Insurance Group Capital Current Developments

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Content

- Capital concepts (5 minutes)
- Capital adequacy (5)
- IAIS – Insurance Capital Standard (10)
- US – Federal Reserve (2.5)
- US – NAIC (2.5)
- Questions & Answers (5)

Definition of Capital 1 of 2

- Excess of assets over liabilities
- Varies by accounting basis (Canadian, US stat, US GAAP, IFRS, S2)
- Synonyms – surplus (insurance accounting term), equity (the basic accounting term) (capital is a regulatory term)

Definition of Capital 2 of 2

Major variations caused by

- Selection of liability discount rate
- Admissibility of assets (i.e. what asset you count)
- Some debt not counted as debt (surplus notes)
- Degree of conservatism in liabilities / existence of MOCE
- Current vs original assumptions
- Revenue/expense matching
- Reflection of counterparty reliance
- Recognition of policyholder ownership

Uses of Capital 1 of 2

- Enhances Ability to pay off policyholder obligations in adverse situations (scenarios)
- Sustainability of business (going concern)
  - New business (assuming there's a new business strain. Not always the case)
  - Acquisitions (sometimes. Some acquisitions don't use capital)
  - Research
  - Interest earnings support operations
  - Absorb adverse fluctuations
  - Dividends – policyholder and shareholder (most often these derive from earnings)

Uses of Capital 2 of 2

- Major users of capital information are shareholders, rating agencies, regulators, policyholders, management

Capital Adequacy   1 of 4

Required capital is the minimum amount of regulatory capital that has to exist (i.e. the amount of assets you need in excess of your liabilities as defined) – below which regulators are legally empowered to take actions up to management of the company.

- In US, addresses existing policyholders
- Around the world, in some jurisdictions, also includes financial stability (employment, insurance availability)

Capital Adequacy

– Can’t have too little… shouldn’t have too much
– Supervisory authorities around the world establish the required amount of capital, usually tiered by type of regulatory action

Capital Adequacy 3 of 4

Ten principles to be used to set supervisory capital adequacy requirements (from Academy)

- Be clear regarding purpose and goals
- Metrics and info should be useful to all parties
- Promote responsible risk management
- Consider local jurisdictional environments
- Be compatible across accounting regimes

Capital Adequacy 4 of 4

Ten principles (continued)

- Minimize pro-cyclical volatility
- Present realistic views of financial position and exposures to risk
- Assumptions should be internally consistent
- Focus on total asset requirement
- Demonstrate that capital is accessible
- From TH, perform on regular, timely basis

IAIS ICS 1 of 8

Background

- Who is International Association of Insurance Supervisors
  - Member of FSB, which is called upon by th eG20
  - 200 members including 50 US states
- ICP's, then ComFrame, then HLA
- Solo insurers, IAIG's, G-SII's
- BCR (applies to groups) to be replaced with ICS

IAIS ICS

Development of Insurance Capital Standard

- Extensive Field Testing (in midst of 4 year period)
- Results available only to supervising regulators and participants
- Interested parties have limited input
  - Field Testers (50)
  - Trade Associations,
- 250 question consultation document issued last summer
- Three years are behind us; three years to go

IAIS ICS 3 of 8

ICS Features 1 of 3

- Start with MAV or GAAP +
- If GAAP +, use current assumptions
- Contract boundary definition different from IASB’s
- Develop a MOCE
- Discount rate options
- No explicit ALM
- Targeting a 99.5% VAR under 1-yeaar time horizon

IAIS ICS 4 of 8

ICS Features 2 of 3

- Has some elements similar to Solvency 2 (Europe, Australia, Singapore
- Multiple correlation matrices
- Future tax rates
- Life company stress tests – mortality, morbidity, longevity, lapse, expense
- Non-life risk factors for premiums and claims
- Also considerations for these risks:
  - Operational
  - Market (interest rate, equity, real estate, currency)
  - Credit (default)

IAIS ICS 5 of 8

ICS Features 3 of 3

- Need to define head of insurance group
- Capital likely to be tiered as in banks – meaning will have tiers, but the tiers in insurance will be different than for banks. And not defined by the banking tiers
- Non-insurance entities
- Modeling effects of natural and man-made catastrophes (typhoons, earthquakes, pandemics, terrorism)
- Submitting data so supervisors can develop factors

IAIS ICS 6 of 8

Key concepts still in the spotlight 1 of 2

- Interplay between ComFrame and ICP’s – Major review just initiated
- Redundancy between MOCE and capital
- Use of ALM
- Use of internal models
- Discount rates – 2017 field test will likely look at
  - Blend of prescribed rates/curves
  - Based on own assets with guard rails
  - AA minus a spread (industry says A is more typical)

IAIS ICS 7 of 8

Key concepts still in the spotlight 2 of 2

- Linkage between assets and liability rates
- Surplus notes and senior debt
- Elimination of artificial volatility
- Non-insurance entities
- Fungibility
- Valuation of participating and non-guaranteed element products

IAIS ICS 8 of 8

Timeline ahead

- May 2017 – specs for 2017 Field Testing
- July 2017 – release of ICS 1.0
- 2019 – release of ICS 2.0
- IAIS cannot mandate that its standards be enacted but it expects its members to implement to the best of their ability

US Federal Reserve 1 of 4

Federal oversight

- Systemically Important Insurance Companies (2) (was 4) and
- Insurance Depository Institution Holding Companies (12)
- These firms have $2 trillion of assets; 25% of US insurance assets
- FSOC (Financial Stability Oversight Council) designates these
- Enabled by Dodd-Frank

US Federal Reserve 2 of 4

Proposal circulated June 2016

- Would consider consolidated and aggregated approaches
- Wants to strike reasonable balance between simplicity and risk sensitivity
- Pulled away from IAIS initiative a month earlier

US Federal Reserve 3 of 4

Academy responses to proposal

- General
  - Support identification of Chief Actuary (CA) role
  - Support separation of CA and CRO in large organizations
  - Consider entity-level liquidity constraints
- Specific
  - Don’t forget income tax, shareholder dividends and cash needs of non-insurance affiliates
  - For the liquidity buffer requirement, clarify whether it is a liability or a component of capital
  - Are assets identified as highly liquid unavailable to be used to fund any other type of liability?

US Federal Reserve 4 of 4

- Other key considerations
  - Non-insurance and non-regulated subsidiaries
  - Statutory – levels of conservatism in liabilities and permitted practices
  - GAAP – different levels of conservatism by product type (Consolidated)
  - Maintaining this system for future accounting regime changes
- The Elephant in the room – has new president’s (Congress’s) desire to undo Dodd-Frank impaired this initiative?

US – NAIC 1 of 2

- Will address a noted deficiency in FSAP review
- Started Feb 2016
- Number to be calculated – a group capital ratio of Available Regulatory Capital divided by Minimum Regulatory Capital
- Will be an analytic tool, not a capital standard
- Will address entity-by-entity (aggregation)
- Will be an inventory approach and use what is already there
- Factors for non-regulated non-insurers – capital charge of 22.5%
- Factors for regulated non-insures – their capital requirements or 22.5%

US – NAIC 2 of 2

- Factors for insurers who don’t calculate RBC
  - Adapt their results to ours; uses scalars
  - Scalars – considers differences in
    - Valuation standards (assets and liabilities) and
    - Definitions of capital (available and required)
  - Vary by jurisdiction; vary by life/PC
  - A lot of work to initiate and maintain
- Items of curiosity
  - Where is stress testing?
  - What about fungibility?

Insurance Group Capital Current Developments

Questions & Answers