

Guidance Notice FSI GN 4

Calculation of the SCR Using the Standardised Formula

Objectives of this Guidance Notice

The FSI Guidance Notices aim to assist insurers in complying with the requirements outlined in the Financial Soundness Standards for Insurers. While the Standards have the force of law and are used to establish minimum requirements with which insurers must comply, the Guidance Notices provide guidance only and do not have the same level of enforceability as the Standards. Insurers are not obliged to adopt the guidance, and are free to demonstrate that the requirements of the Standards are otherwise met.

Guidance Notice FSI GN 4 sets out practices and guidelines aimed to assist insurers with their compliance with the requirements of FSI 4 (Calculation of the SCR Using the Standardised Formula). Not all practices or guidelines in this Guidance Notice may be relevant to all insurers, and some aspects may need to be varied based on an insurer's individual circumstances and characteristics. Subject to the requirements of FSI 4 (Calculation of the SCR Using the Standardised Formula), insurers have the flexibility to calculate their capital requirements in the way most suited to the nature, size, complexity and risk profile of their business.

The Guidance Notices may reference specific provisions within the FSI Standards and as such must be read in conjunction with the respective Standards cited.

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Chapter 1: Stressing Incurred But Not Reported Reserves for Life Insurance Obligations

Incurred but not reported (IBNR) reserves are held in respect of claim events that have already occurred, but have not yet been reported to the insurer. These claims are in respect of policies that are either in-force or out-of-force. In the case of out-of-force policies, the claim event relates to a period where the policy was in-force.

The IBNR provisions are calculated using best estimate assumptions. There is a risk that the IBNR estimates calculated are different from the actual claims that arise.

This Chapter provides guidance for the stressing of IBNR provisions by life insurers in order to calculate the capital requirements as set out in FSI 4 (Calculation of the SCR Using the Standardised Formula).

General Guidance

1. IBNR provisions should reflect consideration of the events that can influence the size and timing of the IBNR claims. The uncertainty of IBNR provision assumptions is different to the uncertainty of insurance obligations in general, since the exposure period is before the valuation date.
2. The main drivers of the uncertainty of IBNR provision assumptions relate to the number of claims, the skewness of the sum assured distribution and the stability of the claims development pattern. These IBNR uncertainties may emerge as either an increase in the expected value and timing of claims in respect of the book of business, or a change in operational processes which understates the ultimate loss ratio.
3. The standardised formula stress scenarios on the policies relating to the IBNR provisions address some of these risks in the various risk modules for in-force policies. For this Guidance Notice, risk modules refer to the individual risk components within the market risk, underwriting risk and operational risk modules. Insurers should appropriately assess the adequacy of the capital held for the risks inherent in the insurer's IBNR provisions.
4. The insurer's ORSA should address shortcomings of the standardised formula for the SCR, where the insurer is of the view that the formula does not sufficiently or appropriately capture the risks that the insurer is exposed to. This includes instances where the insurer believes that the risks inherent in the insurer's IBNR provisions are not fully captured by the standardised formula.

IBNR provisions for in-force policies

1. Policies relating to the IBNR provisions held by insurers at the valuation date, considered in-force policies, are already stressed under a number of standardised formula SCR risk modules. Insurers should, however, consider the adequacy of the capital requirements held for the risks inherent in the insurer's IBNR provisions.

2. Where risks exist that are not addressed or not adequately addressed in the existing standardised formula stress scenarios on the policies relating to the IBNR provisions, these should be reported in the insurer's ORSA.

IBNR provisions for policies that are out-of-force

1. The IBNR provisions for policies that are out-of-force at / on the valuation date are not typically stressed with the best estimate liabilities (BEL) as these policies are not typically included in the in-force book at the valuation date.
2. Standardised formula stress scenarios applied to the current in-force book policies may thus understate the risks associated with these IBNR provisions.
3. Insurers should develop a practical approach to assess the adequacy of capital requirements held for IBNR provisions for policies that are out-of-force. Capital should be held for the risks inherent in IBNR provisions for policies that are out-of-force as these are not addressed by standardised formula stress scenarios.