Insurance Core Principle for Investment (ICP 15)

Lessons/Input for the Pension Sector

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Skopje, 11 May 2012, Dave Finnis, IAIS
IAIS - Insurance Core Principles: Solvency

- ICP 14: Valuation
  - Economic valuation + disclosure
- ICP 15: Investments
  - Asset limitations for regulatory purposes
  - Prudent person approach
- ICP 16: ERM for Solvency Purposes
  - All relevant and material risks addressed
- ICP 17: Capital Adequacy
  - Absorbency of unforeseen losses
  - “Ladder of intervention” for capital controls
“Prudent person approach” – Pension parallels?

• Assets available to meet commitments as they arise
  – **INSURANCE**: Asset/liability management by type and term. Assets realisable when needed.

• Understand before investing
  – **INSURANCE**: Appropriate skills and expertise in investment function

• Spread the risk
  – **INSURANCE**: Diversification of portfolio

• Then, and only then, seek the best return available
  – **INSURANCE**: Employ the best fund manager
ICP 15: The supervisor establishes requirements for solvency purposes on the investment activities of insurers in order to address the risks faced by insurers

- Applies to insurance entities and risks posed by non-insurance entities within the group
- Requirements tailored to the insurer’s investment activities
- Openness and transparency regarding supervisory needs
- Requirements address security, liquidity and diversification (at a minimum)
- Ensure investment in a manner appropriate to the nature of the liabilities
- Asset risk should be assessable and manageable by the insurer
- Additional requirements where appropriate (e.g. complex instruments)
15.1: The supervisor establishes requirements that are applicable to the investment activities of the insurer

- Asset/liability management (or ALM)
- Not immunisation and not (usually) matching, but careful monitoring and examination by “type and term”
- Governance and risk management frameworks (and application) are key
- Regulatory requirements may take many forms (including specific rules)
- Group considerations are important (particularly in stressed situations!)
15.2: The supervisor is open and transparent as to the regulatory investment requirements that apply and is explicit about the objectives of those requirements

- Investment requirements should be consistent with other solvency “building blocks”
- Insurer should have clear instructions
- For groups, there is a particular need for clarity regarding liquidity, transferability and fungibility of capital
15.3: The regulatory investment requirements address, at a minimum, the security, liquidity and diversification of an insurer’s portfolio of investments as a whole

- Payments to policyholders should be made on time and in the right place
- Additional to enterprise risk requirements if necessary
- Group exposures need to be monitored in this context
- Security of assets is a subject on its own and guidance is intensive
- Additional guidance is provided for group asset security issues
- Liquidity: focus on access to assets at entity and group levels
- Diversification: within and between risk categories and use of maximum permittable holdings
15.4: The supervisor requires the insurer to invest in a manner that is appropriate to the nature of its liabilities

- Matching considerations for policyholder liabilities
- Mismatch risk provision?
- Specific management of conflicts of interest
- For groups: entity considerations are predominant
15.5: The supervisor requires the insurer to invest only in assets whose risks it can properly assess and manage

- Insurer ensures transparency of investments (i.e. allows identification, measurement, monitoring, control and report)
- Understand first, invest later
- Consider risk characteristics of underlying assets where possible
- Untraded assets kept as suitably prudent levels in the overall portfolio
- Central management of group assets – or at least a centralised management function
Standards underlying ICP 15 - 6

• 15.6: The supervisor establishes quantitative and qualitative requirements, where appropriate, on the use of more complex and less transparent classes of assets, and investment in markets or instruments that are subject to less governance or regulation
  – Understand the additional risks posed by off balance sheet vehicles (e.g. historical case studies and stress testing)
  – Special consideration for assets in an un/under-regulated market
  – Should investment in off-balance sheet structures be allowed?
  – Restrictive strategies for SPEs (SPVs)?
  – Qualitative/quantitative restrictions for structured credit products
  – Riskiness of various products should be assessed
  – Derivatives: reasons behind use should be articulated – i.e. predominantly for risk management rather than speculative investment?
Discussion starters: Case studies

• Is insurance the prime motivation of the entity/group?
  – Dealing with policyholders’ liabilities/provisions must be the first priority

• Do the Board and management “look like insurers”?
  – Appropriate experience and seniority

• Are the investment expertise and knowledge appropriate?
  – Are the right people in place to deal with the investment strategy?