SAIA
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SAIA SAM PSO
Newsletter

Comparing SA QIS 1 with QIS 5:

Insurers in South Africa have been asked to voluntarily participate in the first quantitative impact study. SA QIS1 needs to be completed on a solo entity basis only, i.e. no group results are required. The results of this study, which are calculated on the reporting date 31 December 2010, are due for submission to the FSB on 16th September 2011. This study is intended to assist in the development of the proposed SAM regime and tests the calibration of parameters for the standard formula to calculate the SCR. In some cases alternative methods are tested to inform the decision making process. SA QIS1 will also be used by the FSB to identify areas where further work is required as well as areas of difficulty. While participation in SA QIS1 is voluntary for South African insurers, it is a requirement if the insurer is intending to apply to the FSB for approval to use an internal model to calculate capital requirements as opposed to using the standard formula.

The purpose of this article is to detail differences in the standard formula capital calculations required for SA QIS1 to those that were required for the Solvency II fifth quantitative impact study (QIS5). QIS5 was requested by EIOPA in 2010, based on the reporting date 31 December 2009, to inform discussions of the European Commission's proposed level 2 implementing measures for the Solvency II Directive 2009. Solvency II QIS5 required submission of both solo entity and group calculations.

More detail has been incorporated in the SA QIS1 technical specifications where the EIOPA QIS5 report, published in April 2011, flagged difficulty or the use of inconsistent approaches by insurers in the Solvency II QIS5 exercise. Worthy of mention are:

- Contract boundaries of pure savings contracts that allow changes to be made to management fees are to be restricted to one year.

- The base case calculations assign products to either a 100% or 0% illiquidity bucket. Alternatives tested are the Solvency II QIS5 approach and no allowance for any illiquidity premium.

- There is no requirement to include unavoidable market risk in the risk-margin calculations.
- Detail of the simplification to use is given for the expected profits included in future premiums (EPIFP) calculation which is to be included in Tier 1 as was the case in QIS5.
- Detail has been supplied for the calculation of the loss-absorbing capacity of technical provisions for the South African smoothed bonus investment products. A restriction of 3 years has been placed on the term for which future bonuses may be set to zero in a stressed scenario.
- Life business segmentation by risk driver is not required. Additional segments are required viz. with-profit annuities, annuities where the insurer is exposed to longevity risk and insurance business where the only underwriting risk is expense risk.
- An additional non-life business segment is required in respect of engineering business. There is a requirement to split certain non-life segments into commercial and personal lines of business.
- For the purposes of SA QIS1 it has been assumed that no ring-fenced funds exist in South Africa.
- Subordinated capital and hybrid debt are to be classified as Tier 3.

Differences between Solvency II QIS5 and SA QIS1 SCR calculations:

Risk sub-module	Solvency II QIS5	SA QIS1	Alternative methods to be tested
Market risk			
Volatility	n/a	Volatility stresses are required	
Interest rate	Δ interest rate-up 70% to 25% Δ interest rate-dn -70% to -25%	Δ interest rate-up 88% to 57% Δ interest rate-dn -68% to -34%	
Equity	Global 39% Other 49% Symmetry adjustment -9%	Global 39% SA 43% Other 49% Symmetry adjustment +10%	
Spread	Capital requirements for South African government bonds	No capital requirements for South African government bonds. Note – where international ratings are not available insurers can use their own internal ratings provided that they have a robust system for obtaining them.	An alternative calculation based on the Canadian approach which focuses on the "Loss given default" and "Probability of default" is required.
Life underwriting risk			
Revision		Not applicable to South Africa	

Longevity		No changes	The following additional calculations are requested. The impact of a 25% reduction in mortality for ages under 60 and 15% thereafter. 15% reduction on annuity business and 25% on other business subject to longevity risk. Higher improvement in each future year of 1.5% in absolute terms of the annual mortality improvement assumption.
Life catastrophe	Absolute increase in the rate of policyholders dying of 1.5 per mille	Absolute increase in the rate of policyholders dying of 12*min(max(35%*MortRate; 0.0002;0.0005)	
Non-life underwriting risk			
Non-life catastrophe		The Catastrophe Task Force (CTF) formed for SAM calibrated the Natural Catastrophes for South Africa. Man-made Catastrophes will be calibrated for SA QIS2.	The “maximum event retention” (MER) approach is being investigated as an alternative.

Note:
There is no requirement to perform single equivalent scenario calculations.

This article was submitted courtesy of Margaret Carey from Old Mutual

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Other markets seek inspiration from Solvency II:

While Switzerland, the US and Bermuda are seen as the most important countries in terms of equivalence with Solvency II, other jurisdictions are also pressing ahead in developing similar risk-based regulation. Lorna Davies reports.

Many countries outside the EU are looking to adopt a Solvency II-like regime. For some, the aim is to become Solvency II equivalent in order to facilitate international trade; while others see Europe's regime as simply a good model to follow. Some countries have been working with the same insurance and capital regulations for over a decade and many agree it is time for a change.

Yet developing a similar regime to Solvency II is clearly not as simple as merely implementing the European directive which is tailored to match the European insurance industry's products and history. None the less, observations and lessons from Europe are certainly relevant, and here *InsuranceERM* looks at the progress made by five countries: Australia, Israel, Mexico, South Africa and Turkey.

Australia

Australia's regulator is keeping a close eye on the progress of Solvency II, although stresses it is not following the regime.

The Australian Prudential Regulation Authority (APRA) is, it says, "watching [Solvency II] closely and assessing our own capital and other requirements against Solvency II".
The APRA describes Solvency II as a "very uncertain venture when viewed from outside Europe".

It is currently refining its regulatory framework for non-life groups, with the intention of introducing some changes to prudential and reporting standards. In a discussion paper, released on 16 May 2011, APRA mentions learning lessons from Solvency II but says it is taking a slightly different route.

Andrew Cox, a partner at Lane Clark & Peacock and appointed actuary for two Australian insurers, says the APRA is taking a pragmatic approach to regulation. "For example there has been lots of talk about the theoretical impossibility of calculating Solvency II technical provisions properly, because of the apparent circularity in the definition of the risk margin.

"APRA's approach is much more practical -- it sets reserves at the 75% confidence level. This loses some of the theoretical purity of Solvency II but is much more practical and gives similar answers."

Ulrich Zink, policy adviser at the Association of British Insurers, says: "Although [Australia] is moving towards a regulatory framework based on similar principles, like the US it is keen to steer away from adopting the Solvency II regime off-the-shelf."

He adds: "There are at least two legitimate reasons why third countries might wish to make their own way: from the outset Solvency II was designed for the specificities of the European market, third countries have a limited input into the European legislative process."

Australia has undertaken two quantitative impact studies to date (QIS and QIS2). The QIS document is similar to Europe's QIS5 in that there is a spreadsheet and a questionnaire to complete, but the required document is significantly shorter than the European one. Cox comments: "A client of mine managed to fill in the Australian QIS in half a day. Compared to the effort required to fill in QIS5 over here [in the UK], I think Australia must be doing something right."

Israel

Israel is aiming to develop a Solvency II-type regime, although one or two years behind Europe. Israeli insurers have "mixed feelings" about Solvency II as it is "a cumbersome exercise", according to Marc Beckers, head of Aon Benfield Analytics for Europe, Middle East & Africa.

"There is still work to be done in terms of risk management but in some ways [Israel and Turkey] are more straightforward than the EU as these markets grew fast, but later on, so there is less work to be undone and technology systems are more up to date.“

Israeli insurers completed an exercise similar to Europe's QIS5, with 19 companies completing three versions of QIS5 with different parameters.

QIS 5 was used as a basis as it is the latest document used by Europe; it would also put smaller companies in a good position should they want to begin trading outside the country, says Beckers. "[QIS5 was used] because it is risk-based and because the whole world (excluding US, Canada, and Australia) is looking at it as the way to go," he says.

"Overall the results of Israel's QIS5 were often different from Europe," says Beckers. For instance, the non-life catastrophe module was "less of an issue" for Israeli insurers as the industry is well protected by earthquake reinsurance cover, Beckers says.

The results, however, showed that there were a number of insurers that struggled to meet the solvency capital requirement, he adds. A key issue for Israeli insurers is the development of natural catastrophe scenarios. Beckers says: "Earthquakes are quite common so they need to design their own models and this is something they are working on by collaborating with universities and the EU."

For life insurers, another issue is the inclusion of expected profits included in future premiums (EPIFP) as tier 1 capital. For Israeli insurers, the EPIFP as a proportion of tier 1 capital was much higher than their European counterparts, at 68% compared to 21%. Beckers says this raises issues of calibration. "The same goes for other risks like lapse risk and diversification benefit," he adds.

It is expected that initially few insurers in Israel will use an internal model, save for some international subsidiaries, as the regulator does not have the resources to assess the models in detail.

Mexico

Mexico is quickly emerging as a key market for outside investors largely due to the opportunities available and improving regulatory oversight.

In 2007, Mexico's insurance watchdog, the Comision Nacional de Seguros y Fianzas (CNSF), said it was preparing a work plan to move towards Solvency II. At the time Manuel Aguilera, the head of the CNSF, said the goal was to adopt the Solvency II requirements at the same time as the European insurance industry, and that work on this would start in 2008.

Mirroring Solvency II's pillar approach, the CNSF has drafted a level-one text establishing the principles underpinning the three pillars which is currently being reviewed by lawyers at the ministry of finance before passing to congress for approval, after which there would be some transitional periods for implementation.

Norma Rosas, vice president of analysis and industry studies at CNSF, says it is hoped the bill will be approved in September. "The focus of the CNSF work has moved to drafting the level-two rules setting out the calibration of the standard formula for capital requirements, amongst others.

"A draft is due to be ready for consultation by the end of the year, ahead of a quantitative and qualitative impact study by mid-year."

South Africa

South Africa is developing a regime based on Solvency II, called Solvency Assessment and Management (SAM). According to the Financial Services Board (FSB), South Africa's insurance regulator, SAM will share the same broad features as Solvency II: being principles-based with a three- pillar structure and using an economic balance sheet.

The aim is for the recommendations arising from the SAM project to meet the requirements of a third- country equivalence assessment. The target is for the standard and internal model approaches for both long-term and short-term insurance business in South Africa to be implemented in January 2014. However, the FSB is keen to ensure that South Africa's regime is reflective of the local insurance industry's characteristics.

"Given that the shift towards an advanced risk-based regulatory regime implies the deployment of significant resources, cost, time and effort, the principle of proportionality will be adopted, to ensure that insurers' compliance burden reflects the nature, scale and complexity of the risks they face," says the FSB.

Marius Du Toit, chief actuary at the FSB, says that, like Solvency II, the primary purpose of SAM is to improve the protection afforded to policyholders and beneficiaries and encourage insurers to adopt a more sophisticated approach to risk monitoring and risk management."SAM is a very necessary and very important development," he says.

Du Toit emphasises that South Africa should learn from the QIS5 process including the various criticisms, such as the over-complication of the regime. "As a whole, the industry has responded very well. Industry players form part of the committees and working groups, and they have grabbed the opportunity to participate in the development," he says.

Turkey

Turkish insurers are currently regulated by Solvency I and the country's domestic regulator is keen for local insurers and reinsurers to sign up to Solvency II in order to bring the insurance industry in line with the EU.

According to Beckers at Aon Benfield Analytics, 10 Turkish insurers piloted the fourth quantitative impact study (QIS4) in 2010 and most companies are planning to undertake QIS5.

"Solvency II is going to be a thorough and complex issue for both companies and regulators in Turkey," he comments.

While insurers will see the benefits of increased transparency and greater understanding of risk, they will need to dedicate time and resources to engage with a complex regime that has challenging capital requirements, says Beckers.

"The Turkish insurance industry is in a high growth phase, so there is extra pressure to assess its risks in the most effective way. Solvency II is the next step in achieving this."
As with Israel, one of the more challenging parts of the process for the Turkish regulator will be the treatment of catastrophe risks, particularly how the catastrophe scenarios for Turkey will be designed and how partial internal models will be approached.

Few Turkish insurers are also expected to use internal models initially.

Bancassurance is also a growing business sector in Turkey so these companies will need to review the risks and rewards of addressing both the Solvency II and Basel III regulatory regimes, adds Beckers.

Article taken from:
http://www.insuranceerm.com/analysis/other-markets-seek-inspiration-from-solvency-ii.html?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+InsuranceERMRssFeed+%28InsuranceERM+RSS+feed%29

Discussion Documents:

A Discussion Document is in essence a technical paper that covers and investigates specific aspects of the Solvency II Directive, CEOIPS Level Two Implementation Advice (former Consultation Papers), the Australian and Canadian Regulatory Jurisdictions and any other relevant existing South African legislation, in formulating an opinion that represents the views of the insurance industry regarding the topic assigned to the task groups.

Discussion Documents are ultimately constructed with the intention to provide valuable input to the FSB Drafter for the purpose of compiling the Secondary or Subordinate SAM legislation. It is therefore extremely important that these technical papers have due consideration for the Solvency II Directive, various other jurisdictions and local legislation as previously mentioned. The first draft of the Subordinate legislation is expected to be released for industry comment by the 4th Quarter of 2011.

Once a Discussion Document, addressing a specific SAM/Solvency II topic, has been drafted by the task group it is then submitted to the relevant Pillar Sub-Committee for comment and debate. After the Pillar Sub-Committee is satisfied that the Discussion Document represents the best efforts of the task groups covering all aspects assigned to the task group, the document is then forwarded to the FSB SAM Steering Committee where it is subject to further debate and discussion. Once the Steering Committee unanimously agrees that the document is complete the document is then released for public comment.

All interested stakeholders will be given an adequate time period in which to submit their comments on the Discussion Documents. After the time period has elapsed and all the comments received are collated and taken into account by the FSB SAM Steering Committee, the Discussion Document undergoes a name change and becomes a Position Paper. A Position Paper will give rise to a board notice which will ultimately culminate in legislation thereby completing the journey of the Discussion Document.

It is extremely important that all stakeholders understand the evolutionary process that Discussion Documents undergo to ensure that comments are submitted at the appropriate time in the process. After a Discussion Document becomes a Position Paper it is highly unlikely that any further *fundamental changes* will be made to the document by the FSB.

The SAIA SAM Project Support Office has already embarked on a comprehensive process to ensure that all Discussion Documents that have been approved for comment by the FSB SAM Steering Committee will be disseminated to all our members SAM Coordinators. We sincerely appeal to all our SAM Coordinators to distribute these documents to the relevant appropriate persons within their organisations to provide comment. All Discussion Documents released for public comment as at the date of this newsletter can be found on our SAIA SAM Webpage.

The construction of the new proposed SAM legislation is intended to be a consultative process between the FSB, the Insurance industry and various other stakeholders. The Discussion Document methodology is a crucial component of this consultative process and provides a unique opportunity for all interested stakeholders to say their say or forever hold their peace

Proportionality:

At the SSNI Forum *(Small Specialised Niche Insurers)* meeting held on the 24th June 2011, the SAIA SAM Project Support Office (PSO) introduced our objective of addressing proportionality aspects relating to all Discussion Documents.

The principle of proportionality, as introduced by the Solvency II Directive, takes into account the nature, scale and complexity of an insurer's business when considering the manner in which aspects of the new proposed legislation for SAM will be applied.

The PSO would like to gather all relevant comments from our SAIA members regarding the principle of proportionality relating to the Discussion Documents that have been made available for public comment by the FSB SAM Steering Committee. The importance of the principle of proportionality should not be underestimated and we would encourage our members to consider this principle in detail when working through the various Discussion Documents.

Members of the SSNI Forum are requested to please complete the Proportionality Principle Comments Templates that will be distributed to them by the PSO. Further discussion and analysis of the principle of proportionality applicable to the Discussion Documents, open for public comment, will be addressed at our next SSNI Forum meeting to be held on the 29th July 2011.

SAIA SAM Webpage Update:

During the month of June 2011 the SAIA SAM webpage has been updated with the following new items:

- The Stress Testing Presentation given by Mr Hugo Louw from KPMG at the SSNI Forum Meeting held on the 24 June 2011.
- The 13 Discussion Documents that have been released for public comment by the FSB SAM Steering Committee have been loaded under the section FSB SAM: Position Papers on the webpage.
- An updated Discussion Document and Position Paper Tracker with important detail relating to the status of the various Discussion Documents in the SAM Governance Structure.
- The SAIA SAM Newsletter Issue number 5 / 2011.

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