

Society of
Actuaries in
Ireland

5 June 2013

The logo for Financial Risk Solutions (FRS) is located in the bottom left corner. It consists of a stylized 'F' made of three squares (grey, white, and black) to the left of an orange square containing the letters 'FRS' in white.

FRS

Spotlight on Unit Linked Funds - Issues Arising from the UK Regulator's Thematic Review

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Unit Linked Funds

Business
Critical



Complexity



Regulated



Risk Controls



Efficiency



FCA Thematic Review

FSA 2012 Retail Conduct Risk Outlook

“We have concerns that some insurance firms have poor governance and control practices around their unit-linked funds.”

3.5.1 Common risk profile of insurance firms (emerging risk)

FSA Thematic Review

“MoneyMarketing 31 January 2013
The FSA has launched a thematic review into
the governance arrangements of the £800bn
unit-linked fund sector.”

Regul

Financial News

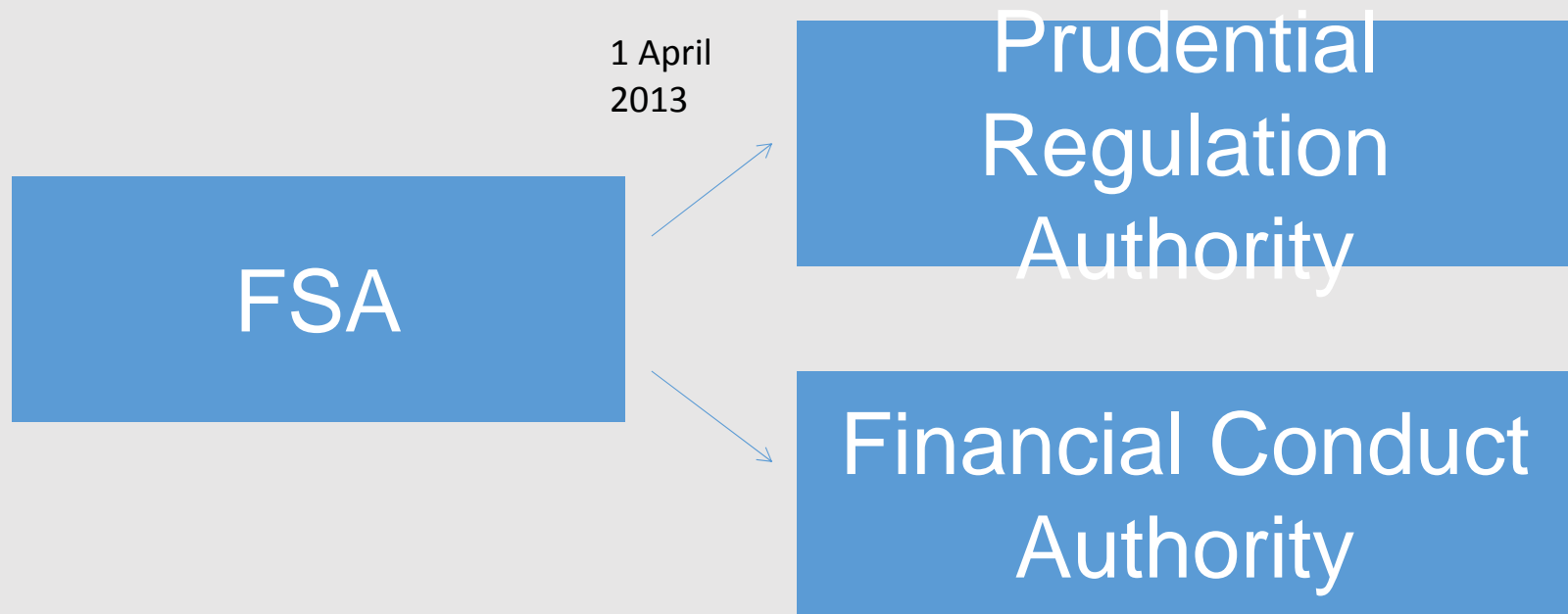
FSA Dual Approach

“Thematic work helps us identify the scale and nature of risks that emerge from our surveillance of markets and, where appropriate, to take action to address these risks.

It enables us to consider the activity taken by different firms across a particular sector in a consistent way and helps us identify good and bad practice.”

Monitoring & Reporting

UK Regulatory Structure



FCA Thematic Review: Assessment of Risks

Adequate
Systems and
Controls

Appropriate
Assets

Accurate and
Fair Calculation

Irish Perspective

Central Bank of Ireland Strategic Plan 2012-2015

Reforming the regulatory and supervisory framework to ensure risks to stability and consumer protection are identified and effectively mitigated.

Protecting consumers by challenging firms, improving firms' compliance, promoting a better culture in the financial sector and helping consumers have more confidence in financial services

Four Key Elements of Supervision

Adequately
Resourced &
High Quality
Supervision

Strong Powers

Supervisory
Philosophy that
Challenges

Independence

Address by Deputy Governor Matthew Elderfield to the European Insurance Forum 2013

Central Bank Enforcement Conference

“...the Central Bank has sanctioned firms and has published details of these sanctions... I am firm in my belief that this is a necessary and best practice element in the regulatory toolkit of the Central Bank. – Matthew Elderfield.”

“The Bank is prepared for the day when settlement is not the correct path for either the firm / the person concerned in the management or the Bank, leading us to enter into the Inquiry (or Assessment) forum. – Peter Oakes.”

...or assertive, risk-based supervision is underpinned by having a credible enforcement deterrent in place.

Nightmare Scenario

“ ...Company X

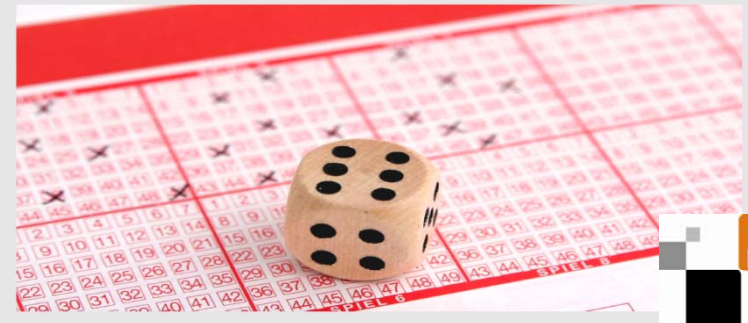
Reprimand and fine

The Regulator reprimanded the Firm and required it to pay a monetary penalty of Y

Breaches

The breaches identified are ... ”

could be you!



Adequate Systems and Controls

Framework Regulations 1994

DIRECTIVE 2002/83/EC

European Communities (Life
Assurance) Framework (Amendment)
Regulations 2006

Article 10(3) Every insurance undertaking shall have and maintain sound and adequate administrative and accounting procedures and internal control mechanisms. –SI 593 of 2011

Solvency II

Article 132 : Prudent person principle

Risks identify, measure, monitor , manage, control & report (IMMMCR)

Security, quality, liquidity & localisation

Best interests of policyholders (disclosed policy objectives)

UL – Technical provisions closely represented by units

Non-UL: Derivatives, not on RFM, diversification, concentration

CP13/08

Preparation for Solvency II

Effective 1/1/2014

(a) Effective System of Governance

(b) Effective Risk Management System

(c) Supporting Qualitative Information

Focus on managing processes and procedures

CP13/08

Documentation (1.24)

Scope and Frequency of Internal Review (1.25 & 1.27)

Policies (1.28)

Outsourcing (1.35 & 1.36)

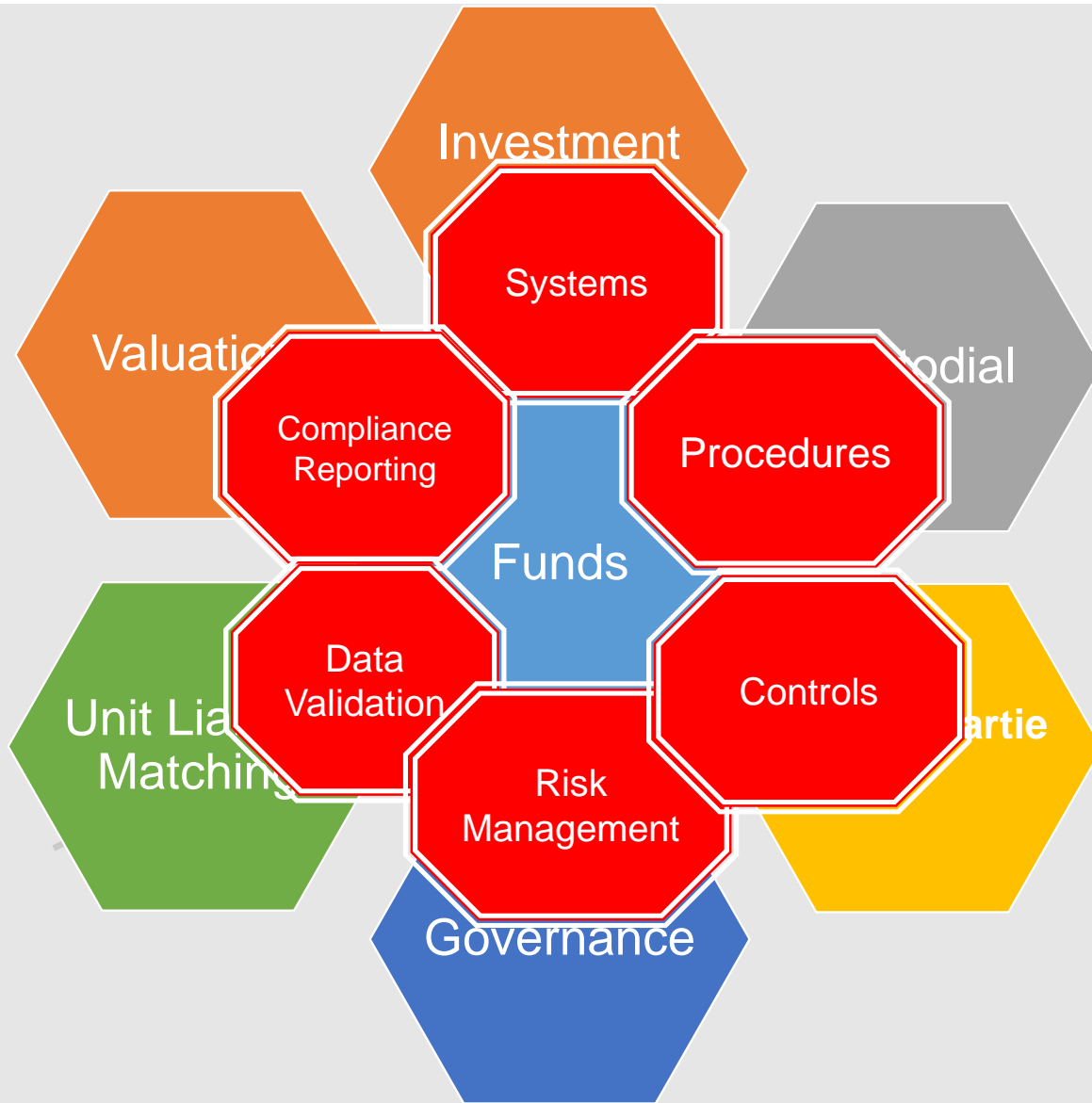
Risk Management Policy & Function (1.40 & 1.41)

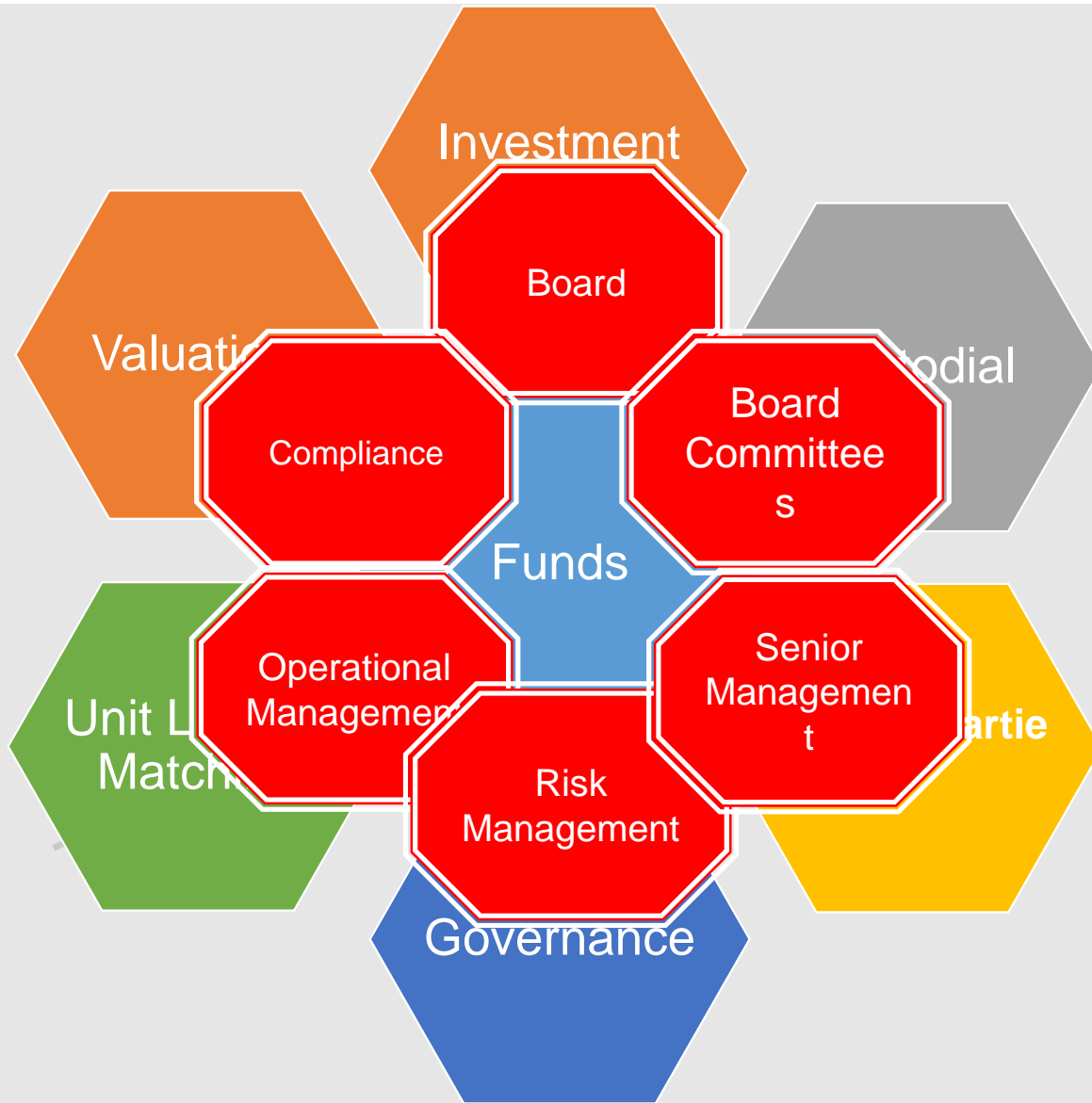
Operational Risk (1.44)

Asset Liability Matching (1.49)

Investment Risk (1.50)

Liquidity Risk (1.51)





Appropriate Assets

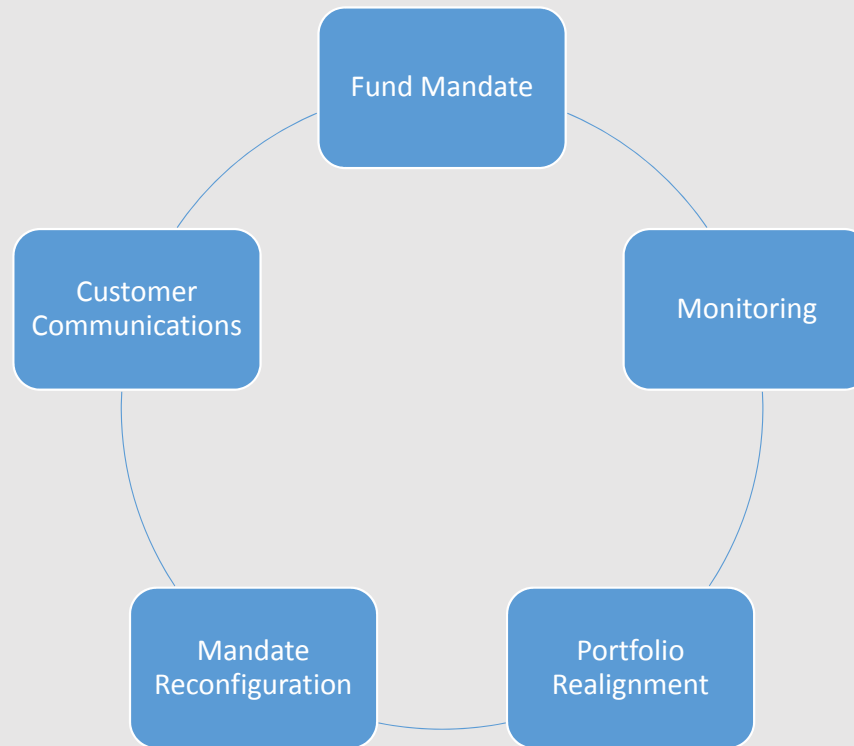
Jurisdictional Approaches

Investment Risk

Fund Categorisation

Monitoring & Review

Fund Mandates



Guideline 27

Investments selected in best interest of policyholders

Takes into Account & Manages Constraints

Peak-to-Trough Falls in Value

Investment	Annualised Risk	Implied 1-year 1/40 Loss	Maximum Peak-to-trough Fall in Value
Typical Managed Fund	12.4%	24.3%	34%
Global DM Equity	14.7%	28.8%	49%

PAST RESULTS ARE NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

Monthly data from 1-MAR-2001 to 30-APR-2013

Accurate & Fair Calculation

Consumer Protection Act 2012

Act Honestly, Fairly and
Professionally

Act with due Skill, Care and
Diligence

Resources, Systems & Controls

Error Correction Speedily and Fairly

FCA Thematic Review of Unit Linked Funds

FCA Thematic Review: Assessment of Risks

Adequate
Systems and
Controls

Appropriate
Assets

Accurate and
Fair Calculation

Assessment Process

Step 1: Desk Based Analysis of Governance & Control

Step 2: On-site Visits

Interviews and Walkthroughs of Processes

Testing of Issues on Specific Funds

Step 3: Feedback

Desk Based Analysis

Overarching Governance

Governance Structure

Strategy & Approach

Risk Management

Breaches

Conflicts of Interest

Outsourcing

Investment Management

Mandate

Asset Matching

Reinsurance

Fund Mergers & Closures

Stock Lending

Fund Administration

Valuations

Pricing

Taxation

Charges & Expenses

Unit Allocation

Interview Subjects

Interview Subjects

Overarching Governance

Operational Governance

Compliance

Investment Management

Valuations

Pricing & Tax

Administration of Policies

Process Walkthrough

Process

Valuations

Pricing Errors

Pricing & Unit
Appropriation

Fund Closures
& Mergers

Other

Conclusions

Themes

Risk & Reward

Communicating
Investment
Risks

Fund Mandates

Control
Environment &
Risk Controls

Regulation

Regulatory Issues

CP13/08

Better
Governance &
Management of
Risk

Consumer
Protection

Unit Price Error
Tolerances

Regulatory
Enforcement

Conclusions

Increased Regulatory Focus

Greater Incidence of Sanctions

Greater Operational Challenges

Adequate Systems and Controls

Importance of Documentation

Communicating Investment Risk

Implementation of Guidelines



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