

Update from the PRA on the impact of the soft market conditions



The PRA has issued another Dear CEO letter with some interesting analysis and observations on pricing and reserving trends in the general insurance sector. This follows their Dear CEO letter in December 2015 setting out their concerns over the soft market conditions and their expectations for insurers.

At PKF Littlejohn we have been focussing on pricing and the latest Dear CEO letter provides a number of interesting observations which internal auditors should consider when developing their internal audit plans for pricing. We have grouped these into three headings.

ROBUSTNESS OF TECHNICAL PRICES

PRA observations

- *While premium rates have fallen across nearly all commercial lines of business, most insurers appear to believe that current market rates are still adequate (in the sense that they exceed internal technical rate).*

IA considerations:

- Are the controls around your organisations technical prices sufficiently robust?
- Are technical pricing models locked down and are areas of underwriter input/judgement sufficiently controlled to ensure that underwriters cannot manipulate or distort the true technical prices that are being generated?

ADEQUACY OF PRICING FOR LIABILITY/LONG TAIL LINES OF BUSINESS

PRA observations

- *Firms appear to expect that the most profitable lines, as measured by the difference between market and technical price, are long tail casualty and financial lines. Historically we note that these lines have been susceptible to unexpected adverse deterioration impacting multiple underwriting years through a changing legal or economic environment.*
- *We note that, at a market level, there is an apparent disconnect between year on year trends in the booked loss ratio for commercial liability lines and the overall view on market pricing.*

IA considerations:

- To what extent is your organisation relying on liability/long tail lines of business to achieve future profits?
- Does your organisation have adequate management information to make an accurate assessment of pricing trends for liability/long tail lines of business?
- Are the controls over pricing for liability/long tail lines of business within your organisation adequate?
- What is the process for identifying the emerging legal and economic risks relevant to these lines of business?
- What are the communication and feedback loops between your risk, underwriting and claims functions in this regard?
- How are emerging legal and economic risks factored into the pricing models or process?

EXPANSIONS INTO NEW MARKETS/PRODUCTS

PRA observations

- *At a market level our analysis indicates that insurers seem to be shedding business that no longer meets technical rate, yet most expect new business to be more profitable than their existing business despite the fact they are likely to have a deeper understanding of their existing portfolio compared to new risks.*
- *We also note that smaller insurers or those entering new markets with typically less information seem to have a more optimistic view of current pricing than their larger competitors.*

IA considerations:

- To what extent is your organisation expanding into new markets/products to achieve growth?
- Does your organisation have the necessary history and expertise (e.g. across underwriting, claims, actuarial) to expand into new markets/products?
- Can your organisation readily demonstrate that the new markets/products are more profitable than existing portfolios?
- Are adequate loads applied in the pricing of new markets/products to reflect your organisations lack of historical claims data?
- Are your governance committees paying enough attention to the pricing and performance of new markets/products and do they receive the right management information to enable this?

The PRA's recent observations support much of their original concerns over the continued soft market conditions and the impact on pricing which were articulated in their Dear CEO letter of December 2015. In addition, the recent observations raise specific concerns over the pricing for long tail/liability lines of business and internal auditors should ensure that this is specifically included in the scope of their pricing reviews for 2016 and beyond.

For further details of the PRA's analysis and observations please see [here](#). If you would like to discuss the implications of the PRA's observations for internal auditors or would like help with your internal audit reviews of pricing, please contact Jessica Wills on 020 7516 2229 or jwills@pkf-littlejohn.com.



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