GUIDANCE NOTES FOR LICENCED INSURERS ON RESILIENCE TESTING
November 2021

1. Introduction

This note provides guidance on the circumstances in which it is appropriate to carry out resilience testing and on the assumptions that should be made. This guidance applies to both long-term and general insurance business.

2. Asset / Liability Matching

Unless there is a close match between assets and liabilities, the insurance company is exposed to a potential loss if investment markets change. Examples of such a mismatch are:

- A general insurance company with long-term employers' liability claims, which are linked to the cost of living. If claims reserves do not increase in line with inflation there is a potential for a loss to be made.

- A general insurance company that invests a portion of its short term claim reserves in equities or long dated fixed interest securities. There is the potential for a loss if equity markets fall or interest rates rise.

- A life insurance company that mismatches annuity assets and liabilities by duration, for example by holding a portfolio of fixed interest securities that are of a shorter average duration than the liabilities. A loss will occur if interest rates fall, and it is therefore not possible to reinvest the proceeds of the securities to provide a sufficiently high yield to meet the assumptions inherent in the annuity pricing basis.

- A life assurance company that does not hold sufficient equities to match its unit linked liabilities. If equity markets rise and the remaining liability is covered by cash, there is a potential loss.

It is rarely possible to achieve a perfect match between assets and liabilities. The purpose of regular resilience testing is to minimise the exposure to an acceptable level given the financial strength of the insurer.

3. Resilience Testing Basis

The Commission does not intend to lay down a prescriptive basis for resilience testing since this will depend upon the nature of the business and the risks underwritten. In particular some companies writing general insurance business where claims are settled shortly after being incurred may decide that resilience testing is not appropriate if they follow a similar short term investment strategy with all reserves being held in bank deposits.

The assumptions should be realistic, but sufficiently large to show the impact of a significant market movement. For example a movement of equity values of plus or minus 25% is not inconceivable in a volatile market. Similarly a movement in interest rates of plus 4% or minus 2% would be realistic if current rates were 4%. Consideration should also be given to possible changes in the shape of the yield curve, e.g. a rise in medium term interest rates and a fall in long-term rates.

Where liabilities are linked to inflation, consideration should be given to the impact of changes in the real rate of return as well as a significant increase in the level of inflation from current levels.

If the resilience testing demonstrates that there is a mismatch between assets and liabilities, the company should have regard to its capital position and consider establishing a specific mismatching reserve to ensure that it can still satisfy the minimum solvency requirements if market conditions change.

4. Control and Monitoring

The basis adopted for resilience testing should form part of the guidelines adopted by the Company regarding the acceptability of any asset / liability mismatching. The basis should be reviewed on a regular basis in line with changing market conditions and changes in the type of risk underwritten or business undertaken by the company.