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Dear Dave

FRC Response to the IAA’s Draft Statement of Intent to issue an International Standard of Actuarial Practice ISAP [7] – “Current estimates” and other matters in relation to the IAIS capital standards

The Financial Reporting Council’s (FRC) mission is to promote high quality corporate governance and reporting to foster investment. To achieve our mission we work to promote high standards in accounting, auditing and actuarial practice; our work therefore includes setting UK financial reporting, auditing and actuarial standards. The UK insurance industry includes two global systemically important insurers and a number of internationally active insurance groups. The work of the IAIS in developing consistent capital standards is therefore of major interest to stakeholders in the UK insurance industry and to the FRC.

1 Do you agree an ISAP is needed on “current estimates” and other matters in relation to the IAIS capital standards?

Yes

The FRC agrees that there is a significant public interest in the stability of the global insurance industry. It also agrees that a consistent basis for assessing the capital needs of Globally Systemically Important Insurers (G-SIIs) and Internationally Active Insurance Groups (IAIGs) will assist:

- policyholders in making decisions concerning where to place their insurance;
- regulators in their monitoring and scrutiny of insurers; and
- investors in making decisions about where to place their money.

It notes that the current proposal for determining the BCR is a factor-based approach applying to defined segments within the main categories of insurance liabilities, assets and non-insurance activities. It also notes that “current estimates” are, for the most part, proposed to be the proxy measure of risk exposure for insurance liabilities where “current estimates” reflect the expected present value of all relevant future cash flows that arise in fulfilling insurance obligations, using unbiased, current assumptions. Actuarial services will be required in the calculation of these “current estimates”.

The FRC commends the IAA in its wish to demonstrate its commitment to the work of the IAIS and it supports activities ensuring that the actuarial services supporting the calculation of current estimates are provided consistently. The FRC therefore agrees that an ISAP may play a useful role in ensuring the required consistency in the calculation of the current estimates within and across jurisdictions. However, we are uncertain that it will be the most effective means of facilitating convergence in the short term. Our observation of other standard-setters who have attempted to develop international standards for estimating insurance liabilities suggests that developing a widely accepted standard is a non-trivial task. What evidence does the ASC have to assert that an ISAP is “the most effective means to facilitate convergence”?

We therefore suggest that the IAA might also consider alternative mechanisms to foster consistency including:

- facilitating debate amongst its members and others on methods and approaches; and
- development of educational material.

2 Are any of the proposed topics inappropriate for inclusion in ISAP [7]?

Yes

The FRC is concerned by the suggestion that the ASC may be unduly influenced by a “desire to avoid artificial instability in the relative values of assets and liabilities especially where these are well-matched”.

If assets and liabilities are well matched and there is a consistent approach to asset and liability valuation then the FRC would be surprised that there would be material instability in relative values. However, the FRC is aware that in the past insurers, advised by actuaries, have attempted to manage results making the assumption that, as insurance is a long-term business, short-term fluctuations mean revert. In many markets, assets and liabilities are not able to be matched given the long-term nature of many insurance liabilities which will exceed the term of available assets. Additionally, there may be substantial credit risk inherent in the assets – even in government backed issues - that are not in the liabilities. We urge the ASC to maintain its objectivity in developing the ISAP so that, while accepting the need for consistency between asset and liability valuations, any proposals to avoid artificial instability are evidence-based.

3 What other topics should be included in this ISAP?

The FRC suggests that the ASC consider the actuary’s role in assessing the quality and relevance of data within the standard. Data includes not just the underlying policy data but data used to develop assumptions. For example, in many parts of the world, there will be limited amounts of market data from which to develop financial assumptions. Similarly for mortality, morbidity and in some non-life business, there may be considerable uncertainty in developing assumptions based on limited relevant historic data.

The FRC notes that it is the task-force's intention to consider profit sharing as an element of the financial basis used to determine the current estimate. It considers, attention should be given to policyholder expectations and the loss-absorbency potential of profit sharing mechanisms when calculating best estimate liabilities.

4 Please use this space for any additional comments not covered above.

The FRC considers that the proposed ISAP should be developed with a particular focus on the outcome that it is designed to deliver – a high quality current estimate in support of the IAIS requirements for the BCR and ICS. There is a risk that it focuses too much on inputs such as assumptions and methodologies. Given the diversity of risks and contract structures inherent to insurance contracts across the world, the FRC cautions that this may result in an inflexible and potentially unworkable standard.

The FRC notes that the very early draft of the standard concerning accounting for insurance contracts being discussed by the Insurance Accounting Standard Task Force is very focused on inputs in the determination of cash flow estimates.

On a small point of consistency, in a number of places the Sol refers variously to "IAIS requirements, "these IAIS requirements", or "these IAIS capital requirements". The FRC suggests that these references are referred to consistently as "IAIS requirements concerning the BCR and ICS".

Yours sincerely



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