Towards a Risk Based Capital framework

11TH SEMINAR ON CURRENT ISSUES IN LIFE INSURANCE

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NOVEMBER 24, 2015

Agenda

Introduction and background

Possible Models

Key Considerations

Transition roadmap

LIAG Industry Opinion: RBC Questionnaire

- A questionnaire was circulated by LIAG to solicit industry views on the various aspects of RBC in November 2015. Throughout this presentation, we present the relevant summary of the feedback received.
- We received responses from the Appointed Actuaries of 15 life insurance companies in India:

Aegon Religare Life	DHFL Pramerica Life	HDFC Life	Kotak Life	Reliance Life
Bharti AXA Life	Exide Life	IndiaFirst Life	Max Life	SBI Life
Birla SunLife	Future Generali Life	ICICI Prudential Life	PNB MetLife	Shriram Life

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Introduction
Solvency standard in India: the Journey so far

Extant regulation: ALSM Regulations, 2000

INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY

NOTIFICATION

New Delhi, the 14th July, 2000

Insurance Regulatory and Development Authority (Assets, Liabilities, and Solvency Margin of Insurers) Regulations, 2000.

F.No. IRDA/Reg/7/2000.—

In exercise of the powers conferred by clauses (y), (z) and (za) of sub-section (2) of section 114A of the Insurance Act, 1938, (4 of 1938), read with section 26 of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999), the Authority, in consultation with the Insurance Advisory Committee, hereby makes the following regulations, namely:-

1.Short title and commencement.—(1) These regulations may be called the Insurance Regulatory and Development Authority (Assets, Liabilities, and Solvency Margin of Insurers) Regulations, 2000.

(2) They shall come into force from the date of their publication in the Official Gazette.

2. Definitions.—(1) In these regulations, unless the context otherwise requires —

(a) "*Act*" means the Insurance Act, 1938 (4 of 1938);

(b) "*Authority*" means the Insurance Regulatory and Development Authority established under sub-section (1) of section 3 of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999);

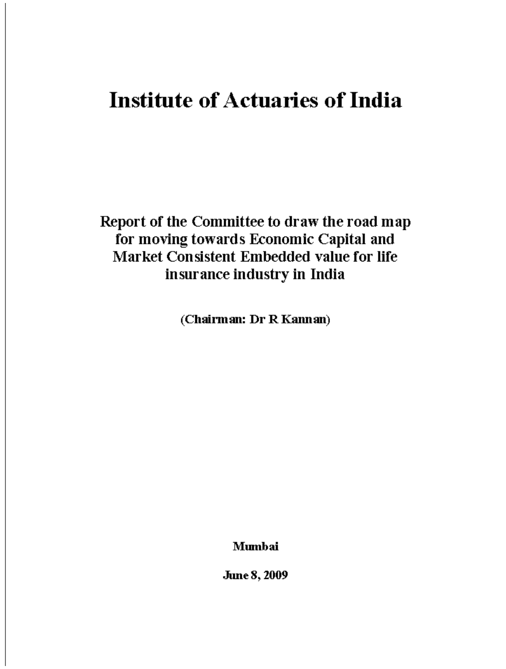
(2) All words and expressions used herein and not defined but defined in the Insurance Act, 1938 (4 of 1938), or in the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999), or in any Rules or Regulations made thereunder, shall have the meanings respectively assigned to them in those Acts or Rules or Regulations.

3. Valuation of Assets.--Every insurer shall prepare a statement of the value of assets in Form IRDA- Assets- AA in accordance with Schedule I.

1983GI/2000-3

Sets out the framework for existing factor-based solvency standard for life insurers.

June 2009: roadmap for moving towards Economic Capital



Institute of Actuaries of India

Report of the Committee to draw the road map for moving towards Economic Capital and Market Consistent Embedded value for life insurance industry in India

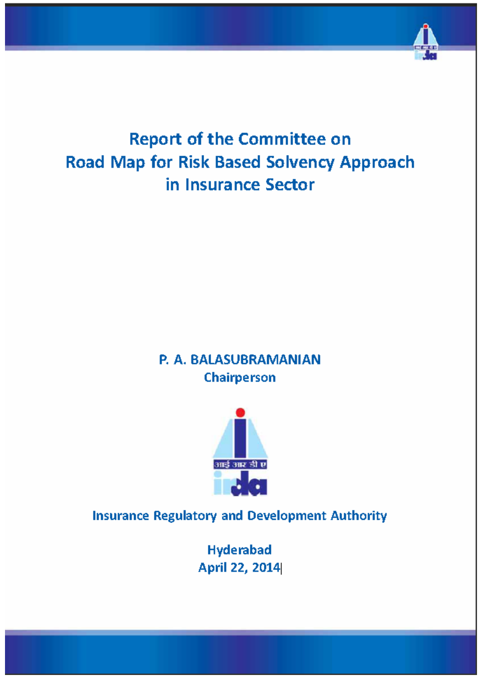
(Chairman: Dr R Kannan)

Mumbai

June 8, 2009

Introduced EC for life insurers in India, with subsequent circular mandating private submissions of an internally calculated EC to the regulator

April 2014: roadmap for RBC approach in the insurance sector



Report of the Committee on
Road Map for Risk Based Solvency Approach
in Insurance Sector

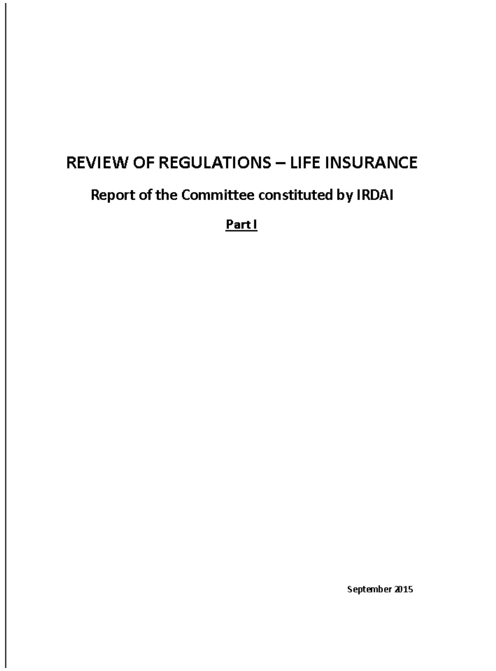
P. A. BALASUBRAMANIAN
Chairperson

Insurance Regulatory and Development Authority

Hyderabad
April 22, 2014

Suggested up to 3 Quantitative Impact Studies starting 31 March 2014, with adoption of a "twin peak" approach to solvency by 31 March 2017

September 2015: review of regulations – life insurance



REVIEW OF REGULATIONS – LIFE INSURANCE

Report of the Committee constituted by IRDAI

Part I

September 2015

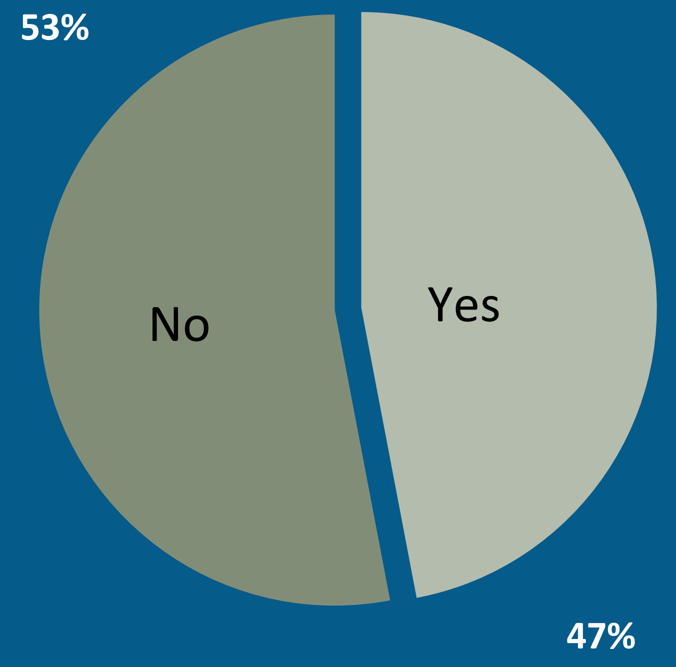
Proposed to keep unchanged the core of the current supervisory structure, with RBC to form another layer so as to supplement the existing solvency structure

WHY is revisiting the current solvency framework pertinent?

An effectively defined capital requirement serves several purposes:	Efficacy of the current regime
❑ provides a rainy day fund, so when bad things happen, there is money to cover them	✓ (too conservative?)
❑ motivates a company to avoid undesirable levels of risk (from a policyholder perspective)	MAYBE?
❑ promotes a risk measurement and management culture within a company, to the extent that the capital requirements are a function of actual economic risk	???
❑ provides a tool for supervisors to assume control of a failed or failing company	✓
❑ alerts supervisors to emerging trends in the market	MAYBE?
❑ ensures that the insurance portfolio of a troubled insurer can be transferred to another carrier with high certainty.	✓

Research Report of the Insurer Solvency Assessment Working Party
INTERNATIONAL ACTUARIAL ASSOCIATION

Are we comfortable with current set of Solvency Regulations on Capital Management?



Please note: A total of 15 responses

Industry view: a mixed perception regarding desire to change the current regime.

Both merits and demerits of the current regulation were given due consideration

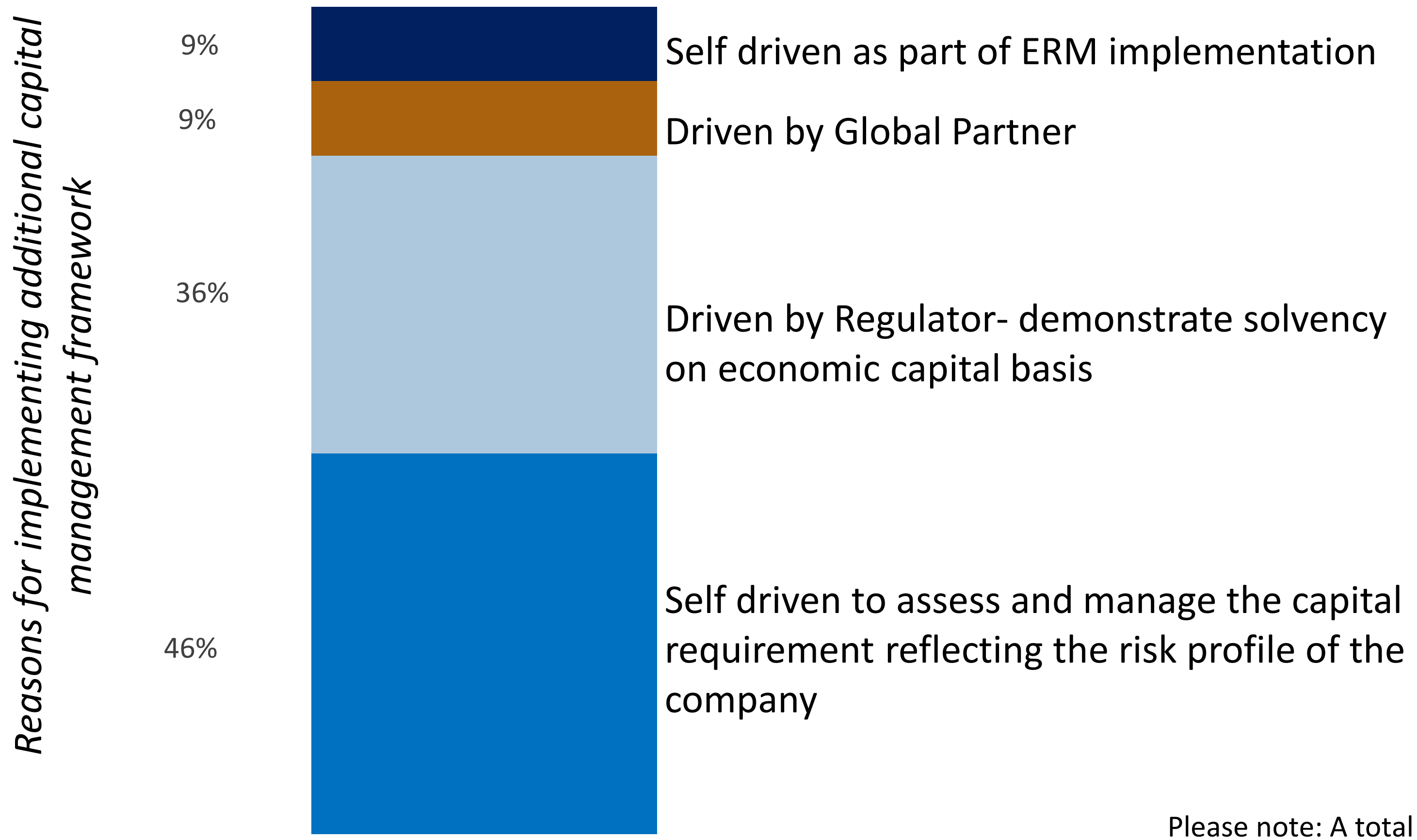
Merits:

- Easy to understand & implement
- Ensures consistency across companies

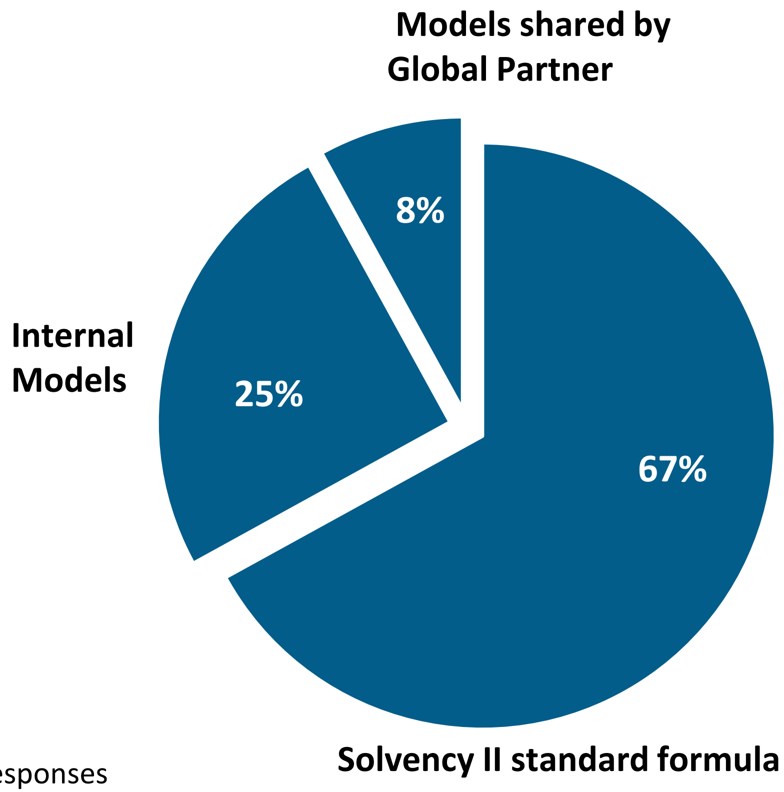
Demerits:

- Factors used for different line of business are not based on actual experiences
- Doesn’t take into account Risk Management practices adopted by Insurers
- Qualitative considerations, such as good Corporate Governance, are ignored.
- Riskiness of the investment portfolio is not given due consideration

Industry view: in two-thirds of the cases, regulatory solvency assessments are being supplemented by internal capital models to provide adequate risk oversight



Additional capital management framework adopted by companies



Please note: A total of 12 responses

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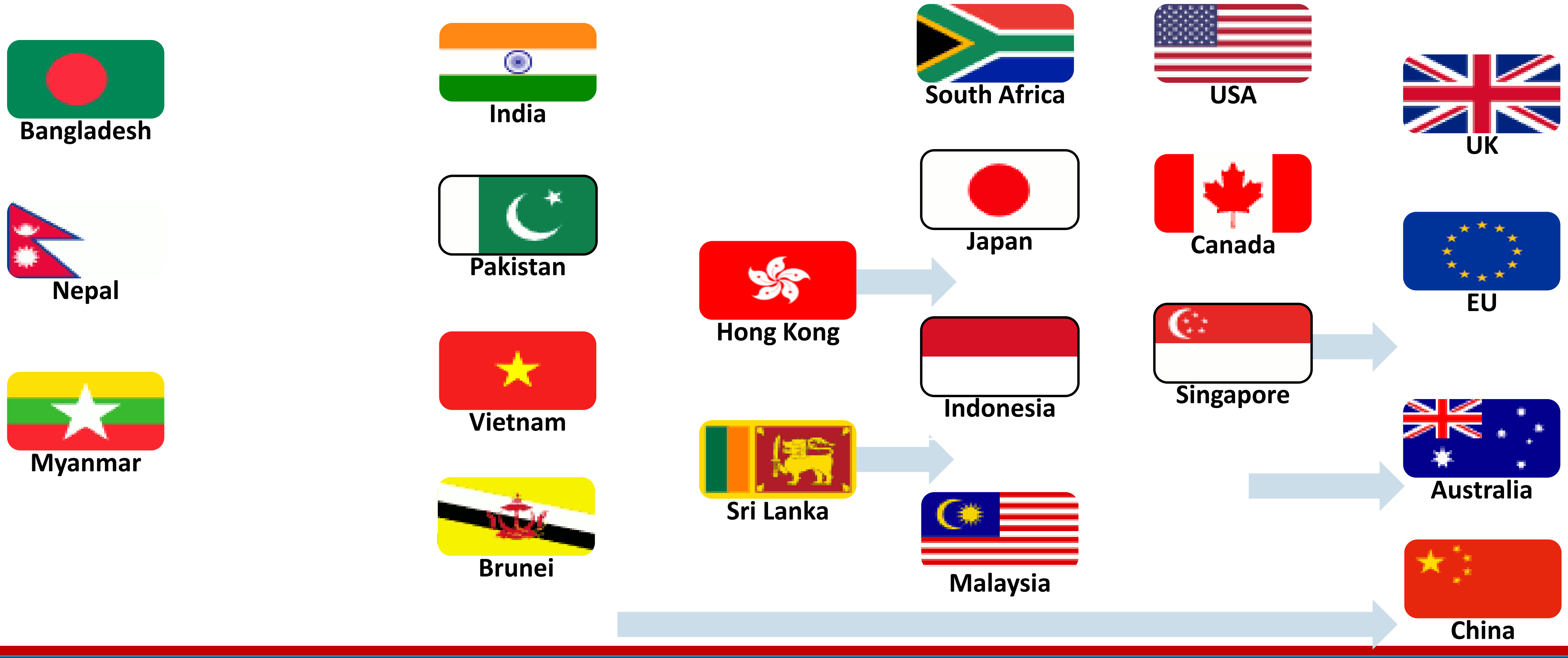
WHAT could a revised solvency framework look like?

Clear global shift towards risk based regimes: are we lagging

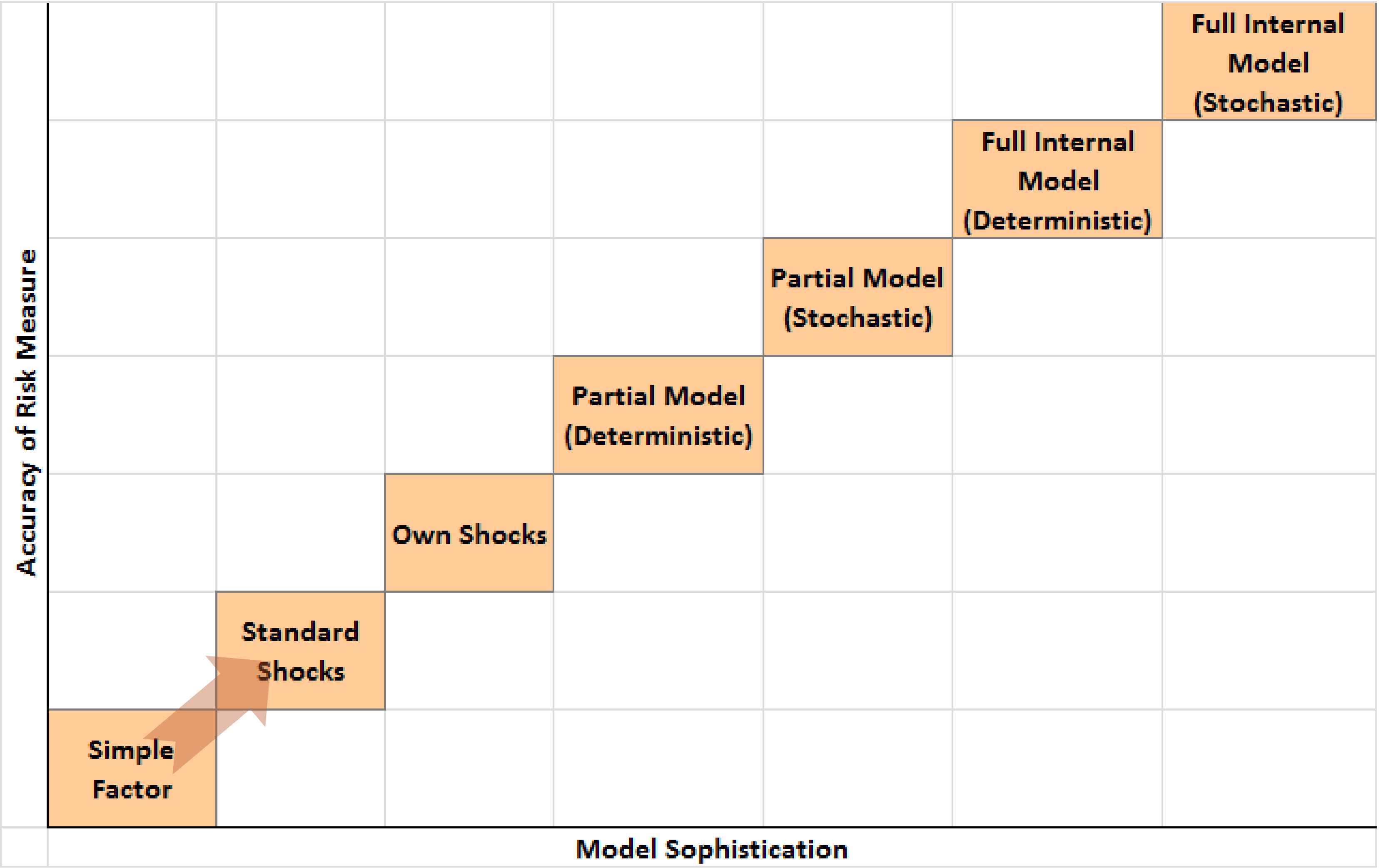
No Solvency Standard	Factor-based solvency standard	Risk-based solvency standard	Internal model based solvency standard

Global points of reference



WHAT could a revised solvency framework look like?

A clear trade-off between accuracy of risk-measure and model sophistication



Consider:

Regulator ↔ Industry engagement

Calibrations:

- **Who?**
- **How?**

Methodologies and practices well established in many cases: We needn't reinvent the wheel

Importance of "relevance"

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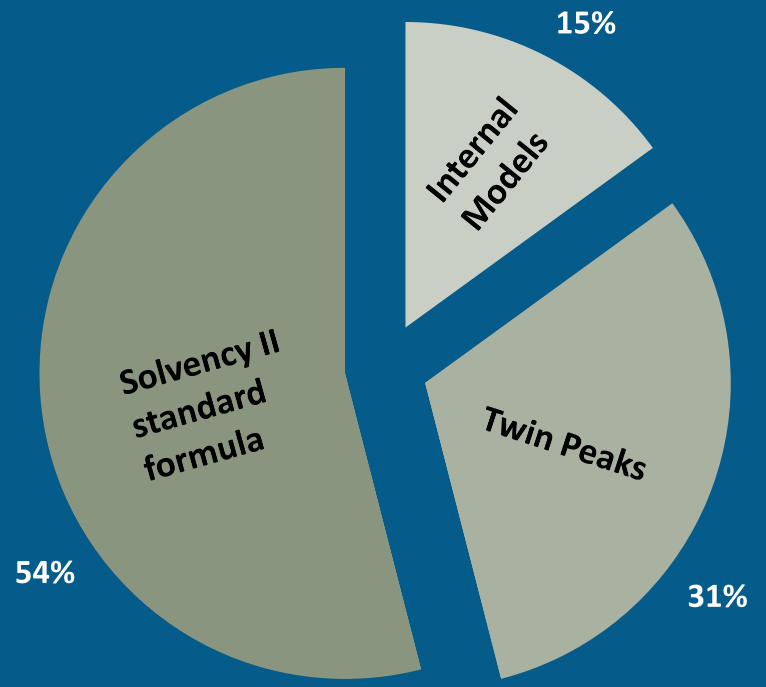
Which RBC framework is suitable for Indian Life Insurance Industry?



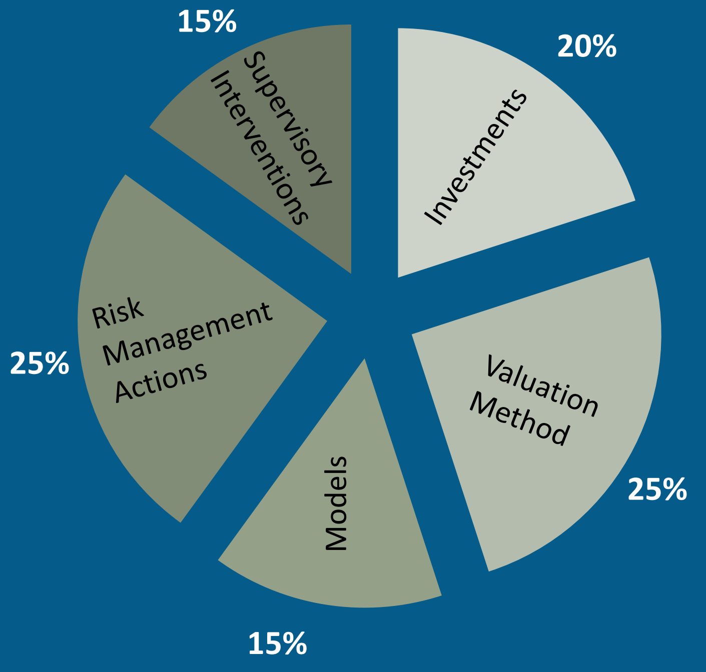
Please note: A total of 15 responses

Solvency II standard formula appears to be the preferred choice, with the following modifications proposed:

- Stresses and correlation matrix should be calibrated with reference to the Indian context
- Simplification of the model in light of unavailability of local expertise
- Amendment of disclosure requirements
- Changes in Operational Risk calculation methodology in line with the Indian Market
- Due consideration of Investment opportunities available with Insurers
- Reduce subjectivity in calculation

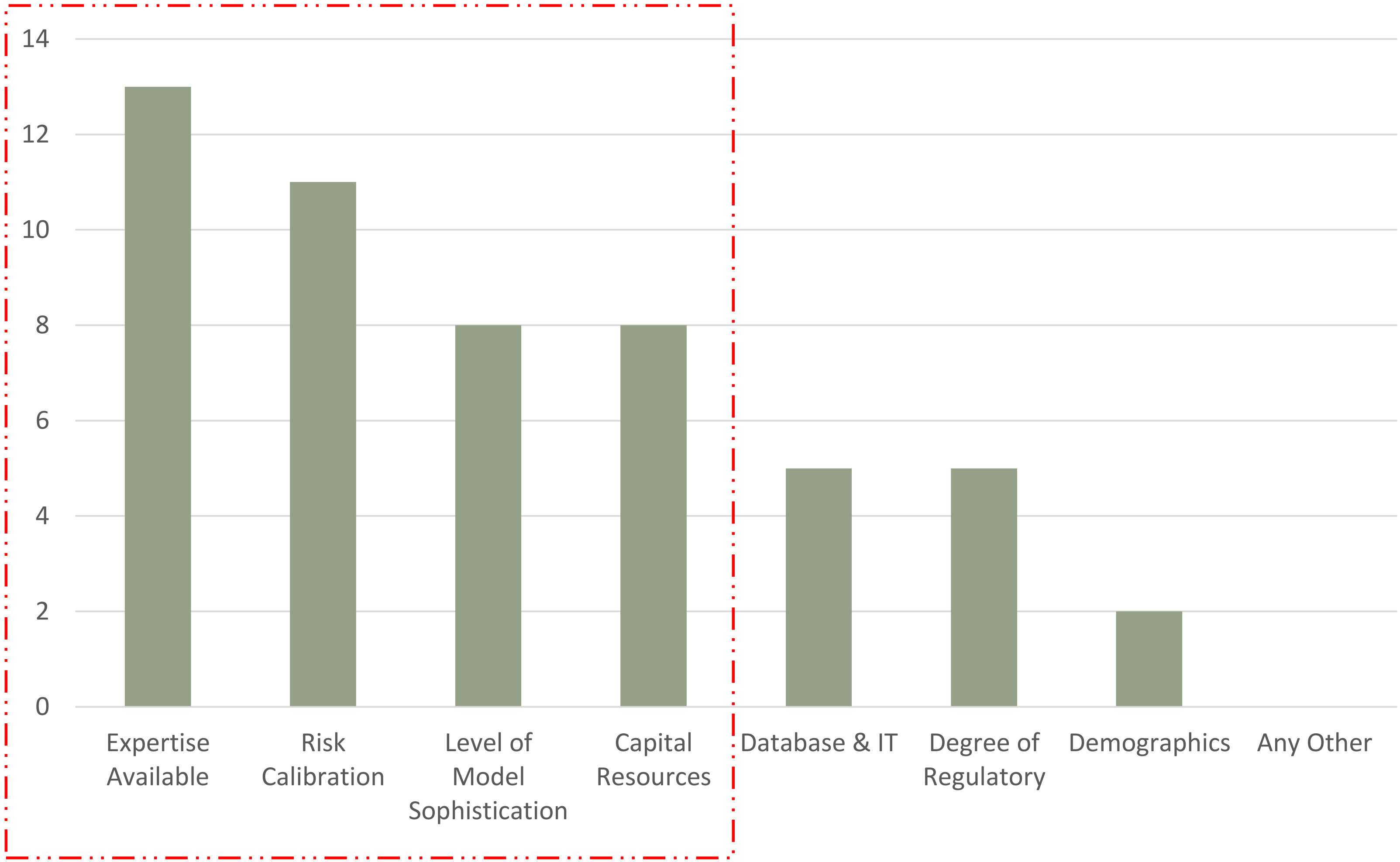
Other frameworks like use of Internal models for economic capital calculation or Twin Peaks approach were also suggested with similar modifications

Weightage of factors to be considered while framing regulations on Capital requirements



Please note: A total of 15 responses

Key challenges in adopting a change in the current solvency framework



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How? A possible roadmap: Solvency II

More than 9 years to implement

1 — 2007

European commission adopted the Solvency II proposal with four level structure

- Level I
- Level II
- Level III
- Level IV

3 — 2009

Level 1: main rules of the regime was adopted

Level 2: CEIOPS consulted publicly on the policy to be covered by the Level 2 rules followed by QIS5

3 — 2011

EU proposed OMNIBUS II directive-an amendment to level 1 directive

Revised version of QIS technical specification was produced

4 — 2014

OMNIBUS-II directive was adopted

5 — Jan, 2015

European Commission (EC) adopted the Delegated regulation containing implementing rules for Solvency II

6 — Mar, 2015

The first set of Solvency II Implementing Regulations laying down implementing technical standards with regard to the supervisory approval was adopted

7 — End, 2015

The second set of Implementing Regulations is expected to be adopted before the end of 2015

8 — Jan 2016

Application of the Solvency II regime

How? A possible roadmap: C-ROSS?

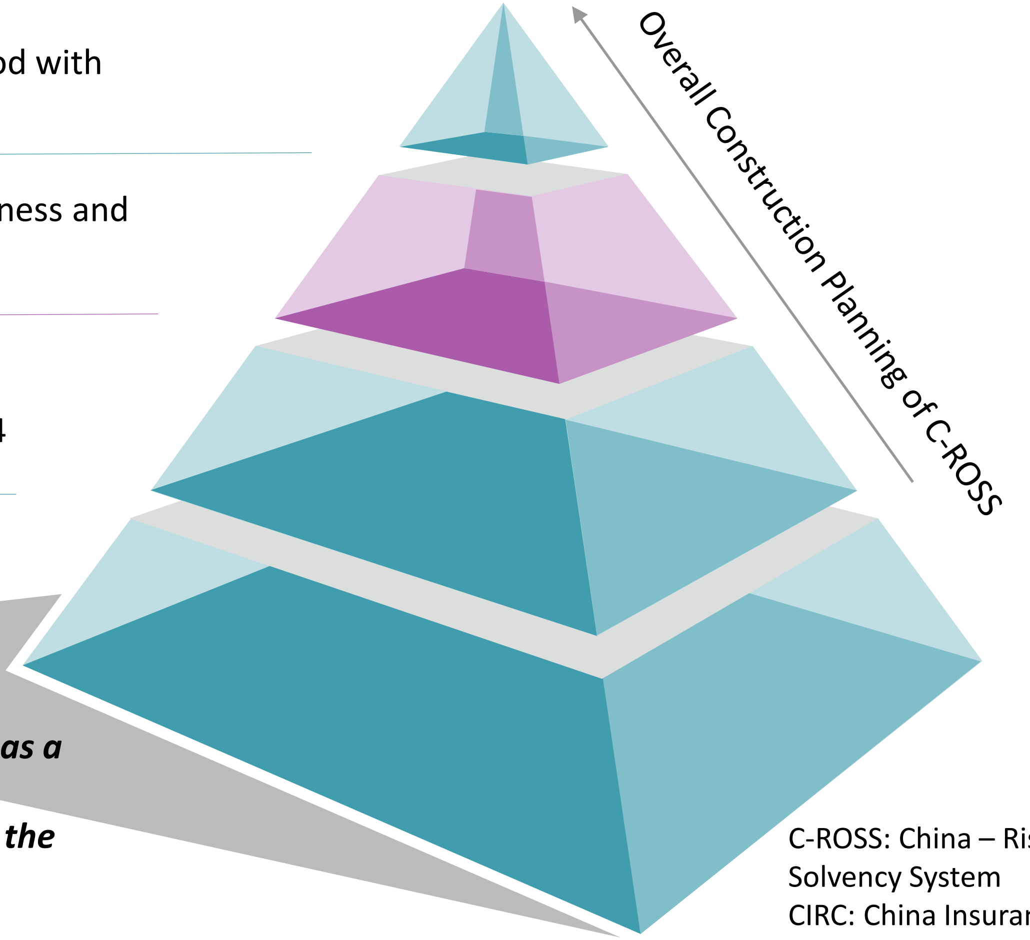
Evolution of Chinese Solvency Regulation

Full implementation of C-ROSS is targeted in 2016 with a transition period with respect to meeting the capital requirements.

Industry testing started in 2014 with the aim to evaluate the reasonableness and practicability of the C-ROSS formula

In 2012, CIRC researched various solvency standards with a target delivery for a new risk-based solvency formula by the end of 2014

Prior to 2012, minimum capital requirements were set based on the 3 year average of net written premium and 3 year average of net reported losses



Key challenges - balance between specific companies' features as well as a standard approach to fit for all

The implementation went fairly smoothly due to the high authority of the regulator in China

C-ROSS: China – Risk Oriented Solvency System
CIRC: China Insurance Regulatory Commission

How? A possible roadmap for India

Twin peaks approach – running the two frameworks in parallel for some time

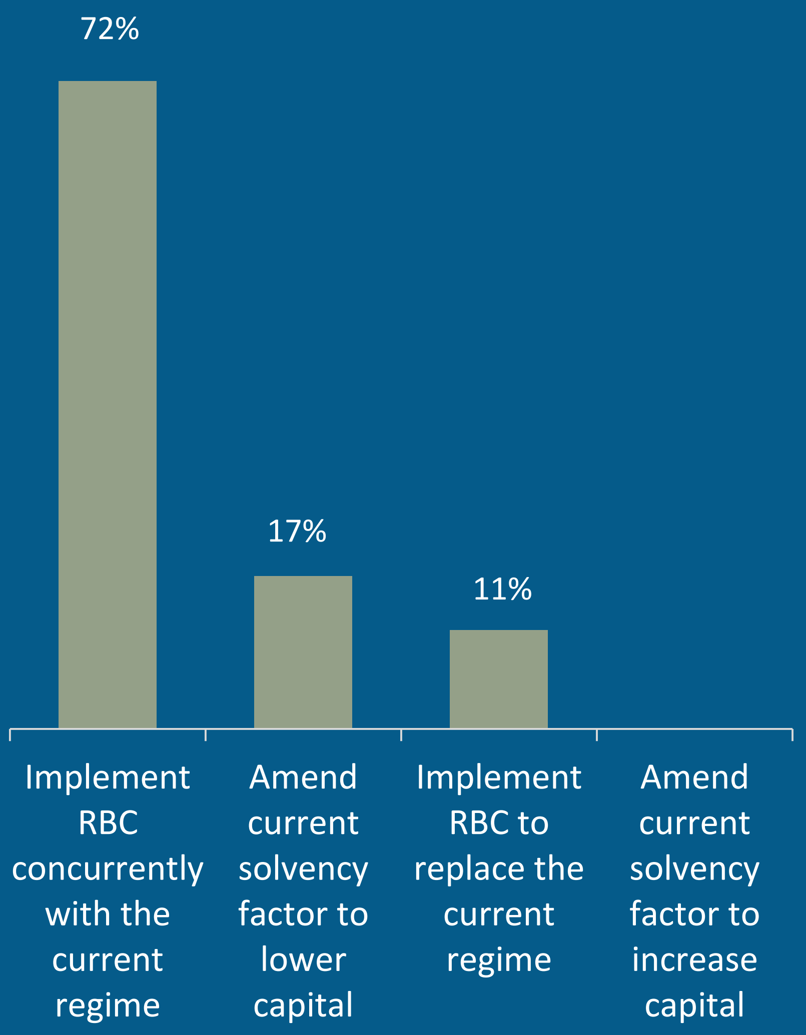
Quantitative study route – similar to QIS studies by EIOPA for Solvency II

Economic Capital or RBC – based on internal models calibrated by the insurers

QIS: Quantitative Impact Study

EIOPA: European Insurance and Occupational Pensions Authority

How do you want the RBC framework to be implemented?



Please note: A total of 15 responses

Majority of respondents want the implementation of RBC framework in India, given the dynamic macro economic environment & emerging risks in the country

Suggestion were made to implement the RBC framework in a phased manner, concurrently with the current regulatory regime before replacing it so as to prepare better for the change

The respondents voiced over their concern on the high solvency factor currently been used for capital requirement under current regime

Thank you

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