



The Actuarial Profession

making financial sense of the future

consultation response

FSA CP07/13

Quarterly consultation (No.13)

Comments from the Actuarial Profession

September 2007

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6 September 2007

Dear Trevor

FSA CP07/13 Quarterly consultation (No.13)

I refer to the FSA's recent consultation paper 07/13 which included proposed amendments to Insurance Prudential sourcebooks. The Actuarial Profession has reviewed the consultation paper and this letter sets out our main comments on the regulations as currently drafted. Some detailed comments are set out in the enclosed appendix.

We are surprised that the FSA has not addressed the issue whereby non-profit funds in a realistic reporting insurer do not require any resilience capital either directly or through the risk capital margin but other non-profit funds do. This creates an imbalance in competitiveness without any apparent theoretical justification.

We are also disappointed that no attempt has been made to reduce the regulatory burden on non-incorporated friendly societies. We assume that this will be taken forward in due course, as part of a review of IPRU(FSOC), which currently contains a good deal of unnecessary material. Ideally, some form of de-regulatory review should be undertaken, with a view to moving towards a risk-based approach, so that the regulatory burden is proportionate to the size of the organisation.

We are also aware of continuing uncertainty regarding whether or not INSPRU 1.3.169 and 1.3.170, as currently drafted, require one to apply the GENPRU 1.3.16 approach to the bid/offer spread when assessing the cost of financial options and guarantees. It would be helpful if the rules could clarify your intention, which we understand to be that the market-consistent valuation envisaged by INSPRU 1.3.169 is calibrated to a mid-market price of the hedging instrument.

Changes to the Handbook Glossary

Quasi-derivatives

We note that the definitions will continue to relate to the definitions in the Regulated Activities Order. The FSA should take this opportunity to consider more widely the way in which quasi-derivatives are used, as the current definition of what is considered a quasi-derivative is very

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wide. This can lead to some unusual results, especially as it is no longer possible to 'ignore' the optional elements.

Sectoral rules

It is stated that the purpose of the changes is to provide greater clarity and that they do not represent a change in policy. We understand that the FSA believes that firms have been following the rules as intended; it would be helpful to confirm this.

Changes to GENPRU

The proposed amendments to the wording of paragraph 3 of Annex 7R of GENPRU 2, relating to admissible assets, could have unintended consequences. It should be possible to value the guaranteed elements and to exclude the optional elements. Previous rules included an opt-out to permit not taking into account the optional elements which would make the asset a quasi-derivative. This was beneficial and should be re-instated.

Changes to INSPRU

Composite insurers (INSPRU 1.5.17G)

There appears to be a disconnect between the proposed changes and the wording of the consultation paper i.e. where supplementary cover is being referred to and where healthcare composites are being referred to. This may be a presentational issue, but the policy intention should be clarified. In addition, inclusion of the word "normally" in the proposed changes suggests that it would be possible to grant permission to carry out life business without including permissions to effect accident or sickness insurance, but it is not clear whether this is actually the case.

Separate identification and maintenance of long-term insurance assets (INSPRU 1.5.18R and INSPRU 1.5.19G)

As currently drafted, the rules do not appear to address situations where there is legacy sub-debt in a with-profits fund that was being covered outside the fund, and the position should be clarified.

Market risk and counter-party limits (INSPRU 2.1.22R(3)) – covered bonds

It is not clear (at least not without detailed technical knowledge in the area) what changes are being proposed or what the effect might be. The draft Sourcebook text is confusing and should be clarified.

Cover for derivatives (INSPRU 3.2.19G)

We understand that the intention of the changes is to remove contradictory guidance to leave the self-explanatory rules. However, we are concerned that the proposed amendments might result in unintended consequences (e.g. an instrument being valueless if not 100% covered), which may not necessarily come to light until after the year end.

Reporting requirements following a transfer of life business (rule 9.3 of IPRU(INS))

It is not clear if the requirements apply only at the time of a total transfer or, if there are excluded policies not transferred, they apply at the first or at a subsequent transfer. In addition, the rules as currently drafted do not provide for an actuarial investigation upon transfer.

Changes to IPRU(FSOC)

The wording relating to the resilience test as currently drafted is misleading; it would be preferable to cross-refer to INSPRU 1.3.16 rather than 1.3.9 and to emphasise that the reserve is not a capital requirement. It might be better to refer to this as a resilience reserve rather than a resilience test.

We hope that these comments are helpful and would be happy to discuss them or offer further explanation if that would be of use.

Yours sincerely

Adrian Eastwood
Chairman, Life Board

Detailed comments

The following detailed points all relate to the proposed changes to the Rules themselves, rather than to the explanatory sections of the CP.

2.2 INSPRU

1.5.19 G: the second-last line should presumably read “provisions, including **those** in respect of ...”.

The wording of 2.1.22 R (3) (b) (ii) seems confusing. It really needs to be set out more clearly, perhaps by introducing more helpful formatting. Also, towards the end, the phrase “5% arising from applying a 10% limit and the 40% limit in (i) in relation to *covered bonds*” doesn’t seem clear – it should be made clear what the 10% applies to.

2.1.41A R: we agree that this is a sensible amendment, but the text needs a comma after “provided” in the penultimate line to pair with the comma before “including” in the second line.

2.3 IPRU(INS)

Form 10.

Line 29 is currently (before the proposed changes) the total of lines 23 to 27, but no change seems to be proposed for line 29 or for the numbering of lines that currently follow the lines 24 to 27 that are to be deleted. This seems strange. A similar point arises from the proposed deletion of lines 51 and 52.

Form 13.

It is not clear what is expected to be shown in line 93, given the inclusion of the phrase “directly held”.

Form 47.

The changes proposed could be improved to avoid ambiguity.

- The term “bulk transfer” is not defined (it currently does not appear in Appendix 9.3, but appears in the proposed new note 4 to Forms 51-54), and at least some aspects of it need to be.
 - Elsewhere in IPRU(INS) the word “transfer” is accompanied by an indication of the source or destination of the transfer and of what is being transferred (e.g. a transfer of business between insurance companies).
 - Here the bulk transfer seems to be a bulk transfer of business from another insurance company, and does not include a bulk transfer of risk (by purchase of annuities) from a pension scheme to the insurer.

However, this has to be inferred from the existing note to Form 47 that says that bulk purchases of annuities by occupational pension schemes are to be treated as CPA annuities.

- It would help if “bulk” were to be inserted ahead of “transfer” in the labels proposed for lines 401 and 906.
- The labels of (or notes on) lines 400, 405 (see below) and 905 should be amended to exclude bulk transfers of business, and the label of (or note on) line 905 would also exclude deferred annuities.
- Is line 401 intended to relate only to CPAs and not to PLAs (line 395)? It would be best to clarify this.
- What is intended for any impaired life annuities contained in a bulk transfer of business? We have assumed above that they would not be included in line 405 (CPA impaired life) but would be treated as part of the bulk transfer.

More generally, FSA will be aware that a good deal of importance is often attached to the exact wording used to describe the various lines on the forms and careful use of words is therefore critical.