

Saudi Arabian Monetary Authority

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General Department of Insurance Control

10 September 2020



Dear CEO

SAMA review of Actuarial Reserves as at Year-end 2019

SAMA conducted its annual review of the actuarial reserves at year-end 2019 in the first quarter of this year. The review-process continues to improve year on year, with more effective liaison between SAMA and the Company's appointed actuary and greater participation of Company management in the discussions held around the actuarial reserves.

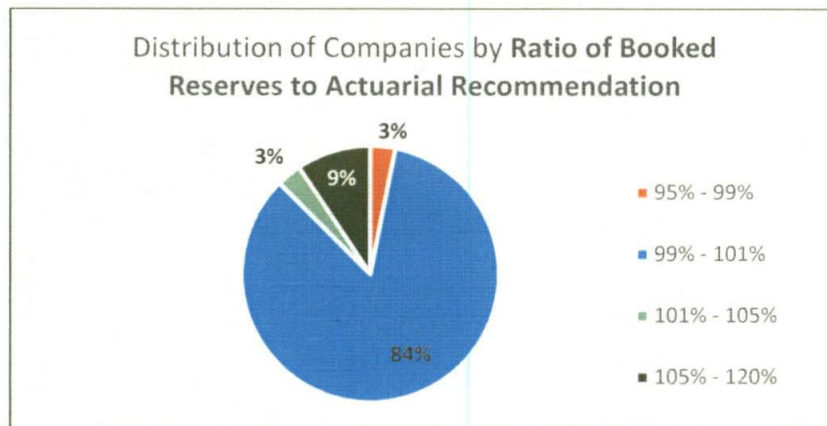
The quality of actuarial reserving carried out by the appointed actuaries continues to improve as well, with better justification around the methodologies used and greater transparency around the results produced.

There were a number of key observations emerging from the above review. SAMA would like to share these observations and its expectations in respect of those observations with management, in anticipation that management will consider these diligently, internal discussions will be held with relevant functions and, where necessary, appropriate actions will be taken.

Moreover, COVID-19 poses special challenge for the insurance sector during 2020, both directly and indirectly. It is expected that management will pay close attention to the evolving market situation, specific management reports will be produced regularly, and appropriate decisions, including those relating to issues mentioned later in this letter, will be made and implemented on a timely basis.

1. Booked Reserves vs Actuarial Recommendation

The graph below summarizes the technical provisions booked by management compared to those recommended by the appointed actuary.



Compared to last year, a greater proportion of companies booked technical provisions in line with the appointed actuary's recommendation, pointing towards limited use of the reserve uncertainty estimates produced by the appointed actuary. Among the companies booking technical provisions different from those recommended by the appointed

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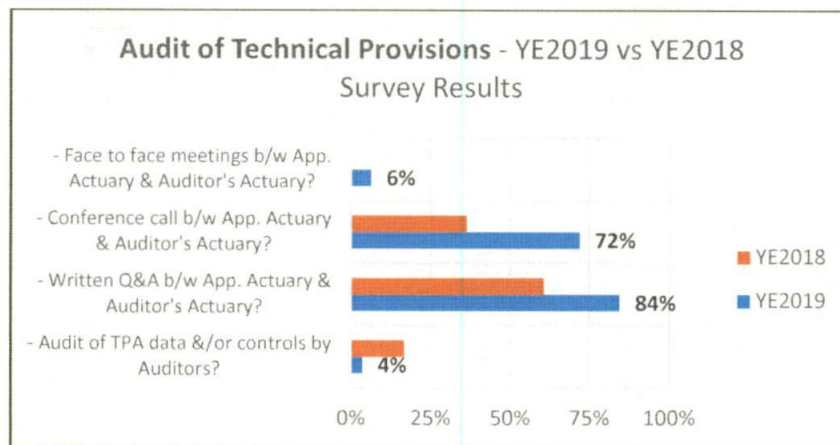
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actuary, the majority booked higher than the recommended reserves, likely in consideration of the reserve uncertainty estimates.

SAMA expects that management will seek to understand and fully own the booked technical provisions through discussion and challenge of the actuarial recommendations, and that its decision regarding the booked technical provisions will have due regard to the reserve uncertainty estimates and the risk appetite of the Company. Over the next quarters, SAMA expects that the impact of COVID-19 on actuarial reserves and reserve uncertainty estimations will feature heavily into management's discussions with the appointed actuary.

2. Role of the External Auditors

In previous years, SAMA had identified significant room for improvement in the work performed by the external auditors around the actuarial reserves. Below are the results of the latest annual survey conducted by SAMA with the appointed actuaries in order to assess improvements in the level of interaction between the external auditors and appointed actuaries.



While marked improvement in interaction between the appointed actuary and the external auditors' actuary can be observed from the above graph, there were still a number of companies where there was no communication between those two actuaries. Also, disappointingly so, the proportion of TPA data and controls audited this year reduced compared to last year. This is indicative of gaps in the performance of audit committees of various insurance companies.

SAMA expects each Audit Committee to ensure that the scope of external audit requires adequate input from the external auditor's actuary, also ensuring that the external auditor's actuary possesses appropriate professional qualification, skills and is fully aware of the latest trends in Saudi insurance sector. Where the Company uses services of a Third Party Administrator (TPA), the Audit Committee shall also satisfy itself that the audit scope appropriately covers the activities of the TPA, as applicable under the International

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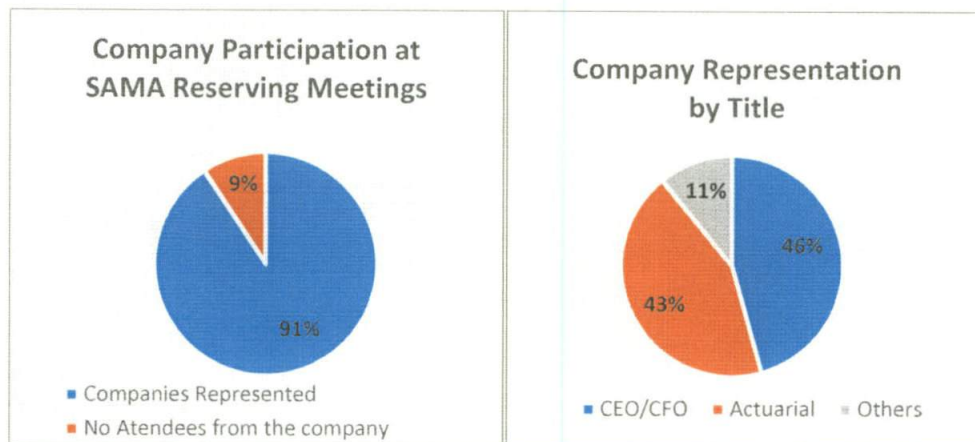
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Auditing Standards. It is expected that the Audit Committee will closely monitor the external auditors' adherence to the above scope items.

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

Compared to prior years, there was a significant improvement in the extent of participation by insurance companies' representatives in the meetings held between SAMA and the appointed actuaries to discuss the actuarial reserve estimates.



The participation rate this year exceeded 90% compared to just above 50% last year. Also, compared to last year, more senior management personnel, particularly CFOs, attended this year. While this enriched the discussions held around the actuarial reserves through addition of business insights, the opportunity to learn from the market benchmarks was appreciated by all those attending.

SAMA encourages management to make active use of and benefit from this opportunity created by SAMA to enhance the transparency and depth of discussions held around the actuarial reserves.



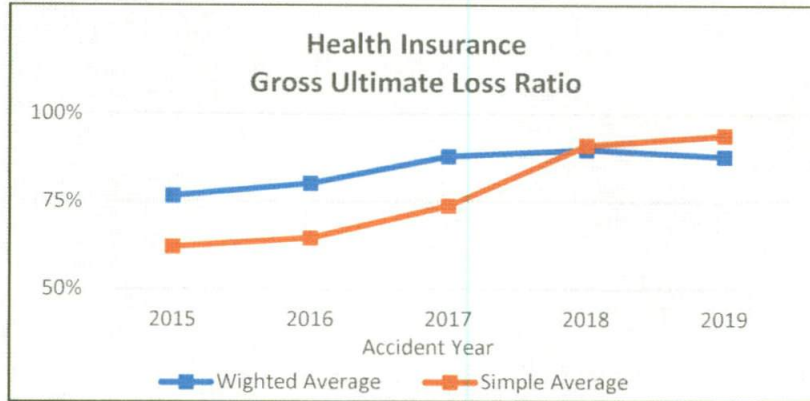
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4. Trends in Health Insurance

The graph below shows the claims experience under Health insurance for the last five accident/treatment years.

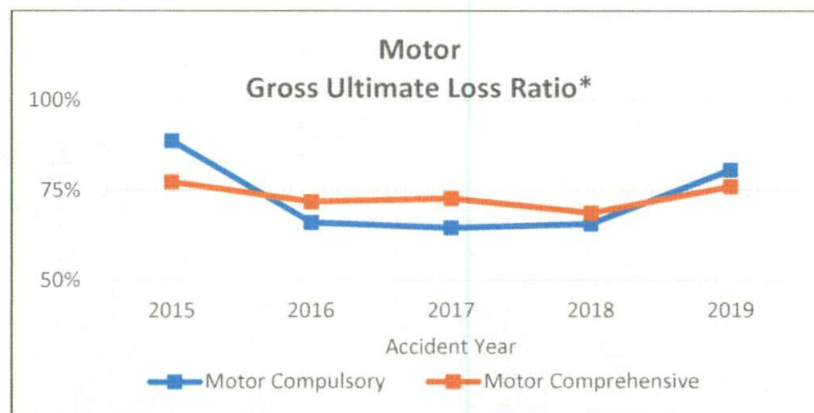


The trend of weighted-average and simple-average loss ratios seen above suggests that smaller insurance companies, which tend to focus on SME business, continue to struggle to keep loss ratios under control in recent years. This trend, coupled with usually a high expense base associated with small companies, is likely to cause significant profitability challenges for management.

SAMA expects that management will thoroughly investigate into the drivers of the above trends and corrective actions in pricing and underwriting will be taken promptly.

5. Trends in Motor Insurance

The graph below shows the claims experience under Motor insurance, separately for Motor Compulsory and Motor Comprehensive, for the last five accident years.



*Weighted average of all companies, net of salvage and subrogation

For both motor classes, the loss ratio in 2019 increased to a level above that seen in the previous three years. The increase is steeper for Motor Compulsory than for Motor Comprehensive class.

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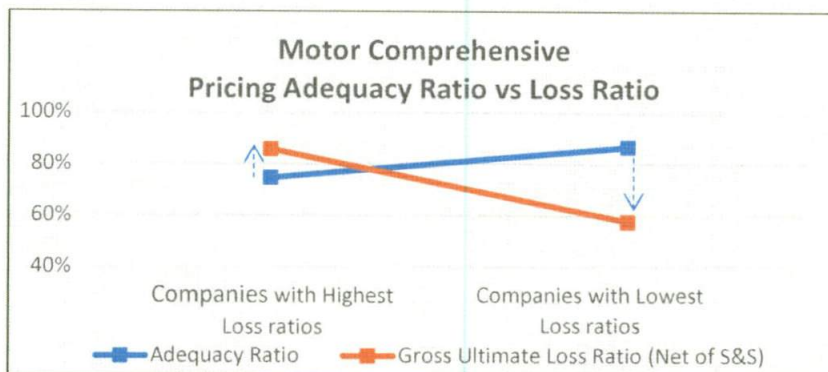
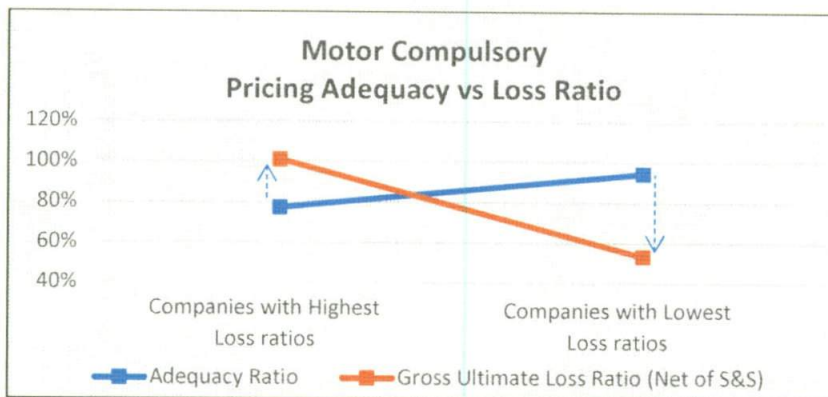
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SAMA expects that management will closely monitor the emerging trends in Motor insurance and continue to refine premium rates, while also considering the impact of external factors including aggregator' sales channel, COVID-19, and recent regulatory initiative to reduce the number of uninsured vehicles.

6. Motor Loss Ratio vs Pricing Adequacy

The graphs below compare the pricing adequacy ratio against the gross ultimate loss ratio, separately for companies with the highest loss ratios and for those with the lowest loss ratios in accident year 2019.



Note: Loss ratio is weighted average gross ultimate loss ratio of top 5 companies in each category for accident year 2019. Pricing adequacy ratio is taken as the average of 2018H2 and 2019H1 ratios to correspond to accident year 2019.

The above graphs show clear evidence of negative correlation between the pricing adequacy achieved by a company and its gross ultimate loss ratio. The correlation seems stronger for Motor Compulsory than for Motor Comprehensive. It is also important to note that the above correlation appears to be less than a 'perfect' one, which highlights the importance of other factors like underwriters' judgement, claims settlement practices, accuracy of actuarial pricing etc. in influencing the gross ultimate loss ratio.

SAMA expects management to ensure that a) internal controls around the discretionary reduction in premium rates are strictly adhered to, b) the Board of Directors is made aware of the expected financial impact of any material pricing discounts on a timely basis, and c) a strong feedback loop exists between the underwriting function and the appointed

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actuary in order to ensure that the technical prices calculated by the appointed actuary remain relevant at all times.

7. Salvage & Subrogation (S&S) Estimates

The graph below shows the range of salvage and subrogation ultimate recoveries as a percentage of gross ultimate claims for the last five accident years.



Last year, we had observed that some companies included the depreciation and/or deductible amounts under the head 'salvage & subrogation', thus distorting the true performance of Company's claims/recovery team. One important correction this year was that a number of those companies removed deductibles & depreciations from the salvage & subrogation data, causing the range to narrow down relative to that seen in previous years. Despite this, it is evident from the above graph that there is a significant room for improvement for those companies currently sitting towards the lower end of the above range. Moreover, very few companies were able to provide data showing salvage and subrogation separately.

SAMA expects that management will continue to improve the efficiency of its salvage & subrogation recovery process in order to maximize the income from this source. Moreover, it is expected that management will improve its data systems in order to record salvage and subrogation separately.

8. Actuarial reserving - areas for improvement

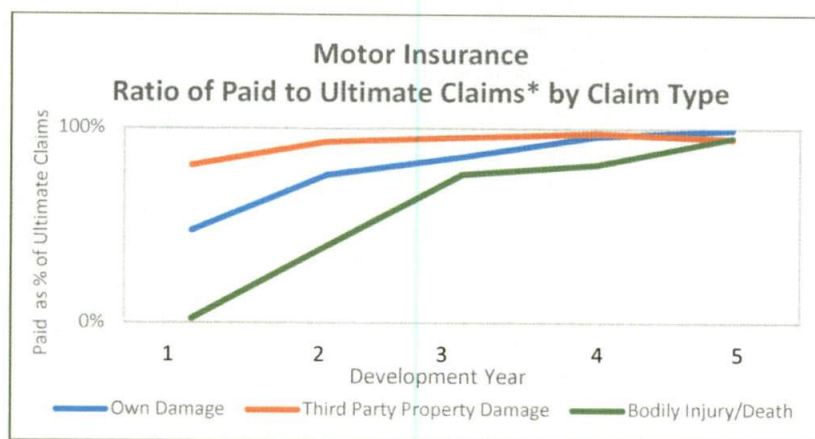
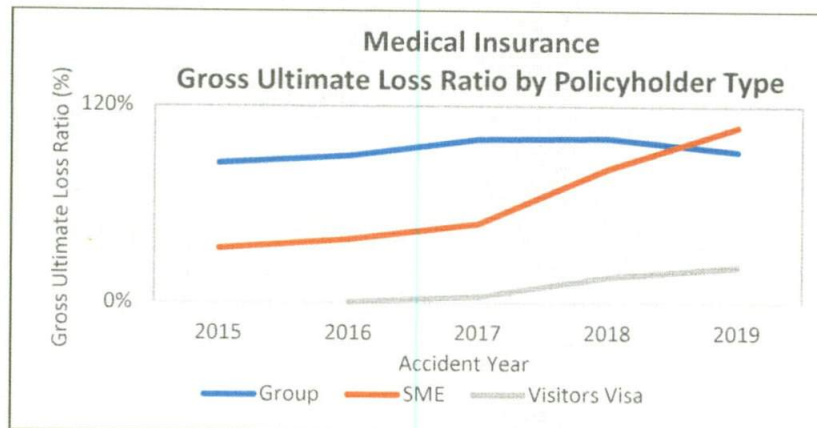
8.1 Reserve segmentation for Health and Motor insurance

- SAMA has continued to emphasize to the appointed actuaries to regularly investigate and refine their reserving methodologies in order to keep pace with the emerging trends and leading actuarial practices. The graphs below show the results of projection for a subset of companies that adopted more refined reserve segmentation than others.

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*net of Salvage & Subrogation

- Clear differences are observed in the projected ultimate loss ratio by policyholder-type in Health insurance and in the claims development pattern by claim-type in Motor insurance, thus supporting the use of these granular segments for reserving.
- SAMA expects the appointed actuary to continue to investigate and, where appropriate, refine the reserving methodology on a regular basis. To facilitate this, it is expected that management will ensure that processes and systems are in place for recording of underwriting and claims data at appropriate levels of granularity.

8.2 Reserving for Medical Malpractice Policies

- Due to the multi-year exposure under these policies, SAMA had previously drawn attention towards the need to review the experience of Medical Malpractice closely, and if appropriate, consider reserving for those policies separately. A few appointed actuaries have carried out the above refinement this year and the graph below shows the results of their projection.

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- Slower claims development is observed in early years for Medical Malpractice than other Accident & Liability sub-classes. In addition, there is limited claims development in the first four years, indicating high uncertainty in estimated claim reserves.
- SAMA expects that the appointed actuary will consider reserving separately for Medical Malpractice class, and management is expected to facilitate capturing and provision of all required data in this regard.

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Director General of Insurance Control

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- All appointed actuaries