Cross Border Update

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Dealing/Transaction Accounts

- Dealing/transaction accounts for Portfolio Bonds
  - Policies usually include a range of unit holdings and deposit accounts
  - There is often a transaction or dealing account
  - Premiums/dividends/asset sales are paid into this account
  - Charges/Asset purchases/Claim payments made from the account
  - Policy has been to pay interest on any balance in this account
  - Interest rate is normally variable – with some relationship to base rates
  - Treasury management of the balance managed by the life company
  - Who has the counterparty risk?
    - AILO commissioned a legal opinion which suggested that the company has the counterparty risk (obviously depends on company rules)
  - Should there be solvency margin?
  - Consider as part of technical provisions and subject to asset admissibility rules

Localisation

1994 Regulations - Annex VII, Article 4(1)(a):

“an undertaking with its head office in the State shall establish and maintain assets in the Member States equal to not less than 60% of its combined linked and non-linked liabilities . . ”

- So 60% of assets must be in the EU
- Not normally a problem
- Difficulty this year for Portfolio Bond companies
  - Substantial amount of assets on deposit – typically in bank accounts in the Isle of Man
  - Generally hold a range of different funds. Many of these funds are registered outside the EU
  - Switch to cash this year pushing some companies towards 60%

Italian Index Linked rules

- Index linked (or tracker bond) business is a large part of the Italian market
- Counterparty risk was generally passed to an international bank
- This caused problems when Lehmann collapsed
- ISVAP (Italian regulator) seeking to change rules (consultation paper 30/2008):
  - Insurance company must guarantee the product – cannot rely on solvency of the bond issuer
  - Equity payoff must be linked to movement in the index value – implication for use of an option to provider the guarantee
  - Rules on spread of assets for Italian companies
  - Italian companies allowed to have 1% solvency margin if they match closely

Variable Annuities

- Extreme levels of volatility in equity markets and interest rates
- Leads to convexity losses
- Basis risk losses – tracking error between fund and index used for hedging
- Pricing changes – falling interest rates and increased volatility
- Some changes to products to de-risk
- Withdrawals from market – Swiss Re, Hartford
- German government deferred plan to allow VA by German insurers
- More limited availability of reinsurance
- Lessons to be applied to new products
- Still new entrants to the market

Other Issues

- Greater focus on lack of an insurance guarantee scheme in Ireland
- Counterparty risk has become a greater issue
- Return of premium on death guarantees being seen to be valuable
- Increase in Minimum Solvency Margin to €3.5m at end 2009
- Closure to new business of three companies