Pakistan Society of Actuaries

PSoA GN 05

Guidance Note for Appointed Actuaries of Life Insurance Companies

Final

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Abbreviations used in this Guidance Notes

IO	The Insurance Ordinance 2000
PSoA	Pakistan Society of Actuaries
SECP	Securities & Exchange Commission of Pakistan

1 BACKGROUND AND SCOPE

1.1 This document has been prepared as a guidance note for Appointed Actuaries (herein after "the Actuary") advising life insurance companies on the management of life insurance business as required under the Insurance Ordinance, 2000 ('the Ordinance') of the Islamic Republic of Pakistan.

Adherence to this guidance note is mandatory. If a member has any concerns about the operation of this guidance note then the issue should be referred to the committee of Appointed Actuaries or the President or members of the council of PSoA. Reference to masculine gender should be read as applicable to feminine gender and vice versa.

1.2 The statutory duties of the Appointed Actuary laid out in the Ordinance are:

a) Provide written advice on equitable apportionment of revenues and expenses among funds (section 17(7))
b) Provide written advice on the distribution of capital in statutory funds (section 21(3))
c) Certify the surplus on with profits fund and any surplus adjustments (section 22(10))
d) Provide written advice on the allocation of surplus from all funds by way of bonus to with profit policies or shareholders (section 23(5))
e) Perform annual investigation into the financial condition of life insurer (section 27(2)a)
f) Certify that terms and conditions of a type of policy issued are sound and workable (section 27(2)c)
g) Certify the premium rates of new products and any change thereafter (section 27(2)d)
h) Certify annually mortality, expenses and other charges for investment contracts (section 27(2)e)
i) Certify the solvency of the operations (section 52 2(b))
j) Carry out other requirements as prescribed by the SECP from time to time.

1.3 Members of the PSoA who undertake activities covered in this guidance note should make reference to their compliance with this guidance note whenever they give written advice. In particular, any area where the Appointed Actuary gives advice which is not consistent with this guidance note should be specifically highlighted. In this case the Appointed Actuary should ensure that adequate records are kept to justify any departure from this guidance note.

1.4 This guidance note is meant to supplement (but not replace) existing professional standards from other actuarial bodies which apply to members belong to those bodies.

1.5 The areas of practice covered in this guidance note are:

Section 2 Accepting the Role of Appointed Actuary;
Section 3 Certification of Terms & Conditions including Premium Rates;
Section 4 Financial Condition Report
Section 5 Participating Business Bonus Allocation
Section 6 Capital Adequacy
Section 7 Report on Adverse Events
Section 8 Valuation of Liabilities

1.6 The responsibilities of actuaries who are appointed in terms of Section 26 of the Ordinance are central to the financial soundness of life insurance business of their companies. The reputation of the profession, therefore, depends in no small measure on the proper discharge of these responsibilities. It is incumbent on all Appointed Actuaries to ensure, so far as is within their authority, that life insurance business is operated on sound financial lines.

1.7 The essence of a profession lies in upholding its standards, technical and ethical, in the public interest. Any Appointed Actuary who becomes doubtful as to the proper course to adopt in relation to a potentially significant problem is strongly advised to seek help and advice from the committee of Appointed Actuaries of PSoA.

1.8 This Guidance Note is applicable with effect from July 1st, 2016.

2 ACCEPTING THE ROLE OF APPOINTED ACTUARY

2.1 When considering an appointment as Appointed Actuary, an actuary should consider carefully the most appropriate approach to the task. This will depend on the circumstances of the company, the nature of its business and how it is conducted.

2.2 An actuary, before accepting appointment as an Appointed Actuary, must consider the minimum requirements in the law and most carefully in the light of previous experience and work whether acceptance would be in line with proper professional behaviour and standards. No actuary should act as an Appointed Actuary without the necessary practical experience and updated knowledge of the external environment that could impact the affairs of the company.

2.3 A potential Appointed Actuary is encouraged to consult his predecessor (if possible) in that role to discover whether there are any professional reasons for not accepting the appointment. An actuary should make this clear to the prospective client and seek permission to hold such consultations.

2.4 An actuary must also ensure that, as an Appointed Actuary, there is a right of direct access to the board of directors of the company, adequate resources to carry out the relevant duties, and access to all relevant information to enable the duties of Appointed Actuary to be carried out satisfactorily; this must be explicit from the inception of the appointment.

Where there is a group structure, consideration should be given to the implications of working within the group and having access to the appropriate decision makers.

2.5 An appointed Actuary and immediate family members of the Appointed Actuary should not have any shareholding in the company for which he is appointed. In case of there being any shareholding at the time of appointment these should be disposed of prior to any advice being given in his capacity as Appointed Actuary.

2.6 The Appointed Actuary should be guaranteed access to accounts, records and documents to provide an understanding of the company's obligations (nature of contracts, guarantees, options, marketing plans, expense and profit allocation to policyholder and shareholder, claims settlement procedures and costs, experience expected, pricing policies for existing and new business, underwriting and risk selection, acquisition and maintenance costs, commitment to costs for development of management information systems and new business acquisition structures, investments and investment policy, reinsurance arrangements, capital and surplus management plans).

2.7 The Appointed Actuary must be given access on an on-going basis to the management of the company at a level senior enough to ensure receipt of full and prompt information on the company's affairs.

3 CERTIFICATION OF TERMS & CONDITIONS INCLUDING PREMIUM RATES

3.1 Under Section 27(2) c and d, an appointed actuary is required to certify the terms and conditions premium rates (or charges structure in case of investment linked) before a company can issue a life policy or long-term accident and health policy as well as the terms / conditions / premium rates / charges for existing products. For this purpose, the Appointed Actuary should ensure that an Actuarial Report is issued as part of the approval process in case of new product. For existing products, a statement is required to be made as part of the financial condition report.

3.2 For the avoidance of doubt, premium rates will include the charge structure of investment-linked contracts and will refer to the policy terms and conditions for the product for which rates are being certified, for both non linked and linked business.

3.3 As per Circular No. 9 of SECP dated 16 August 2005 regarding Group Insurance Premium Rates, a certificate from Appointed Actuaries are required for each Group Insurance Policy, where the annual premium is PKR 2 million or more, that premium rates and other terms & conditions are sound and workable. For the purpose of this circular, the points mentioned in the rest of this section should be considered before issuing the certificate. The above would hold true for any revision in the said circular by SECP in future.

3.4 The premium rates should be sufficient to enable the company to meet its emerging liabilities as and when they arise, and the Actuary should consider the following:

a) the nature of the contract, especially the extent of options / guarantees available to the policy holder
b) the marketing plan, in particular expected volumes and costs of sales
c) reasonability of the key assumptions including mortality, lapse, expense and investment
d) the reinsurance arrangements
e) investment policies
f) the company's vulnerability to fluctuations in experience and the extent of company's free assets
g) the company's policy in regard to the nature and timing of allocations of profits to policyholders and/or to shareholders,
h) cost of capital;
i) current and expected future tax position of the company

3.5 A premium approval report should make reference to the fact that it is a premium approval document for the purposes of this guidance note. The Appointed Actuary should review the previous approvals from time to time and may withdraw the approval in the event that the circumstances change from those expected when the original approval was made.

3.6 All premium rates certified by the Actuary should be "sound and workable" on a standalone basis.

3.7 Should premium rates be such that business is expected to be written on terms which require support from the free assets, the appointed actuary must 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.

3.8 Techniques such as profit testing, scenario testing, stochastic modelling etc. or any other appropriate method should be used to enable the circumstances and the extent of potential insufficiency to be identified and quantified.

3.9 In preparing the advice on the suitability of premium rates, the Appointed Actuary should:

1. Include a statement that the respective regulations have been complied with or identify where regulatory requirements have not been followed;

2. Be satisfied that appropriate assumptions are used when deciding on the adequacy of the premium rates.

3. Clearly define material terms and conditions including surrender values, commission rates, reinsurance arrangements as well as claims and premium payment conditions. In setting terms and conditions, the Appointed Actuary should seek to treat shareholders and policyholders fairly;

4. Consider the investment policy and implications in case of deviation;

5. Take into account new business strain and make sure that the company is able to set up the necessary reserve and solvency margin, and indicate any limits on the volume of business that may prudently be accepted;

6. Consider that each Statutory Fund have sufficient assets to support the writing of projected new business and maintain solvency;

7. Consider the implications for the insurer and for policyholders if future economic, demographic or business circumstances were to be radically different from those of today, particularly where the policy contains guarantees.

8. Make clear to the board of directors of the future demands on capital for any expense overrun and the necessary volume of business and degree of expense control needed to eliminate any expense overrun;

9. Consider, for investment-linked policies, the suitability of the unit pricing process and controls that are in place to ensure the fair treatment of new policyholders, exiting policyholders and continuing policyholders;

10. Indicate, for participating policies, how future bonuses will be determined including whether or not bonuses are smoothed and include support from profits on miscellaneous business;

4 FINANCIAL CONDITION REPORT

4.1 At least once a year the Appointed Actuary should investigate the financial condition of the company, as required under Section 50 of the Ordinance, and prepare the report in accordance with SECP Insurance Rules. The Actuary should be familiar with the prevalent regulations.

4.2 The Appointed Actuary should also be familiar with the Company's Accounting Policies with respect to insurance contracts as well as the business rules built into the systems used to administer such contracts.

4.3 The Appointed Actuary must take all reasonable steps to ensure that the data used for valuation is accurate and carry out such checks as a requirement to ensure completeness, consistency and accuracy. If the Appointed Actuary has any doubts about the accuracy of the data, reserves must be established for the risk that the actual value of the liabilities will be greater than that derived from the available data. If the potential inaccuracy is material, there should be an appropriate qualification in the report.

4.4 The Appointed Actuary should be aware of and comply with any provisions in the Insurance Ordinance and Insurance Rules with respect to valuation of liabilities under insurance contracts as well as any professional guidance note, issued by the PSoA from time to time, with respect to the same.

5. PARTICIPATING BUSINESS BONUS ALLOCATION

5.1 As part of the actuarial investigation, the Appointed Actuary shall determine for each Statutory Fund the amount of surplus arising since the previous actuarial investigation and advice on its equitable allocation between with profits policyholders and shareholders.

5.2 The Appointed Actuary shall also give advice regarding the distribution of capital in Statutory Funds, if any.

5.3 The Appointed Actuary shall take all reasonable steps to ensure that before any allocation of surplus / distribution of capital takes place, the insurer considers the advice in the report and that such allocation / distribution is in compliance with sections 21, 22 and 23 of the Ordinance and any other applicable law. In making such recommendations, the Actuary must carry out appropriate financial investigations including an appraisal of the relevant past experience and should keep in mind the effect the proposed distribution / allocation will have on meeting the current and continued solvency of the Statutory Fund. The Appointed Actuary shall ensure that the bonus declaration is fair and equitable as far as possible among different plans and across different generations of policyholders.

5.4 The Appointed Actuary can make use of any method he thinks appropriate to evaluate the impact of the proposed distribution / allocation.

5.5.1 The Appointed Actuary must provide a report to the board including the above recommendations and should cover the following aspects:

- Compliance with section 21, 22 and 23 of the Ordinance and any other applicable law;
- Sufficient information to justify and enable the board to judge the appropriateness of the recommendations and for the board to understand the implications for the future course of the insurer's business;
- Conclusions from the appraisal of the relevant experience;

- The methodology and assumptions used to arrive at the recommendations.
- Assessment of the whether the allocations / distributions are sustainable in future and the insurer's ability to meet its minimum solvency margin following the recommended allocation;
- Regard for the expectations of policy holders with respect to marketing literature and other publicly available information, benefit illustrations and past and current distribution practice;
- Opinion on appropriateness and fairness of allocation among different groups and generations of policyholders and between the shareholders and policyholders, including the form of the allocation.

6. CAPITAL ADEQUACY

6.1 Clause 2 (i) (iv) of Annexure IV to Rule 19 of the SECP (Insurance) Rules, 2002 requires the Appointed Actuary to provide a statement as to whether in his opinion the life insurer has adequate capital to continue its business at the planned levels for a period of not less than five years.

6.2 Before expressing his opinion on the adequacy of capital, the Appointed Actuary shall project revenue account and balance sheet for the purpose of calculating net admissible assets plus the solvency margin requirements for the next 5 years. The Actuary should take into account the following with regards to methodology and assumptions:

Methodology

- Projections should preferably be on a monthly basis.
- Project in force and new business using adequately comprehensive models for major lines of business and may use high level estimates to project small lines of business.
- Recommended to use projections for each policy, however model points can be used where data set is large enough.
- Should use judgement of combining the product with similar risk classes.
- For the purpose of choosing model points Actuary should perform data analysis.
- Lapse rates should be taken into consideration based on policy year.
- Commissions & acquisition costs should be accounted for on a policy year basis.
- Administrative expenses other than commissions can be calculated for each sales channel or at the company level & then split between statutory funds.
- Consider management view points and future plans.
- Project the actuarial liabilities for the next five years at a minimum in accordance with the minimum valuation bases prescribed by the SECP under Clauses 8 and 9 of Annexure V to Rule 20 of the SECP (Insurance) Rules, 2002.
- Project Solvency Margin as per Annexure III of the Insurance Rules, 2002.

Assumptions

- Assumptions set by the Actuary should be reasonably in line with the economic conditions of the country. Also, the assumptions should have reasonable relationship between each other.
- Realistic new sales assumption separately for major lines of business/products.
- Lapse rates should be based on the most recent lapse study.
- For group businesses claims ratios assumptions, past experience of the claims ratios should be taken into account.

- For participating products, bonus allocations should be projected based on the Actuary's view of policyholder reasonable expectations.
- Future expenses should be in line with the future plans of the Company. The Actuary should discuss the management expenses with management but use his/ her opinion while carrying out the projections.
- For investment income assumption, the following should be taken into account:
    - Investment mix of the portfolio
    - Duration of liabilities
    - Economic conditions of the country (for example inflation)
    - Pakistan Investment Bond rates
    - Stock market performance
- No changes to fixed product charges in the products should be assumed unless Actuary has strong evidence to assume otherwise.
- For all other assumptions, the Actuary should use sound and reasonable judgement while carrying out necessary analysis where possible.

6.3 The Actuary should determine the key variables to which the company is sensitive to & carry out sensitivity analysis on the sensitive variables.

The Actuary should analyse the combined impact of 2 or more scenarios (prescribed below) where deemed appropriate. However, at a minimum, the Actuary should carry out the following sensitivities / scenario testing:

(i) Projected sales lower by 20%.
(ii) Expenses higher by 20%.
(iii) Persistency for in force portfolio lower by 5 percentage points and 10 percentage points.
(iv) Claim ratio for group business worse by 10 percentage points.
(v) Inflation rate higher by 300 bps.
(vi) Investment income lower by 300 bps.
(vii) Equity shock of 30% in year 1 and market grows at 0% for the next of 5 years.
(viii) Equity shock of 30% in year 1 and market grows at PIB (Pakistan Investment Bond) rate of a 5 years bond for the next of 5 years.

6.4 Should the Appointed Actuary feel that he is able to form an opinion as to the Company's future capital position by using alternative techniques, then he may use such techniques provided these are fully documented and justified in a report to the Company.

6.5 Based on the projections under Section 6.2 to 6.3 or evaluation under 6.4, the Appointed Actuary shall from an opinion as to whether the prescribed solvency margins are likely to be met during each of the next five years and report accordingly.

7 REPORT ON ADVERSE EVENTS

7.1 The role of the Appointed Actuary is a continuous role which requires monitoring of the financial condition of the life insurance business throughout the year.

7.2 The Appointed Actuary needs to monitor transactions which will have, or are likely to have, a material impact on the financial condition of the company and, if material, should undertake an investigation. The results of the investigation should be documented and where necessary a report should be produced.

7.3 If the above condition causes a material adverse effect on the company's financial condition and requires rectification, the Appointed Actuary should present a written report to the Principal Officer, including recommendations for corrective actions and a deadline for timely action.

7.4 The Appointed Actuary should advise the board if he feels that appropriate actions have not been taken by the Principal officer. Actuary should notify the board the actions to be taken, reasons for the actions, deadline for the actions to be taken and inform the board that if these actions are not taken within the specified deadline then the Regulatory authority will be notified.

7.5 If suitable action is not taken within the deadline, the Actuary should report to the regulatory authority in writing. The report should include concerns, the matters reported to the Company and a description of events since the writing of the report and Company's response.

7.6 The Appointed Actuary must consider all material external factors outside the control of the company which could lead to insolvency and must then take whatever action he considers necessary. The profession requires that Actuary should apply more rigorous standards in these matters.

8 VALUATION OF LIABILITIES

The Actuary should comply with SECP requirement and the Guidance Notes of PSOA and any other professional association of which he is a member on Actuarial Valuation of Liabilities to fulfil his duties with respect to statements on the valuation of liabilities.