Asia's Changing Capital Requirements – A Global Perspective

Presentation to the Actuarial Society of the Philippines

Paul Melody BSc., FIA, FSAT

Towers Watson, Asia Pacific

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Asia - very different stages of development…

Developed
Developing
Emerging

India
2014 GDP: 2,050 USD bn
7.4% growth pa
2014 Population: 1,236.3 mn
2014 Life GWP: 49.3 USD bn

China
2014 GDP: 10,272 USD bn
7.4% growth pa
2014 Population: 1,367.8 mn
2014 GWP: 272.7 USD bn

Hong Kong
2014 GDP: 272 USD bn
2.9% growth pa
2014 Population: 7.1 mn
2014 Life GWP: 32.06 USD bn

South Korea
2014 GDP: 1,198 USD bn
2.8% growth pa
2014 Population: 49 mn
2014 Life GWP: 71.1USD bn

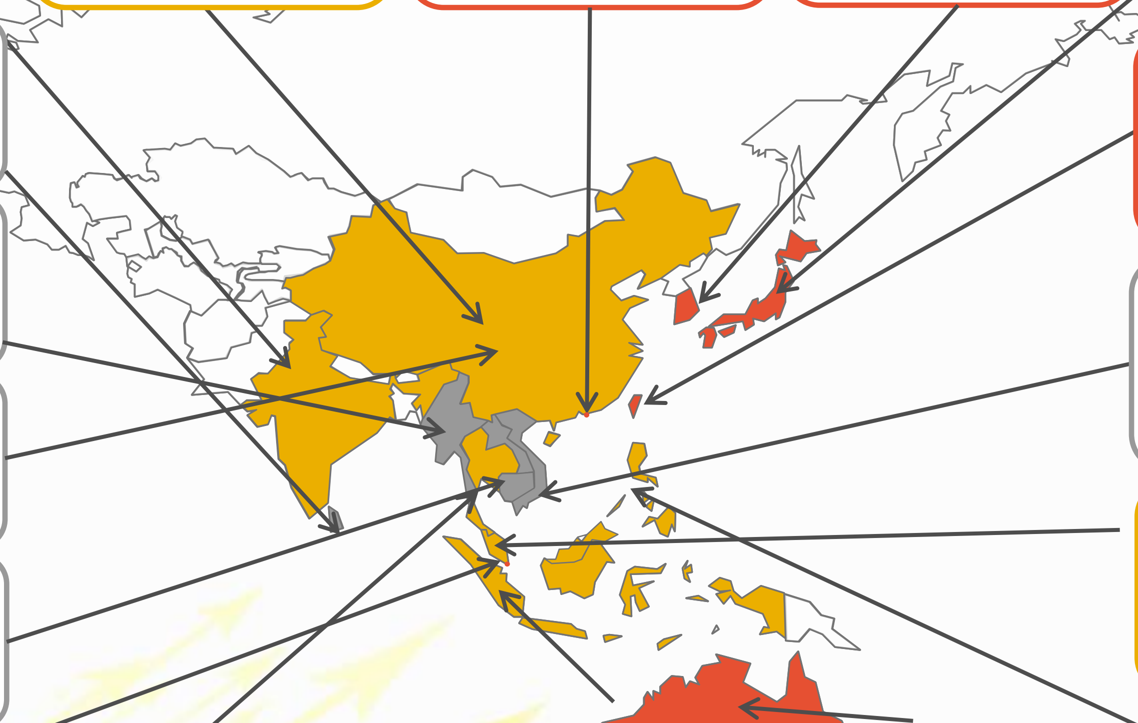
Japan
2014 GDP: 5,007 USD bn
2% growth pa
2014 Population: 127.1 mn
FY13 Life GWP: 281.4 USD bn

Sri Lanka
2014 GDP: 65 USD bn
6.3% growth pa
2014 Population: 21.9 mn

Myanmar
2014 GDP: 59 USD bn
6.8% growth pa
2014 Population: 55.7 mn

Laos
2014 GDP: 10 USD bn
8.3% growth pa
2014 Population: 6.8 mn

Cambodia
2014 GDP: 16 USD bn
7% growth pa
2014 Population: 15.5 mn



Taiwan
2014 GDP: 511.7 USD bn,
3.5% growth pa
2014 Population: 23.4 mn
2014 GWP: 90.0 USD bn

Vietnam
2014 GDP: 170 USD bn
5.3% growth pa
2014 Population: 93.4 mn
2013 Life GWP: 1 USD bn

Malaysia
2014 GDP: 312 USD bn
4.7% growth pa
2014 Population: 30.1 mn
2014 Life GWP: 2.4 USD bn

Singapore
2014 GDP: 296 USD bn
4.1% growth pa
2014 Population: 5.6 mn
2014 Life GWP: 14 USD bn

Thailand
2014 GDP: 401 USD bn
2.9% growth pa
2014 Population: 67.7 mn
2014 Life GWP: 15 USD bn

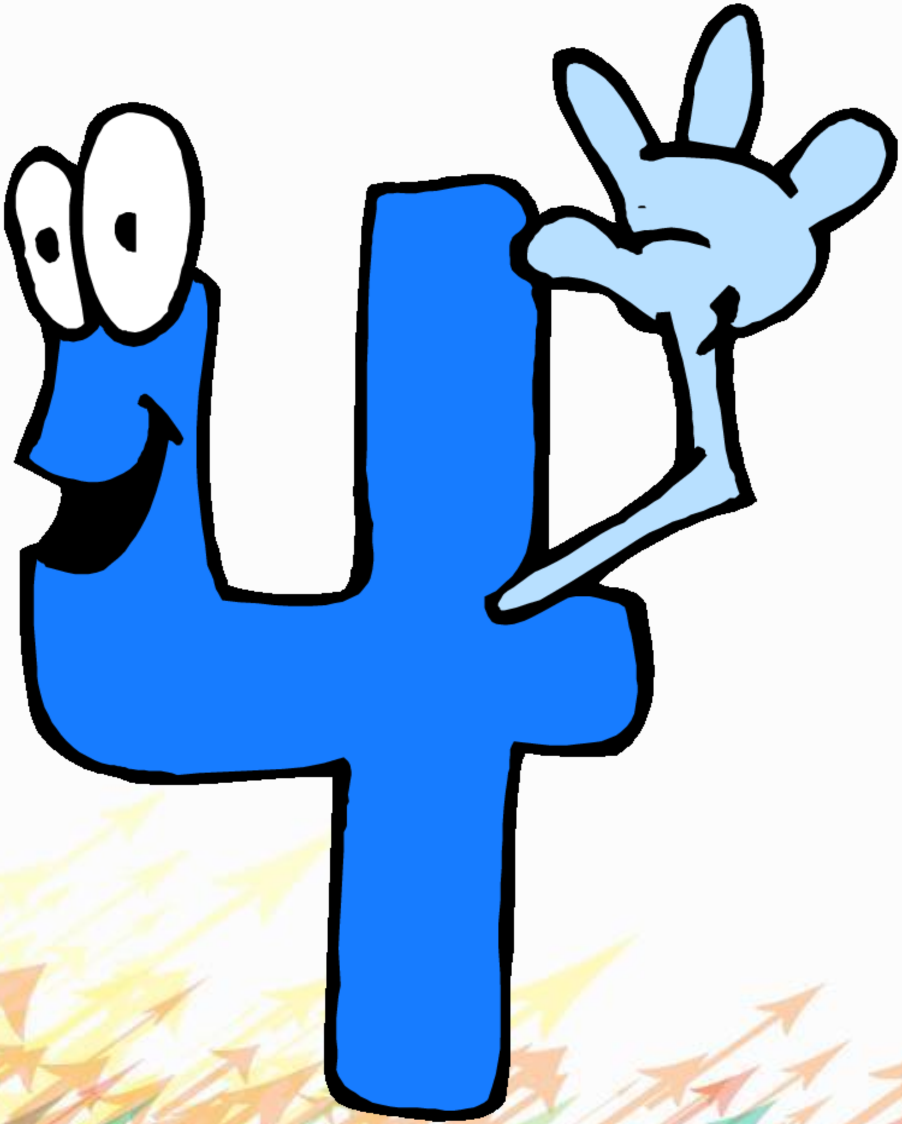
Indonesia
2014 GDP: 868 USD bn
5.3% growth pa
2014 Population: 253.6 mn
2014 Life GWP: 9.8 USD bn

Australia
2014 GDP: 1,488 USD bn
2.5% growth pa
2014 Population: 22.5 mn
2014 Life GWP: 39.2 USD bn

Philippines
2014 GDP: 272 USD bn
6.8% growth pa
2014 Population: 107.7 mn
2014 Life GWP: 3.6 USD bn

Sources: Forbes; Country regulator websites; Towers Watson Analysis (GWP refers to life insurance only), 2013 figures were used where 2014 figures were not available

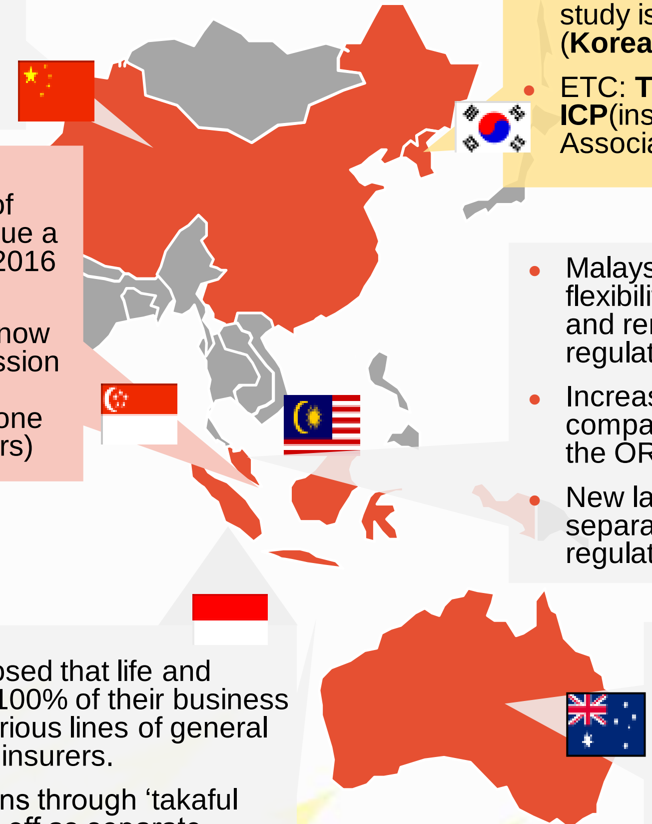
…but they have one thing in common…



…increasingly risk sensitive capital regimes...

- China: The new capital requirements "**C-ROSS**" replace existing volume driven fixed "C-SI" ruling
- C-Ross should promote effective risk and capital management and be internationally comparable

- Singapore: Consultation on **RBC2** continues – the Monetary Authority of Singapore (MAS) now expects to issue a QIS2 specification no later than Q1 2016
- Under the **FAIR initiative** (Financial Advisory Industry Review) the MAS now focusing on the spreading of commission payments on life insurance policies (broadly, no more than 55% in year one and the balance spread over six years)



- Accounting: **Korea goes IFRS**. Currently, impact study is performed - this is **required by the FSS** (**Korean supervisory body**)
- ETC: **Task force** team has been established for the **ICP**(insurance core principle)s **of IAIS** (international Association of Insurance supervision).

- Malaysia: **Proposed liberalisation** with greater flexibility managing insurance company's expenses and remunerations to distributors, which are highly regulated at present; on the other hand:
- Increased focus on risk management and compliance companies to **improve on their ICAP** (equivalent to the ORSA)
- New laws to require to split composite business into separate life and general insurance entities incl. regulations on financial holding company

- Indonesia: The FSA (OJK) has proposed that life and general insurance companies place 100% of their business for covers such as life, health and various lines of general insurance business, with domestic reinsurers.
- Insurers undertaking takaful operations through 'takaful windows' will now have to spin these off as separate businesses within ten years.
- OJK has issued Regulation No 10/2014 requiring Non-Bank Financial Institutions including insurers to assess their risk level. Insurers are required to submit their risk self-assessment by 28 Feb 2015

- **Three-pillar approach like SII** since 2013 for Life and General insurance
- Local equivalent of the ORSA is the Internal Capital Adequacy Assessment Process (ICAAP)
- Recent changes in governance and risk management standards: The **CRO must not be** the CEO, CFO, Appointed Actuary or Head of Internal Audit
- IFRS adopted

…and one of the reasons for these changes is…

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- **Global capital standards?**
- The devil is in the detail
- WIIFM?
- A personal wish list
- And finally…

…but there are others…

- The Global Financial Crisis
- Insurance Core Principles (ICPs)
  - Financial Sector Assessment Program of the IMF
- Insurance Capital Standard (ICS)
- Peer pressure
  - Regulators
  - Other solvency regimes

ICPs - the start of global standards?

- International Association of Insurance Supervisors has issued 26 Insurance Core Principles.
- Relevant ICPs include:
  - ICP 14: Valuation – Requires that assets and liabilities be valued consistently, reflecting risk adjusted PV's of cash flows. Both market and book value approaches are allowed.
  - ICP 17: Capital Adequacy – Required capital should be based on the nature, scale and complexity of the risks faced and be feasible in practice. No specific categories of risk are mandated.
  - ICP 16: Enterprise Risk Management
- ICPs are scheduled to be updated again in 2017.

Why the ICPs matter…

- The ICPs have no legal force of their own. Each jurisdiction is free to adopt its own standards. However…
  - The International Monetary Fund conducts a Financial Sector Assessment Program ("FSAP") that evaluates the quality of supervision of the financial sector around the world.
  - The FSAP covers all sectors - banking, securities and insurance.
- The assessment of the insurance sector is based on the extent to which the supervisory framework complies with the ICPs.
- The observance of each ICP is evaluated as Observed, Largely Observed, Partly Observed or Not Observed.

…as an example…

🟢 Fully Observed 🟡 Largely Observed 🔴 Partly Observed

Jurisdiction	Type of Regime	ICP 14	ICP 17
Hong Kong	NPV / Solvency 1	🟡	🔴
Singapore	GPV / RBC	🟢	🟡
Malaysia	GPV / RBC	🟢	🟡
Korea	NPV / RBC	🟡	🟡
USA	NPV / RBC	🔴	🟡

We also have the International Capital Standard…

- The IAIS is also developing the Common Framework ("ComFrame") for the Supervision of Internationally Active insurance Groups ("IAIGs").
- IAIGs are large multi-national insurers companies, defined as:
  - Assets > US% 50 billion
  - Operating in at least 3 countries
  - At least 10% of premium outside of home jurisdiction
- One of the components of the ComFrame is the ICS.
- The ICS is intended to be a group-wide capital standard.
- Initial field testing in September 2015, with further testing planned in 2016 and 2017.
- The future direction of the ICS is not clear. Significant disagreements between the US and the European regulators.

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But this is easy, isn't it…

Common challenges

Current RBC framework vs. IAIS ICPs (14 and 17, plus elements of others) as well as emerging regional and international best practices

Improved risk sensitivity – coverage of additional risk factors – operational, liquidity, group

Definition of tier 1 vs. tier 2 capital

Risk margin calculation approach

Aligned with other regulations

Minimum paid-up capital and minimum available capital levels

Diversification – between risks within a category, and between risk categories

Standard formula vs. user defined parameters vs. internal models

Target sufficiency level for calibration – between capital levels and between risk categories

Impact of IFRS4

…or maybe not?
Life insurance, as an example

Technical considerations

- Valuation of non-guaranteed benefits
- Discount rate used – e.g. Par, smoothing, interest rate risk
- Dividends and coupons on deposit
- CSV floor
- Consistency of liability valuation approaches – RBC vs. accounting vs tax standards
- Allowances for other forms of risk mitigation
- Reinsurance – recognition of financial re
- Unit-linked products
- Reinsurance – net liability vs gross liability
- Recalibration of risk charges
- Diversification within life insurance risk

… and these are often particularly challenging …

- Setting a discount rate for the liabilities
  - Discount rates beyond a last liquid point
  - Allowance for an illiquidity premium
- Valuation of participating business
  - Allowance for future (discretionary) benefits
  - Methodology
    - – Earned rate consistent with expected dividend scales
    - – Dividend scale consistent with expected earned rates
- Uneconomic nature of a cash surrender value floor on reserves
  - Potential impact on development of long-term savings products
- Allowance for negative reserves?

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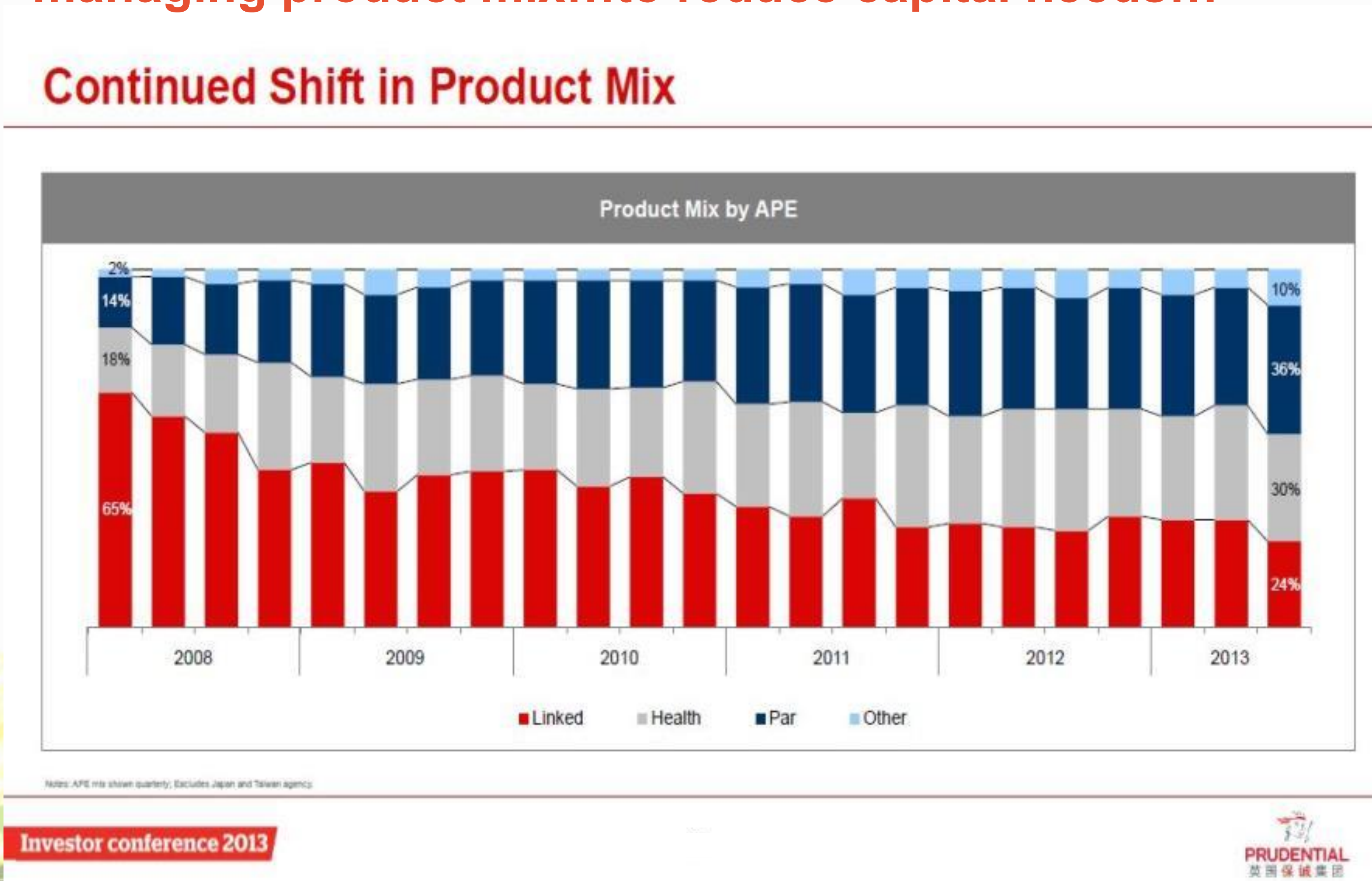
Change offers challenge but also opportunity…

Areas of Capital Management

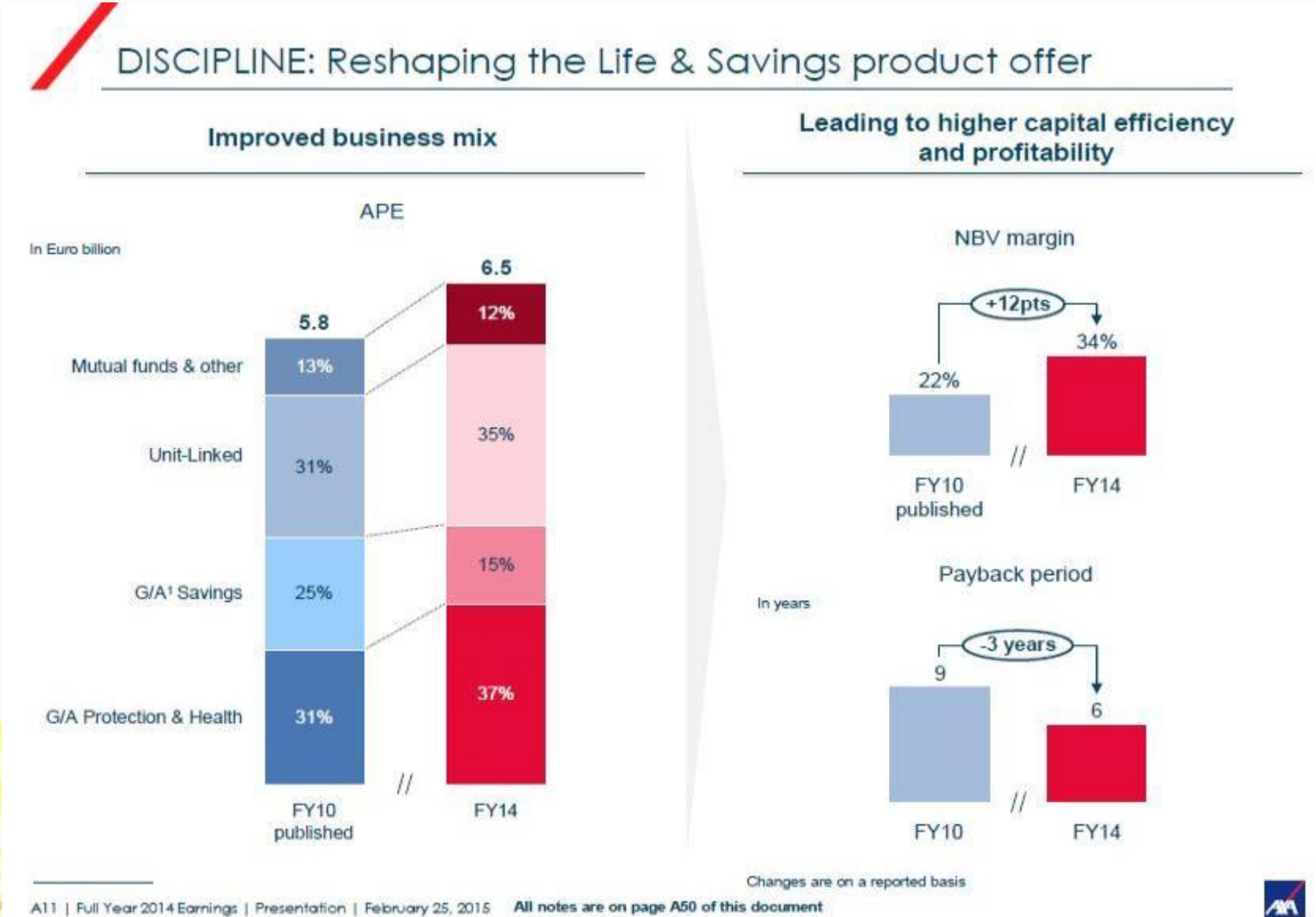
Financial/ actuarial	Business management	Investment	Reinsurance	Capital solutions	Business reorganisation
Review models for prudence	Product redesign/ repricing	Asset portfolio redesign/ restructure	Reinsurance optimisation	Equity raising	Discontinue/ run-off certain lines of business
Review actuarial reserves/DAC for prudence	**In-force management**	Cashflow/ duration matching	Internal reinsurance	Debt structuring	Reorganisation of corporate legal structures
Accounting and tax optimisation	Ongoing business volume/ mix management	Derivatives/static/ dynamic hedging	Risk transfer/ external reinsurance	Contingent capital	Redomiciling/ branch structures
Regulatory arbitrage	Underwriting and claims management	Credit	Financial reinsurance	Sidecars or equivalent	Internal captives/ resources
Inter-group arrangements	Expense management and outsourcing	Alternative Investments	Securitisation	Other (non-reinsurance) internal transactions	Purchase/sale of business/blocks of business

Possible Capital Management Actions

As an example…
managing product mix…to reduce capital needs…



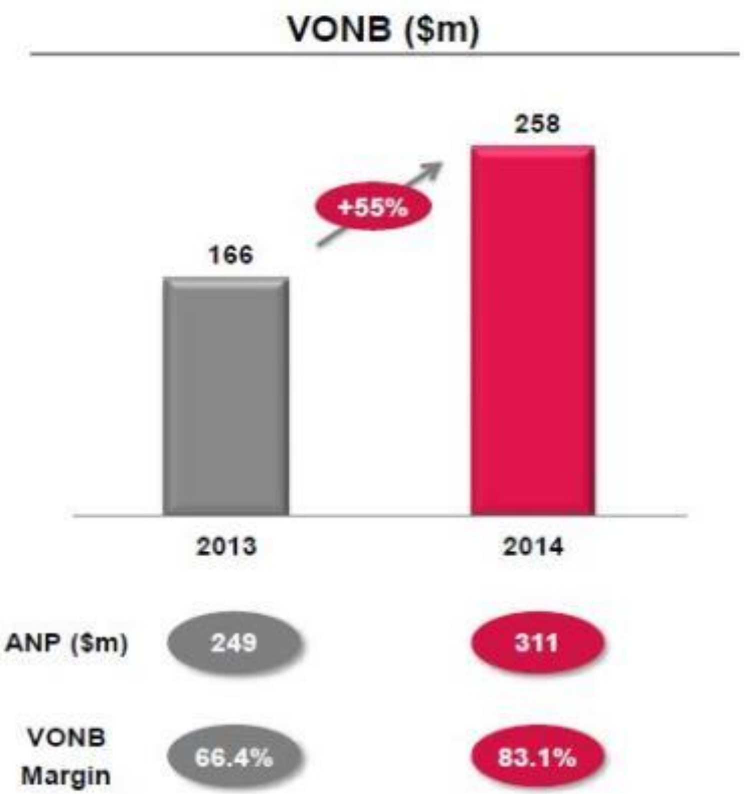
…and improve returns…



…sometimes significantly…

China: Sustained Outperformance

THE REAL LIFE COMPANY



- **Premier Agency**
  - Focus on superior recruitment, best-in-class training and leadership development
  - MDRT qualifiers up 58%
  - Active new agents up 42%
  - Active agent productivity up 9%
  - Increased average agent income
- **Products and Customers**
  - Positive shift towards longer-term savings and protection products
  - Strong sales of new protection and savings products targeting young family segment

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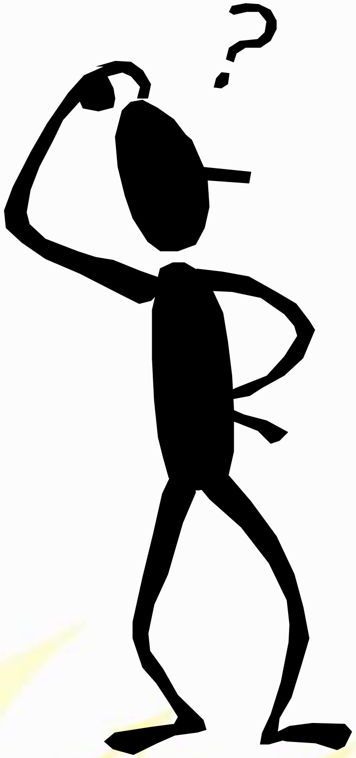
Future direction…my two cents worth…

- Change is inevitable, including in accounting rules…
- But as things develop, the **golden rule** is:
  - KISS (**K**eep **I**t **S**imple **S**tupid)
- Risk sensitive, yes… Solvency II, no
- Rome wasn't built in a day…
  - Products
  - Capital markets
  - Infrastructure investment needs
  - Level playing field
- And finally…

…lest we forget…it is not about taking NO risk…it is about taking MEASURED risks…

Any questions?



Thank you…

Paul Melody
Managing Director
Life Insurance Practice, Asia Pacific

36th Sun Hung Kai Centre
30 Harbour Road
Wanchai
Hong Kong

T +852 2593 4542
F +852 2827 8899
M +852 9173 5332
paul.melody@towerswatson.com

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