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Dear Dave

**FRC Response to the IAA's Draft Statement of Intent to issue International Standards of Actuarial Practice in relation to insurer ERM models and programs (ISAPs [5] and [6])**

The Financial Reporting Council's (FRC) mission is to promote high quality corporate governance and reporting to foster investment. To achieve our mission we work to promote high standards in accounting, auditing and actuarial practice.

**1 Do you agree an ISAP is needed on actuarial services in relation to insurer ERM models?**

<input checked="" type="checkbox"/>	<b>Yes</b>
<input type="checkbox"/>	<b>No</b>

We agree that there is a significant public interest in the continuing solvency of insurers and that ERM models can and do play an important role in supporting prudent management of the risks that insurers run. We also agree that actuarial services are an important component in building an effective ERM model.

We note that the Solvency II legislation, drawing on the IAIS' ICPs, gives a specific role to the actuarial function to contribute to the effective implementation of an insurer's risk-management system, in particular with respect to the risk modelling underlying the calculation of the capital requirements.

There may therefore be a place for actuarial standards applying to this work. Indeed, risk modelling work underlying the calculation of regulatory capital requirements already falls within the scope of the FRC's technical actuarial standards (TASs).

Such work is also likely to be subject to significant regulatory oversight as described in ICP 16 and 17. Indeed, where internal models are used to determine solvency capital then such models are likely to require regulatory approval and independent validation. Therefore, in developing ISAP [5] care needs to be taken to neither cut across regulatory requirements nor impose material additional burdens on regulated insurers.

We note that ISAP 1 already provides generic principles covering data, assumptions, methods and reporting all of which are applicable to actuarial services in relation to ERM models. This may limit the need for additional requirements in some areas particularly concerning data and assumptions. When developing our TASs, we reached the conclusion that the requirements of our generic standards on data, modelling and reporting were largely sufficient to ensure actuarial work in risk modelling was of suitable quality.

Additionally, any actuarial standard in this area needs to enshrine the principle of proportionality that the work required should be proportionate to the nature, scale and complexity of the business being modelled.

## **2 Do you agree an ISAP is needed on actuarial services in relation to insurer ERM programs envisaged by the IAIS's ICPs (particularly 8 and 16)?**

<input type="checkbox"/>	<b>Yes</b>
<input checked="" type="checkbox"/>	<b>No</b>

We agree that there is a high public interest in the effectiveness of insurers' ERM programs and in particular their risk management systems and this is reflected in the requirements of ICPs 8 and 16.

We also agree that actuarial work, especially in the area of risk modelling, will play a significant part in ensuring that Boards and senior management can rely on the risk management system in their management of the risks to which their business is exposed.

However, we are not convinced that an actuarial standard applying to all of the work actuaries may provide concerning advice or opinions on insurer ERM practices is the most effective means to facilitate widely accepted convergence of practices within and across jurisdictions.

We consider that the IAA would be better engaged in:

- facilitating the sharing of experience of practitioners;
- continuing to develop high quality educational material to build competencies and depth of expertise; and
- continuing to provide thought leadership to increase public confidence in the work that actuaries can perform in this space.

However, we do consider that there is considerable existing reliance by insurers on actuarial work in risk modelling. We would therefore suggest that the ASC consider extending ISAP [5] to cover some of the work that is currently proposed to be included within ISAP [6] including:

- Techniques for quantification of various types of risk;
- Determination of risk interdependencies and aggregation of risks;
- The processes for measuring, analysing and modelling risks;

- Implications of the differences between economic and regulatory capital adequacy.

### **3 Are any of the proposed topics inappropriate for inclusion in these ISAPs? If so, please explain why the particular topic should not be included.**

#### **ISAP [5]**

##### *Data quality considerations*

We agree that principles concerning data quality are relevant; however, ISAP 1 already provides principles on data covering:

- the sufficiency and reliability of the data;
- validation of data; and
- sources of data;
- reporting concerning any modifications made, the validation carried out and deficiencies.

Regulatory requirements are also likely to consider data quality – for example ICP 17 requires that underlying data used in an internal model is accurate and complete and specifically the European Solvency II Directive requires:

*Data used for the internal model shall be accurate, complete and appropriate.* (Directive 2009/138/EC article 121(3))

We expect the Delegated Acts supporting the Directive to provide criteria for assessing accuracy, completeness and appropriateness.

We question therefore what additional requirements might be necessary in ISAP [5].

##### *Assumption setting*

Again we agree that principles concerning assumption setting are relevant but as with data quality, ISAP 1 already includes principles covering both selection and reporting of assumptions.

Additionally, regulatory requirements are likely to impose constraints on assumption setting. For example:

- ICP 16 requires appropriately detailed descriptions and explanations of the key assumptions made to be included in the documentation of an insurer's ERM framework; and
- ICP 17 requires that an internal model should be subject to a statistical quality test to justify the assumptions underlying it. Expert judgement should be applied to assess the suitability of assumptions and they should be supported by proper justification, documentation and validation.

We question therefore what additional requirements might be necessary in ISAP [5].

## **ISAP [6]**

### *Risk Identification*

ICP 8 requires insurers to establish and operate within an effective system of risk management. Guidance on an effective risk management system provides that it should take into account all reasonably foreseeable and relevant material risks to which the insurer is exposed. In order to achieve this, insurers should require the risk management function to identify the risks it faces.

Given the existence of these regulatory requirements, we do not consider that an additional actuarial standard laying out what the practitioner should do when undertaking this work is the most appropriate way to address the risk that not all risks are identified.

We accept that guidance to the risk function, or to a practitioner reviewing the work of the risk function, to assist them in fulfilling this identification requirement would be helpful.

### *Identification of causes of risks*

ICP 8 requires that an effective risk management function is able to evaluate the internal and external risk environment on an ongoing basis in order to identify and assess potential risks as early as possible.

We are uncertain that a standard defining what should be done to ensure that risks are not picked up early as the risk environment changes or develops is the most appropriate way to address this matter.

This issue might be better addressed by facilitating discussion of emerging risks among actuaries and related thought leadership activities.

### *ERM framework and risk policy statements including the risk appetite framework and statement*

As noted above, ICP 8 requires the establishment of an effective risk management system and includes guidance that it should include written risk policies and a clearly defined risk appetite. The risk management function is expected to monitor the system's effectiveness and ensure it is maintained and improved.

Given these requirements and the expected challenge of the Board, we are uncertain that a standard defining the minimum that should be done to ensure that the ERM framework is adequate and risk policy and risk appetite statements are complete is the most appropriate way to address the matter.

We suggest the matter is better addressed through development of training material and forums for sharing experience/good practice.

## **4 What other topics should be included in these ISAPs?**

We have no suggestions for further topics to be included in these ISAPs.

We consider that some of the principles that are relevant to work in risk management and that might be included in ISAP [5] have more generic applicability. For example the limitations of models and the uncertainty associated with extreme events also have applicability in other areas of actuarial work including pricing and reserving.

Yours sincerely

A handwritten signature in black ink that reads "John Instance". The signature is written in a cursive style with a large initial "J" and "I".

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