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President

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Submission to IRDA

Comments on IRDA 'Asset-Liability Management and Stress Testing' for General Insurers draft circular issued by IRDA, dated 4th August, 2011

This note provides the comments from the Advisory Group on General Insurance of the Institute of Actuaries of India and does not constitute views of the Council of the Institute.

We thank the IRDA for this opportunity to comment on the Draft Circular.

We have certain suggestions to make with the detail of the proposals which we give below for consideration.

Suggestions:

- 1) Stress tests should make allowance for catastrophes/large losses.
- 2) The Exposure Draft states that stress tests should allow for 50% adverse deterioration in claim rates. Clarity should be made as to whether this refers to claim ratios or claim incidence rates/hit ratios.
- 3) Underwriting risk is the principal risk faced by non-life insurers. Its importance may be better highlighted in the circular.
- 4) Cash flow matching would be more feasible to duration based ALM, given that loss outflows would be matched by premium inflows. Residual cash may be invested based on total risk/return trade-off.
- 5) Clarity may be given on the following terms in Annexure 1 - table ALM : net/hedged and duration (is this expired duration or residual duration?).
- 6) Given that Annexure 1 - table ALM is required by line of business, clarity may be on the allocation of free reserves and investment income by line of business.



- 7) Differential treatment of shareholder's assets and policyholder's assets may be considered.
- 8) Clarity is needed on the definition of liquidity risk (is it mismatch between assets and liabilities or loss due to inability to sell the asset?) and scenarios that should be considered for assessing the same.
- 9) Diversification between different asset classes may as well be considered.
- 10) Clarity is needed on whether the stress tests should allow for a 50% uplift in reserve risk in case of fully developed loss years.
- 11) The stress tests for investment income should allow for a change in the shape of the yield curve. For example, Tests like twists in the yield curve would be beneficial.
- 12) Both annexure (i.e. Table ALM and Format ST-NL) mentions Asset in its heading. A better alternative would be to seek distinction between Assets and Investments. Asset, as normally understood, would include fixed asset (e.g. furniture, fixtures, hardware etc) and current assets (balances with Agents, reinsurer etc). Investments as such is a sub-set of asset. Duration and stress testing etc would be possible for Investments only and not for other asset mentioned above.
- 13) If asset is added in Format-ST-NL for the purpose of solvency calculation, then the valuation norms for asset (which would be different from valuation norms for Investment) under stressed situation should be prescribed. In my opinion, such asset should have nil value for the purpose of this reporting.
- 14) In addition, current valuation norms for General Insurance companies requires government securities and other prescribed debt instruments to be valued at cost of acquisition. It would be good idea to provide clarification on the valuations norms to be adopted for the purpose of this circular. I believe, for the purpose of this reporting, all investment should be valued at market value. In case market value is not easily assessable, normal regulatory valuation norms should be adopted or alternatively they may have nil valuation.

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