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An Actuary's Role – Case Study on Professionalism

Institute of Actuaries of India

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Agenda

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- Objective
- Professional & regulatory considerations
- Options available to the actuary
- Options available to the Appointed Actuary
- Professional requirements for the actuary working in the Finance dept.
- Conclusion
- References

Case Study Synopsis - Professionalism

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Life Insurance Actuary responsible for solvency assessment, blindly trusted by the AA.

Solvency forecasts in middle of every quarter. February results show estimated solvency ratio between ***155% to 170%***.

Appointed Actuary comfortable that the company would meet the regulatory requirement at year end.

Concern raised over financial health of two companies where your company has significant debt investments based on market rumors and reports.

Actuary raised concern in investment review meeting where CIO and CFO were confident about the quality of investments.

Case Study Synopsis - Professionalism

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Further research indicates that these two companies are at **high risk of defaulting** on their borrowings

Actuary discovered that CIO,CFO & CEO unsure about the investments but want to avoid "rocking the boat"

Scenario test determined that solvency ratio comes out to be ***143%*** post impairing the value of these investments

Company does not have resources to infuse capital before Board Meeting which is at the end of April

A manager in the Finance department, who is also a qualified actuary is aware of the situation

Case Study Synopsis – Professionalism *(Issues to be addressed)*

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- How should Actuary deal with this situation? Which professional and regulatory requirements are to be considered?
- The AA leaves the Actuary to handle this situation as he is tied up with year-end valuation & with the peer reviewer for closing open points. What should the Actuary do?
- Actuary, decides to go ahead as per the advice of CIO and CFO and considered full value of investments as provided by them. On day before Board meeting, both investments are downgraded. What are the options in front of AA?
- What professional requirements are applicable to the actuary in the Finance dept.?

Objective

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- Discuss various professional and regulatory considerations
- Discuss the options/alternatives available to the Actuary
- Discuss the options/alternatives available to the AA
- Professional requirements governing the Actuary in the Finance department

PROFESSIONAL & REGULATORY CONSIDERATIONS

1

Actuary needs to bring to attention the possible drop in solvency level below the minimum prescribed level to the AA due to the concerns about impairment in the valuation of investments in two companies based on reports and market rumors about the financial health of the companies.

Professional & Regulatory considerations

- Anything that has the potential to materially impact solvency has to be highlighted to the company. (APS 1 – AA & Life Insurance Business, Section 4.1)
- Actuary needs to discuss the matter and its possible consequences with the AA and the management, since these parties are in power to protect and enhance public interest. (PCS 2.1)
- Actuary needs to ensure that minimum solvency level as prescribed by the relevant regulations (or the "control level of solvency") is met continuously. The control level of solvency is hereby specified as a solvency ratio of 150%. (The Insurance Laws (Amendment) Act, 2015, Section 64VA and ALSM 2016, Schedule III, Section 3)

2

- Actuary needs to ensure sufficient investigations are performed before finalizing the solvency projection results. Ensure the data used for projections has been validated.
- Ensure that calculations have been performed by a competent, knowledgeable and experienced individual.

Professional & Regulatory considerations

The actuary must consider the extent to which it is appropriate to carry out investigations to assess the accuracy and reasonableness of any data being used. (PCS 3.4)

Actuaries must not give advice, unless:

a) satisfied of personal competence in the relevant matters, or

b) acting in co-operation with, or with the guidance of, someone (not necessarily an actuary) with the requisite knowledge and experience. (PCS 3.1)

Valuation of assets should be in line with Schedule I of the IRDAI (Assets, Liabilities, & Solvency Margin of Life Insurance Business) Regulations, 2016

3

- Actuary should clearly communicate the solvency results and discuss the impact on solvency level of taking different levels of impairment.
- Actuary should offer advice to the AA and the management in a way that they understand the impact of it on the company, and the Actuary should take full ownership for this advice.

Professional & Regulatory considerations

Advice should normally include sufficient information and discussion about each relevant factor and about the results of the actuary's investigations to enable the intended recipient of the advice to judge both the appropriateness of the recommendations and the implications of accepting them. Further, the actuary should, in communicating his professional findings, show clearly that he takes responsibility for them. (PCS 3.5)

4

Actuary needs to discuss with the AA on the likelihood and implications of the solvency level dropping below the minimum prescribed level (i.e. 150%). They also need to prepare for the appropriate action to be taken in case such a scenario arises.

Professional & Regulatory considerations

On becoming aware of any event which appears to be a material breach by another member of any professional guidance or other guidance, a member must take appropriate action at the earliest opportunity. (PCS 4.3.1)

OPTIONS AVAILABLE TO ACTUARY

1

- **Provide detailed information to Appointed Actuary about the situation at hand**

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Inform the AA about the market rumors and the discussions conducted with the experts

Discuss with the AA the interpretation that CIO & CFO also have doubts about the quality of these investments but don't want to accept

Present the results of the base solvency projections and also the solvency scenario post impairment.

2

- **Perform detailed solvency projections in light of possible default on debt investments**

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- The actuary has so far only performed a “quick scenario”. Should perform a detailed solvency projection at different time points, considering different levels of impairments.
- The IRDAI Investment Regulations 2016 (Master Circular), (Section 4.1 point 3) suggest that the level of impairment should be guided by RBI notification of 2009 and as updated from time-to-time.
- It also recommends that Board approved investment policy should have necessary guidelines covering the applicable impairment and treatment of “downgrading of rating”.
- Stochastic calculations can be performed, where a large number of scenarios are considered depicting different levels of impairments, with different levels of probability attached to each scenario. Solvency at the desired level of confidence can then be assessed to check whether a breach is likely.

3

- **Propose suitable management actions to the AA**

Review business plan & change future business mix; reassess solvency levels

Review of reinsurance arrangements

Use of alternative capital options such as subordinate debt, financial reinsurance, etc.

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OPTIONS AVAILABLE TO ACTUARY –
Post the AA tells him to deal with the matter on his own

4

- **Determine the appropriate level of solvency ratio to report**

Check with the statutory auditor about the adequate level of impairment to consider.

Check with other companies who have invested in the same debt instruments about the approach they are adopting.

Reassess the likelihood and level of default by performing further market research (analysis of the companies' recent performance, etc.) and having detailed discussions with subject experts.

The most likely to occur level of default can then be considered in determining the level of solvency to be reported.

OPTIONS AVAILABLE TO APPOINTED ACTUARY

1

- **Determination of appropriate level of impairment to incorporate in solvency reporting**

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Verify the news of downgrading from different sources.

Just because investments have been downgraded, does not mean that there will be default on the borrowings.

AA should ask the actuary (or team) to check the history of default on the recent coupons payments.

Depending upon the above factors, a suitable impairment can be assumed on these investments. This impairment needs to be in agreement with the statutory auditors.

2

- **Communication to Board of Directors**

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- The news of downgrading of the two investments.
- The impact on level of solvency after incorporating the appropriate level of default (if any is considered).
- The consequences of breaching the control level of solvency (if this arises) and the regulatory intervention.
- The roles and responsibility of AA with regard to Solvency.

Professional & Regulatory considerations

- The Appointed Actuary shall be entitled to speak and discuss on any matter that may affect the solvency of the insurer. (Appointed Actuary Regulations, 2017, Section 8, sub-section C)
- AA to be responsible for financial soundness & advice insurer on issues that can materially impact solvency (APS 1, Section 2.1 and Section 4.1)
- AA shall suitably advise the Directors to ensure that the company is at all times able to meet the solvency requirements (APS 2, Section 6.1)

3

- **Action Plan if solvency drops below minimum prescribed level**

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- List of management actions should be proposed to Board to ensure solvency is brought back to at least "Control level Solvency".
- Re-project solvency margin for next 12 months, in light of management actions and latest available data.
- Review statutory reserving basis, expected future new business mix and NB Strain.
- Detailed Financial plan of action to be provided to the Authority after due deliberation with the Board of Directors.

Professional & regulatory considerations

- If insurer does not maintain the required control level of solvency margin, he shall, submit a financial plan to the Authority, indicating a plan of action to correct the deficiency within six months. (The Insurance Laws (Amendment) Act, 2015)
- On becoming aware of any event which appears to be a material breach by another member of any professional guidance or other guidance, a member must take appropriate action at the earliest opportunity. (PCS 4.3.1)

4

- **Action Plan if Board disagrees**

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- The AA can discuss the issue at hand with a Fellow Actuary in the company.
- Can further speak to Compliance Officer of the company to take his/her views of the likely actions from the Authority.
- He can speak to Professional Body (Institute of Actuaries of India) or the regulator, for appropriate guidance
- Basis the guidance received from the professional body, intimate the regulator, after due deliberation with the Directors.

Professional & regulatory considerations

- In case a breach is material, it must be discussed with another member. (PCS, Section 4.3.4)
- If a discussion is not appropriate, then it can be referred to the professional body. (PCS, Section 4.3.5)
- If the company does not remedy the situation, the AA is required to advise the IRDA – but not before informing the company first. (APS 1, Section 4.1)

PROFESSIONAL REQUIREMENTS OF FINANCE ACTUARY

1

- The actuary has an obligation to serve the public interests. Hence, needs to ensure that accurate information (possible breach of solvency) is communicated clearly.

Professional Requirements

Professional Conduct Standards, Section 2.1

"The actuarial profession has an obligation to serve the public interest. Collectively it seeks to do so by informed contribution to debate on matters of public interest and by influencing those with power to protect and enhance the public interest. Individually members must maintain and observe the highest standards of conduct. The standing of the profession depends on the judgment of individual members."

2

- The actuary has a duty to the profession and so his responsibility to the client (here the Board of Directors) must be consistent with his duty. So it's the duty of the Actuary to make the Board aware of the solvency situation.

Professional Requirements

Professional Conduct Standards, Section 2.2

"A member has a duty to the profession and must not act in a manner, which denigrates its reputation or impugns its integrity. Responsibility to any client must be consistent with that duty. The requirements of this paragraph do not, however, preclude criticism of the profession which forms part of a justifiable debate conducted in the public interest."

3

- The work here is not constrained by cost and time but its somehow precluded by judgement, he should (qualify the advice) communicate this clearly.

Professional Requirements

Professional Conduct Standards, Section 2.3

“Users of actuarial services, including actuary’s firm and colleagues in that firm, are entitled to have absolute confidence in the skill, objectivity and integrity of any member. If work which an actuary considers necessary is precluded by cost or time constraints the actuary should normally either decline to act or qualify the advice given.”

4

- The finance manager is a colleague of the Actuarial manager hence the quality of advice given to each other should be of same standard as given to an external client.

Professional Requirements

Professional Conduct Standards, Section 2.4

"Advice given to the actuary's firm or to a colleague within the same firm, whether or not the colleague is an actuary, should normally meet the same standards as for external advice. These information may be confidential in nature so utmost care needs to be taken."

CONCLUSIONS

Maintaining a healthy solvency position is one of the key responsibilities of the Appointed Actuary and other actuaries.

- In this case study the solvency position was assessed over the next 12 months so that corrective actions can be taken in advance for possible adverse scenario.

One must always remember to follow the professional and regulatory guidance in place.

- In this case study both the actuary (in the actuarial and finance department) and the AA are bound by numerous guidelines which have to be implemented in their work.

Advice can be received from other members and the professional body.

- In this case study the actuary could receive advice from actuaries from other companies, Finance actuary, the IAI and even the regulator.

Clear communication is crucial to ensure all stakeholders are aware about material issues and their implications.

- In this case study clear and effective communication is imperative between the actuary, AA and the management.

REFERENCES

Regulatory Requirements

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The Insurance Laws (Amendment) Act, 2015, Section 64VA (1)

- "Every insurer and re-insurer shall at all times maintain an excess of value of assets over the amount of liabilities of, not less than fifty per cent. of the amount of minimum capital as stated under section 6 and arrived at in the manner specified by the regulations."

The Insurance Laws (Amendment) Act, 2015, Section 64VA (4)

- "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."

Assets, Liabilities, and Solvency Margin of Life Insurance Business Regulations, 2016, Schedule III, Section 3

- "Control level of Solvency" shall mean the level of solvency margin specified by the Authority in accordance with sub-section (3) of Section 64VA of the Act on the breach of which the Authority shall act in accordance with sub-section (4) of section 64VA of the Act without prejudice to taking any other remedial measures as deemed fit. The control level of solvency is hereby specified as a solvency ratio of 150 %."

Regulatory Requirements

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Appointed Actuary Regulations, 2017, Section 8, Sub-section C

- "The Appointed Actuary shall be entitled to speak and discuss on any matter that may affect the solvency of the insurer."

Appointed Actuary Regulations, 2017, Section 9, Duties and Obligations

- "Ensuring the solvency of the insurer at all times"
- "Complying with the provisions of the section 64 VA of the Act in regard to maintenance of required control level of solvency margin in the manner required under the said section"

Regulatory Requirements

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Re-insurance Regulations, 2018, Section 8

- "Alternate Risk Transfer (ART): - An Indian Insurer, intending to adopt ART solutions, shall submit such proposals to the Authority. – The Authority, after necessary examination and on being satisfied with the type of ART solution may allow the ART proposal on a case to case basis."

Professional Requirements

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Actuarial Practice Standard (APS) 1, Section 2.1

- "The Appointed Actuary shall be entitled to speak and discuss on any matter that may affect the solvency of the insurer."

Actuarial Practice Standard (APS) 1, Section 4.1

- "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."

Professional Requirements

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Actuarial Practice Standard (APS) 1, Section 5.1

- "Though Sec 13(1) of Insurance Act 1938 requires an investigation to be made by an actuary into the financial condition of the Life Insurance business every year, the Appointed Actuary must as any provision or provisions contained in the code of conduct of the IAI which might seem to Page 4 of 8 Actuarial Practice standard (APS) 1 a matter of duty have processes and methodology in place so as to carry out investigations to satisfy himself/herself that the company is solvent at all times."

Actuarial Practice Standard (APS) 1, Section 10

- "The Appointed Actuary shall also ensure that the ratio of the available solvency margin to the required solvency margin is reasonable taking into consideration the risk profile of the assets and liabilities."

Actuarial Practice Standard (APS) 2, Section 6

- "The Appointed Actuary shall, in terms of sub-regulation 8 (a) to 8 (e) of the AA Regulations, suitably advise the Directors to ensure that the company is at all times able to meet the solvency requirements as prescribed in section 64VA of the Act."

Professional requirements – Professional Conduct Standards

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"On becoming aware of any event which appears to be a material breach by another member of any professional guidance or other guidance, a member must take appropriate action at the earliest opportunity."

"An actuary is expected to use best judgment in formulating advice, whilst paying proper regard to any relevant professional guidance or other guidance."

"An actuary must consider the extent to which it is appropriate to carry out investigations to assess the accuracy and reasonableness of any data being used."

"Advice should normally include sufficient information and discussion about each relevant factor and about the results of the actuary's investigations to enable the intended recipient of the advice to judge both the appropriateness of the recommendations and the implications of accepting them. Further, the actuary should, in communicating his professional findings, show clearly that he takes responsibility for them."

Questions

Thank You

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