At a glance

PRA concerns on underwriting and pricing optimism reiterated amongst new calls for GI Chief Actuaries to take action

What's new?

- On 17 September, James Orr, the PRA's general insurance Chief Actuary, released a letter to all general insurance Chief Actuaries which builds upon recent messages, including those in Anna Sweeney's Dear CEO letter in May.
- The letter provides further detail on concerns that optimism in pricing, underwriting and claims functions is feeding into business planning, reserving and capital. Orr considers these matters through the lens of the responsibilities of the Actuarial Function, including communicating issues to the board.
- The letter summarises findings from: the 2018 Chief Actuary Forum; ongoing PRA work on business planning and underwriting policies and the PRA's targeted review of reserving for London Market Casualty lines of business.

What does this mean?

The letter sets out the PRA's view on firms "joining the dots" between the Actuarial Function, underwriting, capital and reserving. It highlights concerns around an observed market wide reduction in reserve strength, demonstrated by recent underwriting years across the industry reserved at lower loss ratios than historical experience. It also references changes to terms and conditions that indicate possible inadequacy of large claims reserves for casualty business, in addition to unrealistic profitability assumptions in business plans and the unrealistic pricing of new business. Specific matters for consideration were:

Board engagement with the Actuarial Function

- The Actuarial Function is seen to need to provide clearer views to the board and challenging discussion, particularly on the realism of business planning and pricing assumptions of firms. This needs to be achieved by improving the interconnectedness of the Actuarial Function within firms.
- Board engagement with the Actuarial Function would benefit from the usefulness of information in the Actuarial Function report as well as one-to-one discussions with board members.

Appropriate capability in the Actuarial Function to assess premium adequacy

- The PRA have identified weaknesses in the process to assess premium adequacy, using historical data alone, amongst changing market conditions and deteriorating terms and conditions.
- The PRA will be undertaking further work on reviewing Actuarial Functions with respect to how they interact with business planning, underwriting policies and capital, and plan to share the findings in due course.

The impact of optimism on reserving

- Initial expected loss ratio assumptions on recent underwriting years are considerably lower than historical experience – where instances of a 30% reduction compared to prior years were noted. Firms are seen to exclude historical years of poor performance, to allow for expected improvements from portfolio changes, without having objective evidence to support the improvements. In some cases, credit for portfolio improvements are taken, despite experience showing a different story.
- The following examples were also highlighted: optimistic loss ratios for new business, a clear disconnect between reserving assumptions and emerging experience, overreliance on the accuracy of case reserves for large claims, evidence of a weakening of case reserve strength levels, absence of explicit inflation allowances for long tail lines and delays in reserving estimates feeding into capital and business planning.
- The PRA also reported specific findings on the classes considered in its targeted reserving review. On Casualty accounts, there was concern about adequately estimating future development for larger 'one-off' claims. In financial and professional lines, the PRA emphasised optimism on new business loss ratios and capturing any move to higher excess layers in development patterns.

Linkage with Lloyd's Actuarial Reviews

- The issues identified in this and previous PRA letters are reflected in the stance being taken by the Lloyd's actuarial team in its oversight of the Lloyd's Market.
- Lloyd's has written to both Chief Actuaries and Signing Actuaries, setting out its expectation for reserving at the 2018 year end. One central component of this is greater rigour and discussion where there is a difference in estimates between the syndicate actuarial estimate and that of the signing actuary, and the implications of any differences on capital setting. The letters specifically require more information be provided by signing actuaries, particularly around the loss ratio setting of recent underwriting years, review of loss ratios used in the business plan for reasonableness where this is relied on and historic loss ratios by years of account where the signing actuary has been engaged.

Lloyd's Business Plan Review and return to attritonal underwriting profitability

- Lloyd's have added additional rigour around its business planning process for 2019, following significant losses as at 31.12.2017 which although were exacerbated by the 2017 hurricane season, also occurred at an attritional level.
- Lloyd's has indicated that it will put into run-off syndicates or classes that cannot credibly turn around their business.
- Part of the concern around the losses incurred were over optimistic assumptions being used within both business planning and reserving.
- In response, Lloyd's instigated a "decile 10" review, whereby every syndicate had to review their 10 worst performing lines, whichever class they fell in, and establish a remedial plan to take the lines back to profitability. In some cases this has meant cutting classes completely.
- For circa one fifth of the market, for those syndicates with three consecutive years of losses, Lloyd's required full remedial plans.
- Lloyd's has now started its 2019 business planning approval process. There are some specific expectations:
    - Expenses will be cut
    - Aggregate premium will be cut
    - Loss making classes will be cut
    - Some plans will not be agreed and the viability of the syndicate and managing agent will be challenged
    - Any new business will have loss ratios based on realistic and known historical data, rather than an assumption that al new business must be profitable.

What do firms need to do?

- All insurers should understand the importance of these requirements, that they must now become the norm and be cognisant of the accountability to address and monitor these under the Senior Managers Regime.
- The findings in the PRA Chief Actuary letter specifically are detailed and substantial. Chief Actuaries should assess how the issues raised will be acted upon in their firms. Firms should take tangible actions where they have not already.

Next steps

To understand our cross market view of this letter and the specific changes that are taking place, please contact us.

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