



Institute
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Solvency II Preparation and IMAP

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8 September 2014



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Solvency II Preparation

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Solvency II Preparation

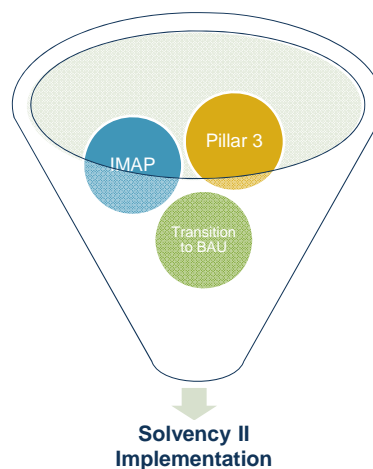
Balancing priorities

Insurers need to balance priorities over the next year:

- Main focus is often on IMAP
- Pillar 3 and external reporting needs sufficient focus
- Ensure smooth transition to Solvency II

Challenges:

- Resource constraints
- Some issues need senior input and cannot be resolved by extra resources

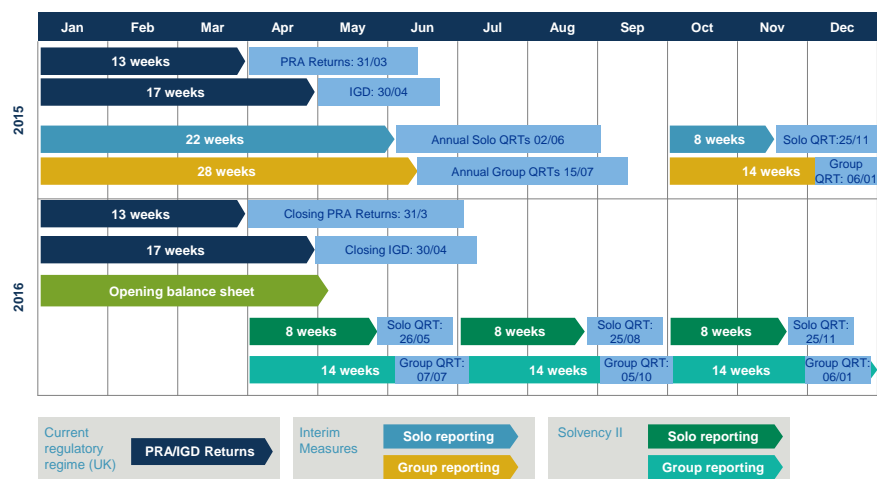


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Solvency II Preparation

Pillar 3 timeframes – 2015 and 2016



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Solvency II Preparation

External market and analyst reporting

- When to start publishing Solvency II position?
- Frequency and granularity of market reporting under Solvency II
- When to switch off existing metrics
- MCEV value/profit metric under Solvency II
- Auditors role on Solvency II

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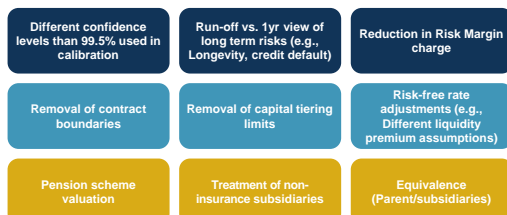
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Solvency II Preparation

Pillar 2 metric

- Challenging to agree Pillar 2 metric whilst Pillar 1 requirements are still being finalised
- Firms eager to reduce number of bottom up metrics
- Different balance sheet and/or difference capital requirement

Potential differences between Pillar I and II include



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Solvency II Preparation

Transition to BAU and Solvency II TOM

Transitioning to BAU of Solvency II programmes has started

- Often ICA/Economic Capital reporting does not sit within finance
- Many firms still considering optimal TOM between line 1 and line 2 and Solvency II actuarial and risk functions
- No one size fits all approach and there a number of factors to consider on TOM:
 - People/Culture and Skills/Capabilities
 - Size and complexity of organisation
 - Maturity of Risk function and Solvency II programme
 - Desire to have consistent Group/BU structure
 - Timeframe to achieve transition and whether changing earlier will assist with SII embedding



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IMAP

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IMAP

PRA engagement on IMAP

IMAP approval	<ul style="list-style-type: none"> Firms are unlikely to get any positive confirmations on their Internal Model until the formal submission and approval. There is likely to be a component-based review process to spread the workload.
Benchmarking	<ul style="list-style-type: none"> PRA has refreshed and validated their own benchmarking data using the data collection exercise in 2013 and in 2014 has clearer view on where it is appropriate to make use of it. With IMAP, PRA now have more info on different firm's methodology when benchmarking. Having this info, their intention is to have better conversations with firms and are open to discussions if a firm on whether conclusions on benchmarking is appropriate if a firm looks different to the pack.
Proxy Models	<ul style="list-style-type: none"> Proxy model validation has been the subject of much attention, given that it is a relatively new technique. PRA are still forming their own views of what best practice should be. The main concern here is that the proxy models do not provide a good fit in the scenarios that may matter most. A lot of this is because the PRA are not getting enough visibility of the thinking process and logic behind selecting the validation/calibration scenarios.
2nd line interaction	<ul style="list-style-type: none"> Challenges of showing 2nd line review and challenge.
Expert Judgement	<ul style="list-style-type: none"> Firms need to take more scientific approach to applying and validation expert judgement. This means making judgements explicit and visible (so that Board is also aware), testing the judgement systematically and fully documenting the conclusions/limitations.

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IMAP

Managing an IMAP project

IMV has taken significantly longer and used significantly more resources than originally anticipated in the plans

- The project management of IMV has been one of the key challenges faced by firms. Clearly, this has been exacerbated by the lack of clarity around certain rules and the need to perform IMV whilst certain internal model components and methodology are still being developed to enable the firm to meet the IMAP timescales.

Challenges	Consequences
Detailed work plan not produced at a sufficiently early stage. The work plans would have contained the validation and evidence expected from the first line.	Second line raised a large number of findings for remediation. In hindsight, a large majority could be dealt with as part of the methodology development if this was specified at the outset.
Lack of clarity of the end-to-end IMV process from mapping of the Solvency II requirements, performing the review and the governance process.	Lack of key stakeholder engagement and lack of governance of the review process.
No time allowed in the plans for second line to review iterations of documents where the method or the model component are still being developed in parallel with IMV	Second line did not have sufficient resources at the right time to perform reviews of the revised documents, leading to delays in the review process.
No time allowed in the plans to perform remediation to address the findings from the second line review and feedback from the PRA	First and second line did not have sufficient resources at the right time to perform remediation. Furthermore, second line did not have sufficient time to review the remediation completed by the first line.

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IMAP

Documentation feedback

The PRA released guidance in December 2013 on good and bad documentation, including a number of specific examples from their review work to date.

Principle	✓ Good practice	✗ Bad practice
Principle 1 – Accessibility	<ul style="list-style-type: none"> Multiple layers of documentation for different levels of granularity Effective 'signposting' of document structure Links to Solvency II requirements in the L1 or L2 texts Consideration of the audience and appropriate level of technical detail 	<ul style="list-style-type: none"> Inappropriate level of complexity Unintuitive document structure
Principle 2 – Evidence	<ul style="list-style-type: none"> Where multiple options have been considered the documentation should demonstrate consideration of each and rationale for selection Expert judgement must be fully justified Justifications should be firm-specific 	<ul style="list-style-type: none"> Vague language Insufficient commentary on graphs and diagrams Inadequate explanation of decisions made
Principle 3 – Quality Control	<ul style="list-style-type: none"> Robust version control, change control and signoff processes Evidence of an appropriate level of challenge 	<ul style="list-style-type: none"> Missing dates/version information

Source: <http://www.bankofengland.co.uk/prd/Documents/solvency2/documentationimap.pdf>

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IMAP

Expert judgement challenges

Validation of expert judgement have been a large part of feedback firms have received from the PRA

- The main challenge associated with expert judgement is in defining what it covers and how it can be validated in proportion to its materiality. There has been significant debate in the industry as to what expert judgement is.

Challenges	Consequences
Lack of clarity of what is covered by expert judgement.	Adopting too narrow a view has meant for some firms that expert judgements have not been sufficiently validated and documented (see later slide).
Lack of a process to 'expose' and document key expert judgement in the methodology development and internal model processes.	The internal governance committees and indeed the FSA are not able to get comfort that the firm understands where expert judgements are made and has therefore appropriately validated these judgements (see later slide).
Lack of articulated standards for validating expert judgement.	Inconsistent depth of validation applied to different expert judgements across the firm (see later slide).
Lack of understanding of the sensitivities and materiality of the expert judgements made.	The lack of context around the sensitivity and materiality of the expert judgements made have resulted in a much greater (and often disproportionate) review and remediation work required after review from the 2nd line and the FSA.

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IMAP

Applying materiality

Firms have struggled to articulate how they will implement a risk based approach and apply the concept of materiality to their IMV in practice

- The concept of materiality can only be considered usefully in the context of a purpose and result. A useful starting point would be to identify which risk modules are material and this assessment will apply to all components used to quantify that risk unless there is a justification to use a stronger or weaker assessment.
- Considering the materiality of each process in isolation could lead to academic discussions about whether for example an item of data is material or not. Qualitative assessments are just as important as quantitative assessments of materiality.

Materiality by 'Risk Modules' versus 'Process'

	Agg SCR	Equity Risk	Lapse Risk	Risk Module x
Results				
Method				
Assumptions				
Expert Judgement				
Data				
Systems & Processes				

Examples of Quantitative Assessments:

- Is the risk module $\geq 5\%$ of undiversified SCR?

Examples of Qualitative Assessments:

- Will deficiencies in the component result in the Board and the regulators to conclude that overall, the internal model is not fit for purpose?
- Is the component new and were there substantial changes made in the last 12 months?
- Does the operation of the component rely heavily on expert judgement?
- How complex is the component?
- Has there been a history of consistent errors?

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Solvency II Preparation and IMAP Summary

- A lot to do over next 15 months and balancing priorities is key
- Preparatory reporting starts in 9 months and in parallel to existing reporting
- Consider SII market announcements in advance of and post go-live
- IMAP more challenging than envisaged
- IMAP documentation and expert judgement have proved problematic

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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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