

CP202: A new regulatory return for insurers

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Introduction

The FSA is in the process of developing a new cross-sectoral regulatory reporting environment. CP198 on regulatory reporting was issued in September 2003. However, as for other areas of regulatory development, it is felt that interim changes are needed to improve insurance supervision. The FSA therefore proposes to amend the publicly available annual return for insurers for financial years ending on or after 31 December 2004. CP202 is the first in a series of CPs, specifically for insurers, aimed at evolving the present regulatory reporting requirements. The changes proposed in CP202 primarily relate to the level of detailed analyses provided in the annual returns. The FSA is not currently proposing significant changes in the valuation bases of insurers' assets and liabilities pending international accounting developments in this area. In addition, CP202 proposes significant changes in respect of the directors' reporting on, and the audit of, the annual return.

This bulletin provides a summary of the key changes set out in CP202. It also highlights the changes to the reporting of solvency calculations resulting from the implementation of the Solvency I directives, the implications of the proposed requirement for general insurers to report an Enhanced Capital Requirement as proposed in CP190 and the additional reporting requirements consulted upon in CP195 in respect of the new capital regime for life insurers.

Changes to the annual return for long-term insurance business

The most significant change for long-term business relates to the change in actuarial and audit responsibilities. However, there are also detailed changes proposed for the forms aimed at improving the clarity of long-term business information and to enable more timely and improved analyses for the FSA and other users. Certain of the changes may require significant system changes to produce the required information.

Changes to responsibilities for policyholder liabilities

As set out in PS167, the FSA is eliminating the role of the appointed actuary and placing responsibility for the determination of policyholder liabilities with the directors. This includes responsibility for the determination of the so-called “realistic liabilities” determined in accordance with the proposals in CP195.

Firms will need to review their actuarial governance arrangements to ensure that the directors have appropriate procedures in place to enable them to “sign off” on all aspects of the return.

One of the consequent changes is that the FSA intends to replace the Actuary’s Abstract report with a mainly narrative document, a Valuation Report, prepared by the directors. There will be de minimis limits applied to certain reporting requirements which will result in a reduction in the amount of information required compared to the current abstract but the level of information will still be voluminous and firms will need to consider their governance arrangements for its production and review.

There are consequent changes to the proposed audit scope and a proposed new role for an independent actuary, who will act as an advisor to the auditor. These are addressed in more detail below.

Long-term business forms

The main changes to the Return for long-term insurers that the FSA is proposing to introduce include:

- Introducing standard classification of product categories, based on the Association of British Insurers (ABI) new business reporting categories
- Requiring reporting of the number of policyholders instead of the number of contracts
- Changing the definition and reporting of overseas business
- Requiring separate reporting of external and intra-group reinsurance
- The introduction of a new form reporting with-profits pay outs for the main with-profits products
- Eliminating separate reporting of “permanent health” and “other contracts”
- Introducing de minimis limits for certain reporting requirements
- Removing the disclosure of persistency information from the annual return
- Reduction of information in Form 57.

Solvency calculation

The Solvency I Directives make certain amendments to the solvency margin requirements for life insurers. In summary, the following changes will affect the solvency margin:

- An increased minimum guarantee fund (MGF), inflation-indexed
- A new margin requirement for certain types of linked life business
- An increased margin for permanent health insurance business
- Amendments to the margin for supplementary insurance
- Phasing out of future profits implicit items

The changes relating to Solvency I fall within the same timescale as CP202 for the purposes of reporting in the annual return, i.e. for financial years ending on or after 31 December 2004. However, firms are required to comply with the requirements in respect of their ongoing solvency monitoring from the beginning of that financial year. As a result, the FSA is requiring that firms submit privately revised forms showing the Solvency I solvency position within 4 months of the previous year-end (ie by 30 April 2004 in respect of 31 December 2003 year ends). Accordingly firms need to assess as a matter of urgency the impact on their regulatory solvency requirements of the Solvency I implementation and to take appropriate actions to address any shortfalls. Solvency monitoring systems may also need to be reviewed.

Enhanced Capital Requirement ("ECR")

CP195 introduced a new capital regime for life insurers. In addition to new disclosure requirements, two new forms are proposed to be included in the publicly available annual return for periods ending on or after 31 December 2004:

- Form 19 (realistic balance sheet); and
- Form 18 (the twin-peaks calculation).

In addition to inclusion in the annual return CP195 proposes these forms are also prepared and submitted privately on a six-monthly basis. Our previous bulletin on CP195 gives more details.

Changes to the return for general insurance

Although not formally consulted upon, the FSA included their initial proposals for general insurance annual returns as an annex to CP202. These will be consulted upon in detail in a separate CP, but the FSA is seeking initial comments now. The aim of the proposed changes is to provide a more meaningful return that is more comparable across the industry whilst reducing, or removing, the reporting of immaterial information. However, changing to the newly proposed prescribed reporting categories is likely to require a significant investment in systems for insurers.

General insurance business forms

The main changes outlined in CP202 for the annual returns for general insurers are as follows:

- New standardised reporting categories.
- De-minimis reporting criteria to lighten the reporting burden of smaller firms

- A new Form for key summary information of each reporting category

The FSA intends to allow transitional arrangements.

Solvency calculation

The Solvency I Directives make certain amendments to the solvency margin requirements for general insurers. In summary, the following changes will affect the solvency margin:

- An increased minimum guarantee fund (MGF), inflation-indexed
- A 50% increased margin requirement for certain liability classes (classes 11,12,13)
- A new margin calculation for companies with declining technical provisions
- Increased thresholds in the calculation, indexed.
- Disallowing the discounting of claims provisions

The reporting requirements in respect of the Solvency I position for general insurers are the same as the requirements for long-term insurers set out above.

Enhanced Capital Requirement (“ECR”)

The proposals outlining the ECR for general insurers were set out in CP190 issued in August 2003. As no final decision has been made as to when the ECR will become a prudential requirement, firms will be required to calculate their ECR and report their capital position compared with their ECR privately to the FSA. This reporting will take place at the same time as public returns are submitted to the FSA for periods ending on or after 31 December 2004. After the ECR becomes a prudential requirement it is likely that it will be reported as part of the insurance annual return. The FSA has not yet detailed the format such reporting will take. The FSA has indicated that it will announce in 2004 a date at which the ECR will become a prudential requirement and that it will give at least twelve months’ notice of this. Our previous bulletin on CP190 gives further details.

Statements and reports on the returns

The FSA intends to broaden the scope of the directors’ statements on the Returns and statements of compliance with broader aspects of the FSA rulebook. Directors will have to “certify” that they have complied with the requirements of SYSC and PRIN in addition to the current certification requirement in respect of IPRU (INS). We note that “certify” implies a high (even perfect!) level of assurance of compliance. If the proposals are implemented as currently worded, the regime may require very detailed control processes to be put in place and we may see more fulsome “certificates” where matters cannot be reported on at that level of assurance.

In addition, in respect of long-term insurance, the directors will have to certify that:

- policyholder liabilities have been assessed in line with requirements;
- premiums were sufficient to meet obligations in respect of the contracts;
- with-profits funds have been managed in line with the Principles and Practices of Financial Management; and

- the directors have taken advice in preparing the return from the holder of the actuarial function

With the broadening of the scope of the directors' certificate the FSA intends to exclude it from the scope of the audit opinion. However, for long-term insurers, it is proposed that the auditors will be required to state whether, according to the information and explanations received, the information in the valuation report is consistent with the audited parts of the return. It is our view that this is a potentially onerous requirement which will require considerable detailed work on the part of auditors.

For a long-term insurer, the audit scope has also been amended to extend to forms containing policyholder liabilities. It is proposed that the auditor will be required to take appropriate advice from a suitable qualified actuary who is independent of the insurer. It is proposed that this "reviewing actuary" will be required to provide a personal public opinion to be published alongside the audit report and will include opinions relating methods and assumptions used and the regulatory requirements followed to calculate the mathematical reserves

For long-term insurers reporting on a "realistic" basis, the FSA has already proposed in CP195 that all certificates and opinions will extend to the new Forms 18 and 19 containing the "realistic" reporting calculations.

In our response to the CP we will be commenting that there are several aspects of this regime which will need to be managed so as to avoid inappropriate extensions of liability to the auditor and the reviewing actuary.

Business Impact

Management of insurers need to be aware of the proposals in CP202 and consider how they plan to implement them and meet the reporting requirements in the tight timescales proposed. In particular management will need to consider the system requirements to collate the data needed to complete the new forms.

Management will need to put procedures in place to enable them to make the certifications required in the directors' certificate in respect of compliance with SYSC, PRIN and IPRU (INS). In addition the directors of long-term insurers now have more explicit responsibility for actuarial information in the Annual Return, particularly with the introduction of the Valuation Report requirement and responsibility for the valuation of policyholders' liabilities including on a "realistic" basis.

For long-term insurers in particular, there will be additional costs associated with the extension of audit scope to policyholder liabilities and in respect of the public opinion required to be given by the reviewing actuary

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If you would like to discuss any of these issues arising from the proposals, please speak with your usual contact at PricewaterhouseCoopers, or one of the people listed below:-

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