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Editorial

By Kathrin Hoppe[+]

Policymakers around the world have been working on improving financial markets oversight in order to increase global financial stability, not least in insurance. Throughout this period, The Geneva Association has pursued an intensive dialogue with regulators, supervisors, central bankers and the insurance industry to develop research, analysis and input to support the development of appropriate regulatory and supervisory outcomes.

As our detailed report of this year's PROGRES seminar demonstrates (see page 11), the current regulatory discussions continue to be centred on the consequences of the financial crisis: the supervision of global systemically important insurers (G-SIIs), crisis management, recovery and resolution plans, and the global insurance capital standard (ICS). These topics ensured a lively discussion among the many attendees from industry and the supervisory and regulatory community. The conference provided once again a great platform for the different stakeholders to enter into a constructive dialogue on the ongoing international regulatory developments.

However, given the current heavily loaded international regulatory agenda, we tend to forget about the national supervisory and regulatory developments which will influence the global landscape. For this very reason, we decided to dedicate this newsletter edition to Asia—a region, which brings many new regulatory developments forward in the pursuit of attracting insurers to take more insurance business on in the region.

The article by Chua Hui Shan and Lee Wai Yi from the Monetary Authority of Singapore very nicely sets the scene by explaining the emerging challenges in Asia—the higher frequency of natural catastrophes just being one of them. It then presents the steps Asian markets have taken to be prepared to face these challenges, while ensuring that Asia remains an attractive market place for insurers. One of these measures designed to enhance preparedness is the modernisation of existing capital frameworks.

The following articles, by Junbo Xiang from the China Insurance Regulatory Commission and Seungjoon Lee and Hae Sik Kim from the Korea Research Institute, take a deeper dive

[+] Insurance Regulation and Supervision Expert, The Geneva Association.

into the new solvency regimes that have been developed in China and Korea.

Just to give a snapshot of the markets represented by the authors of the articles, I would like to add a few introductory facts:

- Singapore has a rapidly growing insurance market. In its 2013 detailed assessment report on Singapore, the IMF noted 80 per cent growth in only five years. The IMF complimented the significantly high-level of observance of the insurance core principles including the introduction of the risk-based capital (RBC) framework.
- At the time of the most recent IMF assessment report on the IAIS insurance core principles in 2012, China was the sixth largest insurance market in the world. In only two years it moved to be third largest insurance market in the world. The Chinese Insurance Regulatory Commission, therefore, has had to adapt its regulation to a quickly changing environment and made a first step by entering in the transitional phase of implementation of the China Risk Oriented Solvency System (C-ROSS).
- Korea is known for its high insurance penetration. According to the IMF's 2013 detailed assessment report, the Korean insurance market is still facing a difficult time with negative interest rates spreads, but the Korean regulator and the insurance sector have taken effective steps to mitigate the risk. The IMF especially highlights that Korea has implemented the International Financial Reporting Standards (IFRS) and updated its capital regime in a "proactive and timely manner."[1]

This only demonstrates that the Asian markets are very interesting markets to monitor and also to learn from, as they are facing many challenges at the same time with which the 'old and mature' markets are not as familiar, or had to face at a very different pace. We hope you find it interesting and enjoyable.

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How are Asian Regulators Preparing Themselves for a Changing Landscape?

By Chua Hui Shan and Lee Wai Yi[+]

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

[1] IMF (2014, p. 27).

[+] Monetary Authority of Singapore.

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 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.

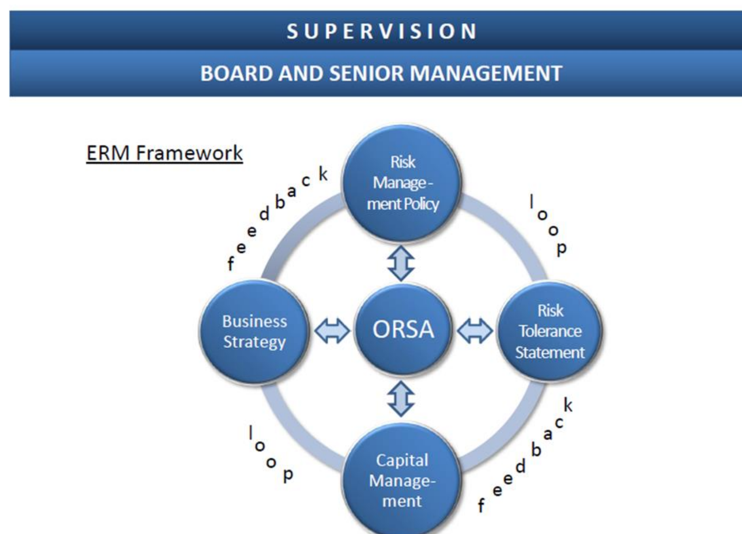
ERM, including ORSA, is very new to insurance regulators globally, including Asia. Malaysian insurers have implemented an internal capital adequacy assessment process (ICAAP) since September 2012 which is subject to review and evaluation by the Malaysian regulator. China also introduced ERM requirements 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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C-ROSS: A Major Reform of China's Insurance Regulatory System

By Junbo Xiang[+]

The China Risk Oriented Solvency System, or C-ROSS, entered the transitional stage of implementation as its 17 solvency regulatory rules were released in Beijing on 13 February 2015. This means a risk-oriented, internationally comparable solvency system reflecting Chinese insurance market realities is now in place.

A revolutionary reform

C-ROSS is a milestone in the reform and development of China's insurance regulation. In the words of Xiang Junbo, Chairman of the China Insurance Regulatory Commission, it will have a revolutionary impact on China's insurance market.

A project to facilitate the transformation and upgrading of China's insurance industry

China's insurance market has undergone three consecutive years of rapid growth since 2012. The year 2014 saw the fastest growth since the international financial crisis, with national premium income hitting RMB 2 trillion for the first time, 17.5 per cent higher than the previous year. The industry's profit also hit a record high, registering RMB 200 billion, achieving 106 per cent growth year on year. China's insurance industry moved up in the global ranking in terms of market size from No. 6 in 2012 to No. 3 in 2014. As one of the most important insurance markets in the world and with the "new normal", China's insurance industry has to adapt to the new situation. C-ROSS is expected to enable insurers to expand and grow in a more rational way as insurers bear in mind both risks and capital in their pursuit of such development goals as size, speed and returns. With the advent of the new system, insurers will transform and upgrade their development pattern by reshaping their strategy planning, operation mode and risk

[+] Chairman, China Insurance Regulatory Commission.

management. They are expected to develop in a more balanced and sustainable way under more refined management.

A major step in the all-round, deeper reform and regulation modernisation

The principle guiding the Chinese government's governance reform in recent years has been "Giving the market a decisive role in resource allocation". It is on this principle that the CIRC has based C-ROSS. The CIRC is trying to streamline the relationship between market and regulation, trimming the list of items requiring administrative approval, and giving the market greater freedom and incentives to develop and innovate, while effectively identifying, preventing and mitigating risks. Solvency regulation sets the bottom line for risks and is the key to risk control of the industry.

A contribution to the international insurance regulatory reform

The international standards for insurance supervision are being upgraded. C-ROSS, a system that reflects China's market characteristics and international reform trends, can contribute to more representative, fairer and sounder standards for sustainable and inclusive growth of the global insurance industry.

The framework and characteristics of C-ROSS

C-ROSS is a complete, logical and substantial system, which can be summarised as "one framework", "three features" and a series of regulatory and supervisory tools.

Framework

On the basis of thorough research of international insurance regulatory reform and feasibility studies, C-ROSS adopts a regulatory framework of "three pillars" and reshapes it according to the characteristics of China's insurance market to ensure that it is viable and reflects the realities of the emerging market.

The quantitative regulatory requirements of Pillar 1 address three quantifiable risks, namely, insurance risk, market risk and credit risk. Through scientific measurement, Pillar 1 requires insurers to hold adequate capital for the risks. The tools of Pillar 1 include (1) available capital evaluation criteria, (2) minimum capital requirements, (3) capital classification, (4) stress testing, and (5) supervisory measures.

The qualitative regulatory requirements of Pillar 2 address risks that are difficult to quantify and require more qualitative regulatory tools, especially for emerging markets with imperfect and immature financial systems, and incomplete basic sector data. These include operational risk, strategic risk, reputational risk and liquidity risk. For example, operational risk in some countries is classified as a quantitative risk but, due to the lack of historical data, C-ROSS uses qualitative regulatory tools to assess it. The regulatory tools of Pillar 2 include (1) integrated risk rating, (2) solvency risk management requirements and assessment, (3) liquidity risk supervision, (4) supervisory inspection and analysis, and (5) supervisory measures. The above-mentioned "solvency risk management requirements and assessment" means the regulator evaluates insurers' solvency risk management capabilities. The evaluation results are linked directly with the insurers' capital requirements.

The market discipline mechanism of Pillar 3, through public information disclosure and transparency enhancement, leverages market disciplinary power to address risks which are difficult to deal with by the conventional regulatory tools of Pillars 1 and 2. The tools of Pillar 3 include (1) requirements governing insurers' public information disclosure on solvency, (2) a sustainable two-way communication mechanism established between the regulator and market stakeholders, and (3) ratings on insurers issued by credit rating agencies.

Based on international financial regulatory practices and the reality of the development of domestic insurance groups, C-ROSS also has a regulatory framework for the regulation of insurance groups' solvency, which extends the definition of "insurance group" by taking not only normal insurance groups, but also various kinds of invisible or conglomerate insurance groups into the scope of regulation so as to reinforce the regulation of a series of sophisticated group risks.[2]

[2] Three kinds of groups will be under supervision in C-ROSS:

Features

Every technical standard of C-ROSS embodies the three distinctive features of the system, namely, risk-orientedness, reflection of Chinese market characteristics and international comparability.

C-ROSS is a risk-oriented solvency regime. The risks of insurers are classified into seven major categories, which are further subdivided into more specific risks. Regulatory standards are formulated based on the risk classification and subdivision. Quantitative regulatory indicators (solvency adequacy indicators) and qualitative, integrated risk-rating methods are used to accurately identify, fully cover and comprehensively analyse all kinds of risks, and to measure the risk profile of the underwriting, investment, corporate governance and liquidity of insurers accurately and promptly.

C-ROSS reflects the characteristics of China's insurance market and features the development of emerging markets. As the most important emerging market, China differs from Western mature markets in market structure, growth speed, risk features, data accumulation and insurance expertise. With full consideration of the reality of the Chinese market and the principle of risk prevention, C-ROSS measures risks scientifically and changes the over-conservative reserving requirements of the current solvency system to raise the efficiency of capital. In order to improve the viability of the system and reduce the cost of implementation, risk modelling and measuring are performed during the construction of the system, and a composite factor-based method is adopted with regard to quantitative capital standards, making it easier for insurers to implement C-ROSS at a lower cost. C-ROSS is designed to be flexible and dynamic to adapt better to the rapid changes of the emerging market. Therefore, it can be updated and fine-tuned to adjust to market conditions and regulatory needs without changing the framework. The models and factors of C-ROSS are based on the data collected in the last two decades from China's insurance market and calibrated through several rounds of quantitative tests. The test result shows that C-ROSS, with a sound risk classification system, is responsive to risks and can identify and measure insurance industry risks scientifically, accurately and comprehensively.

C-ROSS is internationally comparable. Against the backdrop of economic globalisation, China's insurance industry is actively implementing the strategy of "attracting foreign investment and going global", and becoming more and more closely connected with the international insurance market. C-ROSS is comparable with other representative solvency regimes in the world in terms of its "three-pillar" structure and specific regulatory standards and requirements. An internationally comparable solvency regime can both encourage global capital to enter China's insurance market and facilitate the presence of Chinese insurers in the global market.

Transition period of C-ROSS

C-ROSS has been in the transitional implementation stage since the beginning of 2015, which is a milestone for China's insurance industry. During the transition period, the current solvency system will remain in force. The CIRC will decide when to fully implement C-ROSS based on an assessment of the situation and the preparedness of the industry.

CIRC welcomes the presence of foreign insurers from more jurisdictions, is willing to communicate and share solvency regulatory experience with other regulators in the world, and is devoted to contributing to the reform of global insurance solvency system for sustainable and sound development of the global insurance market.

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a) insurance holding groups, including the parent insurance group (holding) company or insurance company and the insurance or non-insurance company (ies) under its direct/indirect control or co-control;
b) non-insurance holding companies, including the parent non-insurance institution and the insurance company (ies) and/or non-insurance company (ies) under its direct/indirect or co-control;
c) conglomerate groups, meaning groups of multiple insurance companies (jointly) controlled by a single, de facto controller or people acting in concert with no explicit controller.

Recent Regulatory Changes in the Korean Insurance Industry

By Seungjoon Lee[+] and Hae Sik Kim[++]

Summary

Insurance regulation in South Korea has always kept pace with global standards. The recently announced risk-based capital (RBC) road map will bring it to an even higher level.

A brief overview of the Korean insurance market

South Korea had been impressive in catching up with the more advanced economies, when it was caught by the "Asian flu" (the 1997 Asian financial crisis) that hit many of the newly emerging Asian economies. It had to take emergency bailout funding from The International Monetary Fund (IMF) in December, 1997. However, the country made a swift recovery within four years and paid back all the bailout loans from IMF in 2001. Since then, South Korea has made modest yet steady economic progress and currently, according to 2014 IMF figures, ranks 13th in the world in terms of GDP.[3]

The insurance market in South Korea has also shown robust growth. At the end of the 2013 fiscal year, the total premium volume of the Korean insurance market was USD 145.4 billion, ranking it 8th in the world following Germany and Italy; the insurance penetration rate, or premiums in percent of GDP, was 11.9, putting it in 5th place in the world; and with an insurance density (or premiums per capita) of USD 2,895, it ranks 20th in the world.[4]

On the regulatory side, South Korea has made great efforts to keep abreast of the global standard. The South Korean financial supervisory authority [the Financial Supervisory Service or FSS] introduced EU-type Solvency rules for regulating insurance capital in 1999 following the IMF's recommendation. Although simple and easy to apply, the Solvency approach had a critical weakness as it does not reflect all the relevant and necessary risks of insurance companies. Consequently, the current Solvency framework is weak at assessing the total risks the insurance companies bear and therefore cannot calculate the adequate level of buffer capital the insurance companies should hold in order to prepare for unexpected shocks and fulfil their contractual obligations. Despite its weaknesses, Solvency contributed greatly to capital regulation in South Korea by increasing insurers' capability to cope with unexpected shocks.

As the South Korean insurance market matured, the risks of insurance companies became more complex, with more diverse and sophisticate products being introduced on the market. Reflecting this market change, South Korean insurance supervisors changed capital regulations to adopt the risk-based capital (RBC) method following the U.S., Canada, and Australia. After a two-year testing period, from 2009 to 2011, Korean RBC regulation became fully operative in April, 2011.

As for accounting standards, South Korea made major improvements after the 1997 financial crisis. Since then, South Korea has been keeping up with current international accounting standards and has fully adopted International Financial Reporting Standards (IFRS) from 2011, which all listed companies as well as financial companies must apply in disclosing their financial status. Both insurance regulators and companies in South Korea are well aware of the upcoming IFRS 4 Phase II and are in the process of preparing for the major change in "fair" value accounting for insurance liability.

RBC road map

As we all witnessed for the past six years, financial sectors have been undergoing major regulatory shifts towards stronger financial regulation. The insurance sector is also taking part in this regulatory transition. The International Association of Insurance Supervisors (IAIS) published new insurance core principles (ICPs) in 2010 that reflected

[+] Research Fellow, Department of Financial Policy, Korea Insurance Research Institute.

[++] Research Fellow, Department of Financial Policy, Korea Insurance Research Institute.

[3] World Economic Outlook Database, Oct. 2014.

[4] Swiss Re, World Insurance in 2013: Steering towards Recovery, *Sigma* No.3/2014.

this important shift by including macroprudential aspects in insurance supervision and calling for supervisory coordination and cooperation, as well as information exchange among supervisors in different jurisdictions. Designation of global systemically important insurers or G-SIIs was also an important step towards financial stability. ComFrame and an international capital standard (ICS) will also change insurance regulation by ensuring greater regulatory harmonisation across the continents.

South Korea is no exception and is actively improving insurance regulation to protect consumers in the South Korean insurance market. We would now like to focus on the change in capital regulation of South Korea.

In South Korea, the Financial Services Commission (FSC) is the government agency responsible for the regulation and supervision of the financial market, and the Financial Supervisory Service (FSS) conducts actual inspection and supervision of financial companies under the guidance and oversight of the FSC. Hereafter, they will be collectively referred to as the "financial supervisory authority".

The financial supervisory authority of South Korea is in the process of strengthening the capital regulation of the insurance industry, following global standards such as those of the EU with its more rigorous Solvency 2 capital regulation and the U.S. with its already implemented Solvency Modernization Initiative, or SMI, which strengthens and modernises U.S. capital (or RBC) regulation. Following these examples, the FSC and FSS jointly announced the final version of the so-called RBC road map on 31 July 2014.[5]

The RBC road map is a collection of policy changes the financial supervisory authority is to implement over the next five years to enhance the prudential regulation of insurance companies active in South Korea up to level. These regulatory changes will go into effect step by step to reflect changes in market conditions and other financial developments.

The RBC road map is about risks and liability. It contains many policy change elements to make prudential regulation better. On the "risks" side of the RBC road map, the measurement and management of the risks of insurance companies or groups are to be more sophisticated and strengthened in order to make the insurance industry more robust and to protect its consumers better from less frequent yet stronger shocks. On the "liability" side of the RBC road map, it is imperative to assess insurance liability in a more refined way to reflect "fair" value. And IFRS 4 Phase 2 is in the process of being implemented as a standard for measuring the fair value of insurance liabilities. All of these changes need to be explained in more detail.

First, the value at risk (VaR) of interest rate risk and credit risk, or the inverse of the probability of capital shortage of insurance companies, will increase from the current confidence level of 95 per cent to 99 per cent: interest rate risk is the first to be applied in 2014, followed by credit risk over the ensuing two years, attaining 50 per cent in 2015 and 100 per cent in 2016.

Second, risk measurement is to be refined to reflect the actual risks insurance companies bear more closely. Operational risk will be refined to reflect the sources, such as different distribution channels, starting in 2016. Currently, operational risk is measured as 1 per cent of gross written premiums. In addition, the correlations of individual risks (insurance, market, credit, interest and operational) are to be used in a more refined way from 2015.

Third, longevity risk will be included in the RBC calculation, as South Koreans are ageing rapidly—it is projected to take South Korea only 18 years (2000–2018) for the population aged over 65 to reach 14 per cent from 7 per cent. In contrast, it took Japan, well known for its ageing population, 24 years (1970–1994) to reach the same level.

Fourth, a consolidated RBC system will be introduced for measuring insurance group's risks at group-wide level to reflect subsidiaries' risks to which parent or holding companies are exposed. At present, the system is being tested and will be implemented, based on the test results, during 2015.

Fifth, the own risk and solvency assessment, or ORSA, will be introduced in 2017 for insurance companies to manage their own risks in order to complement quantitative regulation.

[5] Press Release, "The comprehensive roadmap to modernize prudential regulation of insurance companies", FSC and FSS, July 2014 iIn Korean).

Sixth, internal models will be allowed for insurance companies in calculating the RBC ratio using own models and risk coefficients based on own statistics. Actual introduction of internal models will be reviewed during 2015 and implementation is due after 2018, depending on the international trend.

Seventh, evaluation of technical provisions will be reviewed and improved step by step as a bridge method to determine the "fair" value of insurance liability until IFRS 4 Phase II is implemented. In the meantime, overall system improvement and legislation will be undertaken to ensure a smooth transition to the new "fair" value-based solvency test.

Meaning of the changes

The IMF and World Bank conducted the Financial System Stability Assessment (FSSA)on South Korea in 2013. They evaluated South Korea's insurance supervisory system using the IAIS' insurance core principles and concluded that South Korea's insurance supervisory system shows a high level of observance of the ICPs. The limited weakness of the supervisory system is well understood by the supervisory authorities and reforms are under way.

The RBC road map is a statement by South Korea that it is committed to keeping up with the global standard in insurance regulation and supervision. Once the RBC road map is fully implemented, compliance to global standards in insurance capital regulation of South Korea will be at a higher level, and both insurers and consumers will benefit from the increased level of financial robustness for fulfilling the obligations from insurance contracts.

The road ahead

As the insurance market evolves, regulation must keep pace in order to ensure the soundness of insurers and the welfare of the consumers participating in the market. One of the more important roles of supervisors is to make sure the market is functioning well enough to preserve transparency, so that one side of the market does not receive unfair treatment from the other. Equally important is promoting effective competition among market participants in order to ensure optimal prices and the soundness of insurers.

South Korea's insurance supervision has done a good job in keeping the insurance industry sound and safe to protect the insureds already participating in the market. Now is the time to promote freer competition and innovation, the prerequisite of which is the safe and soundness of the insurance companies to deliver contractual obligations; the RBC road map, by strengthening the prudential side of the regulation, is a big step in that direction.

Now the road is open. We need to run to reach to the goal.

The 31st Regulation and Supervision (PROGRES) Seminar on 19 February 2015 Focused on "Enhanced Supervision—First Experiences and Remaining Challenges"

By Kathrin Hoppe[+]

The Supervision of G-SIFIs: first experiences and remaining challenges

The first session addressed the experiences of home and host supervisors with the supervision of (global systemically important financial institutions (G-SIFIs). The panel was joined by a representative from a designated G-SII company to compare the impact the designation and its consequences had on both the supervisor and the supervised. The designated G-SII company was equally designated as a domestic SIFI. While the supervision resulting from the domestic systemically important financial institution (D-SIFI) status was immediate, the global designation and its consequences are currently not fully clear, as they are still being defined. The D-SIFI designation on both sides resulted in the employment of additional staff to comply with the related examinations. The host

[+] Insurance Regulation and Supervision Expert, The Geneva Association.

supervisor, responsible for supervising six of the designated nine G-SIIs, reported that the supervision as such does not differ from the supervision of domestically owned firms. However, special attention was required to the insurance risks ceded to their group-affiliated entities outside the host jurisdiction such as variable insurance products with a minimum guarantee option. Therefore, an examination of the management and soundness of those firms was necessary on a global and group-wide basis. He also highlighted that not only the group, but also the host supervisor, should be able to access group-level information to effectively supervise these firms. All supervisors stressed that new regulation was not—as often claimed—a simple read-across from banking. The industry remained sceptical as the development of higher loss absorbency (HLA) was still under way. The supervisors clarified that the policyholder was guaranteed by the underlying capital requirement, while HLA was meant to assure financial stability.

Crisis management and recovery and resolution plans

The Financial Stability Board's (FSB) roadmap was laid out at the beginning of the discussion to set the scene. The FSB is currently analysing all the submissions which they received on the consultation on the Guidance paper on the identification of critical functions and shared services. The Guidance paper needs to be finalised by mid-2015. At the same time, the FSB is working on a Guidance paper on resolution strategies in insurance until the end of 2015. The paper on resolution strategies will, among others, discuss the choice between a single point of entry and a multiple point of entry. At the same time the IAIS is currently discussing how best to implement the FSB's Key Attributes of Effective Resolution Regimes. The FSB's Key Attributes have prompted voluntary local initiatives in many jurisdictions, among them, the Swiss Financial Market Supervisory Authority's (FINMA) recovery and resolution pilot project. The company representatives who reported on the development of their recovery plan considered it a good exercise to understand how money moves within the company and where capital and liquidity reside in a group. The exercise allowed companies to analyse in detail how capital and liquidity can move within the group if under stress. One of the company representatives explained that their own analysis had shown that a subsidiary-based insurance group is generally resolvable in its current structure so that, in contrast to banking, a multiple point of entry is desirable.

The global insurance capital standard (ICS)—status quo and next steps

The IAIS reminded the audience that supervisors needed a tangible common language, which would allow supervisors to coordinate and cooperate effectively. It was pointed out that the ICS could increase transparency and decrease complexity, but a systematic cost-benefit analysis needed to be made. Furthermore, it was pointed out that new solvency regimes around the world needed a far longer time to be implemented, so that the panellists questioned whether the timeline for the development of ICS was reasonable. Panellists warned that a hastened development would bear the risk that products are withdrawn from the market, investments curtailed and excessive capital cushions be constituted. In addition, the different accounting basis resulted in differences in reported capital and its sensitivities. Panellists pointed out several areas which were crucial to get right: (1) discount rates, (2) the definition of capital resources, (3) the recognition of risk mitigation including diversification, (4) calibration and (5) operational feasibility. The objective of achieving comparability was discussed in detail. It was especially asked who would assess comparability, what will be compared and what level of comparability was intended.

Consumer protection and market conduct

The panel started the discussion by trying to define what consumer protection actually meant. The answers were financial soundness and consistent outcomes for consumers. Consumer protection consisted of three pillars of consumer protection: (1) financial soundness, (2) corporate governance and (3) market conduct. The panellists agreed that there were many recent developments in the area of market conduct, but, given the priority of financial stability measures, it did not receive the same attention. They noted that consumer protection increasingly drives also the insurance companies' thinking, as they needed to be responsive to a competitive environment and the new and increasing expectations of the policyholders. The panellists noted that the product development process was handled differently in various jurisdictions. While some supervisors were not involved in the product development

process, others started an early dialogue with the companies as early as during the product development phase. The panellists were in favour of a conduct regulation which supported a good culture in the insurance firm, a well-functioning insurance market and which required as little intervention as possible. Also, the emerging twin peaks authorities were discussed in detail. The panellists explained that potential conflicts of interests were addressed by regular meetings on domestic supervisory colleges and regular exchange of information.

THE RESEARCH PROGRAMME ON REGULATION AND SUPERVISION (PROGRES)

The PROGRES name stands for Research **PROG**ramme on **RE**gulation, **S**upervision and Legal Issues in insurance. It focuses on questions related to regulation, supervision and international cooperation of insurance and financial services as well as other legal issues of importance. The research programme manages The Geneva Association's cooperation with the supervisory authorities around the world and in particular with the International Association of Insurance Supervisors (IAIS).

The annual PROGRES seminars address the advancement of the regulatory and legal debates as well as trade and international cooperation issues. Since 1983, they have provided an annual forum and focal point for up to 100 specialist interdisciplinary participants—private-sector practitioners and experts from representative organisations, academics, officials from governments and intergovernmental organisations—to discuss and debate in an informal way.

The Geneva Association

The Geneva Association is the leading international insurance think tank for strategically important insurance and risk management issues.

The Geneva Association identifies fundamental trends and strategic issues where insurance plays a substantial role or which influence the insurance sector. Through the development of research programmes, regular publications and the organisation of international meetings, The Geneva Association serves as a catalyst for progress in the understanding of risk and insurance matters and acts as an information creator and disseminator. It is the leading voice of the largest insurance groups worldwide in the dialogue with international institutions. In parallel, it advances—in economic and cultural terms—the development and application of risk management and the understanding of uncertainty in the modern economy.

The Geneva Association membership comprises a statutory maximum of 90 Chief Executive Officers (CEOs) from the world's top insurance and reinsurance companies. It organises international expert networks and manages discussion platforms for senior insurance executives and specialists as well as policymakers, regulators and multilateral organisations. The Geneva Association's annual General Assembly is the most prestigious gathering of leading insurance CEOs worldwide.

Established in 1973, The Geneva Association, officially the "International Association for the Study of Insurance Economics," has offices in Geneva and Basel, Switzerland and is a non-profit organisation funded by its Members.

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© 2015, The Geneva Association, Route de Malagnou 53, CH- 1208 Geneva. Tel: +41 22 707 66 00
The Geneva Association, Sternengasse 17, CH- 4051 Basel, Tel: +41 61 201 35 20

FORTHCOMING CONFERENCES OF THE GENEVA ASSOCIATION

2015

August

2–6	**Munich**	**3rd World Risk and Insurance Economics Congress (WRIEC)**, organised by EGRIE in cooperation with APRIA, ARIA and The Geneva Association

October

20	**Munich**	**9th Geneva Association Meeting of Chief Investment Officers**, hosted by Allianz Investment Management *(CIO members only)*

November

4-5	**Zurich**	**Annual Liability Regimes Conference on "Keeping the floodgates shut? mastering accumulation and bodily injury exposures in a rapidly changing environment"**, hosted by Swiss Re
16–17	**Singapore**	**12th Health and Ageing Conference on "Insuring health-care for the elderly in Asia"**, co-organised with the Singapore College of Insurance

2016

June

8–11	**Rome**	**43rd General Assembly of The Geneva Association**, hosted by the Italian Members (Members only)