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## **Re: Reports supporting the Statement of Actuarial Opinion**

Dear CEO,

In 2013, the Central Bank of Ireland (“The Central Bank”) wrote out to all firms designated as High Impact under our PRISM engagement model and requested that certain amendments be made to the actuarial reports accompanying the Statement of Actuarial Opinion (“SAO”). The letter was very much designed to highlight examples of good practice in certain areas and to draw attention to areas where we felt greater consistency in the methodologies and approaches adopted would be useful.

The Central Bank would like to acknowledge the enhancements made by firms in updating the reports accompanying the 2012 year end submissions and would like to request the assistance of firms again with respect to the 2013 year end actuarial reports. In that regard the Central Bank has identified a number of areas where it would be beneficial to the Central Bank if firms could include additional detail in the report, and document their reasoning and rationale underpinning the items listed below (Items listed in the letter of 22 February 2013 should also continue to be included). Professional judgement should be used when considering whether any of the suggested enhancements are not applicable in light of the risk profile of the Company, and where this is the case, this should be explicitly stated. If firms choose not to include additional information in their SAO reports, then it is acceptable to the Central Bank for these to be dealt with in a supplemental letter or report at the same time.

The additional items for which the Central Bank is requesting additional details are:

1. The methodologies used to calculate the Unearned Premium Reserve (“UPR”);
2. The calculation of the Additional Unexpired Risk Reserve (“AURR”);
3. The calculation of a provision for Unallocated Loss Adjustment Expenses (“ULAE”), also known as a Claims Handling Expense (“CHE”) provision;
4. Actual versus Expected (A v E) Analysis;
5. Periodic Payment Orders;



6. Claims Inflation;
7. Court Awards;
8. Post Balance Sheet events; and
9. Any other key areas of uncertainty identified during the review

There are currently a variety of practices employed by firms in relation to these issues. In order to enhance consistency across the industry, the Central Bank has set out the issues in detail below to provide clarification on the level of information expected.

- 1. UPR:** The Central Bank is requesting commentary by class of business on the rationale behind the method used to calculate the UPR. This should include specific commentary with regard to the treatment of additional considerations or exceptions, which can include but are not limited to:
  - i. Actual amount of premiums written considered in the calculation of earned premiums e.g. net of all discounts, consideration of administration expenses, etc.
  - ii. How these premiums are written i.e. single premiums or instalments and how administration expenses are allowed for in each of these cases e.g. how any non-refundable elements of the premium are earned. For instalment premiums, additional consideration of direct debit payments should be made.
  - iii. Mid-term cancellations, extensions or other premium endorsements and how the UPR is modified in these instances, particularly for instalment premiums. This includes consideration of administration fees charged to policyholders.
  - iv. Term of the contracts i.e. multi-year policies.
  - v. Pipeline premiums where applicable and how these are calculated, including additional expenses. Pipeline premiums in this case relate to premiums on underlying contracts of insurance written by intermediaries accepting business on the firm's behalf where full details of the contracts may not have been notified to the insurer as at the balance sheet date but where the period of cover has commenced prior to the balance sheet date.

Firms are requested to provide evidence that the UPR amount included in the firm's financial statements has been tested for reasonableness.

- 2. AURR:** In the SAO report, the Signing Actuary is required to test the adequacy of the UPR in order to determine whether an AURR is required. The Central Bank requests that firms demonstrate premium sufficiency by class of business, with no offsets between them. This is consistent with the SORP requirements.

For the purposes of this calculation, classes of business are defined as groupings of business that are managed together where no constraints exist on the ability to use assets held in relation to such business to meet liabilities and:



- i. There are significant common characteristics relevant to the assessment of risk and setting of premiums e.g. patterns of risk, claims occurrence and settlement patterns, etc.; or
- ii. The lines of business are written together as separate parts of the same insurance contracts.

If a firm believes that there are viable reasons why they should be able to offset the AURR between categories of business, the firm is requested to set out those reasons.

The AURR calculation should include specific commentary with regard to the treatment of additional considerations or exceptions, which can include but are not limited to:

- i. Adjustments to the loss ratio used to reflect inflation and premium rate changes over the unexpired period of risk;
- ii. Adjustments to the loss ratio used to reflect known differences between the previous accounting period and the unexpired period of risk e.g. for seasonality or non-typical events;
- iii. Allowance for a non-refundable element of the premium where applicable, particularly for premiums that are paid by instalments, with a separate discussion on premiums paid by direct debit; and
- iv. Allowances for pipeline premiums where applicable, including an allowance for additional expenses.

Deferred Acquisition Costs should be deducted from the UPR for the purposes of calculating the AURR. If allowance is made for investment returns on the unexpired period of risk, the discount rate used should be clearly stated with an appropriate rationale given for using the chosen rate.

- 3. ULAE:** An appropriate allowance for all associated costs should be made within the ULAE provision, including an allowance for fixed costs (e.g. office expenses, professional fees, IT, regulatory expenses, operational expenses, etc.) as well as claims handling expenses. The firm's view on salary inflation and the rationale behind this view should be specifically stated. Any material divergence from the industry average ULAE percentage of gross claims reserves (excluding ULAE and MIBI) should be fully explained with reference to the claims run-off of the business written. There should be no allowance for investment returns used when calculating this reserve i.e. no allowance for discounting.
- 4. Actual versus Expected analysis:** The Central Bank requests that an A v E analysis is shown for each material reporting class, along with commentary and explanation in relation to major differences. This analysis should provide an insight into how prior years developed compared to how they were expected to develop at the prior year end and should



be in accordance with point 1 of the letter issued by the Central Bank to CEOs of High Impact firms on 22 February 2013. Graphical representations of the movement in prior year reserves would be helpful. Where a class is not considered material or it is not possible to carry out an A v E analysis e.g. for new classes, appropriate rationale behind the decision not to perform the analysis must be provided. The Central Bank requests that firms provide detailed commentary on the Private Motor Bodily Injury class in particular, highlighting changes in trends or assumptions over the last 3 years and the firm's understanding of why these changes have occurred.

5. **PPOs:** The Central Bank requests that firms provide complete and detailed analysis of how potential PPO claims are treated in the calculation of the reserves. This should include quantification and commentary around the level of uncertainty in the reserves as a result of potential PPO claims. The discount rate used to estimate the impact of PPOs should be clearly stated and an appropriate rationale behind using that rate given. Where a firm believes that it does not have any exposure to PPO claims, appropriate commentary should be provided to justify this assumption.
6. **Claims Inflation:** The Central Bank requests that firms provide details of the degree to which past and future inflation is implicitly or explicitly allowed for in the reserving process. This includes identification of the inflation percentage allowed for and quantification of the level of uncertainty around this percentage.
7. **Court Awards:** The Courts and Civil Law (Miscellaneous Provisions) Act 2013 increased the limits for District and Circuit Court Awards. The Central Bank requests that firms comment on the potential impact of the increased Court Awards on the current and future reserve requirements. If the firm believes that there will be no material impact on reserves as a result of the increase, the rationale behind this assumption should be given.
8. **Post Balance Sheet events:** Firms are requested to provide detailed commentary and quantification of how post balance sheet events have been allowed for in the reserves e.g. the impact of the recent floods and windstorms. If there have been no material post balance sheet events, we would request that this is stated explicitly.
9. **Other Key Uncertainties:** Firms are requested to provide sufficient detail on any other key uncertainties not mentioned above e.g. impact of a change in the discount rate, unusual levels of large claims, changes to claims handling, etc.

Please contact your supervision team within the Central Bank if you have any queries in relation to the points outlined above. If you have material difficulties in complying with any of the above requirements, please contact your supervisor outlining the nature of these difficulties as soon as possible.



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Yours sincerely,

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Head of General Insurance Supervision Division  
Central Bank of Ireland