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Current Issues In Life Assurance May 2010
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Regulatory Requirements

Regulatory Capital Tests – as hard to find as the capital itself?

- PRIN
- GENPRU
- SYSC
- INSPRU

Why do I need to know?

- An *actuary* appointed to perform the *actuarial function* must, in respect of those classes of the *firm's long-term insurance business* which are covered by his appointment :
- (1) advise the *firm's* management, at the level of seniority that is reasonably appropriate, on the risks the *firm* runs in so far as they may have a material impact on the *firm's* ability to meet *liabilities to policyholders* in respect of *long-term insurance contracts* as they fall due and on the capital needed to support the business, including regulatory capital requirements;

PRIN

- **3 Management and control**
 - A *firm* must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
- **4 Financial prudence**
 - A *firm* must maintain adequate financial resources.

GENPRU 1.2 Adequacy of financial resources

- GENPRU 1.2.26R (the “overall financial adequacy rule”)
 - A *firm* must at all times maintain overall financial resources, including *capital resources* and liquidity resources, which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.

GENPRU 1.2 Adequacy of financial resources

- Note - ICAAP rules are : the *rules* in GENPRU 1.2.30 R to GENPRU 1.2.39 R (Systems, strategies, processes and reviews), GENPRU 1.2.42 R (Main Requirements: Stress and scenario tests) and GENPRU 1.2.60 R to GENPRU 1.2.61 R (Documentation of risk assessments) as they apply on a solo level and on a consolidated level.
- GENPRU 1.2.30 R (the “overall Pillar 2 rule”)
 - A *firm* must have in place sound, effective and complete processes, strategies and systems:

GENPRU 1.2.30 continued

- (1) to assess and maintain on an ongoing basis the amounts, types and distribution of financial resources, *capital resources* and internal capital that it considers adequate to cover:
 - (a) the nature and level of the risks to which it is or might be exposed;
 - (b) the risk in the *overall financial adequacy rule*; and
 - (c) the risk that the *firm* might not be able to meet its *CRR* in the future; and

GENPRU 1.2.30 continued

- 2) that enable it to identify and manage the major sources of risks referred to in (1), including the major sources of risk in each of the following categories where they are relevant to the *firm* given the nature and scale of its business:
 - (a) credit risk;
 - (b) *market risk*;
 - (c) *liquidity risk*;
 - (d) *operational risk*;
 - (e) insurance risk;
 - (f) concentration risk;
 - (g) residual risk;
 - (h) *securitisation risk*;
 - (i) business risk;
 - (j) interest rate risk...;
 - (k) pension obligation risk ; and.
 - (l) group risk.

Other ICAAP rules:

- Identification of capital by tier separately that eligible and not eligible to form part of capital resources adequate to meet the rule (GENPRU 1.2.36R)
- Identification of how to deal with major sources of risk, and take into account diversification and how it is factored into risk measurement (GENPRU 1.2.37R)
- Assess regularly both the resources needed and the systems etc required to comply with the overall Pillar 2 rule (GENPRU 1.2.39R)

Other ICAAP rules continued:

- Stress and Scenario testing requirement (GENPRU 1.2.42R)
- Record-keeping requirements on assessments under GENPRU 1.2 (GENPRU 1.2.60R) and these must be kept for three years (GENPRU 1.2.61R)

ICAAP solo or group?

- Note the requirements in GENPRU 1.2.45R to GENPRU 1.2.59R bring group assessments into scope and may disapply the solo basis. (GENPRU 1.2.45R and INSPRU 6.1.9R or 15R primarily)
- (Non-) Transferability of resources can make a group assessment not too different in outcome to a solo one in some cases – or worse of course

Guidance

- Additional guidance is provided on
 - Stress tests and scenario analyses (GENPRU 1.2.63G to 72G)
 - Capital planning (GENPRU 1.2.73A G to 78G)
 - Pension obligation risk (GENPRU 1.2.79G to 86G)
 - Group risk (GENPRU 1.2.87G to 91G)

Capital Planning requirement

- Guidance on Stress and Scenario testing – not additional rules
- Most adverse cycle seen in long history
- Acyclical
- Reflective of risk tolerance in conditions when firm expects to remain a going concern

Capital planning continued

- 3-5 year CRR and "overall financial adequacy rule" test
- Flex the business plan
- No management actions (but not where this would be a nonsense, but still need to estimate the effects however daft!!)
- Separately identify management actions and estimate resulting effects
- May include ceasing to write new business
- Document
- FSA may require action if position is not satisfactory
- Governing body involvement

SYSC 11

- Liquidity testing

SYSC 20 – Reverse stress testing (from 14 December 2010)

As part of its business planning and risk management obligations under SYSC, a *firm* must reverse stress test its business plan; that is, it must carry out stress tests and scenario analyses that test its business plan to failure. To that end, the *firm* must:

- (1) identify a range of adverse circumstances which would cause its business plan to become unviable and assess the likelihood that such events could crystallise; and
- (2) where those tests reveal a risk of business failure that is unacceptably high when considered against the *firm's* risk appetite or tolerance, adopt effective arrangements, processes, systems or other measures to prevent or mitigate that risk.

SYSC 20 cont

- Group as well as solo basis (SYSC 20.2.2)
 - The design and results of a *firm's* reverse stress test must be documented and reviewed and approved at least annually by the *firm's* senior management or *governing body*. A *firm* must update its reverse stress test more frequently if it is appropriate to do so in the light of substantial changes in the market or in macroeconomic conditions. (SYSC 20.2.3)

GENPRU 2.1 – Capital (Pillar 1)

- Generally better understood but in summary form for most it is
 - $CRR = \text{MAX}(\text{MCR}, \text{ECR})$ if realistic reporter, or MCR otherwise
 - $\text{MCR} = \text{MAX}(\text{base capital requirement}, \text{LTICR} + \text{RCR})$
 - Base capital requirement = the amount applicable in € converted to £
 - LTICR = calculation in INSPRU 1.1
 - $\text{ECR} = \text{LTICR} + \text{WPICC}$ calculated in INSPRU 1.3

INSPRU 6.1 Insurance Groups – INSPRU 1.6.9R

- Where a *firm* is the *undertaking* referred to in INSPRU 6.1.17 R (1)(c) or INSPRU 6.1.17 R (2), it must maintain at all times *tier one capital resources* and *tier two capital resources* of such an amount that its *group capital resources* are equal to or exceed its *group capital resources requirement*. (INSPRU 6.1.9R)
- This applies to firms that are “participating insurance undertakings” (insurers down the line)

INSPRU 1.6.15R

- (1) Subject to INSPRU 6.1.27 R, a *firm* must ensure that at all times its *capital resources* are of such an amount that the *group capital resources* of each *undertaking* referred to in INSPRU 6.1.17 R (excluding those referred to in INSPRU 6.1.9 R) are equal to or exceed that *undertaking's group capital resources requirement*
- (2) (1) does not apply to a *pure reinsurer* which became a *firm in run-off* before 10 December 2007 and whose *Part IV permission* has not subsequently been varied to add back the *regulated activity of effecting contracts of insurance*.
- “The rest”

Important limits

- INSPRU 1.6.27R excludes non-EEA ultimate insurance parent undertakings
- Otherwise INSPRU 6.1.17R brings in ultimate and EEA parents, and firms which are participating undertakings
- Note definition of insurance parents includes insurance holding companies which are not “mixed” or “financial conglomerates”

Questions later ...

- ... but only if I can answer them!

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