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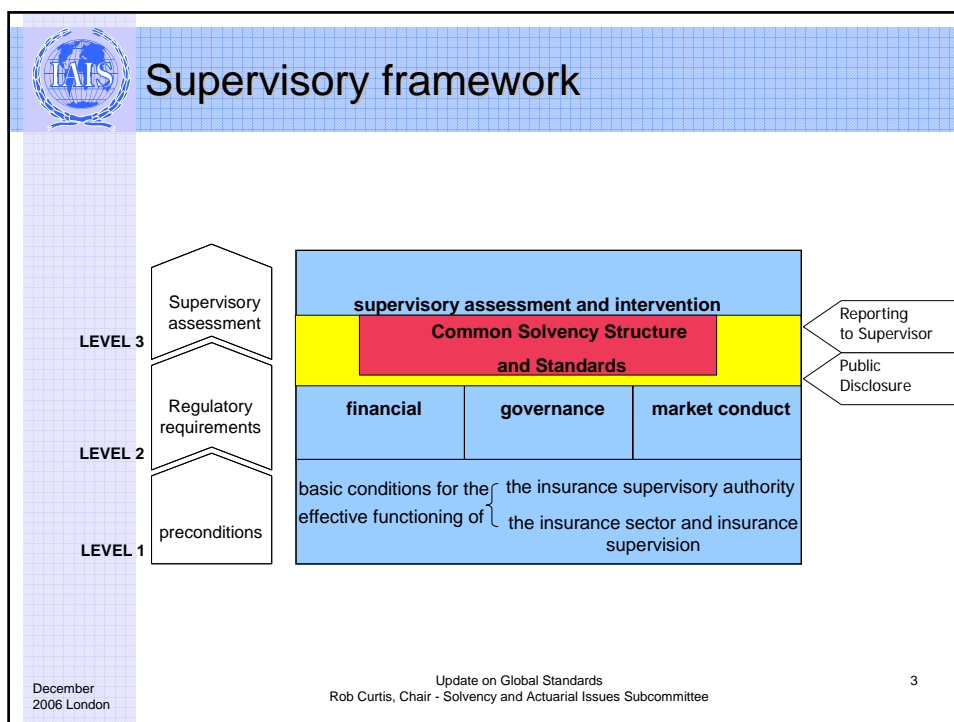
Update on Global Standards

Rob Curtis



Overview of presentation

- Supervisory Framework
- Structure paper
- Structure Elements
- Future Standards and work in 2007
- Time path for Structure paper and Standards



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- Common structure for the assessment of insurer solvency**
- Methodology for financial requirements: roles and determination of technical provisions and required capital.
 - Building from the Cornerstones: 15 **Structure Elements** illustrating further key concepts for a Solvency Structure in a regime.
 - Qualitative components: governance, market conduct and disclosure requirements.
- December 2006 London | Update on Global Standards | Rob Curtis, Chair - Solvency and Actuarial Issues Subcommittee | 4



Framework Level 1 – Preconditions for Solvency Assessment

Structure Element 1:

The supervisor must have powers to:

- *require an insurer to assess and manage the risks to which it is exposed;*
- *set regulatory financial requirements for individual insurers to protect policyholders' interests; and*
- *require that, if necessary, an insurer holds additional capital or takes action to reduce its risks so that the assets it holds are sufficient and appropriate.*

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Framework Level 2 – Regulatory Requirements

Structure Element 2:

Risk sensitive regulatory financial requirements should provide incentives for optimal alignment of risk management by the insurer and regulation.

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Framework Level 2 – Regulatory Requirements (cont.)

Structure Element 3:

A solvency regime should address all relevant potentially material risks, including underwriting risk, credit risk, market risk, operational risk and liquidity risk. All risks should, as a minimum, be addressed by the insurer in its own risk and capital assessment.

- *Risks that are generally readily quantifiable should be reflected in sufficiently risk sensitive regulatory financial requirements.*
- *For risks that are less readily quantifiable, regulatory financial requirements may need to be set in broad terms and complemented with qualitative requirements.*

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Framework Level 2 – Regulatory Requirements (cont.)

Structure Element 4:

A total balance sheet approach should be used to recognise the interdependence between assets, liabilities, capital requirements and capital resources and to ensure that risks are fully and appropriately recognised.

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Framework Level 2 – Regulatory Requirements (cont.)

Structure Element 5:

- Insurance contracts are written in the expectation that obligations under them will be settled with the claimant or beneficiary. The vast majority of obligations are discharged by insurers through settlement of insurance contracts rather than the transfer of obligations to another insurer.
- *In the absence of deep liquid secondary markets that provide sufficiently robust values of insurance obligations, elements of insurance obligations should be valued using cash flow models or methods that reflect the settlement of the insurance obligations and accord with principles, methodologies and parameters that the market would expect to be used. Such valuations could be considered to be "market consistent".*
- *Such valuations provide consistency with the other elements of the balance sheet for which reliable market values are available and with the assessments made by market participants of value and risk.*

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Framework Level 2 – Regulatory Requirements (cont.)

Structure Element 6:

A market consistent valuation of technical provisions is based on the risk characteristics of the portfolio and not on the characteristics of the specific insurer holding the portfolio. However it may be appropriate to use assumptions that reflect aspects of the insurer's specific business model and practices where they can be sufficiently substantiated as indicative of general market practice and relevant and reliable for determining market consistent values of technical provisions.

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Framework Level 2 – Regulatory Requirements (cont.)

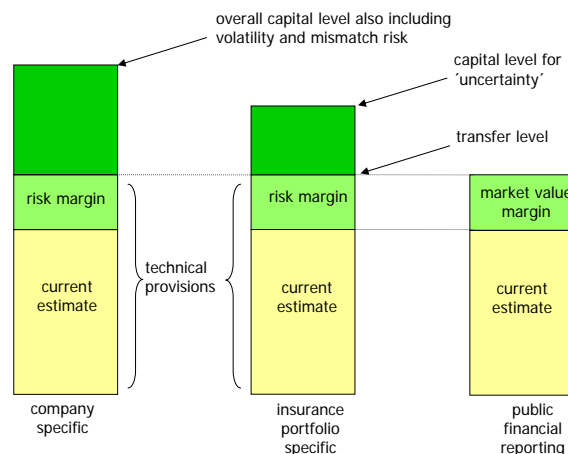
Structure Element 7:

Given the intrinsic uncertainty of insurance obligations, a market participant would demand that a market price include a risk margin over the current estimate of the cost of meeting the policy obligations. The risk margin should be calibrated such that the value of the technical provisions is equivalent to the value that an insurer would be expected to require in order to take over the obligations.



Concepts for current estimate policy obligations, risk margin and capital requirements

Diagram:





Framework Level 2 – Regulatory Requirements (cont.)

Structure Element 8:

From a regulatory perspective, the purpose of capital is to ensure that, despite adverse conditions, policy claims and obligations will still be met as they fall due and the required technical provisions remain covered.

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Framework Level 2 – Regulatory Requirements (cont.)

Structure Element 9:

- *In a market consistent valuation methodology, technical provisions should be calibrated based on assumptions about diversification of the relevant risk factors which are consistent with market assumptions. Lack of diversification within a risk factor, relative to these assumptions, should be reflected in (additional) required capital, not in technical provisions.*
- *Therefore, volatility in underwriting risk greater than used to calibrate the technical provisions should be covered by capital requirements and not technical provisions.*

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Framework Level 2 – Regulatory Requirements (cont.)

Structure Element 10:

Mismatch risk exposure which is not intrinsic to the policy portfolio and is assumed voluntarily by the insurer should be reflected in required capital, and not in the technical provisions.

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Framework Level 2 – Regulatory Requirements (cont.)

Structure Element 11:

- *The risk reflected in the risk margin in technical provisions relates to all liability cash flows and thus to the full time horizon of the insurance contracts underlying these technical provisions.*
- *Capital requirements should be calibrated such that, in adversity, assets will exceed technical provisions with a specified level of safety over a defined time horizon.*

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Framework Level 2 – Governance Requirements

Structure Element 12:

The supervisory regime should require insurers to have and maintain corporate governance policies, practices and structures and undertake sound risk management in relation to all aspects of their business. Sound governance is a pre-requisite for a solvency regime to operate effectively.

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Framework Level 2 – Market Conduct Requirements

Structure Element 13:

The supervisory regime should require insurers to have sound market conduct policies and procedures. The regime should be transparent as to how policyholder expectations should be expressed and reflected in solvency assessment.

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Framework Level 3 – Supervisory assessment and intervention

Structure Element 14:

There should be a number of solvency control levels which trigger different degrees of intervention by the supervisor in a timely manner. The solvency regime should have due regard to the coherence of the solvency control levels and any corrective action that may be at the disposal of the insurer, and of the supervisor, including options to reduce the risks being taken by the insurer as well as to raise more capital.



Disclosure

Structure Element 15:

- *The supervisory regime should specify which solvency information should be made public to enhance market discipline and provide strong incentives for insurers to conduct their business in a safe, sound and efficient manner which treats policyholders fairly.*
- *Information provided to the supervisor and subject to confidentiality supports and fosters openness on commercially sensitive issues between the supervisor and the insurer.*
- *The regime should be open and transparent as to the regulatory requirements in force, and be explicit about its objectives and the level of safety that it requires.*



Future Standards and work in 2007

- Standard on risk management for solvency purposes
- Standard on capital resources and requirements
- Standard on the valuation of technical provisions and assets
- Guidance paper on internal models (this paper would form the basis for a Standard in 2008)

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Time path for Structure paper and Standards

- *Formal consultation until 5 January*
- *Finalise at Subcommittee mid January*
- *For approval to the Dubai Technical Committee (TC) in February*
- *Draft Standards developed with March – August consultation periods*
- *Finalise at Subcommittee mid September*
- *For approval by TC in October*

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