

general
insurance
seminar

Tides of Change

12-13 November 2012
Sofitel Sydney Wentworth



ICAAP

Case Study for Small Insurers and Branches

Martin Fry & Sharanjit Paddam

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ICAAP

- What is ICAAP?
- Challenges for small insurers and branches
- Some options and approaches based on case studies



What is ICAAP?

The insurers' **process** for assessing and managing target and actual capital levels.

Provides a comprehensive **picture** of the insurer's risks and their capital adequacy framework in light of these risks.

Responsibility of the Board of Directors
or Senior Officer Outside Australia



What is ICAAP?

Annual Report

- Submitted to APRA annually
- Application of ICAAP over previous year
- Changes in ICAAP over previous year

Summary Statement

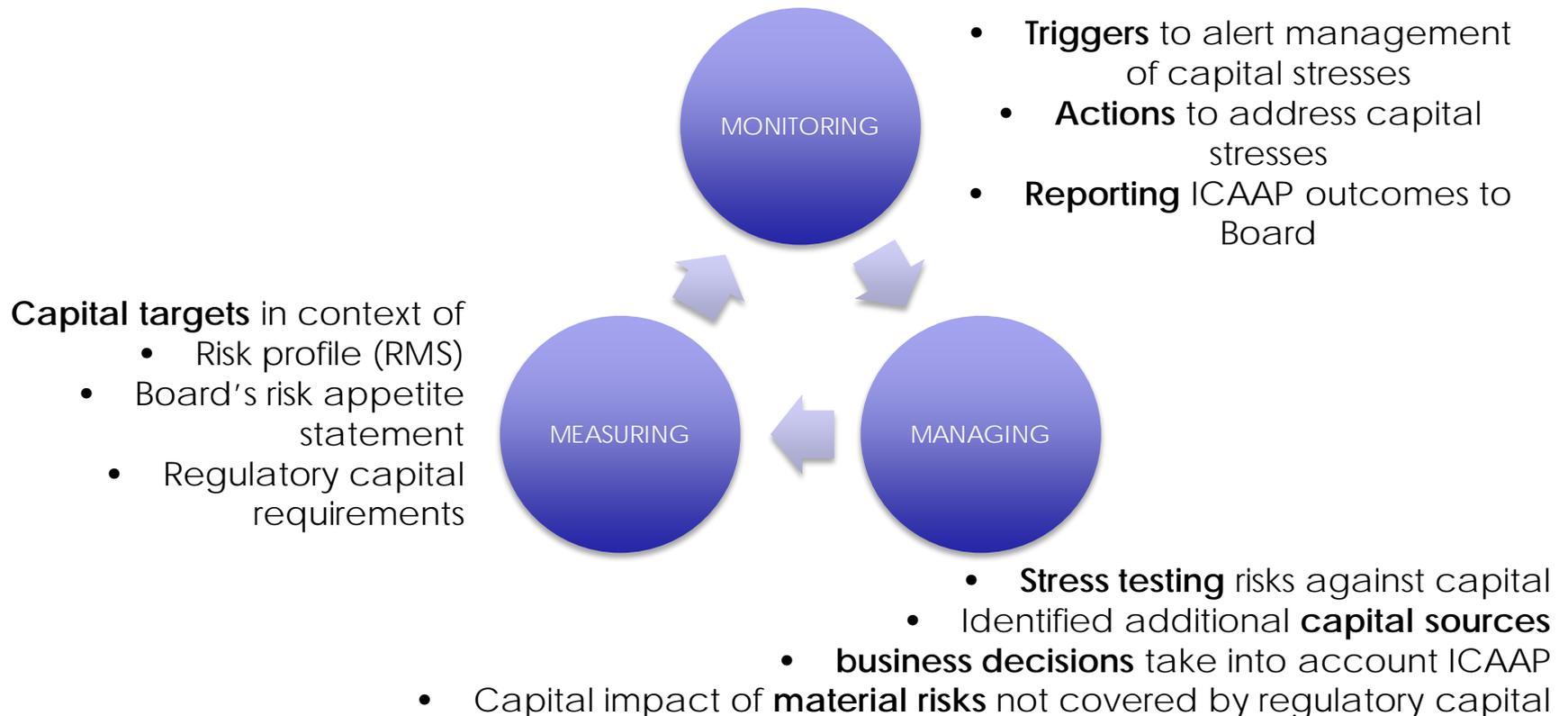
- High level road map or picture
- Point in time summary
- Independent review policy

Process

- Risk appetite statement
- Target capital
- Monitoring and reporting
- Capital projections
- Stress and scenario testing
- Trigger points and actions
- Independent review process

Process Overview

Strategy for ensuring adequate capital is maintained over time, including policies, procedures, systems, controls and personnel.





Summary Statement

How do we know
we have enough
capital?



Annual Report

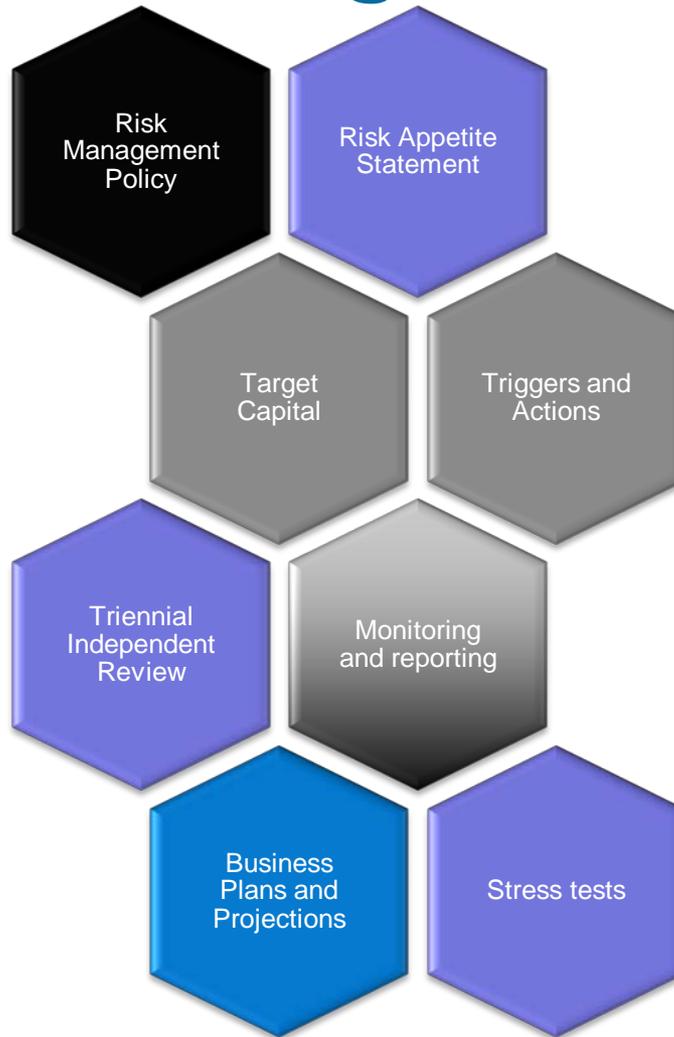
How did we know
we had enough
capital over the last
year?



Challenges for small insurers & branches

- **Minimal in-house resources**
 - “Regulatory burden”
 - Detailed in-house modelling not a realistic option
 - Difficult to outsource ICAAP
- **Differing circumstances to large stable insurers**
 - Small focussed operations with conservative approach
 - Heavily dependent on parent for capital and operational support
- **Key person risk**
 - Knowledge and processes were embedded in a few individuals
 - Overlap between board and management
- **Independent review**
 - AA not likely to be independent. EPR Actuary?
- **Head office engagement**
 - Difficult when branch is small part of overall operation
- **Small portfolios hard to analyse for variability and risk**

Options: Integrate existing processes



GAP ANALYSIS

What remains to be enhanced?

Consistency with Risk Appetite Statement?

Challenge: Risk Appetite Statement

The Risk Appetite Statement is the key to ICAAP and drives the processes



- **Given our business plans and objectives, what are the risks we face?**
 - Risk Register – List the risks, mitigation and controls and residual risk
 - FCR – comments on the significant risks to capital position
 - Identify significant residual risks to capital
- **What are our risk tolerances and risk limits?**
 - Focus on the impact on capital adequacy
 - Describe in terms of scenarios
 - Develop stress tests to business plans
 - Ensure that tolerated risks do not result in capital impairment when stress tested
 - Cascade into business decisions



Options: Scenario & Stress testing (1)

Scenario based approach

Under the following defined events, the company will have a solvency ratio exceeding X, e.g.

- *Investment market crashes*
- *X number of catastrophe losses of 1 in n years*
- *X% drop in market share / premium income*
- *X% deterioration in loss ratio*

- *Can be more concrete, less abstract, and easier to communicate to stakeholders*
- *Feeds naturally in to stress testing of the business plan*
- *Is generally more suitable for smaller insurers and branches*

Probabilistic based approach

"probability of the solvency ratio falling below 1.5 times PCA over the next five years, is less than p%"

Context: APRA PCA is intended to give a probability of ruin of less than 0.5% over the next year.

- *Requires DFA modelling – this was too complex for a small insurer*

- *Can simultaneously assess risk/reward relationship of different RAS and business plans*

- *Level of modelling required depends on complexity of and interaction of the risks.*

- *Must incorporate the key business risks as captured in the risk register*



Options: Scenario & Stress Testing (2)

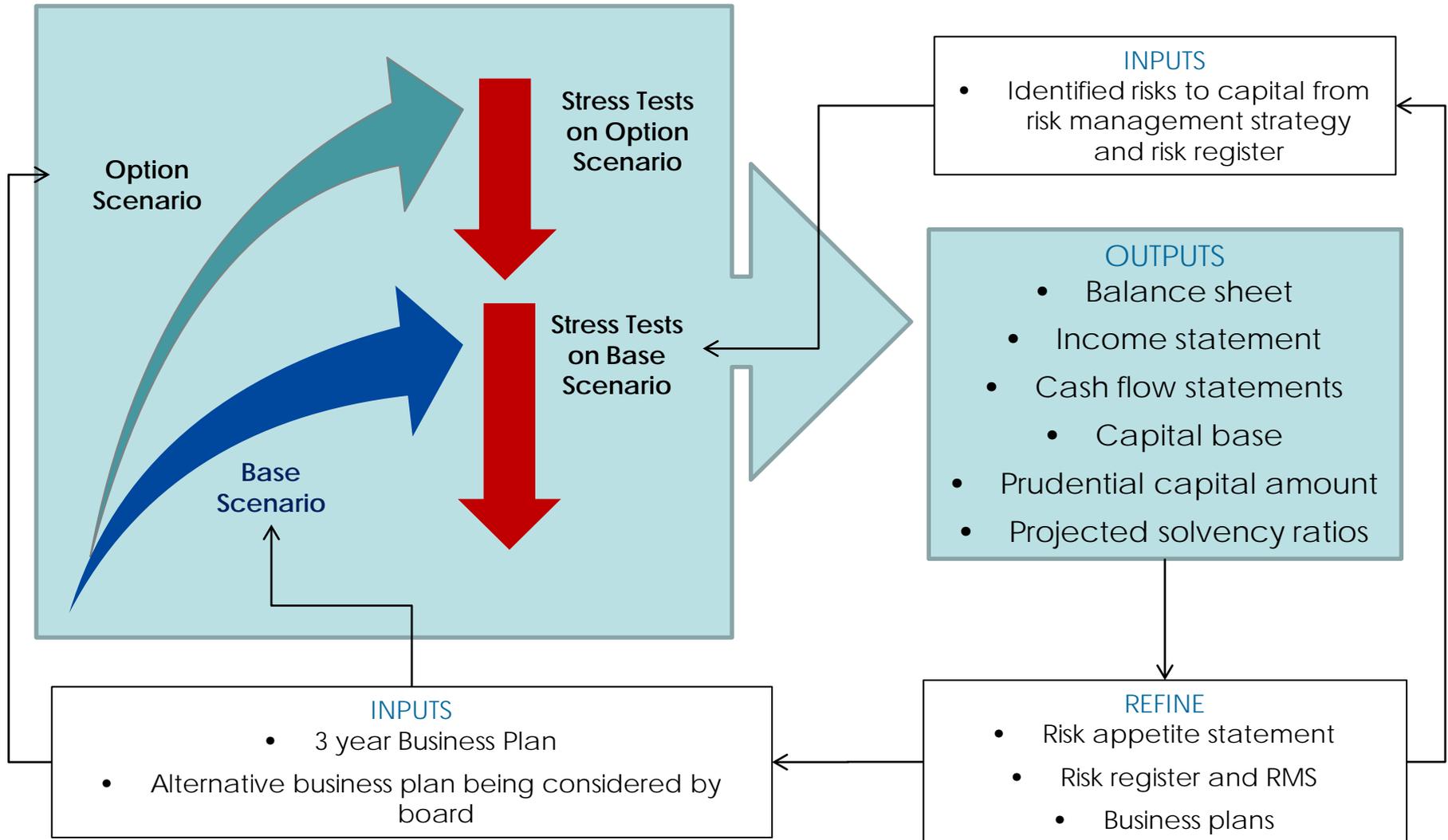
Scenarios

- Base Scenario
 - Based on business plan
 - Realistic estimate of likely future business
- Option scenario
 - Alternative strategy being tested by business
 - e.g. new product/channel
 - Realistic estimate of likely future business under scenario

Stress Tests

- Test financial outcome of undesirable or unexpected events resulting from identified risks on all scenarios
- Consistent with Risk Register – Include all risks with significant residual impact after mitigation
- Different types of stress test

Show me the model





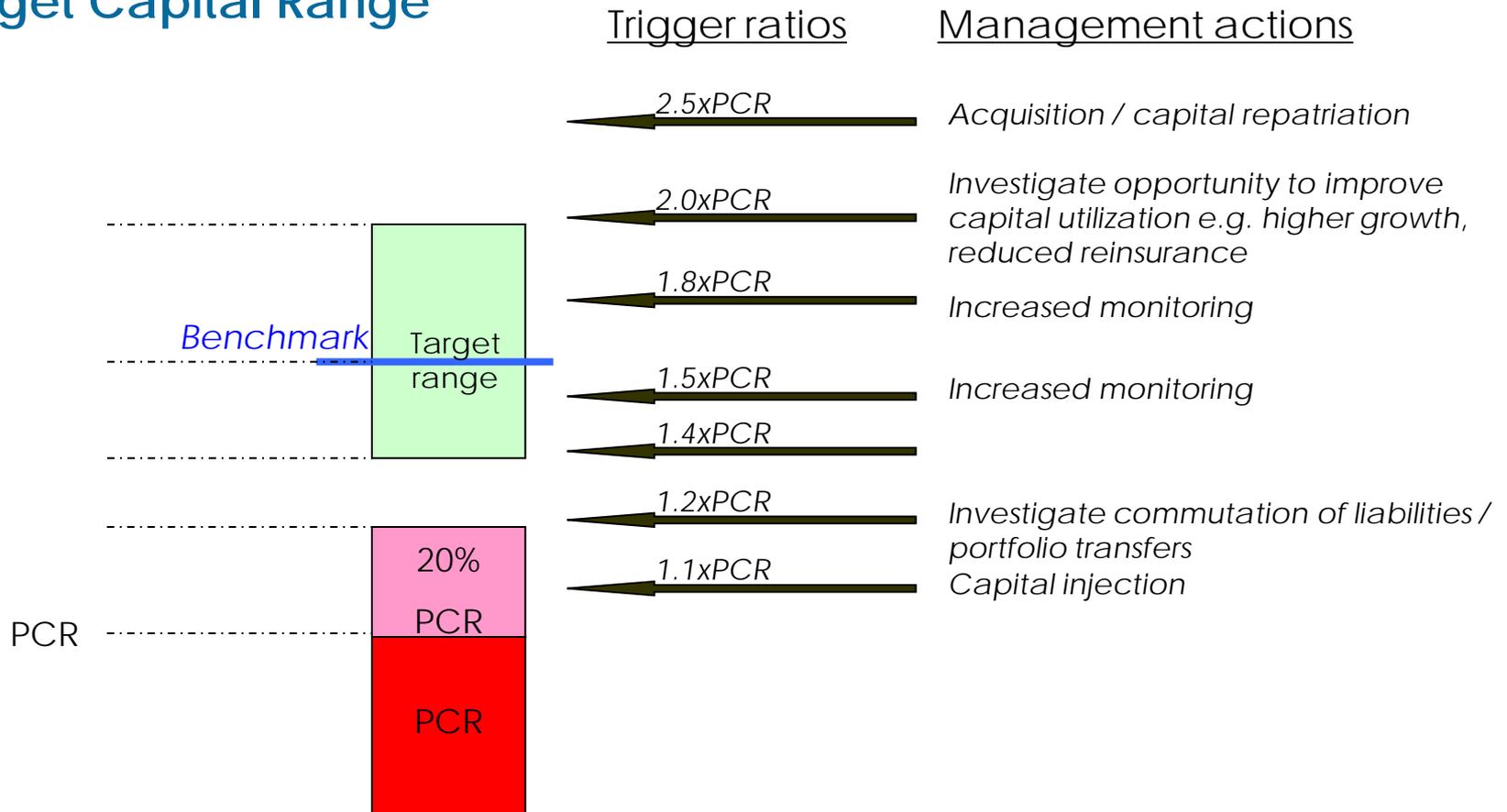
Options: Types of Stress Tests

Type	Outcome	Capital Impact	Likelihood	Risk appetite statement
Tolerable	Within risk tolerance	Above minimum target capital	Small	Included
Reverse	Limit of risk tolerance	Equal to minimum target capital	To be assessed by board	Limit
Intolerable	Outside risk tolerance	Below minimum target capital	Very small	Outside
Disaster	Outside risk tolerance	Equal to APRA PCA	To be assessed by board	Outside

- **Tolerable and Intolerable** assesses outcome of given model assumptions
- **Reverse and Disaster** assesses model assumptions leading to a given outcome
- Leads to refinement of
 - **minimum target capital**
 - **risk appetite statement**
 - **triggers and actions**

Options: Triggers and Actions

Triggers and Actions selected to ensure Insurer stays within the Target Capital Range





Options: Monitoring Process

- How often will capital projections be updated and results presented to the board?
- e.g. Set reporting frequency based on solvency levels reported in quarterly APRA returns, this is an example trigger and action
- **Careful:** Higher reporting trigger gives higher regulatory burden, when other activities may be more effective
- When new risks are identified, new stress tests may need to be developed
- Who is responsible? Clearly identified in Summary Statement



Discussion

- Challenges for small insurers and branches?
- Options and suggestions?