refer to 'economic and competitive situation' – we often see strategic difficulties arising from insufficient consideration of probable competitor actions.	
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3.137.	The logic is somewhat difficult here. It says that the directive does not preclude the risk management system from calling upon outside expertise and then says that "Hence there needs to be in place a communication loop...". While we do not disagree with the conclusion it could be expressed in a more logical manner	
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3.163.	This may be the place at least to offer the example of what is regarded as good governance practice of having internal audit report to a non-executive audit committee which also has oversight of external audit.	

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3.178.	A key point is that the management body should be in a position to review progress in implementation of internal audit recommendations.	
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3.184.	See comment on 3.178	

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3.185.		
3.186.	See our comments in 2.5 and 2.12	
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3.195.	Although 'actuarial assumptions' is in general usage, adding 'estimates' in brackets would make clear that the actuary is making estimates (of future mortality, of the future course of maintenance expenses etc. etc.) when calculating technical provisions.	
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3.197.		
3.198.	"...the model is seen as a widely-understood risk management tool within the business and not purely a mathematical model" is not as actuaries/mathematicians see things. We would replace "a mathematical model" here with "an academic toy model"	
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3.217.	"Depending on the complexity of the risk management system..." – should this rather refer to the complexity of the undertaking and its risks?	
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3.230.	"technological or human causes" – how are these separated? Is lack of data a technological cause? Is an it error technological or human?	
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