SAIA
Publication of the South African Insurance Association
SAM NEWS

SAIA – (011) 726 5381 *Issue 3 / 2012*

Table of Contents

SAM Snippets.. 2
The SAIA SAM Financial Impact Study 7
Understanding a breach of the SCR (under Solvency II).. 10

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SAM Snippets

Insurance Laws Amendment Bill (ILAB)

The Insurance Laws Amendment Bill was submitted to National Treasury on 13 April 2012 to follow the necessary process before being adopted. It is expected that the Bill will be finalised by the end of 2012 and become effective by the middle of 2013.

In short, the objective of the Bill is to amend the Short-term Insurance Act, 1998, so as to define certain terms; to state the objects of insurance regulation; to extend the powers of the Registrar; to extend the provisions relating to the licensing of insurers; to provide for explicit governance, risk management and internal control requirements of insurers; to provide for the supervision of insurance groups, and for matters connected therewith.

The Bill forms part of the SAM Interim Measures that will be applied to Insurance Groups, Governance, Risk Management and Internal Controls.

Internal Model Approval Process

The FSB is currently conducting consultations and interviews with those insurers who have successfully completed the Pre-Application Qualifying Criteria Template (PAQC) during the first window and have become eligible to enter the Pre-Application Phase for the approval of their Internal Models.

Due to the final SAM implementation date being revised to 1 January 2015, the timeline for the approval of internal models has also been revised. The second window where insurers have the opportunity to submit their PAQC template to the FSB will be open from 1 August 2012 to 31 October 2012. Once all PAQC's have been received, the FSB will communicate decisions back to the insurers by 30 November 2012. The open-ended PAQC window 3 will start 1 January 2014.

South African Quantitative Impact Study Two (SA QIS2)

All the relevant Task Groups operating under the FSB SAM Governance Structure have been asked to provide input for consideration in drafting the SA QIS2 Technical Specifications. The adjusted SA QIS2 timelines as communicated in the FSB SAM Update Newsletter issued on the 12 April 2012 are as follows:

Publishing of draft SA QIS2 technical specification for comment ***(Issued)***	**31 May 2012**
Final date for submission of comments	**22 June 2012**

Publication of final SA QIS2 technical specification	**13 July 2012**
Submission of results for solo calculations	**15 October 2012**
Submission of results for group calculations	**5 November 2012**
SA QIS2 report published by FSB	**31 January 2013**

In light of the SA QIS3 being a compulsory requirement in 2013 insurers will find participation in the SA QIS2 exercise a beneficial stepping stone towards preparing for the third and final quantitative impact study.

SA QIS2 contains a number of differences when compared to SA QIS 1. The FSB therefore released two copies of the SA QIS2 Technical Specifications, one “clean” version and the other with track changes. This will assist those insurers that participated in SA QIS1 as well as those who have a solid understanding of the Solvency QIS5 to obtain a clear understanding of these changes.

The number of lines of business (LoB) falling under Segmentation, have been significantly reduced and barring a few exceptions are similar to the current authorisation classes in the Short-term Insurance Act. Insurers will notice that Accident and Health policies are not included under the Non-Life sections. It is the intention of SA QIS2 to value and assess these policies using life-insurance techniques due to the nature of these policies having similar features to that of life products.

A group solvency calculation has also been included in SA QIS2. Different methods will be tested in order for the Insurance Groups Task Group to continue with informed views with regards to finalising Discussion Document 27 (Group own funds) and Discussion Document 92 (Group solvency).

SA QIS2 will require additional “operational ring-fenced funds” information. This will apply to all cell-captive arrangements, including contingency policies and discretionary participating funds. “Operational ring-fenced funds” require insurers to calculate the SCR for each of the different funds and to determine if each fund has sufficient “own” capital resources to cover the individual SCR’s.

The SAIA SAM Project Support Office would like to encourage all insurers to participate in SA QIS2 as it will provide the FSB with beneficial information on the impact on the proposals on individual and types of insurers.

Further to this, the information gathered in SA QIS2 will provide substantial input for the Economic Impact Study.

For any information pertaining to the draft SA QIS2 Technical Specifications please feel free to contact the SAIA SAM Project Support Office directly.

Publication of the South African Insurance Association

SAM NEWS

SAIA – (011) 726 5381 | Issue 3 / 2012

Discussion Documents

Discussion Documents provide crucial input for consideration of technical proposals by the FSB in the drafting of legislative requirements within the SAM process. The following Discussion Documents were approved for public comment by the FSB SAM Steering Committee:

Discussion Document	Title	Task Group
50	Detailed contents of SFCR and RSR: Quantitative, Qualitative and Supplementary internal model disclosure and reporting requirements	Reporting and Disclosure
53	Treatment of participation in financial and credit institutions in own funds	Capital Resources
85	Treatment of insurance operations (in “non-equivalent” jurisdictions) under the final measures to regulate the solvency of South African insurance groups (“groups”)	Insurance Groups
89	Calculation of SCR on total balance sheet	Capital Requirements

Position Papers

Discussion Documents that have been in the public domain for comment will ultimately take the form of a Position Paper before becoming legislation. The following Discussion Documents were recently approved by the FSB SAM Steering Committee for adoption as Position Papers:

Former Discussion Document	New Position Paper	Title	Task Group
25	**25**	Own Funds – Supervisory approval of ancillary own funds	Capital Resources

SAIA
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SAM NEWS

SAIA – (011) 726 5381 *Issue 3 / 2012*

Final Position Papers

The following Positions Papers have been accepted and approved as "Final" Position Papers by the FSB SAM Steering Committee.

These Final Position Papers have been subjected to a comprehensive public comment process and as such do not require any further industry input. These papers will now be construed by the FSB Drafter as the final input from industry for the design of the SAM Secondary Legislation.

Final Position Paper Number	Title	Committee
14	Solvency and Financial Condition Report: Undertakings using an approved internal model	Steering Committee
15	Structure of the Regulatory Return	Steering Committee
17	Report to Supervisors – Undertaking's reporting and disclosure policy	Steering Committee
19	Level of harmonization and quantum of data	Steering Committee
34	Own Risk and Solvency Assessment	Steering Committee
42	Calculation of technical provisions as a whole	Steering Committee
43	Internal Models: Validation	Steering Committee
55	Internal Models: Statistical Quality and Calibration	Steering Committee
56	Internal Models: Documentation and Data Requirements	Steering Committee
57	Partial Internal Models	Steering Committee

Insurance Bill update

The second Draft of the Insurance Bill has been released for consultation within the SAM structures only. It is expected that the third Draft of the Insurance Bill will be made available for comment within the SAM structure in the third quarter of 2012.

Draft 4 will be released for public comment in the fourth quarter of 2012 while Draft 5 is envisaged to be released for public comment in the second quarter of 2013. The Final draft (Draft 6) will be submitted to National Treasury by the end of the third quarter in 2013.

National Treasury will provide the public with a further opportunity to comment by the end of 2013 and beginning of 2014. The Bill will enter the parliamentary process in quarter three and four of 2014 providing a final opportunity for public comment before the Bill is enacted by latest December 2014.

Pillar II Readiness Survey Update

The FSB have considered and reviewed the consolidated comments pertaining to the draft Pillar II Readiness Survey, as obtained from the various task groups operating within the SAM Governance Structure.

The Readiness Survey will be circulated to all insurers to complete in June 2012 with the deadline for completion and submission to the FSB currently set for late Quarter 3 of 2012. A report on the findings of the survey is envisioned to be published early in 2013.

The survey is not intended to be construed as a checklist of the final Pillar II requirements as these are still being developed and refined by the relevant task groups.

Completion of the survey will be compulsory and shall require sign-off" by the Chief Executive Officer (CEO) and a member of the Board.

3rd Country Equivalence

An overarching principle of SAM is that the recommendations arising from the SAM project should meet the requirements of a 3rd country equivalence assessment, as established by the European Union.

The Solvency II regime is still being developed, and the requirements for 3rd country equivalence are not yet finalised. However, the European Commission is considering transitional arrangements whereby countries may be deemed equivalent for a set period of time from Solvency II implementation.

The European Commission has identified South Africa as one of seven countries where they have asked EIOPA to carry out a technical analysis on the regulatory regime for insurers. This technical analysis will assist the European Commission in making a decision on whether South Africa should qualify for the transitional arrangements.

The FSB submitted a response to a questionnaire posed by EIOPA in April 2012 and are awaiting further feedback from EIOPA pertaining to the process of qualifying for "deemed equivalence" with the Solvency II Directive.

It is expected that the European Commission will render their verdict as to which countries qualify for these transitional arrangements in 2013.

For further information regarding these SAM Snippets please contact Gareth van Deventer at gareth@saia.co.za

The SAIA SAM Financial Impact Study

Introduction

During the month of March 2012 the SAIA SAM Project Support Office (PSO) conducted a high-level telephonic survey ***among our members*** to gage their perception of the potential financial impact that SAM would have on their companies.

The survey began on the 6th March 2012 and was concluded by the 30th March 2012. Within this brief period of time 64% of our SAIA members participated in our survey.

Our survey was conducted post the SA QIS1, and as such additional positive and negative financial effects that SAM may have on our members companies might be further identified after the conclusion of the SA QIS2, scheduled to take place in the second half of 2012.

Some Highlights:

- Close to **86%** of respondents believe that there will be an increase in merger and acquisition activity due to SAM
- Approximately **77%** of insurers and reinsurers surveyed have indicated that they will not be fundamentally altering their asset spread under the SAM regime
- Approximately **94%** of those surveyed have no intention to remove, discontinue or alter any of their current product-offering at this early stage in SAM's development
- A resounding **80%** of respondents surveyed indicated that they foresee an overall increase in the costs associated with maintaining their current product offering due to SAM
- **54%** of respondents believe that policyholders will be better off under the new SAM regime

Publication of the South African Insurance Association
SAM NEWS
SAIA – (011) 726 5381 Issue 3 / 2012

General Findings

Most respondents shared the view that SAM would suite the larger insurers and reinsurers increasing their dominance while the smaller insurers and reinsurers would be at a disadvantage becoming less competitive under SAM.

Some respondents felt that SAM would be a regime more suited to a typical insurer and that niche and mono-line insurers would find it extremely difficult to continue to remain competitive.

There was a particular concern that SAM would threaten the survival of insurers writing guarantee insurance as their core business offering due to the large capital holding that is required.

It was the belief of some that SAM would create greater barriers of entry for new competition in the insurance sector thereby limiting further competition.

From an international perspective most agreed that SAM would put the South Africa insurance market on an equal footing with Europe, thereby improving South Africa as an investment destination and a more attractive stable market for international companies.

In general most respondents felt that competition within the South African short-term insurance sector would be negatively affected due to SAM.

Some insurers had taken steps to disinvest from equities and high risk investments some time ago as a consequence of the global financial crisis and not in anticipation of the proposed SAM regime.

The results were neck and neck throughout the duration of the survey but in the end, 54% of respondents believe that the use of an approved internal model or partial internal model will ***not*** give insurers or reinsurers a significant capital and competitive advantage over those using the Standard Formula.

Given the rather conservative investment strategies that short-term insurers currently have in place and the high degree of respondents that will not be changing their asset spread under SAM, a 66% majority of those surveyed believe that they will be able to maintain their current return on capital under the new SAM regime.

Due to the current uncertainty encompassing SAM, 94% of insurers and reinsurers surveyed will not be removing, discontinuing or changing any of their current product offering at this early stage in SAM's development. Most insurers and reinsurers acknowledge that SAM will have some kind of effect on product development with 37% of those surveyed indicating that SAM will limit or affect their ability to develop new insurance products.

A resounding 80% of insurers and reinsurers surveyed indicated that they foresee an overall increase in the costs associated with maintaining their current product offering. These costs were primarily attributed to the recruitment of further skilled resources as well as the cost of compliance and preparing information technology systems equipped and suited to SAM.

Close to 49% of those surveyed indicated that they **do** expect their premiums to increase under SAM. Of these, a 63% majority expect the increase to be in the region of between 0 - 5%, while 25% expect premiums to increase between 5 - 10% with a further 12% foreseeing increases of between 10 - 15%. No insurer expected an increase in their premiums in excess of 15%.

Conclusion

Much work is still required to be undertaken in refining and calibrating the Standard Formula as well as ironing out a number of identified challenges, before the new SAM regime becomes suitable to insurers in South Africa.

Potential unintended financial consequences of SAM need to be identified and closely monitored at an early stage, to ensure that these do not have an adverse effect on the current competitiveness and stability of the short-term insurance industry.

The SAIA SAM Project Support Office sincerely appreciates the participation and support received by those of our members who partook in our high level SAM Financial Impact Survey.

For further information regarding this article please contact Gareth van Deventer at gareth@saia.co.za

Publication of the South African Insurance Association

SAM NEWS

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Understanding a breach of the SCR (under Solvency II)

Suggesting that the regulator will take a 'relaxed' attitude towards a breach in a firm's SCR is unjustified, according to ***Carlos Montalvo, Executive Director of EIOPA****. Instead he urges market participants to learn how to interpret this important regulatory tool correctly.*

The idea of introducing a two tier capital requirement for Solvency II is designed to provide supervisors with a so called "supervisory ladder of intervention". This ensures the supervisory response is tailored to the specific situation of the firm and represents a major cultural shift from the current regime.

Supervisors will treat the breach of the higher capital threshold, the SCR (Solvency Capital Requirement), as an indication that the financial soundness of the undertaking is deteriorating and take appropriate action. This approach is a cornerstone of a risk based framework that focuses on pre-emption and should not be viewed as a 'relaxed' attitude on the part of the supervisors towards firms that breach their SCR.

Since the Solvency II project started more than a decade ago, it has always been the intention to create two capital requirements in order to allow for a supervisory ladder of intervention. The recent market developments have no impact on this decision. There is, of course, a concern that some market participants, especially analysts and ratings agencies, might misinterpret this mechanism as a financial crisis in the company. Indeed, we have seen signs of this in the misguided criticism EIOPA received for using the lower of the two thresholds, the MCR (Minimum Capital Requirement), in its stress testing.

If analysts and other market participants focus only on the capital requirements, this would be a false approach. They should consider the amount of the breach of the SCR as well as understand the factors that caused it. And they will also be able to consult public disclosure (balance sheets, elements of governance, etc.) for more clarifications.

It should also be noted that capital requirement is not the only thing that can endanger the company. Other early warning signs of trouble could relate to governance requirements; frequent changes of management or bad management in principle can also lead to the collapse of a company.

As regulators and as an industry as a whole, we have a job on our hands: to make sure the breach in the SCR is interpreted as it is intended. Market participants and supervisory authorities must have the same understanding of the solvency ratio in Solvency II and it is very important to differentiate the MCR from the SCR. This is crucial.

Publication of the South African Insurance Association

SAM NEWS

SAIA – (011) 726 5381 Issue 3 / 2012

The breach of the MCR triggers a very strict recovery plan and if that plan is not complied with, the company will be closed down. The SCR is a regulatory tool for monitoring the financial soundness of a firm. The supervisor will have a possibility to interpret the breach of the SCR because sometimes the difficult situation of the company is not due to a fundamental unsoundness, but can be caused by exceptional market volatility.

It might be the case that solvency ratios are not well understood by markets. But at the same time markets will know that in case of a breach in the SCR, the supervisor will enter into discussion with the company and a recovery plan will be implemented. The supervisor will also have to state that the breach in the SCR does not mean that the company is insolvent.

EIOPA stands ready to help educating supervisors, investors, analysts and the media on how to interpret a breach in the SCR. As indeed this is a significant cultural change, and like all changes of this magnitude, it requires care and attention to produce the best results.

This article was taken from the Solvency II Wire website posted 29 January 2012. The author is Executive Director of the European Insurance and Occupational Pensions Authority (EIOPA). The views expressed are the author's own and pertain to the Solvency II Directive and not to SAM.

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