



Institute  
and Faculty  
of Actuaries

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### **Procyclicality of Life Insurers' Capital Requirements – Countercyclical Capital Buffers Working Party:**

This is the original scope for this working party

#### **Background**

In falling markets there is a strong tendency for many investors to respond by selling which tends to drive prices down further encouraging markets even lower. This sort of behaviour is described as procyclical. It has been suggested that if investors were less procyclical in their approach investment markets and the economy would flourish. It is believed that Life Insurance regulation in relation to capital requirements encourages procyclical behaviour amongst insurers. The Bank of England has undertaken research in this area and a copy of a recent paper is available at <http://www.bankofengland.co.uk/publications/Documents/news/2014/dp310714.pdf>

The ERSB have expressed support for the introduction of Countercyclical Capital Buffers (CCBs) in a paper: <https://www.esrb.europa.eu/pub/html/index.en.html?skey=16/12/2015> and in particular Annex 5: [https://www.esrb.europa.eu/pub/pdf/other/2015-12-16\\_esrb\\_report\\_annex\\_5.pdf](https://www.esrb.europa.eu/pub/pdf/other/2015-12-16_esrb_report_annex_5.pdf)

These documents suggest that there is interest in such developments.

#### **Proposal**

The Life Insurance Board / Life Research Committee has launched a new member-led working party looking at different aspects of the capital regulation of Life Insurers and whether changes would reduce the tendency for Capital to be consumed or for Capital requirements to increase in falling markets. Unless the insurer is able and happy to accept the reduction in capital coverage or it opts to raise additional capital, a way of dealing with the reduction can be to lower risk by selling equities which is itself procyclical investment behaviour. In particular, the Working party should consider whether the introduction of countercyclical capital buffers (CCBs) would address this issue and if so what characteristics such buffers should contain to work effectively without excessive cost.

It should be noted that two other Working Parties are being commissioned by the profession: one looking at how changing investment mandates could be used to tackle this issue, the other considering whether alternative capital metrics to the VaR central to Solvency II regime could still be effective but reduce Procyclicality.

#### **Brief Description**

The Working Party should be open to consider alternatives which fit within the Solvency II framework, or would require changes to that framework.

Areas for research could include:

- The impact of historic extreme market movements on Life Insurers' need for capital and changes in required capital under different capital regimes.

- Modelling capital impacts and dynamic investment strategies with different structures of capital buffers through historic and simulated scenarios.
- An investigation of alternative approaches to capital management that may reduce the Procyclicality of capital needs. This work should consider any implications of the existence of the “Alternatives to VaR” WP referred to above.
- How CCBs work in other areas, e.g. banking
- Consider how CCBs could be designed within the existing Solvency II framework e.g. in the choice of risk-free rate or Standard Formulae changes., or within companies own capital policies e.g. ORSA

### **Working Party Objective/Aims**

The aim of this Working Party is to establish a position whereby the profession is able to contribute to a wider debate on the viability of CCBs and the optimum structure of such buffers if they were to be introduced, and to support practitioners.

### **Experience/Skills/Background desirable:**

We are seeking one Fellow with experience of auditing or validating Solvency II calculations to replace someone on a very active working party – Procyclicality and Contra-cyclical buffers for life assurance. This is a key area where the profession can take a leading role. The work will inform decision makers in the UK and, hopefully, beyond.

### **Outputs:**

Working parties should aim to produce a written record of their findings, as well as seeking opportunities to present their research.

The potential outputs should be substantive and could include:

- Actuary article to draw attention to the research
- Present at Life Conference
- Preparing and presenting a Sessional Event or British Actuarial Journal paper
- Presentations at regional societies and other Professional conferences (e.g. Risk & Investment conference)
- A website
- Liaison with the IFoA policy team to put together a proposal for government

### **The types of tasks working party members take part in:**

- Chairing meetings
- Reviewing literature and draft papers/reports
- Interviews
- Creating questionnaires
- Writing
- Modelling
- Collecting and analysing data

### **Time Commitment:**

For this working party, volunteers will typically be expected to attend between 6 – 12 meetings per annum and to perform research between meetings. Volunteers should expect to contribute to the research and drafting of articles and papers.

Participation in this working party will be by conference call to allow us to widen this opportunity to all members. Calls will be arranged at a mutually convenient time for all involved. If you live or work near to one of the IFoA offices, you are welcome to make use of our facilities for the call. Similarly, if more than one member of the working party is based close to each other, you may agree to meet up and dial in together, but there will be no requirement for volunteers to meet in one place.

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