

***Case study***

***Capital Injection in a Life Company***

***18<sup>th</sup> Indian Fellowship Seminar***  
***December 2012***

Guided by:  
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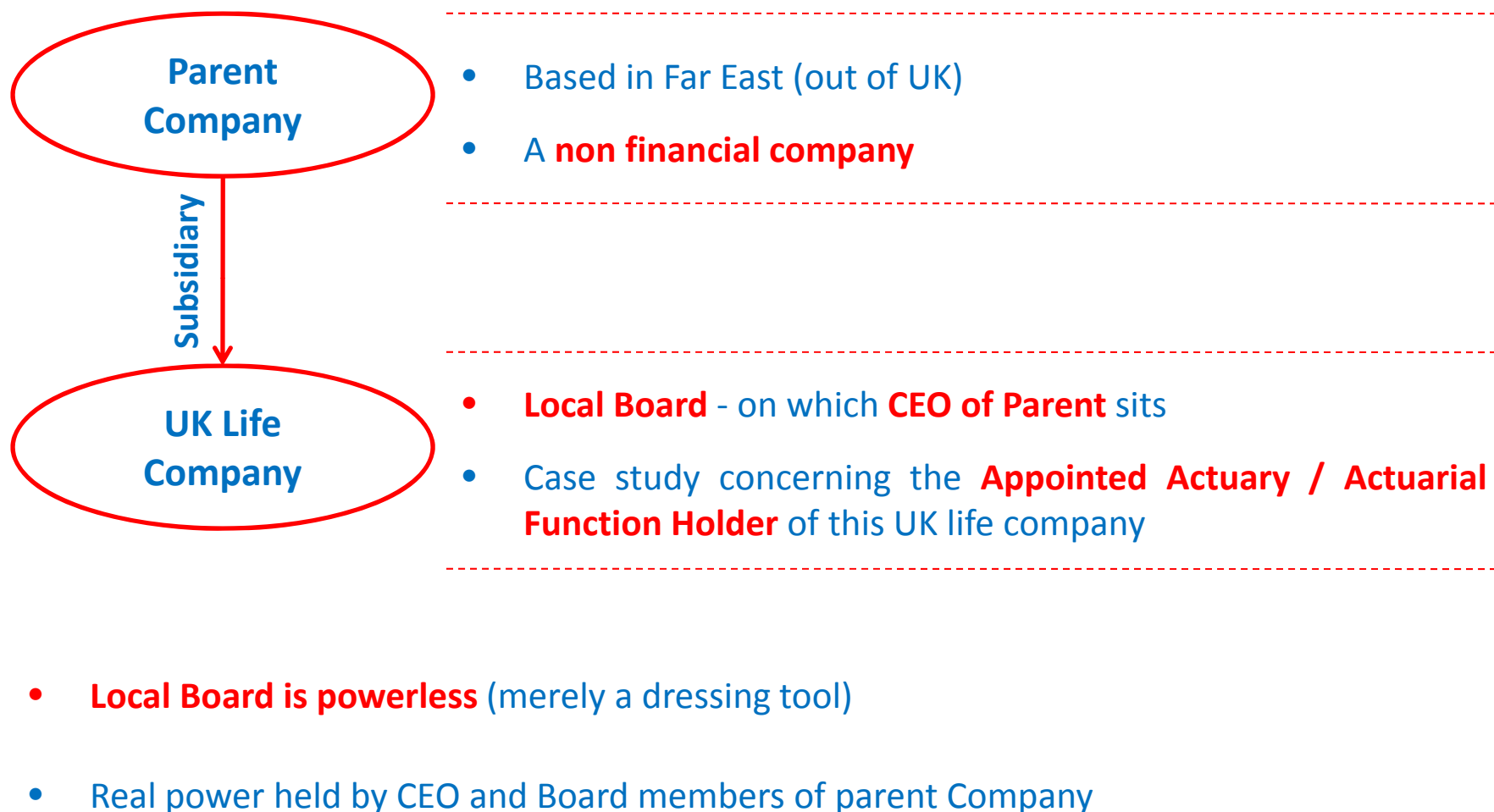
Presentation by:  
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# Agenda

- ▶ **Introduction to the Case Study**
- ▶ **Setting the background**
  - ▶ Role of Capital: free assets vs. insolvency
  - ▶ Role of AA / AFH – wider than just ensuring solvency!
  - ▶ Powers & Duties of AA / AFH
  - ▶ Role of Head of Actuarial
- ▶ **The Action Plan**
  - ▶ Various levels of actions
- ▶ **Conclusion**



# Introduction – the arrangement



# Introduction – the problem



To maintain “**Competitive Free Assets Position**”

- Local Board notes concern but says - it **is nothing to do with them, merely one for the parent!**
- The **Chief Executive informs** the Appointed Actuary / Actuarial Function Holder that:
  - **he will decide on capital injection.**
  - with all the money invested, the parent company **will not let the Life Company go insolvent.**

# Introduction – the problem

**What should the Appointed Actuary / Actuarial Function Holder do?**



- We are going to address the problem from point of view of both:
  - **Appointed Actuary / Actuarial Function Holder (Regulatory Position)**
  - **Head of Actuarial (Non Regulatory Position)**
- We are going to address problem in both UK and Indian context.

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- ▶ Powers & Duties of AA / AFH
- ▶ Role of Head of Actuarial

- ▶ **The Action Plan**

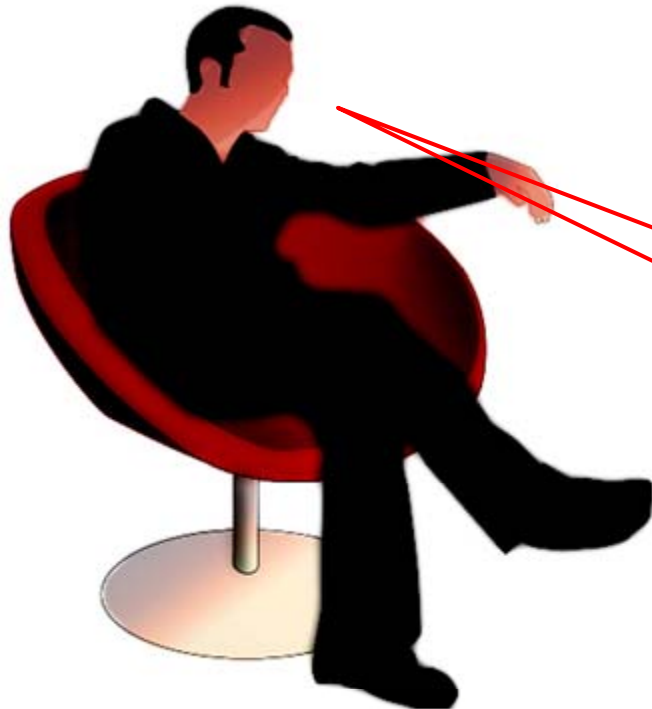
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- ▶ **Conclusion**



# Role of Capital: free assets vs. insolvency

CEO



AA / AFH



Inject capital to  
maintain competitive  
free assets!

Will not let the  
Company go insolvent!

- Is capital required only to prevent technical insolvency?
- Should AA / AFH be concerned with only solvency?

(Above questions answered in detail in following slides)

**NO**

# Role of Capital: free assets vs. insolvency (Cont.)

Capital has wider role than just ensuring solvency:

- Needed to meet regulatory **solvency requirements (the bare minimum capital!)** failing which Company would attract regulatory intervention, including possible closure to new business / wind up.
- Needed to meet **new business strain and other development expenses.**
- Level of capital plays a key role in achieving Company's overall strategic direction. For example, capital levels will impact acquisitions, mergers, de-mutualisations and new ventures.
- Level of (free) capital **determines the financial strength**, which has significant impact on credit ratings and new business levels.
- The level of free capital **impacts the investment strategy (particularly in a with-profits fund).**

Lower free capital (i.e. less cushion) means the Company invests in less risky investments (e.g. gilts rather than equities). This could **negatively impact policyholder returns.**



# Statutory Duties of Appointed Actuary

**Regulation 8 of the IRDA (Appointed Actuary) Regulations, 2000** on AA's duties and obligations states as under:

“In particular and without prejudice to the generality of the foregoing matters, and in the interests of the insurance industry and the policyholders, the duties and obligations of an appointed actuary of an insurer shall include:

- a) .....
- b) ensuring the solvency of the insurer at all times;**
- c) .....
- d) .....
- e) drawing the attention of management of the insurer,** to any matter on which he or she thinks that action is required to be taken by the insurer to avoid—
  - i. any contravention of the Act; or
  - ii. prejudice to the interests of policyholders;”**



# Role of AA – wider than just ensuring solvency!!

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**Section 2 of APS 1** concerning Nature of Responsibility further explains as under:

2.1. The responsibilities of an actuary who is appointed under the AA Regulations, are central to the **financial soundness of the life insurance company** to which he is so appointed.

2.2. An Appointed Actuary should ensure, so far as is within his/her authority, that the life insurance business of the company is conducted on **sound financial lines and that he/she has regard to Policyholders' Reasonable Expectations (PRE)**.

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Clearly, the Appointed Actuary is concerned with not just solvency....

....but his role is to ensure that the business is run on sound financial lines....

.....and policyholders' interests are taken care of.

# Statutory Powers of Appointed Actuary

Regulations also enable fulfillment of responsibility

Sub Regulation (3) of Regulation 7 of the IRDA (Appointed Actuary) Regulations, 2000 concerning Powers of Appointed Actuary reads as under:

(3) The appointed actuary shall be entitled:

(a) to attend all meetings of the management including the directors of the insurer;

(b) to speak and discuss on any matter, at such meeting,--

(i) .....

(ii) that may affect the solvency of the insurer;

(iii) that may affect the ability of the insurer to meet the reasonable expectations of policyholders; or

(iv) .....

(c) to attend:

(i) any meeting of the shareholders or the policyholders of the insurer; or

## Statutory Powers of Appointed Actuary (Cont.)

Regulation 9 of the IRDA (Appointed Actuary) Regulations, 2000 concerning Absolute Privilege of Appointed Actuary reads as under:

1. An appointed actuary shall enjoy **absolute privilege to make any statement, oral or written, for the purpose of the performance of his functions as appointed actuary.** This is in addition to any other privilege conferred upon an appointed actuary under any other Regulations.
2. Any provision of the letter of appointment of the appointed actuary, which restricts or prevents his duties, obligations and privileges under these regulations, shall be of no effect.

# Statutory Duties of Actuarial Function Holder

*With effect from 31/12/2004, the statutory requirement for a life insurance company transacting long-term business to have an Appointed Actuary has been replaced by the statutory need to have an Actuarial Function Holder (AFH).*

Roles and responsibilities of the AFH as set out in SUP 4 Manual include :

- ▶ To advise management on the risks being run by the firm that may affect the long-term liabilities relating to policyholders, and **on the capital required to support the business on an ongoing basis.**
- ▶ To monitor these risks and inform the management of any concerns that the firm may fail to meet its liabilities, including with regard to the terms on which new business is written.
- ▶ To advise the firm's governing body on the **methods and assumptions for actuarial investigations**, to perform the investigations and to report the results to the firm's governing body. The actuarial investigations **include those relating to solvency**

# Role of AFH – wider than just ensuring solvency!!

**GN 40 states that the AFH:**

- ▶ Advise the firm in writing of the actions that could be taken if the **solvency of the firm were to deteriorate, or capital requirements were to increase** .
- ▶ Should present his or her report in person to the governing body (**Decision making body**) so that he or she may identify and address any areas of misunderstanding or concern that may arise.
- ▶ Must consider whether it is necessary to take advice from appropriately qualified professionals having regard to the materiality of the issues.
- ▶ For a composite firm, assets held outside the long-term insurance fund (in the present case - **capital available with parent company**) **cannot automatically be assumed to be available for the purposes of future new business strain**.

## Role of AFH – wider than just ensuring solvency!! Contd..

*GN 37 gives guidance on whistle-blowing, i.e. the circumstances under which a statutory obligation arises for an Actuarial Function Holder to communicate matters of which he or she becomes aware to the FSA.*

*This includes:*

- ▶ Need to verify that the matter comes under the scope of the relevant regulations and to take appropriate initial steps, such as discussion with the firm's compliance officer or relevant senior management in order to agree the facts of the situation.
- ▶ Need to communicate matters with urgency, when the actuary reasonably believes that a contravention may have occurred, that a matter may be of material significance to the FSA, or that a significant risk may be present.
- ▶ The **whistle-blowing obligation over-rides** any legal duty of confidentiality to the company.

# Role of AFH – wider than just ensuring solvency!! Contd..

GN 37 includes the following matters to be communicated to the FSA:

- ▶ Contravention of legislation by an insurer.
- ▶ **Significant risk** that an insurer's assets may become **insufficient to meet liabilities**.
- ▶ Significant risk that the **insurer did not or may not take into account policyholder interests**.
- ▶ Inadequacies in the insurer's relationship with the actuary (e.g. the provision of information and resources).



# Role of Head of Actuarial

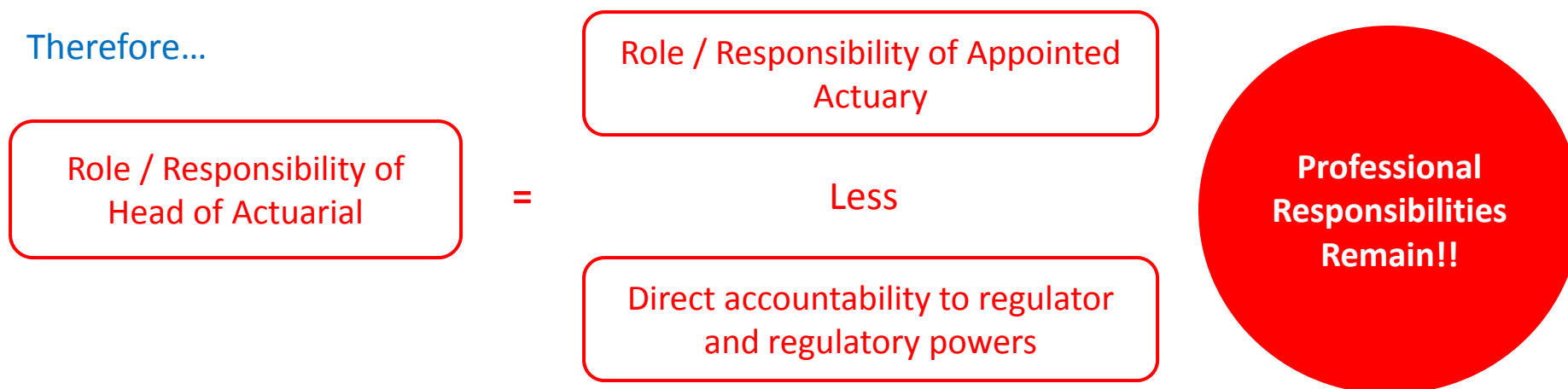
Regulatory responsibilities and powers are not available in case of a Head of Actuarial who is not an Appointed Actuary....

....but he / she shall be **subjected to Professional Guidance** (Actuarial Practice Standards / Guidance Notes and Professional Conduct Standards in Indian context).

Above is also explicitly mentioned in Actuarial Practice Standards. For example, applicability clause of **APS 1** states at the outset that it...

... **“is also applicable to all other actuaries who as a matter of course get associated with a life insurer and have to relate directly or indirectly to the Appointed Actuary of such life insurer.”**

Therefore...



# Summary

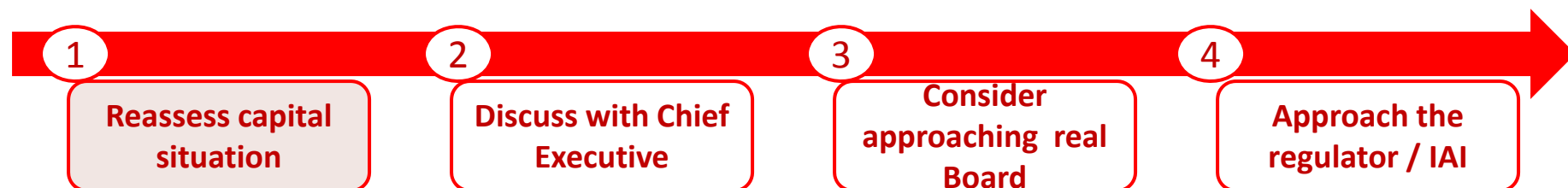
Particulars	Appointed Actuary / Actuarial Function Holder	Head of Actuarial
Governed by...	<p><b>Governed by statutory requirements, as discussed above</b></p> <p>Governed by professional guidance:</p> <ul style="list-style-type: none"> <li>Professional Conduct Standards</li> <li>Actuarial Practice Standards / Guidance notes</li> </ul>	<p>Governed by professional guidance:</p> <ul style="list-style-type: none"> <li>Professional Conduct Standards</li> <li>Actuarial Practice Standards / Guidance notes</li> </ul>
Powers & Privileges	<p>Explicit powers &amp; privileges given under statute.</p> <p>Also, can seek help of IAI / FSA.</p>	<p>Depends on nature of engagement.</p> <p>Also, can seek help of IAI / FSA.</p>
Responsibility	<b>Largely similar</b>	
Accountability	<p>Accountable to both:</p> <ul style="list-style-type: none"> <li>the regulator (IRDA / FSA)</li> <li>Institute of Actuaries (India / UK)</li> </ul>	<p>Accountable to both:</p> <ul style="list-style-type: none"> <li>Institute of Actuaries (India / UK)</li> </ul>

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# The Action Plan



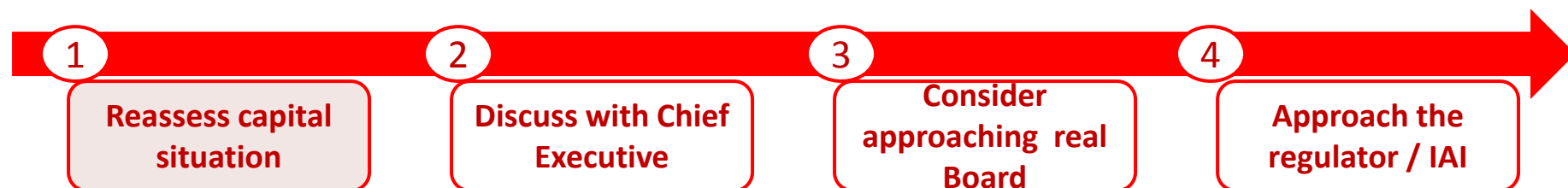
- Re-assess the capital position, based on various plausible assumptions and scenarios.

Examine: **Impact of change in projected business volumes, level of operational expenses etc.**

Required to be done as a part of Financial Conditions Report.

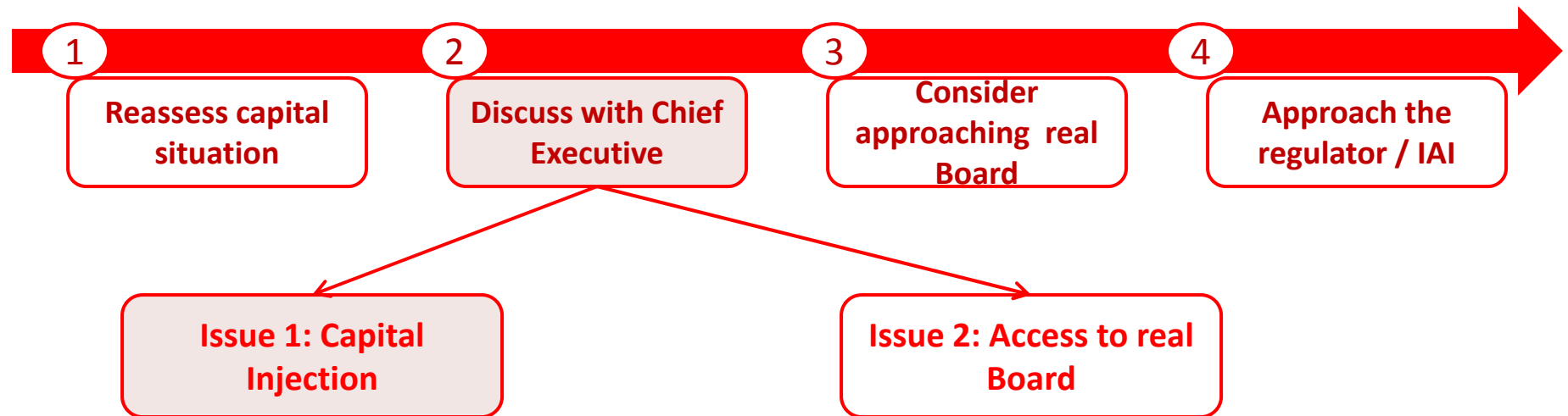
- Consider impact of low free assets on investment freedom and other business functioning. **How is the policyholder likely to be impacted?**
- **Is solvency also potentially at risk?**

# The Action Plan



- Get the results peer reviewed – internal and external?
- **External Peer Review or second opinion from Institute - feasible?**  
Whether correct or otherwise, if the news of capital insufficiency spreads, the implications for the Company may be negative. **Capital injection is a commercial issue!**  
  
Considering the sensitivity of the information, external peer review in such a situation is **not feasible**.
- **Compare capital adequacy position of other companies**
- Assess impact of poor capital adequacy on reputation and consequent implications on intermediary's ability to obtain business, customer confidence, market rating etc.
- Note: **Not having access to real board may be discussed with the Institute?**

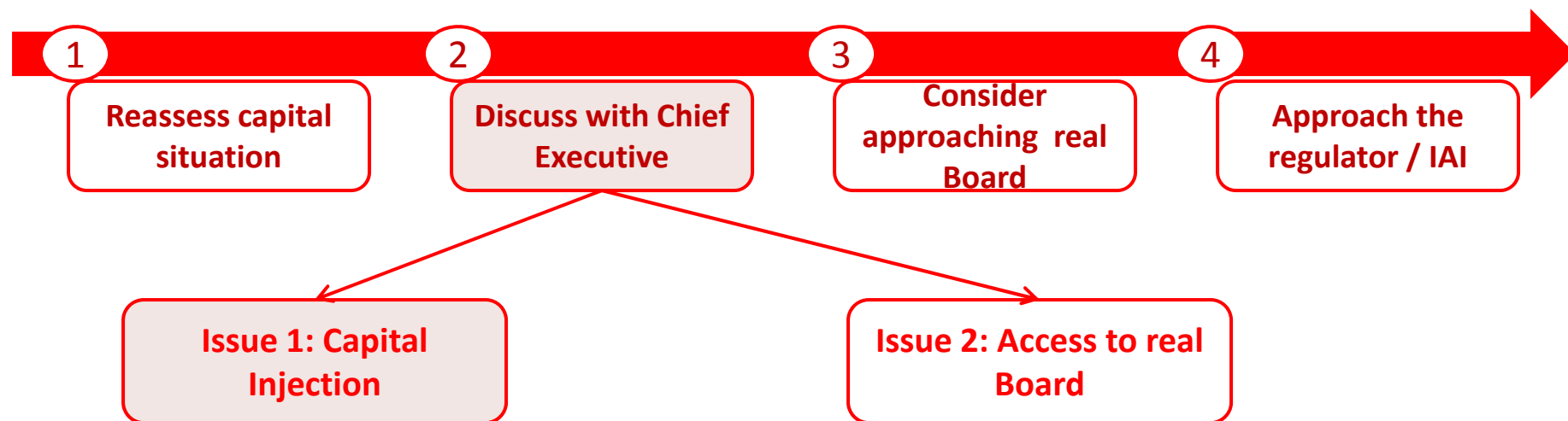
# The Action Plan



- **Bridge the understanding:** Explain why capital beyond solvency is needed and implications of not having the same.
- Explain the potential negative impact on credit ratings and consequent negative impact on new business sales and persistency.
- **Illustrate impact on various stakeholders (in particular – policyholders!)**

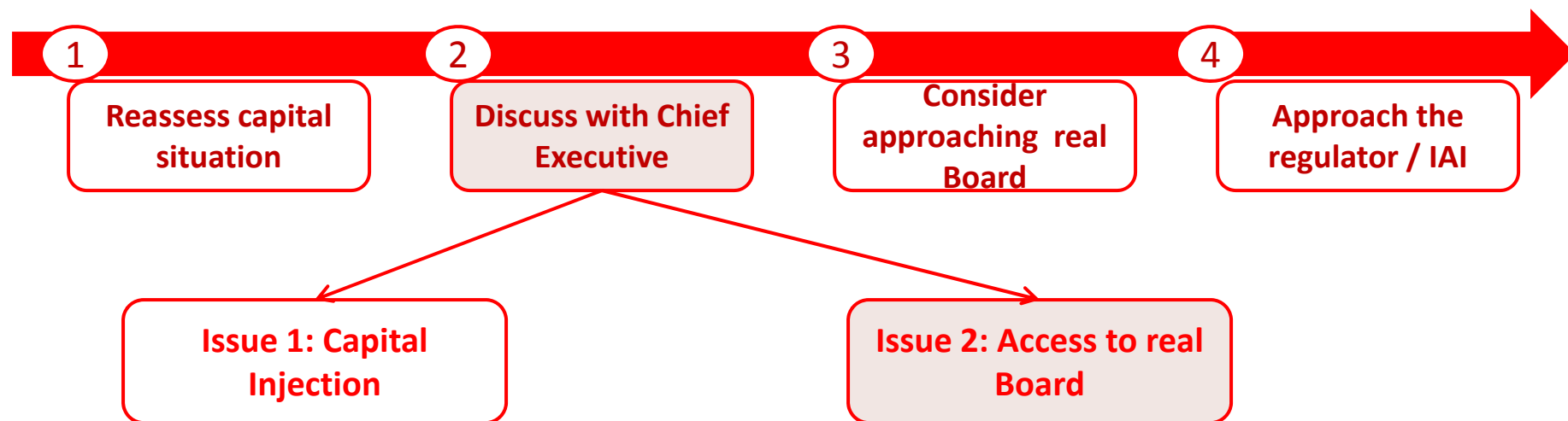
Both the above to be done in a manner understandable to a non - actuary.

# The Action Plan



- **Highlight duties and rights on AA / AFH:** In particular, highlight:
  - **Right to make statement to management / shareholders** (Regulation 7 of IRDA (AA) Regulation).
  - **Right to recommend new business levels** that can be written with available free assets (Section 6 of APS 1)
  - Right as well as the **obligation to inform the regulator** (whistle blower), along with indication of steps that regulator may take (including potentially capping or stopping new business sales).

# The Action Plan



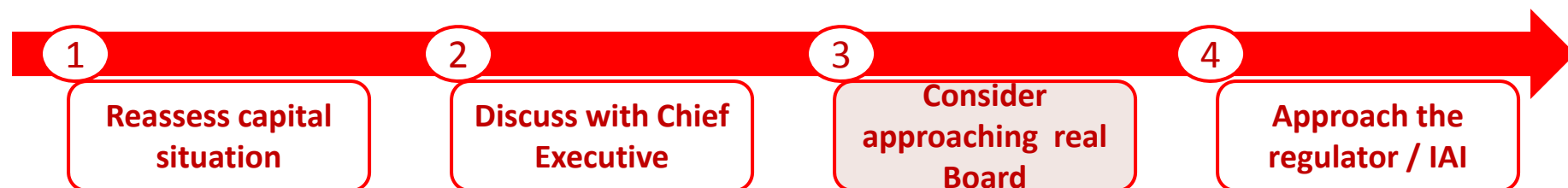
Section 3.5 of APS 1 states:

“Where there is a group structure, the Appointed Actuary should bear in mind any possible implications on his/her right to information and **ensure a right of direct access to the relevant decision making bodies and/or persons.**”

- AA / AFH or Head of Actuarial should approach the Compliance officer of the Company who can raise the issues with the board.
- He / she should also highlight that he may be forced to approach the regulator (GN 37 requires to blow the whistle)
- Also, this is a **professional issue – so assistance of Institute can also be sought!**



# The Action Plan



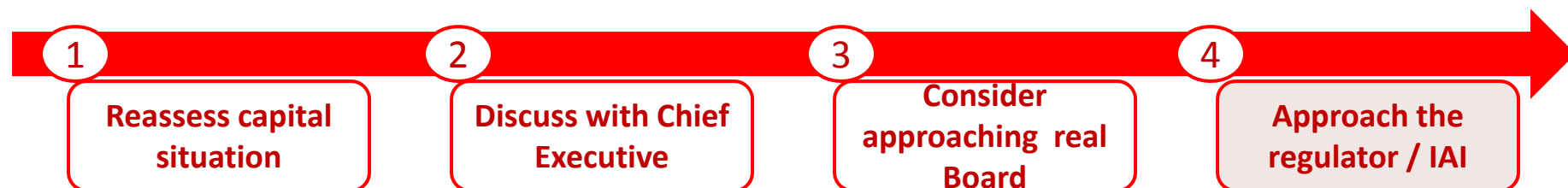
If issues are not resolved with Chief Executive, AA / AFH or Head of Actuarial should approach the real board (Board of parent company) through the Compliance officer of the Company.

The points of discussion would be the same as mentioned above for step 2 (Discuss with Chief Executive).

## **Key Issue: Parent is a non financial company**

- It will be hard to explain issues and implications.
- Actuary should consider investing time to educate them, considering they are the decision making board.
- Use of language and communication (written as well as verbal) should be appropriate and understandable to a financially literate but not technical person.

# The Action Plan



If none of the measures work, the AA / AFH or Head of Actuarial will be forced to approach the regulator or ensure that management does!

Section 4.1 of APS 1 states:

“Every actuary has a responsibility to the profession and his/her responsibilities to a client must be consistent with this. An Appointed Actuary is however also in a special position as he/she has statutory responsibilities to the IRDA. If these two aspects materially conflict, the Appointed Actuary has to advise the company as soon as he/she feels that the company has initiated action – or **a situation has arisen outside the control of the company – that materially threatens its solvency. If the company does not remedy the situation, the Appointed Actuary is required to advise the IRDA – but not before informing the company first.**”

GN 37 specifically provides the AFH the responsibility to blow the whistle in case of any contravention.

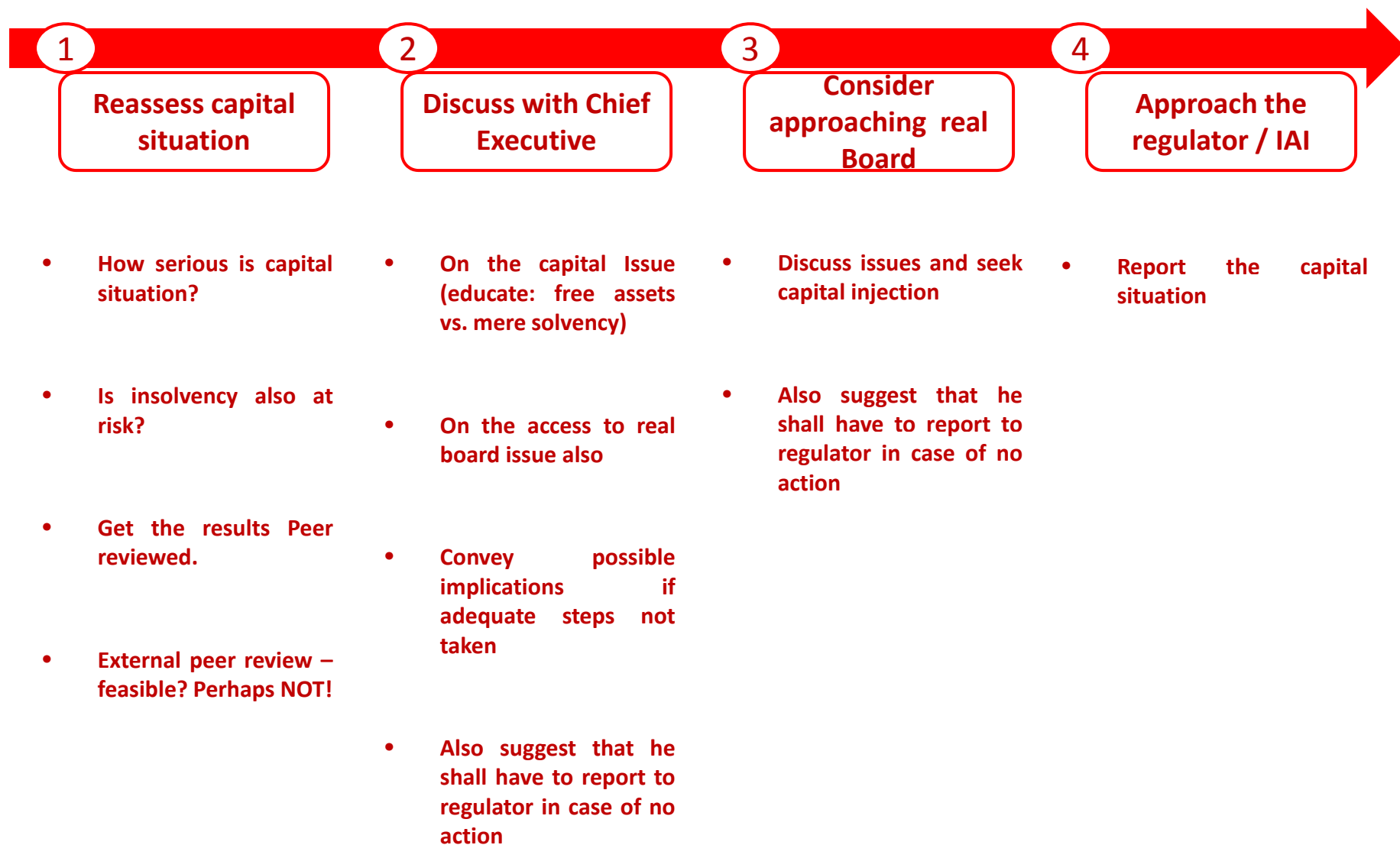
As a procedure, AA / AFH should give a notice to the local board before informing the regulator.

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# Conclusion



***Any Questions?***

***Thank you!***