# Solvency Regulation in Mexico for Non Life

## In Focus

## Government In Insurance Seminar

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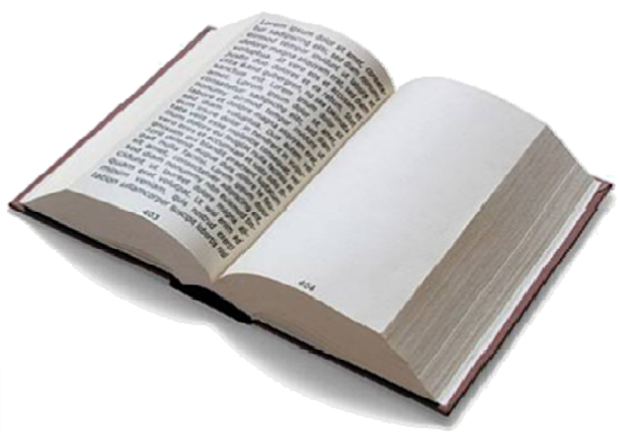
## Solvency Regulation for Non Life: México Context

- Mexican Regulators:
  - Treasury – Secretaría de Hacienda y Crédito Público (SHCP)
  - National Commission of Insurance and Surety – Comisión Nacional de Seguros y Fianzas (CNSF)
- There are companies that can only operate in one line of business (LOB) as:
  - Health
  - Credit
  - Mortgage Insurance
  - Financial Guarantee
- Old multi line companies where allowed to operate Property Casualty, Accidents and Illness and Life. Current structure can only be Property Casualty and Accidents and Illness or Life and Accidents and Illness

# Regulation Context

- Regulations established
  - Required Capital is based on factors which apply to Premium or Losses except for Earthquake and Hurricane
  - Reinsurance ceded is only considered for proportional reinsurance
  - Movement to have more principles in place
  - The position of Normative Controller needs to be established
- There is a proposal for a new law based on Solvency II; which should be reviewed and voted on by the congress soon



# Products and Reserves

- Products
  - Need to file new products with the CNSF before selling and need to have a formula to define the price; can not be a range
  - The CNSF can suspend the product in cases where not actuarially supported or legal conditions are against the insured
- Reserves
  - Unearned Premium Reserve
    - Need to estimate a Premium Deficiency Reserve
    - The administration expenses need to be reserved on gross basis
    - Have different rules for Earthquake and Hurricane
  - Loss Reserves
    - Models are mechanical and pre-approved by the CNSF (no judgment allowed)
    - Need to estimate IBNER and IBNYR separately
    - Only ALAE is estimated, not ULAE

# Catastrophic Reserves

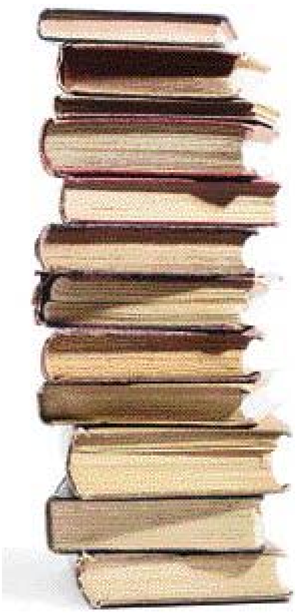
- Earthquake - Hurricane
  - The Limit of the reserve is 90% of the average net PML (net of ceded proportional reinsurance) updated with inflation of the last five years
    - The direct values of the PML come from the system used for the unearned premium reserve
    - For reinsurance assumed or risks that can not be assessed the PML is created as 9% of the net sum insured at the end of the year. Earthquake can use the same PML factor to Sum Insured coming from the ERN model
- Other Catastrophic Reserves
  - Crop-hail and Livestock Insurance
  - Mortgage Insurance
  - Financial Guarantee
  - Travel Third Party Liability

# Responsibility of the Actuary

- Products
  - Certifying Actuary in Products for the Operation needs to sign the technical note plus the congruency analysis with the general conditions, which also needs to be signed by a registered lawyer
- Reserves
  - Certifying Actuary in Reserves for the Operation needs to sign off on reports presented every quarter to the CNSF
    - Unearned Premium Reserve
    - Loss Reserves
    - Catastrophic Reserves
- Limit of Retention by Risk
  - Certifying Actuary in Products needs to create a technical note and study to estimate the Limit of Retention by risk and LOB at least once a year
- Appointed Actuary
  - Independent from the company
  - Provide a sufficiency opinion on the Reserves

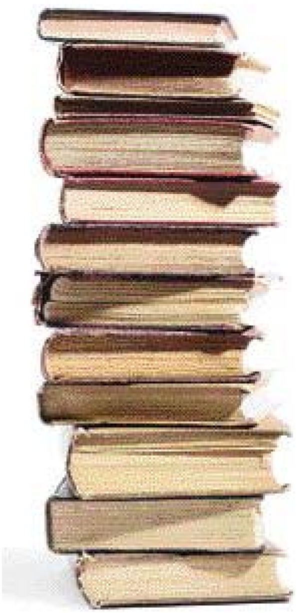
# Solvency Regulations

- Required Capital
  - Estimated as the higher of a percentage of premium or losses, adjusted by the reinsurance ceded to a non registered reinsurer, plus an amount due to the ceded reinsurance and cost of reinsurance adjusted by concentration of reinsurance and quality of reinsurance. This applies to:
    - Automobile
    - Liability
    - Crop-hail and Livestock
    - Credit
    - Rest of P/C
  - For Earthquake and Hurricane
    - The PML estimated
  - For Mortgage Insurance
    - Formula related to the credits covered
  - Investment



# Solvency Regulations (cont'd)

- Assets
  - Define which assets can cover Reserves and which cover Capital
  - First cover Reserves
  - Second cover the Capital
- Deductible
  - The required capital for Earthquake and Hurricane can deduct the Catastrophic Reserve plus the XL adjusted by credit for reinsurance
  - In case the Catastrophic Reserve is over 50% of the total value, an additional deduction to Required Capital can be applied
- Solvency Margin
  - Assets that cover the Capital minus the Required Capital net of the deductible must be positive



# Dynamic Adequacy Capital Test

- Dynamic Adequacy Capital Test (DCAT)
  - Stress test of solvency of the company over the next 3 to 5 years
  - Based on company business plan and actual performance
  - Embedded in ERM concepts of managing future risk, i.e. identification of solvency risks and mitigation actions
- Stress tests regulatory (Provided by the CNSF)
  - Premium risk
  - Claims Liabilities risk
  - Interest risk
  - Worst case of the above
- In addition
  - At least 3 feasible adverse risk tests

# New Law

# Solvency II Mexico

- Not only emphasis on quantitative regulations, also on corporate governance and market discipline.
- Responsibility of Company Management (Board)
- Reserves
  - Better estimator plus a risk margin
  - Catastrophic Reserve continues
  - Following international regulation
- Requirement Capital
  - Better estimation of the risks in order to calculate the SRC
  - Have internal models following rules and principles, have stochastic models, measured by Tail Var or Var
  - Stress Tests

# Solvency II Mexico (cont'd)

- Corporate governance - Precision of the functions and responsibilities related to:
  - Risk Management
    - Policies and procedures in order to watch over, management, measure, control and mitigate the risks
    - Acceptable limits of risk
    - Global needs and future impacts over solvency
  - Control and Internal Auditing
    - Functions and responsibilities in this area
    - Responsibilities of the person external to the company and independent actuary
  - Actuarial Function
  - Subcontract with vendors
- Strengthening of information presented and transparency
- Responsibility of the Board and their function

# Questions and Answers

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