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Case Study 6: Professionalism

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Institute of Actuaries of India

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Agenda

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- Case study synopsis
- Regulatory requirements around Solvency Margin
- Professional standards
- Initial action points
- Possible Scenarios
  - Action under Scenario 1
  - Action under Scenario 2
  - Action under Scenario3
- Conclusion

Case Study Synopsis:

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- You are an actuary who has recently joined the company and is reporting to the Appointed Actuary
- Responsibilities include forecasting and reporting solvency position

- Solvency is externally reported only at end of each Quarter
- Company's Targeted Solvency Ratio >= 170%
- Monthly practice - forecasting solvency ratio over next 6 months

- April's forecast - solvency ratio > 170% for the next 6 months
- Actual solvency ratio as at end of May - 144%

- CFO informally informed
- CFO's view – **only solvency position at quarter end matters so current solvency not a cause of concern**

Regulatory Requirements around Solvency Margin

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The Insurance Laws (Amendment) Act,2015

- Section 64VA
  - Sub-section (3) – Empowers the Authority to set a 'control level of solvency', non-compliance of which allows the Authority to take action.
  - Sub-section (4) - Breach of 'control level of solvency' shall require the insurer to submit a financial plan to the Authority.
    "If at any time, an insurer or re-insurer does not maintain the required control level of solvency margin, he shall, in accordance with the directions issued by the Authority, submit a financial plan to the Authority, indicating a plan of action to correct the deficiency within a specified period not exceeding six months."
  - Sub-section (9) – Requires submission of regulatory returns furnishing details on solvency margin.

Assets, Liabilities & Solvency Margin Regulations, 2016

- Schedule III stipulates:
  - 'Control level of solvency' specified as solvency ratio of 150% by the Authority* in accordance with sub-section (3) of section 64VA of the Act**.
  - Breach of 'control level of solvency' triggers sub-section (4) of section 64VA of the Act leading to remedial actions by the Authority, highlighted above.

**Authority means the Insurance Regulatory and Development Authority of India*
*** Act means the Insurance Laws (Amendment) Act, 2015*

Appointed Actuary & Solvency Margin

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Appointed Actuary Regulations, 2017

- Section 8, sub-section C(ii) - Appointed Actuary entitled to discuss matters that affect the insurer's solvency with management.
- Section 9 - Duties of Appointed Actuary include:
  - (iii) "Ensuring the solvency of the insurer at all times"
  - (v) "Complying with the provisions of the Section 64 VA of the Act in regard to maintenance of required control level of solvency margin …."

Actuarial Practice Standard (APS) 1

- Section 2.1 – Responsibility of Appointed Actuary central to financial soundness
- Section 4.1 – Advice insurer on situations that materially impacts solvency.
- Section 5.1 – Have process and methodology to investigate solvency position.
- Section 10 – Ensure ratio of available solvency margin to required solvency margin is reasonable to risk profile.

Actuarial Practice Standard (APS) 2

- Section 6 – Meet solvency requirements under section 64VA of the Act.

Professionalism Standards

Professional Conduct Standards (PSC)

- Section 3.4 – Exercise judgement to assess accuracy and reasonableness of data
- Section 3.5 – Provision of sufficient information to enable the recipients (Appointed Actuary/Board in this case) to judge appropriateness and implications of results/investigations provided.
- Section 4.1 –Material breach of any regulations is ground for compliant.
- Section 4.3.1 - Take appropriate action at the earliest opportunity on discovery of breach by another member.
- Section 4.3.2 – Consider if the matter is protected by confidentiality
- Section 4.3.3 - Exercise judgement on materiality of breach.
- Section 4.3.4 - Requirement to discuss the issue with another member(AA) prior to taking action, in order to seek additional information.
- Section 4.3.5 – Refer the matter to professional body post discussions.
- Section 8.1 - While a member should refrain from actions which unfairly injure reputation of another member, criticism is welcome if well-reasoned.

Initial Action Points

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- Validate calculation of solvency margin at May
- Validate projected solvency margin calculated in April
- Analyze reasons for fall from projected to actual solvency margin
- Analyze solvency projections for next 6 months as at May

Initial Action Points

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Validate solvency projected during April & actual solvency margin at May

- Investigate accuracy of the data and the calculations used
- Get calculations peer-reviewed by a colleague/superior
- Identify reasons for gap between projected and actual solvency ratio
- Prepare a detailed report identifying reasons for fall in solvency ratio, possible reasons being:
  - New Business (NB) strain or was something unusual in recent NB written
  - Adverse claim experience or one-off costs
  - Increase or reclassification of inadmissible assets
- Review Financial Condition Report(FCR) and Future Financial Condition(FFC) to see if such a scenario was envisaged and what actions were proposed.

Regulatory and Professional requirements met

- *APS 1, section 5.1 – AA to have systems in place to ensure solvency at all times.*
- *Insurance Laws (Amendment) Act,2015, section 64V –Accurate valuation of assets and liabilities*
- *PCS section 3.4 – Assess data accuracy and reasonableness*
- *PCS section 3.5 – Provision of adequate information to provide judgement*

Scenarios considered:

Three scenarios and proposed actions considered within the ambit of PCS as issued by IAI, APS and Insurance Act,1938.

Scenario 1 - Appointed Actuary agrees with the issue at hand and takes necessary action. Action plan is proposed to Board and shared with the Authority. *(Permanent scenario)*

Scenario 2 - Appointed Actuary agrees with the issue at hand but also agrees with CFO. *Action plan differs from Scenario 1. it is still proposed to board and shared with the Authority.(Temporary scenario)*

Scenario 3 - Appointed Actuary does not agree with issue at hand and concur with CFO on solvency reporting. *(Unlikely scenario but included for theoretical purpose)*

SCENARIO 1: Appointed Actuary **Agrees** with the Issue

Scenario 1: Issue is ***Permanent*** in nature

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Provide Appointed Actuary with a **detailed report:**

- Include **financial plan of action** to improve future solvency margin
- This can be shared with key stakeholders – Board members, Risk Committee, Investment Committee etc.

(APS 1 – Section 2.1 and 10, APS 2 – Section 6)
(PCS – Section 4.3.1)

Propose suitable management actions to Appointed Actuary, then presented to Board of Directors for approval. Management actions can be:

- Capital Injection requirement
- Review of the business plan and revised projection of solvency margin
- Review of Reinsurance arrangements
- Alternative capital – Sub ordinate debt, Financial Reinsurance etc.

(APS 1 – Section 4.1 and 10, APS 2 – Section 6)
(Appointed Actuary regulations,2017 - Section 8, sub-section C(ii))
(PCS – Section 4.3.1)

Scenario 1: Issue is ***Permanent*** in nature

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Provide Appointed Actuary with a **detailed financial plan of action** to be provided to the **Authority**, detailing –

- The reason for the fall in Solvency
- List of management actions proposed to ensure solvency is brought back to at least "Control level Solvency" or to "Target Level Solvency"

(Insurance Laws(Amendment) Act, 2015- section 64VA, sub-section 3 & 4)
(Assets, Liabilities and Solvency Margin Regulations 2016 – Sch III, section 2)

Further actions to be taken:

- Re -Project solvency margin for next 6 months, in light of management actions.
- Review the business plan as per above point
- Review statutory reserving basis, Bonus Philosophy, Product Mix, SRE on NB, NB Strain (Group and Individual)
- Peer review of the basis

(APS 1 – Section 4.1 and 10, APS 2 – Section 6)

SCENARIO 2: Appointed Actuary agrees with the issue **but** also with CFO

Scenario 2: Issue is ***Temporary*** in nature

Reasons for temporary breach for Solvency be:

- Delay in capital infusion
- Market volatility leading to asset impairment and subsequently, re-classification to inadmissible.
- Impact of "Receivables" not received impacting Available Solvency Margin (ASM)
- Impact of large outgo (e.g. catastrophic event leading to large death claims, in absence of appropriate reinsurance treaty)

Reasons for agreement with CFO can be:

- Scheduled Capital infusion to be made till quarter-end
- Impact of Investment strategy underway
- Alternate Board Action underway, but can't be disclosed on grounds of confidentiality – *ensuring the Authority is made aware of actions*

Scenario 2: Issue is ***Temporary*** in nature

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Assist Appointed Actuary with a **report** to be provided to the Authority, detailing :

- The reason for the fall in solvency and why it is temporary
- List of management actions already underway to ensure solvency is brought back to at least "Control level Solvency" or "Target Level Solvency"

(APS 1 – Section 2.1 and 10, APS 2 – Section 6)
(Insurance Laws(Amendment) Act, 2015- section 64VA, sub-section 3 & 4)
(Assets, Liabilities and Solvency Margin Regulations 2016 – Sch III, section 2)
(PCS – Section 4.3.1)

Further actions to be taken :

- Strictly monitor capital infusion to anticipate further delays
- Evaluate changes in Investment Strategy proposed.
- Review of Business Plan if required
- Project solvency margin at quarter-end, in light of management actions.

(APS 1 – Section 4.1 and 10, APS 2 – Section 6)

SCENARIO 3: Appointed Actuary Agrees with CFO

Scenario 3: Actions Points

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- Discuss with Appointed Actuary his/her reasons for agreement with CFO and not requiring to report to the Authority. *(PCS, 4.3.4)*
- Do the required background work to understand the reasons given
- Discuss the regulatory and professional implications of non-disclosure with Appointed Actuary:
    - Highlight non-compliance with AA responsibilities with reference to relevant APS, Appointed Actuaries Regulations 2017
    - Highlight non compliance of insurer's responsibility with reference to Insurance Act, ALSM regulations 2016

Member will derive guidance from Professional Conduct Standards (v3.0) 2009 as issued by Institute of Actuaries of India as well relevant APS and Insurance Act, 1938 to decide future course of action

Scenario 3: Action points

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- Member can discuss the issue at hand with a Fellow Actuary in the company *(PCS, 4.3.4)*

Given Solvency Ratio is confidential in nature, a member's action needs to be guided by 4.3.2 of PCS V3.0, 2009

- Can further speak to Compliance Officer of the company to take his/her views of the likely actions from the Authority
- It is also imperative to speak to Professional Body (Institute of Actuaries of India) for appropriate guidance. *(PCS, 4.3.5)*

Basis the guidance received from Professional Body, take appropriate actions

As a professional tasked with Solvency Calculations, a member has to ensure compliance to:

- *Insurance Laws(Amendment) Act, 2015- section 64VA, sub-section 3 & 4*
- *Assets, Liabilities and Solvency Margin Regulations, 2016 – schedule III, section 2*

Conclusion:

- Maintaining a healthy solvency position is one of the key responsibility of a member (especially) working in the domain of Statutory Reporting.
- A member's professional conduct at all times is guided by Professional Conduct Standards V3.0, 2009, as issued by Institute of Actuaries of India.
- *Before taking any action, a member:*
  - *understands all the aspects leading to a given situation*
  - *has talked to all the required stakeholder to understand their point of view*
  - *has put across the proposed actions in a clear and well documented manner for easy understanding of all the stakeholders*
- *A member has to take precaution while discussing the matter which is of confidential in nature.*

A member should also approach the Professional Body for guidance, and only after due discussion, should decide on actions to be taken

Questions??

APPENDIX

Scenario 3 – Action points

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PCS requirements complied to

- *Section 4.1 –Material breach of any regulations is ground for compliant.*
- *Section 4.3.1 – Take appropriate action at earliest opportunity on discovery of material breach by fellow member.*
- *Section 4.3.3 – If in doubt about materiality, seek guidance from "Professional Body".*
    - *Equally important to consider confidentiality as per section 4.3.2. (Current Solvency Ratio is not public information)*
    - *Section 2.5.2 allows disclosure of confidential information if in public interest*
- *Section 4.3.4 – Discuss nature of breach with another member.*
- *Section 4.3.5 – Refer the matter to professional body post discussions.*
- *Section 8.1 – While a member should refrain from actions which unfairly injure reputation of another member, criticism is welcome if well-reasoned.*