General Insurance FCRs and EPRs: APRA Feedback

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Tuesday 25 September 2007

Overview

- Brief review of history of FCRs
- FCR requirements in GPS310
- Review of FCRs
- Review of EPRs

Background

- FCRs required for life insurers for a number of years
- Reform of general insurance regulation 2001-02
- HIH Royal Commission
- GI Mark I – introduction of ILVRs
- Vigorous debate about value of GI FCRs
- GI Mark II – introduction of FCRs with effect 1 October 2006

GPS310 and FCRs

- Written by insurer’s Approved Actuary
- Addressed to the Board
- APRA to receive a copy
- To provide the actuary’s “objective assessment of the overall financial condition of the insurer”
- “Should form an important input into decision-making by the Board and senior management in respect of the operations of the insurer”
- Paragraph 45 of GPS310 sets out the areas that must be covered in an FCR

APRA's Analysis To Date

- Around 60 or so FCRs analysed
- First round, so expecting variability
- Diverse companies, so wide range was evident
- Evidence of differing degrees of actuarial ownership

Business Overview

- Generally very well covered
- Actuaries including good descriptions of lines of business written, with discussions of trends in volume and new initiatives
- But sometimes not even a structure diagram to indicate the insurer's place in the group
- Occasional inconsistencies between what the insurer and the actuary tell APRA
- Not a lot of commentary on contagion risk

Recent Profitability and Experience

- Analysis of loss ratios is generally reasonable, although there could be more subdivision by accident year
- Some reports lacking in analysis by class of business
- Where there is analysis of the amount of profit/loss there is not always comment on the reasons for this
- Where business is performing poorly we would expect to see some recommendations on how profitability can be improved and/or the capital cost of the ongoing losses
- We're particularly interested in relationship between emerging loss ratios and future loss ratio assumptions for the Premium Liabilities

Key Results of ILVR

- Generally well summarised
- Actuaries are now familiar with the liability valuation requirements
- Choice of risk margins – how “average” is an insurer?
- Diversification
- Change of methodology – why has this occurred, especially when it results in the release of reserves?
- Changes to blending approaches
- Expense assumptions where there is no expense analysis information available
- Actuary responding to any suggestions made by the EPR actuary

Adequacy of Past Estimates

- Generally well done
- Looking for recommendations on corrective measures where past estimates have not been adequate
- Commentary on case estimates?
- Helpful to see this discussed both gross and net where the use of reinsurance has significantly affected results

Asset/Liability Management

- An area that varies greatly
- Quite a lot of very good analysis (often from some of the smaller insurers)
- Analysis of durational mismatch and calculations of capital effect (similar to Life Resilience Reserves)
- Some good analysis of credit risk of counterparties (especially reinsurance recoveries)
- Some good commentary on investment strategies, particularly where insurers are moving into new strategic areas

Asset/Liability Management

- **More detail on asset valuation methods where the assets are unusual**
- **Other assets and liabilities often well covered too**

Current and Future Capital Adequacy

- Some good analysis, particularly where tied into the insurer's business plan
- Actuarial involvement in assessing and monitoring target surplus?
- Use of scenario testing varies quite a bit – some of the stress testing was a bit limited in terms of the extremity of the scenarios considered
- Not always seeing commentary in situations where an insurer's capital adequacy is based on budgets that are clearly inadequate

Adequacy of Premiums

- An area showing quite wide variation
- Some very good commentary, with suggestions for improvement
- Often not much description of how the pricing process works, the actuary’s involvement etc

Reinsurance Arrangements

- Generally well covered
- Evidence of some degree of actuarial involvement in assessing details, suitability of reinsurance arrangements
- Advice regarding suitability, possible changes to retentions
- Some analysis of creditworthiness of reinsurance counterparties
- More detail would be useful on the method/responsibility for setting/assessing MER and any use of catastrophe modelling

Risk Management

- Variable, but generally better than APRA expected
- Many actuaries have constructed a template of risks and refer to this throughout the FCR
- Good commentary of operational risks that actuaries have noted, with suggestions for improvement
- Expect to see follow-up commentary on any recommendations that actuary has made in previous FCRs
- Some good commentary on risks arising from insurers' distribution channels
- Data and associated issues should always be covered

FCR Summary

- **Overall the standard has been good**
- **The best FCRs have been those where:**
  - actuaries have been prepared to tackle the difficult issues
  - the FCR contained recommendations and suggestions for improvement , grouped in terms of impact on the insurer's financial condition
- **It's clear that actuaries have been using the FCRs to "lift the standard" of actuarial analysis for some of the smaller insurers**

Response from insurers

- **Response from the majority of insurers (Board and management) has been that the FCR has been a valuable document, despite the expected teething problems**

External Peer Reviews

- Still bedding down
- Significant variation in length and level of detail
- General agreement with primary actuary's methodologies and assumptions, although some commentary on future loss ratio assumptions
- Quite a lot of comments around suggestions for improving data and reconciliation
- Suggestions of greater use of scenario testing/sensitivity analysis
- Justification of risk margins and diversification benefits
- Feedback from insurers