



The Function of the Actuary in Prudential Supervision

Panel VII: Building Competency in Managing Reliance Relationships

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International Actuarial Association

- **1895, restructured 1998**
- **50 Full and 24 Observer Members**
- **35,000 actuaries in 70 countries**
- **Sections**
- **Committees**



IAA Membership Requirements

- Professional Conduct Code**
- Formal Discipline Process**
- Education Requirements**
- Standards of Practice**



Function of the Actuary in Prudential Supervision

- Insurance Regulation Committee**
- Adopted by Council after exposure and due process**
- IAA an Observer Member of IAIS**
- IAIS an Institutional Member of IAA**



Contents of the paper

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Introduction

- **Purpose of the paper– to set out IAA’s position on the role that actuaries should fulfill in prudential supervision of insurers**
- **Basis of an ongoing dialogue with IAIS**
- **Prudential supervision and the role of actuaries are both evolving**



Importance of Prudential Supervision

- IAA committed to effective supervision**
- Supports the IAIS in raising standards of solvency management**
- IAA promotes the highest standards of actuarial practice in insurance finances**
- IAA promotes common standards based on best practice internationally for:**
 - Examining technical competence**
 - Professional conduct**
 - Disciplinary procedures**



Framework for Solvency and Capital Adequacy

- Realistic provision which meets existing liabilities based on the expected value of future experience – plus**
- An additional capital sum based on the risks in the insurer's business and the business's immediate capital investment plans intended to meet a confidence level of capital adequacy at least as high as a particular defined level**



Framework Comments

- Prudent management depends on the broadest application of risk management techniques including dynamic financial models to enable management to avoid or mitigate adverse outcomes.
- Regulators are coming to see these as the most comprehensive form of solvency management.
- The actuarial profession endorses this development and is well placed to provide professional opinions on this work.
- The actuarial profession also has the experience to support qualitative analysis, “fit and proper” standards, and strong corporate governance.



Involvement of Actuaries

- **Regulators may rely on formulaic approach**
 - **Simplest approach**
 - **Actuaries helpful but not essential**

- **Increasing complexity of markets and products makes formulaic approach unreliable making it necessary to utilize on site professional practitioners**
 - **Actuaries are most appropriate by training and experience**
 - **Actuaries are members of a professional body**

- **IAA supports the “appointed” actuary approach**



Range of Actuarial Involvement

- **Pricing and Product Design**
- **Establishing policy and claim liabilities and determining capital requirements**
- **Monitoring market conduct and policyholders' expectations; and**
- **Direct responsibility to the regulators**



Pricing and Product Design

- **Board of directors responsible with advice from actuary on soundness to cover:**
 - **Policy obligations**
 - **Capital required**
 - **Policy options including the cost of hedging**
 - **Front and back office operations**



Policy and Claim Liabilities and Capital Requirements

- **Actuary should ensure that the total assets of the insurer can meet the following criteria**
 - **Funding Adequacy**
 - **Earnings Capacity**
 - **Strategic Capital Adequacy**
 - **Dynamic Solvency Testing**



Funding Adequacy

- **Total assets plus future revenues shall be sufficient to cover:**
 - **Expected value of obligations for existing business with appropriate margins for risk**
 - **Capital requirements**
 - **Risk absorption and hedging**
 - **Administrative costs**
 - **Funding of sales activities**



Earnings Capacity

- **The present value of expected future free cash flows (existing and new business) should not be negative under a reasonably probable future scenario to ensure that there is:**
 - **Appropriate incidence of distributable profits**
 - **Transferability of policy liabilities**
 - **Advance warning of adverse developments**



Strategic Capital Adequacy

Total free surplus plus free asset revenues should be sufficient to finance

- future expected new business costs and**
- associated additional solvency requirements according to the organization's approved medium term business plan.**
- The involvement of actuaries in general business planning provides a proper balance of shareholder and policyholder interests from the outset.**



Dynamic Solvency Testing

- **Capital should be sufficient under demanding but not unrealistic scenarios either to:**
 - **Supplement available funds to cover the cost of policy obligations and operations; or**
 - **Transfer the liabilities to another carrier.**



Monitoring Market Conduct and Policyholders' Expectations

- **Actuary's advice to directors should ensure that:**
 - **Promises made are being honored**
 - **There is equitable distribution of policyholder dividends/bonuses**
 - **Unit pricing for unit linked policies is accurate and fair**
 - **Discretionary alterations of policies do not involve excessive cost to policyholder**
 - **Illustrations to prospective policyholders are not misleading or overly optimistic**



Direct Responsibility to Regulators

- Appointed actuary must have right to present concerns to board of directors**
- If the board does not respond to advice, it may be appropriate that the actuary has right and responsibility to inform regulatory authorities as a last resort**
- In that case appointed actuary should have legal protection from action by management**



Summary

- **The ability of regulatory authorities to protect policyholders, by maintaining solvency and by ensuring that their reasonable expectations are met, is greatly enhanced by the extensive involvement of actuaries in insurers' operations.**
- **IAA believes that the appointment of an actuary to take professional responsibility for the monitoring of key areas of the insurers' operations provides comfort to both regulators and policyholders that regulations are being correctly applied and policyholders and claimants are protected.**



Solvency Working Party

- Risk based solvency capital system**
- Meet policyholder obligations at a specified confidence level**
- Specific and practical**
- Coherent risk framework, risk measures**
- Implementation issues**
- Case studies**



Other IAA Activities

- **Financial Risk**
- **ASTIN/AFIR**
- **IASC**
- **IPEF**



Comments Questions

Thank You

Link for the papers (both):

<http://www.actuaries.org/public/en/committees/INSREG/documents.cfm>

For the current draft of the Solvency Working Party paper,
contact the IAA Secretariat

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