

## Update from the FSA

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Barbican, Tuesday 16 May 2006

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## Update from the FSA

### Agenda:

- Brief ICAS Update
- Solvency II
- Hot Topics Roundup

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## Brief ICAS Update

### Key Themes:

- ICGs given, observations, issues emerging
- High-level Principles and Expert Group
- Integration into Arrow II

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## Brief ICAS Update

### ICA Reviews and ICG Progress:

- 64 ICGs given; on track for mid-2007 completion
- Observations and issues (update on Sector Briefing)
  - 'Embedding' in the business – ICA model and other risk models
  - Time horizon and confidence level 'equivalence'
  - Run-off assumptions (risks and expenses)
  - 'Realistic' asset and liability valuations
  - Allowance for future profits
  - Allowance for cycles
  - Pensions and Taxation
  - What do we do when nobody knows the answer?

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## Brief ICAS Update

### High-level Principles and Expert Groups:

- Insurance Standing Group agreed to the formation of Expert Groups (Life and GI)
- Objective is to address the questions left open
- Monthly meetings since January
- Very useful and open conversations
  
- Objective: to set out 'high-level principles' for internal models
  - Everyone can sign up
  - All points of debate can use them as a frame of reference

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## Brief ICAS Update

### Integration into Arrow II:

- Arrow assessment already informs ICG
- ICA review to become integral to risk assessment
- Interaction is already there if not synchronous
- New timetabling to work towards synchronisation

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## Solvency II

### Key Themes:

- Update on CEIOPS position
- FSA view on important questions
- QIS II

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## Solvency II

### Objectives of Solvency II:

- Modernise approach to assessment of liabilities and capital requirements for insurance companies
- For this purpose, take account of all relevant risks and uncertainties within insurance business, in a proportionate and cost effective manner
- Compatible with likely IAS framework, and with other financial sectors
- Incentivise good risk management within insurance firms, including internal modelling

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## Solvency II

### EU Commission's 'Straw Man':

- Provisions set with 75% confidence over run-off, or by application of cost-of-capital approach based on SCR
- Pillar 1 SCR capital requirement based on 99.5% VAR over 1 year for market, credit, u/w and operational risks – may include appropriate use of internal models
- Pillar 1 MCR is a lower trigger for mandatory supervisory action
- Pillar 2 review process – for risks not adequately covered by SCR (and an assessment of overall risk management)
- Pillar 3 disclosure requirements

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## Solvency II

### FSA view - Framework:

- Market-consistent provisions on the balance sheet that are sufficient to allow transfer of insurance liabilities to a third party (or an incentive to recapitalise a firm)
- Include risk margins in provisions only for unhedgeable risks, eg underwriting risk; and in order to cover uncertainty in 'best estimates' for such risks, eg for longevity or for non-life claim size
- Capital held by firms should be sufficient to ensure with high degree of confidence that liabilities can still be met after any adverse events or developments in next 12 months, and reflect ALM
- Incorporate ICAS approach based on use of internal models within firms – Pillar 1 and Pillar 2

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## Solvency II

### Alternative views - Framework:

- Require high levels of prudence within provisions eg undiscounted plus additional margins
- Factor based approach to SCR that does not properly take account of ALM (or bonus changes)
- Minimum floor on unearned premium provisions, and for surrender values
- Quantitative hard limits on investments

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## Solvency II

### QIS II - objectives:

- Look at impact on individual entities of possible overall Solvency II framework, covering
  - Practicability of calculations
  - Effect on level of capital needed by firms
  - Suitability of approaches for establishing capital requirements
- Information to assist in further development and calibration of SCR and MCR

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## Solvency II

### QIS II - issues:

- Timetable tight and work comes at a bad time
- Some concerns over the calibration of some aspects – probably borne of misunderstanding objectives
- Other concerns about the way the information might be used (e.g. tax)
  
- These problems will not go away because you don't participate – and you will have far less opportunity to influence the framework that will be compulsory.

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## Solvency II

### QIS II - resources:

- FSA resolution of pre-test general queries
    - This will be developed as we resolve queries
- <http://www.fsa.gov.uk/Pages/About/What/International/solvency/index.shtml>
- Dedicated email address for QIS 2 queries

[QIS2@fsa.gov.uk](mailto:QIS2@fsa.gov.uk)

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## Hot Topics Roundup

### Key Themes:

- Contract Certainty
- Catastrophe Models
- Collateralisation
- Reinsurance Directive
- Authorisations

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