

General Insurance Stress Test 2015

In 2015 the Prudential Regulation Authority (PRA) conducted a General Insurance Stress Test exercise for all Category 1 and 2 UK regulated general insurers. 63% of the general insurance market (by premium) participated, covering 26 insurance groups across 39 legal entities.

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Eleven stress tests were examined, covering market-wide, difficult-to-assess and horizon scenarios.

The purpose of this exercise was to assess the market-wide impact of specific scenarios, to assess how these losses would be borne by different firms, and to explore individual firms' vulnerabilities.

Insurers were asked to consider eleven stress tests, which can be grouped into the following three categories:

- Market-wide scenarios: those that could reasonably be expected to impact a number of insurers simultaneously and for which the PRA has been able to define the scenario in sufficient depth to ensure broad consistency;
- Difficult-to-assess scenarios: industry ability to assess emerging and difficult-to-assess risks that have potential for systemic risk; and
- Horizon scenarios: identification of risks to be included in future stress tests.

Market-wide stress tests

Five stress tests were examined, covering economic shocks, natural and man-made catastrophes.

Key findings:

- Overall the sample insurers are resilient against specific market-wide stresses.
- The economic scenario is the most material shock, in which losses are primarily driven by credit spreads widening.
- Insurers are heavily invested in highly rated corporate debt securities because these are deemed to be a suitable match against their liabilities.
- The largest insurers are able to withstand scenarios such as US hurricanes, due to their diversification and improvements in managing concentrations.
- Significant reliance is placed on reinsurance, but these counterparties are well diversified at an industry level.
- Insurers have a wide range of views on the likelihood of market-wide stress tests. This inconsistency is driven by differing views on correlation between multiple events, different approaches or differing interpretations.

Difficult-to-assess scenarios

Four scenarios were examined, covering supply chain disturbance, liability stresses, impacts of a solar flare and a serious cyber attack.

Key findings:

- Emerging and complex risks require common terminology and a common framework for the assessment of exposure before a wider assessment of firm and sector resilience can be determined on a consistent basis.
- Individual firms interpret reverse stress tests differently. Some target recovery while others assume the point at which the firm goes into run-off.

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Reserve stress tests needs to be more clearly defined.

Horizon scanning

Two scenarios were examined, in which firms identified extreme events that would render their business plan unviable.

Key findings:

- limited consistency as to how insurers are assessing their reverse stress test
- little commonality was identified in the risks
- examples of events are:
 - catastrophes;
 - hyper claims inflation;
 - operational; and
 - counterparty reinsurance credit risk.

Next Steps for the PRA

The PRA will increase focus on the supervision of insurers' processes for exposure measurement and management. The results of the stress test exercise will be used to inform the design and implementation of future exercises, and the PRA will consider whether there would be merit in increasing the number of participants.

The full letter can found [here](#).

Three points to take away:

1. The most material scenario is the economic shock, which is a bit surprising given that GI investment portfolios are typically less adventurous. We normally see more risk taking investment portfolios in the life insurance sector.
2. More work is required on creating a universal understanding of emerging risks, such as supply chain, solar flares and cyber.
3. Reverse stress tests needs to be more clearly defined, particularly with regards to the trigger at which the business model is rendered unviable.

Barnett Waddingham has experience in helping firms set up their stress and scenario framework and scenarios. Please contact your usual Barnett Waddingham contact for further information. Alternatively contact Cherry Chan via the following:

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