



SYNOPSIS

GREATER EXPECTATIONS – GLOBAL REGULATORY CONVERGENCE, PRESSURES, AND HOW INSURERS IN DIFFERENT PARTS OF THE WORLD ARE RESPONDING

Richard Weatherill

Key words: IFRS, Solvency II, ORSA, C-ROSS, ComFrame, G-SII, Data Management, Process Management, Governance Framework

Purpose of your paper: To give delegates an overview of insurance regulatory developments worldwide, and the array of industry best practices that are emerging in response to these new regimes.

Synopsis: I'm an actuary, but I don't work for an insurance company or a consultancy; I work for a software solution provider. So what wisdom do I have to offer other actuaries?

Well, the nature of my work entails my asking insurers all over the world what their problems are, figuring out the solutions, and then building them. Unlike other actuarial consultants, my focus is not on providing the answers, instead it's on clearly understanding the questions.

The vast majority of my time is spent listening. I listen to a lot of people doing a lot of different jobs in a lot of different parts of the world. And I look for the patterns in what people are saying, and try to identify the common themes and trends. My presentation starts by examining these developments:

Insurance regulation across the world is changing. I'm sure that, as actuaries, you have always been told that insurance regulation was changing, and I think it probably always has been. In retrospect, that's probably what has kept us all employed for so long, and made our roles more challenging and interesting than those of other professional disciplines.

What you may never have heard said before is that insurance regulation across the world is reaching a consensus.

Everywhere, from Europe to South America to South Africa to China, from national to supranational regimes, insurers and their regulators are reaching the conclusion that understanding and managing the risks in your insurance business is so important that insurers should actually be allowed to reflect their risk management practices in their calculations when determining how much capital they need to hold in order to meet their liabilities to policyholders with a reasonable degree of certainty.

In exchange for being allowed to take credit for their risk management strategies, insurers are being asked to divulge more information about those strategies than they might previously have been willing to share. They are also being asked to evidence the effective execution of their stated strategies, and how their broader decision-making refers back to their risk management strategy and the actuarial model that incorporates it.

The computing power that goes into a risk-based capital calculation is onerous compared to any predecessor requirements. The entire business of the insurer has to be re-evaluated on many different stressed bases, and the results of from each of the stresses need to be aggregated using techniques of varying degrees of complexity.



If you have to work out the cost of capital, or do any kind of business projection, both of which are required in Europe by Solvency II, you'll have to roll forward all of the above to obtain projected risk-based capital balance sheets at each future valuation date. Oh, and if you have any kind of non-linearity in your insurance business liabilities, you can multiply the above computation effort by at least 1,000, as you'll have to run a set of stochastic simulations to obtain the distribution of results.

Yet the calculations are only part of the story in terms of compliance with Solvency II and its parallel regimes across the globe. By volume of verbiage in the Solvency II text, and by anecdotal accounts of insurers' Solvency II compliance spend over the last decade, there is more focus on risk management, process documentation, and governance and control – both of the insurer itself and the actuarial model – than there is on the calculations.

Software providers, actuarial consultants and insurers themselves have responded to these demands by developing vast swathes of additional tools around their core calculation engine, to create a governance framework around the inputs into the actuarial model, the process of managing and scheduling the complex calculation runs required, and the handling of the enormous volume of ostensibly impenetrable results that come out of the other end.

There is another area of insurance regulation where consensus finally seems within reach, and that is the creation of an International Financial Reporting Standard (IFRS) for Insurance Contracts. The idea of creating a global accounting standard for insurance business goes back more than 20 years – it took the first ten years just to agree on the definition of an insurance contract! But we do now expect a final published IFRS for Insurance Contracts standard before the end of this year, though I'm pretty sure I was saying that throughout the whole of last year.

Some of the features of the proposed IFRS for Insurance Contracts regime resemble those already present in the risk-based capital regimes, such as the concept of Fulfilment Cashflows, i.e. the amount you need to have a 50/50 chance of meeting obligations to policyholders, and the Risk Adjustment, being the additional amount that you would have to pay to another party in order to take on those insurance liabilities. Other calculation features are more specific to the IFRS for Insurance Contracts regime, most notably the Contractual Services Margin, a mechanism which serves to defer the emergence of expected profit.

The proposed IFRS for Insurance Contracts regime is ostensibly just a calculation requirement – it doesn't have all the explicit governance and risk management framework requirements of Solvency II and its parallel regimes. However, what IFRS for Insurance Contracts does require is unprecedented levels of cooperation between actuaries and accountants, and accountants expect, and indeed demand, robust processes and robust governance around any numbers that they put into their published accounts.

Actuaries are therefore starting to find that the governance framework that they put in place in response to their solvency regime requirements will be equally applicable to their production of IFRS numbers. The process governance tools meet the accountants' demand for robust control over how published numbers are created, and the data governance tools provide the connectivity mechanism to pass an unprecedented volume and complexity of actuarial data forward into other systems.