Address to the IAA Council

by Peter Braumüller, Chair of the IAIS Executive Committee

Singapore – Sunday 13 October 2013

President, delegates, ladies and gentlemen,

Today is almost three years to the day since my address to IAA Council in Vienna, when I encouraged the IAA to take on the challenge of establishing global actuarial standards. It is a pleasure to meet with you again to review the last three years of activity of the IAA and the IAIS and to commence preparation for the next three years. The IAIS has just agreed to develop a global insurance capital standard by 2016. This is one of the most challenging tasks in the history of IAIS. Today I will be encouraging the IAA to become a partner in this challenging task. Before I say more about the future challenges we face, let me say a few words about Singapore and the Asian region and then reflect on the significant IAIS/IAA developments since 2010, including the signing of the Memorandum of Understanding (MoU) in 2012.

Singapore is in one of the fastest growing regions of the World, due to the growth driven by China and other countries in the Asian region. Today, Singapore is home to a rich mix of insurers and reinsurers. Singapore has now developed the capacity and expertise to underwrite large and complex risks across Asia. One of the ingredients of Singapore's success has been strong and effective regulation provided by the Monetary Authority of Singapore (MAS). MAS is a member of IAIS, the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision. I note that apart from the IAA meetings this week, the Singapore Actuarial Society will host the East Asian Actuarial

Conference this week for the second time. Singapore is well placed to continue to develop its role as a key financial hub in the Asian region.

Ten years ago, I myself had the pleasure to be here in Singapore as part of the IMF's mission team for the Financial Sector Assessment Programme (FSAP) and I could learn a lot about the insurance market here and the supervisory system.

Since 2010, there have been several major developments by the IAIS. A major revision of IAIS's Insurance Core Principles (ICPs) was agreed and published in 2011. The new set of ICPs was based on developments in insurance markets and supervision since the last revision in 2003. It took account of experience gained from the FSAP assessments as well as recommendations issued by the G20 Finance Ministers and Central Bank Governors and the FSB. Furthermore, the new ICPs took into account lessons learned from the financial crisis. The revised ICPs, which also include an entirely new principle guiding future work in the area of macroprudential surveillance, represent a solid basis for the further strengthening of insurance supervision globally.

Since the ICPs, we have been developing a comprehensive framework for the supervision of internationally active insurance groups (IAIGs) or ComFrame. The three year ComFrame development phase is almost complete and the last major consultation of this phase will commence later this month. We have scheduled several years of field testing before ComFrame will be adopted in 2018 with implementation commencing in 2019. The IAIS has agreed with the FSB to develop straightforward, backstop capital requirements (BCRs) for all global systemically important insurers – or G-SIIs – by the end of 2014. We expect to begin public consultation on these backstop capital requirements by the end of this year. After finalizing the BCRs, we will continue work on G-SII

policy measures at high speed. Already by the end of 2015, we plan to develop the higher loss absorbency requirements for the G-SIIs.

The first stage of IAIS's financial stability project on G-SIIs concluded in July 2013 with the FSB designating nine G-SIIs and IAIS publishing the policy measures that will be applied to all G-SIIs. We are examining major reinsurers more closely and some of these may be added to the list of G-SIIs next July. All nine G-SIIs are expected to develop Systemic Risk Management Plans by July 2014 and Recovery and Resolution Plans by the end of 2014. More intensive supervision applies immediately and straightforward, backstop capital requirements will be ready for implementation by end 2014 and higher loss absorbency will apply by 2019.

Before discussing other IAIS developments and future plans further, I wish to comment on major IAA developments since 2010.

The IAIS was very pleased when the IAA agreed to develop International Standards of Actuarial Practice (ISAPs) and when it established the Actuarial Standards Committee at the start of this year. The IAIS is the global standard setter for the insurance sector and firmly believes that the development of strong and effective global professional standards is a prerequisite for effective insurance supervision.

Indeed the introduction to our ICPs states the need for: "the availability of skilled, competent, independent and experienced **actuaries**, accountants and auditors, whose work complies with transparent technical and ethical standards set and enforced by official or professional bodies in line with international standards and is subject to appropriate oversight." It is fair to say that we still have a lot to do to improve the availability of skilled and experienced actuaries, in particular in many emerging markets.

There is also a specific standard on the actuarial function in both the ICPs and in the Draft ComFrame: “The supervisor requires that there is an effective actuarial function capable of evaluating and providing advice to the insurer regarding, at a minimum, technical provisions, premium and pricing activities, and compliance with related statutory and regulatory requirements”. There is also guidance on the role of an “Appointed Actuary” in the ICPs. Hence, it is clear that effective global insurance supervision requires effective global actuarial standards.

Making progress with any global standards is challenging and time consuming. This is true for global insurance standards as well as global actuarial standards. Hence the publication of the first International Standard of Actuarial Practice last November on general actuarial practice was a major milestone for the actuarial profession. I noted with interest the section on Margins for Adverse Deviations which states “In cases where unbiased calculations are not required, the actuary should consider to what extent it is appropriate to adjust the assumptions or methodology with margins for adverse deviations in order to allow for uncertainty in the underlying data, assumptions, or methodology. The actuary should disclose any incorporation of margins for adverse deviations in assumptions or methodology.” Such disclosure is an important step in better understanding the different level of conservatism that exists in different jurisdictions.

Another section deals with “Assumptions and Methodology Mandated by Law” and states “When an assumption or methodology is mandated by law, the actuary should disclose in the report that the assumption or methodology was mandated by law and that the report should not be used for other purposes where the assumptions and methodology used are not appropriate (unless appropriately adjusted).” This section may be relevant as global insurance capital standards are developed and implemented.

Other global actuarial standards are in development and we will closely review those of relevance to the insurance sector, especially the proposed standard relating to the revised insurance contracts financial reporting standard. The building block approach proposed by the International Accounting Standards Board (IASB) will provide a different perspective on various components of insurance financial reporting, including insurance liabilities (ie technical provisions).

Insurance financial reporting relies heavily on use of discounted cash flows. The IAIS congratulates the IAA on the recent publication of the monograph “Discount Rates in Financial Reports - A Practical Guide”. While the purpose of the monograph is to document the wide range of existing techniques and approaches that actuaries use for discounting cash flows for various purposes in various jurisdictions, I believe that the monograph could assist with convergence over time. As actuaries become more familiar with how and why their colleagues use different techniques and approaches for discounting cash flows, I expect there will be convergence towards use of those techniques and approaches that are regarded as most suitable for the purpose required.

For example, supervisors would find it much easier to compare financial reports of IAIGs if there was more consistency of the discount rates that were used by different IAIGs.

Low interest rates are a major issue for the insurance and pension sectors and for the financial sector more generally. The IAA could closely monitor and research this issue to help protect financial institutions and their customers and to promote financial stability.

The July 2013 IAA paper on Stress Testing and Scenario Analysis was a very timely addition to actuarial literature. The thinking behind this paper has been influential for our work on ComFrame capital benchmarks: The Draft ComFrame includes: "The capital benchmark is determined using a scenario-based approach which includes measuring the impacts of key relevant risks facing the IAIG using multiple individual stresses and/or severe but plausible adverse scenarios."

The IAA paper on Actuarial Viewpoints on and Roles in Systemic Risk Regulation in Insurance Markets is very interesting as the discussions on systemic risk have been dominated by central bankers and macro economists for many years. It is desirable for a broader input to such discussions including input from both insurance supervisors and actuaries. I noted with interest the statement: "From a regulatory position, the simple postulation that insurance sector entities will not be a source of future systemic risk events due to historical observation could lead to the failure to identify, assess, monitor and mitigate the critical trends and signs of future systemic risk events." This statement echoes positions adopted by the IAIS for some years now.

The IAA Paper on the Role of the Actuary should be a useful document to give greater visibility to the benefits that actuaries can provide more broadly. Insurance supervisors are very familiar with these benefits but many other supervisors are not as familiar.

Let me quote one of the key messages: "Actuaries also provide advice on the adequacy of risk assessment, reinsurance arrangements, investment policies, capital levels and stress testing of the future financial condition of a financial institution. In this paper "financial institution" is used broadly to include pension plans and governmental systems, such as social insurance plans, as well as retail and investment banks." The "future financial condition of a financial institution" is of interest to many supervisors and other parties. There is a significant opportunity for the actuarial profession to become a provider of such financial condition reports. However, if the actuarial profession doesn't step up to this challenge, then other professional groups may fill the void.

The IAIS carefully monitors reinsurers due to their role in the sector. Hence, we welcome the recent IAA paper explaining the nature and rationale for intra-group reinsurance transactions.

Let me now return to the major announcement that the IAIS made earlier this week. The IAIS is committed to develop a risk based global insurance capital standard by end-2016. Full implementation is scheduled to begin in 2019 following a phased two year process with supervisors and IAIGs in which the capital standard will be further refined and issues of fungability of capital will be examined closely. The global insurance capital standard will be included within ComFrame, which already includes a capital adequacy assessment that will be used as a starting point for development of this new capital standard. This commitment follows the IAIS's announcement in July 2013 that it

considers a sound capital and supervisory framework for the insurance sector essential for supporting financial stability and protecting policyholders.

The implications of this decision will be far reaching for the insurance sector and for the actuarial profession. The timeframe is challenging but it is also achievable. One of the reasons that I believe it is achievable is because of the strong partnership between the IAIS and the IAA (as demonstrated clearly by the MoU). That strong partnership has already put in place many of the building blocks required for a global insurance capital standard.

These building blocks include: A Global Framework for Insurer Solvency Assessment (Blue Book, 2004), the Measurement of Liabilities for Insurance Contracts: Current Estimates and Risk Margins (2009) and the monographs on Stochastic Modelling (2010) and Discount Rates (2013). In particular, I encourage both actuaries and supervisors to review the 2004 Blue Book which had several objectives including: "[It] should be specific and practical enough that its recommended principles and methods could be used as a foundation for a global risk-based solvency capital system for consideration by the IAIS."

However, despite the very important contributions that the global actuarial profession has made over the past decade, there is more that needs to be done. An effective and sound global insurance capital standard needs to be supported by effective and sound global actuarial standards. ISAP 1 is already in place. More ISAPs will need to be developed to support the global insurance capital standard and other parts of ComFrame. Once we have clarified the nature of the global insurance capital standard that the IAIS will develop by 2016, we may request the IAA to develop one or more additional ISAPs that are likely to be required to provide consistency of insurance liabilities (ie technical provisions) and other components of the capital standard.

I note that the ISAP due process encourages supervisors (including IAIS) to make such requests and look forward to a constructive dialogue on the nature of such additional ISAPs.

In addition to the development of global actuarial standards, we also welcome the IAA's input to the design and nature of the global insurance capital standard. I have asked the IAIS Secretariat to explore the best way how this could be done.

The decision to go for a Global Insurance Capital Standard is one of the most important that the IAIS has ever made. I encourage the IAA to carefully study the implications of this decision for the insurance sector and for the actuarial profession. I also encourage the IAA to continue the strong partnership with the IAIS to ensure that the proposed global insurance capital standard becomes a reality that we can all be proud of. It will help us pursue our mission to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders and to contribute to global financial stability. It will also help the actuarial profession to be recognised as a major contributor to global standard setting within the financial services sector, and hence to the "well-being of society as a whole".

Thank you for the opportunity to address the IAA Council today.
I look forward to welcoming your President to address our Executive Committee and Annual Conference in Taipei over the coming week.
