



The Actuarial Profession

making financial sense of the future

consultation response

FSA Consultation Paper 08/24:

Stress and scenario testing

Comments from the Actuarial Profession

March 2009



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Dear Rory

FSA Consultation Paper CP08/24 Stress and scenario testing

Thank you for providing the Actuarial Profession with the opportunity to comment on this consultation. Our substantive comments are attached to this letter.

If you have any questions or would like to discuss any of these matters further, please do not hesitate to contact us as per details below.

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Yours sincerely

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Introduction to The Actuarial Profession

Actuaries provide commercial, financial and prudential advice on the management of a business's assets and liabilities, especially where long term management and planning are critical to the success of any business venture. They also advise individuals, and advise on social and public interest issues.

Members of the Profession have a statutory role in the supervision of pension funds and life insurance companies. They also have a statutory role to provide actuarial opinions for managing agents at Lloyd's.

The Profession is governed jointly by the Faculty of Actuaries in Edinburgh and the Institute of Actuaries in London. A rigorous examination system is supported by a programme of continuing professional development and a professional code of conduct supports high standards reflecting the significant role of the Profession in society.

Response to CP08/24

The UK Actuarial Profession is pleased to be able to comment on your Consultation Paper 08/24 "Stress and Scenario testing". We do so from the perspective of the changes proposed for insurance companies rather than comment on the implications for deposit taking institutions.

The main point we would like to make relates to the proposed "reverse stress test". We find the nomenclature adopted somewhat misleading and believe it would be more helpful to refer to this as a business model stress test.

We do not consider that a case is made out in the paper for the application of a reverse stress test to insurance companies. For life insurance companies the capital assessed under both Pillar 1 and Pillar 2 already requires consideration of the costs involved in closing the fund and running off the liabilities if this should provide a higher capital requirement than on a going concern basis. For general insurance, this is not the case for the Pillar 1 capital assessment but is a requirement under Pillar 2. There are many examples of both life and general insurance companies which are already effectively or legally in run-off and such a status has not generally given rise to difficulties in securing appropriate arrangements with counterparties, for example reinsurers. If a blanket exemption for insurers is not deemed acceptable we would suggest either an exemption for companies already substantially in run-off or for guidance to be provided on what is intended by the reverse stress test for such companies.

We do have a number of more detailed points to raise on the proposals:

- In the new INSPRU rules proposed in Annex E, there is reference to 7.1.9 A G which implies the scope of the projections on the Pillar 1 basis have been extended to cover both the capital resources requirement and "major sources of risk". We find this difficult to interpret. In our view this projection should be of capital cover for the capital resources requirement only in stressed (1 in 25) scenarios.

- We note that Annex C, covering changes to GENPRU in the overall Pillar 2 regime, has reduced the drafting differences in the requirements for insurance companies and deposit taking institutions. As a consequence, by virtue of 1.4.42R(2)(c) an insurer is required to include scenarios which “may include...an economic recession”. This wording seems more appropriate for deposit taking institutions where risk is directly related to the state of the economy and we suggest it is best targeted directly at them.
- The proposed GENPRU 1.2.73 A G (2) incorporates the need to demonstrate capital cover for something beyond the capital resources requirement. See our comment
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- related to INSPRU 7.1.9 A G above.
- The proposed GENPRU 1.2.73 A G (3) sets out the need to project a position before and after management actions. We believe that for practical purposes this requirement should exclude routine actions such as the reasonable flexing of bonus rates and surrender values in accordance with a company’s PPFM.

We are happy for our response to be placed in the public domain.