CONSULTATION PAPER

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Group Capital Framework for Designated Financial Holding Companies (Licensed Insurer)

Monetary Authority of Singapore

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1 Preface

1.1 The Financial Holding Companies Act ("FHC Act") and its supporting Regulations took effect on 30 Jun 2022. The supporting Notices relating to appointment of key persons, returns, investment activities and enterprise risk management, took effect on 1 July 2022.

1.2 MAS is working towards issuing a new Notice ("Group Capital Notice") that applies to all designated financial holding companies that have a subsidiary that is a licensed insurer incorporated, formed or established in Singapore ("DFHC (Licensed Insurer)"). The Group Capital Notice sets out the valuation and capital requirements for all DFHC (Licensed Insurer) in a transparent manner and based on the RBC 2 consolidation approach. Currently, group capital requirements are imposed on DFHC (Licensed Insurer) via directions drawing from the powers of the FHC Act (prior to enactment of the FHC Act, these directives were imposed via the MAS Act).

1.3 MAS aims to implement the Group Capital Notice by Q2 2023 (in time for Q2 2023 reporting). This consultation paper sets out the key proposals that will be encapsulated within the Group Capital Notice, which MAS would like to seek feedback on.

1.4 MAS invites comments from the insurance industry and other interested parties.

Please note that all submissions received will be published and attributed to the respective respondents unless they expressly request MAS not to do so. As such, if respondents would like (i) their whole submission or part of it (but not their identity), or (ii) their identity along with their whole submission, to be kept confidential, please expressly state so in the submission to MAS. MAS will only publish non-anonymous submissions. In addition, MAS reserves the right not to publish any submission received where MAS considers it not in the public interest to do so, such as where the submission appears to be libellous or offensive.

1.5 Please submit written comments by 15 December 2022 via the link provided here (link to Survey Form).

2 Background

What constitutes a DFHC (Licensed Insurer)?

2.1 A DFHC (Licensed Insurer) is a designated financial holding company that has a subsidiary that is a licensed insurer incorporated, formed or established in Singapore. A FHC group refers to the financial holding company, its subsidiaries and any other company or entity treated as part of the financial holding company's group of companies according to the Accounting Standards.

The Existing Capital Treatment for a DFHC (Licensed Insurer)?

2.2 Group capital requirements are not new regulatory requirements imposed on an existing DFHC (Licensed Insurer). Currently, a DFHC (Licensed Insurer) is already subject to group capital requirements which are imposed via Directions drawing from the powers of the FHC Act. Prior to the enactment of the FHC Act, these Directions were imposed via the MAS Act. The Group Capital Notice aims to set out the valuation and capital requirements for a DFHC (Licensed Insurer) in a transparent manner and based on the RBC 2 consolidation approach.

3 Group Capital Adequacy Requirement

Assessment of Solvency Position

Group CAR

3.1 Under the RBC 2 framework for solo insurers licensed in Singapore, insurers must maintain a minimum capital adequacy ratio (“CAR”) of 100% at the company level. Similarly, for a DFHC (Licensed Insurer), the FHC group will also be required to calculate Group CAR and maintain Group CAR at a minimum level of 100%.

$$\text{Group CAR} = \frac{\text{Group Financial Resources ("Group FR")}}{\text{Group Total Risk Requirement ("Group TRR")}}$$

3.2 Group CAR is defined as above where both the Group FR and Group TRR are to be determined based on the RBC 2 consolidation approach. Given that it is based on the consolidation approach, any effect of intra-group transactions such as intra-group reinsurance arrangements would have to be eliminated. Similar to RBC 2 for solo insurers, the financial resources at the group level must also not fall below a minimum amount of $5 million.

3.3 Group TRR, also referred to as the group prescribed capital requirements, are calibrated at 99.5% Value-at-Risk (“VaR”) over a one-year period. The details of the calculations are set out in the draft Group Capital Notice.

3.4 MAS may consider on a case-by-case basis for aggregation method to be used to calculate Group CAR. Aggregation method derives the Group FR and Group TRR from the sum of the legal entities’ financial resources and total risk requirements that are calculated in accordance with each entity’s local regulatory requirements. The key consideration would be the comparability of the local valuation and capital framework with the RBC 2 framework. Non-insurance entities that are subject to their own sectoral capital requirements, and are scoped within Group CAR calculation, may also be included in the aggregation method.

3.5 Further to the above, MAS may also impose additional capital add-ons on the DFHC (Licensed Insurer) under certain circumstances, for example:

a) To address any areas of deficiencies or supervisory concerns at the group level such as higher operational risks and deficiencies in the group's controls and processes which have led to under-estimation of the group's policy liabilities or capital positions, as well as inaccurate financial figures;

b) To account for any group-related risks not covered at the solo insurer's level such as significant risks arising from intra-group transactions, contagion risks and risks from non-insurance entities or non-regulated entities within the group.

Quality of Capital

3.6 To meet the capital adequacy requirement, the DFHC (Licensed Insurer) will also be required to ensure that minimum quality of capital ratios are met. The quality of capital ratio includes CET 1 and Tier 1 ratios which are to be calculated at the group level. Similar to the approach for solo insurers, the minimum quality of capital ratios ensure that the FHC group holds a minimum level of available capital (excluding those arising from participating business) that are of high quality to meet the group-required capital (excluding the total risk requirements of participating business).

3.7 If an additional capital add-on is imposed at the group level based on paragraph 3.5, the minimum Group CAR to be met by the DFHC (Licensed Insurer) will become (100% + capital add-on). Correspondingly, the minimum CET 1 and Tier 1 ratios to be met by the DFHC (Licensed Insurer) will also increase. We have included a numerical example below to illustrate this:

<u>Example on determination of CET1 and Tier 1 ratios</u>

Assuming that there is a capital add-on of 20% at the group level for risk management deficiencies. The minimum Group CAR to be met would be 120% (ie. 100% + 20%).

The DFHC (Licensed Insurer) must also ensure that –

a) at least 72% (i.e. 60% of 120%) of the Total Risk Requirements ("TRR") (excluding participating business) must be met by CET 1 capital and;

b) at least 96% (i.e. 80% of 120%) of the TRR (excluding participating business) must be met by Tier 1 capital.

Supervisory Intervention

3.8 Upon breach of the capital adequacy requirement, MAS may require the DFHC (Licensed Insurer) to undertake restorative actions such as submitting a plan on how it intends to restore the capital position within a stipulated period, be subject to more frequent monitoring or meet any other conditions imposed by MAS.

3.9 Besides the above, a DFHC (Licensed Insurer) should also notify MAS if any entity within the FHC group breaches its local regulatory solvency requirements.

Scope of the FHC Group for Solvency Assessment

3.10 All entities within the FHC group should be included in the calculation of Group CAR in the assessment of the group's solvency. However, an entity may be excluded if the entity is deemed as not material. For this purpose, an entity is considered as not material if the entity's assets are not more than 1% of the FHC group's total assets. In addition, if there is more than one entity deemed as not material within the group, the aggregate of the assets of these entities should not exceed 5% of the FHC group's total assets. Such a criteria is consistent with the approach under the International Association of Insurance Supervisors' ("IAIS") International Capital Standard ("ICS") currently under development.

3.11 Other circumstances where an entity may be excluded from the calculation of Group CAR includes where the entity is already consolidated as part of the parent group's capital assessment and the parent is a regulated entity by MAS, or the entity is not subject to any sector-specific regulatory capital requirements under the laws where it operates in. For entities where capital may not adequately address the risks involved, other supervisory tools may be prescribed or employed by MAS instead of scoping in the entity in the Group CAR calculation.

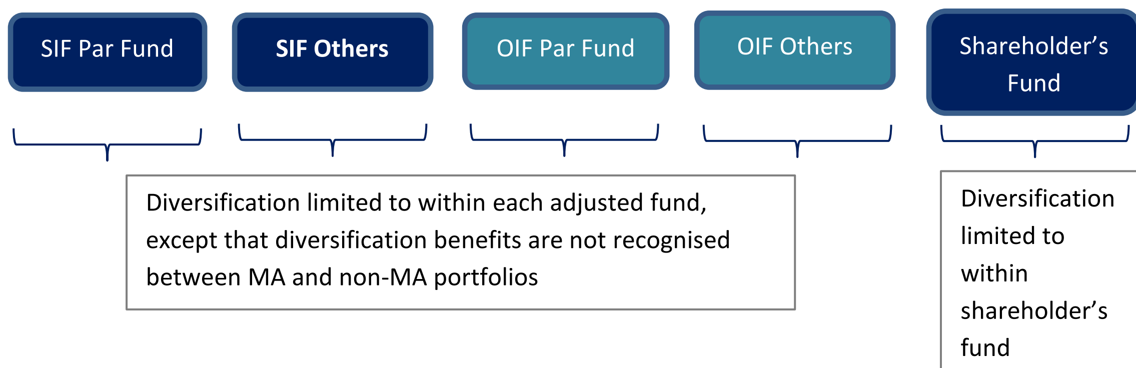
3.12 For entities excluded from the calculation of Group CAR, for prudence, any deficits arising from these entities would be deducted from the Group FR.

Question 1. MAS seeks views on the group capital adequacy requirements as described in paragraphs 3.1 to 3.12 above.

4 Recognition of Diversification Benefits

4.1 Under the RBC 2 framework for solo insurers, diversification benefits are recognised in aggregating risk requirements. This recognises that not all one-in-200 year events would happen at the same time for all risks. For this purpose, correlation matrices are prescribed for the aggregation of the various risk requirements. However, the diversification benefits are limited to within each adjusted fund[1], except for the interest rate mismatch risk requirement which is calculated at the company level (excluding the portfolios with non-fungible capital such as Participating Funds ("Par Funds") and Matching Adjustment ("MA") portfolios). Diversification benefits are also not recognised between MA portfolios and non-MA portfolios given that the assets in the MA portfolios are managed separately to back the liabilities of the MA portfolios. The diagram below illustrates the high-level approach under RBC 2 for solo insurers.

Diagram 1:



4.2 Under the group capital framework, MAS proposes to recognise diversification benefits across portfolios (including portfolios of a foreign insurance entity ("FIE")) so long

[1] Under the Insurance (Valuation and Capital) Regulations 2004, an adjusted fund is –

(a) a participating fund established and maintained by a licensed insurer under the Insurance Act that relates to Singapore policies;

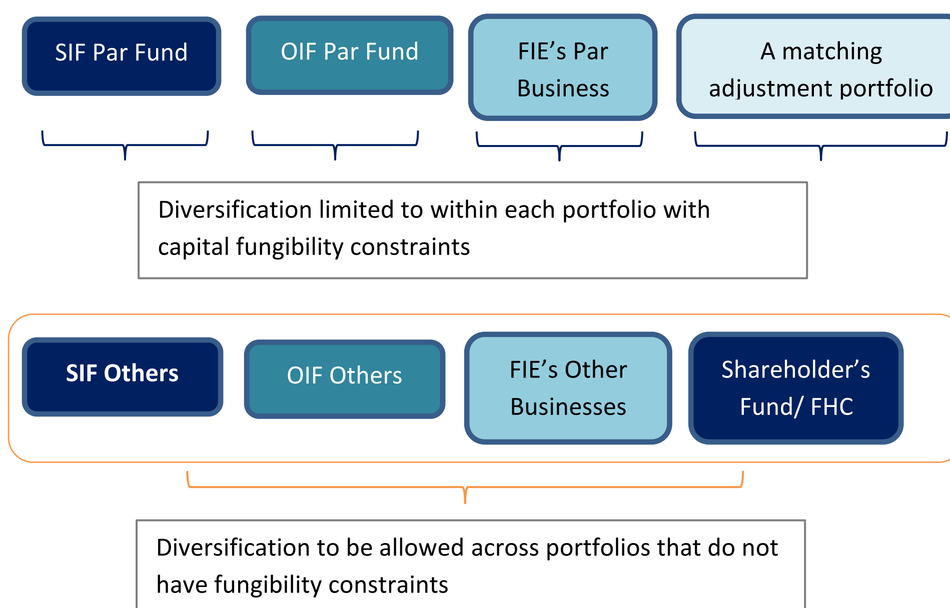
(b) a participating fund established and maintained by a licensed insurer under the Insurance Act that relates to offshore policies;

(c) the aggregate of a non-participating fund, an investment-linked fund and a general fund (if any) established and maintained by a licensed insurer under the Insurance Act that relates to Singapore policies; or

(d) the aggregate of a non-participating fund, an investment-linked fund and a general fund (if any) established and maintained by a licensed insurer under the Insurance Act that relates to offshore policies.

as they do not have capital fungibility constraints. For instance, if capital is genuinely fungible across some of the underlying funds and businesses such as across SIF Others, OIF Others, FIE's businesses (excluding participating businesses), shareholder's fund and holding companies, diversification benefit can be recognised in aggregating the risk requirements from these funds and businesses. This approach at the FHC group level would provide greater latitude in recognising diversification benefits as compared to the RBC 2 solo framework. Portfolios with capital fungibility constraints would include Par Funds, the participating businesses of a FIE as well as MA portfolios, where diversification benefits would be limited to within each of these portfolios itself. The diagram below illustrates the proposed high-level approach under RBC 2 for a DFHC (Licensed Insurer).

Diagram 2:



4.3 The above approach recognises that the extent of diversification benefits that can be recognised is interlinked with the fungibility of capital. Diversification recognises that risk events are not likely to happen at the same time. Hence, capital held for a certain risk event may be used to meet another risk event. However, if capital is not fungible to be transferred beyond a certain portfolio, it would not be prudent to recognise diversification benefits between the non-fungible portfolio with another portfolio. MAS' proposed approach recognises the benefits of diversification at the group level while balancing the need to consider fungibility of capital to meet group risk requirements.

Question 2. MAS seeks comments on the approach taken in recognising diversification benefits at the group level in calculating Group CAR.

Interest rate mismatch risk requirement

4.4 Under RBC 2 for solo insurers, the dominant interest rate scenario (the maximum risk charge arising from upward and downward interest rate shocks) is determined at the company level (excluding Par Funds and MA portfolios). This is on the consideration that interest rates can only move up or down at any one time. At a FHC group level, it becomes more pertinent to determine the dominant interest rate scenario at each currency level given that the group may have one or more foreign entities, and interest rates of different currencies may not always move in the same direction.

4.5 However, MAS recognises that it would be punitive to assume that interest rates of different currencies are completely independent as there are correlations of interest rate movements across currencies (which is also considered under ICS for the interest rate risk module[2]). Furthermore, MAS recognises that there may be insufficient long-dated SGD denominated assets to match insurance liabilities, and hence insurers may invest materially in non-SGD denominated assets. If the dominant interest rate risk scenario is determined at each currency level, the risk requirement is expected to increase, and hence, may discourage investments in non-SGD assets which is needed for liability matching purpose.

4.6 On balance, for a FHC group, MAS proposes to determine the interest rate mismatch risk requirement at each jurisdiction level (i.e., the dominant interest rate scenario would be determined for all entities operating within the same jurisdiction). This approach would at least consider interest rate risk of the dominant currency which a foreign entity is exposed to, which may be different from the rest of the entities operating in other jurisdictions within the group.

Question 3. MAS seeks comments on the approach taken in calculating the interest rate mismatch risk requirement for a FHC group.

[2] However, the interest rate risk module under ICS is structured differently from RBC 2 which considers upward and downward shocks while ICS uses the dynamic Nelson-Siegel (DNS) model.

5 Fungibility of Capital

5.1 The Insurance Core Principles (ICP 17) provides guidance[3] that the group-wide capital adequacy assessment should reflect constraints on fungibility of capital and transferability of assets among group members. Without considering the lack of fungibility of capital in the assessment of a group's solvency, Group CAR may overstate the capital buffer that a FHC group has because some of these capital buffers may not actually be fungible to make up any capital shortfall in other parts of the group. Circumstances where capital may not be fungible (as given in the ICP guidance) include:

a) Assets ring-fenced for certain portfolios (for example, Par Funds or portfolios akin to RBC 2's MA portfolios);

b) Capital retained to meet a legal entity's local regulatory capital adequacy requirements;

c) Rights that holders of certain instruments may have over the assets of the legal entity; and

d) Exchange controls in some jurisdictions.

5.2 Whilst it is important to consider lack of fungibility of capital when assessing group solvency, MAS understands that work on this is still being undertaken by the IAIS for the ICS. Meanwhile, MAS proposes to collect additional information from the group to internally assess the impact of any capital fungibility constraints on group solvency[4]. Such information may include the specific circumstances where lack of capital fungibility would apply at the group level, and getting the group to adjust its financial resources to account for the non-fungible nature of a particular portfolio or asset. Any concerns with the group's solvency after considering the lack of capital fungibility will trigger further supervisory engagements with MAS.

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[3] ICP 17.1.12 Under a group-wide capital adequacy assessment which takes a group level focus, the insurance group is considered primarily as a single integrated entity for which a separate assessment is made for the group as a whole on a consistent basis, including adjustments to reflect constraints on the fungibility of capital and transferability of assets among group members.

[4] To avoid doubt, this will mean that for the purposes of solvency reporting under the returns to be submitted to MAS, the Group CAR will not include adjustments for the lack of capital fungibility, except for the calculation of diversification benefits where diversification can only be recognised across portfolios that do not have fungibility constraints (as discussed in Section 4).

5.3 MAS will continue to monitor the development of the ICS with respect to further guidance on how the lack of capital fungibility should be accounted for in the group-wide capital adequacy assessment.

Question 4. MAS seeks comments on the approach taken in assessing the impact of capital fungibility on the solvency for a FHC group.

6 Draft Group Capital Notice

6.1 The Group Capital Notice is largely similar in structure and content to MAS Notice 133, which is the Notice on Valuation and Capital Framework for solo insurers licensed in Singapore, given that the capital requirements for a DFHC (Licensed Insurer) are by default based on RBC 2 consolidation approach. The key differences between the Group Capital Notice compared to MAS Notice 133 are the inclusion and amendments of certain concepts and approaches that are only relevant to a DFHC (Licensed Insurer). Some of these key concepts and approaches have been discussed in this Consultation Paper.

6.2 Another difference in the layout of the Group Capital Notice (compared to MAS Notice 133) is that the applicable contents of the Insurance (Valuation and Capital) Regulations 2004 ("V&C Regs"), which applies to solo insurers licensed in Singapore, are included within the relevant sections of the Group Capital Notice. For instance, the sections on the recognition and valuation of assets and liabilities of the V&C Regs are updated to reflect the approach to be taken for a FHC group and included within the respective sections on the valuation of assets and liabilities in the Group Capital Notice.

Question 5. MAS seeks feedback on the draft Group Capital Notice.

Question 6. In particular, MAS seeks views on the calculation of adjustment for asset concentration risk ("ACR") for a FHC group. Under the RBC 2 framework for solo insurers, some of the limits used in the calculation of ACR (such as the property exposure limit, foreign currency risk exposure and the limit on assets that are not liquid assets backing the general business) are applied to exposures in Singapore or in respect to Singapore policies only where the case may be. Given that a FHC group may have overseas operations that are material, it becomes more pertinent that the calculation of ACR be extended to cover the group's overseas exposures for these limits (instead of limiting to

Singapore exposure or policies only). To that, MAS seeks views if this approach would be appropriate.

7 Implementation Date

7.1 MAS targets to implement the Group Capital Notice, and any consequential amendments to MAS Notice FHC-N129, by the end of Q2 2023 such that the first set of quarterly returns submitted for a DFHC (Licensed Insurer) on the RBC 2 consolidation basis will be for Q2 2023.

Question 7. MAS seeks views on the target implementation timeline for the new Group Capital Notice.

Annex A

LIST OF QUESTIONS

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Question 5. MAS seeks feedback on the draft Group Capital Notice. 12

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