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

Draft Paper by the Insurance Regulation Committee of the IAA

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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 assist the IAIS and the World Bank in the development of international guidelines or standards**
- **To outline international frameworks for actuarial standards of practice in relation to the role of actuaries**
- **To develop outline protocols regarding the respective responsibilities of actuaries and auditors in relation to financial statements prepared for supervisory purposes.**
- **To promote the role of actuaries in the regulation and supervision of insurance companies in order to ensure that the public interest is served.**

Background of the paper

- IAA's position on the role that actuaries should fulfill in prudential supervision
- meant to be a <u>vision</u> of best practices
- basis of an ongoing dialogue with IAIS
- released for members' vote in January 02
- general approval, but rejections from 3 major member associations

Contents of the paper

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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 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 Supervision

- 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

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.

General critics

- extends the role of the actuary too much
- places too much responsibility on the actuary as an individual
- “one size fits all” approach too ambitious
  - different legislative cultures
  - different types of companies
- actuary cannot “ensure” things to happen

Critics: market conduct

- actuary’s role would be constructive, but ultimate responsibility cannot be placed on her/him
- ignores the roles of other members of the management team
- this issue especially problematic in general insurance

Critics: whistleblowing

- places the actuary in the role of police officer
- information to actuary may be restricted
- may marginalize the actuary from the other management
- may limit carrier opportunities of actuaries

Next steps

- A new draft will be prepared to take into account concerns expressed
- different alternatives to the role?
- IAIS is prepapering their own paper on the role of the actuaries

The Finnish experience

- in 1980 appointed actuary was made mandatory for general insurance companies running compulsory lines
- in 1989 mandatory for all general insurance companies

The Finnish experience (cont.)

- the responsibilities of appointed actuary
  - calculation of technical provisions
  - tariff bases for compulsory lines
  - statement about the approriateness of the company’s investment plan
  - statement about the solvency position
- experiences have so far been positive
  - enhanced the role of actuary
  - more actuarial involvement in senior management