



DCAT and the Business Plan

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Dynamic Capital Adequacy Testing

- Required by OSFI annually
- Appointed Actuary signs opinion regarding satisfactory financial condition of the Society
- Starts with a base scenario – should be directly related to the business plan
- Tests projected 5 years of future financial conditions under “plausible, adverse circumstances”
- Expects projections to reflect reasonable management action in response to the adverse conditions
- Historically, OSFI believes seen as a compliance exercise, not used as risk management

Dynamic Capital Adequacy Testing

- Examples of “plausible, adverse circumstances” – these need to be integrated business circumstances
 - Future economic circumstances
 - Integrated scenario of interest, inflation, stock market conditions
 - What happens with sales in that scenario?
 - What happens with lapses?
 - Pandemic
 - How much excess mortality?
 - Implications for sales?
 - Implications for lapses?
 - Implications for economic conditions?

Business Plan

- Most companies / societies produce at least a one-year plan
- Many do 3 to 5-year plan
- Forecasts sales, investment income, expenses, benefit payments, changes in actuarial liabilities, taxes, etc
- Look at net income, total comprehensive income, total assets and surplus; capital ratios

Annual Cycle at Foresters –

Q1

- Start with the approved Business Plan
- After year-end, rebalance assets and liabilities to actual values at year-end
- What has happened since the plan was established?
 - Economic conditions
 - Sales
 - Any other emerging experience
- Establish a base that is consistent with the plan (but not necessarily identical)
- Design possible future conditions that could impair the fulfilment of the plan – adverse scenarios

Annual Cycle at Foresters – Q2

- Complete projections under these adverse scenarios
- What management actions would mitigate the adversity; incorporate those actions into the projections
- Calibrate against our Risk Appetite criteria
- Present full DCAT Report to Board of Directors
- Start next year's planning process; forecast sales for rest of current year and following year, similarly expenses and economic conditions – update model
- Consider the adverse scenarios – start to consider management actions

Annual Cycle at Foresters –

Q3

- Draft of next year's plan is presented to Board in August
 - What is still outstanding?
 - What issues will be addressed before the final plan?
- True-up again to second quarter actual results; assets and liabilities; recalibrate to current economics
- Based on preliminary sales, expenses, economic conditions, experience studies, model any other management action that appears appropriate; for example:
 - Do products need to be re-priced or withdrawn?
 - Should there be a dividend scale decrease (or increase)?
 - Can you eliminate some expenses (or do you have to increase)?
 - Are new products planned?

Annual Cycle at Foresters – Q4

- Incorporate all of latest thinking, based on actual sales and expenses to the end of Q3; redo projections
- Consider carefully the current year forecast – plan can only be “right” with the right starting point
- Model additional stress or sensitivity tests – risks that are well-understood to be our most significant
- Calibrate these against risk appetite to ensure that major risks are identified and discussed in plan document
- Present plan to Board in November for approval

Annual Cycle at Foresters

- Almost continuous process
- Seeing DCAT as part of ongoing risk assessment process
- Seeing the plan as part of our risk mitigation process
- Model maintenance is critical – keeping it up-to-date with products, capital structure
 - E.g. in 2009, Fraternal was split as separate line of business
- Reality is that DCAT, the business plan and risk monitoring are not yet perfectly integrated, but that is my stated goal for our Finance and Actuarial teams

Future State – Guideline E-18

- OSFI defines more requirements
- Looking for more integration of risk management into regular management
- Expecting more in terms of stress and sensitivity testing on more frequent basis:
 - More extreme than DCAT scenarios
 - Analysis over a shorter time horizon
 - Without mitigating actions
 - Macro and company-specific risks
 - Reverse scenarios – how bad a scenario can be withstood?

Future State – Guideline E-18

- Expect analysis of impact on capital position
- Timing of DCAT – must be first 6 months of year (2010)
- OSFI will define some scenarios
 - Assist in identifying systemic risk
 - Assist in comparison of relative riskiness of all insurers
- Company models will have to be “approved”
 - Appropriate calibration
 - Pass the “use” test – models are used for management decisions
- And more

Questions?