



**Financial Services  
Commission**

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**Insurance Companies Ordinance 1987**  
**Systems Of Control Over General Business Claims**  
**Provisions**

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## Introduction

1. This note provides guidance for insurance and reinsurance companies on the controls which should be in place in order to ensure that the amounts set aside for claims outstanding and for claims handling expenses are appropriately established, properly recorded and effectively monitored.
2. The guidance is in two parts; "Claims handling" covers the systems of control over the recording and processing of notified claims incurred and the associated costs of handling claims, whilst "Claims outstanding" addresses the setting of the technical claims provision.
3. In the context of this guidance,
  - "claims provision" or "provision of claims outstanding" means the amount provided in the company's financial statements to cover the estimated ultimate cost of settling claims (including claims incurred but not reported and claims handling expenses) arising from events which have occurred by the end of the accounting period, less amounts already paid in respect of those claims;
  - "case estimate" means an estimated provision for an individual claim outstanding based on information relevant to that claim;
  - "statistical estimate" means an estimated provision for a group of claims outstanding, based on information relevant to the group.
4. The guidance should be read in conjunction with the explanatory note at Appendix A.
5. Appendices B and C set out "Areas for management to consider.....". These have been included for illustration purposes only and are not exhaustive.

## Claims Handling

6. Suitable controls, systems and procedures should be in place to ensure adequate and accurate information is appropriately and promptly recorded to enable a proper assessment to be made of the ultimate cost of all claims or potential claims.

### Systems

7. Appropriate and effective systems and controls should be in place to allow the company to record and monitor its financial liability to policyholders in respect of claims arising from insurance contracts.
8. In determining what are "appropriate and effective systems and controls" we would normally expect an insurance company to consider the areas summarised in Appendix B.

### Resources

9. Resources allocated to the claims handling function should be appropriate, both in quality and quantity, for ensuring that the controls are effective at all times.
10. Management should regularly monitor the pertinent indicators of resource pressure (for example, backlogs, inactive files, missed deadlines from the diary, inaccuracies in case estimates or statistical estimates, late or inappropriate amendments to estimates).
11. In order to satisfy themselves that information received from external resources can be relied upon, management should take reasonable and appropriate steps to satisfy themselves that the resource is of the appropriate quality, experience and competence.

12. The management should maintain adequate supervision and control over any external resources used to assist the claims handling function.

#### **Function autonomy**

13. The claims handling department should maintain regular liaison with other key functions within the company.
14. Notwithstanding the requirement of paragraph 13 above, management should ensure that the extent of the segregation of disciplines is appropriate for the nature and size of the business. (For example, whilst it is necessary for the claims handling department including the reserving function to have a certain degree of contact with the underwriters, the two groups must maintain a suitable level of independence from each other.)

#### **Data**

15. Appropriate systems should be in place to satisfy management that data is complete and accurate, and is being correctly recorded on a timely basis.
16. Considerations which management should take into account when assessing the suitability of the data collection include, but are not limited to, the items listed in Appendix C.

### **Provision For Claims Outstanding**

17. Management should maintain appropriate controls, systems and procedures to ensure that the provision for claims outstanding is, at all times, sufficient to cover any liabilities that have been incurred on insurance contracts as far as can be reasonably foreseen.

#### **Resources**

18. Resources for setting and monitoring the provision for claims outstanding should be appropriate, both in terms of skill and experience.
19. In satisfying themselves that the company has the appropriate skill and experience, management should consider the following points:
  - The value of using appropriately qualified, experienced and proven loss reserving specialists (including the use of actuaries with general insurance experience if the class of business warrants it).
  - Procedures should be in place to ensure that external loss reserving specialists, possess the appropriate level of skill and experience.
  - Individuals responsible for carrying out the calculations to determine the provision for claims outstanding must be adequately familiar with the nature, complexity and size of the business.
  - Management should ensure the necessary information (gathered, for example, by regular liaison with underwriters, intermediaries and reinsurers) is available for the determination of the provision for claims outstanding.

#### **Data**

20. Suitable controls should be in place to ensure that the data used in determining the provision for claims outstanding are extracted from the underlying records accurately and to the necessary level of detail. (In this regard, the data available to management in their assessment of the company's claims provisions should cover the whole of the company's insurance liabilities and exposures).

21. Considerations which management should take into account when assessing the suitability of the data analysis include, but are not limited to, the items listed in Appendix C.
22. If the company uses an external resource to assist in estimating the provision to be made for claims outstanding, suitable controls should be in place to ensure that the source data is complete, and suitable procedures should be in place to ensure that the results received from the third party can be relied upon and are reported in the correct format to the necessary level of detail.

#### **Estimation methods**

23. Appropriate methods should be applied in estimating the provision to be made for claims outstanding.
24. Regard should be given to relevant judicial developments, changes in legislation and economic assumptions.
25. Management should consider alternative estimation approaches before selecting the most appropriate to the nature of the business.
26. The frequency with which a comparison of estimation methods should be undertaken depends on the type of business and the adequacy of the methods in use, as evidenced by the run-off performance or other pertinent factors.
27. Efforts should be made to identify and understand the reasons for any significant differences between the results from the different approaches.
28. Suitable controls should be in place to ensure that the selected approaches are applied accurately and on a consistent basis.
29. Procedures should be in place to review and monitor, on a regular basis, the out-turn of provisions made in prior years for claims outstanding.
30. Evaluation of the out-turn should normally be carried out by line of business and by accident year or underwriting year. The out-turn of the element within the claims provisions which relates to claims handling expenses (both direct and indirect) should be monitored separately.

#### **Function autonomy**

31. The individuals responsible for setting provision for claims outstanding should maintain regular liaison with other key functions within the company.
32. The work of those responsible for setting provision for claims outstanding should be subject to regular review by senior management independent from the underwriting function.

#### **Reinsurance**

33. Suitable systems should be in place to ensure that reinsurance recoveries are identified and appropriately recorded on a timely basis.
34. Procedures should be in place to allow management to evaluate and monitor the application (and hence the effect) of the reinsurance programme to the gross provision for claims outstanding (including claims incurred but not reported).
35. Appropriate systems should be in place to evaluate and monitor the company's credit risk exposure to individual reinsurers.
36. Management should update the provision for reinsurance bad and doubtful debts on a regular basis.
37. Further detailed recommendations on controls over reinsurance will be issued in a separate guidance note.

## Appendix A

### Explanatory Note

1. The note has been prepared to assist directors of insurance and reinsurance companies, their auditors and others who may be concerned in setting general business claims provisions for the purposes of both the supervisory returns and the statutory shareholder accounts.
2. Other technical provisions, namely the provision for unearned premiums, the unexpired risk provision and equalisation provisions are not specifically covered by this note, although much of the guidance deals with issues which are generic to all technical provisions.
3. The guidance note recognises that the systems and controls required for the claims handling function will not be the same as those required for the function of setting the provision for claims outstanding. Whilst the two areas are strongly interrelated, the guidance note recognises that effective management controls are required in both areas in order to establish and report appropriate provisions.
4. The guidance is not intended to be prescriptive in defining the controls which all general insurance companies must employ. Rather, it is recognised that it is a matter for the directors to be satisfied that the company's controls are appropriate for the business that it operates. Control objectives can be attained in many different ways, depending on the size and nature of the business. It is the responsibility of Management to ensure that adequate resources are available to meet the control objectives.
5. Accordingly, the guidance note provides an overview of the key control systems and procedures. This should then enable management to evaluate the company's existing controls in conjunction with the note in order to identify whether there are any worthwhile areas for enhancement.
6. For the preparation of the annual return, the company must value its technical provisions in accordance with the Insurance Companies (Valuation of Assets and Liabilities) Regulations 1996. In effect, therefore, the general business liabilities for such returns shall be valued under the same rules that apply to the technical provisions disclosed in the shareholder accounts.
7. This guidance note does not seek to discuss or comment on the advantages of any one claims estimation method when compared to another. The appropriateness of a company's methods in establishing provisions for claims outstanding should be assessed by whether the methods used have yielded or are expected to yield an appropriate level of provisions for that company.
8. The Commissioner considers this guidance is relevant for the purposes of the statements required in the Director's certificate in accordance with Schedule 5 to the Insurance Companies (Accounts and Statements) Regulations 1996.
9. The Insurance Supervisor will be pleased to provide additional assistance if there are any areas that you would like to discuss further.

## Appendix B

### Areas For Management To Consider When Establishing Appropriate And Effective Claims Handling Systems And Procedures

Management's considerations would be expected to include, but should not necessarily be limited to, the items set out below.

1. The appropriate controls should be in place to ensure that all liabilities or potential liabilities notified to the company are recorded promptly and accurately. Accordingly, the controls in place should ensure that a proper record is established for each notified claim.
2. Suitable systems should be in place to identify and quantify, for the key claims handling procedures, the effects of processing backlogs and to ensure that appropriate corrective action is taken.
3. Suitable controls should be maintained to ensure that case estimates and statistical estimates are appropriately made on a consistent basis and are properly categorised.
4. Regular reviews of the out-turn of the case estimates and statistical estimates should be carried out to check for inconsistencies and to ensure that procedures remain appropriate. The reviews should include the use of statistical techniques to compare the estimates with the eventual cost of settling the claims, after deducting the amounts already paid at the time the estimates were made.
5. Appropriate systems and procedures should be in place to ensure that claim files without activity are reviewed on a regular basis. For example, the use of a 'diary' system should identify areas of inactivity, thereby prompting the claims handler to examine the file and reassess the priority of the action required.
6. Appropriate systems and procedures should be in place to assess the validity of notified claims by reference to the underlying insurance contracts and reinsurance treaties.
7. Suitable systems and procedures should be in place to accommodate the use of suitable experts such as loss adjusters, lawyers, accountants, etc. as and when appropriate.
8. There should be suitable systems and procedures in place to identify and deal with any "large" claims, thereby allowing Management to be involved in the processing of the "large" claim from the outset.

## Appendix C

### Areas For Management To Consider When Assessing The Suitability Of Data Collection And Analysis Used In Determining The Provision For Claims Outstanding

1. Management will be expected to consider the accuracy and completeness of data collection and recording. In the context of utilising data to determine the provision for claims outstanding, management's considerations would be expected to include, but should not necessarily be limited to, the items set out below.

#### **General matters**

2. Management should establish the data requirements, having regard to
  - the size of the business
  - the nature of the business written
  - the level of business written in foreign currencies
  - the specific requirements of the users (e.g. the actuary)
  - the data sources available
  - the homogeneity of the class groups

#### **Data for the assessment of the company's claims experience**

3. Data should be capable of assisting management to assess
  - the type of claims experienced
  - the settlement patterns and changes thereto
  - the reinsurance arrangements
  - claims frequency
  - claims severity
  - incidence of 'large' claims
  - origin of each case estimate
  - third party recoverables
  - special issues (e.g. requirements for catastrophe data or latent claim data)
  - the effect of portfolio transfers and commutations of business

#### **Data for the assessment of the company's claims exposure**

4. Data should be in a format to provide management with:
  - the appropriate exposure base for each class of business
  - an appropriate analysis of changes in premium levels
  - an appropriate analysis of changes in policy terms
  - an appropriate analysis of the effect of specific loss scenarios