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Comparison of regulation in Australia, Canada, and the U.K. – CLRS 2007 San Diego

Ming Roest

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Agenda

Introduction

Canada

Australia

Europe
and UK

Comparison

Conclusions

Introduction

- Insurance regulation in the U.S. has evolved over the years, and it seems that the current pace of change is faster than ever.
- In some other countries, however, the pace of change has been even greater and many innovative techniques have been introduced.
  - Australia
  - Canada
  - U.K
- This session will help attendees get a better perspective of how the U.S. regulatory environment compares to those of other countries
- This session will provide a perspective on the challenges faced by international insurance companies.

Agenda

- Introduction
- Canada
- Australia
- Europe and UK
- Comparison
- Conclusions

History of EU Solvency regime

- EC solvency margins introduced in 1973 Directives (non-life)
- Solvency I review (1997 to 2002) resulted in some revisions to solvency margins
  - 50% increase for certain non-life liability classes
  - Disallowance of benefits of discounting non-life claims provisions
- Established that EC margins are minimum standards which Member States can increase
- Little harmonisation of the basis for mathematical reserves
- Assets can be valued at either book value or market value

Solvency I Capital Requirements

Description

- The greater of:
  - 16-18% of net written premium
  - 23-26% of average claims incurred over last three years – increased for some classes by 50%

Advantages

- Easy to calculate
- Easy to predict development in capital base
- Fits to a book-value accounting system

Disadvantages

- Does not measure the real risks of an individual company
- Not consistent with solvency measures applied by other types of financial institutions
- Does not reflect changes in economic environment

Actions Taken in Advance of Solvency II

- A number of supervisors have already taken steps to make their local prudential regulation meet the aims set for Solvency II.
- The most advanced forms of regulations are those applicable in the United Kingdom, Switzerland and Sweden.
- In all cases the new regulation is based on marking assets and liabilities to market with capital requirements based on scenario tests or economic modelling.

UK – What is ICAS?

- The ICA is the Directors own assessment of how much capital they need to hold in order to meet policyholder liabilities as they fall due.
- Firms must identify all major financial risks and quantify appropriate amounts of capital
  - Requires stress testing and scenario analysis
  - Proportionate to nature, scale and complexity of firm
- Typically reviewed annually or when there has been a major change
- FSA will perform its own assessment (Individual Capital Guidance “ICG”) and advise if they think the ICA is insufficient.

UK – Aims of ICAS

- For firms to hold capital appropriate to their particular business, management practice, systems and controls
- To emphasise the responsibility of senior management for ensuring that the firm has adequate financial resources
- To provide incentives for better risk management
- To enhance consumer protection through a reduced, but non-zero, risk of financial failure
- ICA calculations need to be well documented in order to demonstrate their appropriateness to the FSA

Two key aspects to the ICA

Risk management

- **Governance – Board level accountability**
- **Risk appetite – A clear risk strategy and risk tolerance**
- **Roles and responsibilities – Reporting lines, Committees**
- **Policies and procedures – Risk standards, risk rules, risk limits**

Risk measurement

- **Risk identification – Key risk exposures**
- **Risk assessment – Effectiveness of controls, capital required**
- **Risk monitoring – KRI's, capital utilisation, expected losses**

Europe in 2012…

- Solvency II will replace ***all*** existing prudential regulation:
  - Solvency I
  - Enhanced Capital Requirements
  - Realistic Balance Sheets (twin peaks)
  - ICAS

Solvency II – Supervisory Aims

- Establish solvency standard to match risks
- Encourage risk control in line with IAIS principles

- Harmonise across EU
- Assets and liabilities on fair value basis consistent with IASB if possible

- Practical approach
- 3 Pillar approach broadly consistent with Basel II

Solvency II – Three Pillars

Pillar 1 :

Technical rules for valuation of assets, liabilities and solvency margin (both SCR and MCR)

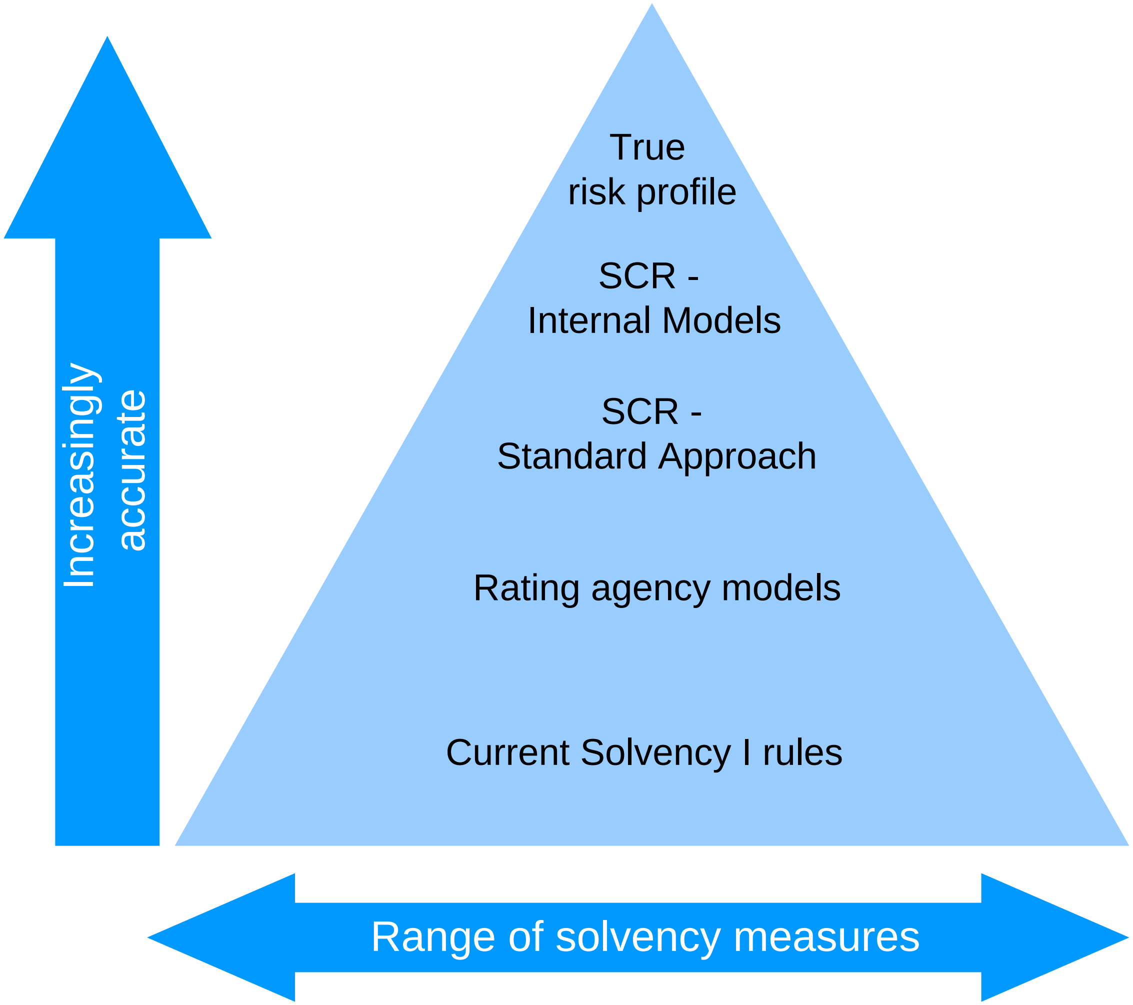
Pillar 2 :

Supervisory review process including individual capital adjustments having regard to effectiveness of risk management and corporate governance arrangements

Pillar 3 :

Public and private disclosures to the regulator

From Solvency I to Solvency II towards a coherent economic approach



Future

- Consistent view on solvency measures across all parties
- Discussions with supervisors and rating agencies focus on accuracy of internal model and quality of risk management

Current situation

- Multiple ways of assessing solvency which are not always consistent and can even contradict each other
- Not aligned with best practice internal risk management

Comparison solvency regimes

Issue	Canada	Australia	UK / Europe	US
Valuation Assets			Market consistent	
Valuation Liabilities			Market consistent	
Allowance Internal models			Yes	
Rules based or principles based			Principles based supervision	
Focus on Risk Management			Is main aim	

Comparison solvency regimes (cont')

Issue	Canada	Australia	UK / Europe	US
Alignment with IASB			As much as possible	
Alignment with IAIS			Yes	