



**The Actuarial Profession**

making financial sense of the future

Momentum Conference, December 2010  
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# Key Challenges Reflections from the FSA

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# Agenda

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## Update from GIAT

- Issues on the regulatory agenda
- Managing practical aspects of the ICAS process in the lead up to Solvency II

## Update on Solvency II

- Solvency II – aims and benefits
- Internal models pre-application

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# Issues on the Regulatory Agenda

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- Economic Issues
- General State of the Market
  - Retail
  - Wholesale / Commercial
  - Reinsurance
- Reserving Adequacy
- Stress and Scenario Testing
- Solvency II

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# Economic Issues (1)

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- Economic environment now more benign
  - Central scenario is one of steady recovery
- Macroeconomic changes affected non-life and life insurers in different ways
  - In the life sector capital levels came under pressure
  - In the non-life sector reserve releases supported results, cushioning the impact of investment and underwriting losses
- Now we are recovering the economic crisis has left challenges for the non-life industry

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## Economic Issues (2)

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- Financial crisis on the non-life sector was less immediate
- Prolonged recession and the slow and uncertain recovery have increased the prudential risks in this sector
  - Altered characteristics of the risks insured
  - Increased propensity to claim
  - Reserving adequacy
  - Exchange rate volatility

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# General State of the Market (1)

## Retail

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- Underwriting performance under pressure
- Deterioration in loss ratios and low investment yields
- Customer appetite shifted towards the self-service model
- 2010 at a glance:
  - Robust balance sheets
  - Pressurised investment returns
  - Profit margin erosion
  - Reserve releases appear unsustainable
- Key risk areas:
  - Rate increases
  - Data validation
  - Conduct Risk

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# General State of the Market (2)

## Wholesale and Commercial

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- Extended soft market raises questions over pricing and reserving adequacy
- 2010 at a glance:
  - Low interest rates and conservative investment strategies
  - H1 one of the costliest on record
  - General trends in the wider environment
    - Outlook of low returns
    - Delayed claims
    - FX volatility
    - Crime and insurance fraud
    - Legal and regulatory change
- Key risk areas:
  - Reserve strength / releases
  - Underwriting management
  - Risk management

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## General State of the Market (3)

### Reinsurance

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- Abundant capacity as confidence and capital levels recover
- Reinsurers have managed to generate profits
- Contraction in demand, further augmenting current over-supply
- Impact of Deepwater Horizon BP oil spill to date on rates is restricted to energy risks
- Reduced demand, higher net retention by primary insurers and limited growth opportunities
- **Key risk areas:**
  - Price adequacy and reserving assumptions
  - Structural challenges
  - Understanding of very low frequency cat exposures



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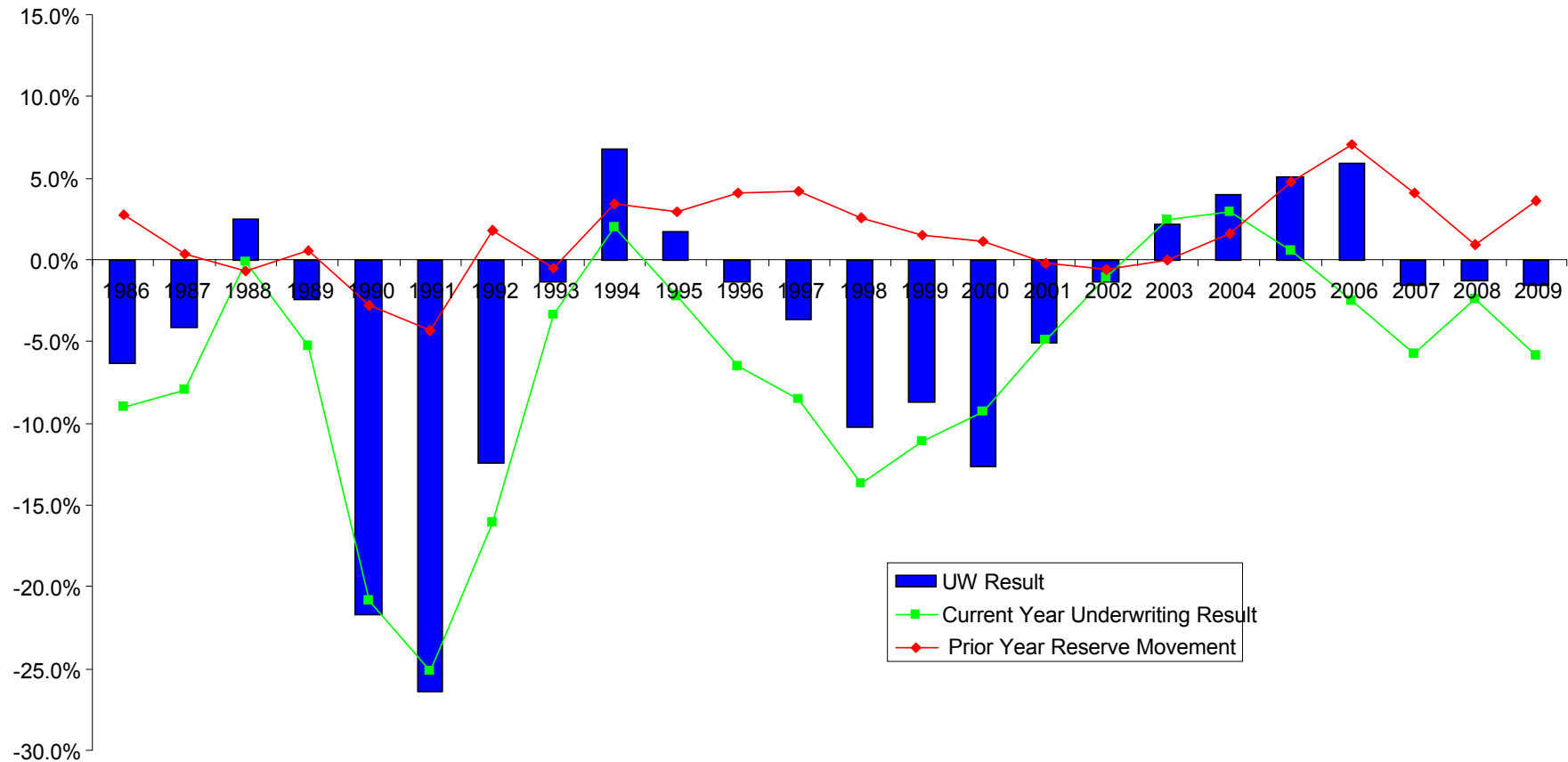
# Reserving Adequacy (1)

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- Reserving Adequacy Project
  - To put reserving at the centre of our consideration of firms' financial positions...and to keep it there
- Greater focus and support to supervisors
  - complementary to ICAS
- Quantitative
  - reserve statistics
- Qualitative
  - oversight and controls
  - focus on policy

# Reserving Adequacy (2)

## Market Level View – The Reserving Cycle



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## Reserving Adequacy (3)

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- Focus on reserve releases
  - over time
  - against market
  - against peers
- Resource provided to supervisors
  - prompt for discussion
  - basis for challenge
- Expect direct and pressing questions from the FSA

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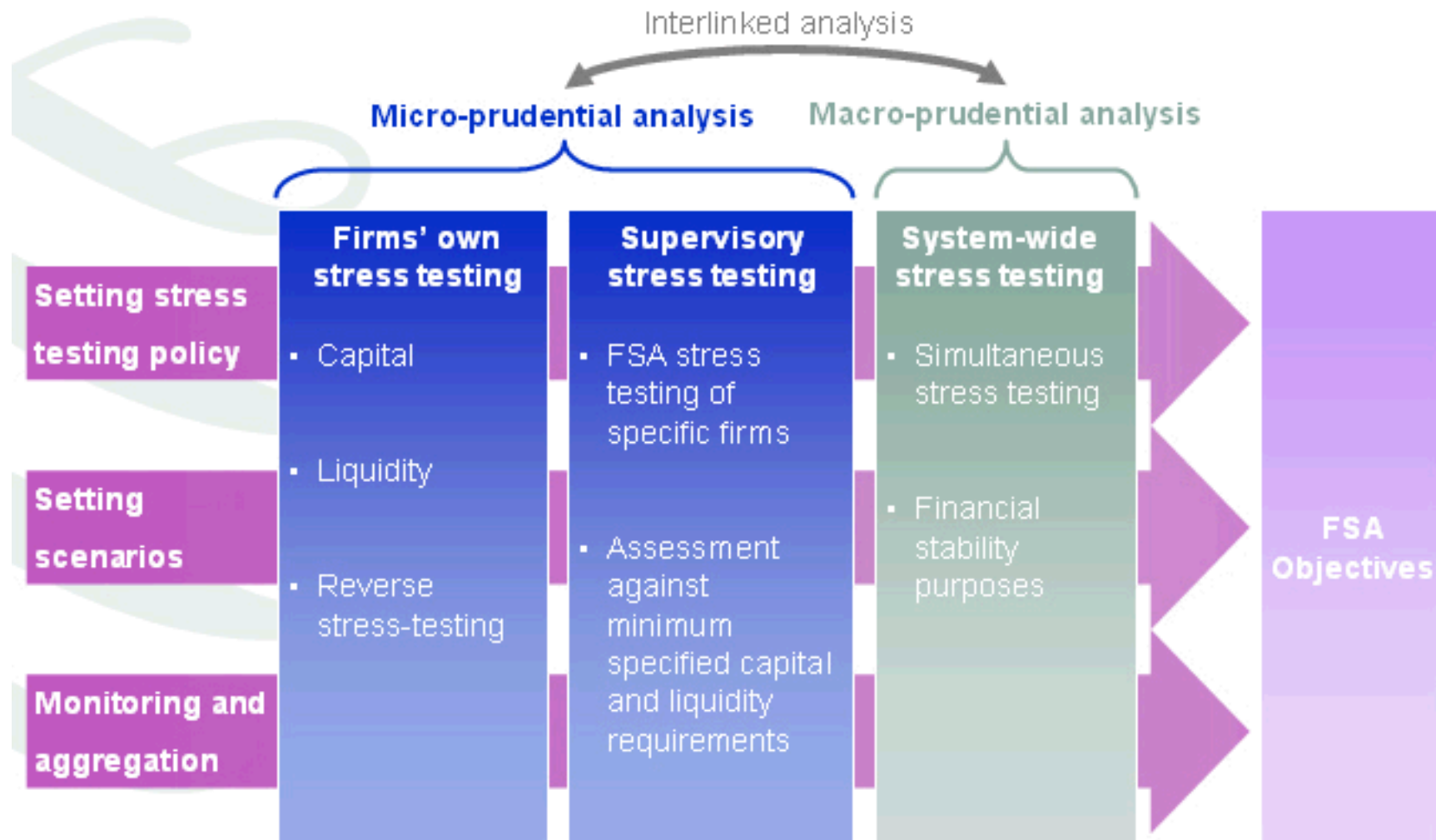
## Reserving Adequacy (4)

### What we'd like to see

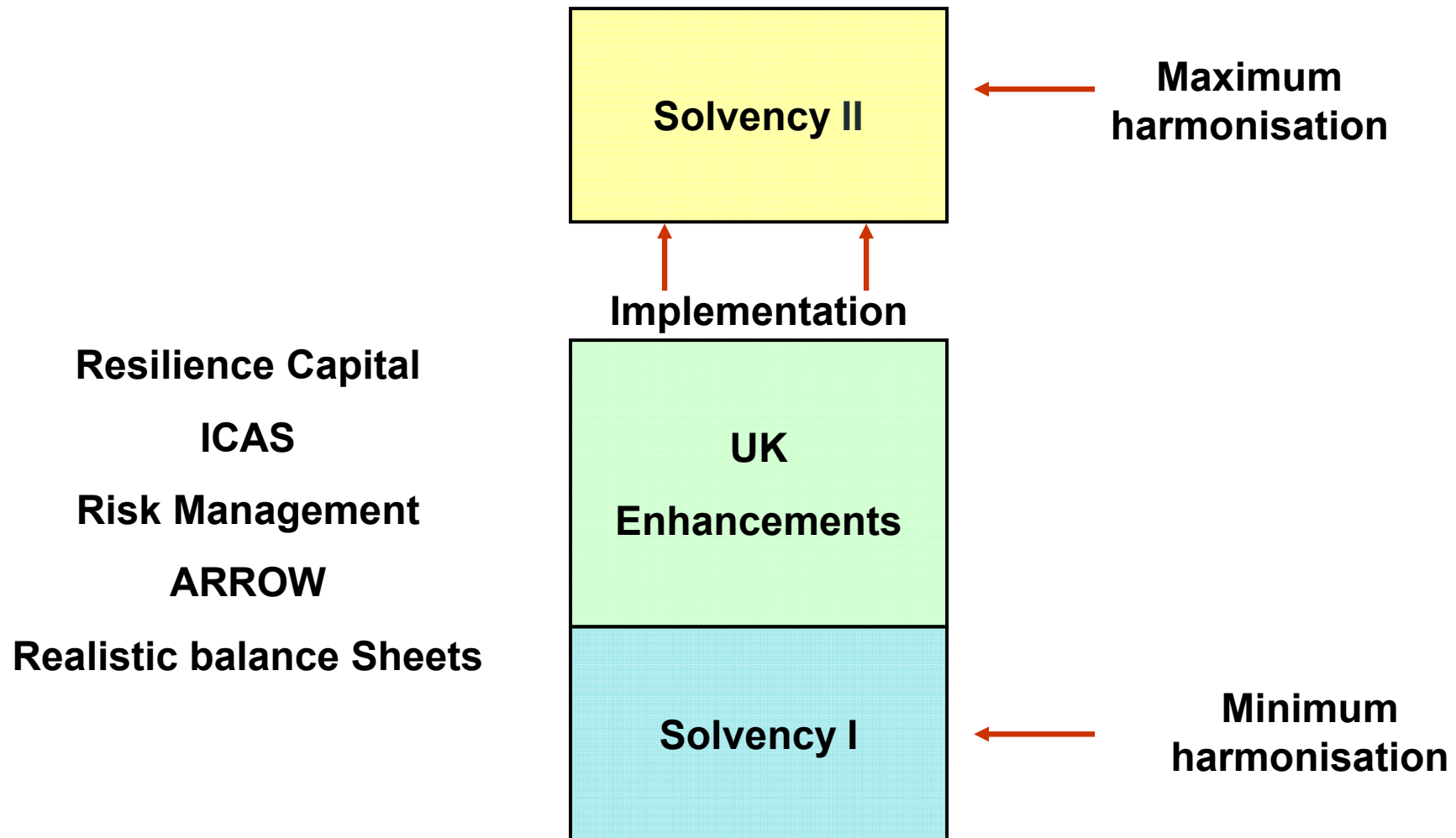
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- Firms that understand and manage their risks
- Consistent approaches to risk and key processes
- Clearly articulated policies around
  - case estimation and claims management
  - actuarial reserves (IBNR / IBNER)
  - reserve margins controlled by management
- Transparent and verifiable decision-making

# Stress and Scenario Testing



# Solvency II



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# It's not all about the calculation kernel

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## Solvency II aims to deliver...

- Good quality capital
- Market consistent balance sheets
- Strong requirements on forward looking risk identification and management
- Strong emphasis on enhanced transparency of firms' financial positions and risk management approaches

It's no good having a great capital model if the framework around it is weak

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# Managing practical aspects of the ICAS process in the lead up to Solvency II (1)

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- As we move towards implementing the Solvency II regime we are changing our approach to reviewing firms scheduled ICAS
- FAQ's in the FSA Insurance Sector Newsletter, July 2010
  - Do I still need to calculate my ICA?
  - Do I still need to notify the FSA of material changes in my business
  - Will ARROW reviews continue?
  - How will I know if you decide not to proceed with a scheduled ICA submission?
  - What happens if the Solvency II implementation date is changed?
  - If I feel my ICG no longer matches my business – may I still request an ICG review?
- Information available at [www.fsa.gov.uk](http://www.fsa.gov.uk)



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## Managing practical aspects of the ICAS process in the lead up to Solvency II (2)

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- ICAS was designed to anticipate Solvency II
- Good practice aligned to Solvency II
  - Data quality, documentation and justification much stricter
  - Data quality - design, capture and policy
  - Case Reserving - focus and standards
  - Governance Framework
  - Reporting and management information feeds
- Main point is that Solvency II will soon be BAU so the BAU issues will soon be Solvency II issues - think about the implications of the current risk environment and BAU issues; many of which will be relevant under Solvency II

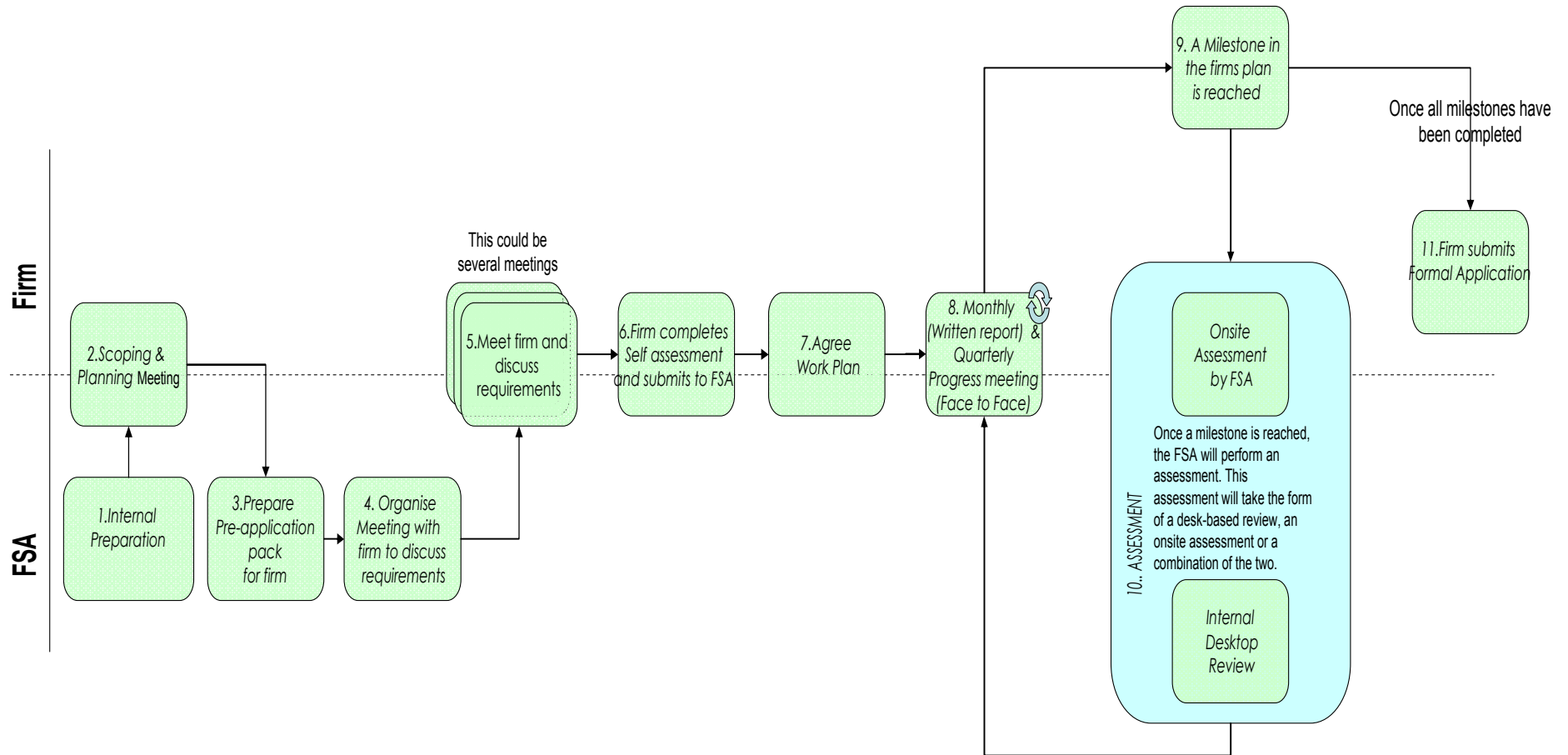
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# Solvency II

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- Transfers of business
  - Firms considering Part VII transfers as part of their Solvency II planning
  - Practical implications for us
  - Contact us as soon as possible
- Adequacy of actuarial resources in the market

# Pre-application Process



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# Some of the benefits we are already seeing

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## Pre-application proving a positive and informative experience...

- PAQC useful at identifying better prepared firms
- Promoting efficient direction of limited resource
- Working with other supervisory authorities laying way for group supervision
- Providing early sight of potential areas of concern and where to focus review
- Allowing us to compare and contrast firms, informing view of acceptability

... not just for our firms but also for us as the regulator

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# Getting ready for internal model pre-application (1)

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## Sound planning has already been completed...

- Robust, credible Solvency II implementation plan in place
- Adequate budget and fully mobilised resource
- Clear link between project plan activity to Directive and Level 2 requirements
- Whole business engaged in the development of governance, risk and capital management framework.
- Implications of Solvency II on group structure considered

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# Getting ready for internal model pre-application (2)

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## ... and implementation is well under way

- Engaging in dialogue with all relevant regulatory authorities; pre-application underway
- Developing a strong governance and risk management framework
- Defining its internal model scope and underway with capital model build
- Making progress with wider aspects – ORSA, technical provisions, reporting
- Completing QIS5
- Drafting detailed documentation vision with significant material

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# Embedding Solvency II into the organisation

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For us as regulator Solvency II is about embedding the Directive...

- Ultimately, firms must embed Solvency II into their business and can demonstrate that they:
  - understand the risks they face;
  - manage risks effectively and appropriately; and
  - have greater senior management accountability......at day 1 of the new regime and ongoing.
- With the aim of increasing policyholder protection, reducing the possibility of consumer loss or market disruption in insurance.

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## Questions or comments?

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Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

