

Alignment Between Risk and Capital Management in the Insurance Industry

Presentation to Fields Institute by
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Agenda

- Forces of alignment
- Common risk models
- Canadian stakeholder vision
- Where are we now?
- Why is this important?
- Alignment issues
- Practical issues
- Assuris concerns

Forces of Alignment

- Globalization of insurance
- International standards
 - IASB insurance accounting
 - IAIS solvency standards
 - IAA solvency assessment
- Rise of enterprise risk management (ERM)
- Increased desire for
 - Realistic, market-based reporting
 - Common risk models for ERM, economic and regulatory capital

Common Risk Models

- Shared attributes
 - Comprehensive provision for all risks measured on a consistent basis
 - Confidence level linked to desired financial strength (credit rating for economic capital; probability of insolvency for regulatory capital)
 - Enable better business decisions through consistent measurement of risk and return

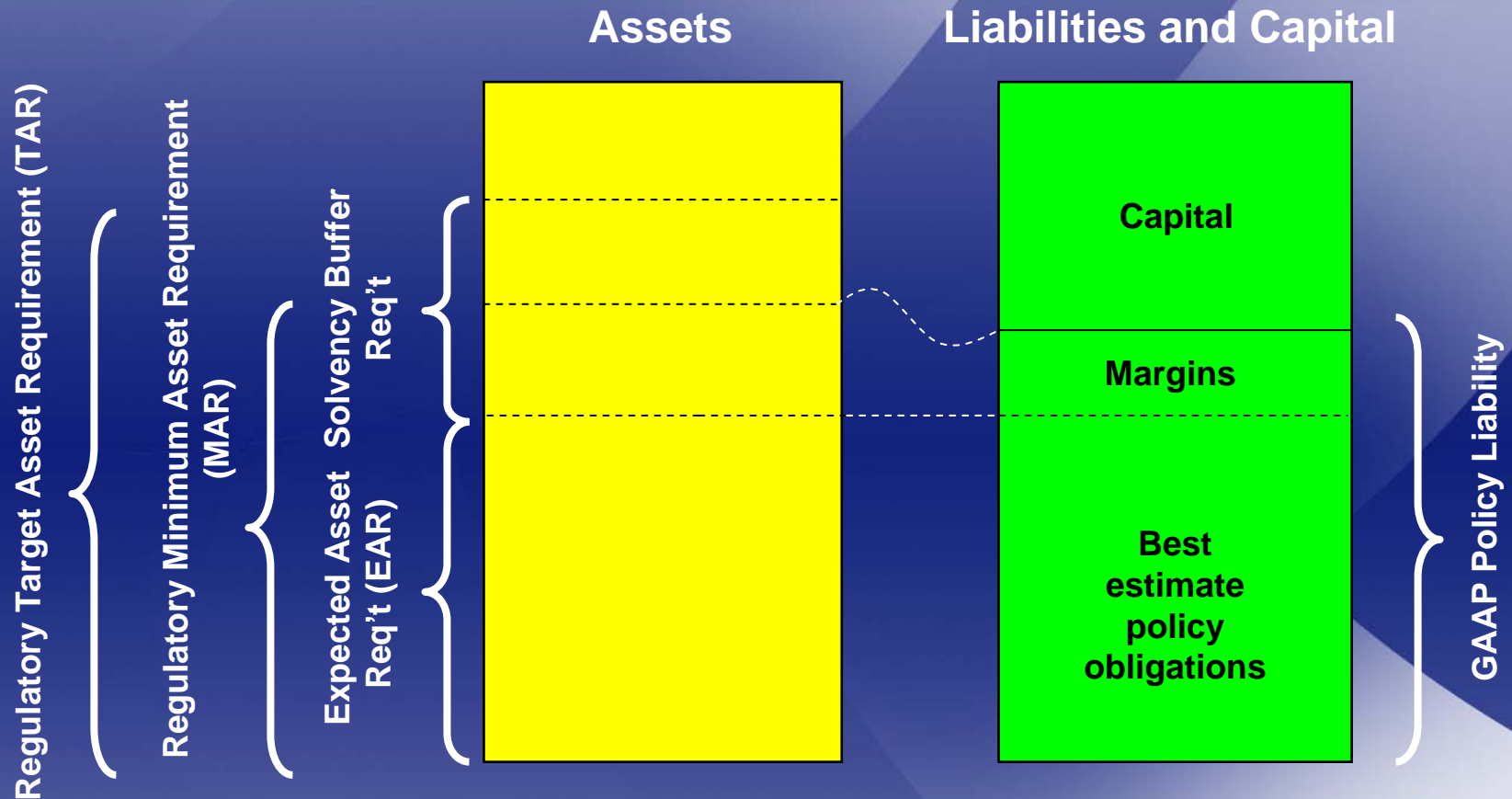
Common Principles for New Solvency Framework - Stakeholders (MAC)

- Consider all risks
- Measure assets & liabilities on a consistent basis
- Be practical, but technically sound
- Measure risks on going concern basis; consider wind-up costs
- Use risk measures that are comparable across risks & products
- Ensure that capital is prudent

Common Principles for New Solvency Framework - Stakeholders (MAC)

- Encourage good risk management
- Adapt international principles and practices
- Allow comparison of similar risks across Financial Institutions
- Be transparent, validated and based on credible data
- Use reliable processes with assumptions sustainable in time of stress
- Be part of intervention levels for supervisory action

Total Asset Requirement - MAC Vision



Comparison of Minimum and Target Asset Requirements

	Minumum Asset Requirement (MAR)	Target Asset Requirement (TAR)
Purpose	Regulatory control point	<i>Going concern</i> level of assets to be maintained
Standard vs Advanced	Standard only	Standard or Advanced
Sufficiency Level	To be determined	99% CTE over 1 yr + terminal provision

Comparison of Advanced and Standard Approaches

	Advanced	Standard
Type	Internal model based on multiple scenarios; company specific data & assumptions	Formula or factor-based calculation using industry assumptions & applied to company specific data
Risks	All risks explicitly & appropriately modeled	All risks recognized implicitly or explicitly in formulation of Standard Approach
Application	Selection of Adv'd vs Std Approach made separately for credit, market, underwriting, op risks	

Comparison of Advanced and Standard Approaches

	Advanced	Standard
Mitigation	Risk mitigation modeled	Key mitigation types recognized implicitly or explicitly
Dependencies	Risk dependencies within and between risks modeled	Partial recognition of dependencies within key risks
Confidence	99% CTE over 1 yr + terminal provision	99% CTE over 1 yr + terminal provision

Comparison of Advanced and Standard Approaches

	Advanced	Standard
Calibration	According to internal model standards of regulator & actuaries	Periodically by regulator in reference to advanced approaches filed with regulator
Results	Understandable & verifiable	Understandable, verifiable and objective
Use	Used for TAR if approved by regulator	Calculated by all companies; used by many companies for TAR; used by all for MAR

Where are we now?

- Canadian life insurer stakeholders have agreed on vision for a new solvency framework
- Advanced model technical preparation work is underway by largest insurers
- No stakeholder project plan in place for Standard Approach
- Majority of Canadian life insurers have not begun preparations for the vision
- Industry progress towards vision is slow

Why is This Important?

- Change will be forced on us by the 2011/2012 International Insurance Accounting Standards and European Solvency II framework
- Important to Assuris as our mission is to mitigate the impact on Canadian policyholders of the financial failure of a life insurance company

Alignment Issues

- Basel II
 - Basel requirements for credit risk are well established and insurers will be hard pressed to propose new approaches in light of integrated financial services supervision
 - Market risk is more significant for life insurers and improvements on Basel approach will be needed
 - Basel approach to operational risk is a useful start
 - Underwriting risk is unique to insurance
 - How will differences in risk diversification and mitigation be handled between insurance and Basel II?

Alignment Issues

- Role of the actuarial profession
 - Current Canadian statutory reserved roles for the actuary (i.e. all insurers must have an Appointed Actuary; AA opines on policy liabilities in accordance with GAAP etc) is unique in world
 - Future Solvency II and IASB insurance accounting standards will not have reserved roles for the actuary
 - Who will set the standards for determining the policy liabilities? Capital requirements?
 - Will the needs of the regulators and auditors be aligned?

Alignment Issues

- Earnings vs solvency
 - What provision for margins will the IASB include in its insurance accounting standard?
 - What provision for solvency will regulators require (e.g. total asset requirement at 99% CTE)?
 - Are these stand-alone decisions or should they be aligned?

Practical Issues

- Advanced Approach
 - Need for internal model standards
 - Need for clear understanding of regulatory approval requirements
- Standard Approach
 - Need for work to commence on designing a Standard Approach
 - Need for all insurers to participate

Practical Issues

- Capacity
 - Is there sufficient expertise within companies and the regulators to implement the new solvency framework?
- Groups
 - How will capital requirements be determined for groups of companies?
- Cross-border
 - How will regulators deal with each other in cross-border issues regarding capital requirements?

Assuris Concerns

- Standard Approach
 - All companies will need to apply the Standard Approach (whether for MAR or TAR) yet no work has commenced on it
- Project management
 - Current Canadian progress is too slow and should be revitalized
 - Is there sufficient Canadian capacity to get the work done?

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