CONSULTATION PAPER

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Proposed Revisions to the Regulatory Framework for Trade Credit Insurance, Political Risk Insurance and Mortgage Insurance

MAS
Monetary Authority of Singapore

PUBLIC CONSULTATION ON THE PROPOSED REVISIONS TO THE REGULATORY FRAMEWORK FOR TRADE CREDIT INSURANCE, POLITICAL RISK INSURANCE AND MORTGAGE INSURANCE

PREFACE

1.1 Under the Insurance (Valuation & Capital) Regulations, insurers writing trade credit insurance, political risk insurance and mortgage insurance are required to hold contingency reserves in addition to the usual policy liability reserves. Given that these lines are particularly vulnerable to economic cycles, the contingency reserves are meant to buffer surges in the insurers' loss experience as a result of a spike in claims during economic downturns.

1.2 MAS has conducted a review of the regulations on contingency reserves and the overall regulatory framework to ensure that they are in line with international practices[1]. This consultation paper sets out the issues considered by MAS under the review and the proposed revisions to the existing regulations.

1.3 MAS invites interested parties to submit their views and comments on the proposed revisions outlined in this consultation paper. Electronic submission is encouraged. Written comments should be submitted to:

Insurance Department
Monetary Authority of Singapore
10 Shenton Way
MAS Building
Singapore 079117
Fax : (65) 6-229 9694
Email : tpm@mas.gov.sg

[1] The jurisdictions researched for the purposes of our review had include the United Kingdom, France, Germany, Japan, Australia, New York and Bermuda.

All comments should be submitted to MAS by 23 August 2010.

1.4 Please note that all submissions received may be made public unless confidentiality is specifically requested for the whole or part of the submission.

1 BACKGROUND

1.1 The existing contingency reserves requirements specify the amount to be transferred into contingency reserves each year (the "Contribution Rules"), the circumstances under which withdrawals can be made from the contingency reserves (the "Withdrawal Rules") and the threshold amount to which contingency reserves have to be built (the "Threshold Amount"). These rules are currently set out in the Seventh Schedule of the Insurance (Valuation & Capital) (Amendment) Regulations 2007.

2 PROPOSED REVISIONS

2.1 Trade Credit Insurance ("TCI")

(i) Lowering of the Percentage used for the Calculation of the Threshold Amount from 400% to 150%

2.1.1 Under the current regulations, the Threshold Amount is set at 400% of the highest of net premiums written in the preceding 3 accounting periods [2] ("Preceding Years"). MAS proposes to lower this percentage from 400% to 150% to align with the rules imposed in other jurisdictions. The lowering of the percentage also takes into account the fact that insurers in Singapore writing TCI business have grown their portfolios sufficiently to achieve greater diversification, which in turn reduces volatility in underwriting results.

2.1.2 However, MAS recognizes that there will be situations where a higher Threshold Amount could be necessary, for example where the portfolio size of

[2] Under the Insurance Act (Cap 142), "accounting period" in relation to any insurer, means the period beginning from the commencement of its business in Singapore or 1st January of any year, as the case may be, and ending on 31st December of that year for which accounts relating to the insurance business carried on by the insurer in Singapore are kept and for which an insurance fund has been established under this Act, unless otherwise allowed by the Authority

the insurer is too small to achieve adequate diversification. As such, while we propose that the percentage be lowered to a baseline requirement of 150%, MAS will have discretionary powers to impose a higher percentage on an insurer where necessary. Similarly, MAS will also have discretionary powers to require an insurer to increase its contribution to the contingency reserves beyond that specified by the Contribution Rules in order for it to attain the Threshold Amount within a shorter period of time.

(ii) Increasing the duration of Preceding Years from 3 to 5 years

2.1.3 Currently, the computation applicable for the Threshold Amount is based on the net premiums of the preceding 3 accounting periods. This duration is shorter than those applied by the other jurisdictions, which stretch back to 5 years. MAS proposes to increase the duration of the Preceding Years from 3 to 5 years to align with international practice.

2.2 Political Risk Insurance ("PRI")

(i) Separating TCI and PRI in our Insurance Regulations

2.2.1 Currently, TCI and PRI are combined under a single category called "Trade Credit and Political Risk Insurance" under the Insurance (Valuation & Capital) Regulations ("V&C Regulations") and Insurance (Accounts & Statements) Regulations ("A&S Regulations"). As a result, these two lines of business are subject to the same requirements under our regulatory framework, including the requirement to establish contingency reserves.

2.2.2 The Authority's earlier decision to combine the two lines of business under a single category under the V&C Regulations had been based on the standard definition of a credit insurance policy. Under this definition, a credit insurance policy is to cover two types of risks, namely:

- Commercial Risk (i.e. credit risk), including protracted default and/or buyer insolvency; and

- Political Risk, including currency inconvertibility and non-transfer, contract frustration as a result of government action, public buyer default, government import and export regulation or restrictions and act of war, civil war, insurrection, rebellion and/or revolution.

2.2.3 However, based on industry feedback that there is a de-coupling of TCI and PRI covers offered by insurers operating in Singapore, we propose to treat the two as separate and distinct business lines in our regulatory framework. Such a distinction will enable us to impose different risk requirements on the two business lines in order to capture the underlying risks more appropriately. This treatment is also in line with international practice, where the two business lines are subject to different regulatory requirements.

(ii) Volatility Category for PRI

2.2.4 Given that PRI will be considered as a business line on its own, the volatility categories for the purpose of calculating the insurance risk requirements (C1 requirements) under the V&C Regulations will have to be determined for this business line.

2.2.5 With reference to Table 4 in the Sixth Schedule of the Insurance (V&C) Regulations, we propose to apply the following volatility categories to PRI:

- Business written in the Singapore Insurance Fund (SIF) – "Low" given the remote likelihood of adverse political developments in Singapore; and
- Business written in the Offshore Insurance Fund (OIF) – "High" for reasons of adverse selection given that insureds will generally only purchase political risk coverage for jurisdictions that experience high political instability and uncertainty.

(iii)　Contingency Reserves Requirement for PRI

2.2.6 We propose not to require contingency reserves to be established for PRI business, given that the loss experience on this business line has little correlation to economic cycles. This approach is also in line with international practices.

2.3 Mortgage Insurance ("MI")

(i)　Requirement to Operate as a Mono-line Direct General Insurer

2.3.1 Under the existing framework, mortgage insurers are required to operate as mono-line direct general insurers. This restriction would help focus management's attention and expertise on the long term sustainability of the business which is particularly important given the cyclical nature of MI business. Besides, there are limited diversification benefits from other business lines. The results of the MI business would also pose contagion risks to the other policyholders in other lines of businesses as the results tend to be highly cyclical with pronounced peaks and troughs given the strong correlation with the performance of the economy.

2.3.2 However, for reinsurance inward business, it was noted that the liabilities are short tailed, usually for three to five years as the reinsurers do not provide coverage for the term of the loan, instead, they provide protection of losses arising from the insurer's portfolio for a limited period of time, usually for a year. Other jurisdictions also do not require a reinsurer to be set up a mono-line outfit in order to underwrite MI risks on a reinsurance basis. As such, we propose not to impose the requirement to operate as a mono-line direct insurer for reinsurance inward MI business, i.e. a multi-line direct general insurer or reinsurer registered in Singapore could write reinsurance inwards MI business.

(ii) Volatility Category for MI

2.3.3 In line with the treatment for TCI business originating in Singapore, MI was assigned a “Medium” volatility category for the purpose of calculating the insurance risk requirements. Recognising that there is a wider range of credit risks, economic stability and regulatory frameworks for MI business originating from overseas, we propose to differentiate the risk requirements for Singapore and offshore MI business by assigning a “High” volatility category for MI business in the OIF. MI business in the SIF will continue to be assigned a “Medium” volatility category.

(iii) Contingency Reserves Requirement for MI

2.3.4 Currently, mortgage insurers are required to maintain each year’s contingency reserves contributions for 10 years. However, for reinsurance inwards business, there may be situations where the mortgage insurers would be maintaining contingency reserves when they do not have any liabilities in respect of MI business given the shorter term of the business. As such, we propose to include an additional limb to the Withdrawal Rules for MI business, to allow mortgage insurers to withdraw the contingency reserves before the 10 years is reached when there are no corresponding policy liabilities held on the balance sheet in respect of MI business, as certified by the actuary approved by the MAS.

3 IMPLEMENTATION OF THE PROPOSED REVISIONS

3.1 MAS will assess the views and comments received from interested parties in determining the final revisions to the existing regulatory requirements. The final revisions will be incorporated as amendments to the relevant legislations.

Monetary Authority of Singapore