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Briefing note

Actuarial Function Structure Survey 2015

Ever since the publication of Article 48 of the Solvency II Directive, there has been much debate and discussion as to the role and responsibilities of the Solvency II Actuary and how actuarial departments should be structured.

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In the Autumn of 2015, we carried out a survey to see how UK insurers have addressed the challenges.

The key issues have been:

- Understanding the roles of the Actuarial Function as set out in Article 48 of the Directive and of the Solvency II Actuarial Function Holder / Chief Actuary;
- Determining whether the Actuarial Function should take additional responsibilities to those set out in Article 48 (particularly in respect of calculating the technical provisions and Solvency Capital Requirement);
- Deciding whether team structure changes are required to meet the new regulatory requirements and to manage any actual or potential conflicts of interest; and
- Determining where the Actuarial Function and Solvency II Actuarial Function Holder / Chief Actuary sit within the typical ‘three lines of defence’ control framework.

It is easy to see why there has been considerable deliberation and, indeed, some confusion in interpreting the Solvency II requirements, for example:

- The term ‘Actuarial Function’ is familiar to many of us under the current solvency regime, however, under Solvency II it means something different. It’s not always easy to discard the old and embrace the new.
- As with many aspects of Solvency II, we have the delicate matter of interpretation. For example, Article 48 says that the Actuarial Function should “coordinate the calculation of the technical provisions” and “contribute to the effective implementation of the risk-management system…”. However, views on what ‘coordinate’ and ‘contribute’ mean in this context may well differ between individuals.
- The Prudential Regulation Authority’s (PRA’s) Senior Insurance Managers Regime (SIMR) has also introduced a new role into the mix, the Chief Actuary Function, at a relatively late stage.

In addition, the absence of a universally accepted definition of the ‘three lines of defence’ control framework can easily lead to misunderstandings and different, but equally valid, interpretations of where the Chief Actuary and Actuarial Function sit within the three lines.

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Below, we've outlined and explained some of the key terminology in relation to the main results of our survey.

Solvency II Actuarial Function

The Solvency II Actuarial Function includes all persons performing tasks to meet the requirements of Article 48 of the Solvency II Directive.

The Solvency II Actuarial Function is not necessarily a single department - the regulations impose no set structure. It could be a single department, a number of departments or comprise a number of individuals, from one or a number of different departments.

The Solvency II Actuarial Function may perform other duties in addition to those set out in Article 48 but, where this is the case, any actual or potential conflicts of interest need to be managed appropriately.

Solvency II Actuarial Function Holder

A Solvency II key function holder is defined as the person responsible for a key function, so the Solvency II Actuarial Function Holder is the person responsible for the Actuarial Function.

Chief Actuary Function (SIMF20 position under SIMR)

The definition of the Chief Actuary Function (SIMF20), hereafter referred to simply as the 'Chief Actuary', is aligned with that of the Solvency II Actuarial Function Holder (i.e. the Chief Actuary is the person responsible for the Actuarial Function).

Where the Chief Actuary is internal he / she will be both the SIMF20 role holder and the Solvency II Actuarial Function Holder. However, where the Chief Actuary is external he / she will hold the SIMF20 role, but the Solvency II Actuarial Function Holder will be the person within the firm responsible for oversight of the outsourcing. This particular point has caused a bit of confusion within the industry and is explored further in our briefing note 'Chief Actuary or not Chief Actuary? – that is the question'.

Actuarial Function Structure Survey

Our recent interactions with insurance firms indicated that some were still thinking about how to structure their actuarial teams post Solvency II implementation, while others were wondering if their proposed operational models were in line with the approach of their peers. We carried out our survey to uncover the 'cold hard facts' to help firms (and us) gain a better understanding of the approaches being taken and the incidence of those approaches.

Participants

We would like to thank the 49 firms that took part in the survey, covering a wide cross-section of the market including:

- life, non-life, composite and health insurers;
- firms from all five PRA categories; and
- firms employing anything from zero actuaries, to those employing more than 20 qualified actuaries and 20 actuarial students.

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Survey Results

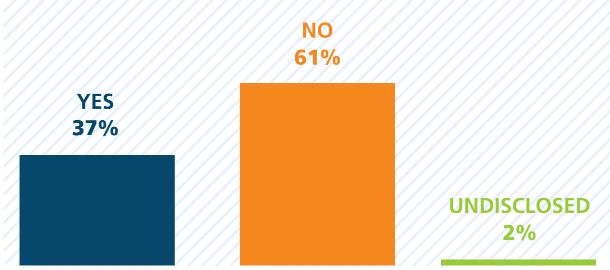
Although we asked a number of supplementary questions, the results of which are available to the survey participants, in this briefing note we cover only the key aspects related to:

- Whether firms are changing the structure of their actuarial teams;
- Whether the Chief Actuary will be responsible for the calculation of the technical provisions and Solvency Capital Requirement (SCR); and
- Where firms place the Chief Actuary and Actuarial Function within the 'three lines of defence' control framework.

We asked:

Have you or are you planning to make changes to your actuarial team's or teams' structure as part of your Solvency II preparations?

Fig.1



Over a third of participants said they have made changes, or are planning to make changes, to their team's or teams' structure. While showing some differences in the split of 'yes' and 'no' responses by type of firm / PRA category etc., a more granular analysis of the survey results offered nothing really conclusive. There was, however, an indication that firms with a large pool (over 20) of trainee actuaries are more likely to be undergoing change, perhaps reflecting greater ability to segregate duties among more junior personnel.

Naturally, we were also interested to see whether firms are intending to make use of outsourced actuarial services post Solvency II. The survey results indicate that firms which currently outsource are likely to continue to do so. Some of the survey respondents, who said they are not planning to make changes to their actuarial team structure, indicated that they are still considering whether or not to outsource actuarial work. As a result of this, some of the 'no' responses shown on Figure 1 may ultimately change to 'yes'.

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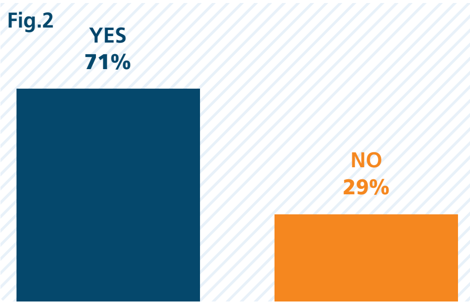
> Firms with a larger pool of actuarial resource are more likely to have the calculations of technical provisions and SCR outside of the Chief Actuary’s remit.

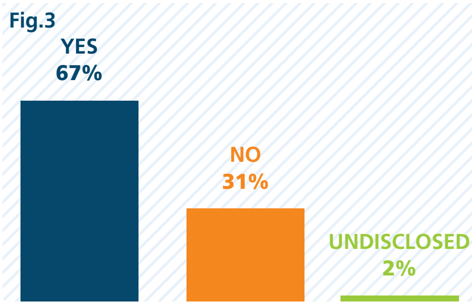
We asked:

Will the Chief Actuary head / be responsible for the team that calculates the technical provisions and / or SCR?

Will the Chief Actuary (SIMF20) head / be responsible for the team that calculates the technical provisions?



Will the Chief Actuary (SIMF20) head / be responsible for the team that calculates the SCR?



The duties of the Actuarial Function, as set out in Article 48 of the Solvency II Directive, do not include the calculation of the technical provisions. Level 3 Guidelines confirm this to be the case, suggesting that the Actuarial Function’s role is one of validation rather than calculation. However, they also indicate that the Actuarial Function may perform the calculations subject to any conflicts of interest being managed in a proportionate way. Similarly, the Article 48 duties do not make explicit reference to the calculation of the SCR.

As can be seen from Figures 2 and 3, the Chief Actuary, who is responsible for the Actuarial Function, will also be responsible for the calculation of the technical provisions and the SCR in the majority of firms. Almost all firms responded identically to the two questions, with the expectation being that the Chief Actuary will typically either be responsible for both or neither calculation.

Analysing the results at a granular level highlighted that, based on the survey responses:

- Life firms appear more likely than non-life firms to segregate the calculation responsibilities; and
- Firms with a larger pool of actuarial resource are more likely to have the calculations of technical provisions and SCR outside of the Chief Actuary’s remit.

Interestingly, the Chief Actuary will be responsible for the calculations in the majority of firms that have either restructured, or intend to restructure, their actuarial teams.

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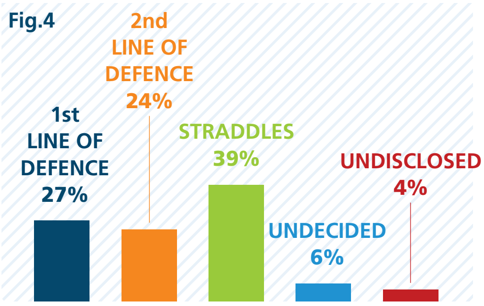
> Our discussions with firms have indicated that it is not uncommon for there to be different interpretations and different levels of understanding within the firm.

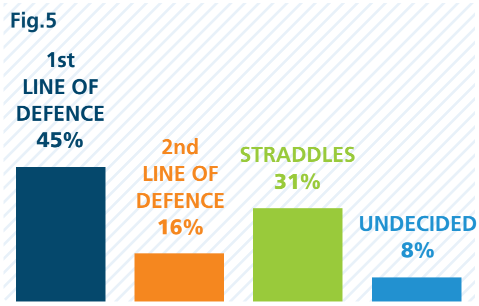
We asked:

Under Solvency II where will your Chief Actuary and Actuarial Function sit within your firm's control framework?

Under Solvency II where will your Chief Actuary (SIMF20) sit within your firm's control framework?



Under Solvency II where will your Actuarial Function (Article 48/CGB 6) sit within your firm's control framework?



Unfortunately, any reference to the typical 'three lines of defence' control framework is hampered by there being no single universal definition of the three lines of defence. Furthermore, our discussions with firms have indicated that it is not uncommon for there to be different interpretations and different levels of understanding within a firm. It is quite easy to see how the choice of definitions for the three lines and the understanding of those definitions can influence where the Actuarial Function is seen to sit. Consequently, it is possible for two firms to say the Actuarial Function is in a different position when the duties are identical.

Nevertheless, the 'which line of defence' Solvency II Actuarial Function debate has been rumbling on for a number of years now, so we asked firms about their own analyses using the following definitions:

First line

Business operations responsible for the day-to-day management and control of risks.

Second line

Oversight functions which set and police policies, define work practices and oversee the business operations to provide assurance.

Third line

Independent assurance, i.e. Internal Audit and other independent assurance providers that provide independent review and challenge.

As can be seen from Figures 4 and 5, market views are mixed and some are still undecided.

With regards to the Chief Actuary (Figure 4), the greatest categorisation is that the Chief Actuary straddles the first and second lines. Here, the Chief Actuary is considered to carry out duties that encompass elements of both the first and second lines, with many referring to this situation as 'line one and a half'.

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> We know that many firms have spent a great deal of time and energy considering the Actuarial Function operational model and, with only weeks remaining before Solvency II is ‘live’, a number of firms are still deliberating.

It is interesting to note that in PS3/15 the PRA suggested that it expected, “in many cases”, that the Chief Actuary would be a second line role. The results of our survey suggest that only a quarter of firms concur, although it is possible that the categorisation is influenced by any responsibilities accepted by the Chief Actuary additional to those strictly required by the regulations.

Approximately two fifths of firms placed the Chief Actuary and the Actuarial Function in the same line of defence. In the majority, but not all, of the remaining cases the Actuarial Function was placed either one half or one line lower than the Chief Actuary.

In our view, while the three lines of defence control framework is a useful risk management tool, it should not be viewed as a universal panacea for risk or a straight-jacket. We believe it matters little whether the Chief Actuary / Actuarial Function is considered to be first line, line one and a half or second line, so long as everyone is aware of their role and responsibilities and risks are appropriately managed.

Conclusion

As confirmed by our survey results, firms are adopting a variety of approaches to the structure of their actuarial teams and the allocation of responsibilities. We know that many firms have spent a great deal of time and energy considering the Actuarial Function operational model and, with only weeks remaining before Solvency II is ‘live’, a number of firms are still deliberating.

When trying to mould the actuarial teams to fit in with the Solvency II requirements and the three lines of defence control framework, we do wonder if firms (and some advisers) are perhaps ‘over-thinking’ the process. Ultimately firms should organise their personnel or outsource as appropriate to fit in with the wider firm structure and the specific nature of the firm. For us, the key elements for the operational structure are that:

- responsibilities are clearly defined, adequately documented and understood;
- conflicts of interest are appropriately managed; and
- risks are adequately controlled.

Please contact your Barnett Waddingham consultant if you would like to discuss the above topic or Solvency II outsourcing options with us. Alternatively contact us via the following:

john.hoskin@barnett-waddingham.co.uk
020 7776 3803
www.barnett-waddingham.co.uk/insurance
