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Deriving Value from Regulation

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General Insurance Financial Modelling Seminar



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Outline

- Background and the macro view
- Costs and Benefits of Modelling
- Deriving Value
- The Alternate View



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The Macro View



Statutory Objectives of Regulators

FCA

- *To secure an appropriate degree of protection for consumers.*
- *To protect and enhance the integrity of the UK financial system.*
- *To promote effective competition in the interests of consumers*

PRA

- *The safety and soundness of these firms and, specifically for insurers*
- *To contribute to the securing of an appropriate degree of protection for policyholders*

EIOPA

- *Better protecting consumers, rebuilding trust in the financial system.*
- *Ensuring a high, effective and consistent level of regulation and supervision taking account of the varying interests of all Member States and the different nature of financial institutions.*
- *Greater harmonisation and coherent application of rules for financial institutions & markets across the European Union.*
- *Strengthening oversight of cross-border groups.*
- *Promote coordinated European Union supervisory response.*



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Insurance and the UK economy



The UK insurance industry is the largest in Europe and the third largest in the world.

It plays an essential part in the UK's economic strength, managing investments of £1.8 trillion (equivalent to 25% of the UK's total net worth) and paying nearly £12bn in taxes to the Government.

It employs around 315,000 individuals, of which more than a third are employed directly by insurers with the remainder in auxiliary services such as broking.



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Costs and Benefits



Onus horribilis

SII places the onus for the running of the Internal Model on the board.

Article 116

“The administrative, management or supervisory body shall have responsibility for putting in place systems which ensure that the internal model operates properly on a continuous basis”

Article 120

“The administrative, management or supervisory body shall be responsible for ensuring the on-going appropriateness of the design and operations of the internal model, and that the internal model continues to appropriately reflect the risk profile of the insurance undertaking concerned”

The regulation ensures that the modelling team get their ‘seat at the table’ but without making actuaries only a regulatory requirement. Once there, it’s up to the actuaries themselves to demonstrate value – the regulation will not do this for us.



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Benefits of Modelling

Regulation is driving the use of models within the insurance industry.
Modelling provides a fundamental benefit to insurance companies.

- Modelling a process requires a thorough understanding of the underlying risks
- Discovering drivers and dependencies
- Use as a ‘What-If’ engine
- Identifying areas for potential growth

Financial modelling is something that we would be doing regardless of regulatory requirements.



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Deriving Value



Governance

Overheads

- Policies, Terms of Reference, independent review, ... can't we just get on with it?
- More information for Boards and Committees to digest (too much?)
- Evidential requirements

Value

- Empowerment and Escalation – opportunity to ensure boards and committees are digesting the right information
- Less time spent on preparing papers, more on preparing ideas
- Use committees for Discussion & Decision, not to Update or Inform



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Documentation

Overheads

- Design, methodology, data, processes, techniques, justification, expert judgements, assumptions, limitations, ... when does it stop?
- It's three times the work: Technical, Specialist and Executive
- Not the natural strength of the average actuary

Value

- Build trust through documentation and checklists – e.g. for strengths and limitations – avoid constantly changing the model
- Limitations become your to-do list; get them sponsored by the business
- 'Upsourcing': identify the key technical documents and ask Board members to summarise and report back to their peers



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Validation

Overheads

- Somebody else to check my work...
- Access to sufficiently independent resource and expertise
- Documentation requirements
- Time and resource demands on the modelling team; scope creep

Value

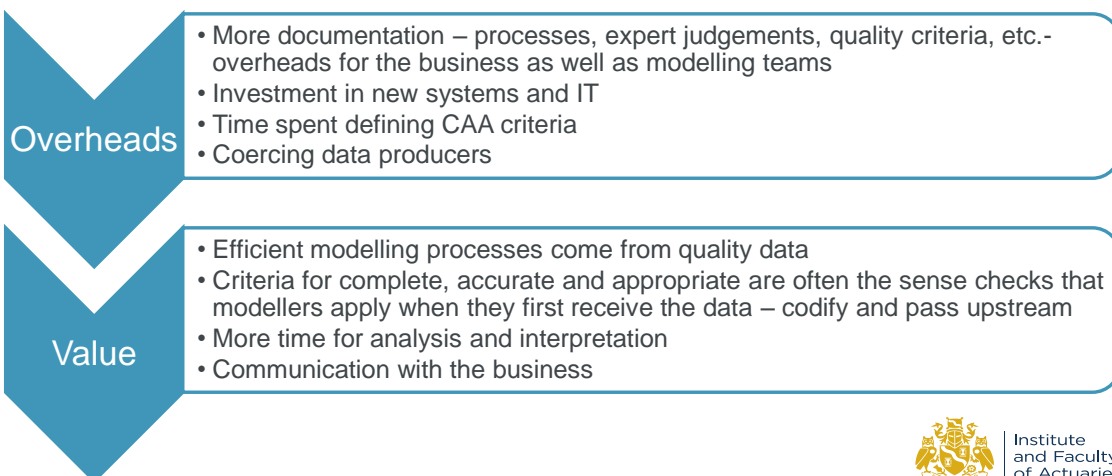
- Some firms are inventing it anyway, but take care with terms of engagement
- Opportunity to rotate team responsibilities
- All feedback is good feedback, as long as materiality is understood
- Dual use validation tests



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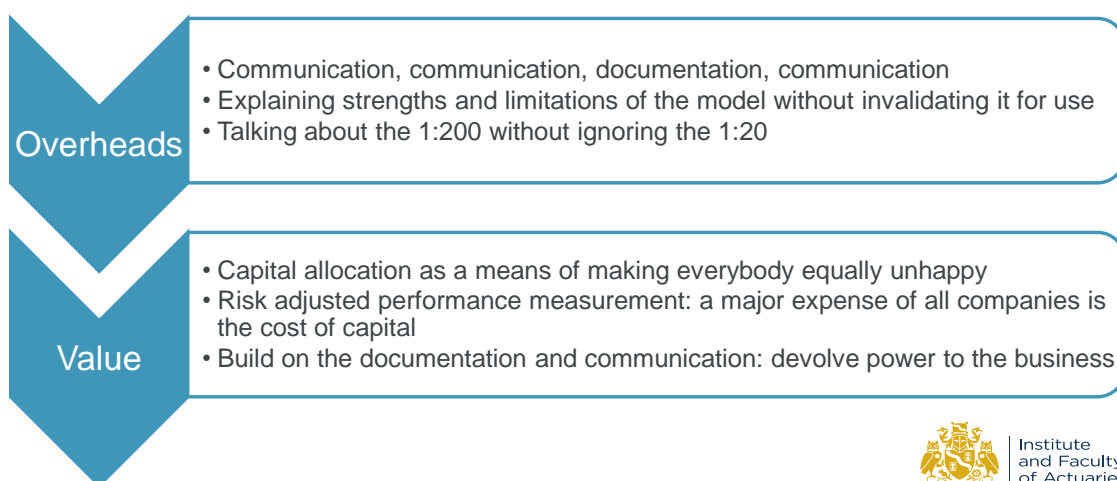
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Data



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Use Test



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The Alternate View

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ponsorship
Thought leadership
Progress
Community
Sessional Meetings
Education
Working parties
Volunteering
Research
Shaping the future
Networking
Professional support
Enterprise and risk
Learned society
Opportunity
International profile
Journals
Support

The Alternate View

Contrary

- Increased regulation doesn't add value
- SII has not promoted competition; effective barrier to entry
- PRA don't like models; what is a 1 in 200 anyway?
- Genuine black swans are off the radar of models (by definition)

Cynical

- Models point to recent events rather than sources of future losses
- Value from regulation has been for actuaries and consultancies
- Regulation creates demand and inevitably leads to financial benefit for suppliers

Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

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



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