

RISK BASED CAPITAL AND SOLVENCY

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ISLE OF MAN
FINANCIAL SERVICES AUTHORITY

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AIMS OF RISK BASED CAPITAL AND SOLVENCY WORKSTREAM

- Establish a high level of observance of IAIS ICPs as assessed by IAIS and IMF
 - ICPs 14 and 17 for Valuation and Capital Adequacy
 - ICP16 for ERM
- Regime which is appropriate and proportionate to the risks of the different parts of the IOM insurance industry
- Allow IOM to be recognised as an up to date and responsible regime for insurance business
- Possible Solvency II (transitional) equivalence for life business



TOTAL BALANCE SHEET APPROACH

- Capital resources = assets - liabilities, on basis of their recognition and valuation for solvency purposes
- Financial statements for solvency purposes may differ from those used for general purpose financial reporting, but should be able to be reconciled
- Assets and liabilities valued on a consistent, economic basis



TECHNICAL PROVISIONS

- TPs represent the economic value of the insurer fulfilling its obligations to policyholders and other beneficiaries arising over the lifetime of the insurer's portfolio
- Conceptually, equal to the amount another insurer would require to take on the liabilities.
- In two parts:
 - Best estimate provision is expected PV of all relevant cash flows that arise in fulfilling insurance obligations, using unbiased, current assumptions
 - Risk margin to compensate for the inherent uncertainty of those obligations

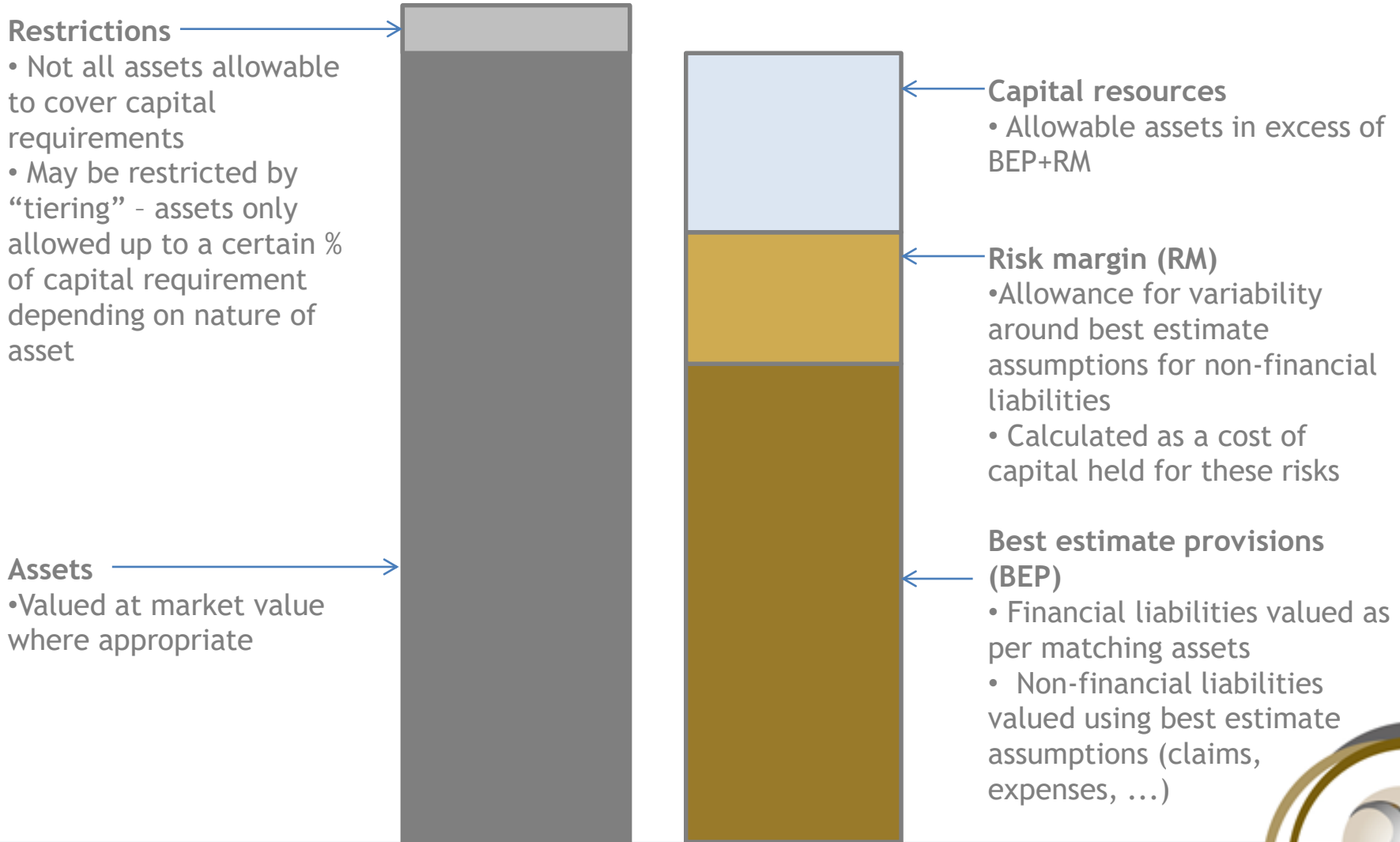


RISK MARGIN - QIS1 / QIS2 APPROACH

- For non-financial liabilities:
 - project the future capital required, as per the statutory Solvency Capital Requirement (see later), at the start of each future year until the current risks have run off completely
 - calculate a cost of holding that capital in each future year, by multiplying the capital required in each year by a (prescribed) cost of capital rate of 5%
 - discount the cost of capital in each future year back to the present using the appropriate risk-free rate



ECONOMIC BALANCE SHEET

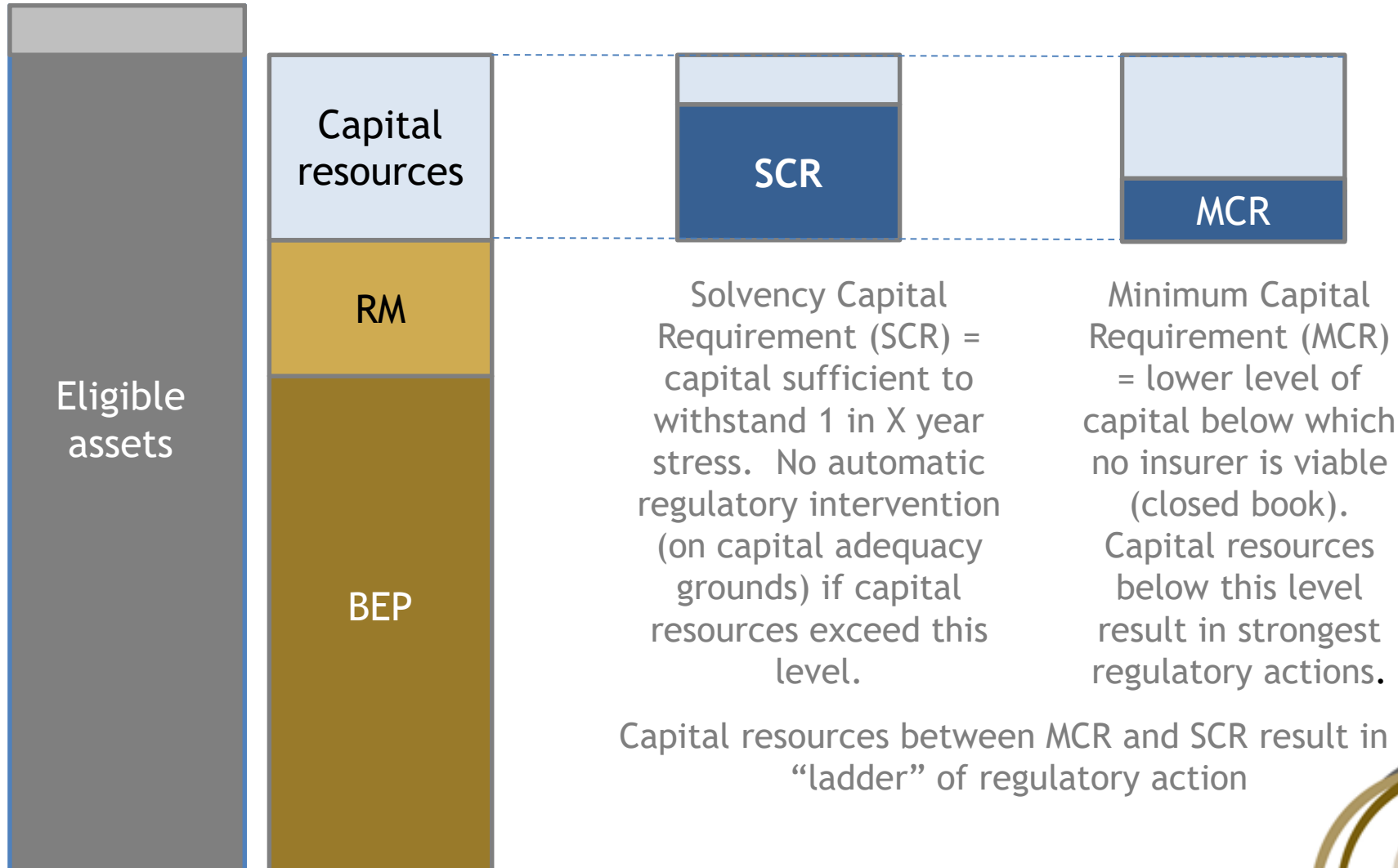


REGULATORY CAPITAL REQUIREMENT

- Board and senior management required to ensure insurer has adequate and appropriate capital to support risks (as per CGC)
- Regulatory capital requirement set at a level such that in adversity an insurer's obligations to policyholders will continue to be met as they fall due



CAPITAL REQUIREMENTS



SCR - RISKS TO BE COVERED

- All relevant and material categories, including
 - Interest rate risk
 - Equity risk
 - Property risk
 - Spread risk
 - Currency risk
 - Concentration risk
 - Counterparty default risk
 - Mortality risk
 - Longevity risk
 - Disability and morbidity risk
 - Life lapse risk
 - Expense risk
 - Revision risk
 - Life catastrophe risk
 - Premium and reserve risk
 - Non-life lapse risk
 - Non-life catastrophe risk
 - Operational risk (not in QIS2)
 - Group risk (not in QIS2)



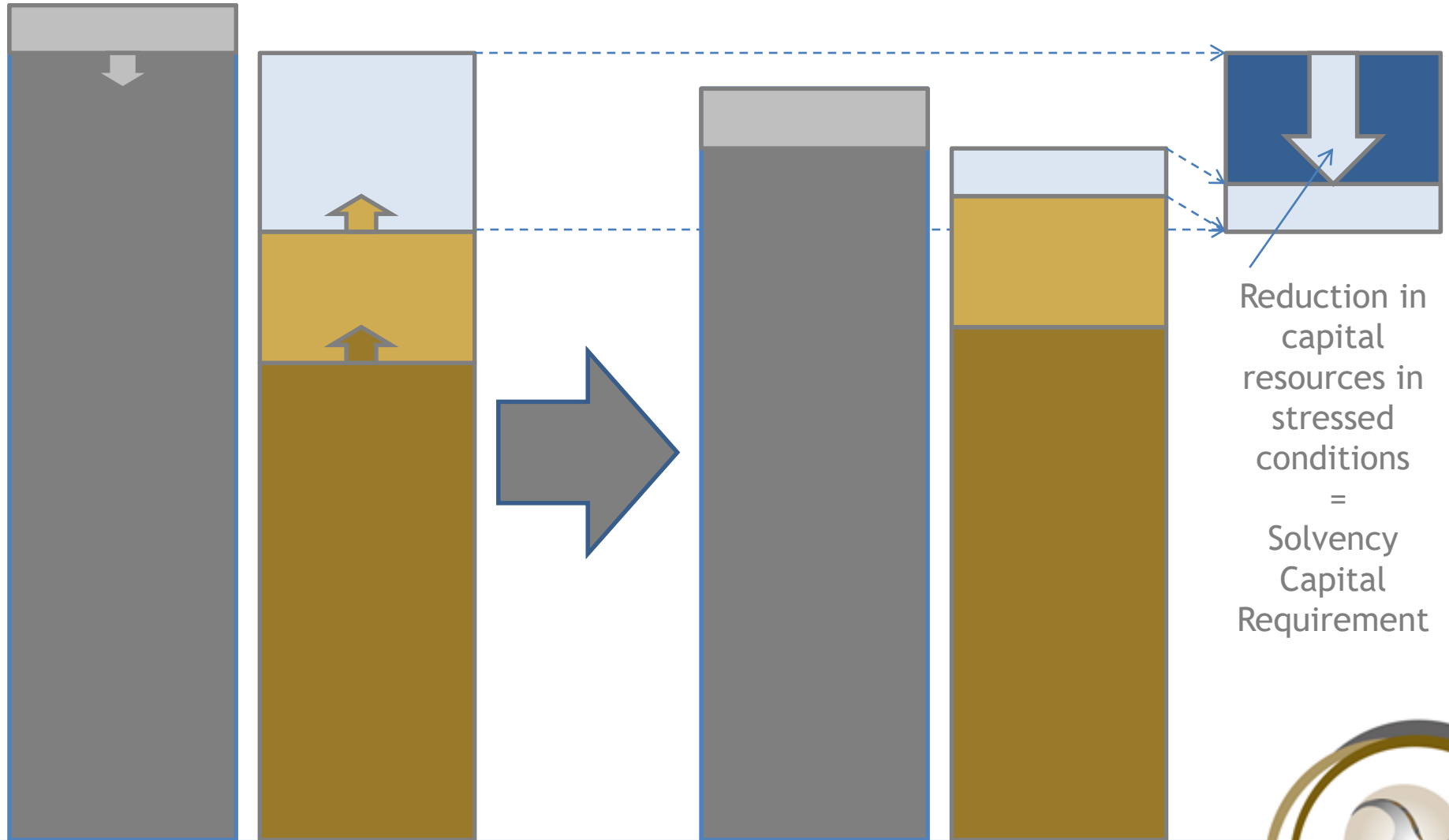
SCR - CALIBRATION

- For life, as per Solvency II
 - 99.5% VaR approach over one year (that is, hold sufficient capital such that there is only a 1 in 200 chance of having insufficient assets to meet the TPs at the end of one year, given the risks to which the company is exposed)
- For non-life we will be calibrating the SCR to suitable confidence levels (to be decided) depending on the nature of policyholders.
- For QIS2 purposes we will be testing two confidence levels (all non-life insurers to calculate both):
 - 99.5% VaR (1 in 200) as per life
 - 90% VaR (1 in 10)



SOLVENCY CAPITAL REQUIREMENT

STRESS ECONOMIC BALANCE SHEET USING A [1 IN 10 OR 200 YEAR] CONFIDENCE LEVEL

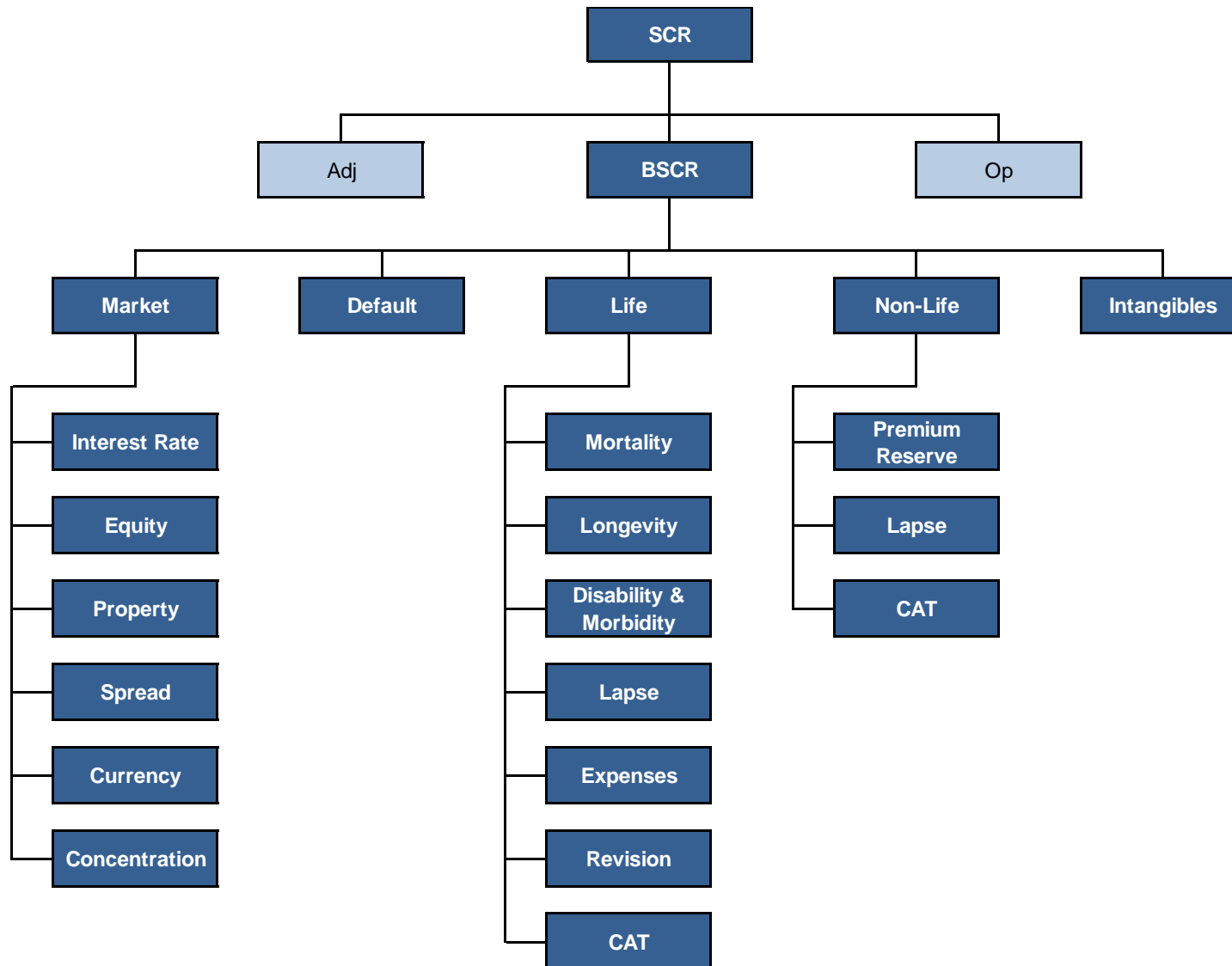


1 IN X YEAR STRESSES

- Apply a 1 in X year stress for each (material) risk the company is exposed to
- Calculate the capital requirement for each of these risks separately
- Then aggregate the capital requirements allowing for the fact that the various risks are unlikely to occur at the 1 in X year level simultaneously, using a correlation approach
- Correlations allow for the potential for risks to become more closely correlated in adverse scenarios



STRUCTURE OF SCR COMPONENTS



EXAMPLE ADJUSTMENTS FROM SOLVENCY II

- Cost of capital for risk margin reduced to 5% from 6%
- Diversification between currency exposures allowed for
- Testing non-linearity of lapse, equity, and other risks in life business
- Substantial simplification of non-life catastrophe risks
- Exploring lower confidence level for captive business
- Exploring possible bespoke allowance for operational risk, and diversification with other risks



QIS TIMELINES

Date	Life	Non-life
H1 2014	<i>Initial consultation</i>	
September 2014	<i>QIS1 launch</i>	
March 2015	<i>QIS1 results deadline</i>	
July 2015	<i>QIS1 feedback</i>	
Q2/3 2015		<i>Initial discussions</i>
September 2015	QIS2 launch	
October 2015		QIS2 launch
March 2016	QIS2 results deadline	
April 2016		QIS2 results deadline
Q2 2016	QIS2 feedback	QIS2 feedback
Q3 2016	QIS3 launch	QIS3 launch
End 2017	Final spec	Final spec

