

**The Actuarial Profession**  
making financial sense of the future

Life Conference 2011  
Andrew Chamberlain and James Tuley



## Counterparty risks within groups

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## Counterparty risks within groups

### Agenda

- Entities subject to counterparty risk
- How are intra-group counterparty risks different?
- Assessing intra-group counterparty risks

### Working party members

- Andrew Chamberlain, Alexis Iglauer, Paul Simmons, James Tuley (chair)

## Working party terms of reference

- Appropriate allowance in technical provisions and capital assessment for risks arising from membership of a group
- Appropriate issues an actuary should address in viewing the impact of intra-group transactions

In scope	Out of scope
Solo company	Parent/Group balance sheet
Direct impact on solo balance sheet arising from failure of another company in the group to fulfil their obligations	Indirect consequences (e.g. Impact of tarnished brands)
Intra-group transactions	Softer issues (e.g. general management constraints imposed by group/parent)

## Definitions

### Intra-group transaction

*“any legally enforceable transaction, whether or not contractual and whether or not for payment, by which an insurance undertaking relies, directly or indirectly, on other undertakings within the same group or natural/legal person linked to undertakings within that group”*

- Arise from moving “risk to capital” (e.g. reinsurance) or “capital to risk” (e.g. contingent loans)

## Entities subject to counterparty risk

- Solo entities
  - Range from those with a strong sense of their own entity to captives
- Mutual as well as Proprietary entities
  - E.g. Mutuals may outsource services to “sister” entities
- Branches
  - Structures that cross jurisdictions (e.g. EU)
  - Localisation of asset requirements
- Groups
  - Concentration/dispersal of risks across its subsidiaries

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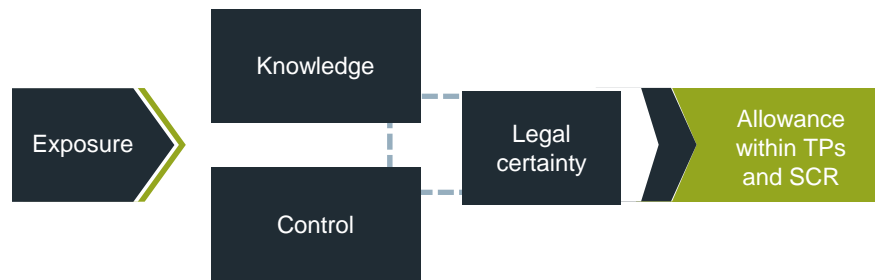
## How are intra-group counterparty risks different?

- Different governance approach?
- Less likely to have own credit rating?
- Less likely to have process to manage counterparty risks e.g. collateral arrangements
- Knowledge about the counterparty?
  - Includes unpublished information
- Control over the counterparty?
  - Ability to stop/influence the counterparty from taking actions that increase risk

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## Approach



A reliable, and repeatable method is need to reach the allowance.

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## Knowledge

- Information that relates to creditworthiness of counterparty
- Additional information shared privately by the counterparty beyond that publically available
- Regularity of knowledge “transfer” important
- Quality, and insightfulness, of information equally important
- Must understand the information provided and how the other party
  - interprets it
  - would react to changes in the information

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## Control

### Directive control, ability to

- stop the counterparty taking action that increases the risk of it failing to meet its obligations
- require the counterparty to take action that reduces the risk of it failing to meet its obligations

### Mitigatory control, ability to

- take action to mitigate impact of actions by the counterparty such as recapture of the exposure
- Seeking of guarantees or hedges to offset the counterparty's actions

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## Case Study 0

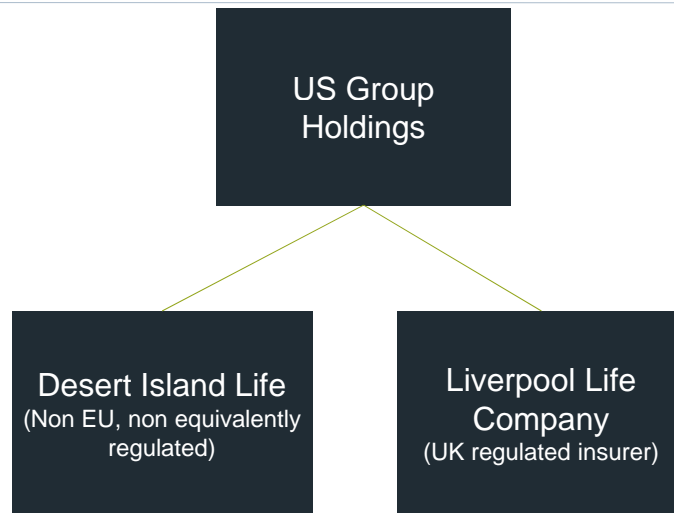
Liverpool Life  
Company  
(UK regulated insurer)

Wirral Life Company  
(UK regulated insurer)

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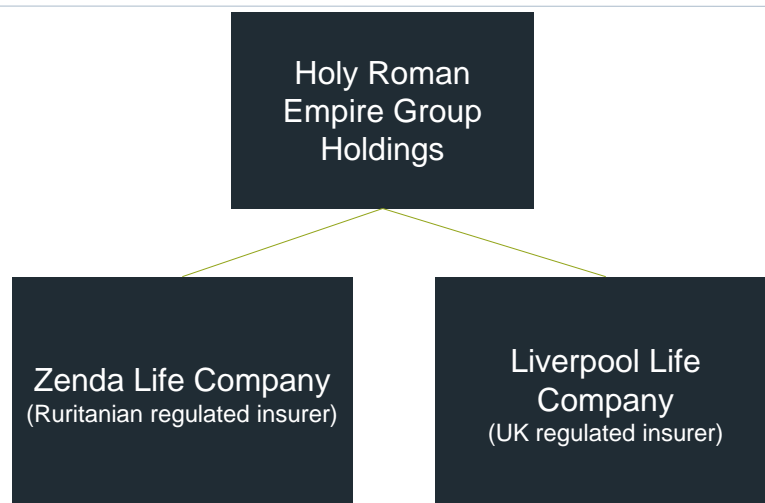
## Case Study 1



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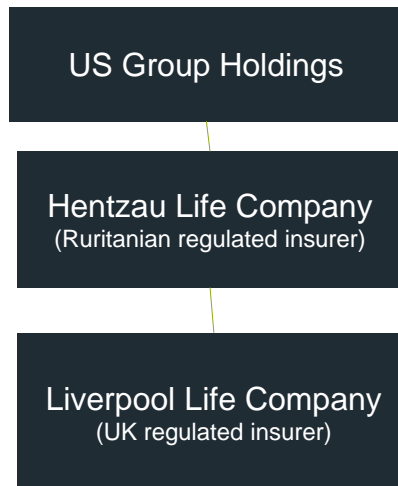
## Case Study 2



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### Case Study 3



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### Possible scoring process

Scoring	Knowledge	Control
5	Full, and immediate	Full control, shared systems, captive reinsurer
4	Full, and frequent	Full control, shared systems
3	Full, but infrequent	Completely common directors , and unlikely to change
2	Incomplete but updated (infrequently)	Completely common directors, but only for now
1	Only at outset	Some common directors
0	None	No common directors

Legal uncertainty reduces the score by at least 2

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## Impact - Considerable caveats apply – the detailed facts are all important

- Case study 0 – Friendly UK
  - We propose 0% of the charge that the internal model would suggest for an arm's length counterparty
- Case study 1 – Life on a Desert Island
  - We propose 100% of the charge.....
- Case study 2 – Prisoner of Zenda
  - We propose 80% of the charge.....
- Case study 3 – Can you trust Hentzau
  - We propose 40% of the charge.....

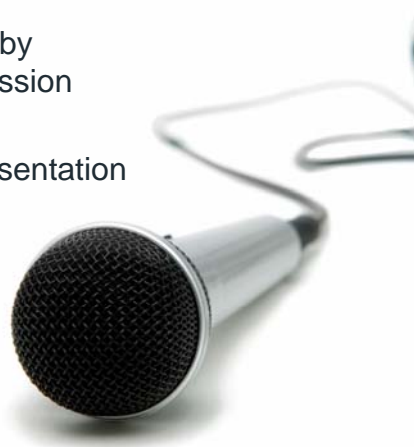
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## Questions or comments?

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

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