

FSA's Response to the ABI Proposals on Pillar 1

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Background

Conjunction of four practical drivers:

- ABI proposals
- Waivers possible given Pillar 2 results
- Implementation of Reinsurance Directive
- *The march to Solvency 2 – today's seminar*

Background

And two drivers from principles:

- A general desire for more principle based regulation rather than rules
- Various (governmental) red tape initiatives that include removing "gold-plating" of EU directives

Changes – Process

- CP recently published
 - Changes to reserving standards for non-profit
 - Capital requirement change for realistic reporters
- CP also includes ICA principles and feedback on the Reinsurance Directive and other CPs.
 - ICA principles very aligned with Solvency 2
 - Direct insurers and reinsurers broadly in line (not capital)
- Short consultation to enact for year end.

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Changes – With-profit

- No change to realistic “twin peak” presentation - Form 19
- Removal of resilience capital for a realistic reporting firm (not just fund)
- Capital double count in WPICC addressed
 - Brings Pillar 1 in line with ICA Pillar 2
 - Means some recognition of EV; i.e. new premium receipt can lead to immediate reduction in WPICC.
 - Covers both 1/9th transfer and amc.

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Changes – Non-profit

- Expenses – impact expected on unit linked business.
- Lapses – all contracts but main impact expected on protection business.
- Contracts as assets - revised legal view on recognition of assets – impact on protection.
- Each assumption to be prudent.
- Consequential changes to returns.

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Changes – where do these stand compared to Solvency 2?

- Theory – market or some other consistency?
 - Requirement for market margins for adverse deviations.
 - Solvency 2 market consistent/cost of capital approach?
 - But market consistent can ignore margins for non investment risks?
- Practice - Scale of prudence?
 - Current ICA models versus modeled Solvency 2 results
 - Modeled Solvency 2 versus standard Solvency 2

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Changes – setting Prudent margins

- Comparison to ICA Pillar 2 but
 - Liabilities and capital?
 - Diversification benefits?
 - Percentile approach not cost of capital?
- If from market and/or judgment of margin then
 - Industry standards?
 - Credibility of own experience?
 - Try to capture “market” margins – Solvency 2?

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Changes – setting Standards

- FSA wishes to be more principles based
 - But auditors need comforts?
 - A sensible market need accepted standards?
 - Solvency 2 (and accounting future) will start to set limits?
- Standard setters
 - BAS,
 - Trade bodies (as seen for the further ICA guidance).
 - In time international bodies?

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Changes – market impacts

- In particular for protection business
 - Pricing
 - Reinsurance – off shore and intra group
 - Financing
- More generally
 - Tax
 - Service agreements and expenses
 - Accounting
 - EVs – net assets versus reported value of in force

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Questions
