Actuarial & Insurance Solutions

Industry Update

March 2018

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Latest regulatory updates in the Insurance Industry, and an informative panel discussion on the role of the CRO.

National Assembly Passes Insurance Bill

The Insurance Bill is part of several Bills giving effect to the new "Twin Peaks" model. The Bill aims to promote maintenance of a fair, safe and stable insurance market.

The Insurance Bill was passed in the National Assembly on 28 November 2017. It is now referred to the National Council of Provinces for consideration. For Solvency Assessment and Management (SAM) to become effective in July 2018, the following milestones should be met:

- Insurance Bill to be enacted by end-March 2018
- Promulgation of the Prudential Standards by end-June 2018

Financial Soundness Standards

On 10 January 2018, the FSB released a report detailing areas in the Financial Soundness Standards (FSI) where they decided to follow a different approach to that suggested by the SAM structures. Here are the details:

Valuation of Participations

Task Group	FSB Policy Steer
Final PP 39 (v8)	FSI 2.1 Section 5
The Task Group suggested a fair value approach to value Participations which could be based on a model. This ties in with Article 75 of the Solvency II Directive and ICP14.	The FSB proposes a prudent valuation method based on the excess of assets over liabilities (i.e. Net Asset Value). The reason for the FSB's approach is to avoid an insurer valuing a Participation in a way that is more favourable to the insurer.

Treatment of Participations in SCR and Own Funds

Task Group	FSB Policy Steer
DD 53 (v10.2)	FSI 1; FSI 2.3; FSI 4; FSI 4.1
The Task Group members could not reach consensus on the following: 1. Definition of Participation (share ownership vs control). 2. Definition of a financial and credit institution. 3. Non-South African (re)insurance participations should be treated in the same manner as South African (re)insurance participations. 4. Participations in non-financial undertakings should be treated as ordinary equity investments i.e. included in the appropriate equity risk sub-module.	1. In the definition of a Participation, the FSB has allowed for both share ownership and control. 2. The definition of a financial institution is defined as per the Financial Sector Regulation Act. The definition of a credit institution is as per the National Credit Act. There was no difference in principle between the FSB and Task Group. 3. The FSB agrees with this, provided allowance is made for whether the participation is in the same sector of the insurer or not. 4. The FSB agrees with this. In essence, any participation not within the same sector as the insurer should be treated as any other equity investment.

Illiquidity Premium

Task Group	FSB Policy Steer
DD 31 (v2.1)	FSI 2.2 Section 13
As no consensus was reached by the Task Group on matters dealing with the illiquidity premium, DD 31 (v2.1) was handed over to the FSB for consideration and finalisation.	Considering the lack of a generally accepted method to strip out the illiquidity premium from the spread above the risk free rate, and from the information gathered during the SA QIS 3 exercise, the FSB's decision is to allow for an illiquidity premium, but with a cap of 50 basis points.

Risk Free Rates (Government Bond vs Swaps)

Task Group	FSB Policy Steer
PP 40 (v3)	FSI 2.2 Section 13
The Task Group recommended that the swap yield curve (i.e. swap rates) be used to determine the risk-free rate term structure.	After considering the advantages in terms of credit risk, realism, reliability, liquidity, objectivity and simplicity, the FSB made a decision to use the government bond curve as the default basis for determining the risk-free rate term structure. Nonetheless, (re)insurers may apply to the regulator to use the swap curve.

Concentration Risk

Task Group	FSB Policy Steer
Final PP 44 (v4)	FSI 4.1 Section 10
The Task Group requested that the FSB give consideration to industry concerns regarding the concentration risk arising as a result of the limited number of banking counterparties in South Africa.	The FSB agrees that the South African banking sector is highly concentrated and that any attempt to reduce concentration risk may increase other risks. The FSB introduced separate concentration thresholds for cash and short-term deposits held in South African banks. The FSB is comfortable with the lower concentration risk capital requirements this will lead to.

Calculation of Own Funds and SCR for Cells

Task Group	FSB Policy Steer
DD 90 (v1)	FSI 4 Attachment 4
The view of the Task Group and FSB on Own Funds is aligned. In terms of SCR, the Task Group proposed that the total SCR for the insurer should be the sum of the notional SCR for the ring-fenced funds and the SCR for the remaining part of the insurer. Hence, the aggregate SCR across cells is added without allowing for diversification.	The cell captive insurer needs to hold capital against the shortfalls in its cells. This capital requirement for the cell captive insurer falls outside the ring-fenced fund, therefore the FSB decided that the total shortfall may be diversified across all the cells with a shortfall. Each cell with a shortfall needs to hold capital for the risk of default of the cell captive insurer.

SCR: Infrastructure Assets

Task Group	FSB Policy Steer
N/A	FSI 1 & FSI 4.1
Infrastructure Assets were not considered by a Task Group.	The FSB has added Infrastructure assets as an asset class. This has an impact on FSI 1 (Framework for Financial Soundness of Insurers) and FSI 4.1 (Market Risk Capital Requirement).

SCR: Catastrophe Risk (Life)	
Task Group	**FSB Policy Steer**
Final PP 62 V5	FSI 4.2 Section 10
The Task Group proposed that the Life Catastrophe Risk capital requirement should be calculated based on an instantaneous increase in policyholder mortality and morbidity rates.	The FSB disagrees with an instantaneous shock as the epidemic and pandemic event is likely to be over a longer period. The FSB has suggested an alternate calculation of the increase to the mortality and morbidity rates.

SCR: Lapse Risk (Life)	
Task Group	**FSB Policy Steer**
Final PP 59 V4	FSI 4.2 Section 8
Based on the industry comments that were received, the Task Group proposed that the explicit mention of linked business under the 70% shock should be removed.	The FSB has approved the proposal by the SAM task group.

The role of the Actuary in Risk Management

The actuarial industry is characterised by a shortage of experienced resources. This is even more acutely felt in the Insurance Risk Management field, where actuaries are playing an increasingly active role.

Actuaries are well suited to the insurance Chief Risk Officer (CRO) role, and many insurers are specifically recruiting actuarial specialists into this role. With this position being enforced as regulatory requirement under SAM, we sought to explore the role of the actuary in the risk management space through an industry survey.

Follow the results of our industry survey below, where we discuss the outcomes with a panel of industry experts (including CROs of leading insurers) at the most recent Annual Convention of the Actuarial Society of South Africa.

Click here to view the video.

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