Insurance Capital Review Seminar

30 June 2010

Hosted by

IFSA

INSURANCE COUNCIL OF AUSTRALIA

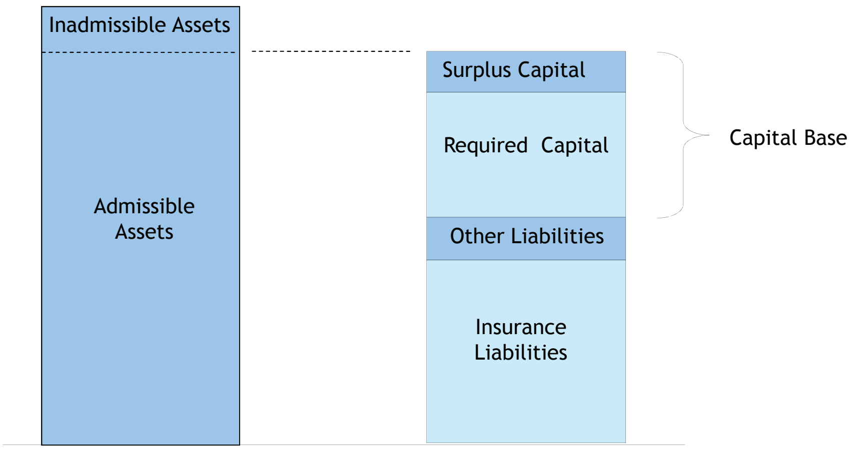
Agenda highlights

- First session - overview
  - Setting the scene
  - Key proposals
  - Questions and answers - panel
- Morning tea
- Concurrent sessions - the detail
  - General insurance
  - Life insurance
- Lunch (including short overview)

Objectives of the review

- Review the risk sensitivity and appropriateness of the capital standards
- Improve alignment of capital standards for general insurance and life insurance industries and with ADIs, where appropriate
- Monitor international regulatory developments

Proposed capital concepts



Capital base

- Capital base to exceed required capital at all times
- For Life:
  - Replacement of solvency & capital adequacy with one capital requirement
  - Introduce concept of 'eligible capital base'
  - Inadmissible assets reduce capital base
  - Asset concentration included in required capital
  - Harmonise with GI/ADI 'Tier 1/Tier 2' but…
- Will finalise proposals for Tier1/Tier 2 capital once international position is clearer

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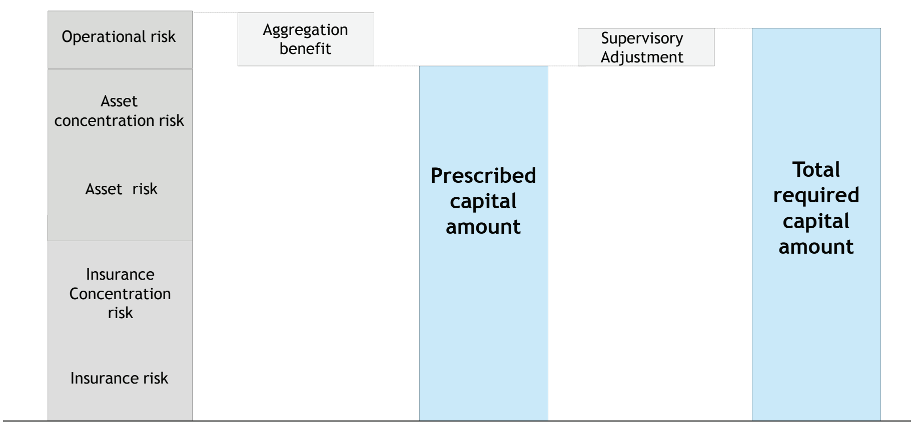
Components of required capital



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Prescribed capital amount defined

Prescribed capital amount comprises of capital charges for:

- Asset risk
- Asset concentration risk
- Insurance risk
- Insurance concentration risk
- Operational risk

An aggregation benefit is then applied to produce the prescribed capital amount

- No Expense or New Business Reserves (change for Life)
- Internal models – will consider for Life (no change for GIs)

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Asset risk capital charge

- Currently 'resilience reserve' for Life; factor-based calculation for GI
- Propose to revise the resilience reserve (renamed 'asset risk capital charge') and use for both Life and GI
- Charge is based on a series of stress tests applied to the balance sheet using parameters specified by APRA
- Capital required for each risk will be the change in net assets for a specified stress
- These net asset movements combined via correlation matrix (to be specified by APRA) provide the overall capital requirement

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Asset concentration risk capital charge

- GI proposals:
  - tighter limits on large investment exposures - broadly aligning with ADIs
  - reinsurance limits unchanged
- Life proposals:
  - similar to existing requirements
  - reduce concentration limits for specialist reinsurers retroceding to parent
  - require specialist reinsurers to hold direct and reinsurance business in separate statutory funds

Insurance risk charge

- GIs - minor adjustment to classification of classes
- Life
  - similar to existing standards
  - will now include an assessment of extreme events
- Risk free rate: CGS the best proxy for risk free rates
  - may allow liquidity premium in limited cases

Insurance concentration risk charge

- Life
  - included in Insurance Risk Charge (allowance for extreme events)
- GI
  - current principle: maintain adequate capital to withstand one large event - MER
  - proposals still being developed – further discussion in concurrent session this morning

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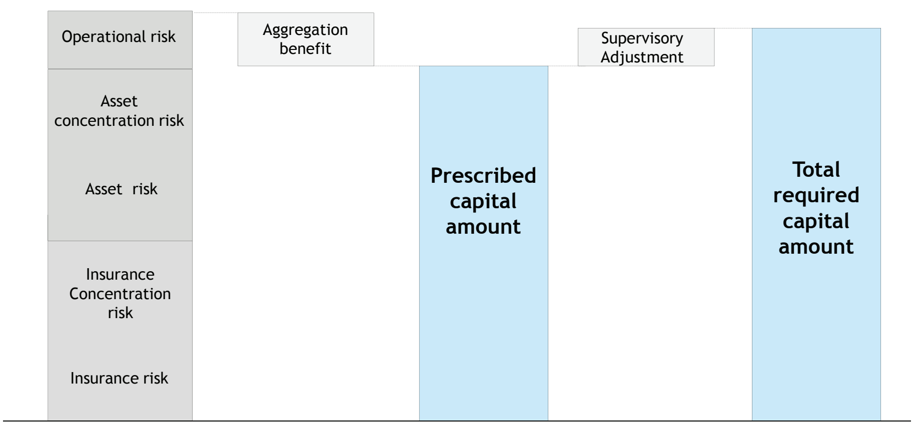
Components of required capital



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Operational risk charge

- APRA proposes introducing an explicit operational risk charge as a component of prescribed capital
- This is consistent with the principle of improving risk sensitivity
- Operational risk charge to be based on exposure measures (e.g. premium, liabilities, FUM)
- Details will be released with QIS

Aggregation benefit

- Current requirements do not directly allow for the diversification that may exist between risk types
- APRA proposes an explicit allowance for diversification between asset and insurance risks only
- Level to be set by APRA
- Will reduce required capital for insurers exposed to both risks

3 Pillars

Pillar 1	Pillar 2	Pillar 3
Quantitative requirements	Supervisory review process	Disclosure requirements
for required capital, eligible capital and liability valuations	Supervision of: • risk mgt • capital mgt May include a supervisory adjustment to capital	Designed to encourage market discipline

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Supervisory review and assessment

- Insurers should have process to assess and manage capital
- ICAAP requirements build on current requirements
- APRA Pillar 2 adjustment to required capital or capital base only one supervisory tool

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Disclosure

- Required capital consists of
  - a prescribed capital amount determined in accordance with the quantitative rules set out in APRA standards; and
  - an additional capital amount in the nature of a supervisory adjustment that may be required by APRA
- Disclosure of
  - prescribed capital amount and components
  - capital base and components

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Proposed timetable

• Nov 2009	Informal industry consultation
• May 2010	First discussion paper issued
• Jul 2010	Technical papers issued
• Jul-Oct 2010	Quantitative impact study period
• Aug 2010	Deadline for first discussion paper comments
• Dec 2010	Draft standards and second discussion paper issued
• 2011	Final standards and reporting forms issued
• 2012	Implementation

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Panel discussion

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