

Saudi Arabian Monetary Authority

HEAD OFFICE

General Department of Insurance Control

18 July 2019

Dear CEO

SAMA review of Actuarial Reserves as at Year-end 2018

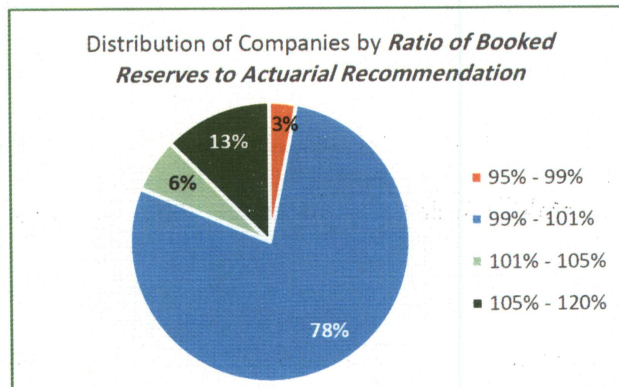
The Saudi Arabian Monetary Authority ("SAMA") would like to thank your Company for its responsiveness during the course of SAMA's review of the actuarial reserves as at year-end 2018. Compared to last year, this year's review-exercise ran more smoothly and involved greater participation from the Company in general.

SAMA acknowledges the improvements made in the quality of the technical analysis performed by the appointed actuaries, as majority have taken on board SAMA's feedback on their past submissions. SAMA sees these improvements as part of a journey and expects the appointed actuary and management to continue to strive and enhance the reliability of the technical provisions.

In this regard, SAMA would like to share with management the key observations from the above review-exercise, in anticipation that management will consider each of these observations diligently and appropriate actions will be taken in line with SAMA's expectations under each of these observations – refer below.

1. Booked reserves v Actuarial recommendation

The graph below summarizes the technical provisions booked by management compared to the appointed actuary's recommendation in respect of those provisions.



While majority of managements booked the technical provisions in line with the appointed actuary's recommendation, one-fifth of the companies booked these provisions above the appointed actuary's recommendation and a very small proportion booked below.

SAMA expects that management will continue to enhance its understanding of the basis of the actuarial recommendation in liaison with the appointed actuary and will make informed decision on the level of booked reserves, with due regard to the reserve uncertainty estimated by the appointed actuary and the risk appetite of the Company.



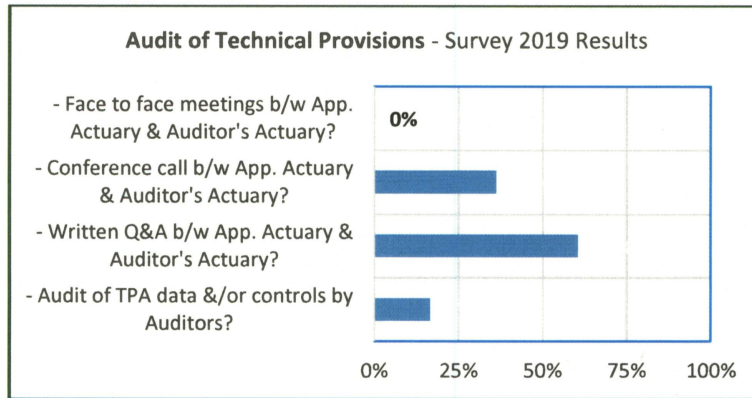
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2. Role of the External Auditors

Similar to last year, in March 2019 SAMA conducted a survey with the appointed actuaries to assess the level of interaction between the appointed actuary and the external auditors during the course of audit of the year-end 2018 technical provisions. The graph below shows some key findings from the survey:

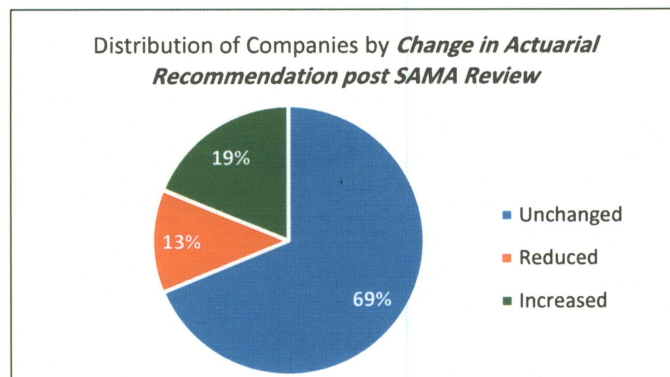


From the low percentage of positive responses in the above survey, it can be inferred that there is significant room for improvement in the audit of the technical provisions, including greater involvement of the external auditor's actuary.

SAMA expects the Audit Committee to define a comprehensive audit scope for the external auditors, in order to ensure that sufficient audit work has been performed, including adequate input from the external auditor's actuary who is expected to possess appropriate professional skills and knowledge of the trends and issues observed in the insurance sector in Saudi Arabia. Where the Company uses services of a Third Party Administrator (TPA), the audit scope shall also specify the audit requirements around the activities of the TPA, as applicable under the International Auditing Standards.

3. Review of the actuarial reserves by SAMA

The graph below summarizes the changes made by the appointed actuaries to their recommendations on the technical provisions subsequent to the review carried out by SAMA Actuarial team.



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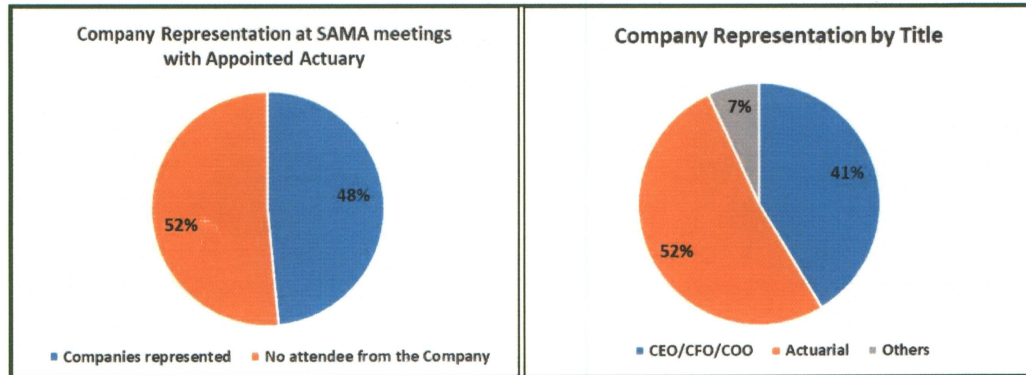
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Compared to last year when the appointed actuaries revised the technical provisions for nearly two-third of the insurance companies subsequent to SAMA's review-exercise, this year less than one-third of the companies witnessed results being updated by their appointed actuary. This indicates improvement in the quality of actuarial analysis compared to last year, though we note that there are still areas requiring attention of the appointed actuary (refer section 11).

SAMA would like to reiterate that it expects the appointed actuaries to adopt neither an aggressive approach nor an overly prudent approach to reserving, and at the same time, strive to improve the quality of actuarial analysis by maintaining pace with the professional best practice.

4. Company representatives' participation in discussions between SAMA and Appointed Actuaries

Taking on board the feedback received from the insurance companies, this year SAMA invited representatives from the insurance companies to attend the meetings held between their appointed actuary and the SAMA Actuarial team to discuss the technical provisions recommended by the appointed actuary. The graph below shows statistics regarding participation from the insurance companies:



It can be observed that nearly one-half of the companies benefitted from the opportunity and sent representatives, mainly from senior management and in-house actuarial teams. SAMA has received very positive feedback from those attending the above meetings.

SAMA encourages company management to participate actively in opportunities provided by SAMA for the sector to contribute, whether by attending meetings at SAMA or by providing input in response to draft regulations/ circulars issued by SAMA.

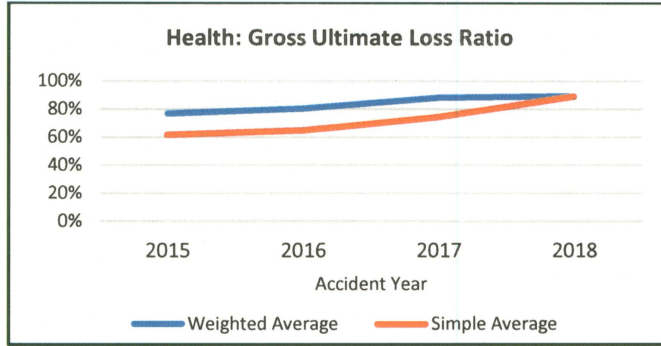
5. Trends in Health Insurance

The graph below shows the gross ultimate loss ratio for Health insurance for the last four accident/treatment years.

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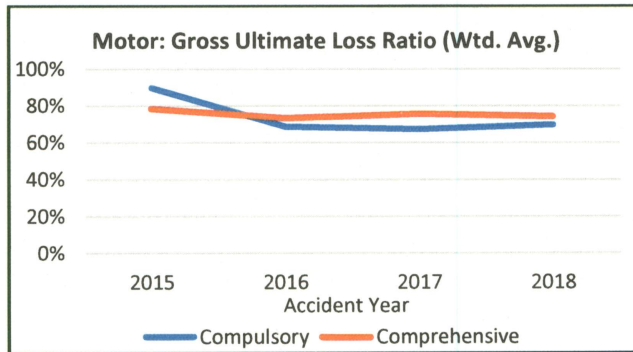


It can be observed that the loss ratios have continued to increase during AY2018, with the difference between simple and weighted average loss ratios indicating that, compared to large companies, smaller companies have suffered a steeper increase in loss ratio, partly driven by enhancement of minimum benefits by the regulator and increasing awareness amongst the insured population in low-benefit segment. .

SAMA expects management to closely monitor the profitability of its Health insurance business by 'underwriting segment' in close coordination with its appointed actuary, supported by key performance indicators (KPIs) and frequent management reports, and take remedial measures promptly.

6. Motor Insurance experience

The graph below shows the gross ultimate loss ratio (net of salvage & subrogation) for Motor, separately for Compulsory Third Party Liability policies and Comprehensive policies, for the last four accident years.



It can be observed that loss ratios for both motor segments remained stable during AY2018. Given the major changes in the motor sector during the year 2018 (e.g., enhanced no-claim-discount scale, more rating variables, female driving, etc.), this stable performance indicates that the sector has adapted well to those changes.

SAMA expects management to continue to monitor the performance of its motor book, particularly as pricing sophistication in the sector increases in line with SAMA's strategy and competition intensifies due to new distribution channels (e.g., Aggregators).

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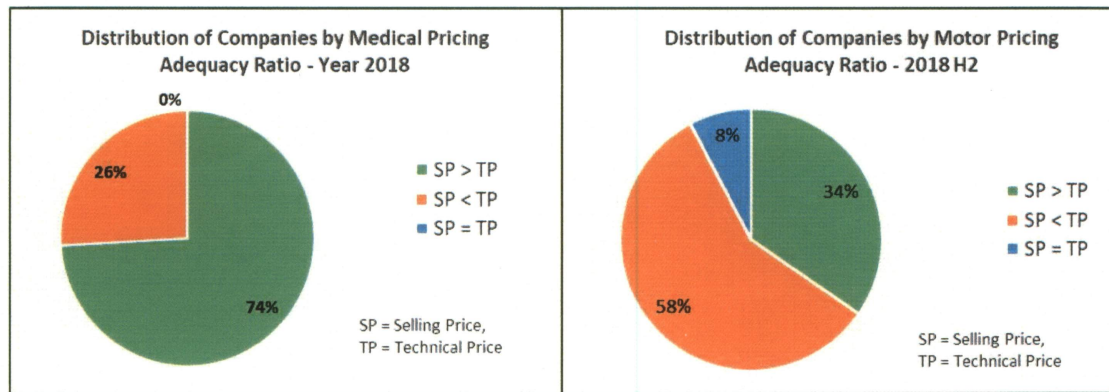
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7. Pricing Adequacy – Motor & Medical

While management is ultimately responsible for the price charged to its customers, SAMA periodically monitors the selling price against the technical price recommended by the appointed actuary with the main objective of detecting and preventing mispricing of policies in order to ensure fair treatment of policyholders and financial stability of the insurance sector.

The graphs below summarize the results of the pricing adequacy exercise for Health insurance (1st Jan-31st Dec 2018) and Motor insurance (24th Jun – 31st Dec 2018).



The price adequacy of Health insurance business improved during the year 2018, as SAMA had followed up with those companies where issues were identified in the previous run.

For Motor insurance however, several companies have been identified as writing business well below the technical price. At the year-end 2018, many of those companies were obliged to take a hit on their profitability due to substantially increased premium deficiency reserves (PDR).

SAMA expects that management will enforce strong underwriting discipline within the underwriting function of the Company, and use its discretion on final selling price diligently and responsibly, with due consideration of SAMA's objectives as outlined above.

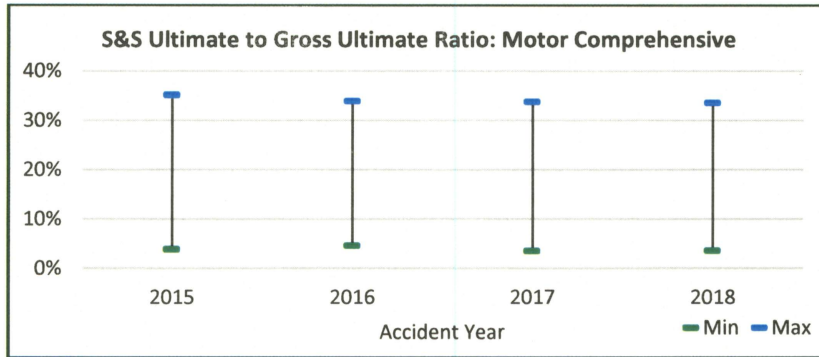
8. Salvage & Subrogation (S&S) Estimates

The graph below shows the range of S&S ultimate recoveries, as a percentage of gross ultimate claims, for Motor Comprehensive policies for the last four accident years.

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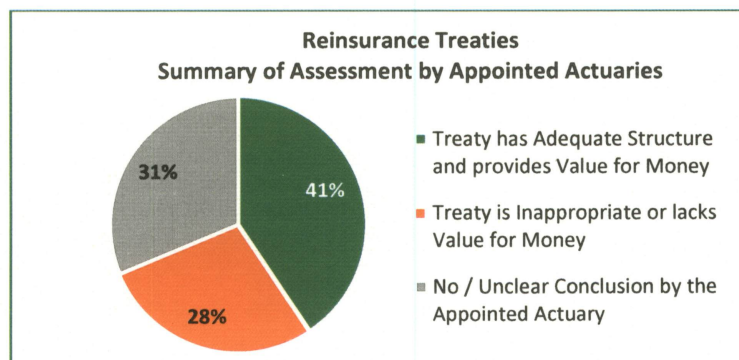
The year-on-year wide range above implies that while some companies have been striving to fully benefit from this source of revenue, likely through efficient and active management of these cases, other companies are missing this significant opportunity to improve their revenues.

We have also observed that some companies continue to include the depreciation and/or deductible amounts under the head 'salvage & subrogation', thus distorting true performance of the Company's claims/recovery team.

SAMA expects that management will take full cognizance of the potentially large impact of salvage & subrogation recoveries on the overall revenues, and efforts will be made to improve 'true' performance of the Company in this regard.

9. Adequacy of Reinsurance Arrangements

The graph below summarizes the opinions provided by the appointed actuaries, as part of the year-end 2018 Financial Condition Report, on the value and appropriateness of the existing reinsurance arrangement.



It can be observed that the reinsurance arrangements of over one-fourth of the insurance companies have been assessed by the appointed actuaries as 'inappropriate' or 'not providing value for money'. Nearly one-third of the opinions did not provide a clear recommendation to management. We also note that, in general, the technical analysis performed by the appointed actuaries was at best 'high-level' and there is significant room for improvement.

SAMA expects management to actively engage with the appointed actuary in order to seek and understand his findings on the existing reinsurance arrangements and make informed decisions

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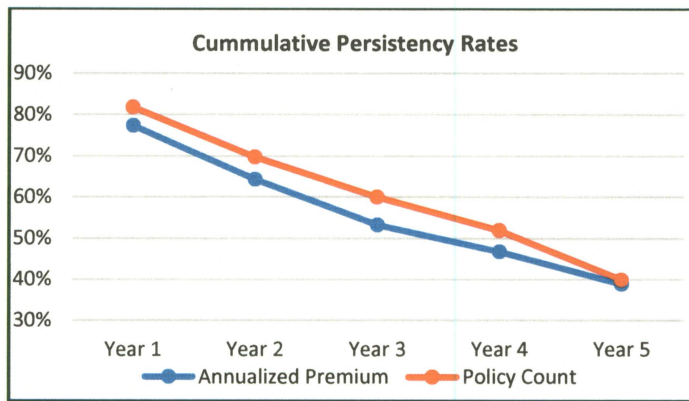
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on future reinsurance placements, with due regard to the Company's risk appetite. SAMA also expects that the appointed actuary will deploy professional best practice in order to evaluate and recommend the optimal reinsurance arrangement for the Company.

10. Persistency rates of Protection & Saving policies

The graph below shows the average persistency of long-term protection & savings products at each policy duration, as obtained from the Persistency reports submitted by the appointed actuaries.



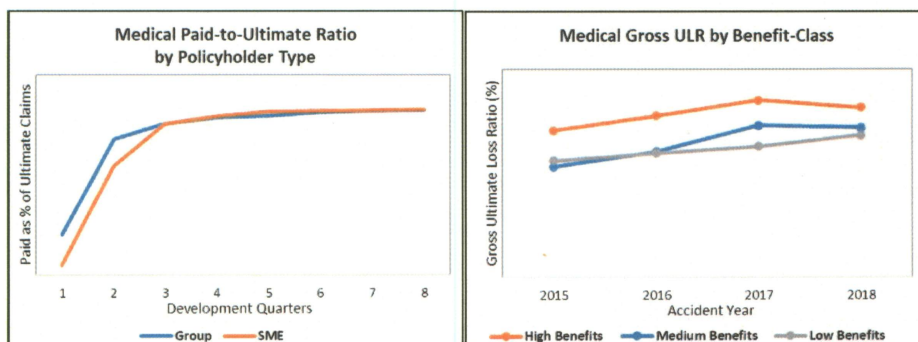
It can be observed that the average customer retention is very low. By the end of the fifth policy year, on average, only **40%** of the policies sold remain in force.

SAMA expects that management will invest in training of its marketing staff and in improving the value of its product offerings in order to improve the persistency ratios in the market.

11. Actuarial reserving - areas for improvement

11.1. Reserve segmentation for Health insurance

- In the past, SAMA had encouraged the appointed actuaries to enhance the reserving segmentation for Health insurance. The graphs below show the differences between reserving segments in respect of those companies which made such improvements at year-end 2018.



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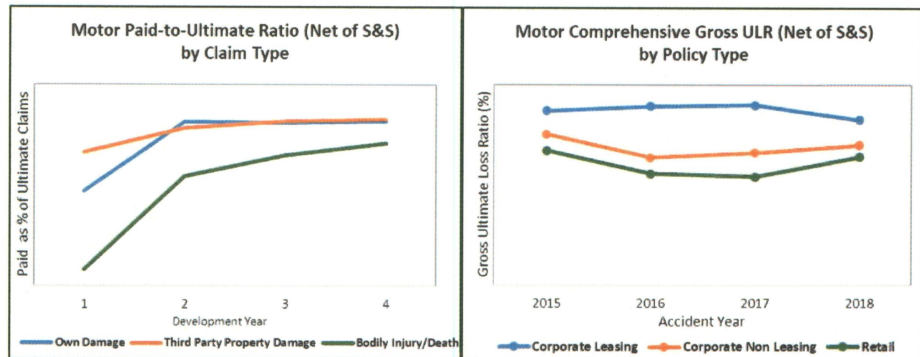
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- Clear differences can be observed in the claims development pattern between Group and SME segments. Likewise, the loss ratios can be seen to differ materially by benefit segment.
- *SAMA expects the appointed actuary to investigate and adopt a reserving segmentation based on the risk-characteristics of individual segments and which provides most insightful results to management.*

11.2. Reserve segmentation for Motor

- In the past, SAMA had encouraged the appointed actuaries to enhance the reserving segmentation for Motor insurance. The graphs below show the differences between reserving segments in respect of those companies which made such improvements at year-end 2018.



- Clear differences can be observed in the claims development pattern by claim-type. Likewise, the loss ratios can be seen to differ materially by policy-type.
- *SAMA expects the appointed actuary to investigate and adopt a reserving segmentation based on the risk-characteristics of individual segments and which provides most insightful results to management.*

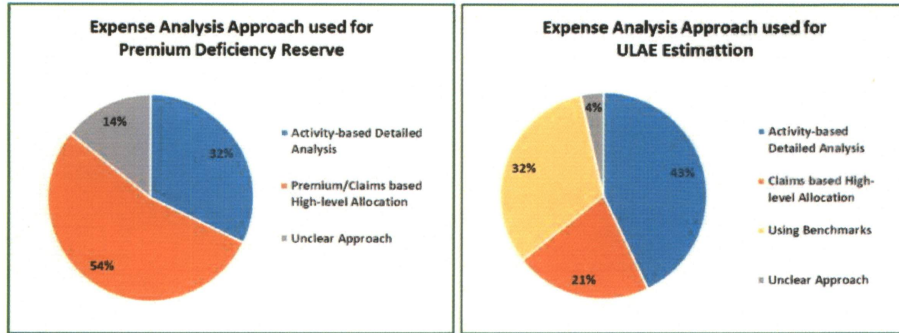
11.3. Expense Analysis

- The graph below provides a summary of methodologies used by the appointed actuaries to conduct 'expense analysis' for estimating Premium Deficiency reserves and Unallocated Loss Adjustment Expense reserves.

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- It can be seen that only a small number of appointed actuaries performed a detailed activity-based analysis to derive their results. A majority relied on high-level estimation approaches or used market-benchmarks.
- *SAMA expects the appointed actuary to deploy professional best practice when carrying out the expense analysis. For those aspects of expense analysis, where reliance is placed on the Finance function, the appointed actuary is expected to perform appropriate validation of the input received.*

11.4. Reserving for (multi-year) Medical Malpractice Insurance

- We have observed that a number of companies write Medical Malpractice insurance, offering protection over a multi-year policy period. Such multi-year policies are likely to have material implications for reserving, both in terms of premium earnings-pattern and claims development-pattern.
- *SAMA expects that management will make all relevant information available to the appointed actuary to assist in setting adequate reserves for Medical Malpractice insurance policies.*

Abdullah A. Al Towaijri
Director General of Insurance Control

Copy to:

- All appointed actuaries