

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 life underwriting capital requirement in the way most suited to the nature, size, complexity and risk profile of their business.

The Guidance Notices may reference specific provisions within 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 reserves 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 reserves by life insurers in order to calculate the capital requirements as set out in FSI 4 (Life Underwriting Risk Capital Requirement).

A. General Guidance

1. IBNR reserves should reflect consideration of the events that can influence the size and timing of the IBNR claims. The uncertainty of IBNR reserve assumptions is different to the uncertainty of insurance obligations in general, since the exposure period is before the valuation date. An insurer's Head of Actuarial Control Function (HAF) may consider making adjustments to the IBNR reserves using information available at the time the IBNR reserves are valued on a best estimate basis. These adjustments should be incorporated into the stresses for IBNR reserves.
2. Such an assumption could be the assumption of the number of claim events that have occurred that have not been reported. This assumption, based on the insurer's experience, needs to be stressed in the SCR (Solvency Capital Requirement) event and any adjustments made by the HAF should be incorporated in the relevant SCR module.
3. Additional capital requirements should be added to the risk module that is most relevant to the additional capital requirement. For this Guidance Notice, risk modules refer to the individual risk components within the market risk, underwriting risk and operational risk modules.
4. Insurers should avoid double counting of capital requirements when stressing IBNR reserves.
5. 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 IBNRs are not fully captured by the standardised formula and the HAF could not make the appropriate changes in the standard formula.

B. IBNR reserves for in-force policies

1. IBNR reserves should be included in the best estimate liabilities (BEL) of an insurer, and stressed with the BEL.

2. The HAF should consider the adequacy of the capital requirements for the IBNR reserves and make appropriate adjustments where necessary. Where the HAF is of the opinion that the IBNR reserves are sufficiently stressed, there is no need to allow for additional capital requirements.

C. *IBNR reserves for policies that are out-of-force*

1. The IBNR reserves for policies that are out-of-force are not typically stressed with the BEL as these policies are not typically included in the in-force book at the reporting date.
2. The IBNR reserves' assumptions should be stressed within the applicable risk modules.
3. The HAF should consider if the IBNR reserves for these policies are appropriately included in the stresses required to calculate SCR and in consequence make adjustments in the relevant risk module as deemed appropriate.