RESPONSE TO FEEDBACK RECEIVED - CONSULTATION ON PROPOSED RISK-BASED CAPITAL FRAMEWORK FOR INSURANCE BUSINESS

MAS published the consultation paper on the proposed Risk-Based Capital (RBC) Framework for Insurance Business on 28 November 2003. The consultation closed on 9 January 2004.

The consultation paper sought to obtain feedback on the operational details, as well as draft Regulations, Notice and Guidelines on the RBC framework for insurance companies.

The RBC framework seeks to:

- amend the existing valuation methodology for assets and liabilities.
- establish new capital requirements.
- update the role of actuaries and
- introduce a new set of statutory reporting requirements.

The framework was formulated in close consultation with insurance practitioners and representatives from the actuarial and accounting professions. It is based on emerging international standards and good practices in developed countries.

By being more risk-focused and transparent, the new framework would encourage:

- more active risk management by insurers.
- provide clearer information on the performance and financial strength of insurers and
- facilitate early and effective intervention by MAS, if necessary.

Various parties commented on the consultation paper. The respondents are listed in Appendix A.

MAS has considered the comments received and incorporated them into the RBC framework, where appropriate. MAS would like to thank all respondents for their contributions.

We highlight the comments that are of wider interest and our responses to these comments below.

Insurance (Valuation and Capital) Regulations

1 Valuation Issues

1.1 Several respondents suggested that the valuation of unearned premium reserves (UPR) should not be distorted by the prescribed deduction limits of reinsurance from unregistered and authorised reinsurers. They felt that it is better to calculate UPR using a fair value approach and to deal with the deduction limits of reinsurance separately in the capital calculation.

<u>MAS' response</u>: MAS agrees with the suggestions and has made the necessary changes to the method for calculating UPR such that it takes into account reinsurance ceded, regardless of the registration status of the reinsurers. Corresponding adjustments have also been made to include reinsurance ceded in the calculation of financial resources (FR) which takes into account the registration status and counterparty risk class of the reinsurers.

1.2 One respondent commented that the basis of provision for adverse deviations (PAD) of life insurance policy liabilities was not defined in the regulations. This could lead to significant variations of PAD among different insurers. Some respondents asked whether MAS will issue guidelines on PAD.

<u>MAS' response</u>: The valuation of policy liabilities takes into account both the best estimate experience of each insurer as well as PAD from the expected experience. Calculation of PAD requires the actuary to exercise his professional judgment, taking into account the methodology and assumptions adopted to determine the

best estimate experience. MAS intends to work with the Singapore Actuarial Society, the professional body for actuaries in Singapore, to further develop the professional guidelines for setting PAD.

1.3 Some respondents said that it is onerous for life reinsurers to value policy liabilities at each underlying policy level. Reinsurers typically write treaty business covering a group of policies and may not have detailed information at each underlying policy level.

MAS' response: MAS agrees that reinsurers could face data limitations in valuing treaty business, where detailed information of each underlying policy may not be readily available. As provided for in the Notice on Valuation of Policy Liabilities of Life Business, reinsurers could adopt approximation and simplified methods under such circumstance provided that the policy liabilities derived are not understated.

1.4 A respondent said negative reserves should be allowed for the valuation of life reinsurance business when the insured could not unilaterally cancel the contract without paying back a penalty on early recapture of the reinsurance treaty to the reinsurer.

MAS' response: MAS agrees and has incorporated this into the new regulations. The negative reserves for such business should not be greater than the expected value of the penalty paid to the reinsurer.

1.5 A few respondents sought clarification on whether the requirement to set policy liabilities to zero at policy level applies to the non-unit reserves of investment-linked policies.

MAS' response: For investment-linked policies, this requirement applies to the sum of the unit and non-unit reserves of each policy. However, an insurer should exercise more prudence in assessing the expected experience of the policy when deriving negative non-unit reserves. In particular, insurers should take note of the expected future lapses and surrenders so that the policy liabilities would not be understated.

1.6 One respondent commented that the unrealised gains and losses should not be brought into the profit and loss account.

MAS' response: Changes in assets valuation such as unrealised gains and losses should be included in the profit and loss accounts like changes in policy liabilities to ensure consistency in asset and liability valuation.

2 Capital Issues

2.1 Some said using fixed adjustments of best estimate or fixed bases to calculate C1 (the liability risk component of the insurer's capital requirement) requirement may result in distorted pricing of life insurance products in Singapore. They suggested prescribing a range so the Appointed Actuary could exercise flexibility within this range to determine the C1 requirement.

MAS' response: The adjustments and the fixed bases were determined in close consultation with industry practitioners, taking into consideration the overall industry experience. This approach has the advantage of reducing subjectivity in determining C1 requirement, compared to the suggested prescribed range approach. As the RBC framework is new to the Singapore insurance market, most insurers are unlikely to have gathered sufficient information based on their own experience to set the appropriate level of adjustments.

However, MAS would not rule out adopting an approach that relies on a company's own experience in the future when more insurers put in place their internal models.

2.2 One respondent said the prescribed mortality table for calculating C1 requirement is conservative as mortality rates tend to improve rather than worsen.

This would create a significant C1 requirement for insurers, especially those insurers writing long-term contracts.

<u>MAS' response</u>: The prescribed mortality table is based on the latest mortality study of the insured lives in Singapore from 1997 to 2002. The study was conducted by the Singapore Actuarial Society, with no allowance for any improvement or deterioration in future mortality experience. It may not be prudent to assume that future mortality experience would necessarily improve. However, we will continue to study future trends in mortality experience in close consultation with the Singapore Actuarial Society and make the necessary adjustments to the prescribed table accordingly.

2.3 One respondent suggested lowering the premium and claim liability risk factors as they were set much higher compared to countries like Australia and Canada.

<u>MAS' response</u>: The RBC General Workgroup determined the risk factors primarily by analysing the claims volatility experience of insurers in Singapore. Risk factors used in other countries may not be suitable for Singapore because of the potential differences in average portfolio size and underlying risk volatility.

2.4 Some respondents said the risk factor for reinsurance recoverables from unregistered insurers is too onerous. They said it should be differentiated by credit rating of the reinsurance counterparty and the ageing period of the recoverables. The respondents said it is common for insurers to reinsure with overseas insurers who could undertake bigger and complex risks, and these overseas insurers are generally financially strong.

<u>MAS' response:</u> MAS agrees with the comments. We have revised the risk factors for reinsurance recoverables. The factors now depend on both the ageing period of the recoverables and the counterparty risk class of the reinsurance counterparty, in addition to the registration status of the reinsurance counterparty.

2.5 Several commented that credit should be given to reinsurance placed by a registered insurer to its parent company or head office when it comes to the treatment for reinsurance in the valuation of policy liabilities. Such reinsurance should not be treated in the same way as that of an unregistered insurer.

MAS' response: MAS recognises that some insurers reinsure their businesses to their head offices, related corporations or related branches. We have clarified in the new regulations that for the purpose of capital calculation, the reinsurance arrangements placed with these entities, subject to specified criteria, will be treated the same as reinsurance arrangements placed with authorised reinsurers.

2.6 One respondent commented that inter-fund balances not related to the participating fund and intra-group balances should not attract a risk charge of 100%.

MAS' response: MAS does not agree that there should be distinction between the type of insurance funds in respect of inter-fund balances. We would also like to clarify that the 100% risk charge stated in the consultation paper is only imposed on inter-fund and intra-group balances which are outstanding for more than three months. Inter-fund and intra-group balances which are outstanding for three months or less attract a risk charge of 8%. Imposing a lower risk charge for inter-fund and intra-group balances outstanding for three months or less would create incentives for insurers to settle them in the shortest time. Imposing punitive charges for balances outstanding for more than three months is consistent with our expectation that insurers should settle inter-fund balances within three months.

2.7 Some respondents were concerned that the proposed minimum $10 million FR (financial resources, the capital available to meet the capital requirement of the insurer) represents a significant increase in capital requirement for small direct insurers and reinsurers that just write a single class of business, compared to the margin of solvency of $5m under the former capital framework.

MAS' response: MAS agrees that the minimum $10m FR represents a substantial increase over the current requirements, especially for direct insurers and reinsurers that write a limited volume or range of business. We have lowered the minimum FR to $5m, which is in line with the margin of solvency under the former capital framework.

2.8 One respondent commented that assets in the shareholders fund should not be subject to risk charges under the RBC framework, or subject to less stringent risk charges compared to assets in the insurance funds.

MAS' response: MAS does not agree that assets in shareholders fund should not be subject to the RBC framework, or subject to less stringent risk requirements. Assets risk charges should be determined based on the underlying volatility regardless of where they reside.

2.9 One suggested that bank guarantees or letters of credit could be accepted as a form of FR to meet the total risk requirement of an insurance fund when the fund is insolvent instead of capital injection from the shareholders fund or head office of the insurer.

MAS' response: MAS thinks that a bank guarantee or letter of credit is not an acceptable form of FR because it is not a form of FR that is paid-up and readily accessible to settle liabilities of insurance funds.

2.10 One respondent commented that there should be more frequent reporting to MAS to ensure that insurers remain within the concentration limits to prevent over-concentration of assets as the financial position of the insurers could be adversely affected.

MAS' response: MAS would like to clarify that although insurers only need to submit statutory returns to MAS on quarterly and annual basis, insurers are required under the Insurance Act to satisfy solvency at all times, taking into account all the requirements under the RBC framework. We maintain close and vigilant supervision of all insurers and reserve the right to take action against any insurer who breaches any fund solvency requirement or capital adequacy requirement.

3 Insurance (Accounts and Statements) Regulations

3.1 Several respondents commented that the new reporting requirements are onerous and would entail changes to reporting systems.

MAS' response: MAS recognises that the new reporting requirements represent a substantial increase over the current ones in several areas. The new reporting requirements are derived from the new valuation bases and capital requirements. They will provide a greater level of disclosure on the performance and financial strength of insurers in Singapore, which will benefit both the insurers and policy owners.

MAS has conducted several industry briefings and engaged insurers to test the RBC framework based on the new reporting requirements. This is to familiarise insurers with the new framework and give them time to alter their reporting systems.

3.2 One respondent asked whether the form relating to accident and health benefits (Form 7) is supplementary information on the profit and loss accounts of insurance funds.

MAS' response: The purpose of Form 7 is to capture information relating to accident and health benefits with respect to both the life and general businesses of an insurer. Therefore, it may not necessarily correspond to the profit and loss account of insurance funds which include all lines of business.

3.3 One respondent wrote that some insurers include outstanding claims as part of "claim liabilities" in the fund balance sheet, as opposed to "outstanding claims."

MAS' response: MAS recognises insurers' different practices. In particular, while many general insurers report outstanding claims under "claim liabilities", some life insurers report such claims that are approved but not yet paid under "outstanding claims". The reporting basis allows insurers to adopt either one of these two approaches. This should not have any material impact on risk requirement calculations.

3.4 One respondent suggested incorporating quarterly returns into the Insurance (Accounts and Statements) Regulations instead of leaving the requirements in the existing Notices.

<u>MAS' response:</u> MAS agrees with the comment and has incorporated the requirements for quarterly returns into the Insurance (Accounts and Statements) Regulations.

4 Notice on Valuation of Policy Liabilities of Life Business

4.1 One respondent commented that the risk-free discount rate, the market yield of the Singapore Government Securities for policies with duration of 10 years or less, could introduce volatility to policy liabilities and hence the financial positions of insurers.

<u>MAS' response:</u> The value of policy liabilities could potentially be more volatile under the new valuation basis. However, volatility on policy liabilities can, to large extent, be offset by corresponding movements in the value of the assets backing them. This is provided there is minimal durational mismatching between assets and liabilities. Insurers must consider the level of volatility and mismatching risk they are prepared to accept in managing insurance funds.

Appendix A

List of respondents to the consultation paper on the proposed Risk-Based Capital Framework for Insurance Business

1. Aviva Ltd
2. AXA Re Asia Pacific Pte Ltd
3. General Insurance Association of Singapore
4. Hannover Ruckverischerung AG
5. India International Insurance Pte Ltd
6. Institute of Certified Public Accountants of Singapore
7. John Hancock Life Assurance Company Ltd
8. Liberty Insurance Pte Ltd
9. Life Insurance Association of Singapore
10. Muenchener Rueckverischerungs Gesellschaft
11. NTUC Income Insurance Co-operative Ltd
12. QBE Insurance International Ltd
13. R&V Versicherung AG
14. Revios Ruckversicherung AG
15. Singapore Reinsurers' Association
16. Sompo Japan Insurance Company (Asia) Pte Ltd
17. Swiss Reinsurance Company
18. Toa Reinsurance Company Ltd
19. The Wing On Fire & Marine Insurance Co. Ltd
20. Vanguard Investments Singapore Pte Ltd
21. Two individual respondents