General Department of Insurance Control

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Circular

Chief Executive Officer

Subject: Medical Expenses Insurance - Actuarial Pricing 2017

This Circular is an update to previous circulars on the subject issued by SAMA from time to time, as set out in the Table below.

Date (Gregorian)	SAMA Circular Issued
26 March 2014	SAMA issued the original Underwriting Circular.
1 December 2014	At the request of the Insurance Executive Committee (IEC), SAMA subsequently issued standard claims experience forms for Medical and Motor insurance, to come into effect on 1 January 2015. These forms included clarifications, corrections and updates to the original Underwriting Circular.
4 June 2015	The Underwriting Practices 2015 update was issued.
12 July 2016	An updated 'Medical Expenses - Underwriting Practices Circular' was issued referring to Medical Expenses Insurance only.
12 July 2016	Updated versions of the claims experience forms for Medical Expenses Insurance were issued with the '2016 Medical Expenses – Underwriting Practices Circular'.

The technical instructions for Actuarial Pricing Reports are also included within SAMA's Actuarial Work Regulations, and these Regulations should be read in conjunction with this Circular.

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Please note, an insurance company must never provide a quotation without obtaining adequate underwriting information, including claims experience, on which to scientifically determine the premium rates appropriate for the policy terms & conditions offered. It should be noted that this applies to all insurance policies of all classes.

1. Medical Pricing Report

1.1 General Requirements

SAMA is requiring all insurance companies approved to sell Medical Expenses Insurance to provide full actuarial pricing reports as per the below deadline:

- **August 31, 2017** if using data as at **March 31, 2017**.
- **September 30, 2017** if using data as at **June 30, 2017**.

For any medical pricing reports, the Appointed Actuary must validate that the data provided by the company to determine the premium rates is up-to-date, complete and accurate. The Appointed Actuary should identify and document all material limitations of the data used in pricing.

Medical products' approval may be withdrawn if the updated Actuarial Pricing Reports are not submitted or are not compliant with SAMA's instructions.

Only the Insurance Company's Appointed Actuary shall prepare the medical pricing reports that are to be submitted to SAMA unless the Insurance Company has obtained SAMA's no objection to ask *another* Appointed Actuary to prepare the pricing reports at least three months before the date of the actuarial report submission. It should be noted that SAMA will only allow another Appointed Actuary to be used only if it is justified, and SAMA will require a report to be submitted from the incumbent Appointed Actuary in addition to the one prepared by the *other* Appointed Actuary. If a company submits two actuarial reports to SAMA then it may only implement the premium rates in the *other* Appointed Actuary's report if and when it receives SAMA's no-objection. It should be noted that there are no restrictions on the preparation of technical or actuarial reports that are not submitted to SAMA.

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Subsequent to the submission of the above full Actuarial Pricing Report, SAMA may require an insurance company to submit another update if the circumstances require to do so. In such cases, the Insurance Company may provide an addendum to SAMA from the Appointed Actuary in respect of:

a. Revisions to credibility formula
b. Changes to expense and other loadings
c. Pricing of a single product within the medical class
d. Introduction of a new rating factor
e. A new TPA/Provider-Network option
f. Other material changes to the pricing basis that the Appointed Actuary recommends.

In other circumstances, the Insurance Company may seek SAMA's prior approval to provide an addendum from the Appointed Actuary.

If the Company makes any material alteration in its reinsurance arrangements for Medical Expenses Insurance, then it must consult with its Appointed Actuary to determine whether the recommended loadings in the premium rates remain adequate, and must amend its rates as appropriate.

It should be noted that the Appointed Actuary must recommend premium rates with no cross-subsidies between the rating factors, in line with Article 46 of the Implementing Regulations. However, if for competitive purposes, the Company wishes to charge rates which have some element of cross-subsidisation, then it may ask the Appointed Actuary to prepare an additional report setting out the risks of applying the cross-subsidies, based on the expected portfolios of business written, which may not be too dissimilar to the in-force portfolio. SAMA will share its views on the cross-subsidy report with the Company in due course if deem necessary.

It should be noted that cross-subsidies are only permitted within the same class of insurance. In addition, no cross-subsidies are permitted between Individual and Group business.

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The Appointed Actuary is responsible to ensure that a comprehensive report is provided to SAMA, so as to minimize the extent of required follow-up queries from SAMA.

In addition, the Appointed Actuary must prepare a short summary document highlighting his key findings for each Actuarial Pricing Report. This shall be no more than five (5) pages in length, and must be submitted to the Board of Directors of the Company as a Board paper within five working days of the Appointed Actuary's submission, with the Appointed Actuary's full report being an appendix to the Board paper.

The Actuarial Pricing Reports submitted to SAMA cannot be preliminary or initial and are required to be the final reports. All reports shall clearly summarize and compare the Company's current premium rates (including loadings and discounts) and the new premium rates (including loadings and discounts) calculated by the Appointed Actuary.

1.2 Mandatory Loading Requirements

The Appointed Actuary is required to include the following loadings within the gross premium rates:

1) An **Expense Loading** covering *all* of the Company's expenses, excluding commissions, both for policyholders and shareholders, calculated in line with Appendix Two.

2) A **Commission Loading** covering any direct payments made in respect of the acquisition of a policy, whether to intermediaries or to internal staff.

3) A **Profit Loading** that must be explicitly approved by the Board of Directors of the Company.

4) A **Contingency Loading**.

Detailed requirements for the calculation of these loadings are shown in Appendix Two.

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2. Pricing of Group Medical Expenses Insurance

Insurance companies must comply with the following instructions when using the past claims experience for pricing of Group Medical Expenses Insurance policies:

1. Apply an experience rating approach for group risks, and must also provide a fully justified credibility formula, blending the tariff rates with the experience rate, recommended and signed off by the Company's Appointed Actuary.
2. A form or Excel spreadsheet shall be produced which ensures that the pricing mechanism adopted complies with the credibility formula that is recommended by the Company's Appointed Actuary. A copy of the blank form or Excel spreadsheet must be provided to SAMA along with the Actuarial Pricing Report.
3. When determining the blended premium rate, the Appointed Actuary shall make allowance for annual increase in the burning costs due to past claims trends and inflation.
4. The Appointed Actuary's Pricing Report shall specify the size of schemes for which this blended pricing approach must be adopted. It must define the size of smaller schemes where book rates shall be used.
5. The Insurance Company may request that its Appointed Actuary assists with quotations for a particular scheme if it considers that there are reasons why the scheme falls outside the standard pricing process. All such specific quotations must be fully documented, be auditable, and be made available to SAMA on request. The Appointed Actuary should ensure that these specific quotations indeed fall outside the standard pricing process before providing his/her recommendation.
6. The Appointed Actuary is required to specify in his pricing report the range of discounts that companies can adopt in their pricing based on discounts received on the existing portfolio. Companies should use the discount that they expect to receive from the Medical Service Providers in their quotation. The underwriter's justification for the discount used should be fully documented, and provided to SAMA and the internal control functions upon request.

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It should be noted that SAMA imposes no restrictions on the form of the credibility formula to be adopted by each company, provided that it has been recommended by the Appointed Actuary. For instance, the Appointed Actuary may choose to vary the credibility formula by class of insurance, own or other insurer's experience, good or poor experience etc. SAMA may challenge the credibility formula adopted if it considers that it has not been fully justified technically.

3. Discretionary reductions in premium for specific quotations

If the company decides to charge rates different from those recommended by the Appointed Actuary in his pricing report, the rationale for the rates charged by the company must be fully documented, along with due consideration for Article (46) of Implementing Regulations.

Any discretion to reduce premium for a specific quote would normally only lie with the Chief Underwriter Officer, Chief Technical Officer or Chief Executive Officer must be fully documented. The scope to which this discretion extends must be fully documented in the Underwriting Manual.

No discretion to reduce premium to a particular quotation may be applied until the Underwriting Authority Statement has been approved by the Board of Directors, and it has been submitted to SAMA.

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For each company, SAMA will require the Appointed Actuary to submit a **'Pricing Adequacy Report'** later in the year. The purpose of the report will be to compare the actuarial prices against the price at which the business was actually underwritten. The report will be required at a segment level as well as at the overall portfolio level. SAMA will issue necessary instructions regarding this report later in the year.

Yours sincerely,

Hesham Tashkandi
General Director of Insurance Control

To:
- Insurance Companies
- Insurance Brokers
- Insurance Agents
- Insurance Claims Settlement Specialist (Third Party Administrators)
- Appointed Actuaries

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Appendix One – Additional Requirements

Blending Book Rates with Experience for Larger Schemes

An Excel spreadsheet must be produced which ensures that the pricing mechanism adopted complies with the credibility formula recommended by the Appointed Actuary.

Compliance with the Prior Actuarial Pricing Reports

In order to investigate the compliance with the prior experience-rating basis recommended, the Actuary shall take samples of the top five groups by premium income from the Insurance Company's portfolio and derive the experienced-rated premium rate. These shall be compared against the actual premium rate charged for each of the top five groups. The Actuary is required to provide this comparison in MS Excel format along with the pricing report.

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Appendix Two - Mandatory Loading Requirements - Details

The Appointed Actuary is required to include at least the following loadings within the Office Premium rates:

1) An expense loading (e)
2) A commission loading (c)
3) A profit loading (p)
4) A contingency loading (co)

That is,

Office Premium >= Risk Premium / (1 - e - c - p - co)

1. Expense loading

1.1 The expense loading must cover all of the Company's expenses, excluding commission expenses, both for policyholders and shareholders, which are considered relevant for Medical Expenses Insurance line of business. For this purpose, the Appointed Actuary should carry out four sets of calculations, as listed below:

i) Expense loading based on the **overall expenses** of the company determined with reference to the **last financial year's actual expenses**, using the formula referred to in Appendix Three.
ii) Expense loading based on the **expenses for the Medical Expenses Insurance line of business** as allocated by the Appointed Actuary with reference to the **last financial year's actual expenses.**
iii) Expense loading based on the **overall expenses** of the company determined with reference to the **next year's business plan**, using the formula referred to in Appendix Three.
iv) Expense loading based on the **expenses for the Medical Expenses Insurance line of business** as allocated by the Appointed Actuary with reference to the **next year's business plan.**

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1.2 Where the expenses loadings calculated under items (iii) and (iv) in the preceding paragraph above are lower than the corresponding loadings based on the last year's actual expenses, the use of expenses loadings based on the next year's business as a reference is permitted only if the Company has cover for its required solvency margin in excess of 100% as at 31 December 2016, and the Company is not known to have breached that threshold of 100% since then.

1.3 The Appointed Actuary should use his professional judgment to select an appropriate expense loading with due reference to the above four estimates. This selection should be justified and documented. Where the selected expense loading is lower than the above four estimates, SAMA may require additional explanation for the Appointed Actuary's selection.

1.4 The Appointed Actuary should develop an appropriate allocation of expenses for the medical line of business. The methodology and assumptions used for this allocation must be justified and documented adequately.

1.5 The expenses projected for the next year's business plan must be based on justified and documented assumptions.

1.6 For the purpose of paras (1.1) (i) and (1.1) (ii) above, the last financial year's expenses must be calculated using the formula in Appendix Three.

1.7 Any Composite Insurance Company, defined as any company writing General/Medical Expenses Insurance and a material amount of long-term Protection & Savings business, must not use the expense ratio for the Company as a whole. Instead, the expense report shall determine a suitable split of expenses between Protection & Savings and General/Medical Expenses Insurance, and the Expense Ratio determined for General/Medical Expenses Insurance only.

1.8 Any expenses that may be subject to unusual fluctuations may be smoothed. In particular, the change in Doubtful Debt Reserve must be considered as part of the Company's expenses, but consideration should be given to smoothing this item.

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2. Commission loading

The commission loading will normally reflect the actual commission to be paid on a case-by-case basis.

3. Profit loading

The profit loading must be at least 2% of gross premium. It must be explicitly approved by the Board of Directors of the Company.

4. Contingency loading

The contingency loading must be set at a minimum of 2.5% of gross premium.

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Appendix Three – Standard Income Statement Ratio Definitions

This section sets out the standard definitions of the Loss Ratio, Expense Ratio and Combined Ratio, which should be followed consistently in all Medical Expenses Insurance pricing reports.

The key points to note are:

1) Combined Ratio = Loss Ratio + Expense Ratio (including commissions)

2) A Combined Ratio in excess of 100% means a General/Medical Insurance Company is making Underwriting Losses. These may be mitigated by investment returns.

3) These ratios must not be used for any Company writing material amounts of long-term Protection & Savings business.

For all three ratios above, the Denominator is the Net Earned Premium plus any 'Other Income' other than that arising from investments and underwriting activities:

Net Earned Premium (Form 21, Line 17, Column E) +
Other Income (Form 21, Line 71, Column E) +
Other Income - Shareholders (Form 22, Line 19, Column A)

If a Company has incorrectly treated movements in Premium Deficiency Reserves as part of its earned premium for accounting purposes, then it should reverse these movements out for the purposes of calculating its Standard Income Statements Ratios.

For Loss Ratio, the Numerator is the Net Claims Incurred (in Form 21, Line 37, Column E), adjusted to exclude any changes in Premium Reserves, such as Premium Deficiency Reserves or Catastrophe Reserves.

The adjusted Claims Incurred is then divided by the Denominator to determine the Loss Ratio.

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For the Expense Ratio, the Numerator is:

Commission Incurred (*) (Form 21, Line 38, Column E)
Minus Reinsurance Commissions Earned (Form 21, Line 18, Column E)
Minus Other Underwriting Income (Form 21, Line 19, Column E)
Plus Policy Acquisition Costs (Form 21, Line 39, Column E)
Plus Other direct underwriting Expenses (Form 21, Line 40, Column E)
Plus Doubtful Debt Expense (Form 21, Line 41, Column E)
Plus Operational and Technical Expenses (Form 21, Line 51, Column E)
Plus Shareholders Expenses (Form 22, Line 39, Column A)
Plus Zakat (Form 22, Line 51, Column A)
Plus Medical TPA fees (if not already included in the above line items)
Plus Taxes (Form 22, Line 52, Column A)

* The item "commission incurred (Form 21, Line 38, Column E)" should be replaced with the 'expected' commission at the portfolio level for the business to be underwritten.

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