Content

• Capital concepts (5 minutes)
• Capital adequacy (5)
• IAIS – Insurance Capital Standard (10)
• US – Federal Reserve (2.5)
• US – NAIC (2.5)
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Definition of Capital

• 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

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

• 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

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)
– 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
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
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
Background

• Who is International Association of Insurance Supervisors
  – Member of FSB, which is called upon by the G20
  – 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
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
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-year time horizon
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)
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
Key concepts still in the spotlight

- 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)
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
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
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
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
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?
• 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%
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?
Questions & Answers