

INSTITUTE OF ACTUARIES OF INDIA

GN31: GN on the Financial Condition Assessment Report for General Insurance Companies

Classification: Recommended Practice

Legislation or Authority:

1. **The Insurance Act 1938** (hereinafter referred to as the Act) and amendments made thereto.
2. **The Insurance Regulatory and Development Authority Act, 1999** (hereinafter referred to as the IRDA Act)
3. **The Insurance Rules 1939** (hereinafter referred to as **the Rules**).
4. **IRDA (Appointed Actuary) Regulations 2000** (hereinafter referred to as **Appointed Actuary Regulations**);

Application

This Guidance Note is applicable to an Appointed Actuary, appointed in accordance with the provisions contained under Appointed Actuary Regulations, by an Insurer carrying on the business of General Insurance (as defined under Section 2(6B), 2 (13A), 2 (13B) of the) under the Insurance Act 1938. This is also applicable to all other actuaries, as defined in the Actuaries Act, 2006 who as a matter of course, get associated with preparation of a financial condition report for a general insurer and have to relate directly or indirectly to the Appointed Actuary of such a general insurer.

Status

Issued under Due Process in accordance with the “Principles and Procedure for issue of Actuarial Practice Standards (APSs) {adopted by EC on 16.11.1997 and as amended subsequently}”.

Version Ver.1.00 - effective from 02.03.2013.

Background

1. The Appointed Actuary

Legal Framework: The following regulations and amendments thereto from time to time issued under the IRDA Act, 1999 define the role of the Appointed Actuary in respect of General Insurance companies:

- 1.1 IRDA (Registration of Indian Insurance Companies) Regulations 2000** (hereinafter referred to as **Registration of Indian Insurance Companies Regulations**),
- 1.2 IRDA (Assets, Liabilities and Solvency Margin of Insurers) Regulations, 2000** (hereinafter referred to as **Solvency Regulations**);
- 1.3 IRDA (Investment) Regulations, 2000** (hereinafter referred to as **Investment Regulations**) as amendments issued thereto in 2001
- 1.4 IRDA (Preparation of Financial Statements and Auditor's Report of Insurance Companies) 2000** (hereinafter referred to as **Accounting Regulations**) and amendments issued thereto in 2002
- 1.5 IRDA (General Insurance -- Re-insurance) Regulations, 2000** hereinafter referred to as **Reinsurance Regulations**).
- 1.6 Circular No. 019 dated 06-11-2008: file and use guidelines for general insurance products and circular No. 021 dated 28-09-2006**
- 1.7 Circular No. 025 dated 05-08-2009 and No.014 dated 29-01-2010 on corporate governance, hereinafter referred to as Corporate Governance circular.**
- 1.8 IRDA/ F&A circular 012 dated 28-01-2010 on disclosure norms**
- 1.9 Circular No. 081 dated 13-05-2010 on financial condition report (subsequently changed to Financial Condition Assessment Report), hereinafter referred to as FCAR circular.**
- 1.10 IBNR Manual placed on the web site of IRDA by IRDA, hereinafter referred to as IBNR Manual**

Notes

2. Scope

- 2.1** This Guidance Note applies to a Financial Condition Assessment Report (FCAR) prepared by an Appointed Actuary as per the IRDA's circular no. 081 dated 13th May 2010.
- 2.2** This Guidance Note is applicable to all Appointed Actuaries of non-life insurance companies of India, including stand-alone health insurance companies, and any actuary as defined in the Actuaries Act, 2006.
- 2.3** This Guidance Note is not applicable to the Appointed Actuaries or actuaries of non-life reinsurance companies in India. In case such actuaries are asked to prepare an FCAR, they may contact the Professional Advisory Group of IAI for guidance.
- 2.4** This Guidance Note does not override the requirements of GN21 and it should be read and followed in conjunction with GN21.

3. Reporting requirements:

3.1 General guidance

- 3.1.1** The FCAR circular gives complete detail of the format in which the report is required to be submitted to the IRDA. While it is expected that the report in the format required for submission to IRDA will be presented by the Appointed Actuary to the company's Board, there may be additional notes which the Appointed Actuary may submit to the Board by way of elaboration of information incorporated in the FCAR or otherwise.
- 3.1.2** The Appointed Actuary must take materiality into account while preparing the FCAR. The Appointed Actuary will use his or her judgment to decide if something is material or not. For example, impact on the available solvency margin could be used as a measure to decide materiality.
- 3.1.3** Apart from discussing the impact of material risks identified as described in the FCAR format, the Appointed Actuary should make recommendations on how to address any adverse findings; such recommendations may cover other relevant aspects not indicated in the FCAR.
- 3.1.4** The Appointed Actuary's work is carried out under certain assumptions relating to events connected with the insurer's business and do imply a residual uncertainty in spite of best efforts on all relevant assumptions. However, the Appointed Actuary is expected to quantify the underlying uncertainty of the key results in the various sections of the FCAR. In situations where quantification is not feasible, a description of the underlying uncertainty should be provided.
- 3.1.5** Where it is not clear as to how a business metrics required in the FCAR should be calculated, the Appointed Actuary should explain the formula used for the calculation.

3.2 Data requirements.

- 3.2.1 The Appointed Actuary should request for all the data required for preparing the FCAR from the company. The Appointed Actuary should also identify the staffs of the company who will provide the data or whom the Appointed Actuary needs to interview during the FCAR preparation.
- 3.2.2 The Appointed Actuary should check the reasonability and appropriateness of the data and information received for FCAR preparation. The Appointed Actuary should record the inconsistencies observed in the data and explain how the inconsistencies might have impacted the analysis performed.
- 3.2.3 Where the company does not provide adequate data related to some part of the FCAR on time, that part may be omitted from the FCAR and provide an explanation as to the omission of that part and the resulting limitations of the report.
- 3.2.4 If a data item required in the FCAR report is not captured by the company, it should be pointed out by the Appointed Actuary. After discussions with the suitable staff, the action plan to capture the data items in future should be provided.
- 3.2.5 Where reliance on other actuaries has been placed for certain aspects of the work, the nature of such reliance and steps taken to ensure that objective information and conclusions have been arrived at should be recorded. Similar requirement also applies to reliance on any other professionals.

3.3 Statements by the Appointed Actuary

- 3.3.1 The Appointed Actuary must provide a statement that the FCAR has been prepared in accordance with this Guidance Note. In case of material deviations from the Guidance Note, the reasons of deviation should be explained.
- 3.3.2 The Appointed Actuary should provide a statement setting out who commissioned the report and the scope and purpose of the report. The Appointed Actuary should also provide details about any restrictions or limitations faced while preparing the report.
- 3.3.3 The Appointed Actuary should clearly set out the target audience for the report. The Appointed Actuary may add a note of caution for readers other than the target audience.

4. Guidance on specific sections of the FCAR format

This Guidance Note is in the context of the FCAR format required to be submitted to the IRDA and the Board of the company and follow the order of the sections of the FCAR. Only those sections of the FCAR format have been covered where a need for guidance was felt necessary.

4.1 Section 2 – Executive Summary

- 4.1.1 In this section, the Appointed Actuary should summarize the material risks and issues identified in the subsequent sections.
- 4.1.2 Wherever a material risk has adverse implications on the financial condition of the company, the Appointed Actuary should also provide recommendations to address those risks and issues.
- 4.1.3 The Appointed Actuary should also comment on the action taken by the management on the recommendations of the previous FCAR.

4.2 Section 5 - Analysis of experience

- 4.2.1 The recent experience of the company in respect of expenses, commissions, claims, investment income, persistency and profit / loss should be analyzed for the current year. The Appointed Actuary should also comment on the features of the trend of the experience over the past few years if available.
- 4.2.2 If the method used by the company to allocate the overall experience to LOBs for example expenses and investment income is not accurate, a more accurate method may be recommended.
- 4.2.3 The Appointed Actuary should comment on the steps recommended to address any adverse experience or trends in experience.
- 4.2.4 Based on the management inputs, the Appointed Actuary may comment on the control processes in place to:
 - regularly monitor the experiences and
 - take actions to address adverse movements.
- 4.2.5 If some deviations are required from the FCAR format to perform a more accurate experience analysis for example claim frequency calculation at risk level rather than policy level, such deviations may be done with a proper explanation.
- 4.2.6 Where possible, the company's experience may be compared with an Industry statistics or any external source to identify any adverse experience.

4.3 Section 6 - Adequacy of premium

- 4.3.1 The Appointed Actuary should analyze the adequacy of premium for all LOBs. Where possible the adequacy of premium may be analyzed for sub-segments within an LOB to analyze the suitability of the rating structure.
- 4.3.2 If the competitor's premiums and claim experience are available for similar products, the Appointed Actuary should consider them to understand if the inadequacy of premium may be addressed through better underwriting and / or claim management.
- 4.3.3 In case of any changes in the underwriting and / or claim management processes during the year, it's likely impact on the profitability should be commented upon.
- 4.3.4 Credibility of the premium volume of a line of business must be considered before making a conclusion about profitability of the LOB.
- 4.3.5 Based on the management's inputs, the Appointed Actuary may comment on the control processes in place to:
- regularly monitor the loss ratio experiences by various rating variables and
 - take actions to address adverse movements.
- 4.3.6 For long tail LOBs, the uncertainty in estimating the reserves and its impact on profitability and premium adequacy must be discussed.
- 4.3.7 The Appointed Actuary should comment on the impact of any recent trends in the business environment, legislation, regulation etc. on premium adequacy of an LOB.
- 4.3.8 Loss ratios compiled for the FCAR may be compared to budget plans as well as those submitted to IRDA in the 'File and Use' documents. Adverse experiences and recommendations for controlling such experiences may be discussed briefly for management action.

4.4 Section 7 - Adequacy of reserves

- 4.4.1 The Appointed Actuary should comment on the appropriateness of the assumptions underlying the reserving methodology used and any significant movement between closing of accounts and FCAR reporting date should be explained.
- 4.4.2 The Appointed Actuary should carry out an analysis to test the adequacy of past reserves estimates. The analysis may be in the form of a comparison of actual cash flows with the expected cash flows as per the IBNR and case reserve

estimates. In case the past reserve estimates turned out to be inadequate for some LOBs, the measures taken in the subsequent reserving analysis to address this should be explained.

- 4.4.3 The Appointed Actuary should comment on the uncertainty related to the reserve estimates and its implications for the adequacy of the current reserve estimates.

4.5 Section 8 – Reinsurance

- 4.5.1 The Appointed Actuary should comment on the material risk arising due to the company's current or past reinsurance arrangements, taking into account the liability profile of the LOBs covered.

- 4.5.2 The Appointed Actuary should comment on the method used to decide on the maximum retention for each LOB and its appropriateness. The Appointed Actuary may perform a reinsurance modelling exercise for various scenarios and document the results. Impact on return on capital for various options may be highlighted, in such a case.

- 4.5.3 The Appointed Actuary should comment on the details of the guidelines in place to use Facultative reinsurance and the Facultative covers bought by the company.

- 4.5.4 The Appointed Actuary should comment on the ratings of the current and past reinsurers and possible risk of default on future or current outstanding reinsurance recoverable and its impact on solvency.

4.6 Section 9 - Risk management

- 4.6.1 The Appointed Actuary should describe the risk management framework adopted by the company with the risk appetite statement approved by the Board. Risk management roles and responsibilities should be clearly outlined with a brief description of the Governance structure.

- 4.6.2 The Appointed Actuary should detail the approach adopted by the company for identifying and profiling risks within each business unit and at an enterprise level, the frequency for updating risk profiles and approach for internal/external risk reporting. The process for assigning ownership of key risks and their materiality limits should be detailed with a brief description of the controls in place for minimising the impact of inherent risks.

- 4.6.3 The Appointed Actuary should form an independent view of the robustness and effectiveness of the risk mitigation controls in place.

- 4.6.4 The Appointed Actuary should provide details of the compliance program in place, summarising compliance obligations and processes demonstrating how compliance is achieved, breach reporting and escalation procedures. Further, the

Appointed Actuary should detail the approach adopted for internal audit to ensure effective implementation and compliance with the risk management framework and frequency and scope of such audits.

4.7 Section 10 - Capital adequacy

- 4.7.1 The Appointed Actuary must consider and comment on the company's capacity to meet the statutory capital requirements over the next three years.
- 4.7.2 The Appointed Actuary should comment on the extent of the known breaches of the statutory capital requirement in the past and their reasons. Any steps taken by the company to ensure that such events do not happen again in the future should also be explained.
- 4.7.3 The Appointed Actuary should comment on the company's approach to assign and monitor capital over time. The Appointed Actuary should also discuss the processes in place to ensure that the company is always able to meet the statutory capital requirement in accordance with the IRDA's solvency regulations.
- 4.7.4 In case the company uses an approach to allocate capital by LOB the Appointed Actuary should comment on the suitability of the method used for the capital allocation.
- 4.7.5 The Appointed Actuary should comment on the probability of ruin of the company over the next one year period. This may be based on a deterministic or stochastic modelling. The method and assumptions used for the analysis should be explained in brief in the report. In case a deterministic method is used for capital adequacy analysis, the Appointed Actuary should make efforts to gradually move towards stochastic modelling techniques.
- 4.7.6 In case the company calculates the economic capital for either internal or statutory purposes, the Appointed Actuary should comment on the comparison between the statutory and the economic capital and its implications on future solvency.
- 4.7.7 The Appointed Actuary should perform stress testing to study the impact of various adverse scenarios on the capital adequacy situation of the company over the next one year and comment on the results.

4.8 Section 11 – Investments and Asset Liability Management

- 4.8.1 The Appointed Actuary should outline the company's approach to Asset Liability Management (ALM). Any material risks arising due to the methods or assumptions used should be commented upon. The Appointed Actuary should also provide the results of the ALM exercise performed.

- 4.8.2 The Appointed Actuary should comment on any stress or scenario testing performed as a part of the ALM exercise and the impact on asset liability matching or solvency position under these test scenarios.
- 4.8.3 The data and information on expected proceeds from investments and expected returns from assets received from the investment department should be checked for reasonableness.

4.9 Section 12 – Miscellaneous

- 4.9.1 The information in the miscellaneous section and any other relevant data may be used to assess the operational risk faced by the insurer and review corrective steps to be taken. Appointed Actuary may comment on these aspects.
- 4.9.2 The data and information received from the operations department related to number of complaints received and resolved should be checked for reasonableness.
- 4.9.3 The Appointed Actuary should use this section to outline and comments on any material risk to the company which were not appropriate to be covered in other sections of the FCAR.

4.10 Section 13 – Current financial condition

- 4.10.1 In this section, the Appointed Actuary should summarize those comments from the previous sections which were related to the material risk which impact the solvency position of the company. This will include but may not be limited to material risks related to reserve adequacy, premium adequacy, reinsurance arrangements, risk management practices, ALM.

4.11 Section 14 – Future financial condition

- 4.11.1 The Appointed Actuary should use the future three years business plan as the base scenario. The assumptions used in the business plan should be compared with the ratios calculated during experience analysis based on the current year. Any major deviation from those ratios in the future business plan should be investigated and commented upon.
- 4.11.2 The Appointed Actuary may determine and use at least two adverse scenarios for modelling based on key areas subject to uncertainty or the business metric to which the solvency position is most sensitive. The scenario testing should be done for a three year horizon.

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