Risk-based capital and governance in Asia-Pacific: emerging regulations
Changing regulations in a changing market

Across the Asia-Pacific region, countries are reviewing their approach to regulation and holistic risk management. Regulators are synchronizing their efforts across borders, as they introduce new risk-based capital (RBC) or revisit existing RBC frameworks.

Regulatory changes present both challenges and opportunities for insurers. More investment will be required. But when those investments are directed effectively, the business as a whole will benefit.

Asia-Pacific is different

This e-book report outlines the current status of regulatory changes and RBC regimes in key countries across the Asia-Pacific region.
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The implications of RBC

- A robust regulatory framework is good for the industry, but will increase the cost of compliance
- Changing regulations may prompt innovation and provide incentives to enhance organizational metrics
- Better-managed companies may benefit from lower capital requirements
- Companies focusing on new business value will look more closely at in-force value management
- Deeper understanding of risk profiles and appetites will be needed, as will more sophisticated modeling of risk-adjusted returns
- Convergence of regulations toward RBC will make the Asia-Pacific insurance markets more attractive for foreign investments
- Customers may benefit from new ideas and solutions and a healthier competitive marketplace will result
The China Insurance Regulatory Commission (CIRC) is adopting a system similar to Europe’s Solvency I. Internal risk management, solvency reporting, financial analysis and supervision, regulatory intervention, and bankruptcy remediation. The Solvency regulation system was developed 2003-07.

The Chinese insurance industry is actively looking to learn from the experience of developed markets.

Increased complexity and risk in fast-growing market

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A new system is needed

- Current limitations in providing good guidance for improved risk management
- To meet local market needs and provide experience for other emerging markets and the international insurance industry
- The transition period and new measures are still unclear at this stage
Australian Prudential Regulation Authority (APRA) seeks to harmonize cross-industry risk management

Recent enhancements to regulatory regime: capital adequacy framework and draft conglomerate supervision

Higher cost of compliance is topic of government inquiry into Australia’s financial system

Current standards

- 2013: Life and General Insurance Capital (LAGIC) for general and life insurers
- Three-pillar approach consistent with Basel III and Solvency II
- The aim is to assess and meet the country’s evolving needs and support economic growth
- Topics such as recovery and resolution planning will be a natural extension of stress- and scenario-testing exercises
- International capital standards (targeted for 2019) impact only a few larger insurers
A decade of strong growth

- 155 authorized companies - diverse set of firms
- Office of the Commissioner of Insurance (OCI) oversees industry
- A rule-based capital adequacy regime in place since the 1980s, with predefined formula (based on SI) to determine solvency margin requirement
- New Independent Insurance Authority (IIA) in works
- Aligned with international standards and practices
- OCI consulting with the industry about RBC since 2013
- Expected implementation in 2016
- Focus on need to maintain a level playing field for all insurers

New RBC framework

- Latest Insurance Core Principles, Standards, Guidance and Assessment Methodology (ICP) from IAIS
- Experience of overseas jurisdictions Incentives to introduce enhanced risk management
- Ease of use
- Avoidance of regulatory arbitrage
Life (24 companies)
- Huge impact of opening market in 2001
- 30% CAGR for nearly a decade, but slowing growth with regulatory changes

General (28 companies)
- 16% CAGR in last decade
- Evolving regulation, entry of new private companies, changing demographics, and greater disposable income driving growth

Market in flux – political uncertainty, slower economic growth, regulatory changes and increased competition

Current solvency model
- Factor-based with a set formula determined by Insurance Regulatory and Development Authority
- Method for establishing capital requirements is easy, with no consideration of the underlying risk
- Minimum capital requirement INR1 billion

Plan for new RBC framework
- Leveraging broader parameters of US, UK and Canada
- Target implementation: 2018-19
- Focus on enterprise risk management components – data controls and governance
Indonesia

Large and high-growth market with many challenges

- Expanding middle class and young population driving savings and investment products
- Life insurance growing exponentially
- Microinsurance market gaining traction with low-income consumers
- More new entrants to the market and greater opportunities for mergers, acquisitions and joint partnerships
- Changing regulations and stricter capital requirements aim for greater transparency and stability

New RBC regime launched in 2013

- Guidelines for the creation of technical reserves
- Guidelines for calculating risk-based minimum capital
- Financial healthiness of insurers and reinsurers

Challenges with new regimes

- Valuation discount rate: discrepancy in the discount rate between statutory and accounting rules and a mismatch in asset and liability valuation
- MAD: need to conduct solid experience studies and determine confidence levels of 75% for margin for adverse deviation

Key issues moving forward

- Setting up a risk management framework
- Separation of conventional and sharia business (mainly life and health microinsurance) products
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**Current RBC framework**
- Statutory requirements since 2009
- Introduction of ICAAP in 2012 challenged industry
- Parliament aims for risk-focused, integrated approach to regulation and supervision across financial services

**Moving forward**
- Future convergence with IAIS core principles
- Focus on risk and capital management
- More guidelines expected in ERM implementation, recovery planning and corporate governance

**Malaysia**

**Strong market focused on stability**
- Well-developed, stable economy – strong GDP growth and low inflation
- Demographics generate demand for takaful insurance and bancassurance
- Wide-ranging reforms aimed at improving regulatory efficiency and increasing competition
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RBC updates underway

- Risk calibration features of RBC framework finalized for 2017 implementation
- Risk-focused approach in assessing capital adequacy and reflecting most relevant risks
- Minimum capital prescribed serves as buffer to absorb losses
- Early intervention by Monetary Authority of Singapore (MAS) if necessary

Further updates being assessed

- RBC 2 review underway in light of evolving market practice and global regulatory shifts
- In 2014, consultation paper released with detailed technical specifications of quantitative impact study
- New proposals include solvency intervention, asset and liability interventions, required capital components
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Future enhancements expected

- Increased confidence levels for interest rate risk
- Lower solvency ratio
- IFRS 4 Phase II to be introduced in 2018

Current RBC approach

- Financial Supervisory Service (FSS) introduced RBC in 2009, with goal of soundness and stability in the overall insurance industry
- Ongoing reviews aligned to that objective
- FSS encourages insurance providers to adopt risk-based management in their governance
- 2012 changes subdivided capital classes and categorized risk factors
- Enhanced RBC calculation methodology added reverse margin risk in 2013 and raised confidence level of risk factors in 2014
- Recent changes have led some insurers’ solvency margin ratio to fall below recommended ratio of 150%
Thailand

Current state

- RBC framework and gross premium valuation (GPV) regime implemented in 2011, with testing to gauge impact and gather response
- Temporary RBC exemptions to deal with difficulties associated with floods
- Solvency requirement increased in 2013
- Market testing would allow regulators to gather industry responses and assess financial impact on insurers
- Insurers would have to reconsider their business plans and capital management plans in order to optimize profit and capital

Looking ahead

- RBC 2 features address shortcomings of previous approach
- More emphasis on qualitative risk measures, with stress testing and consideration of additional risks
With many changes to come, insurers must:

- Understand the operational implications
- Make adjustments to their future business plans and investment needs
- Consider both specific tactical modifications and broader strategic initiatives with potentially dramatic effects on entity rationalization and capital optimization
- Draw upon the experiences and challenges in more developed markets relative to regulation, economic shifts and the purchasing behavior of policyholders
Contacts

Martin Bradley
Global Risk & Regulatory Leader
mbradley@uk.ey.com
+44 20 7951 8815

Ranjit Jaswal
Asia-Pacific Risk & Regulatory Leader
ranjit.Jaswal@hk.ey.com
+852 2846 9888

Jonathan Zhao
Asia-Pacific Insurance Leader
jonathan.zhao@hk.ey.com
+852 2846 9023