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SAM Update & Impact

David Kirk

September 2012

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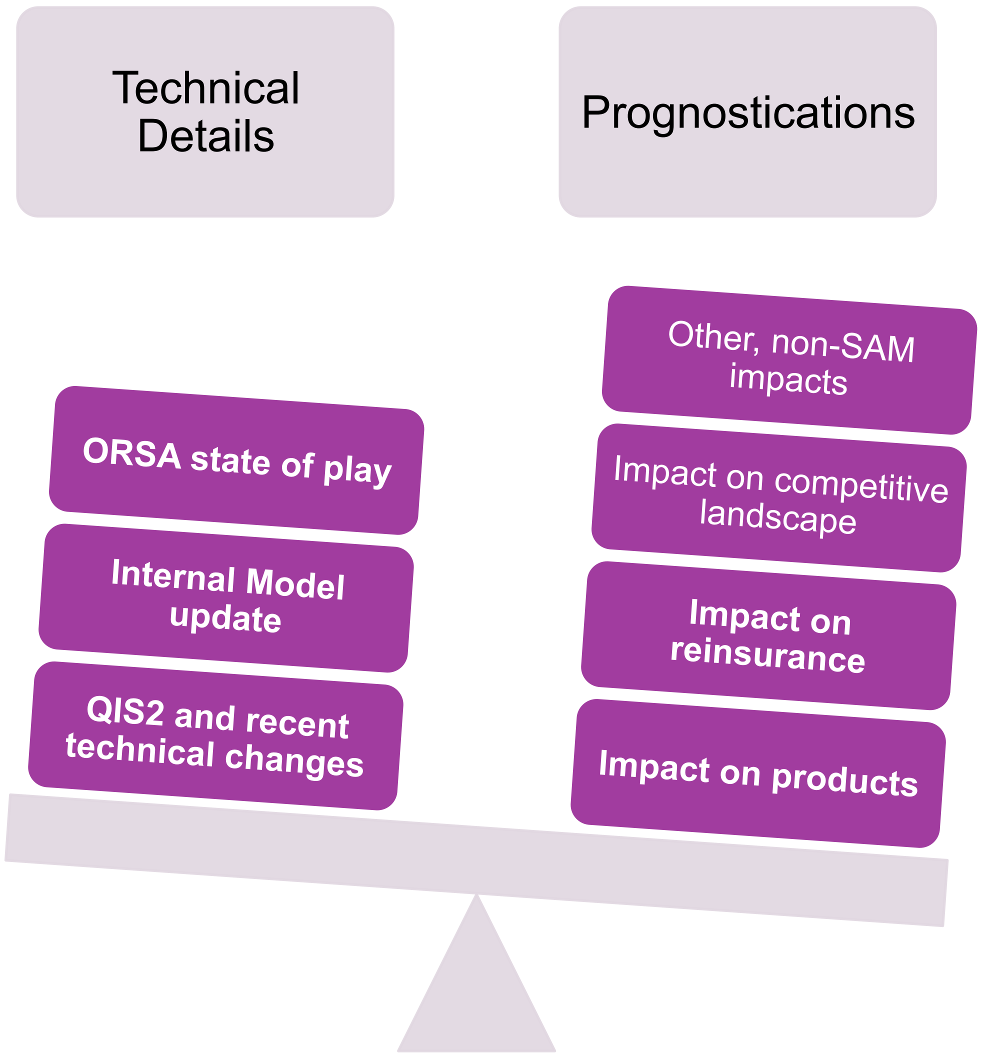
Solvency Assessment & Management

What we're covering today

What we're covering



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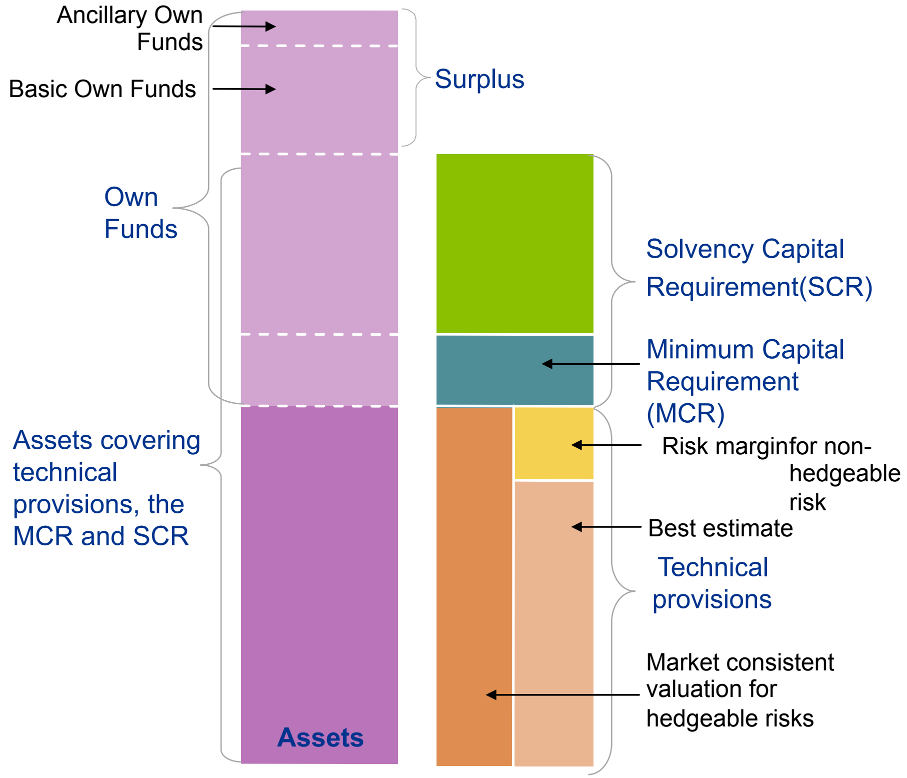
QIS2 and recent technical changes

Overview of SAM Technical Provisions

How do we go from this complicated diagram to something we can apply in our reporting and in our business?

Pillar 1 – The building blocks



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SAM QIS2 – What and When

Actual QIS2 exercise

- Solo calculation submissions by 15 October 2012 (3 months from final specifications)
- Group calculation submissions by 6 November 2012

FSB QIS2 report

- Expected to be published 31 January 2013

FSB Pillar Two Readiness Self-Assessment

- Expected to be published early next year

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SAM QIS2 – key changes for short term insurers

- Segmentation has changed – major issue for short-term, less so on life
- Contract Boundaries
  - More guidance to enable uniform application
  - Clarification that “unlimited ability to re-price” or “unilateral right to terminate” is what cancels the contract
  - For risk products, individual risk re-assessment (underwriting) severs the boundary
- Removal of Health Underwriting Risk Module
- Change in parameterisation of non-life risks
- Changes in shocks for participations and yields
- Different credit risk treatment of illiquid bonds

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SAM QIS2 – key changes for long term insurers…1

Technical Provisions

- Segmentation has changed – major issue for short-term, less so on life
- Contract Boundaries
  - More guidance to enable uniform application
  - Clarification that “unlimited ability to re-price” or “unilateral right to terminate” is what cancels the contract
  - For risk products, individual risk re-assessment (underwriting) severs the boundary
  - For individual investment contracts, also likely to be a long boundary
  - For some linked, corporate investment contracts, short boundary (30 to 90 days => 0 day practically)
- Also testing a shorter boundary with more granular information request

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SAM QIS2 – key changes for long term insurers…2

Other changes

- Removal of Health Underwriting Risk Module
- Changes in shocks for participations and yields
- Different credit risk treatment of illiquid bonds
- Matching Adjustment simpler and more complicated
- Different approach for with profit management actions

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Recognition of the contract

•Current QIS2 wording

- A reinsurance or insurance contract should be initially recognised by insurers or reinsurers as an existing contract when the insurer becomes a party of the contract, and at latest when the insurance or reinsurance cover begins. In particular, tacit renewals which have already taken place at the reporting date should lead to the recognition of the renewed contract.

•IFRS4 Phase 2 changes

- When the risk starts, unless onerous
- SAM may well follow this approach

•What should you do for QIS2?

- Whatever is practical!

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Technical Provisions – Key Issues

Reinsurance as Risk Mitigation

- Reinsurance is viewed as a Risk Mitigation Technique
- Modelled on an expected basis under all scenarios
  - Base and shocks
- Therefore not reasonable to assume it will continue on existing rates through all shock scenarios
  - Greatly reduced the capital-benefit of reinsurance with short premium review periods
- Viewed by some as conservative

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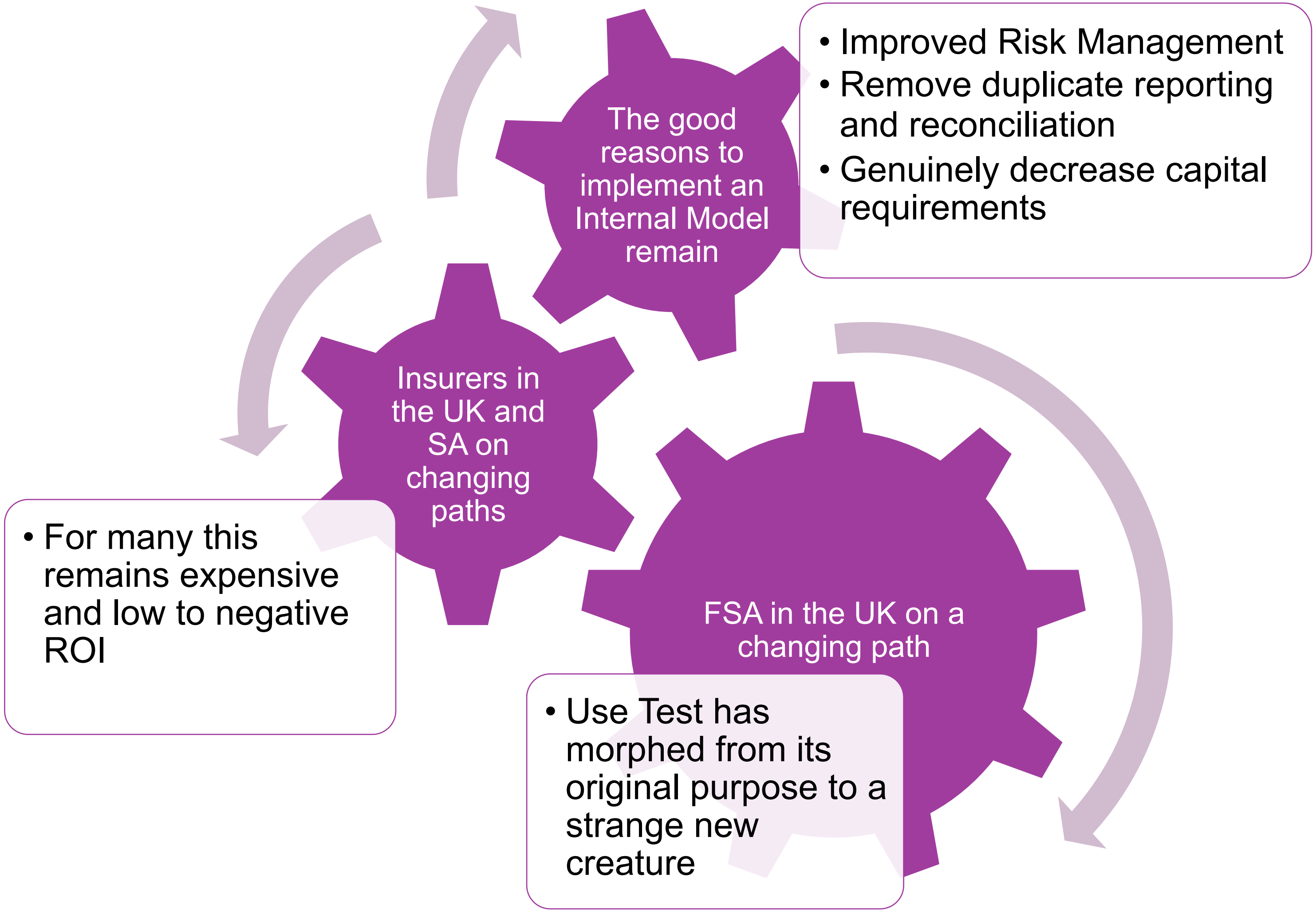
Internal Model update

Internal Models



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ORSA state of play

ORSA – one of the larger gaps for most insurers

Where insurers should be:

1. Have collated existing risk management documents, reports, MI and processes from within the organisation
2. Vigorously discussed the firm's "own view" of ORSA
3. Checked this view for compliance externally
4. Drafted outline and structure of ORSA
5. Had this draft outline discussed widely within the firm
6. Significant progress with populating ORSA with less volatile information
7. Begun populating volatile information as part of regular reporting
8. Record necessary improvements and take action
9. Have a plan for completion, including full and effective dry-runs

Position of a typical insurer

1. Aware of the need for ORSA, but unsure what it is and what will mean compliance
2. Attended presentations on ORSA, left with more information but no real clarity
3. Allocated the task of completion to a relatively junior resource (or assumed consultants will do it all)
4. Worry about it from time to time
5. Prioritise other work flows over ORSA

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A very incomplete view on ORSA

How to start?

Risk Appetite

- Including tolerances and limits

Detailed descriptions of key and secondary risks

Quantification of risks on the basis used within the organisation

- But hopefully included SCR, stress tests, reverse stress tests, scenario testing and on multiple risk measures, over multiple periods with business and balance sheet projections

Detailed descriptions of how risks are managed

- specifics on high risk items such as catastrophe, embedded derivatives, policyholder options and dependency on reinsurers

Use Test?

Backwards looking (evaluating against plan and metrics) and forwards looking

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Sample ORSA dashboard

For illustrative purposes only

- Assess risk in the short and long term
- Show risk appetite against tolerance and limits
- Incorporate aggregation and diversification effects
- Evidence continual monitoring

Key:
- Risk appetite limit breach
- Management action required
- Within Risk appetite
- Insufficient risk-taking

Risk profile and tolerance (pre-mitigation)

Own capital requirement – allocation to risk type (£bn)	2012	2013	2014	2015	Commentary on key risk profile vs. risk appetite
Own Capital Requirement (OCR), incl. buffer	170	176	180	180	
Insurance Risk – EC estimate	64	65	80	72	Capital requirement increases in 2013 in line with launch of new products across our global markets.
Insurance Risk Appetite (RAG)					
Market – EC estimate	38	41	42	45	Market risk and economic downturn are procyclical with lowering growth expected to bottom out in 2014.
Market Risk Appetite (RAG)					
Credit – EC estimate	22	12	7	12	Reinsurance treaty disputes due to be resolved in 2012. Not taking on enough credit risk in 2014, so opportunity for increasing profit in this area.
Credit Risk Appetite (RAG)					
Operational – EC estimate	21	23	25	24	Capital requirement increases in 2013 in line with launch of new products across our global markets.
Operational Risk Appetite (RAG)					
Other Risks – estimate	5	15	6	7	Strategic risks will increase as we seek to expand and diversify during an economic downturn, which will have a negative but manageable impact on capital adequacy.
Other Risks Appetite (RAG)					

Aggregation and diversification
1. Insurance risk profile is not the sum of its constituent parts, but reduced by 20% due to a diversification benefit from our product range taking on many unrelated risks across diverse markets.
2. Aggregation of bottom-up risk within appetite across the Group has revealed a concentration and over-exposure of risks to individuals and companies dependant on the success of the UK economy.

Commentary on overall risk profile and variance with risk appetite (trends and emerging risks)
1. We expect an increase in insurance and operational risk above our risk appetite over 2013 as a result of launching new products as part of our Diversification Strategy. Action is planned for 2012 to mitigate the risks concerned once product design and marketing have matured.

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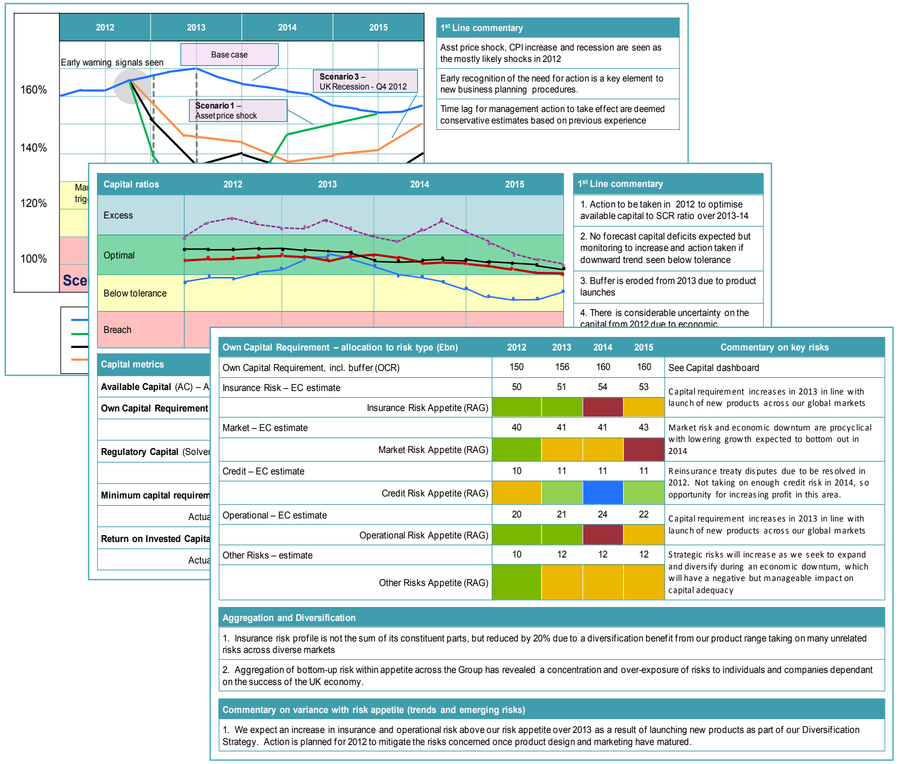
ORSA dashboard – key challenges



Key challenges

- Alignment of the MI dashboard to all the ORSA requirements and the decisions that need to be informed.

Consolidation

- Plethora of information.
- Aggregation of separate risks to produce a description of total risk.
- Balance between summation and losing informative detail.
- Succinct reporting of the scope and outcome of stress testing and scenario analysis.

Capability

- Adjusting the MI design to take account of the firm's risk management capability.
- Integration of 'bottom-up' risk and 'top-down' capital metrics.
- Quantification of the interaction between risks.
- Ability to issue timely reports.
- Interpretation of data to make informed comment and recommendations for management action.

Different perspectives

- Reflecting a business and a risk point of view, where these diverge.

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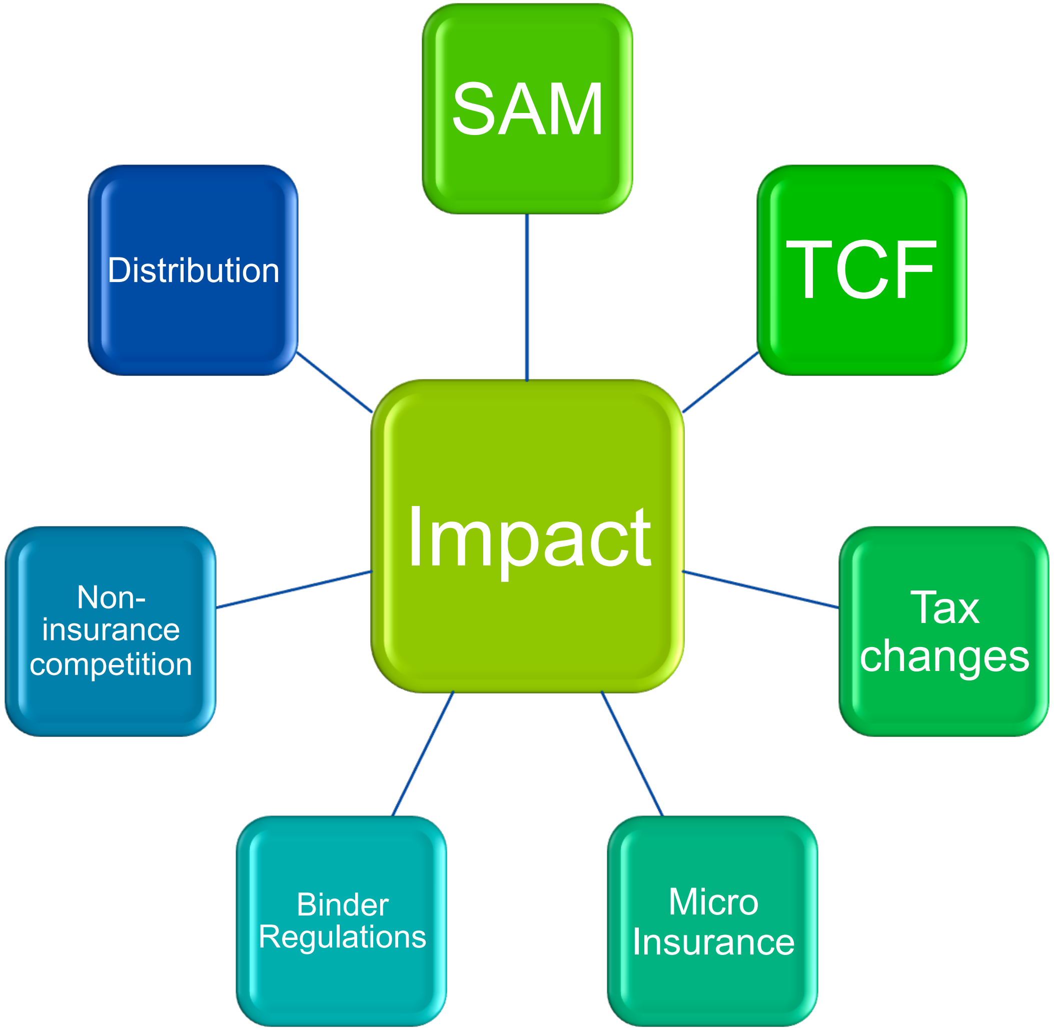
Prognostications

some early views on insurance sector impact

Will SAM have a significant impact?



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Likely impact across some of the drivers

Change Driver	Product	Reinsurance	Distribution	Industry Structure	Profitability
SAM	Slight	Potentially significant	Slight	Moderate	Moderate
TCF	Potentially significant	Slight	Significant	Moderate	Potentially significant
Tax	Potentially significant	Moderate	Moderate	Moderate	Potentially significant
Binder regulations	Slight	Moderate	Potentially significant	Potentially significant	Potentially significant

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David Kirk is a partner with KPMG and leads the actuarial consulting business. He specialises in insurance strategy, risk and capital management and financial reporting. He has been involved in significant insurance projects in the UK, Africa, the Middle East and China.

He is the creator of New Business Margin on Revenue.

Before joining KPMG, David worked at Tillinghast – Towers Perrin and was a partner with PwC.

David is a Fellow of the Institute of Actuaries (London), a CFA Charterholder, a Chartered Alternative Investment Analyst (CAIA) and a Professional Risk Manager (PRM). He has a current Life Insurance Practising Certificate. He read Business Science (actuarial science at finance) at the University of Cape Town.

Ask me about:

- Dealing with rapid regulatory change
- Strategies for market expansion, policyholder retention and new products
- Independent review, of internal models, of actuarial work in general or simply a second opinion on key decisions
- Business sensitive, no-nonsense advice and valuations as your Statutory Actuary
- Managing risk and capital while growing your insurance organisation
- Financial Reporting

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