

Actuarial Insurance Matters*

Providing an actuarial insight into current issues of the UK Insurance Industry

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Improving capital efficiency

Illiquidity margin and the value of insurance liabilities

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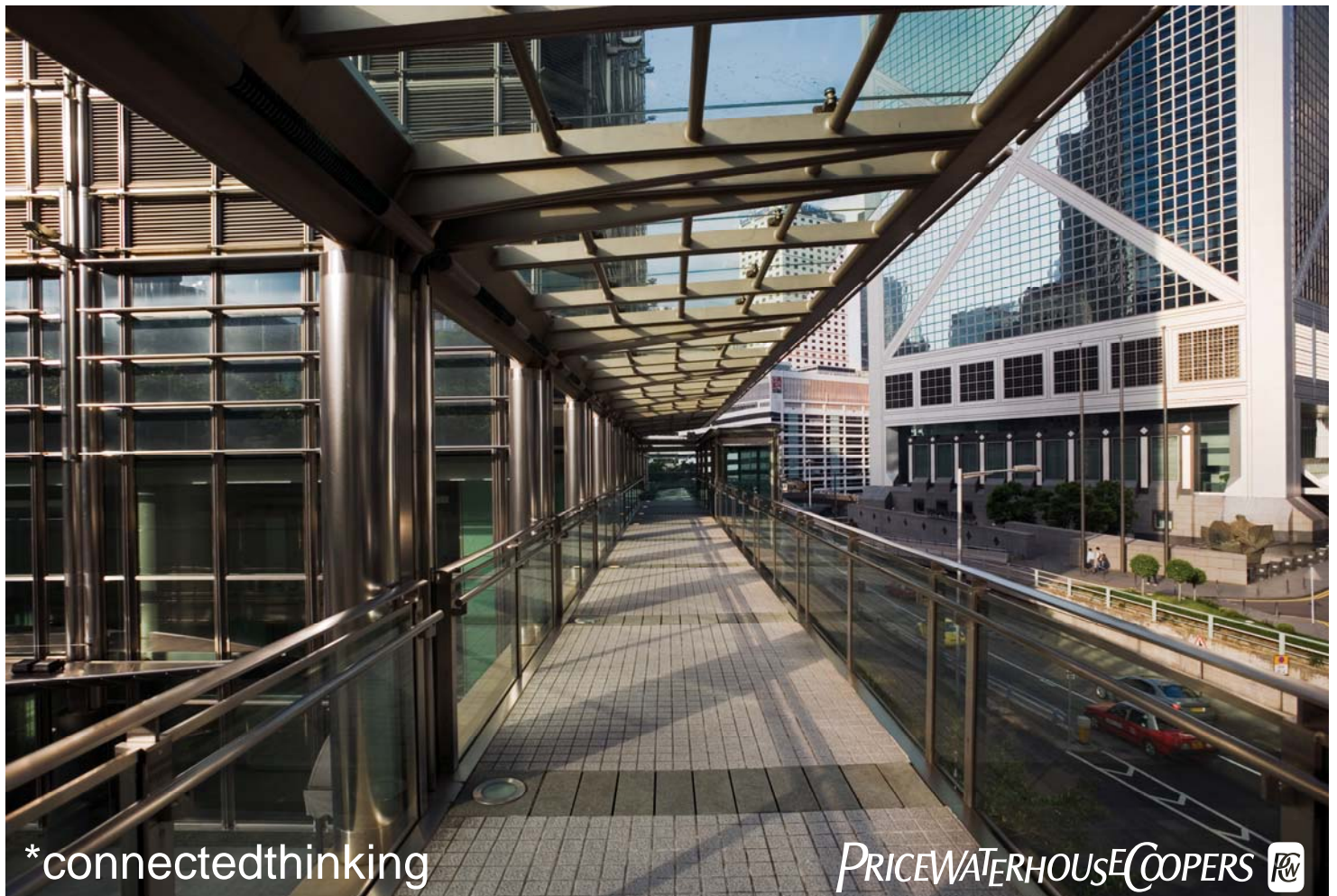
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Spring 2009



Introduction

Welcome to the spring edition of PricewaterhouseCoopers¹ Actuarial Insurance Matters.

It does feel like the end of the beginning of the financial crisis and the economic recession. Possibly this is as much to do with the days getting longer and hotter, as it is with announcements by the 24 world leaders (inapty called the G20) or with the increases in the FTSE and the house prices.

We are certainly long enough into this banking crisis for the FSA to publish the Turner Review on Bank Regulation. This is well worth a read as there are many useful lessons for those that measure and manage risk. Perhaps it is little surprise that the FSA would conclude that more regulation is needed.

In addition to this there are some interesting sections such as the "Misplaced reliance of sophisticated maths", reflecting how Value At Risk (VAR) techniques, instead of reducing risk, led to false assurance that other risks could safely be ignored. Scenario testing, which has been established practice for insurers, has now become a key technique for banks too. Many of our articles in this issue discuss managing or measuring specific risks, as these areas are where most insurers are looking to enhance. It seems that the economic environment has greatly increased the desire for pragmatic solutions to managing risks in a downturn, helping accelerate innovation in many areas of risk management, such as liquidity risk, currency risk and credit risk.

We cannot determine when the end of the recession will arrive, but we do believe that until then both the desire to survive and push by regulators will increase risk management technology, and the demand for risk managers and risk professionals. It is a good time to decide if you need or want to be part of this evolution, and if so how.



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Life insurance – 2008 results summary

Despite some brave attempts to make things look good, with one or two exceptions, this year's results have not been pretty. Companies have been great at focussing on "operating" or "underlying" profit which in some cases has provided good news. Unfortunately, tucked away in the detailed disclosures, there have been some horror stories in the amount of "economic variances" that have come through below the line.

Surely it's about time that we recognised that companies should have some control over their market exposures and that implicitly suggesting that these non-operating variances are out of the hands of management seems like something we should be rethinking as an industry. But that is probably for another article.

UK life companies have survived this year end, but the impact on share prices has been severe despite some recent recoveries. Share prices have been driven far more by whether the market believes that companies are a going concern or not rather than anything to do with embedded values (market consistent or otherwise).

From the perspective of UK new business for the major listed companies, volumes have held up remarkably well (only dropping by 4 percent on an APE basis).

However, the PVNBP and new business value numbers tell another story:

- Overall new business values have been hit hard, reducing by an average of 20 percent reflecting the drop in volumes but also a reduction in average margin (%PVNBP) to 2.7 percent from 3.1 percent in 2007.
- PVNBP dropped by 10 percent which reflects less optimistic lapse assumptions added to drops in premium volume.

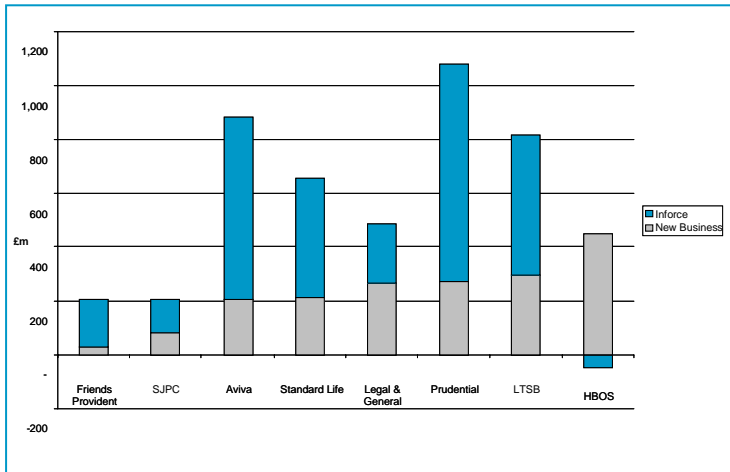
The graph on the following page splits out the 2008 new business contribution from total embedded value (EV) operating profit with the difference being attributed to "in force". The usual caveat needs to be made about the varying definitions of covered business, operating profit and (Market Consistent) EV, which means that care must be taken when making comparisons between companies.

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Figure: 2008 EV Operating Profit Breakdown



That being said it is clear that the bancassurance model continues to prosper relative to the more traditional players, but it will be interesting to see whether the LTSB/HBOS union can maintain such an impressive lead in future. Prudential have moved up the rankings this year, overtaking Aviva, Standard Life and Legal & General.

This is mainly to do with the fact that they almost managed to maintain their new business value and the others took some large hits.

All in all, it has been a difficult year for the industry with insurance companies (probably wrongly) being compared to banks and the lack of certainty that this has brought has been very damaging. Despite this, the industry has held up remarkably well (so far).

Looking back, there will be some valuable lessons to learn, but it is probably too early to be reflecting on the past just yet. That will require something more solid to be growing than hopes of "green shoots"

Improving capital efficiency

As we approach the end of the year-end reporting period, the focus on capital and shorter term value measures has never been more dominant. The FSA has recently requested information on capital positions, testing the impact of additional stresses to determine the impact on the industry of further falls in asset values.

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We have seen an increased focus on improving the capital position often on a number of different metrics as a result of the additional stress tests, including Pillar 1, Pillar 2 and Financial Group Directive / Insurance Group Directive measures. However, for most companies, capital has been depleted by the changes in the economic environment, making existing capital even more valuable and new capital harder to obtain.

Traditional sources of capital, via the markets, are currently either no longer available, or only available at a significant cost. Accessing capital through securitisation, for instance, could be a perfect way of releasing value from the existing business but is current a less widely available option. However, this situation will not persist forever and because the lead time required to get to market can be long, time spent now preparing for restructuring will enable a company to be in a strong position when the markets do open up. In the meantime, there are other ways by which companies can “generate” capital by using the capital that they do have more efficiently.

Reassurance or sale of annuity books keeps increasing, and the market for longevity remains active. With pension scheme buyout companies looking to take on deferred members as well as current pensioners, there is scope for more mature books of deferred annuities to be reassured or sold. Similar strategies can also be explored for other non core blocks of business.

De-risking strategies in with profits funds can also help to manage these funds at a time when there is increased pressure on bonus rates and capital, as well as a reduction in the amount of new with profits business being written. A review of the structure of the current insurance entities could also offer the potential to free up capital, through exploitation of tax and other synergies as well as capital synergies. Merging entities through Part VII transfers, or establishing ISPV's, may offer the ability to use existing capital more efficient.

A range of techniques exist for unlocking sources of capital to count towards a firm's Insurance Group Directive now. These may include being able to count the with profits surplus in the calculation; surplus the long term fund and enhance the recognised value of non-insurance holdings.

Illiquidity margin and the valuation of insurance liabilities

Life insurers often hold corporate bonds to back annuities in the expectation that the return on these bonds over a reference risk-free investment includes an element above that required to meet the expected risk of default. Pricing of new annuities makes allowance for this, but how should this spread be treated when calculating liabilities?

For the Peak 1, INSPRU 1.2 valuation, it is clear – one can capitalise any of the spread that is not expected to be lost in future credit defaults. The European Insurance CFO Forum MCEV Principles¹, as they currently stand, are also clear – a swap rate must be used so the spread must be ignored completely. Less clear is the treatment that will be adopted in Solvency II and the future IFRS for insurance contracts, as there is yet no consensus on whether inclusion of any of the spread can be market consistent.

It now seems to be commonly accepted that a part of the spread is an “illiquidity margin”, and that this part has increased significantly during the credit crunch. This is common sense: investors will require some compensation for locking up their money, and will be able to obtain more when liquidity in the market is tight.

Assuming an illiquidity margin exists, illiquid assets are worth less than similar, liquid assets. In a market consistent world, the same applies to liabilities – the value of an illiquid liability should be lower than that of a similar, but liquid liability by the value of the illiquidity margin.

Are insurance liabilities liquid or illiquid (or somewhere in between)? The lack of any “deep” or “liquid” market in them means they are pretty illiquid. However, for most policy types, the policyholder has an option to surrender: this increases the liability of the provider and some analysis shows that increase is also the value of the illiquidity margin. So, for most insurance policies, we are back to ignoring any illiquidity margins and treating the liability as if it were liquid.

However, annuities are qualitatively different – there is no option to surrender. So it is quite reasonable to value annuities as illiquid liabilities - a certainty equivalent valuation would discount the cash flows at the gilt or swap risk-free rate increased by the illiquidity margin. In short, it is arguably not market consistent to ignore the illiquidity premium when placing a value on annuity cash flows.

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Management information in turbulent markets

If the last 12 months has taught us anything, it is to expect the unexpected. As the shares in the insurance sector took a pounding, was this simply an aberration triggered by a spate of short-selling, or was there real cause to be worried about the financial viability of life insurers?

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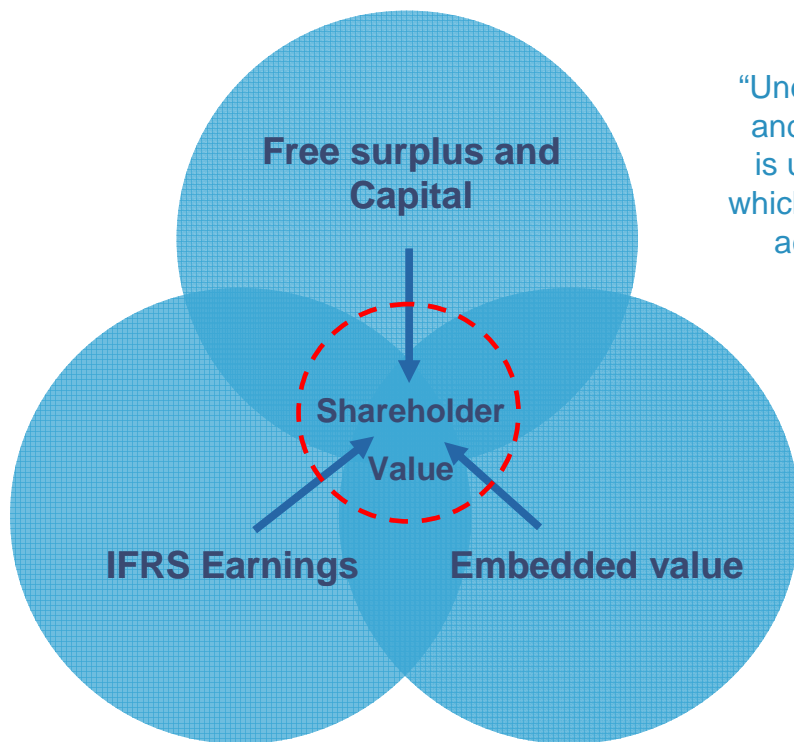
The press headlines would seem to suggest the latter, with the city reportedly "stunned" by the results announced by some early reporters which would seem to imply that the market was taken completely by surprise. However, the reaction of the firms was more resolute, suggesting that the market was displaying a "complete misunderstanding of what was in the nature of the numbers".

So who is right?

No-one would dispute that insurance reporting is complicated, however, the industry has taken strides over the last few years, working more closely with analysts and improving reporting disclosures and transparency. The real test has been to manage the messages during these turbulent times and from all appearances the industry seems to have been found wanting.

Analysts, for example, who were keen to understand the quality of insurers' assets, particular given the sector's exposure to the corporate bond market, were often left speculating for days as insurers struggled to work out their exposures to Lehman's or AIG. Furthermore, the inability to respond promptly to questions on the firm's current solvency position/free surplus has not inspired market confidence. However, the truth of the matter is that, for most insurers, assessing a firm's solvency position on a "real-time" basis remains a significant challenge. Since the 2003 equity crisis, insurers have strengthened and de-risked their balance sheets and many argue that to invest in expensive systems to regularly and accurately monitor solvency was overkill. After all, the markets were fairly benign and the balance sheets fairly resilient to modest changes in equity markets.

But times have changed, and the volatility in the markets over the last six months has changed what firms need to do to understand and manage their capital position. Firms have begun to respond and are developing new management information systems and processes to estimate current solvency and predict the impact of market shocks and rapidly changing conditions.



“Understanding the links between free surplus and other reporting measures is essential, as is understanding the underlying value drivers which themselves link to tangible management actions that can influence the behaviours of staff or customers.”

Of course, capital is only part of the management information challenge. Executives and analysts are seeking more regular information on other drivers of shareholder value, namely: shareholder cash generation, embedded value or economic value and profitability.

Understanding the links between free surplus and other reporting measures is essential, as is understanding the underlying value drivers which themselves link to tangible management actions that can influence the behaviours of staff or customers. At the highest level, the Board performance measures need to be linked to strategic objectives of the business and satisfy external stakeholder requirements. At the operational level, metrics should be chosen that are relatively easy to measure, include both quantitative and qualitative measures, and have clear links to underlying value drivers.

In other words, management need to be able to identify the correct ‘levers’ to pull and measure the impact of change.

The real challenge is to identify the links and value drivers and establish systems and processes which can produce the management information on a regular basis in a timely fashion.

This will help to assess the direction and performance of the business without necessarily resorting to say full monthly reporting.

In the eyes of the market, insurers appear to be leaden-footed, only knowing the true state of their finances months after the event.

In these turbulent times, with more data at their fingertips, management can start to be more pro-active and confident in their communication with the market.

As an industry we need to learn to expect the unexpected and respond quickly to dispel fears and uncertainty in the market. Perhaps then the trader’s spotlight will turn elsewhere.

Credit insurance – Why all the fuss?

Credit insurance has been much discussed in the press recently as many journalists, MPs and union representatives have commented that “the credit insurers have been starving the economy of credit” and that “they are responsible for the collapse of many legitimate businesses”. So is any of this true? Are the credit insurers responsible for the collapse of British Industry?

In order to attempt an answer to these questions, it is necessary to understand a bit more about credit insurance and the credit insurance market. Credit insurance is often confused with creditor insurance.

Creditor insurance provides cover for the loans taken out by individuals protecting against a range of perils including redundancy, illness, and death. Credit insurance on the other hand is a commercial line of insurance, purchased by corporations. The majority of business transactions involve the supply of goods in advance with payment following, typically within ninety days of the receipt of an invoice. Credit insurance covers the purchaser against failure to settle the invoice caused by the insolvency of the buyer. It is therefore an integral tool in the risk and cash management processes of the insured. It is not, however, a substitute for the insured’s own cash management processes.

Credit insurance is very cyclical. Under ‘normal’ market conditions, a small number of businesses fail and the associated claims are settled as part of the normal cycle. During recessionary conditions, many more businesses become insolvent and therefore claims on credit insurance policies are substantially higher. The claims experience of credit insurers therefore moves from being relatively benign in normal conditions with observed loss ratios of 30-40 percent to loss ratios well in excess of 100 percent during recession periods.

Indeed this has been recognised by insurance regulation in the European Union with credit insurance being one of the classes of business where equalisation reserves are expressly allowed by statute.

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There is one feature of credit insurance that makes it different from most of the other classes of general insurance. Most credit insurance policies contractually allow the insurer to adjust the limits (or sum insured exposed to a particular event) of the policy during its exposure period. Credit insurers employ credit analysts who continually look at each of the companies where they are exposed.

If a credit insurer identifies a business that is likely to experience payment difficulties (or potentially become insolvent) then it notifies its clients and reduces the limits that it will offer to clients dealing with that business.

The impact of this is that its insureds reduce or cease to trade with that buyer and while existing exposure will be honoured the credit insurer and its clients are able to control adding to their exposure to the vulnerable buyer during the time of its financial difficulty.

It is this feature of the policies that is not understood and has led to the adverse press comment. So is the comment that the policies fail to protect when needed fair?

Given that it is the duty of each insured to take steps to minimise loss, then arguably the insurer is simply assisting its clients' credit management departments with this process. It is the duty of the insurer to protect its shareholders by controlling its exposed limits and not adding to them if it is aware that there is a high probability of loss.

A motor insurer that insists that an expensive vehicle is fitted with a tracker device before theft cover is granted is behaving in a similar fashion. The credit insurer will settle claims on all of its earlier exposure which was incurred before financial difficulty becomes apparent but it would be injudicious if it did not use all of the terms and conditions available to it to minimise its loss.

To conclude, the insurer is being perfectly fair in taking actions to minimise its loss. It is providing insurance and not a business support service, the latter being the responsibility of the Government if it chooses to act in such a fashion.

How reserve uncertainty can help to make a difference

The reduction in the availability of capital and an increase in the cost of risk have caused firms to re-evaluate their risks and the capital held against these risks to see if they can make efficiency savings. A frequently overlooked area is reserve uncertainty. Many executives assume as the business is already written there is little they can do about this risk.

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However, in the few cases where firms have applied management attention in this area, significant savings have been made through changes in claims handling, targeted schemes of arrangement, reinsurance recoveries or commutation strategy.

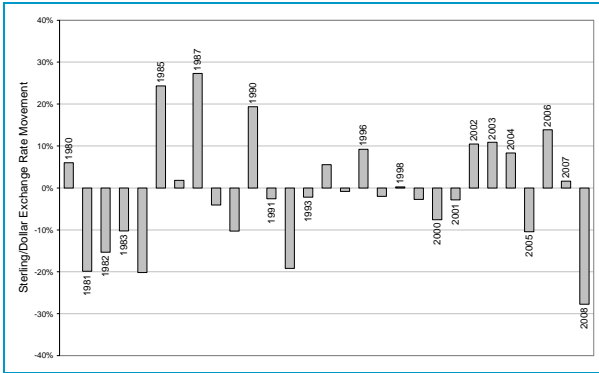
There are examples of firms or branches of firms who have not understood their reserve risk either when they wrote the business or later on as it accumulated, causing at best large adverse earning surprises and at worst closure.

Many future claim projections techniques used to derive uncertainty rely on statistical analysis of limited past data, with no link between the drivers of the risk (such as legislative changes, future inflation, exposure to precedents) and the overall risk to the insurer. We have devised an alternative approach:

- **Understand key risks:** Understanding and quantifying the key risks a company is exposed to and the potential impact on future claims will enable companies to move away from accepting model results on a "black box" basis. This will enable companies to check that the results being produced are sensible relative to its fundamental understanding of the risks.
- **Communication:** Key decision makers should be provided with what impact a change in a fundamental uncertainty driver will have on the overall reserve position in a commercial and practical manner, for example, the implication of a material change in future inflation, or a more aggressive stance on certain types of claim.

The PwC actuarial practice has developed a Reserve Uncertainty Drivers database that enables us to provide a clear and concise list of reserve uncertainty drivers, methods to quantify the uncertainty and also how to mitigate these risks. The database is split between general drivers and class specific drivers. When implemented this approach has led to claims and cost savings due to improved management of prior years.

Managing currency risk – Predicting the unpredictable



Source: Bank of England

The last twelve months have seen some dramatic swings in world exchange rates which have at times shown up in some unexpected places – from the collapse of the Icelandic Króna to the soaring cost of foreign currency mortgages in Eastern Europe. Closer to home, some Lloyd’s syndicates writing large amounts of US dollar business have higher peak exposures measured in Sterling and hence in some cases found themselves in need of more capital.

While the fall of Sterling by more than a quarter against the dollar during 2008 was unprecedented in recent years, looking further back in time this seems less surprising. Half of the years from 1981 to 1992 saw movements in the exchange rate of more than 19 percent. A return to this environment would make currency management skills core to many insurers prosperity.

There is a need to manage or hedge currency risk of the following:

- 1) Earnings
- 2) Balance Sheets
- 3) Solvency Regulators Capital
- 4) Tax
- 5) Exposures
- 6) Cash Flows

Some of the measures to manage the risk from currency exposure include:

- Natural hedging can be provided by holding assets backing expenses and reserves in the local currency.
- Tactical use of reinsurance can help reduce net currency exposures.
- Local funding such as overdrafts or debt issuance can be used to reduce the funding

In these cases a clear board policy is required as to which risks should be retained and which should be hedged – together with the circumstances under which this is reviewed. This should form part of insurers Enterprise Risk Management framework.

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Turner Review – Themes for wider consideration

On 18 March 2009 the FSA published the Turner Review, its response to the global banking crisis. The Review is expected to have a deep impact on the banking system. Announcing the Review, Lord Turner said: “The changes recommended are profound, and the banking system of the future will be different from that of the last decade. The world’s economy will be better served as a result.” It is a wide-ranging and far-reaching review, with significant implications not only for banking but also for the insurance sector.

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While the scope of the Review and the accompanying Discussion Paper (DP 09/02) is clearly defined as applying to banking and banking-related activity, Lord Turner and the FSA outlined several regulatory themes that are relevant to – and should already be recognised by – the insurance world. We expect these themes to become even more apparent to insurance Boards and management over the coming years, particularly as Solvency II takes effect.

‘Intensive Supervision’

Lord Turner has openly acknowledged there were mistakes made in regulation and provides a clear direction for restoring confidence in the future. The FSA’s key response is what it calls ‘Intensive Supervision’. This will result in significantly more emphasis on risk identification based on business-model risk and a focus on ‘outcomes-based’ regulation (rather than simply ensuring that the right systems and controls are in place). This is likely, over time, to have a fundamental impact on the way in which all financial services firms are regulated, not just banks – though clearly that is where focus will be initially – particularly those with large and complex businesses.

Macro-prudential regulation

The FSA is also seeking to strengthen macro-prudential regulation to allow for systemic effects to the financial system using mechanisms designed to provide counter-cyclicality. Whilst the focus is on banks here, the FSA specifically notes that the wider economic effect of a system-wide failure in the life insurance and annuities markets or withdrawal of general insurance cover could be significant and may require government intervention.

Governance and risk management

The Walker Review, being conducted by the Treasury with FSA input, is looking at governance and risk management in the banking industry, including the Board’s role, the Risk Committee and the risk management function.

The FSA is looking specifically at increasing the regulatory responsibilities of non-executive directors, the competence of candidates for 'Significant Influence Functions' (such as Chair, CEO, Finance Director) and the outcomes of the risk management and governance framework.

It has also said that it will seek to engage auditors increasingly in its assessments of the risk management function, particularly in respect of systems and controls. While the focus of the Walker Review is on the banking sector, the FSA is looking at governance and risk management from a much wider perspective.

Regulation of groups

While the FSA acknowledges the potential for capital and operational efficiencies of large international corporate structures, the potential for contagion is also likely to be greater, and indeed that potential has been realised starkly in recent months.

The regulatory implications are challenging: how to place a value at the local supervision level, particularly in distressed conditions, on the existence of parental guarantees, and conversely how to value that liability at the group level, are extremely difficult questions.

Recognising that there are no straightforward solutions, the Turner Review sets out a need for stronger international cooperation in supervision, together with stronger host country supervision which looks through the business-line relationships to risks which affect the level of support. The announcement by the G20 leaders on 2 April 2009 of "systematic cooperation" and the establishment of the Financial Stability Board is clearly an important step in this direction.

Those who follow the Solvency II debate will know that the European Commission attempted to include a method for allowing for group support within the draft Framework Directive. However, in the draft to be put before the European Parliament on 22 April 2009, group support has been deleted given the lack of consensus on its operation.

The FSA, the UK government and the other G20 leaders clearly see international cooperation in supervision of financial groups as a priority, and this will continue to be an area for insurers to pay close attention to in the months and years ahead.

Use of models

The Review highlights the problems with banks relying too much on certain modelling techniques – in particular it criticises in the way that VAR-based methodologies have been applied. Models frequently assume that the underlying population is normally distributed but in fact the evidence suggests financial market movements may be inherently characterized by fat-tail distributions.

The Review states that any use of VAR models therefore "needs to be buttressed by the application of stress test techniques which consider the impact of extreme movements beyond those which the model suggests are at all probable". It goes on to emphasise that deciding suitable stresses is inherently difficult and must involve judgement, not just blind application of a mathematical model.

These comments certainly have relevance also for insurers. It is, though, worth remembering that the Pillar II capital regime for UK insurers does take these concerns into account already in several ways:

- There is significant emphasis placed on the statistical credibility of data for modelling financial and insurance risks, and it is clear this will grow in importance under Solvency II
- Fat-tail distributions are indeed often used in modelling market and insurance risks, particularly for modelling extreme events
- There is already a significant emphasis in the ICA regime on stress testing (and indeed the FSA has been requesting stress testing of Pillar I requirements recently too)

No model can guard fully against failure, and use of capital model results are only one aspect of sound risk management, but the key requirement of Solvency II of requiring management to demonstrate that it believes in the model results so much that it uses them to run the business (the "use test") is likely to enhance the risk management process significantly.

Wide-ranging crisis, wide-ranging response

Just as the lessons from the global financial crisis reach much further into the financial sector than just banking, so the regulatory response is likely to be felt much more widely – particularly by the insurance sector.

Regulatory round- up (Spring 2009)

Providing an update of the latest developments in UK Financial Services Regulation

With-profits funds – compensation and redress

Last summer the FSA consulted on proposals to amend the charges which can be made to with-profits funds. The intention was to prevent proprietary firms from paying compensation to policyholders, e.g. for mis-selling, out of the inherited estate and thus to force shareholders to meet the costs of management failures. There was some delay in implementation while the proposals were revised following consultation.

The FSA has now published a further consultation paper on this topic (CP 09/09). The main thrust is unchanged but there is an important modification – rather than applying to all future compensation payments arising from events which may have happened in the past, the new requirements will apply only to compensation payments arising from events which occur after the rule change has been finalised.

The consultation period closes on 22 May 2009.

Stress and scenario testing

In December, the FSA published a consultation paper on stress and scenario testing (CP 08/24), applying to insurers as well as other financial services firms.

The consultation period closes on 31 March 2009.

There are two main thrusts to the proposals:

- To introduce a "reverse-stress test" requirement, under which firms must consider scenarios most likely to render their current business model unviable; the aim is to focus attention on "tail risks" and how to gain time in the event of imminent failure to restructure the business or achieve an orderly wind-up of it
- To clarify some of the existing rules and guidance around individual capital adequacy in order to signal that firms need to assess their material risks and appropriate mitigation more comprehensive.

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Other FSA activity

The FSA has published its annual Financial Risk Outlook. Unsurprisingly, it is dominated by the current financial and economic crisis. It contains key messages applicable to all financial services firms before considering individual sectors of the industry in turn.

Following on from this, the FSA has also published its annual business plan. In addition to sections on work relating to the FSA's normal objectives, there is a chapter on "responding to the crisis".

As many will be aware, the FSA has recently conducted a stress testing exercise with insurers to examine their potential position at end 2009 and their ability to pay dividends.

Professional regulation

In December, the Board for Actuarial Standards (BAS) issued a consultation paper on a generic modelling standard for actuarial

work which sets out the themes to be covered in the standards. It includes some general concepts, relevance and parsimony, inputs and outputs, fitness for purpose and consideration of the limitations of models. The consultation closed on 23 February 2009 and responses can be found on the BAS website, including a response from PricewaterhouseCoopers.

BAS also published feedback on the responses it received to its discussion paper on mortality assumptions.

There will be no separate standard prepared on mortality but guidance, which may include criteria which mortality assumptions must meet, will be included in some of the specific Technical Actuarial Standards as they are developed

The Financial Reporting Council has published its "Actuarial Quality Framework", which is based around six main drivers for quality.

The Professional Oversight Board has announced that it will consult on additional quality assurance requirements for individual actuaries and actuarial firms within this framework.

Watch this space for further regulatory developments.

Solvency II update

Recent and upcoming publications:

- To find out what good practice for internal models will look like, refer to the Institute of Actuaries paper "Actuarial Aspects of Internal Models for Solvency II"
- "Gaining Comfort: Capital model validation for insurers" - A PwC discussion paper which outlines some of the practical considerations that can significantly strengthen the credibility of the model evaluation process.
- What impact will Solvency II have on you and me? Read the PwC article in the April edition of 'The Actuary' to find out more.
- Look out for the next version of "Countdown to Solvency II" in May 2009 which will include information on:
 - Understanding Pillar 3 - an analyst perspective as well as a regulatory one
 - Relocating: Why are companies attracted to the likes of Switzerland, Ireland or Luxembourg?
 - Review of recent IAIS papers on ERM, models, capital requirements and groups
 - What will the ORSA look like?

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Since the launch of the Discussion Paper (DP 08/04) "The Path to Solvency II" in September last year, insurers have stepped up their efforts to address the key requirements outlined by the FSA:

- Gap Analysis: To understand their current state of readiness for Solvency II.
- Implementation Plan: Developing a detailed plan with a timeline and milestones to help them prioritise activity.
- Quantitative Impact Study (QIS) 4 calculation: Understanding the process and data requirements for completion of the standard Solvency Capital Requirement (SCR) formula.

We have supported numerous insurers around the three areas above and some messages we have found so far include:

Internal model approval is paramount to the competitive position of the insurer. The standard SCR formula is not fit-for-purpose for risk based capital assessment and does not allow the insurer to incentivise the business appropriately.

Positioning Solvency II not as a regulatory compliance exercise but one which integrates with improving risk-based management becomes the mechanism to achieve better buy-in across the business.

While much focus to date has been placed around Pillar I (Quantitative Requirements), significant gaps exist with regards to Pillar II (Supervisory Review) and Pillar III (Disclosure) which require attention for effective preparation towards Solvency II.

About us

The Actuarial & Insurance Management Solutions (AIMS) practice at PricewaterhouseCoopers LLP (PwC) has over 200 staff providing life and non-life advisory services to financial institutions across the UK. Our actuaries and specialists provide advice to the insurance industry, its regulators and other financial services providers.

The PwC (AIMS) practice in the UK is able to call on the expertise of accountants, risk managers, performance improvement consultants and tax advisors across the global network of PricewaterhouseCoopers member firms, as well as corporate finance and business recovery specialists. This provides a broad multi-disciplinary perspective to our solutions for our clients.

For more information about the PricewaterhouseCoopers Actuarial & Insurance Management Solutions practice in the UK, visit our website at www.pwc.com/uk/aims.

Contacts

If you have any feedback about this newsletter or if specific advice is required on one of the topics discussed, please contact one of the Actuarial practice leaders:



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The latest insights

Find out more about PwC in the latest publications for the financial services industry.

- Back to the 'domestic' future – From strategic expansion to rapid contraction in FS M&A in EMEA
- Unlocking value in run-off – A survey of discontinued insurance business in Europe
- Insurance Banana Skins Survey 2009
- Countdown to Solvency II: Bridging risk and capital (edition 4)
- Now for the good news: Realising the competitive potential of reporting convergence
- Gaining Comfort: Capital model validation for insurers

Something to look out for

- PwC Modelling Survey UK & EU 2009

In the coming month PwC will be launching a survey of modelling within the UK and European life insurance markets, comparing the software products that insurers use, for what purposes and their suitability and effectiveness.

The survey will cover both quantitative measures, such as number of computers and run times, and qualitative measures, such as how closely the software meets your current requirements. The report, to be published in the summer, will give a comprehensive view of the modelling market and will allow you to assess where you are against your peers.

For further information, or for a link to the survey, please contact Kevin Denman at kevin.n.denman@uk.pwc.com.

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