

ACTUARIAL SOCIETY OF INDIA

GUIDANCE NOTE (GN) 1

APPOINTED ACTUARY AND LIFE INSURANCE BUSINESS

Classification: Practice Standard

Legislation or Authority:

1. The Insurance Act 1938 (hereinafter referred to as the Act) and amendments thereto including the Insurance Regulatory and Development Authority Act, 1999.
2. The Insurance Rules 1939 (hereinafter referred to as the Rules).
3. Insurance Regulatory and Development Authority (Appointed Actuary) Regulations 2000 - (hereinafter referred to as AA Regulations).

Application

This Guidance Note is applicable to an Appointed Actuary, appointed in accordance with provisions contained under AA Regulations, who is appointed by an Insurer carrying on the business of Life Insurance as defined under Section 2(11) of the Insurance Act 1938, and shall constitute 'Professional Standard' within the meaning of Regulation 2(e) of the AA Regulations. This is also applicable to all other actuaries who as a matter of course get associated with a life insurer and have to relate directly or indirectly to the Appointed Actuary of such life insurer.

Status

Issued under Due Process in accordance with the "Principles and Procedure for issue of Guidance Notes (GNs) {adopted by EC on 16.11.1997}".

Version	Effective from
1.0	1.11.2001

A: The Appointed Actuary

1. Legal Framework

- 1.1. The following regulations and amendments thereto formed under the Insurance Regulatory and Development Authority Act, 1999 define the role of the Appointed Actuary in the management of life insurance companies:
 - 1.1.1. Appointed Actuary,
 - 1.1.2. Registration of Indian Insurance Companies,
 - 1.1.3. Actuarial Report and Abstract,
 - 1.1.4. Assets, Liabilities and Solvency Margin of Insurers,
 - 1.1.5. Investment,
 - 1.1.6. Preparation of Financial Statements and Auditor's Report of Insurance Companies, and
 - 1.1.7. Life Insurance -Re-insurance.
- 1.2. Section 13(1) of the Act requires the Appointed Actuary to perform an annual investigation into the financial condition of the life insurance business.

2. Nature of Responsibility

- 2.1. The responsibilities of an actuary who is appointed under the AA Regulations, are central to the financial soundness of the life insurance company to which he is so appointed.
- 2.2. An Appointed Actuary should ensure, so far as is within his/her authority, that the life insurance business of the company is conducted on sound financial lines and that he/she has regard to Policyholders' Reasonable Expectations (PRE).
- 2.3. The essence of a profession lies in upholding its standards, technical and ethical, in the public interest. As a member of the Actuarial Society of India (ASI), every actuary has the responsibility to maintain the highest professional standards envisaged by the ASI. Any Appointed Actuary who becomes doubtful as to the proper course to adopt in relation to a potentially significant matter, is strongly advised to seek help and advice from the ASI.

3. Considerations affecting the position of Appointed Actuary

- 3.1. The role of the Appointed Actuary constitutes an 'actuary-in- practice' and in order to practise as such, an actuary must have a Certificate of Practice (CoP) issued by the ASI.
- 3.2. Any actuary, before accepting appointment as an Appointed Actuary must consider most carefully in the light of individual previous experience and work whether acceptance would be in line with proper professional behavior and standards. No actuary should act as Appointed Actuary if that individual does not have the appropriate knowledge and practical experience relevant to the assignment concerned. There may be exceptional circumstances where this need not apply, but in such cases appropriate arrangements must be made for the Appointed Actuary to have recourse on a professional and formal basis to an actuary who has such knowledge and experience and such an arrangement must be approved by the ASI and the Insurance Regulatory & Development Authority (IRDA).
- 3.3. An Actuary before accepting an appointment as Appointed Actuary must satisfy himself/herself that all stipulations as specified under regulation 3(2) of AA Regulations are complied with and shall continue to be complied with as long as he/she continues as Appointed Actuary.
- 3.4. The AA Regulations require the Appointed Actuary to be an employee of the insurer to which he/she is or will be an Appointed Actuary. The actuary must ensure that a contractual relationship with the insurer through an appointment letter, aside from appointment letter as an employee, exists at all times and that the conditionalities of the appointment letter of the Appointed Actuary are not influenced, particularly in a manner in which there is a possibility that responsibilities as Appointed Actuary might get compromised.
- 3.5. The Appointed Actuary must have right of access to the Board of Directors in general and the Principal Officer in particular and should have access to all relevant information so that the full range of duties and obligations can be carried out satisfactorily. This must be explicit in the appointment letter of the Appointed Actuary. Such access will be facilitated if the Appointed Actuary is a senior member of the management of the insurer. Where there is a group structure, the Appointed Actuary should bear in mind any possible implications on his/her right to information and ensure a right of direct access to the relevant decision making bodies and/or persons.
- 3.6. Where an actuary's financial interests in the Insurance Company or the Group Companies, by their nature and size are or become such that material conflict of interest would in the normal course of events, arise or seem to arise (or where a material conflict arises from some other reasons), the actuary should not accept the position of Appointed Actuary or continue in it, as the case may be.
- 3.7. The Appointed Actuary has responsibility in respect of all the provisions of the Act, the Rules and the Regulations framed by the IRDA wherein specific mention has been made of an actuary carrying out certain duties and obligations, except those provided for under section 35 (3) (d) of

the Act. The Appointed Actuary, therefore, must ensure that only he or she has responsibility in respect of these functions at all times.

- 3.8. Specific responsibilities have been placed on the Appointed Actuary to carry out and sign off certain certifications in terms of regulations and the Appointed Actuary should carry out the same keeping in view the generalities of this Guidance Note and other Guidance Notes specifically issued, if any, in respect of the provisions of these regulations.
- 3.9. Certain provisions of Insurance Regulatory and Development Authority (Registration of Insurance Companies) Regulations, 2000 imply projections based on actuarial methods and principles and certain provisions, such as item 13 of Form IRDA / R2, are explicit about the role of the Appointed Actuary. In case an Actuary had been involved with and had responsibility in respect of these requirements prior to the company obtaining Certificate of Registration, such Actuary must carry out these functions in a manner in which he or she would have carried out these functions if he or she were the Appointed Actuary of the company having obtained the Certificate of Registration.
- 3.10. If the Appointed Actuary is not the Actuary who was associated with responsibilities in respect of Forms IRDA / R1 and IRDA / R2, he or she should discharge duties and obligations under Regulation (8) of AA Regulations in the manner in which he or she considers appropriate.

4. **Extent of the Appointed Actuary's responsibility**

- 4.1. Every actuary has a responsibility to the profession and his/her responsibilities to a client must be consistent with this. An Appointed Actuary is however also in a special position as he/she has statutory responsibilities to the IRDA. If these two aspects materially conflict, the Appointed Actuary has to advise the company as soon as he/she feels that the company has initiated action – or a situation has arisen outside the control of the company – that materially threatens its solvency. If the company does not remedy the situation, the Appointed Actuary is required to advise the IRDA – but not before informing the company first. This duty applies, notwithstanding any provision or provisions contained in the code of conduct of the ASI which might seem to restrict or inhibit discharge of this responsibility.
- 4.2. The Appointed Actuary has a continuing responsibility to look after the reasonable expectations of the company's policyholders, having regard to;
 - i. the broad nature of the company, and
 - ii. its approach to the treatment of policyholders both individual and as a group vis-à-vis shareholders.

If a significant change is likely, the Appointed Actuary must make sure that the company appreciates the implications of this on its policyholders reasonable expectations.

- 4.3. The Appointed Actuary must take all reasonable steps to ensure that new policyholders are not misled with regard to their expectations, e.g. in connection with illustrations at the point of sales.
- 4.4. The Appointed Actuary must ensure that his or her conduct and reach and depth of his or her functionalities enable him or her to discharge his or her duties and obligations in letter and spirit in accordance with regulation (8) of AA Regulations.

5. **The duties of the Appointed Actuary**

- 5.1. Though Sec 13(1) of Insurance Act 1938 requires an investigation to be made by an actuary into the financial condition of the Life Insurance business every year, the Appointed Actuary must as

- a matter of duty have processes and methodology in place so as to carry out investigations to satisfy himself/herself that the company is solvent at all times.
- 5.2. The Appointed Actuary while carrying out the valuation of liabilities for the purpose of schedule II-A of Insurance Regulatory and Development Authority (Assets, Liabilities and Solvency Margin of Insurers), Regulations, 2000 must ensure consistency with the methodology prescribed and valuation carried out in respect of the assets.
 - 5.3. The Appointed Actuary must advise the company keeping in view the provisions contained under Section 49 of the Act as to how much of any surplus be distributed to policyholders or transferred to shareholders and recommend the allocation thereof.
 - 5.4. The Appointed Actuary must take all reasonable steps to ensure that the company's constitution or authorised procedures are or will be such that it will not make or undertake to make a specific allocation of surplus (whether to policyholders, shareholders or both) before the Board of Directors have obtained from the Appointed Actuary and duly considered a written report containing the Appointed Actuary's observations and recommendations on the subject.
 - 5.5. The Appointed Actuary must have regard to all aspects likely to affect the financial condition of the company, in particular the following;
 - i. the premium rates on which the company has written existing business and intends writing new business
 - ii. the nature of the contracts in force and currently being sold with particular reference to all options and guarantees
 - iii. the existing investments and continuing investment policy including the use of derivative instruments.
 - iv. the marketing plan, in particular the expected volumes and costs of sales
 - v. the current and likely future level of expenses
 - vi. the extent of the company's free assets
 - vii. the reinsurance and underwriting arrangements
 - viii. the company's policy in regard to the nature and timing of allocations of surplus to policyholders and/or shareholders
 - ix. the company's current and likely future taxation position
 - x. the current and likely future level of policy persistency rates,
 - xi. the robustness of the financials in the face of volatile market conditions, and
 - xii. the current and likely future mortality and morbidity experience.
 - xiii. for linked business the Appointed Actuary shall have regard to the pricing policy for segregated linked funds
 - 5.6. The Appointed Actuary must have the above information made available to him/her and he/she must make sure that the company understands the necessity of this information and makes suitable arrangements to ensure that the information is made available.
- 6. Premium rates and policy conditions for new products and existing products on sale**
- 6.1. The Appointed Actuary must be satisfied that premium rates for new business are appropriate, that is to say sufficient in due course to enable the company to meet its liabilities. If future new business is being written on inadequate terms, it will require support from the free assets in the shareholders fund, the Appointed Actuary should consider the company's ability to continue to write new business in the context of how much capital is required and should inform the Board of Directors accordingly.
 - 6.2. Whether the premium rates are appropriate is a probability statement and hence the Appointed Actuary must exercise judgement. This judgement needs to be based on the use of sound techniques and the Appointed Actuary must specifically consider;
 - a) the impact of taxation
 - b) the adequacy of the provision for expenses
 - c) the existence of any options, including guaranteed surrender values, and the risk that financial conditions could be such that a policyholder could gain by surrender and re-entry.
 - 6.3. If the contract is likely to give rise to significant new business strain then the Appointed Actuary must be satisfied that the company can set up the necessary reserves. If need be, he/she should indicate limits on the volume of sales that may prudently be accepted and/or how much capital is

required and gain reassurance from the Board of Directors that the required level of capital will be available and not earmarked for other purposes. For this purpose the Appointed Actuary will take into account the shareholders' assets, however, it cannot automatically be assumed that they are equivalent to free reserves held as part of the policyholders' fund because they can be used for other than life insurance business.

- 6.4 For linked business, including unitised with profit business the Appointed Actuary must be satisfied that all discretionary elements of unit pricing and fund charges are applied consistently with policyholders' reasonable expectations. In addition, the Appointed Actuary must be satisfied that the procedures for determining
- (a) the prices at which units are allocated to or de-allocated from policies;
 - (b) the prices at which units are created or cancelled; and
 - (c) compensation where errors of a material size in unit pricing or in the allocation or de-allocation of units to policies have occurred:

are equitable to any policyholders affected either directly or indirectly. For these purposes the Appointed Actuary must have regard, inter alia, to the tax position of the business and to the expected future growth or decline of the particular fund, if any

7. Capital Requirements

- 7.1 One of the important factors that will affect the financial position of a life assurance company is its marketing plan and the projected volume of new business. The Appointed Actuary should form an assessment as to whether the projected volumes are realistic and advise the Board of Directors as to the capital requirements associated with writing the required volume of business.
- 7.2 The Appointed Actuary should be satisfied that, if new business strain is likely to be a problem, the company will be able to meet the necessary reserves and solvency margin requirements from capital within the shareholders funds.
- 7.3 The Appointed Actuary should as far as possible assess the capital requirements by using a cash flow approach.

8. Actuarial investigations

- 8.1. Consideration must be given to the liabilities, the assets and the relationship between the two and the Appointed Actuary should be satisfied as to the resilience of the financial position of the company in all reasonably foreseeable circumstances that might affect the position.
- 8.2. The data used should be accurate. If there are any doubts on the data, the Appointed Actuary is expected to seek assurance from the company as to their accuracy and completeness. The Appointed Actuary should also be satisfied that the company is correctly carrying out appropriate valuation procedures and that adequate documentation exists in respect of them.
- 8.3. Valuation methods should be appropriate to the contracts concerned. For this purpose regard must be had not just to the principal benefits under the contracts but also to any guarantees on surrender, paid-up values etc. and any options.
- 8.4. The Appointed Actuary must also have regard to policyholders' reasonable expectations when determining the value of the liabilities.
- 8.5. The assumed value for each valuation parameter should consist of two parts. The first part should represent the expected level and the second should represent a margin for adverse deviation. The expected level should be appropriate for the coverage being valued and, where possible, should be based on the insurer's experience for similar products. If such data is not available or is not appropriate, then it can be based on industry data. The size of the margin for adverse deviation should reflect the degree of confidence the Appointed Actuary has in the expected level of the parameter and his/her perception about the extent of such deviation. Further, the margin for adverse deviation should be such that its addition to the expected level results in an increase in the reserve.

- 8.6. The value placed on the liabilities must make appropriate provision for future expenses and this provision must at least equal that required if the company were to close to new business one year after the valuation date. The possibility that preferential service agreements, if any, might be altered or terminated also needs to be allowed for.
- 8.7. Responsibility for investment policy and the value placed on the investments in any balance sheets rests with the company's Board of Directors. However, the Appointed Actuary's assessment of the rate of interest to be used in the valuation of the liabilities is affected by his/her estimate of the likely future proceeds of the existing assets and the rate at which future investment will be possible. The first requires an assessment of the nature of the company's investments and consideration of the rate of return, in terms of both capital and income likely over the future lifetime of the liabilities. The Appointed Actuary must have regard to the relationship between the term of the assets and of the corresponding liabilities in carrying out his/her investigations.
- 8.8. Keeping in view tax regime as applicable to life insurance companies, due allowance must be made for tax, taking into account the current and future taxation position of the company. This allowance must then be consistent with any allowance made for the tax relief on expenses.
- 8.9. The Appointed Actuary must judge and decide whether the investment policy pursued by the company is appropriate having regard to the nature and term of the liabilities. If it is not, the company must be informed of any constraints on investment policy needed to protect the interests of policyholders and additional reserves, which may need to be set up.
- 8.10. The Appointed Actuary must advise the company that it must give appropriate guidelines to its investment managers regarding the use of derivative instruments and that appropriate procedures should be in place to monitor the company's exposure to loss through their use;
- 8.11. The investigation and valuation must take into account the company's reinsurance arrangements. If these are considered to be inappropriate or inadequate, the company must be advised as to how the company needs to modify them to protect the policyholders' interests. Regard also needs to be given to the possibility that the reinsurance company may fail to meet its obligations or that reinsurance contracts may lapse or prove to be unenforceable in certain circumstances.
- 8.12. Where the company intends publishing the results of a valuation of the liabilities aside from valuation for the purposes of the Act, the Rules or IRDA Regulations, the Appointed Actuary must be satisfied in the public interest that the margins in the valuation are in total adequate taking into account his/her assessment of the risks inherent in the nature and conduct of the company's business.

9. Allocation of Surplus

- 9.1 As part of the actuarial investigation, the Appointed Actuary should determine the amount of surplus arising since the previous actuarial investigation and advise on its equitable allocation between with profits policyholders and shareholders, and submit a report to the Board of Directors on the same. The Appointed Actuary should take all reasonable steps to ensure that before any allocation of surplus takes place, the insurer considers the advice in the report and that the allocation is in compliance with section 49 of the Act.
- 9.2 The report to the Board of Directors should cover the following aspects:
 - 9.2.1. The report should contain enough information to judge the appropriateness of the allocations between the policyholders and shareholders.
 - 9.2.2. An indication of whether the allocations are sustainable in the future should be provided. This should include terminal bonuses.
 - 9.2.3. A statement confirming that Policyholders' Reasonable Expectations are being met.

10. Insolvency

- 10.1 Where an Appointed Actuary has to use judgement, this can be based in some circumstances on his/her estimates of the most probable outcome. If, however, the solvency of the company is involved, then the Appointed Actuary must apply much more rigorous standards. The Appointed Actuary shall also ensure that the ratio of the available solvency margin to the required solvency margin is reasonable taking into consideration the risk profile of the assets and liabilities.

10.2 Insolvency - or intervention on the part of the IRDA - can arise either from factors within the control of a company or from factors which are outside its control. Where the factors are within the control of the company, the Appointed Actuary must advise it of the limits within which it must act and why. Where the factors are outside the company's control, the Appointed Actuary must take whatever action he/she considers necessary, including that of communicating to IRDA after due deliberation with the Board of Directors.

11. Written reports

- 11.1 The Appointed Actuary must report in writing to the Board of Directors on the results and implications of any valuation carried out for statutory purposes before any report is made to the IRDA. In any report to the IRDA, the Appointed Actuary should use his/her best endeavors to ensure that;
- i. the financial results are presented in a way that demonstrates the true underlying position of the company, and
 - ii. these results are not distorted by any undisclosed valuation methods or assumptions.
- 11.2 The Appointed Actuary should take all reasonable steps to ensure that the Board of Directors consider the written report before they make an allocation of surplus to policyholders or shareholders, if any.
- 11.3 When the Appointed Actuary reports on or makes recommendations concerning a proposed allocation of surplus, he or she must take into account the points mentioned under note 9 of these Guidance Notes and any other factors, to be recorded which are considered significant. The Appointed Actuary must also carry out appropriate financial investigations including an appraisal of relevant experience.
- 11.4 The report must include enough information and discussion relating to the above so as to enable the Board of Directors to judge the appropriateness of the allocations and understand their implications for the future conduct of the business, in particular;
- i. if the amount of available surplus has not yet been determined, the report must indicate how in the context of statutory requirements the company can finance the allocation. The Appointed Actuary must discuss how the proposed allocation relates to the relevant experience. Also the Appointed Actuary must indicate whether continuation of the distribution policy is consistent with that proposed, will be sustainable. If it will not be, the Appointed Actuary needs to explain how this could be appropriately dealt with.
 - ii. in the case of with-profit business, the comments above must cover bonus prospects and make particular reference to the ability of the company to meet future payments of unreserved terminal bonus, if any in different investment scenarios.
- iii. any recommendations made have to be justified by reference to the Appointed Actuary's;
- a) appraisal of the relevant experience,
 - b) understanding of the company's financial and business objectives, and
 - c) assessment of the company's continuing ability to meet its statutory solvency requirements.
- 11.5 The Appointed Actuary has to assume that among the conditions for the fulfillment of PRE are the following;
- i. that groups of with-profit contracts are appropriately and equitably treated having regard among other things to the terms of the policies, their duration and their relevant pooled experience, and
 - ii. that the company conducts its affairs, including its new business and investment strategies, with due regard to its financial resources.

11.6 The Appointed Actuary or any other Actuary to whom this guidance note applies shall specifically confirm in his/her written report that he/she has complied with this guidance note. If he/she is not in a position to confirm his/her compliance to the guidance note he/she shall explain the reasons for the same in the report.

B: Guidance to Actuaries who are Directors and Employees of a Life Insurance Company

1. An actuary should make suitable enquiries and satisfy himself or herself about the affairs of a company before and after joining its board, as the public and the other directors will assume that he/she is satisfied with the way the company is being run;
2. Where the Appointed Actuary is also a member of the Board of Directors or the senior management, he/she needs to take all reasonable steps to ensure that other members of the Board of Directors or other senior managers know the capacity in which he/she is expressing any views.
3. Any other actuary who is on the Board of Directors owes a special responsibility to the Appointed Actuary and should take care to respect the status of the Appointed Actuary.
4. The requirement of paragraph (3) above also applies to any other actuary holding a managerial or other position of authority in the company.
5. As regards guidance to actuaries - external to a particular company - who are asked either by the company or someone with a legitimate interest in it to comment on either a valuation carried out by the Appointed Actuary or a report he/she has made to the company, the guidance for such actuaries is that, although there is room for differences of opinion with regard to actuarial advice and judgement, they should always take care to respect the status of the Appointed Actuary. This does not though stop them from making properly reasoned comments on the work of the Appointed Actuary, if need be.

C: Guidance to Independent Actuaries

1. From time to time, an actuary may be called upon to act in an independent capacity (for example, to function as an independent actuary in accordance with Section 35(3)(d) of the Act).
2. Such an actuary should exercise an independent judgement in the matters he/she has been asked to work upon. He/she should discuss the matters, where appropriate, with the Appointed Actuary, bearing in mind that there is always a room for differences of opinion with regard to actuarial matters and judgement.
3. Subject to paragraph B (5), the independent actuary should provide advice which in his/her opinion is appropriate.