

The Actuarial Profession
 making financial sense of the future

33rd ANNUAL GIRO CONVENTION
 Hilton Vienna Hotel, Am Stadtpark
 General insurance reserves for accounting and solvency:
 incorporating provision for risk
 Risk Margins Working Party 2006


General insurance reserves for accounting and solvency: incorporating provision for risk
Risk margin working party 2006
Why?

- No consensus yet on how to “do risk margins”
- IAA advising IAIS and IASB – international effort
- Working party needed to produce non-life examples
- Interim report to GIRO (very interim!)


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Working party members

- Jonathan Broughton
- Bob Buchanan (Australia)
- Tony Coleman (Australia)
- Peter Hinton
- Andrew Hitchcox
- Allan Kaufman (FCAS)
- Julian Leigh
- Erica Nicholson
- Justin Skinner
- Martin White


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Overview

- Framework
- Reference Company concept
- Some numbers
- The challenge of calibration
- The players and their positions

IAIS (International Association of Insurance Supervisors)

- Aims for convergence of regulatory regimes
 - Regulators will set solvency standards
 - Technical reserves to follow IASB/IFRS
- IAIS "Cornerstone 1" emphasises the need for an insurer to meet its liabilities under all reasonably foreseeable circumstances, in the short and long term-capital plus technical reserves)
- IASB's fair value thinking for technical reserves compares well with regulators' "willing reinsurer" transfer test

IAIS – Solvency- Rise and fall of xyz insurance co

- Company launched with fanfare, capital subscribed
- All goes well for some years
- Couple of bad years, capital falls below acceptable level for brokers to recommend
- Shareholders disenchanted, aware of risks in tail
- Company goes into solvent run – off
- Given that run-off is always possible, what expected policyholder deficit would be acceptable to policyholders at that point? 5%? 10%? 25%? >25%?

IAIS – Technical Reserves

- Solvency considerations define sum of capital and technical reserves
- But, IAIS (and the industry) want technical liabilities for solvency = technical reserves for general purpose financial reporting
- Hence, a fair value liabilities model such as cost of capital

Reference Company

- A market price – Not a prudential reserve
- “Own Portfolio” or “Assuming Co Portfolio”
- Leads to
 - Additivity
 - Consistency
 - Transparency
 - “Simplicity” (relatively, anyway)

Fair value impact

(starting with undiscounted no margins)

Model	Short Tail	Long Tail
Tillinghast	-1%	-6%
PwC	+5%	+20%
Straw-man	-7%	-11%
CEA	-5%	-11%
SST	-6%	-16%

The Challenge of Calibration-1

- Reality check - Are reserves really 5% to 15% above 'market value'?
- Watch the calibration
 - Cost of capital
 - Required capital

Calibration -2

- Capital = ECR, SCR (a work in progress),
 - Is that an A-rated company or BBB rated company
 - SCR reduced if reserve transfer assumed
- Cost of Capital=15%, 12%, 10%? 10%, more, less?
 - Tillinghast retail approach
- Reinsurance & Net – An open question

The Players

Regulatory IAIS CEIOPS FOPI APRA	Accounting IASB FASB
Industry CEA CRO CFO Forum GNAIE	Actuaries Group consultatif IAA "Giro" CAS & ASB

The Players Agree (Mostly)

- Actuaries know how to do expected value estimates!!
- Cost of capital is an acceptable approach
- Discounting is appropriate
- Calibrating a cost of capital model is described as simple, but no one has done a 'real' calibration (apologies to FOPI).

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Next Steps

- Questions today
- Further GIRO feedback
- IAA and other feedback
- Further work by the working party

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