Session H6
International Issues in Private Sector Health Insurance Supervision

"The Role of the Actuary in the Prudential Supervision of Insurance Companies"

IAA White Paper .

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Insurance Regulation Committee
Terms of Reference

- To liaise with the International Association of Insurance Supervisors (IAIS) on issues relating to the regulation and supervision of insurance companies.
- To liaise with other interested bodies at the international level, on issues relating to the regulation and supervision of insurance companies.
- To assist the IAIS and the World Bank in the development of international guidelines or standards relating to matters such as technical reserves, capital adequacy requirements, valuation of assets and liabilities, financial condition reporting, the role of the actuary, actuarial opinions and actuarial qualification standards.
- To outline international frameworks for actuarial standards of practice in relation to the role of actuaries in insurance companies with regard to regulatory requirements.
- To develop outline protocols regarding the respective responsibilities of actuaries and auditors in relation to financial statements prepared for supervisory purposes.
- To liaise with the Insurance Accounting Standards Committee of the IAA in relation to the interface between accounting standards and supervisory requirements for insurance companies.
- To promote the role of actuaries in the regulation and supervision of insurance companies in order to ensure that the public interest is served.
- The Chair of the Committee will act as the Representative Observer Member to the IAIS on behalf of the IAA. This role will include attending such IAIS meetings as are appropriate, promoting the IAA within the IAIS and liaising with other Observer Members to further the interests of the IAAA and the actuarial profession. The Representative Member will also encourage proactively other senior members of the IAA to attend or listen to IAIS and Observer meetings and conference calls as relevant topics emerge. This responsibility will include the circulation of papers and the dissemination of information on developing issues to interested actuaries.

The IAA and the IAIS

- The IAA is an Observer Member of the IAIS
- The IAIS is an Institutional Member of the IAA

Introduction

- Purpose – 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

Actuarial Profession

- Standards of training and conduct
- Monitored by professional colleagues and subject to disciplinary procedures
- Codes of professional conduct set priorities by which actuaries abide despite commercial pressure
- Standards set nationally and coordinated across national borders

Range of Actuarial Supervision

"Responsible" actuary should have access to board and highest executive management.

- 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

- Funding Adequacy
- Earnings Capacity
- Strategic Capital Adequacy
- Dynamic Capital Adequacy Testing

Funding Adequacy

- Actuary should ensure that 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

- Actuary should ensure 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

- Actuary should ensure 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 Capital Adequacy Testing

- Actuary should ensure 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

- Actuaries 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, the actuary has right and responsibility to inform regulatory authorities as a last resort
- 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 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.