

Generalised Solvency Principles

Generalised Solvency Principles

Subjects of Presentation

- 1 Why GSP?
- 2 Principles of a new Solvency Regime
- 3 Proposal of a New Method
- 4 Opportunities

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Why GSP?

- 1 Unsatisfactory Current Environment
- 2 Threats to Current Environment
- 3 Globalisation of Regulation

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Unsatisfactory Current

Environment : Life

- 1 Little bit here little bit there
- 2 RSM Too High and Too Low
- 3 Not Risk Based But AA system

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Unsatisfactory Current Environment : Non-Life

- 1 RSM only prudence
- 2 RSM Too Low for certain Types (but augmented)
- 3 Not Risk Based

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Unsatisfactory Current Environment : Banking

- 1 Very much more Sophisticated on Investment side
- 2 Allows internal models
- 3 Not Customer Risk Based

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Unsatisfactory Current

Environment : Summary

- Doesn't work in Theory
- Does in Practice (usually)

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Threats to Current Environment

- 1 Blurring of Boundaries between Types of Financial Service Company
- 2 Blurring of Country Borders
- 3 Increasing speed of change

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Globalisation of Regulation

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 - 2 Blurring of Country Borders
 - 3 Increasing speed of change
- = Globalisation of Regulation

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Principles of a new Solvency Regime

- 1 Independence
- 2 Assessed Purely on the Future
- 3 Integration
- 4 Risk Based
- 5 Simplicity
- 6 Speed
- 7 Reproducibility
- 8 Appropriateness

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Principle 1 : Independence

- It is essential that those who sell do not reserve
- Solvency should be based on longer view and not dependent on latest experience only

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Principle 2 : Assessed Purely on the Future

- Historical/Accounting/Smoothed/Nominal Values are irrelevant
- Assets are worth only what they can be sold for
- Liabilities are what they will cost

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Principle 3 : Integration

- Assets and liabilities considered together
- Relationships between parameters must be examined and allowed for (bad news comes in battalions especially in recessions)

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Principle 4 : Risk Based

- Method should always be based on real risks
- Percentages approach can never be right (not RBC)

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Principle 5 : Simplicity

- Should never use a method more complex than is necessary for the situation
- It is necessary to allow for greater desire for information by informed publics

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Principle 6 : Speed

- A solvency system must be able to keep pace with changes in the market
- Therefore a rules based system rather than a methodology will not suffice
- Standard setting better done through a professional body than legislation especially EU legislation

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Principle 7 : Reproducibility

- A solvency system must be such that the result will not depend on who does the calculations

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Principle 8 : Appropriateness

- A solvency system should not impose onerous requirements on a company unless it is definitely in the public interest

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Proposal of a New Method

- 1 Start with Cautious Fair Value
- 2 Add Deviation Allowance to allow for Reasonable Extreme Deviation (“RED”)
- 3 Operate with internal Solvency Compliance Officer
- 4 External Review
- 5 International Standards Board

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Cautious Fair Value

- Assets with free market value at free market value less selling costs
- Liabilities at best estimate of discounted current value at risk free rate
- Where there is doubt a cautious view is required
- Caution is for doubt not for the purpose of a margin

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Reasonable Extreme Deviation

(A) Questions

- In assessing RED need to ask
 - Can this happen?
 - If it did happen is it reasonable for the public to expect the company to be still solvent?
- Only if both answers are yes is the event RED.

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Reasonable Extreme Deviation

(B) Precedent Risk Rules

- 1 If it has happened here before then it can probably happen again
- 2 If it has happened before elsewhere then it could possibly happen here
- 3 If something has happened before then it might be possible for the reverse to happen
- 4 If something has happened before to degree X then it may not be impossible for $X + \delta X$ to happen

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Reasonable Extreme Deviation

(C) Other Risk Rules

- 5 The pace of adverse deviation may be quicker than it has been in the past
- 6 The public will be better informed and make choices in their own favour more vociferously than in the past
- 7 If compared to the supposed event the fate of a single financial services company was not significant the RED is too extreme

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Solvency Compliance Officer

- Internal is permissible but a professional post
- Quarterly reviews
- Solvency required at all times
- Required to report failings to external bodies

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External Review

- Minimum of Annually
- Also a professional post

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International Standards Board

- Set standards with regard to RED

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Generalised Solvency Principles Opportunities

- Obvious role for Actuaries in this process

Generalised Solvency Principles Opportunities

- Solvency 2
- IASC

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