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How are Asian Regulators Preparing Themselves for a Changing Landscape?

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Globally, insurers are operating in a more challenging landscape. The outlook in the macro-economic environment remains uncertain, with increased volatility in financial markets. Underwriting results are being pressured by a combination of sluggish economic growth, softening insurance rates and rising claims. Since the global financial crisis, regulations have been, or are being, reformed at a faster pace. In addition, insurers have to remain vigilant on emerging risks such as cyberattacks and catastrophes. Insurers in Asia are similarly not spared from the increasing complexity and volatility in the operating environment.

We will look at three specific challenges that Asia is facing, and how Asian regulators can prepare themselves for a changing landscape.

Emerging challenges in Asia

Use of technology and cyber risks

Insurers are increasingly leveraging on technology to reach out to their customers. Consumers can now access insurance solutions over the Internet and mobile devices. Technology innovations such as developments in telematics and wearable fitness monitoring devices allow real-time customer data collection for more dynamic and precise pricing of insurance solutions. Industry is also gradually taking to big data solutions and predictive modelling to perform better risk selection and assessment. In Asia, the use of technology in insurance is catching up fast as its population becomes more educated, affluent and Internet savvy.

While technology brings benefits and opportunities, it also exposes insurers to cyber risks. Cyberattacks are becoming more common, as seen from recent hacking attacks on various companies. Asian countries are just as susceptible to cyberattacks. The evolving nature of technology means that insurers have to keep abreast of developments so as to detect and deter potential risk events. The impact of such cyber-risk events can be costly and significant, considering the amount of sensitive data that insurers collect on their customers.

Higher frequency of catastrophes and the role of insurers

In addition, the frequency of natural disasters has increased over the years. According to a report by the United Nations, Asia is the world's most disaster-prone region (United Nations, 2010). At the same time, rapid population growth and urbanisation have led to higher economic concentration in Asia. Asia accounted for 41 per cent of global economic losses from disasters between 2000 and 2009, and 81 per cent in 2011 alone.

The financial burden of restoring catastrophe-hit territories, thus far, had largely been borne by the government. Insured losses in Asia represented only 5 per cent of total losses in the past 30 years (Asian Development Bank, 2014). Clearly, insurance has a bigger role to play as an *ex ante* risk-financing solution such that losses do not need to be significantly funded by taxpayer money. A study conducted by Lloyd's in 2012 (Cebr, 2012) on the macroeconomic costs of natural catastrophes has shown that an increase in insurance penetration by one

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percentage point can lower the cost borne by taxpayers by approximately 22 per cent. Unsurprisingly, more governments are looking to transfer a larger portion of the risk to the insurance industry.

Whilst insurers are suitably placed to address this risk, there remains considerable uncertainty in pricing and reserving for catastrophe insurance. First, the effects of climate change on catastrophe occurrences are not fully understood, making estimation less reliable. Second, constraints around data and modelling capabilities tend to be more prevalent in the Asian region, adding to the uncertainty.

Quick pace of regulatory reforms

Regulation of the financial sector has been intensifying since the 2008 global financial crisis. In 2011, the International Association of Insurance Supervisors (IAIS) updated its Insurance Core Principles (ICPs). Recognising that insurance markets have evolved over the years to become increasingly global and interconnected, IAIS also embarked on building a coherent framework for the effective supervision of large, complex, global groups known as internationally active insurance groups (IAIGs). In addition, there are ongoing efforts to identify global systemically important insurers (G-SIIs) and subject them to enhanced policy measures that include capital uplifts.

Although the majority of the regulators in Asia are not home supervisors of G-SIIs or IAIGs, the recent development of global standards is still very relevant from the host perspective. Discussions about the standards for governance and consumer protection and the global trends of insurance markets are also highly relevant to regulators in emerging economies. It is therefore important for Asian regulators to be actively involved in international regulatory discussions both to shape and to benefit from the development of the global standards.

Growing opportunities in Asia and preparing for the future

Despite the challenges mentioned above, the prospects in Asia are especially promising. Over the next decade, the insurance business in Asia is projected to grow at about 8 per cent per annum (Swiss Re, 2013). By 2020, Asia is likely to account for almost 40 per cent of the global market (Munich Re, 2014).

The Asian growth story should come as no surprise. First, Asia is growing at a rapid pace. Rising affluence and a growing middle class will underpin a steady increase in insurance penetration rates that are still well below the global average. Continued industrialisation, expanding cross-border trade and infrastructure development will drive demand for insurance solutions to mitigate a variety of business risks.

Second, as mentioned earlier, Asia is prone to natural catastrophes. Growing risk awareness, coupled with rising asset values, will see more consumers seeking the protection of catastrophe insurance and reinsurance, including alternative risk transfer solutions.

Third, Asia is facing a rapidly ageing population. By 2050, Asia–Pacific will be home to 62 per cent of the world's elderly population, with one in four persons aged 60 and above. This will lead to greater demand for health insurance, annuity and other retirement security products.

So how can Asian regulators prepare themselves to help position insurers operating here to take hold of the opportunities in Asia? We have to modernise our capital frameworks, strengthen enterprise risk management (ERM) requirements for insurers as well as build capacity and capabilities of regulators.

Modernisation of capital frameworks

In response to international developments, many Asian regulators are revamping their national solvency regimes to better reflect the risk profile of their respective insurance markets. Notably, more Asian regulators are taking to the risk-based capital (RBC) regime.

For example, Hong Kong issued a consultation paper in late 2014 setting out the road map of the proposed RBC framework and key approaches. India published an exposure draft in 2013 on introducing a risk-based regime, and an expert committee has been tasked to spearhead the development. In China, insurers are starting to make the necessary preparations as the Chinese authority is expected to roll out its second generation solvency regulatory system known as China Risk Oriented Solvency System (C-ROSS) in 2015.

The modern RBC frameworks seek to address all relevant and material risks of insurers. One enhancement is the incorporation of emerging areas such as operational risk and catastrophe risk. These risks are not easy to quantify, but will help to address the emerging risks identified earlier.

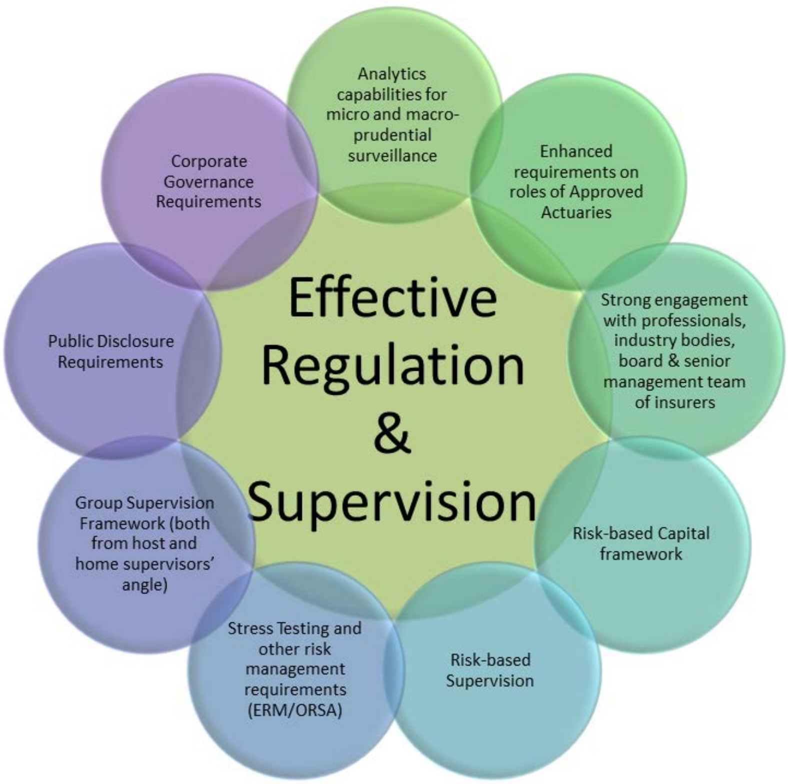
Singapore was one of the front-runners to introduce a RBC regime in the region back in 2004. The RBC framework has served us well, including during the global financial crisis. It allows insurers to better withstand stress and permit more timely and effective regulatory intervention. However an update is necessary to ensure it stays relevant and accords better policyholder protection.

Thus in 2012, we launched a review of the existing framework, aimed at improving the comprehensiveness of risk coverage and risk sensitivity. Last year, a second consultation paper was issued and a comprehensive quantitative impact study (QIS) was conducted. Even under the preliminary proposals, most of our insurers remain well capitalised. We are currently refining the proposals to take into account the feedback received. We will conduct another consultation and QIS in 2015 to assess the impact of our proposals, and address implementation issues and potential unintended consequences. We will only implement the updated framework (RBC 2) after thorough calibration and careful assessment.

Whilst we want RBC 2 to be more risk-sensitive and robust, it should be fit for purpose to support insurers' ability to carry out their important roles in the economy and society on a sustainable basis. In this regard, we are proactively engaging the industry to see how we can better allow for the illiquid nature of certain types of life insurance liabilities in our capital framework, as well as calibrate the risk requirements relevantly for the catastrophe risks undertaken by our general insurance players in the region.

It must be noted that having a RBC framework is not the panacea for all problems. It has to be complemented by a comprehensive suite of regulations and practices that allow effective supervision of insurers.

Figure 1: Whole suite of requirements and practices to ensure effective regulation and supervision of insurers in Singapore



Active engagement with insurers on their ERM framework

Besides modernising their regulatory capital regimes, Asian regulators are also strengthening their governance and risk management requirements for insurers. In particular, the board and senior management of insurers are expected to take greater ownership of their risk profile through the establishment of an ERM framework. After all, insurers should know their own risks best. The regulatory capital framework, which is typically calibrated using industry aggregate data, is unlikely to be adequate on its own. Besides, no set of prescriptive rules will be comprehensive or flexible enough to cater to the varied business and operating models of insurers.

International standards advocate ERM systems to establish close linkages between ongoing risk management, longer-term business goals and strategy, and economic capital management. As part of ERM, insurers are required to regularly undertake a forward-looking self-assessment of all reasonable foreseeable and relevant material risks that they may be exposed to, also known as an own risk and solvency assessment (ORSA). It is important that regulators constantly engage insurers on their ERM and ORSA, as this would give a comprehensive insight into how insurers manage their risks.

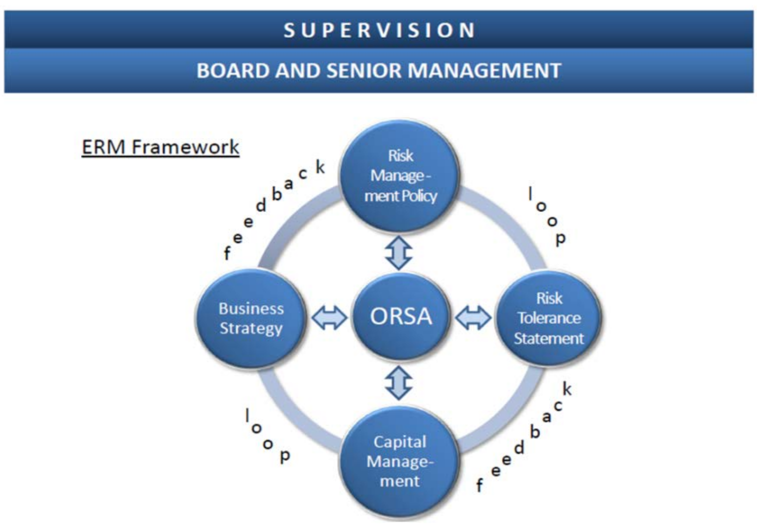
ERM, including ORSA, is very new to insurance regulators globally, including Asia. Malaysian insurers have implemented an internal capital adequacy assessment process (ICAAP) since September 2012 which is subject to review and evaluation by the Malaysian regulator. China also introduced ERM requirements for its life insurers (including health insurers and pension insurers) a few years ago, which required insurers to submit an annual ERM report to the regulator. In its latest consultation paper, the Hong Kong regulator has proposed requiring all insurers to put in place an effective ERM framework, with an ORSA incorporated within.

Singapore rolled out its ERM requirements in 2013. The requirements aim to link the risk identification, measurement and assessment to an insurer's business strategy and capital management more comprehensively and explicitly through the formalisation of its risk appetite and the ORSA process (see Figure 2).

Though several Asian jurisdictions have taken the first step to require an ORSA from their insurers, it will take time for regulators to acquire sufficient experience in the engagement process with insurers, and for insurers to build up a robust framework that is appropriate to its nature, scale and complexity.

Prior to implementing ERM, Singapore had already put in place comprehensive stress-testing requirements for our insurers. These requirements, similar to those in ORSA, included the need to conduct reverse stress testing, as well as for approved actuaries to identify key risks and vulnerabilities and recommend action plans. We have also been ensuring that there are robust deliberations by the board and senior management, and actively engaging the insurers on their risk management processes as part of our supervision. Such experience will be useful as we adopt ERM.

Figure 2: Key features of Singapore's ERM framework and the interactions between components



Capacity building for regulators

With the changing business landscape and evolving regulatory standards, it is essential that regulators have the capacity to carry out their functions effectively. In this regard, Asian regulators can leverage on the work of the IAIS and other stakeholders. For example, the IAIS works closely with regional coordinators and other bodies (e.g. the ASEAN Insurance Training and Research Institute, Financial Stability Institute, Asian Development Bank) to identify gaps between members' practices and standards, and conduct training for insurance supervisors.

In Singapore, we offer a comprehensive suite of programmes to add depth and breadth to our supervisors' knowledge and skills. Reviewed regularly to ensure their continued relevance, these programmes have recently been geared towards ERM, stress testing and global capital developments.

To conclude, a robust regulatory capital framework and high ERM standards are key initiatives that Asian regulators are developing, but the initiatives on their own will not be sufficient. We need to have competent regulators to supervise and engage insurers effectively. This will put Asian regulators in good stead to face the challenges and capitalise on the opportunities that the region will bring.

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