



The Actuarial Profession

making financial sense of the future

Risk Management in Insurers

Is ICAS making a difference?

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Agenda

- Why and how we undertook a review
- Main areas of industry progress
- The impact of ICAS
- Challenges for life insurers

What is this?



Why and how we undertook the 2006 Study

Fulfil commitment in Business Plan 2006/07

..and also follows up on 2003 report “Review of UK Insurers’ Risk Management Practices”

- Assess firms’ progress
- Consider impact of ICAS regime on risk management standards
- Provide views on main priority areas for industry attention
- Reassert senior management responsibilities

Report Yet to be Published

- End November
- Sector Briefing
- Aimed at all senior management

Different approach to 2006 review from 2003

| 2003 | 2006 |
|--|---|
| Surveyed practices | Reviewed effectiveness of practices |
| Surveyed the range of risks identified by firms | Reviewed how different categories of risk are managed |
| Report provided comments on the full range of management practices | Report may include case studies, and focus is on main areas of progress and where most development still needed |
| Used survey data only | Made use of FSA information on recent risk and ICAS assessments |
| 39 firms surveyed of whom 19 visited | 26 firms surveyed of whom 12 visited |

Main Areas of Progress since 2003

Much has happened since 2003

- Integrated Prudential Sourcebook for Insurers
- Implementation of ICAS regime
- TCF
- Solvency II
- Industry developments – CRO Forum, Lloyd's Toolkit, ORIC etc..

Standards of practice have moved on ..and on and on....

In 2003 we saw:

- Firms reacting to emerging regulatory requirements
- Limited segregation between risk-controlling and risk-analysing
- Risk appetite undefined
- MI shortcomings
- Modelling of risk and capital under-developed

In 2003 we saw:

- **Firms reacting to emerging regulatory requirements**
-

In 2006 we saw:

- **Many firms recognising the commercial benefits of good risk management**
 - **Risk management becoming part of “business as usual” rather than discrete**
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In 2003 we saw:

- **Limited segregation between risk-controlling and risk-analysing**
-

In 2006 we saw:

- **Many firms with more objective structures for analysing risk and providing challenge**
 - **Governance structures evolved, with broader networks of committees providing oversight**
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In 2003 we saw:

- **Risk appetite undefined by many**
-

In 2006 we saw:

- **Risk Appetites defined by all, but**
 - Many firms not applying them, and/or
 - Not expressed in terms that facilitate application
 - **Concept poorly understood, so little recognition of potential benefits & potential downsides**
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In 2003 we saw:

- **MI shortcomings**
-

In 2006 we saw:

- **More coverage of risk**
 - **Limited analysis, however**
 - **Use of KRIs/KCIs relatively under-developed**
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In 2003 we saw:

- **Modelling of risk and capital under-developed**
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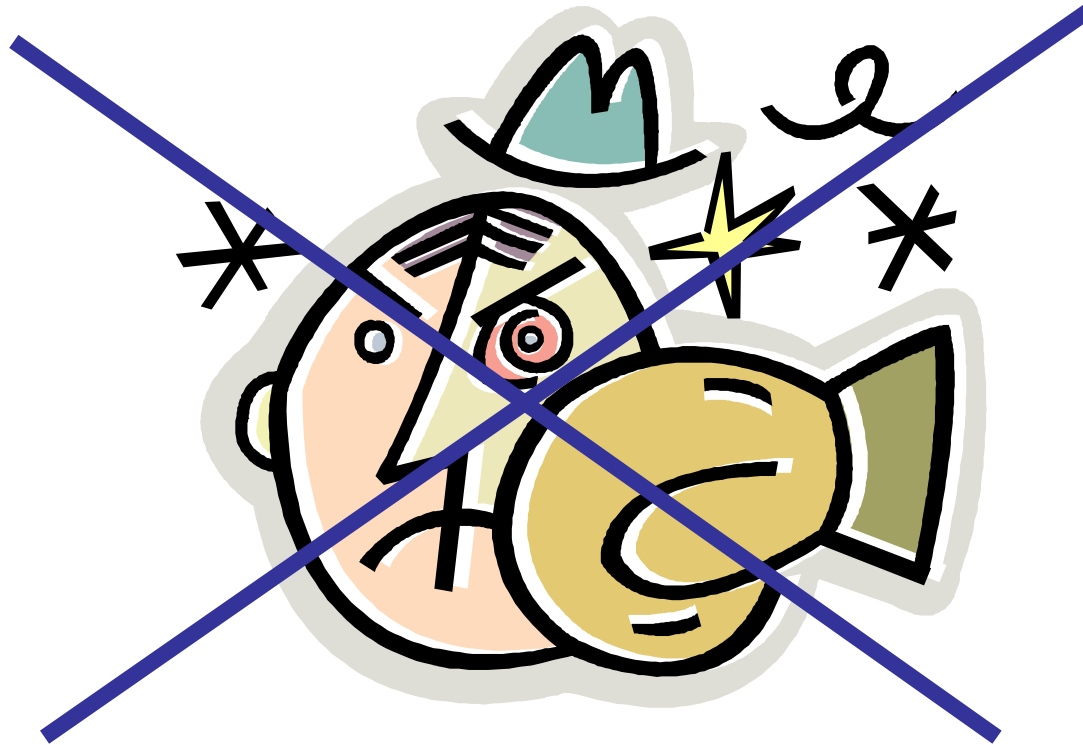
In 2006 we saw:

- **ICAS modelling well established in most firms**

The impact of ICAS

Limitations of Capital:

Capital cannot replace the need to treat customers fairly!



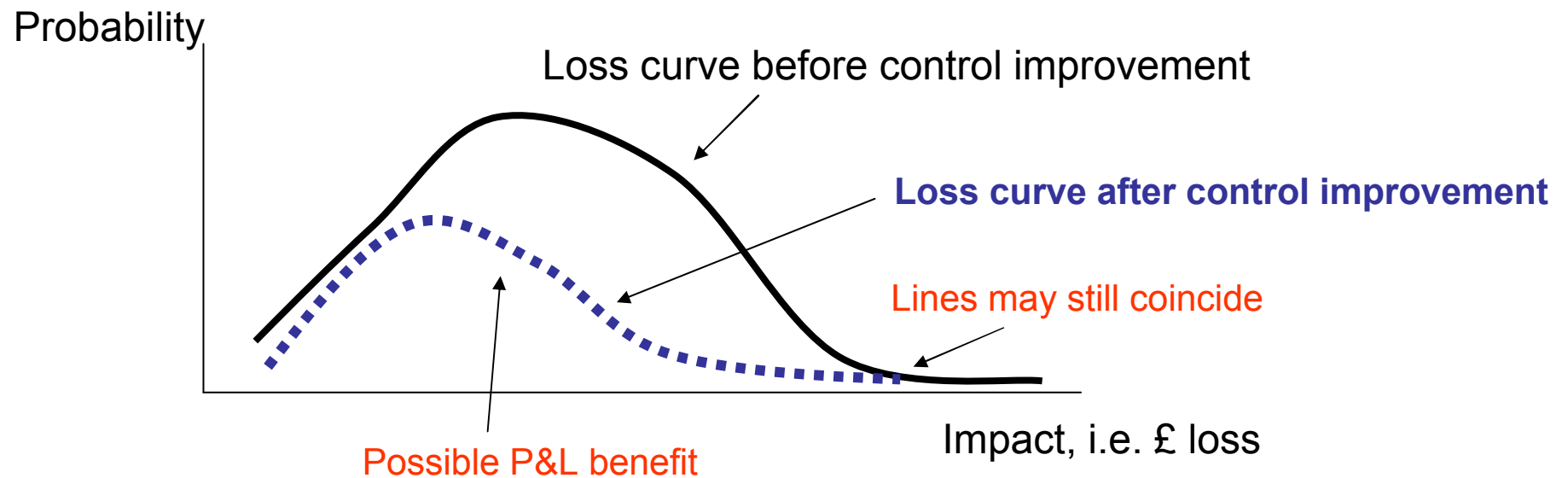
Impact of ICAS

- Significant investment of time by firms
- Focus has been model development
- Many boards commented positively on impact
- Concepts are difficult (even for actuaries)
- Training essential
- More needed to integrate into risk management, decision-making and business planning processes

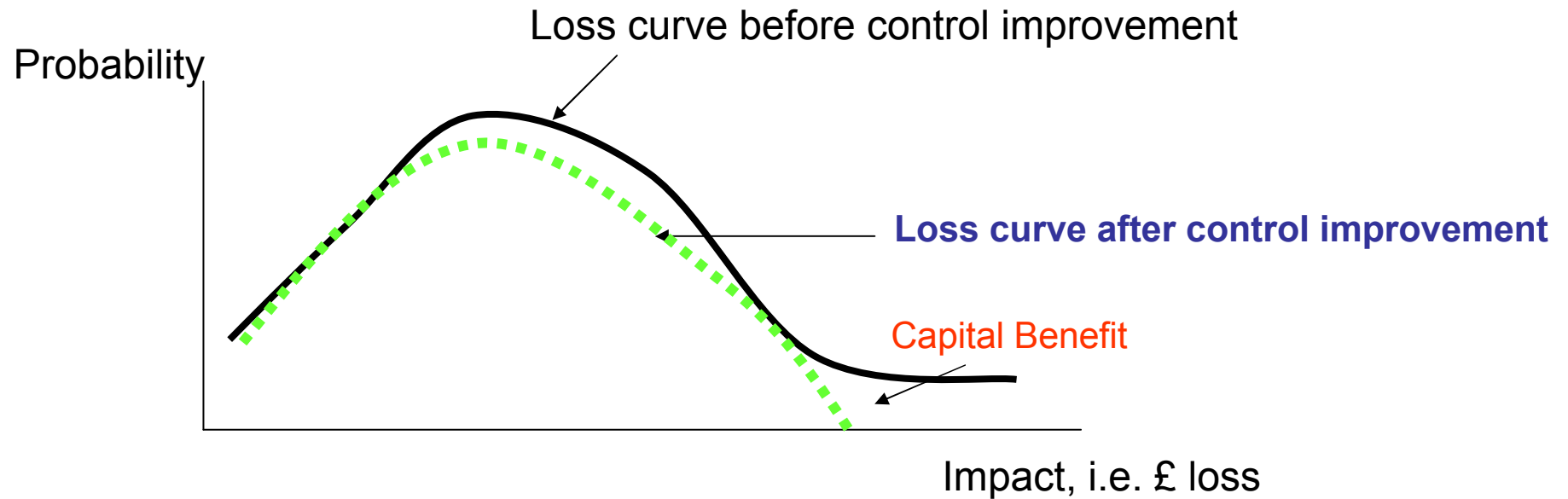
What do we mean by integration?

- “Journey not destination”
- Risk vs reward
- Use test - 3 main questions

Actions to improve controls may have little or no effect on capital



...Or may have beneficial effect on capital but no P&L benefit



Such analysis helps firms to make choices

“Use Test” - 1

How does the firm appropriately engage senior management and other technical expertise, and make use of appropriate data sources in deriving its ICAS/Risk Based Capital results?

- **Involves senior management and board**
- **They are appropriately equipped to challenge**
- **Make use of blend of internal and external data**
- **Management actions are consistent with agreed Policies and plausible**
- **Use of external expertise where appropriate**

“Use Test” - 2

How does the firm use its ICAS calculation principles and models for day to day management purposes?

- **Capital standard at least as strong as ICAS (+ ability to reconcile)**
- **Reflecting economic capital in key financial management processes (e.g. pricing, profitability analyses, reinsurance arrangements etc.)**
- **Reflecting in strategic decision making (incl M&A)**
- **Cost of economic capital in management incentive schemes?**

“Use Test” - 3

How does the firm use its ICAS/RBC calculation results to influence risk management strategy and to prioritise risk management activity?

- **Integral part of internal MI**
- **Consideration of both capital and P&L impact in prioritising risk management activity**
- **Where risks are deemed to be highly correlated in calculations – joined up approach to mitigation**
- **Consistency between loss distributions assumed for capital purposes and for risk scoring of “more likely” impacts**

Challenges for life insurers (and FSA!)

Some areas of difficulty we've observed

- Risk appetites
- Recruiting professional risk managers with technical knowledge (role for actuaries?)
- Consistency of approach across risk types
- Sustaining governance bodies' knowledge
- Applying consistent approaches in groups (especially international and/or banks)

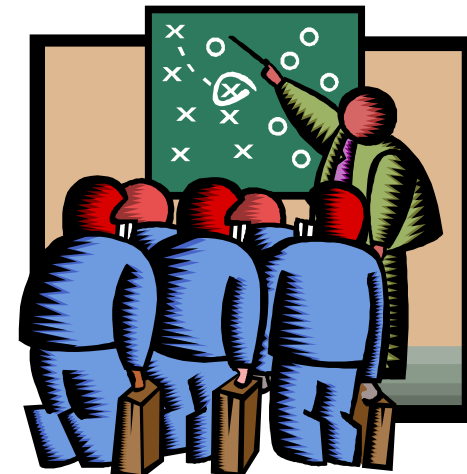
FSA's focus is broadening out



From the **Modelling...**

...to the **Management**

(but don't expect us to ignore the modelling!)



Discussion

- Are commercial benefits of good risk management well enough understood?
- What are your observations on the impact of ICAS?
- What challenges do you face in raising standards of risk management in your firms?
- What role is there for the profession in raising standards further?