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The Regulator's view on Life Assurance ICAs to date

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Overview

- Why is the FSA reviewing ICA's?
- Where we are with the rollout
- Review process
- Methodology
- Current issues and potential hot topics
- Questions

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Why is the FSA reviewing ICA's?

- The ICA regime is designed to increase the use of modern risk management and risk measurement techniques.
- The FSA are placing increasing reliance on principles based regulation and senior management responsibility.
- The FSA wish to better understand the risks and an appropriate level of capital for individual firms.

Link between ARROW and ICA's

- ARROW is the FSA's tool in supervising firms.
- ARROW review occurs over a 2 to 4 year cycle for each firm.
- The FSA provides written feedback to a firm on the risks they may pose to the FSA's objectives.
- Set out a risk mitigation program (RMP) to address some identified risks.
- The ICA forms part of ARROW review of adequate financial resources

Where we are with the roll-out

- Statistics for life insurance (as at 31 March 2006)
  - Received 34 submissions
  - 22 have been through panel
  - 90 (mainly smaller firms) to complete by 2007
- FSA ICAS Sector Briefing
  - Published on 18 November 2005
  - … and discussed
- Next steps

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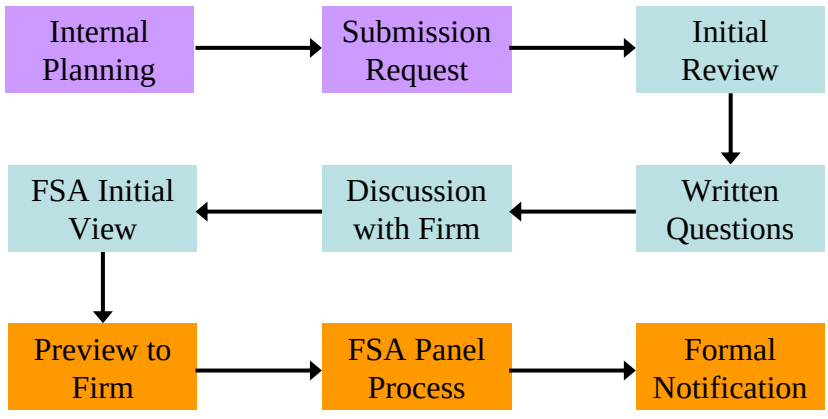
FSA Process – Steps



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FSA process: People

- Reviewing team is made up of supervisors, actuaries and risk review specialists.
- They will prepare a report based on the ICA, the firm's RMP and face-to-face interviews. Policy may be involved in preparing advice for new areas.
- This report is presented to an internal FSA panel composed of senior management and specialists such as actuaries.

FSA process – What we like to see

- That firms are in touch with industry thinking/best practice
- Demonstration that production of the ICA is a business-as-usual process
  - Robust systems and controls
  - Use of audited results
  - Sensitivity testing
  - Analysis of change
  - Link to Pillar 1 assets and liabilities
- That ICA is linked to risk management/risk register
- Board involvement with ICA
- Sufficient technical detail to allow an informed review

Methodology (1) – ICA balance sheet

- Base assets included at market value ignoring admissibility rules.
- Base liabilities included at best estimate/market value ignoring prudential margins.
- ICA calculated from the capital required to withstand the increase in liabilities and decrease in assets in the most onerous scenario.
- Scenarios should be calibrated to be equivalent to a 1 in 200 one-year event.

Methodology (2) – Options for calculating an ICA

- Value at Risk (VaR) – the effect on the current balance sheet of an instantaneous change in assumptions/ conditions consistent with a 99.5th confidence level.
- One-year approach – Similar to VaR but uses the balance sheet at the end of the year rather than the start of the year.
- Run-off approach – Projects the portfolio over a longer time period with a confidence level consistent with the 99.5% over one-year test.

Methodology (3) – Finer detail

- How do you determine the best estimate/market value of insurance liabilities?
- If you already have a market consistent method, how do you get your current systems to produce a robust ICA calculation?
- How do you determine a 1 in 200 year stress assumption?
- How do you aggregate risks/calculate the diversification benefit?
- How do you value the benefit of potential management actions?

Current issues (1)

- Market disclosure of ICG
- ICA's in large groups and small firms
- Operational risk assessments – implementing a bottom-up approach
- Commitments to pension schemes, service companies, and dividends/coupon payments
- Effective communication of results
- Scenarios

Current issues (2)

- Value of inter-company loans – are you double counting the embedded value?
- Valuation of subsidiaries – how are they affected by the same adverse scenarios?
- Correlation assumptions in stressed conditions
- Non-linearity adjustments
- Exposure to binary events such as failure of reinsurers
- Ability to manage expenses on a decreasing portfolio size/expense scenarios
- Tax!!

Issues for healthcare providers

- Morbidity data is not so readily available as mortality data
- Morbidity experience is effected by short term trends such as claims management processes and economic factors
- Allowing for reinsurance arrangements
- Correlation between claims experience and economic factors
- Correlation between morbidity and mortality in stressed scenarios

Questions?