

EDITORIAL AND ANNOUNCEMENTS

GUEST EDITORIAL

ACTUARIES PREPARE FOR 1993!

The Member States of the European Community (EC) have set themselves a target of 1 January 1993 for completing the single market in insurance within the EC. Many still regard this as an unrealistic target, but substantial progress has been made, and continues to be made, in putting the various parts of the programme together.

Efforts to bring about a more liberal European-wide insurance market began in 1956 when the Organization of European Economic Co-operation commissioned a report from Professor Campagne, Chairman of the Verzekeringkamer, the insurance supervisory authority of the Netherlands, on whether it was possible to establish minimum standards of solvency for insurance firms. It was hoped to move towards an agreed standard of solvency, so that each country would be able to rely on supervision carried out in the other countries for the purposes of allowing insurance companies from those countries to carry on business.

After the EC was established by the Treaty of Rome in 1957, the same issue was taken up by the insurance supervisory authorities of the Community. However, it took until 1973 before the Non-Life Establishment Directive was finally agreed. This introduced the current EC solvency margin regime for non-life insurers and opened the way for insurance companies to set up branches in other EC countries, with only the branch assets and liabilities being supervised in that country. Responsibility for checking the overall solvency of the company rested with the supervisory authority of the head office country.

The Directive left unanswered the question of how the assets and the liabilities should be valued in arriving at the solvency margin. This continues to be a matter for debate.

In June 1988 the Council of Ministers adopted the Second Non-Life Directive, which provides for freedom of services for "large risks". This took effect in July 1990, since when it has been possible for an insurer based in one country of the EC to write policies directly on commercial risks throughout the EC. Full extension of this concept to personal lines business as well as to commercial risks is intended under the proposals in the Non-Life Framework Directive, which were published in September 1990 and are currently under discussion in a Working Party of the Council of Ministers. This is based on the principle of a single licence, whereby each company would be supervised only by the supervisor in the member state where the head office is situated, but would receive a licence to operate throughout the EC, either through establish-

ment of branches or directly on a services basis. There would be no further layers of prudential supervision in the host Member States.

Much of the delay in agreeing on arrangements to provide full freedom of services has arisen because of concerns that additional protection was needed for policyholders, in the shape of minimum rules for technical reserves and for permissible assets.

Discussions are still proceeding on the draft Non-Life Framework Directive, but the proposal includes certain limitations on the proportion of the technical provisions which can be backed by different types of assets, outlaws any requirement by Member States to require insurers to invest in particular types of asset and requires "sufficient" technical provisions to be established, along the lines set out in another Directive, relating to the accounts of insurance undertakings.

The Accounts Directive, as agreed by the Council of Ministers in July 1991, although not yet ratified by the European Parliament under the co-operation procedure, sets out the types of technical provisions which should be established, in particular for unearned premiums, unexpired risks and outstanding claims. However, it is still not clear quite what is expected by the key sentence in Article 56;

"the amount of technical provisions must at all times be such that an undertaking can meet any liabilities arising out of insurance contracts as far as can reasonably be foreseen".

What can reasonably be foreseen? Is this a charter for really cautious reserves? I am sure that was not really the intention, given the context that this directive is about reporting to shareholders. This new wording adds a further twist to the development of the concept of the adequacy of technical reserves in the EC.

Statistical methods are acceptable, although Member States may require prior approval to be given to the use of such methods. The provision must allow for claims IBNR and for claim settlement costs. Implicit discounting of provisions to take account of future investment income is not permitted (for example by not allowing for future inflation) but explicit discounting may be permitted by Member States for longer-tailed run-offs (where the average expected date for claim settlement is at least four years after the accounting date) and where the discounting is done on a recognized basis, using approved methodology and a prudent rate of interest.

Although the requirements in relation to discounting do not specifically mention actuaries, the approach required is essentially an actuarial one and could increase the demand for actuarial involvement in establishing non-life technical provisions, although some Member States may decide not to allow any discounting at all.

The *Groupe Consultatif*, which is the umbrella organization representing the fourteen associations of actuaries within the Member States of the EC, has lobbied actively for there to be more explicit mention of actuaries in the Accounts Directive and for the actuary to be defined as someone who is a

member of one of the national associations. Unfortunately, this has not yet been successful, even in respect of the role of the actuary in life insurance. The position is even more unsatisfactory in relation to non-life insurance, where there is no explicit mention at all of actuarial involvement.

This does not mean, however, that the battle is lost. Recent developments in Canada and the United States to require actuarial certification of loss reserves should strengthen the hand of the actuarial profession in Europe in seeking to establish its special role in this field. Italy has already led the way by requiring the auditors of a non-life insurance company to obtain a certificate from an actuary on the adequacy of the technical reserves.

Of course, setting the technical reserves of a non-life insurer is not just a mathematical exercise. It requires a deep appreciation of the nature of the business, a thorough analysis of the available data, including a realistic assessment of their shortcomings, and a proper appreciation of the many uncertainties affecting the number, size and timing of future claim payments. The whole issue must be approached in a professional way and not just by the application of mechanical techniques or computer software packages. The Institute of Actuaries and the Faculty of Actuaries in the United Kingdom have recently issued a revised version of GN12, a Guidance Note on the production of actuarial reports on general insurance business, which helps to set out the framework under which an actuary should operate. It would be useful if agreement could be reached on an international basis as to a minimum set of professional requirements for an actuary producing a report on non-life business or certifying or giving an opinion on the technical reserves.

The business of insurance is becoming increasingly complex and specialist skills are needed to face the challenges which this brings. Actuaries have a great deal to offer to the managements of general insurance companies, not only in the field of loss reserving, but also in rating, experience analysis, profitability testing, designing and managing reinsurance programmes, assessing reinsurance security, investment strategy, asset/liability matching and overall financial control. Actuaries are beginning to devise models which will assist in corporate planning and in the overall financial management of the company. However, a key requirement in all of these areas is to be able to communicate well with management and to have a good appreciation of the underlying business environment.

In 1871 Cornelius Walford (an actuary himself) wrote, in the section of *The Insurance Cyclopaedia* discussing the term "actuary":

"... it may seem superfluous to add that an actuary must be something more than a mathematician. That the must be a mathematician admits of no question; but with that qualification ever so largely developed, and nothing more than that, he never becomes an actuary in the sense here implied. The other qualifications are sound judgement and enlarged knowledge of business affairs - sagacity. The latter can only be obtained with and from experience; the judgement should be inherent."

There is still a lot to play for in the development of a single market in insurance in the EC. 1993 will only be the beginning. The opportunity is there, however, for actuaries to make a vitally important, professional contribution to the sound growth of the non-life insurance market, in an increasingly European environment.

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