Case Study L7 — Capital injections

20th India Fellowship Seminar

Guide: Vishwanath Mahendra

Presentation by: DnkInk Chakravarthi, Shobhna Sharma, Raunak Jha, Anuj Behl

4 December 2013

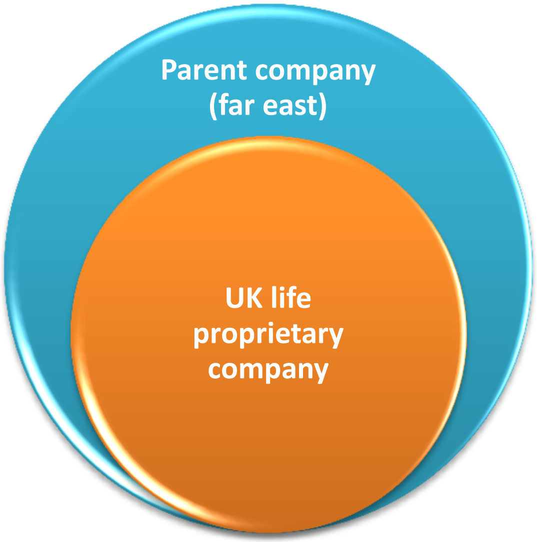
Agenda

- Introduction to the case study
- Responsibility of AA/AFH
- Importance of capital
- Current situation – actions and next steps
- Conclusion

Introduction to the case study

Case study

- The structure of the company where you are AA/AFH



- Real power not with the Board, but with Chief Executive and his Board colleagues in the Far East.

- The local Board is a dressing tool to satisfy UK authorities.

Issue

Capital Required…

In order to retain the company's **competitive free asset position**

Local Board…

Notes and agrees to AA's concern, but say that **it is nothing to do with them**, merely one for the parent.

Chief Executive…

- advises that **he will decide what capital AA will get**, and the report is to go no further.
- Reassures saying with all the money invested in the UK, they **will not let it go insolvent** and
- will decide **as and when appropriate**, as to what money to input to the company.

What should the AA/AFH do?

Responsibility of AA/AFH

Responsibility of AA

Specific Regulation: IRDA (Appointed Actuary) Regulations, 2000

***Regulation 7** :* lists the powers of AA as being entitled,

- **to attend all meetings of the management including the directors of the insurer**;
- to speak and discuss on any matter, at such meeting,--

that may affect the solvency of the insurer;

that may affect the ability of the insurer to meet the reasonable expectations of policyholders

***Regulation 8 :** on AA's duties and obligations* states: 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 amongst other things:

ensuring the solvency of the insurer at all times;

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;"

Responsibility of AA

Related Actuarial Practice Standards (APS):

APS 1 : On AA and Life insurance business

Section 3: **AA must have right of access to the Board of Directors** in general and the **Principal Officer** in particular and **should have access to all relevant information** so that the full range of duties and obligations can be carried out satisfactorily. **Where there is a group structure**, the AA 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**.

Section 4: An AA has responsibility to the profession and its client, however he is also in a special position as he/she has **statutory responsibilities to the IRDA**. If these two aspects materially conflict, the AA 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 AA is required to advise the IRDA – but not before informing the company first.

Responsibility of AA

Section 6: If any contract is likely to give rise to **significant new business strain** then the AA must be satisfied that the company can set up the necessary reserves.

- If need be, he/she should indicate limits on the volume of sales that may prudently be accepted and/or how much capital is required and
- **gain reassurance from the Board of Directors that the required level of capital will be available and not earmarked for other purposes**.

Section 7: The AA should be satisfied that, if new business strain is likely to be a problem, the company will be able **to meet the necessary reserves and solvency margin requirements from capital within the shareholders funds.**

Responsibility of AA

APS 2: On Additional Guidance for Appointed Actuaries and other Actuaries involved in Life Insurance

Section 1: It is the AA's professional **duty to make timely disclosures, both to the company and to the Authority about the financial viability** of the life office. If for some exceptional reason the AA is unable to comply fully with this APS then the report given by him should be suitably qualified.

Corporate governance guidelines for insurance companies :

- The **AA and the statutory/internal auditors have the duty to 'whistle blow'**, i.e., to report in a timely manner to the IRDA if they are aware that the insurer has **failed to take appropriate steps to rectify a matter which has a material adverse effect on its financial condition.**

- It also lists responsibilities of the Board of Directors to ensure that the **AA has direct access to the Board** and reports on important matters to the Board in a timely manner.

Responsibility of 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.**

APS L2: The financial services and markets act 2000 (communications by actuaries) regulations 2003 has replaced GN37***.***

- The Regulations require a Relevant Actuary to communicate information on, or his/her opinion on, certain Specified Circumstances to the PRA including significant risk that the Firm **does not or may not in the future have sufficient assets to meet its capital resources requirement**.
- A guidance on whistleblowing has been issued by the Institute and Faculty of Actuaries' in publication **"Whistleblowing: A guide for actuaries"**

Responsibility of AFH

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.**

Importance of capital

Capital and solvency

Capital only to avoid insolvency?

NO

- NB strain, other expenses,
- Investment freedom
- Indicates financial strength and thus influence credit rating
- To smooth with-profits payouts
- Level of free assets (and thus capital) may impact share price, ability to raise further capital
- To withstand against any adverse experience
- Customer confidence

How free assets can be increased

- Reduce reversionary bonus/terminal bonus
- match more closely
- restrict the new business
- design and offer new less capital intensive contracts
- reinsure
- trimming of margins in the supervisory valuation basis
- use financial reinsurance (eg surplus relief)

Capital and solvency

The capital therefore is required for variety of reasons and not just to ensure solvency. Further, any negative impact of not injecting capital on-time may affect the reputation of the local and parent company.

Both the capital and the level of free assets are important for smooth running of the business and protecting the interests of all the stakeholders and not just the solvency

Current situation – actions and next steps

Next steps

Reassess Capital situation

- Capital required to retain competitive position – what does competitive mean?
- Criticality of solvency position –is technical insolvency a concern?
- Project various Scenarios illustrating the position if capital is not received
- Any alternatives to increase capital – retained profits, sale of assets, reduce opex
- How Competitors are placed (whether any of the other companies are having this issue and if yes, how this is resolved)
- Need to review the company's future plans
- review on the above by an independent actuary may be sought

Next steps

Discuss with Chief Executive & Local Board

- in a language that is non-technical so that can be easily understood by non-actuaries in the Board
- implication of ‘AA not having access to the real board’ is a professional issue for the AA.
- Highlight that it is the professional duty of the AA to make timely disclosures both to the Board and to the Authority about the financial viability of the insurer
- how insufficient capital is a commercial problem
- Implications of low free assets (on NB , Investment strategy etc.)
- affect on policyholders and other stakeholders
- Affect on the local reputation of the parent company and its implications
- Issues of demonstrating financial strength and subsequent effect on credit rating
- The statutory powers vested and need to maintain professional standards

Next steps

Approach the Real Board

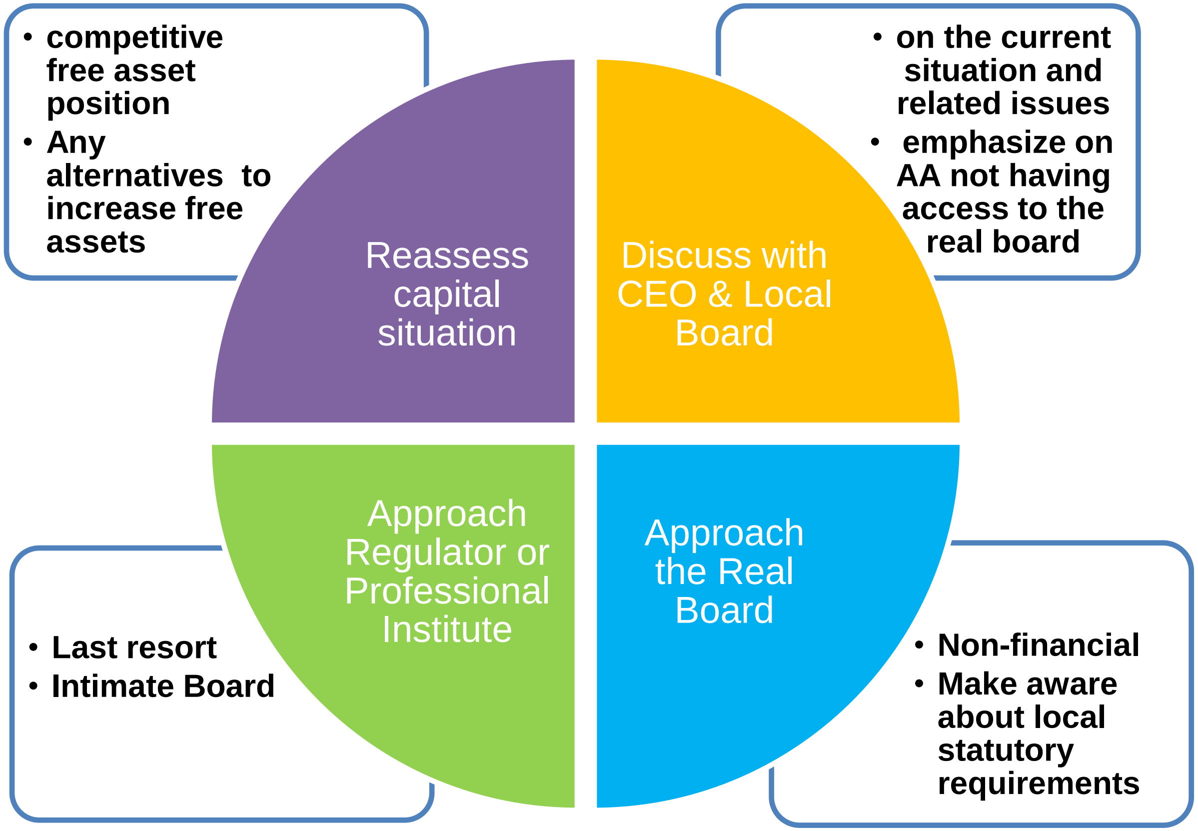
- Non-financial so difficult to explain
- May not be aware of the prevailing practices and statutory requirements, importance of capital so spend time to educate them
- Issues discussed to be similar to local Board
- if the capital is not made available, company's proposed future plans may need to be reviewed which may lead to tweaking/even dropping such plans and the same may not be in the best interest of the Company (both Local/Parent)

Approach Regulator or Professional Institute

- This will be a last resort if situation is serious and management is not ready to take any action and neither willing to discuss with regulator then would need to approach it directly
- as a procedure, AA / AFH should give a notice to the local board before informing the regulator

Conclusion

Conclusion



• competitive free asset position
• Any alternatives to increase free assets
Reassess capital situation
Discuss with CEO & Local Board
• on the current situation and related issues
• emphasize on AA not having access to the real board
Approach Regulator or Professional Institute
• Last resort
• Intimate Board
Approach the Real Board
• Non-financial
• Make aware about local statutory requirements

Thank You