Irish Issues

Dermot Marron
Ger Bradley

2nd May 2013

- Dear Signing Actuary letters
- Solvency II
- MIBI Funding
- Injury trends – ACM’s
- PPO’s
- SAI Practicing Certs Working Party paper
- SAI Actuarial and Risk Management Function Working Party paper
Dear Signing Actuary letters

2nd May 2013

Dear Signing Actuary,...
Dear Signing Actuary

• Communications from Central Bank of Ireland regarding Statements of Actuarial Opinion:
  – Letter to President February 2010
  – Presentation at Non-life Forum November 2010
  – Letter to High Impact firms February 2013

• General comments
  – Level of detail
  – Quantification of uncertainty
  – BF a priori loss ratio picks
  – Choice of methodology

Letter to High Impact firms February 2013

• High Impact in PRISM framework (similar to FSA’s ARROW framework)
  1. Report on claim experience versus Expected and read-through to current pricing
  2. Report on data policy, quality and changes in data
  3. Analysis of material risk to reserve adequacy; distribution of reserves to be provided where available
  4. “Thought process” in arriving at reserves to be documented
  5. Quantification of uncertainty to be prospective as well as retrospective
Solvency II...
Solvency II – Ireland’s EU Presidency

• Long Term Guarantee Assessment
  – Progress Long Term Guarantee Assessment
  – Trilogue prior to July publication
• No ‘quick fix’ directive planned.
  – In absence of this, all members states could be in technical breach of the existing Directive
  – No wish to provide a ‘hook’ for the media to generate any more negative headlines about Sol 2 delay.
• EU Commission anxious to move along Omnibus 2 process with a view to getting agreement later this year.

Solvency II – Central Bank of Ireland

• Implementation of EIOPA guidelines
• Work being done internally in CBI to determine its supervisory approach
• Enforcement unlikely but “open and honest discussion” would be expected in event of non-implementation by a company
• Sensitive to Pillar 3 requirements seeming quite excessive
• Industry event 24 May
Solvency II – Society of Actuaries in Ireland

• 4 Workstreams
  – Pillar 2 - Systems of Governance
  – Pillar 2 - ORSA
  – Pillar 2 - Internal Models
  – Pillar 3 – Reporting

• Response through Groupe Consultatif in the first instance
• Presentations at Society Convention 29 May
Motor Insurance Bureau of Ireland

• Funded on a Pay-as-You-Go basis, based on share of motor market in previous year

• Current reserving – going concern basis
  – each company’s share of the ultimate expected cost of the MIBI claims is determined with reference to its expected share of the motor market for each year of the run-off period of the MIBI liabilities
  – In theory, if the MIBI reserves of each individual company were aggregated, the total reserve would equal that estimated by MIBI
Motor Insurance Bureau of Ireland

- Disadvantages
  - Quinn collapse left (temporary) hole in aggregate reserves
  - Foreign-domiciled insurers with Irish branches required to hold lower reserves – uneven playing field

Motor Insurance Bureau of Ireland

Solvency II

- Discontinuance basis consistent with Market Consistent approach of Solvency II
- Solvency II explicitly on a going concern basis
- Harmonisation requires the same liabilities to be treated the same in all jurisdictions (i.e. in Irish-domiciled insurers and Foreign-owned insurers with Irish branches) – need regulatory guidance

Society of Actuaries in Ireland dialogue with Central Bank in respect of Solvency I and Solvency II
Injury trends / AMC's

Road Deaths per Month (Garda.ie)  Exposure – per Dept of Environment

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<td>1,319</td>
<td>363</td>
<td>1,682</td>
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<td>1,662</td>
<td>477</td>
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<td>2009</td>
<td>1,902</td>
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<td>2010</td>
<td>1,873</td>
<td>543</td>
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Daily Comparison 2012 - 2013:
- Pedestrians: 10 Drivers: 32, Passengers: 7 Motorcyclists: 6
- Pedal Cyclists: 3 Rider Passenger/Other: 0

Yearly Comparison 2012 - 2013:
- Total Killed to 19/04/12: 42, Total Killed to 19/04/13: 58
- Total Collisions to 19/04/12: 41, Total Collisions to 19/04/13: 55

30 April 2013
CSO Exposure Indicators

UK 2012 report on TP Motor Claims

- Accidents giving rise to third party claims are on the decline according to our 2011 data. … the sharpest drop for the last 5 years, representing a decrease of 11%. However...

- Third party bodily injury (TPI) claim frequencies increased by 5% in 2011. Claim numbers have been rising year on year since our records began, (with the exception of 2010 which appears to have been the result of Ministry of Justice personal injury claims reform rather than a change in trend).

- 18% increase in the proportion of third party accidents involving bodily injury (third party bodily injury/third party damage ratio) from 2010 to 2011.

- Since our records began year on year a greater proportion of accidents have involved a bodily injury claim, but this year has seen the greatest increase ever.

- Unprecedented activity by claims management companies.

- This change alone increased costs to insurers in excess of £400m and as a result it is likely that motor insurance premiums will rise.
UK 2012 report on TP Motor Claims

- For the 3rd year in a row PPO awards that were settled in the UK motor insurance market totalled around the 70 mark, suggesting that a ‘mercury level’ has been reached.
- There is evidence of stabilisation in the average PPO awards.
- The average age of PPO claimants increased only slightly from 34.4 years in 2010 to 35.2 years in 2011.
- The average size of an annual PPO payment in 2011 was £78,700 – almost identical to the 2010 data.
Google

Injuries Board Annual Review 2012 - Tuesday 26th March 2013

Board Warns of Threat to Competitiveness if Emerging Claims Culture not addressed

Operating Highlights 2012:
- Compensation Awards up 3.9% to €218m
- Claims volumes up 4.7% or 24% since 2007
- Motor claims up 6.7% or 33.5% since 2007

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<td>No. of new Claims</td>
<td>28,962*</td>
<td>27,669</td>
<td>26,964</td>
<td>25,919</td>
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<td>No. of Awards</td>
<td>10,136</td>
<td>9,833</td>
<td>8,380</td>
<td>8,643</td>
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<td>Total Value of Awards</td>
<td>€217.94m</td>
<td>€209.8m</td>
<td>€186.6m</td>
<td>€200.2m</td>
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<td>Average Award</td>
<td>€21,502</td>
<td>€21,339</td>
<td>€22,271</td>
<td>€23,166</td>
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<td>Average time to process Claim</td>
<td>7.2 months</td>
<td>7.2 months</td>
<td>6.9 months</td>
<td>6.5 months</td>
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*Excluding 641 one-off DuPuy hip replacement claims
Peter O’Brien – Injuries Board Nov 2012

- A gradual but consistent increase in claims volumes with little evidence of a matching increase in accidents 6.6% (to end of September)
  - claimants pursuing lower value claims
  - A noticeable increase in advertising and promotion by providers of claims related services, particularly online
  - anecdotal reports of regressive practices such as ‘claims harvesting’
Statement by Alan Shatter

16 January 2013: The Minister for Justice, Equality and Defence, Mr. Alan Shatter T.D, has announced that the Government yesterday approved his proposals to prepare legislation to give the courts new powers to make periodic payment orders for the benefit of persons catastrophically injured....

It is, of course, vital that any such scheme must ensure the continuity of payments to the plaintiff......will require the establishment of a financial infrastructure to ensure continuity of payment, whilst ensuring that the State’s position under any such scheme is fully protected.

.....the drafting of the General Scheme of the Civil Liability (Amendment) Bill will commence shortly and will take account of the recommendations of the Report of the High Court Working Group on Medical Negligence and Periodic payments published in October 2010........At this stage, there are a significant number of claims awaiting final resolution by means of a regime of periodic payments ........The main challenges associated with the introduction of Periodic Payment Orders relate

• to the security of payments from non-State entities and
• the issue of indexation of payments

SAI Practicing Certs Working Party paper

March 2012
Process

• The WP represented a broad range of areas of actuarial work and it brought practitioner, regulatory and Practising Certificates Committee perspectives to the table
• We consulted with the Life, Pensions, General Insurance, PRSA, Life Reinsurance and Healthcare committees
• We consulted with the relevant regulators
• We carried out research on how other actuarial bodies were dealing with the issue (Appendix 4)
• We considered processes adopted by other professions
• We also received feedback from the Professional Affairs Committee and from Council

Current Role of Practising Certs

• Introduced in 1996 to ensure that actuaries who discharge statutory duties have, and are seen to have, comprehensive, up-to-date knowledge, breadth and depth of experience in matters that require professional judgment and a commitment to high standards of professionalism
• Aimed at safeguarding the financial security of customers
• Preserve the integrity of the profession
• Provide support and protection for individual actuaries from potential client and employer pressure to carry out roles for which they do not yet have adequate experience
View of the Working Party

• We believe the Society’s processes for issuing practising certificates support this objective effectively
• They remain practicable enough to ensure efficient delivery of the service
• While it cannot be expected to be failsafe, the regime encourages and promotes a high standard of performance
• The benefits outweigh the limitations
• The scheme addresses the most significant areas of actuarial responsibility in a proportionate and practical manner

Recommendations to Strengthen the Scheme

• First time applicants should be required to provide details of the activities that they have undertaken in order to properly prepare for the role.
• Applicants for renewal of a certificate should be required to confirm that they have kept up to date with developments in legal, regulatory and professional requirements and outline how they have done so.
• The Society can (under ASP PA-1, Continuing Professional Development) make it obligatory for practising certificate holders to undertake learning on, for example, new legislation or new actuarial methodologies. We recommend that the Society consider how this idea might be taken forward.
• Currently, an applicant may count pre-qualification work experience towards the practising certificate experience requirements in certain circumstances. We recommend that this be changed such that all experience that is relied upon by first time applicants, both technical and professional, must be obtained post-qualification. The Practising Certificate Committee should have discretion to vary this requirement in exceptional circumstances.
Recommendations to Strengthen the Scheme

• The Society should review its “Guidance relating to appropriate practical experience” for each of the practising certificates to ensure that the guidance is up to date in terms of what would currently be expected of reserved role holders.

• Applicants for practising certificates should be required to put in place a formal arrangement under which they may consult or discuss issues with a peer as and when required.

• A lay member should join the Practising Certificate Committee. His or her role would not be to decide on individual applications but rather to provide independent input and challenge on processes and on the overall governance of the application process.

• Formal terms of reference for the Practising Certificate Committee and guidelines on the processes to be followed by the Committee in the assessment of applications should be drafted and published.

Recommendations to Strengthen the Scheme

• Going forward, there should not be different types of Appointed Actuary and Signing Actuary certificates. …In future, in the case of an application for an Appointed Actuary or Signing Actuary certificate, the actuary should demonstrate his or knowledge and experience, having regard specifically and explicitly to the types of business expected to be written …by the company or companies by which he or she is employed or engaged at that time. If an Appointed Actuary or Signing Actuary is subsequently required to consider further types of business, whether under a new engagement or employment or because a company extends its lines of business, he or she should be required to apply to the Society for confirmation that the practising certificate remains valid. This application should be supported by evidence that the Appointed Actuary / Signing Actuary has appropriate knowledge and experience that is relevant to the new areas.

• The processes for assessing applications should be streamlined such that, where applicable, due account is taken of any assessment of compliance with the Standards of Fitness and Probity introduced in 2011 by the Central Bank of Ireland.
Future: Scheme Actuaries / PRSA Actuaries

- Solvency II will not impact on the regulatory responsibilities held by Scheme Actuaries and PRSA Actuaries.
- Other than as per the recommendations above, we do not feel that there is an imperative to change the regime for Scheme Actuary and PRSA Actuary practising certificates.

Future: Actuarial Function Holders / Chief Actuaries

- The imperatives that led to the introduction of the practising certificates regime will continue to apply in a Solvency II world.
- Therefore, we believe that the Society should require members who are Actuarial Function Holders (or Chief Actuaries as defined by the CBI—PCF21) under Solvency II to hold a practising certificate issued by the Society.
- We do not see this as a “voluntary” certification to indicate achievement of an advanced level of experience, but as a necessary part of the Society’s processes for regulating actuarial work and thereby preserving the reputation and standing of the actuarial profession, and we therefore believe that they should be mandatory for members of the Society who wish to be Actuarial Function Holders.
Practical Difficulties

• Lack of a regulatory requirement
• Potential appointment of overseas actuaries who are not members of the Society
• Costs and resourcing implications for the Society of implementing a PC scheme
• Difficulty of setting objective criteria

Further Considerations

• If these proposals are adopted by the Society, further consideration will be required in the following areas:-
  – Whether they would be company specific
  – The criteria and the assessment of applicants
  – The extent to which the PC Committee might be allowed to exercise discretion
Chief Risk Officers

- We believe that there is merit in developing a practising certificate for actuaries who fill the Chief Risk Officer role
- However, we feel it would be premature for the Society to start issuing CRO practising certificates during the transition to and for some time after commencement of Solvency II
- We believe actuaries are holistically the most suitable candidates for this role in insurance companies and we believe it would not be desirable to exclude actuaries from this role because they may lack some elements of the risk management skill-set

Quality Assurance – Scheme and PRSA Actuaries

- Scheme Actuaries are obliged to have a sample of their statutory work reviewed each year for compliance with legal and professional requirements
- Notwithstanding its limitations, the Certificate of Compliance is a useful underpin to the Scheme Actuary practising certificate regime
- Mindful of the need for requirements to be proportionate and cost effective, we do not think that there is an imperative for more extensive quality assurance processes for Scheme Actuary practising certificates
- We do not think there is an imperative to extend compliance monitoring requirements to the statutory work of PRSA Actuaries
Quality Assurance – Appointed & Signing Actuaries

• Their work is provided to the Boards of their companies (client companies) and to the Central Bank of Ireland, who may reasonably be expected to have sufficient expertise to question and challenge the work. Many Boards require that the work be peer reviewed, as a matter of good business practice.

• We do not think there is an imperative to amend the practising certificates regime for these roles by mandating specific quality assurance processes. However, in the interests of transparency, consideration could be given to requiring the actuary to disclose in any written report relating to statutory work whether the work was peer reviewed and if so, whether this was an internal review by an actuary within the same firm as the Appointed / Signing Actuary or an external review by an independent actuary.
Governance Challenges under Solvency II

- Flexibility in organisational structure, provided comply with the governance and fitness and probity requirements of both Solvency II and of the Central Bank of Ireland.
- Key point is that we draw a distinction between "departments" & "functions"; functions can transcend departments.

Conflicts of Interest – Solvency II Functions

Option 1: A person with responsibility for the Actuarial Function only

- Don’t see conflicts of interest in co-ordinating the calculations of technical
- A conflict of interest does not arise if the Actuarial Function were to also calculate the technical provisions.
- Don’t see conflict of interest between these activities and providing opinions on the underwriting policy and the reinsurance arrangements.
- Regarding the technical provisions work, the two pairs of eyes principle would be important in ensuring appropriate challenge and quality assurance.
Conflicts of Interest – Solvency II functions

Option 2: The same person is responsible for the Actuarial Function and other business activities (but not the risk management control activities).

- The organisation will need to consider the conflicts of interest that could arise and manage these accordingly.
- Consideration should be given to whether his/her personal performance is based on measures that could conflict with, for example, the technical provisions-related role of the Actuarial Function.
- Depending on the circumstances, any such conflicts could potentially be managed through executive or Board committee oversight, external review or a combination of approaches.
- An organisation should be satisfied that it can evidence that such conflicts were identified and the controls agreed and introduced were deemed proportionate to the risks perceived.

Option 3: The same person is responsible for both the Actuarial Function and the Risk Management - but with no other responsibilities

- The two pairs of eyes principle will be important even if the person responsible for the integrated function has no other responsibilities or is not conflicted.
- E.g. if an internal model is used, different people should be responsible for (a) designing and implementing the model vs. (b) testing and validating the model.
- If the standard formula applies, there should be independence between the review of the SCR and MCR and their calculation.
- Similar comments apply to other aspects of implementing an effective risk management system.
- An organisation should be in a position to evidence sufficient challenge to the assumptions made and methodologies used to calculate technical reserves.
Conflicts of Interest – Solvency II functions

Option 4: The same person is responsible for both the Actuarial Function and the Risk Management – but with other responsibilities.

- The organisation will need to consider the conflicts that may arise and manage these accordingly.
- E.g. personal performance is based on measures that could conflict with the risk and control operations role of the Actuarial and Risk Management Functions.
- Could potentially be managed through Executive or Board committee oversight, external review or a combination of approaches.
- Identify the conflicts and controls introduced are proportionate to the risks (perceived and/or real).
- “Other responsibilities” that need specific consideration here would include Product Pricing, Business Planning/Strategy, Investment Strategy, Asset/Liability Management, Reinsurance, Embedded Values.

Conflicts of Interest: Three Lines of Defence Risk Management Model

- Conflicts of interest that may arise within or between the lines of defence
- As a general rule, conflicts of interest can arise where a department or function is involved in both the first line and the second line of defence.
- A complete separation of activities between the first and second lines of defence is the ideal.
- In practice, there may be instances where it is better from a risk management perspective for the second line of defence to have some input into first line of defence activities, operating in a pre-emptive control role.
Conflicts of Interest: Board Checklist

What could go wrong? ✓
How much would such an event cost to rectify? ✓
Are there vested interests materially conflicting with responsibilities? ✓
Are the personnel responsible subject to Code of Conduct? ✓
Is regular external review in place? ✓
Could the organisation defend the conflicts of interest? ✓
Would the structure withstand regulator or media scrutiny? ✓

A Year in the Life

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30/04/2013
A Year in the Life

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<tr>
<td>Run Sensitivities</td>
<td>Determine Stress Scenarios</td>
<td>Annual review of standard formula/RM against risk profile correlations, shocks, risk coverage</td>
<td>Annual review and update of QRSA Policy</td>
<td>Annual review and update of the risk appetite statement</td>
<td>Annual review of risk management system</td>
<td>Run best estimate and stress projections</td>
<td>Independent reviews and reporting</td>
<td>Compile QRSA report board and supervisor</td>
<td>Present highlights of QRSA process and results/feedback into budget planning</td>
<td>Annual review of risk culture</td>
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Competencies & Skills Required

**Risk Management Function**

- The new formal Risk Management Function, and the associated Chief Risk Officer (CRO) role, is significantly enhanced in Solvency II relative to the current formal responsibilities.
- The level of direct involvement of the CRO in the day-to-day elements of all areas of Risk Management will depend on the operating model of individual companies.
- Discharging or supporting a robust Risk Management System will require a wider range of competencies than might typically be associated with these roles at the moment.
- In the following slides, we look at the required skills and competencies by outlining the principle responsibilities of the Risk Management Function under Solvency II.
Competencies & Skills Required

- **Internal Model**
  For (re)insurers using a partial or full internal model, skills and capabilities to:
  - Design and implement the internal model
  - Test and validate the internal model
  - Document the internal model and any subsequent changes made to it
  - Analyse the performance of the internal model and to produce summary reports
  - Report on the performance of the internal model

- **Solvency Capital Requirements**
  Skills and capabilities to:
  - Calculate current statutory solvency position (SCR, MCR and Capital Position)
  - Projection of overall solvency needs through stress and sensitivity tests
  - Dividend and capital injection considerations

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Competencies & Skills Required

- **ORSA**
  Skills and capabilities to:
  - Develop and embed an ORSA process in the business’s strategy setting, business planning and decision making processes
  - Review the system of governance taking into account the company’s risk profile
  - Define and document the ORSA process and supporting ORSA report
  
  This includes evaluating the use of the Internal Model or Partial Model in the following areas:
  - Description of risk profile
  - Description of Model and Model Governance
  - Review of risks covered/not covered by Model
  - Assumptions and limitations of the Internal Model
  - Assessment of emerging risks
  - Review of statistical quality and calibration of Model
  - Review P&L attribution
  - Review performance of Model vs Use Test
Competencies & Skills Required

• **Risk Strategy**
  Skills and capabilities to define a risk strategy including definition of:
  - Risk management culture
  - Risk management governance, roles and responsibilities
  - Process for embedding risk management in business planning and performance management
  - Process for establishing minimum requirements for the management of the portfolio of risks
  - Process for the conduct of the ORSA

• **Risk Appetite**
  Skills and capabilities to define a risk appetite:
  - Process to review existing and emerging risks
  - Where the company has a Internal Model using Internal Model output to shape the risk appetite
  - Establishment and statement of the (re)insurers risk appetite and risk tolerances
  - Leading to Qualitative and Quantitative assessment of risks
  - Review of risk limits at a risk category
  - Process to ensure (re)insurer behaves within stated risk tolerances

Competencies & Skills Required

• **Risk Policies**
  Skills and capabilities to define, review and refine risk policies including, but not limited to:
  - Underwriting and reserving
  - Asset-Liability management
  - Investment
  - Liquidity and concentration risk
  - Operational risk
  - Reinsurance

• **Risk Reporting**
  Skills and capabilities to:
  - Provide key information to management through risk committee structures
  - Explain complex risk concepts to management and staff across the organisation
  - Engage with regulators
  - Engage with other professionals with key roles across the business (Actuaries, Lawyers, etc.)
Conclusions

• New Solvency II responsibilities assigned to the Actuarial Function do not mark a large departure from the existing actuarial responsibilities for life insurers, non-life insurers and reinsurers.
• The transition for those involved in Risk Management Function could be more significant
• An effective risk management system will require input from the Actuarial Function
• A full or partial integration of these functions could be possible subject to meeting the requirements of Solvency II framework and addressing any conflicts of interest.
• It’s important to demonstrate that conflicts of interest arising are formally acknowledged, managed and mitigated appropriately.

Conclusions

• Solvency II will require greater formalisation of processes and documentation
• This is likely to be an area where actuaries will need to enhance their skill-sets in transitioning from current actuarial roles to the Solvency II Actuarial Function role.
• From a Risk Management perspective, it is evident that a significantly broader range of skillsets will be required within this function than would typically exist currently.
• The formal Risk Management Function, and the associated Chief Risk Officer role, is significantly enhanced in Solvency II relative to the current formal responsibilities in these areas.
Questions

2nd May 2013