



# **The Actuarial Profession**

making financial sense of the future

consultation response

**FSA CP06/12**

***Implementing the Re-insurance Directive***

**Comments from the Actuarial Profession**

**August 2006**

# **FSA Consultation Paper 06/12 – Implementing the Reinsurance Directive**

## **Comments from the Actuarial Profession**

This document sets out the comments of the Actuarial Profession on CP 06/12 *Implementing the Reinsurance Directive* published by the FSA in June 2006.

### **Life Protection Reinsurance Business - definition**

The definition refers to the business as arising from acceptance in respect of contracts of insurance falling within long-term insurance business class I that are not annuities or with-profits insurance contracts. This does not seem to us to be a sensible distinction. The nature of the contract which is reassured does not necessarily flow through to the reinsurance contract. It is surely better to reflect the nature of the risk taken on by the reinsurer. So, for example, a term assurance rider to a linked contract might be reassured. The original contract is class III, but the rider alone would have been class I. The reinsurance is, however, indistinguishable from class I. Likewise the reinsurance of mortality risks associated with with-profits business without the profit participation risks (such being the more usual form) should not be excluded.

### **Contracts not to be treated as assets (INSPRU 1.2.24R) and Voluntary Discontinuance (INSPRU 1.2.76AR )**

These apply a different test to that above - they relate to the reinsurer's contract. The guidance in 1.2.25G mistakenly relates this to the above definition, but it is not the class of the original contract which applies under 1.2.24R.

### **Issue with Contracts treated as Assets**

A number of technical issues, some of which are identified below, will result from the ability to treat contracts as assets, so that further guidance may be necessary. If guidance is not to be given by FSA, it should indicate to the Board for Actuarial Standards (BAS) that such guidance may be necessary for actuarial function holders.

Where a contract is permitted to be treated as an asset, the usual concepts of prudence may be reversed, especially with regard to the interest rate used. FSA should consider whether the use of a valuation interest rate higher than that permitted for a liability is, in fact, permitted under the rules in INSPRU 3.1. To us it appears not to be, although increasing the rate may be the correct way to take margin for adverse deviations. The direction of the margin in the lapse rate is also a significant issue. On an individual contract it is not clear without doing two calculations whether a low or high lapse rate is prudent and if the answer is that it does not make much difference to the result, it may be that neither is prudent and that prudence on a level premium contract is only achieved by having a high lapse rate initially (i.e. a positive margin) and a low lapse rate (a negative margin) towards the end of the contract. Where liabilities are large and negative it is more likely that the policyholder will be able to lapse and take out a new policy on better terms. The measured experience of offices, typically based on contract type and duration, is unlikely to fully reflect this additional lapse risk for large negative reserve policies. It would be helpful to have some guidance on this. It will also need to be addressed in the CP due in September which is likely to propose allowing prudent lapse assumptions and negative reserves for direct insurers.

FSA should also consider whether it believes there is a need for guidance on how such assets should be regarded in respect of INSPRU 3.1 when used to match other contracts. To us it would appear desirable that these assets be considered as carrying a risk, and less than the full yield should apply, but it is difficult to determine from existing rules any boundaries here.