

PKF's insurance seminar in Gibraltar

28 November 2023

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Introductions

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Today's speakers





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Agenda

Introductions

Daniel Delgado
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Welcome from The Honourable Nigel Feetham KC MP

Regulatory Developments in UK & Gibraltar

Neil Coulson
Partner, London
Daniel Delgado
Partner, Gibraltar

Consumer Duty

Jessica Wills
Partner, London

Capital and resilience

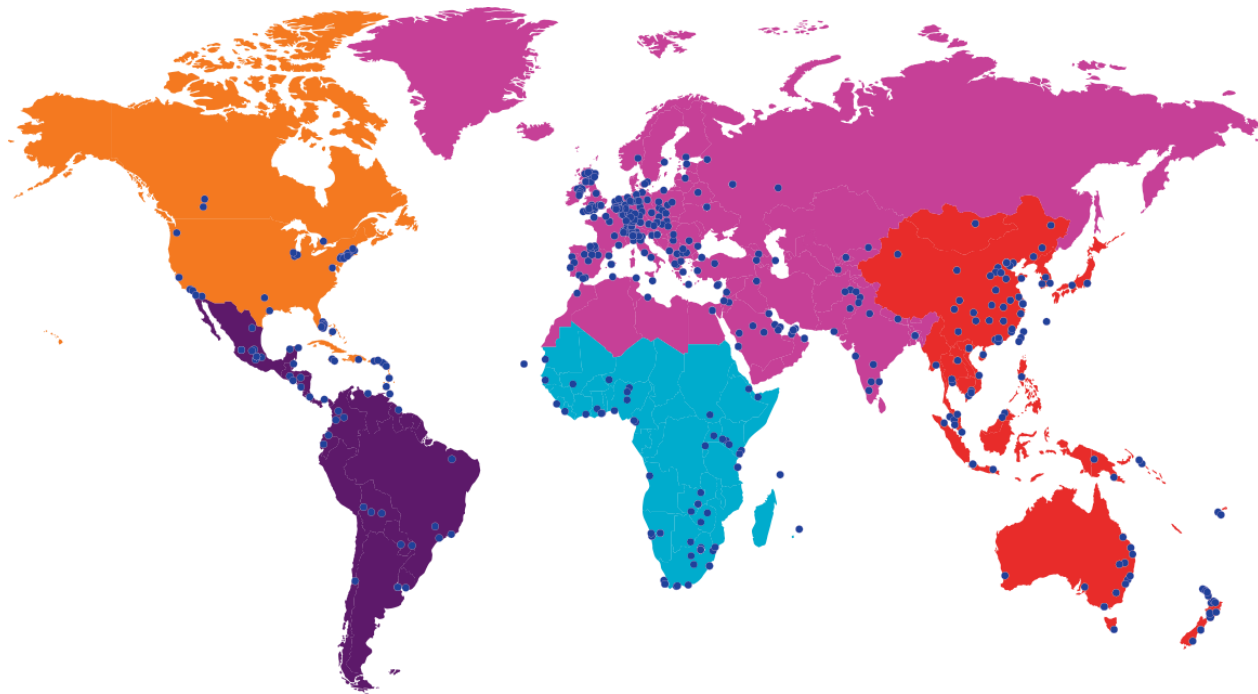
Cheryl Mason
Partner, London
Supported by Peter Hughes
Managing Director, Litmus Analysis

Q&A

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across the globe



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- In-house actuaries and IT specialists
- Efficient and responsive
- We work seamlessly across the UK and Gibraltar



12th largest Audit
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the latest Accountancy
Daily rankings



£152 million annual fee
income



1450+ UK partners and
staff



5th ranked auditor of
listed companies in the
UK, and 2nd on AIM



HM Government of Gibraltar

**The Hon Nigel Feetham KC MP,
Minister for Justice, Trade and Industry**

Regulatory Developments in UK & Gibraltar

Neil Coulson – Partner, London

Daniel Delgado – Partner, Gibraltar

PRA Business Plan 2023-24 (Issued May 2023)

Competitiveness

- Strong & simple – ease of entry & exit (including FSCS regime) - international engagement

Solvency II reforms

- **Capital** – threshold increase - risk margin reduced – investment flexibility – matching adjustment (life)
- **Reporting** - PRA accessible – easier start-up - reduced reporting – no branch capital requirement – insurance holding company definition refined

Financial resilience of insurers

- Insurance resolution regime – stress test H2 2023
- Reinsurance risk (prudent person) – claims inflation

Operational resilience

- Risk policy /tolerances on critical third parties by 2025 – cyber stress test

Governance & risk management

- Remuneration - SMCR reforms – diversity & inclusion

Other emerging risks

- International change – digitalisation– artificial intelligence – crypto assets - climate change

FCA Business Plan 2023-24 (Issued April 2023)

Mostly continuing previous themes

New activities relevant to insurance sector

- Increase the number of problem firms they take action against.
- Improve complaint reporting, review access to Financial Ombudsman, consult on redress.
- New regulatory return for solo financial service firms regarding financial resilience.
- Test embedding new Appointed Representative rules.
- Increased use of data to identify firms susceptible to proceeds of crime, increased assessment of money laundering systems, increased analytical tools to assist money laundering supervision, enhanced oversight of financial promotions.
- Improved co-ordination across multiple regulatory high-risk firms.
- **More supervision of Consumer Duty through sector specific supervision.** Swifter investigation of misconduct.
- **Commence assessing firms' operational resilience and tolerances**, clarify how operational incidents are to be reported to FCA.
- Prepare for replacement of EU law in FCA handbooks.
- Put into operation and report upon competitiveness responsibilities and improved cost benefit analysis.

GFSC 2023-26 Strategic Plan

1) Increased interaction with UK regulation

Successful implementation of GAR

- Ensure permanent mutual market access Gibraltar & UK – monitor UK developments

2) Improved service to the market

Strengthen effective, proportional and risk-based regulation

- Automation to free up regulatory resource – improved speed to market (Staged Approach) – increased guidance

Strengthen GFSC and stakeholder relationship

- Increased consultation – improved application process

Recruit & develop highly trained workforce at GFSC

- Develop staffing & training policies

GFSC Current Focus Areas

S83A material change consultation – when change notifications & revised ORSAs required

Regulated individuals – not UK SMCR – numbers – roles – skills – location – segregation - balance

Group supervision – aligning with UK

Premium debtors – solo and group considerations - SII risk charge

Claims reviews – independent specialists – insightful – cost saving

Inflation – later slide

Operational resilience – later slide

Reinsurance – prudent person principle - Cheryl Mason presentation

Capital planning & stress testing – realism in scenario testing - Cheryl Mason presentation

Conduct risk & product governance – Jess Wills presentation

Inflation & claims

Claims inflation considerations

- Emerging experience – development patterns – claims review findings
- Extent of separate inflation allowance
- Parts inflation, supply chain delays, salary/charge rate increases, other factors (electric vehicle increased costs)
- Expected changes in inflation

Impact upon business plans and capital models

- Future inflation & economic scenarios
- Impact upon premiums (rates & demand), reinsurance, claims, expenses
- Regulatory inflation – additional resource requirements (capital, staff, IT)
- Discount rates (impact on SCR)
- Investment values and returns
- What flexing to perform for realistic stress tests relating to inflation – movements in both directions

Operational resilience

How does a firm manage risk of disruption to its services? - UK requirement

Consider severe but plausible scenarios

- e.g. IT issues, cybersecurity threats, data loss, loss of key staff, disruption of key supplier, pandemic etc.

Plan how to prevent, adapt, respond and recover from disruption.

- Identify what period of time and to what extent will you not be able to provide normal service.
- Ensure clear allocation of responsibility - ownership of responses

Aim is to set standards for service delivery, and tolerance for disruption to normal service.

- Test ability to remain within tolerance.
- Considerations include: harm to clients, risk to operations and stability of firm, and disruption to the market.
- Assessment should be for each Important Business Service (IBS) within the firm including those that are outsourced.

Map and test – disruption impact upon people, processing, IT, facilities, etc. for each IBS and document findings.

- Consider interdependencies, vulnerabilities, future developments and actions..
- Self-assessment required to be documented & retained and obtain approval from compliance/board.

Operational resilience

Many scenarios not fully tested historically

- Covid has only tested some scenarios – e.g. not IT system fail or cyber-attack.
- Lessons learnt exercises expected following disruptions or modelled outcomes – and remedial actions taken.

Early weaknesses identified by FCA/PRA:

- Over focus on IT risks, lack of testing of recovery, poor oversight of outsourced services including cloud storage, poor succession planning for people.

The full requirements do not apply to smaller intermediaries in the UK at present.

GFSC – Plan to align with PRA/FCA guidance.

- 1 year implementation from April 2023 legislation – identify IBS & conduct risk mapping.
- 3 years from legislation (by April 2026) - demonstrate remain within tolerances.

Biggest challenge likely to be assessment of key outsource providers

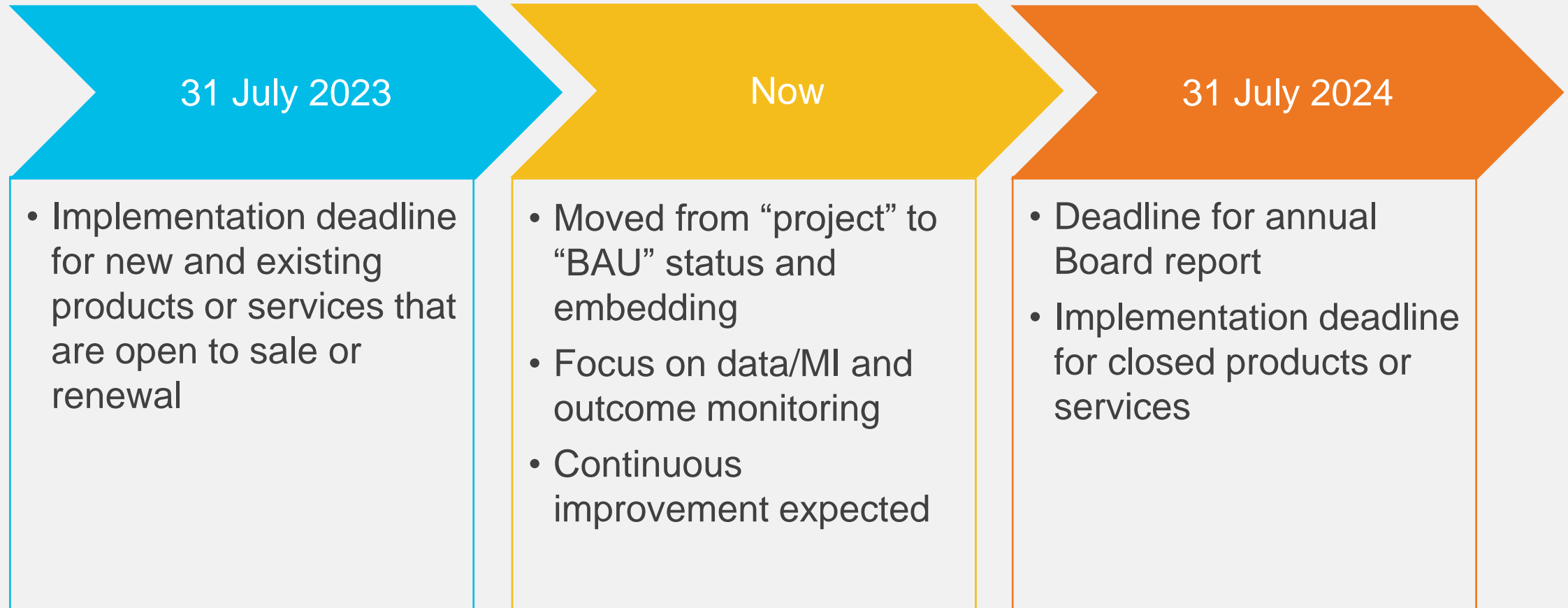
- Especially if UK service providers for underwriting, claims, IT, are not directly subject to the requirements themselves.
- Identify IBS now.
- Start the conversation with providers now.
- Plan who is going to document and test resilience.
- Potential interaction with Internal Audit.

Consumer Duty

Jessica Wills

Partner & Head of Governance, Risk & Control Assurance
London

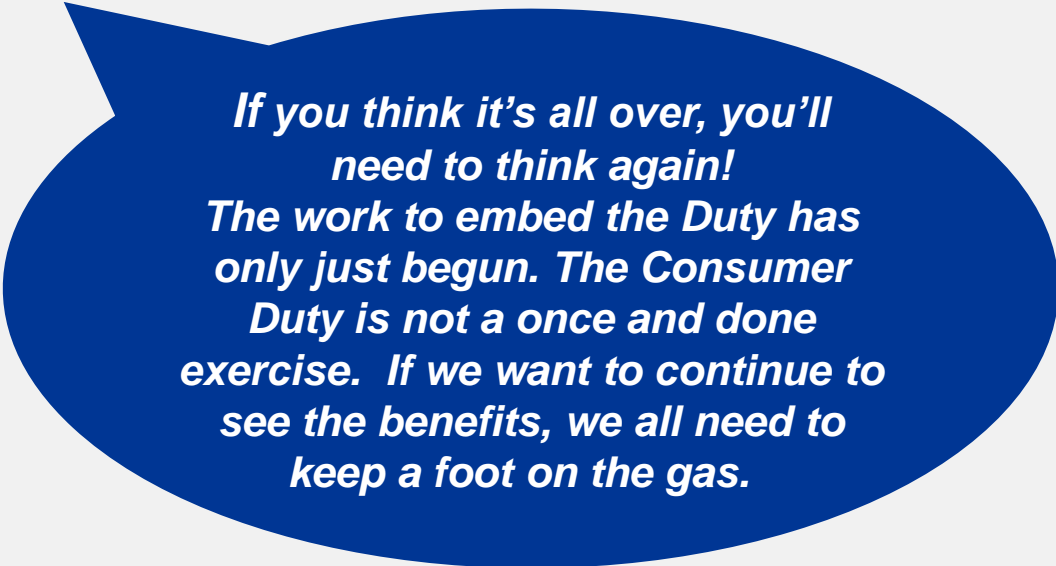
Where are we now?



Key messages from FCA

Speech by Nisha Arora, Director of Cross Cutting Policy and Strategy, on 1 November

- FCA recognise firm's efforts to shift practice and culture – approached in right spirit
- Key areas to focus on:
 - Assess, test, understand and evidence **customer outcomes** – must be ongoing and focused
 - Must monitor outcomes for **different groups of consumers**
 - Expect monitoring to be able to highlight where there are **poor outcomes** – take appropriate action
 - **Data** – can't just repackage existing data – firms to think seriously about what information they need
 - **Continuous learning and improvement** – and evidence this in annual report



*If you think it's all over, you'll need to think again!
The work to embed the Duty has only just begun. The Consumer Duty is not a once and done exercise. If we want to continue to see the benefits, we all need to keep a foot on the gas.*

PKF observations to date

Products & services

Price & value

- Insufficient consideration of all factors relevant to value or poorly evidenced
- Are firms challenging themselves enough? Have any products been amended / withdrawn?
- Failure to identify specific characteristics of vulnerability with target market

1

2

3

4

Consumer understanding

- Work to improve policy wordings and communications
- Testing is at early stages

Consumer support

- Lots of good customer journey mapping to understand touch points
- Challenges demonstrating support to vulnerable customers

PKF observations to date

Governance & culture

- Some examples of good governance – important that momentum is maintained and there is the right data/MI to support decision-making (see below)
- Efforts to shift culture have involved internal communications and training – have you tested the awareness and understanding of staff?

Data & MI

- Data/MI is now a key focus area and very much still evolving
- Challenges where require data from third parties (MGAs/TPAs)
- A lot of focus on complaints data

Vulnerable customers

- Approach to vulnerable customers remains challenging – focus been on identifying and recording vulnerability, staff training etc

What next?

- Double check that you've completed your implementation plan
- Data, data, data!
- Be able to **demonstrate** that you're delivering good customer outcomes
- Be prepared for regulatory scrutiny – FCA and GFSC following implementation of Consumer Duty regime in Gibraltar
- Consider your assurance needs

Capital and resilience

Cheryl Mason

Partner, London and Gibraltar

Supported by Peter Hughes, Litmus Analysis



■ **Capital and resilience – the importance of stress testing reinsurers**

- Reinsurance panels are vital – for smaller insurers, the availability of reinsurance at a reasonable price has considerable influence on ability to survive and grow
- Reinsurance recoverables – are often greater than shareholders' funds
- PRA and GFSC focus area:
 - Reinsurance exposure
 - Impact on underwriting risk and discipline
 - Stress testing
 - Prudent Persons Principles
- Gibraltar insurers appear to have more reinsurance
- Are credit ratings enough – not all a rated reinsurers are created equal. Their resilience to stress differs.
- Litmus Analysis reinsurance stress



STRESS TEST/SCENARIO 'AS IF' TESTING USING LITMUSQST – EXAMPLE (MAJOR REINSURER)

Stress scenarios developed with Top Ten reinsurer client:

Market Risk

30% reduction in equity market values and a 10% reduction in fixed income values

Broad composite stresses based on Litmus' interpretation of rating agency initial estimates of the impact of Covid

PML Impact

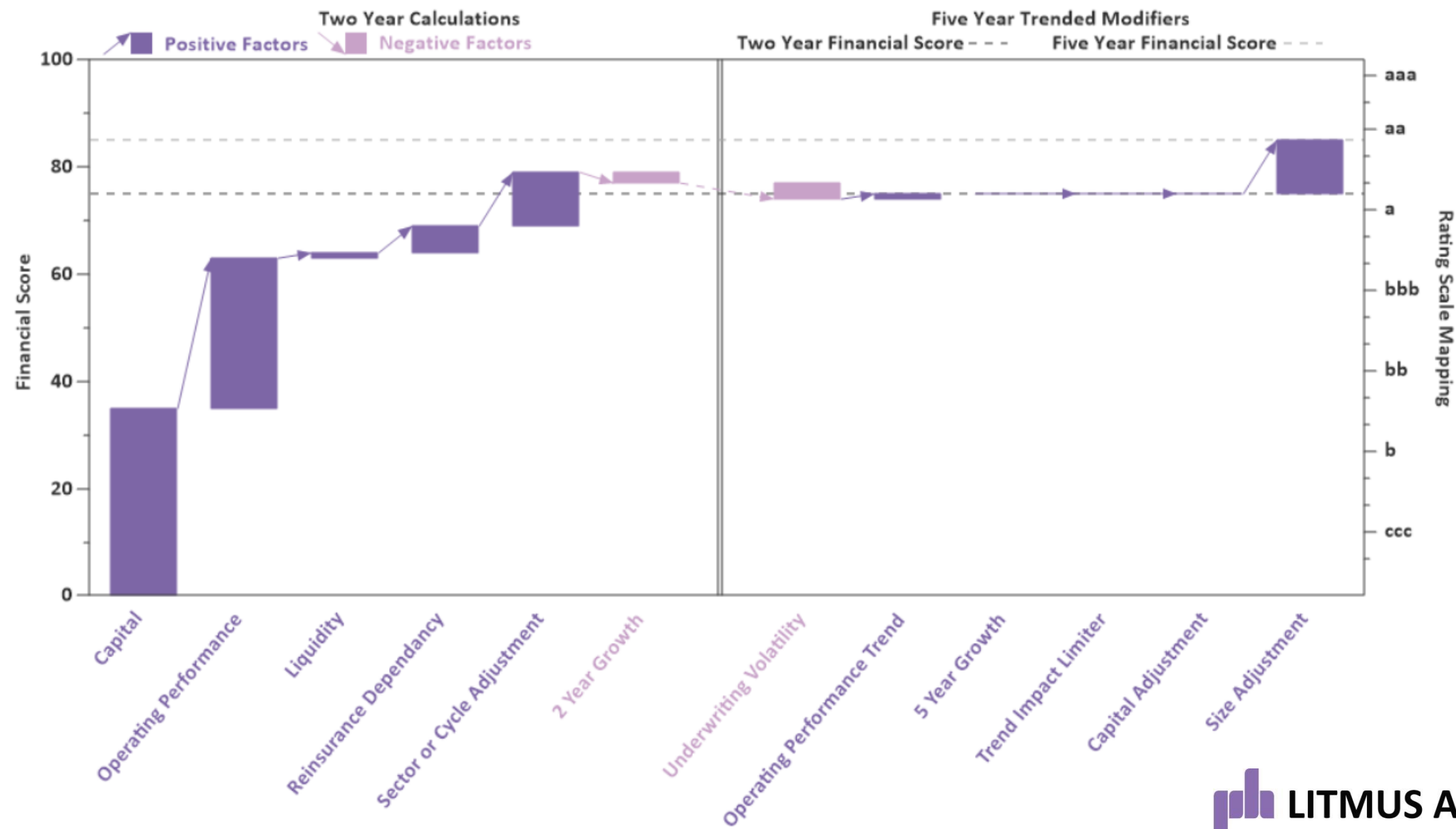
Based on a \$150 billion industry natural catastrophe loss event, *coupled with an impairment to the reinsurance recoverable asset (using an industry-wide event we assumed would impair not only the reinsurance recoverable from the stress event but also the 'in-force' recoverable asset)*

Reserve Shock

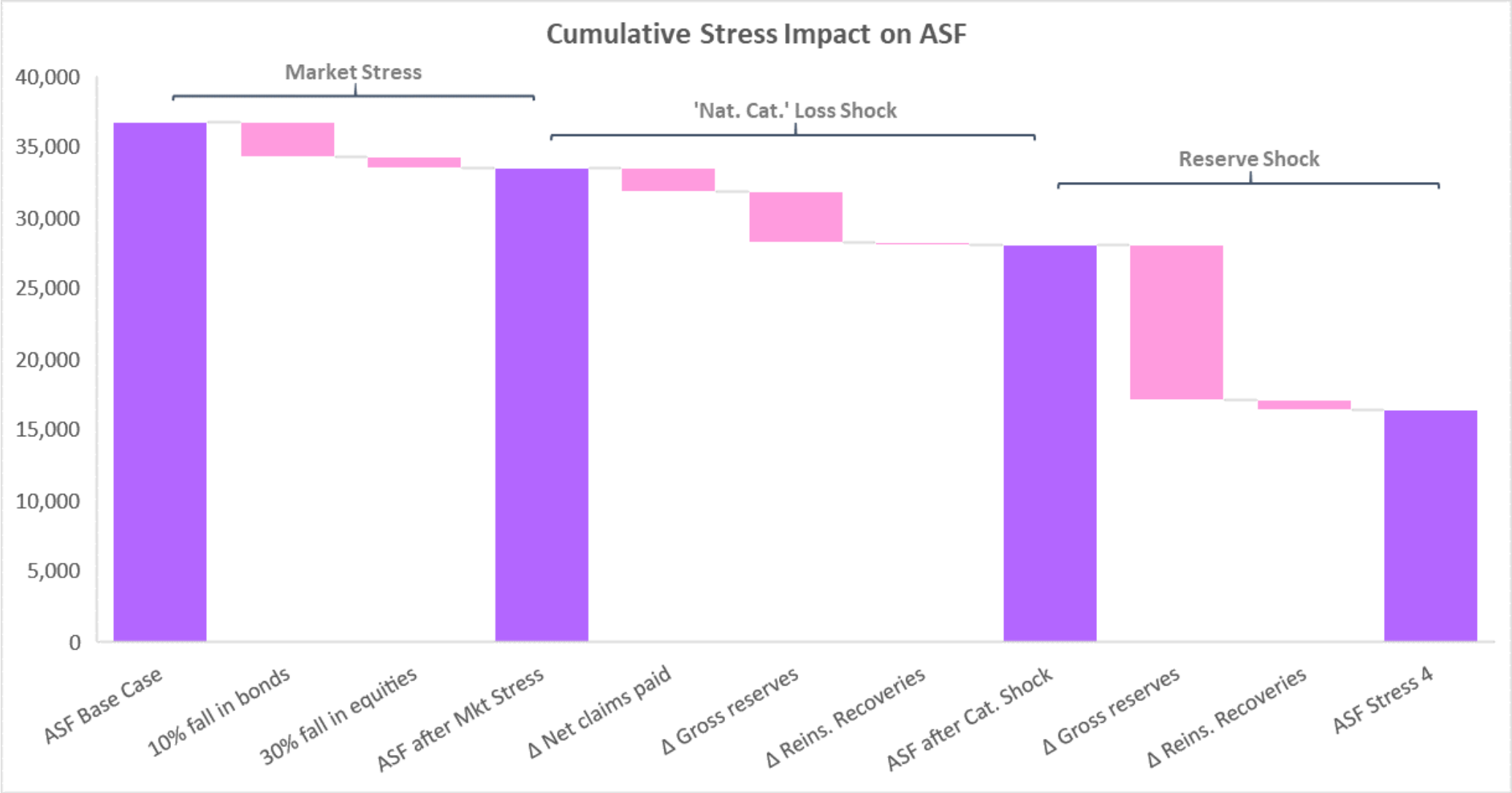
30% deterioration across the company's aggregate net claims & IBNR reserves, coupled with an impairment to the reinsurance recoverable asset

In the absence of sufficiently granular by-line reserve data a reasonable alternative can be used, such as a deterioration of 100% across all Casualty reserves – in this example we assumed it to be an industry-wide phenomenon that would also impact all reinsurance recoverables

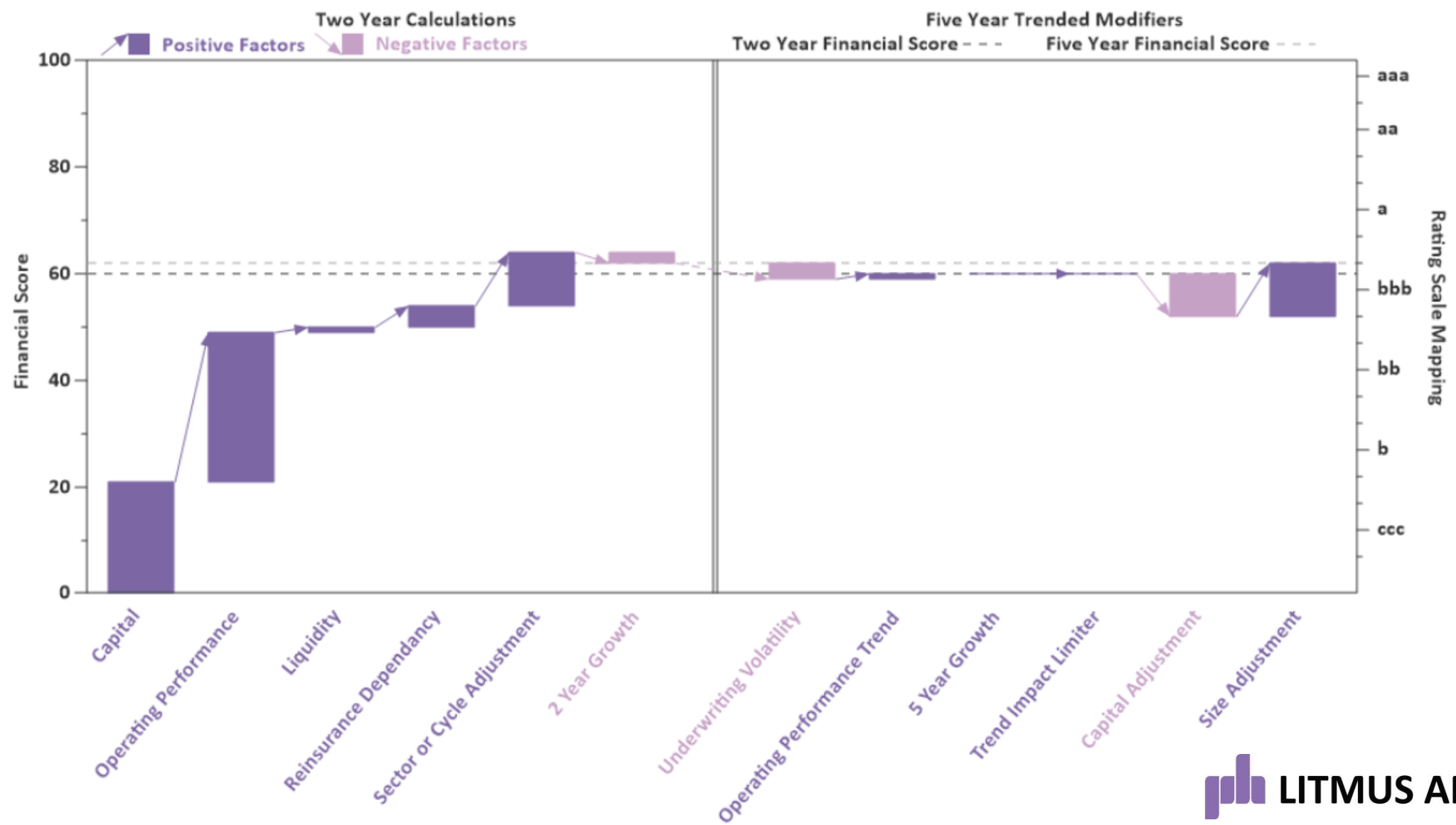
MAJOR REINSURANCE COMPANY - PRE-STRESS LQST SCORE OUTCOME



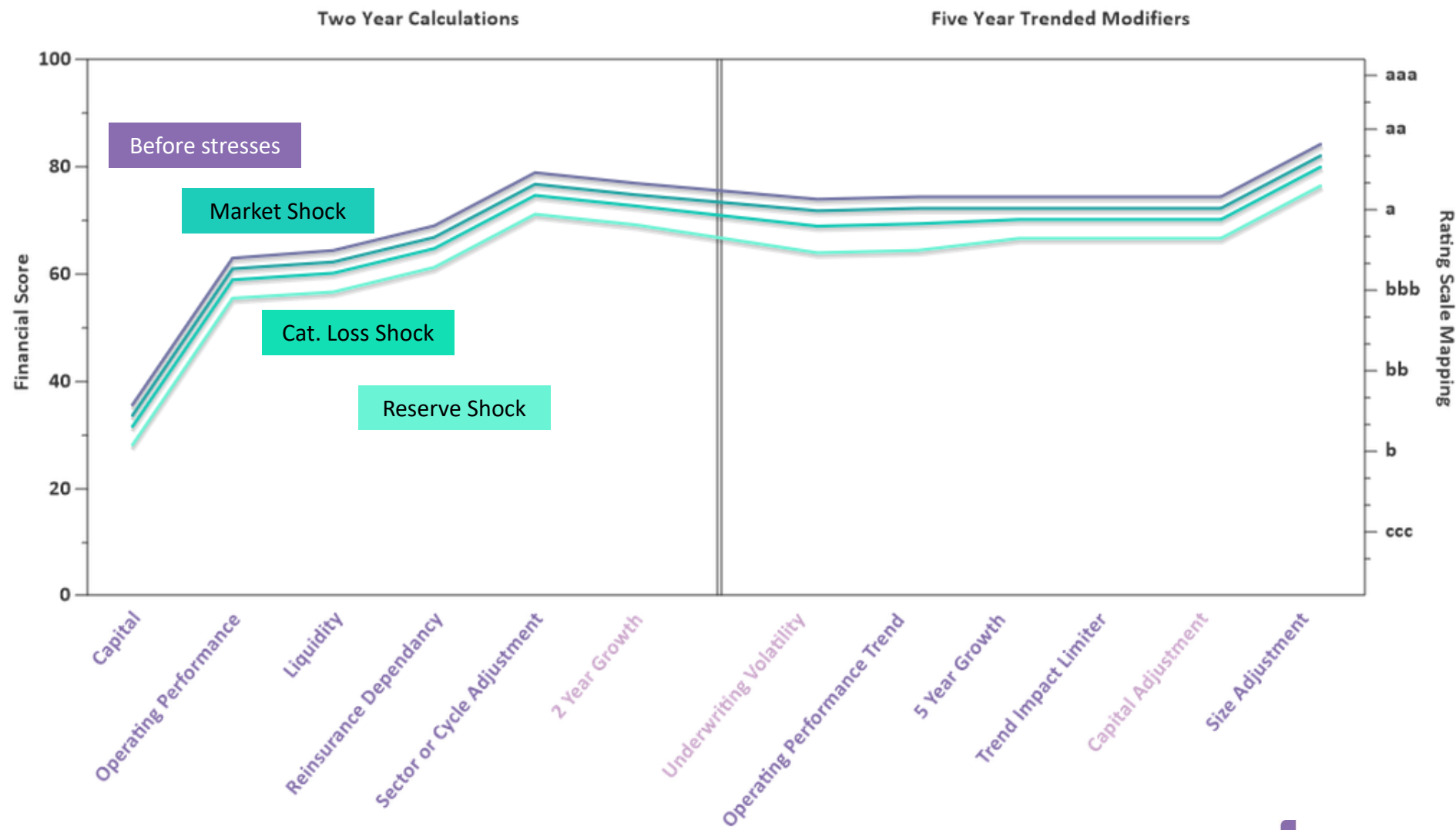
CUMULATIVE IMPACT OF STRESS SCENARIOS ON ADJUSTED SHAREHOLDERS' FUNDS



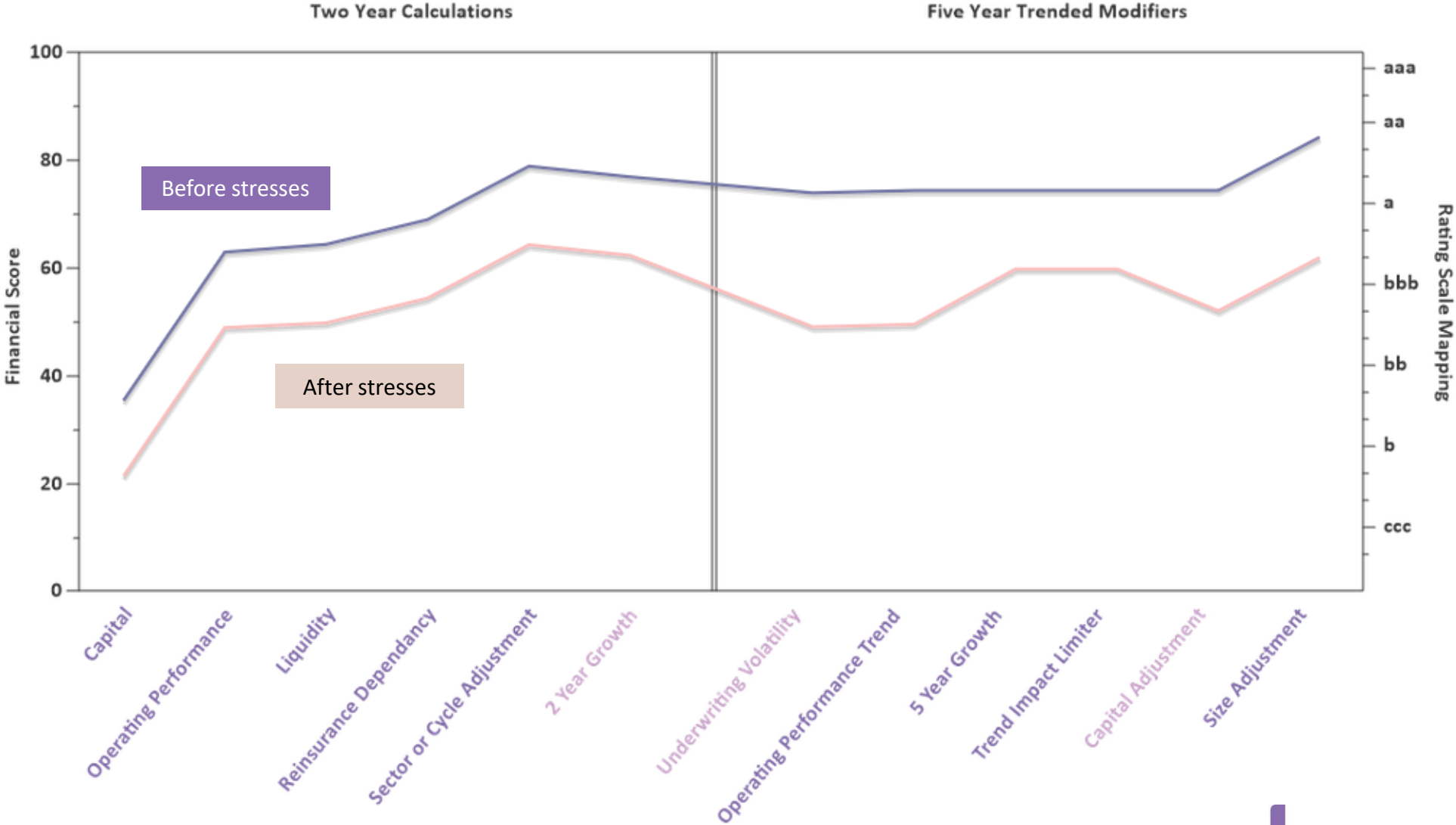
COMBINED POST-STRESS LQST SCORE OUTCOME



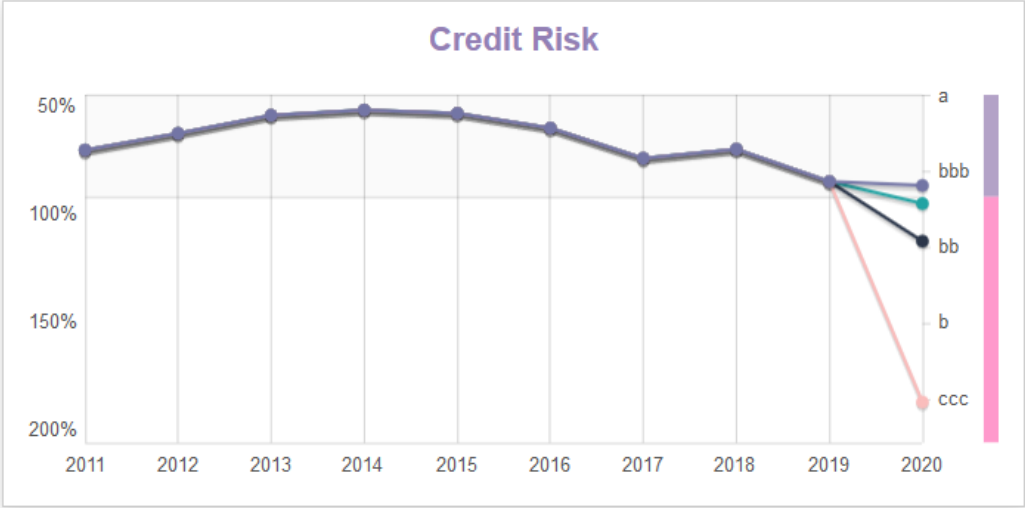
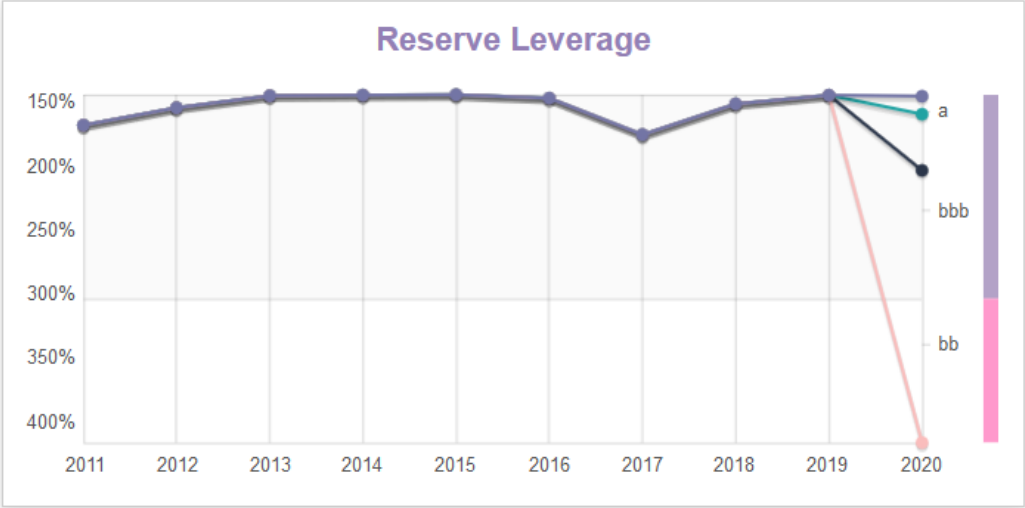
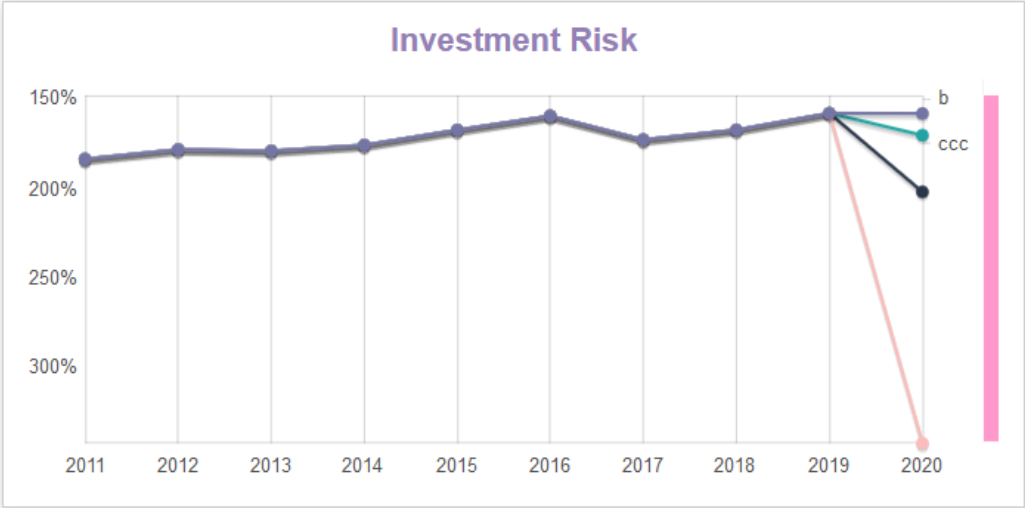
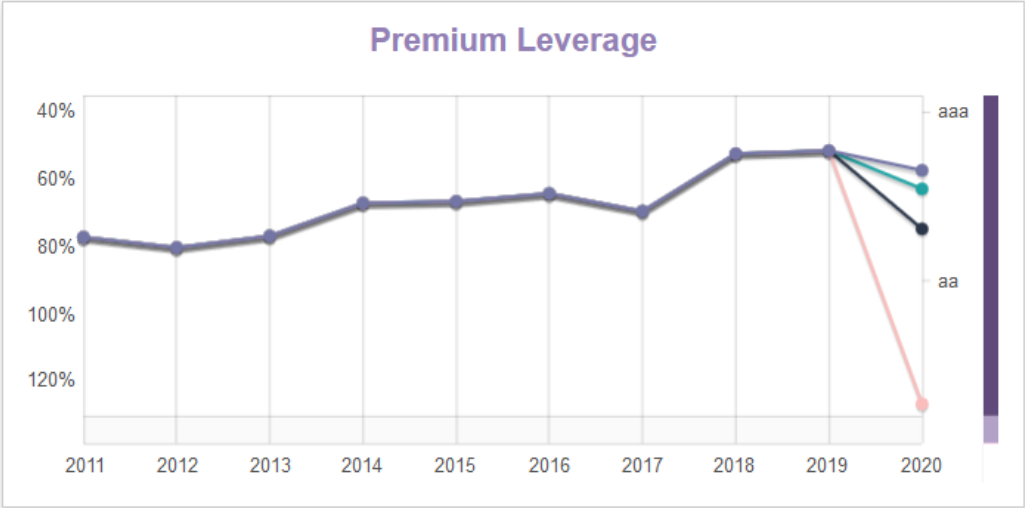
MAJOR REINSURANCE COMPANY – INDIVIDUAL POST-STRESS LITMUSQST SCORE OUTPUT



CUMULATIVE POST-STRESS LQST SCORE OUTCOME

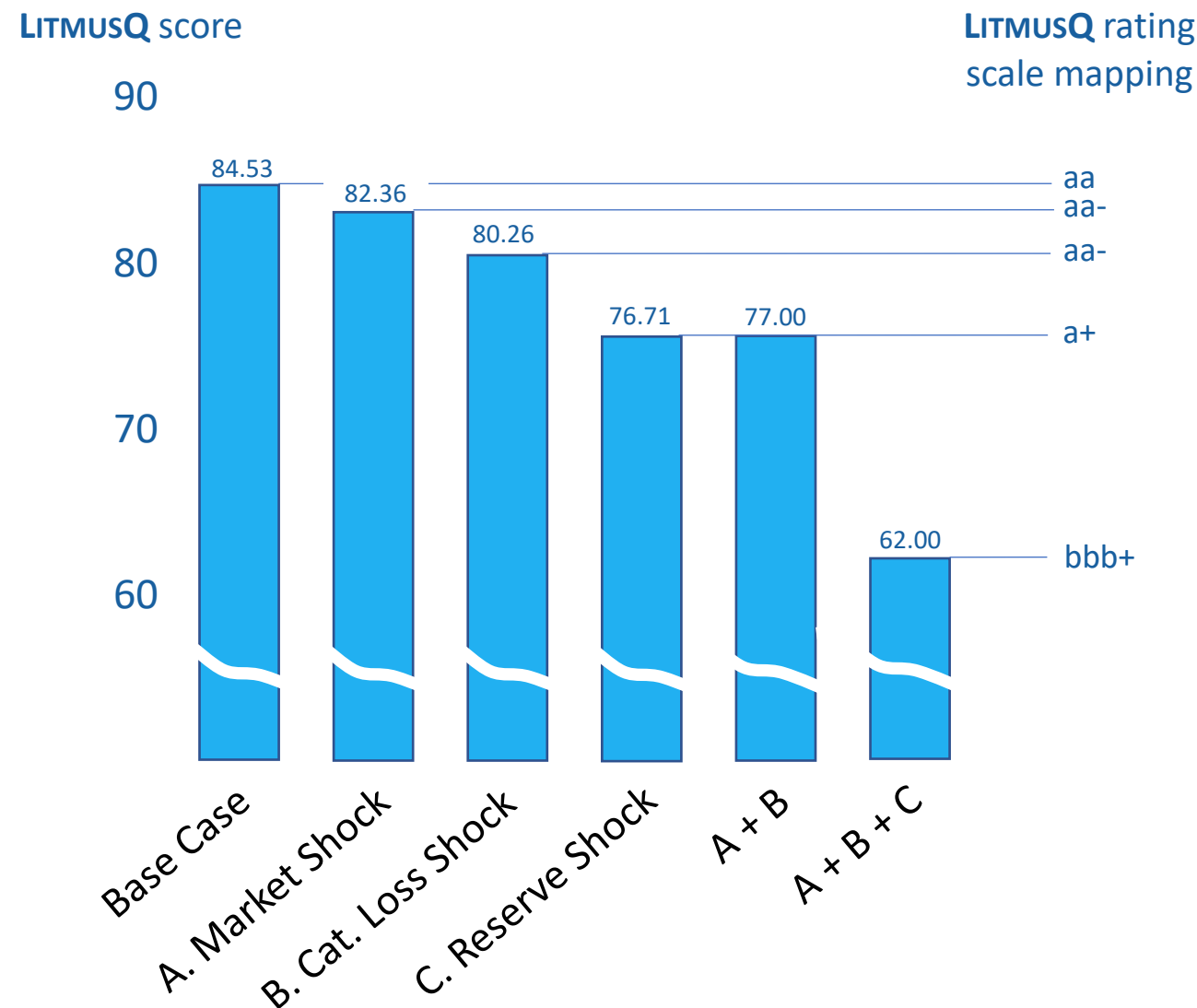


LITMUSQST OUTPUT, KEY CAPITAL RATIOS



- Before stresses
- After 1 stress
- After 2 stresses
- After 3 stresses

SUMMARY OF COHORT LQST ‘TRIPLE WHAMMY’ SCORE OUTCOMES



IMPORTANT NOTE: A score produced by a LITMUSQ model, and the benchmarks displayed that are taken from the model, are not the same thing as a credit rating. Nor do the score produced and benchmarks displayed imply any opinion by Litmus as to the financial condition of the entity being scored. It is entirely the responsibility of the user to judge the applicability and suitability of model use in any given case, and the extent to which they use the outcome. Guidelines on the use of LITMUSQ and understanding the model's output can be obtained from Litmus Analysis.

SUMMARY OF THE LQST RESERVE STRESS SCORE OUTCOMES

LITMUSQ Financial Score Mapping	Pre-Stress Results	Post-Stress Results		
		15%	25%	35%
'aaa' range	0	0	0	0
'aa' range	2	2	2	2
'a' range	14	10	9	7
'bbb' range	18	18	9	7
'bb' range	1	4	8	7
'b' range	0	1	4	6
'ccc' range	0	0	3	6
COHORT TOTAL	35	35	35	35

Reserve Stresses represent 15%, 25% and 35% increases in gross and reinsurers' share of loss reserves respectively

IMPORTANT NOTE: A score produced by a LITMUSQ model, and the benchmarks displayed that are taken from the model, are not the same thing as a credit rating. Nor do the score produced and benchmarks displayed imply any opinion by Litmus as to the financial condition of the entity being scored. It is entirely the responsibility of the user to judge the applicability and suitability of model use in any given case, and the extent to which they use the outcome. Guidelines on the use of LITMUSQ and understanding the model's output can be obtained from Litmus Analysis.

IN SUMMARY

- Reinsurance “asset”/recoverables stress testing is not the same as stress testing other assets (eg debt investments)
- Consider combination stress scenarios
- Reinsurers are unlikely to respond to different stresses in a uniform way
- Pay attention to the specific operating insurer that is reinsuring you – it might carry the group rating and not have the standalone financial characteristics to merit that rating itself
- Consider the read across to your ORSA, Going Concern assessments and upcoming Liquidity risk assessments - plausible downside scenarios.

▀ Question and answer



Any questions?



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