

## **Lloyd's Valuation of Liabilities for Solvency – FAQs for Year-end 2009**

The following FAQs are designed to assist Managing Agents and Actuaries in completing Statements of Actuarial Opinions as at year-end 2009. This list is not intended to be exhaustive and any further queries should be raised with either the Market Reporting or Market Reserving teams at Lloyd's.

### **1. Are there any circumstances under which discounted technical provisions can be held for solvency purposes?**

The prohibition on discounting for solvency arises from GENPRU. Lloyd's have historically stipulated no discounting for Solvency. However, to be consistent with GENPRU, Lloyd's are proposing three situations where discounting may be permitted for solvency.

Firstly, as set out in GENPRU 2.2.107, for classes 1 and 2 (Accident and Sickness) if the expected average settlement date of the claims being discounted and the accounting date is at least four years, then the credit for discounting does not need to be added back to the technical provisions for solvency. Lloyd's see this applying in the following ways:

- to individual booked outstanding claims, such as prospective structured settlements, which are expected to be paid over extended periods of time and will normally be reported on a discounted basis.
- to books of business where the expected mean term of the reserve is greater than 4 years.

This only applies to business in classes 1 & 2 - it does not apply to any other class of business.

Lloyd's also understands that the booking of discounted claims under the above circumstances is normal market practice.

Secondly, for contracts (in any class of business) which contain an automatic commutation clause. Where such clauses include discounting and the Managing Agent and the signing actuary are satisfied that the conditions underlying the clauses have been satisfied, the commutation could take place and accordingly the discount does not need to be unwound in setting the solvency reserves.

Thirdly, as stated in GENPRU 2.2.107, the credit for discounting does not need to be added back in respect of discounting of annuities included in the technical provisions, for all classes other than 1 and 2.

In all cases the signing actuary should apply judgement and this may include unwinding some or all of the discount depending on circumstances.

### **2. Do the reporting reserves for the US trust funds need to be consistent with the original packs provided by Lloyd's?**

No, they need to be consistent with the packs that are returned to Lloyd's by the Managing Agents.

In certain circumstances, the paid or outstanding position initially reported by Lloyd's in the main US reporting packs may differ from the actual position of the syndicate. For example,

where significant items have not been processed through Xchanging. If this is the case, then the Managing Agent should have already adjusted the main packs before returning to Lloyd's. The signing actuary should work to be consistent with the adjusted pack returned to Lloyd's rather than the pack originally produced by Lloyd's, and the Schedule P should be consistent with the adjusted main pack.

### **3. Are all elements of expected future costs to be included in the ULAE provision?**

ULAE must be calculated to ultimate.

For non-life syndicates under UK GAAP, not all future syndicate costs need to be included in ULAE. For example some elements of operating costs/professional fees can be held as creditors outside the technical provisions assuming the syndicate is an on-going concern. In this case this element of expenses will not be included in the SAO as it is not included in the technical provisions. The syndicate auditors will need to be satisfied with this treatment.

Life syndicates need to additionally consider the requirement to hold an expense provision that is at least sufficient to cover closure of the syndicate to new business after 12 months.

### **4. Can elements of the ULAE provision be discounted?**

In general the technical provisions for solvency must not be discounted (see FAQ 1 for exceptions). If items of the technical provisions (including ULAE) held in the balance sheet are discounted then the unwinding of the discount must be included as a solvency adjustment.

Under the ABI SORP some elements of future costs can be held as creditors outside the ULAE provision and offset against future investment income. As this sits outside the technical provisions, this is not considered in the SAO process. The syndicate auditors will need to be satisfied with this treatment.

### **5. The syndicate estimated written premium is (prudently) lower than the signing actuary's but both use the same figure for earned premium. This leads to the syndicate (prudent) UPP being lower than the signing actuary's. Would a solvency loading be required?**

Technically a solvency load would be required as the UPP held by the syndicate is lower than that estimated by the signing actuary. Lloyd's would be satisfied that the lower figure can be held if:

- the syndicate written premium estimates include a demonstrable element of prudence and the debtor for pipeline premium reflects this
- the signing actuary is satisfied that the premium estimates would not be lower without the prudence factor
- the syndicate auditors are satisfied with the treatment
- this approach is documented in the actuarial report that accompanies the SAO

### **6. If an actuary projects a higher inwards loss than the agent does, and a higher inwards reinstatement premium, can he net this off the higher loss?**

This depends on the accounting treatment of earned inwards reinstatement premiums. This may be recorded as an asset on the balance sheet and is thus not part of the actuary's scope. Auditors should be discussing the figures with actuaries and should be aware of the actuary's assumptions regarding losses, so they should be able to check that the receivable reinstatements are consistent with the claims reserves held.

### **7. Is a negative UPP possible?**

There are circumstances where a negative UPP could emerge. For example, a predominantly binder book of business that started writing business late in an underwriting year and has already purchased the outwards reinsurance programme could have a negative UPP.

This is expected to be exceptional and the syndicate auditors must be satisfied with the treatment.

### **8. Can a signing actuary rely on the managing agent's assessment of UPP?**

Lloyd's confirms that the actuary need not make their own assessment of the UPP but rather can rely on the managing agent's assessment. This reliance extends to the agent's assessment of Deferred Acquisition Costs (DAC) – that is, the actuary can use the UPP net of DAC that the agent produces. The actuary should obtain a Data Accuracy Statement (appendix 3) that makes it clear that the agent has supplied and verifies the UPP together with other data.

Actuaries must at all times comply with professional guidance and the actuarial profession may issue further guidance to actuaries regarding their reliance on the agent's UPP. Lloyd's does not expect actuaries to accept UPP and DAC – or any data – uncritically, notwithstanding the Data Accuracy Statement. Actuaries must ensure that they understand the data and its limitations, and need to test data for general reasonableness. This is no different for UPP and DAC than for other supplied data items. However Lloyd's does not expect actuaries to carry out their own full assessment of UPP and DAC unless requested to do so by the agent. Again this is no different for UPP and DAC than for other data items, where a reasonableness test is required but not a full new calculation.

It is part of the actuary's professional judgement to decide how much work is required for a test of reasonableness.

If an actuary has particular concerns about UPP (or any other matter) they should contact the Lloyd's Actuary.

### **9. Does bad debt on unearned business need to be considered?**

Technical provisions for reinsurance bad debt in respect of unearned business are only required to the extent that they may contribute to the Syndicate requiring a URP. Calculation of the bad debt requirement for all business, both earned and unearned, should be carried out in order that the actuary can assess whether or not technical provisions for reinsurance bad debt in respect of unearned business contribute to the Syndicate requiring a URP.