

e-Newsletter – May 2006

This e-Newsletter provides a summary of the discussions at the Spring meetings of the Groupe's committees. These meetings have been spread over a longer period than usual – early March to mid May – and consequently publication has been a little delayed. Full details of these meetings are available on the appropriate section of the members-only page.

Freedoms and General Purposes

The Freedoms and General Purposes Committee and the Insurance Committee met on consecutive days (6/7 April) in Prague, where the Czech association hosted the meetings in the splendid new Deloitte offices.

The business of the Freedoms Committee was dominated by discussion of a draft paper on the role of the actuary. This paper, prepared by Committee Chairman Ad Kok and a small working party, followed on from the presentation made by Ad at last year's Annual Meeting in Cyprus (and subsequently also to the IAA in Rio de Janeiro, and to Internal Market DG at the European Commission). It sets out proposals for –

- The Report of the Solvency Actuary
- Governance of the Actuarial Profession
- Role of the Actuary and Auditor in Solvency II

in order to try to establish a stronger role for the actuary, particularly in relation to Solvency II. Member associations have been invited to comment on these proposals and, in the light of the comments received, a final paper will be submitted for discussion with Internal Market DG and CEIOPS. (It is worth recalling that CEIOPS' consultation paper CP7, Annex A, published last summer, focussed the need for the Groupe to address the question of the Role of the Actuary and Actuarial Function). Extensive discussion of this topic produced a number of interesting comments (reported in full in the minutes, available on the members-only page), in particular the need to ascertain the perception of the actuarial function by other financial professionals and national regulators, and the need for national actuarial associations to be able to deliver the governance required for a stronger actuarial role. It is interesting to note in passing that the role of a "Responsible Actuary for Insurance Companies" has now been designated by law in Switzerland.

During the course of the Solvency II project, there have been occasions when it has proved impossible to present a single consensus view on behalf of the Groupe. In order to address this question of diversity of views, the Solvency II project team drafted proposals to deal with such a situation. The Committee agreed that the proposals should be adopted as general practice within the Groupe, not simply in relation to the Solvency II project, when it is not possible to reach a consensus. The Committee confirmed that consensus gives a much stronger position, but it is not always possible to achieve.

The Groupe has received an invitation from the newly-established UK Board for Actuarial Standards (BAS) to become an Observer Member of BAS. Naturally, the Groupe has accepted this invitation, which reflects well on the Groupe's standing in the international actuarial profession. The Groupe was represented at the first BAS meeting on 20/21 April by James Kehoe (Ireland).

While the Education Committee will be considering the implications of the new EU Directive on Recognition of Professional Qualifications, the Freedoms Committee was concerned to note that the situation regarding professional qualifications is complicated by the introduction of the Services Directive which allows for free provision of services within the EU. This Directive proposes that a "visiting" professional must abide by the standards and code of conduct of the host country, but is not required to join the professional association in the host country.

The Honorary Treasurer, reporting on the Groupe's finances, drew attention to the likely future liability for taxation on activities other than "mutual trade" (this should apply to bank interest only). Despite this, the annual fee will remain at Euros 16.

Provisional arrangements have been made for a high-level meeting between Officers of the Groupe and the Managing Board of CEIOPS in early September. Although there is close and regular dialogue with CEIOPS within the Solvency II working groups, there is also a need for strategic discussion with the Supervisors.

Details of the 19th Colloquium and this year's Summer School are now available on the Groupe events page of the website. An invitation to hold the 20th Colloquium in Norway next year has been accepted, and preliminary details will be published on the website as soon as possible.

Insurance

The main focus of the Insurance Committee meeting on 7 April was, once again, the Solvency II project. The main strategic points to note are –

- the Commission's revised work-plan letter to CEIOPS, and the expectation that a Solvency II Directive will be ready for adoption in July 2007;
- CEIOPS expect to submit their response on the third wave of calls for advice to the Commission by the end of April 2006 (now available on the Solvency II page of the website).
- Increased consultation between CEIOPS and the Groupe on technical provisions, calculation of the risk margin and the formula for SCR/MCR.
- QIS1, on technical provisions, which was difficult and time-consuming for companies, and raised a number of political issues.
- QIS2, on SCR, which is just starting and which is likely to be equally demanding. This will require significant input from working groups 1 and 2.

At working group level, most of the activity over the past six months has been in the Pillar I area (working groups 1 and 2), and the following have been key issues –

- the level of technical provisions, and the political issue of whether and how this might be harmonised across Europe;
- the relative importance of the calculation of the best estimate in comparison to the risk margin;
- clear separation of SCR and the risk margin on technical provisions.
- avoidance of double counting of prudence;
- calculation of the risk margin. A comparison of risk margin methodologies by working groups 1 and 2, in response to a request from CEIOPS, was widely circulated (CEIOPS, Commission, IAIS, CEA, CRO Forum), very well received, and incorporated into CEIOPS and Commission working documents.

In addition, it is worth noting that the publication on Diversification by working group 5 has had a major influence on CEIOPS' thinking in this area.

A final draft of the joint Groupe / CEA Glossary has recently been circulated to member associations for comments by 26 May. It should be borne in mind that this Glossary

- is selective not exhaustive;
- uses preferred terms when several may be in use;
- uses and acknowledges existing published sources.

Subject to any further editing in the light of comments received, the final version of the Glossary should be available by the summer; it will be widely circulated and published on the Groupe's website.

Progress on Pillar III / Accounting issues has been constrained by IASB's development of a new accounting model for insurance contracts. It is IASB's intention to publish a Phase II discussion paper later in 2006, an exposure draft in 2007, and a final standard in 2008 for implementation in 2010. The general consensus appears to be in favour of the prospective cash flow method plus a margin. We believe that IASB will also take account of the views expressed by the Groupe and the IAA on calculation of the risk margin. A number of key areas still under debate within IASB include:

- calibration of the margins in the liability;
- how to account for discretionary participating plans;
- should life and non-life follow the same accounting model?
- beneficial policyholder behaviour and a deposit floor;
- consistency of asset/liability measurement;
- unbundling.

The Committee had a short presentation and discussion on recent work by Henk van Broekhoven on demographic and mortality statistics used in projections for a pandemic of avian flu, and the potential impact of such a pandemic on the insurance industry. Such a pandemic is likely to have a significant impact not only on mortality / life, but also on other risk types, including:

- morbidity;
- P & C (animal insurance);
- financial;
- operational;

Although Henk offered some suggestions regarding solvency margin and diversification for calamity, he emphasised the need for further studies to be undertaken.

The Committee also discussed the role of the actuary and consensus / diversity of views, and these discussions are reflected in the corresponding sections of the Freedoms report above.

Pensions

The Pensions Committee met in Dublin on 3 March, the first meeting under new Chairman, Philip Shier. The first half of the meeting was devoted to a presentation by Prof Richard Verrall on international his mortality research survey, and discussion of the results of the survey. (The executive summary and the full report of the survey can be found on the Publications page of the website). The background to the survey was to examine:

- the significance of the mortality assumption to companies' pension liabilities;
- the different approaches to the level of mortality and allowance for future trends.

The objectives of the study were:

- focus on assumptions used to measure liabilities for current pensioners;
- collect information on the mortality tables most commonly used for valuing occupational pension liabilities;
- compare the tables used both against population mortality in each country and between countries;
- identify the extent to which future improvements in mortality are being considered/allowed for;
- identify whether any conclusions could be drawn with a particular focus on the issues raised for a multinational corporation with significant pension liabilities in the countries considered;
- focus on the EU countries, but also include US and Canada.

Using the UK as an example, Professor Verrall illustrated comparisons between mortality and life expectancy in occupational pensioners and in the population as a whole, and the corresponding annuity costs. He went on to compare standardised mortality ratios in several other countries, which showed a very wide variation. Factors which affected these ratios include:

- the choice of initial mortality table (much more conservative in some countries than others);
- influence of disabled pensioners in pensioners' mortality tables;
- allowance for future improvements in mortality rates, and whether such improvements could continue.

There was clearly wide variation across Europe in the application of these factors. Professor Verrall questioned whether this degree of variation was justified in terms of the financial reporting requirements, and highlighted the problem of valuing liabilities in multi-national companies. He pointed out that the impact of choice of mortality table was in fact more significant than a change in the discount rate, and he illustrated this with a comparison of the deficit in an example pension scheme, using mortality assumptions typically used in each country. Professor Verrall concluded by looking at the implications for multinational companies, and in particular the need to provide meaningful disclosure to investors and other stakeholders, and notes to the accounts which would allow comparative evaluation by analysts on a consistent basis. The report recommended that:

- mortality assumptions be included in the disclosure of pension expense in company accounts as clearly as possible;

- projected mortality tables allowing for future improvements in mortality rules be used in all countries;
- a single figure be used to reflect the strength of the mortality assumptions used.

On this last recommendation, Professor Verrall indicated that this could be the standardised life expectancy; an equivalence in discount rate, or a derived 'Cass Index of Mortality' benchmark. Comments on this last suggestion included:

- would a single benchmark figure be easily understood?
- how would a single figure reflect a multinational's position?
- a life expectancy figure might be the most meaningful to a pensioner but would be of little value to an analyst;
- the importance of realising that a benchmark index would not reflect a "real" position.

Further analysis of the data will be undertaken by Professor Verrall's team at Cass Business School.

The Committee's guidelines on the Prudent Person Principle will be published shortly.

The Committee discussed a briefing paper which had been drafted in response to a request from Internal Market DG on the question of whether it would be appropriate to apply the same Solvency II requirements to pension funds as to insurance undertakings. The key issue is to review the purpose of a pension fund: if this is to provide guaranteed benefits and to deliver a promise (as with insurance products) then there would be a good case for applying the same solvency regime to pension funds. However, this is a political decision between affordability and guarantees, where the Committee agreed that it would be inappropriate for the Groupe to express a view. It was noted that this is an issue on which the industry and the supervisors hold opposite opinions. The following points were also noted:

- insurance regulation is largely harmonised across Europe but pension fund regulation is not;
- there is a need to improve risk management in IORPs, but with more flexibility to recognise the different structure of pension funds;
- the Dutch regulator has introduced a single solvency framework, with a common risk framework but different parameter values for insurance and pensions;
- in Germany, a working party is examining the standard solvency model proposed by the GDV to see if it might be applicable to pension funds.

Investment and Financial Risk

The Investment and Financial Risk Committee's meeting in Vienna on 28 April was the first under the chairmanship of Falco Valkenburg. The Committee is undertaking the final editing of its survey of Risk Management Practices. The survey is expected to be published on the website by the summer. There was a useful discussion of a preliminary draft with Internal Market DG, who offered some constructive suggestions for further development, including:

- comparisons between Solvency II and Basel II;
- more specific comparisons between practices in different EU member states, for example between insurance and pensions, or interest rate guarantees for business in force.

This survey has become rather complex and consequently it has taken longer to deliver results than originally intended. The Committee agreed that future surveys should be less ambitious, and focus on smaller, more discrete topics where results and a report could be achieved on a shorter timescale.

Following discussions between the Chairman and his Insurance and Pensions Committee counterparts, to try to clarify and develop the role of the IFR Committee, and to avoid the risk of duplicating activities across committees, the following key action points emerged for the IFR Committee:

- more proactive involvement with Commission initiatives: be aware of developments in areas other than only Internal Market DG;

- prepare profile of desirable experience for Committee members, and try to find members with experience in banking sector and / or knowledge of EU;
- regular contact between committee chairmen; possible (invited) attendance of representatives from other committees for key topics;
- consider closer coordination of meetings with other committees (probably Pensions) for Spring meeting.
- the need to be more visible, and be seen to be more active;
- the need to identify the Committee's strengths, and to work to them.

Other committees are undertaking work in areas where the IFR Committee ought to be involved and should, in principle, have more appropriate skills, for example, the risk aspects in relation to a bird flu pandemic. The Committee must be clear as to which areas it hoped to cover, and which not to cover. As a first step in achieving this, members of the Committee will be asked to complete a short questionnaire to identify their main areas of knowledge/expertise. With this information, it should be possible for the Committee to be more proactive, more quickly by targeting the appropriate members for comments/advice instead of requesting a general response from the whole Committee. A profile for membership of the Committee will be defined, taking account of the existing areas of expertise, and desirable areas for the future. Apart from technical expertise, other features of the profile could include, for example:

- theoretical understanding of financial markets;
- practising as an actuary in a non-traditional field (e.g. banking), or as a risk assessor for a large financial infrastructural project;
- enthusiasm for the European and wider international environment and for exchanging views with other cultural backgrounds.

At the same time, some minor amendments to the Committee's Terms of Reference will help to distinguish its role more clearly. Closer links with the IAA's Financial Risks Committee and the Committee of European Securities Regulators (CESR) are also planned.

Education

This newsletter has been written before the Education Committee's meeting in London on 12 May and will be updated after the meeting. The agenda and papers for the meeting are available on the members-only page. The main items are:

- the IAA's proposals for a Global Actuarial Qualification (GAQ);
- EU Directives on Recognition of Professional Qualifications, and on Services;
- proposal for an online research database;
- joint Groupe / IAA education seminar.

Looking forward

The Groupe will be represented at the European Pensions Forum in Brussels on 17 May by Philip Shier, Chairman of the Pensions Committee, and at the IAA Presidents Forum in Paris on 28 May by Groupe Chairman, Costa Koutsopoulos.

There will be a bilateral meeting with the European Commission's Internal Market DG Insurance Unit in Brussels on 15 June, at which a number of issues reported above will be discussed, in particular the role of the actuary, and the Solvency II project.

There are provisional arrangements for a meeting with the Managing Board of CEIOPS in Frankfurt on 7 September: Solvency II and the role of the actuary will again feature prominently on the agenda.

The Summer School will be held in Parma from 29 August – 1 September, and the 19th Colloquium in Edinburgh on 22 September. Details of both events can be found on the Groupe Events page.

The next round of Committee meetings will be held in Barcelona in conjunction with the Annual Meeting on 26/27 October.