

Session 4

Capital Adequacy and Solvency



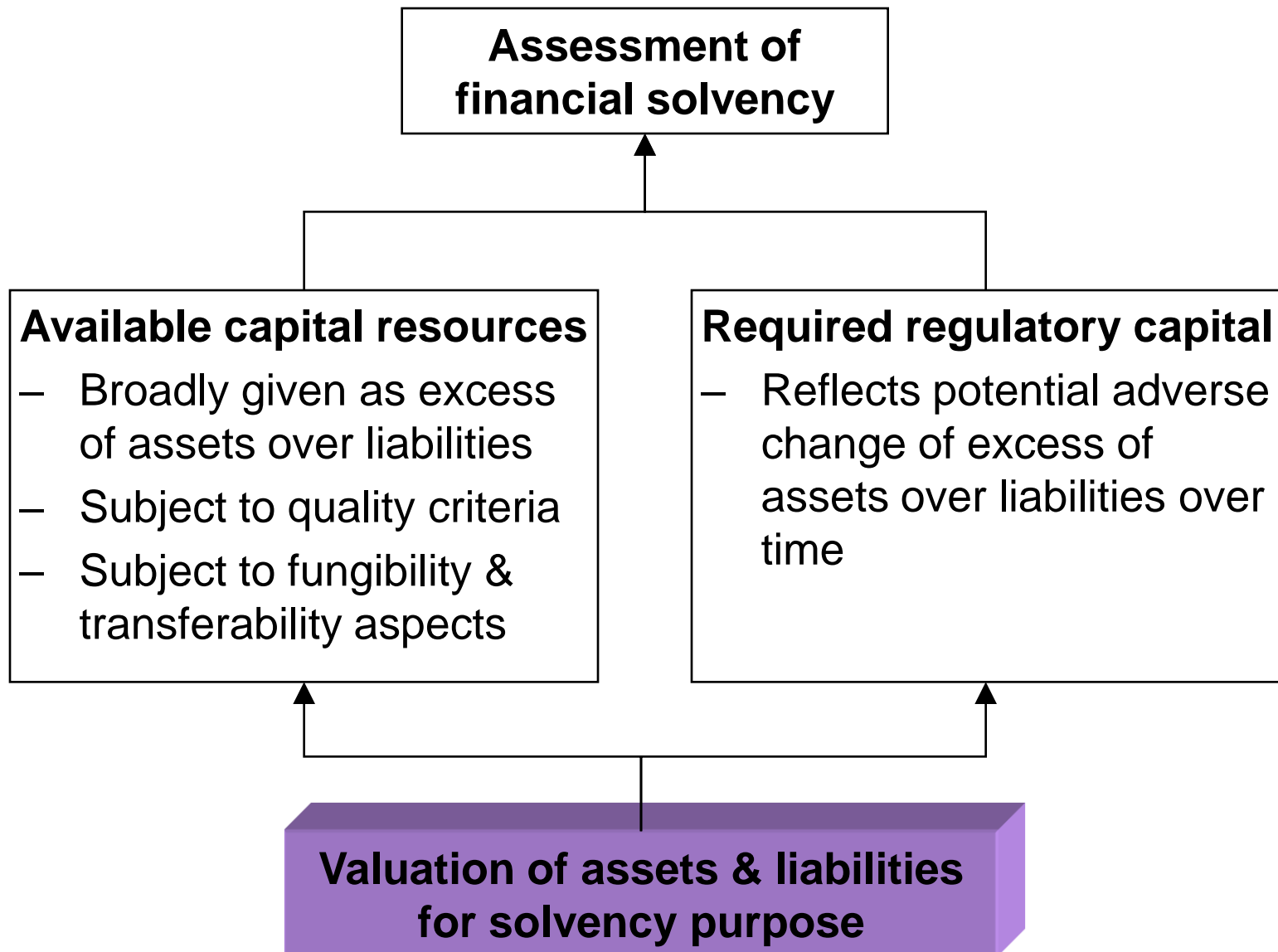
IAIS-ASSAL Training Seminar

San Juan, Puerto Rico, 25-27 April 2011

Takao Miyamoto, IAIS Secretariat



Agenda





Total Balance Sheet Approach

- Solvency is assessment of overall financial position
 - Consistent measurement of assets & liabilities
 - Explicit identification & consistent measurement of risks
 - Potential impact of risks on all components of balance sheet
- Recognise interdependence – cannot be considered in isolation
 - Assets
 - Liabilities
 - Asset-liability management (ALM)
 - Regulatory capital requirements
 - Capital resources



Assets & Liabilities – Quick Look

- Assets
 - Security
 - Liquidity
 - Diversification
- Liabilities
 - Technical provisions: Amount required to fulfill insurance obligations & settle all commitments to policyholders
 - Other liabilities
- Asset-liability management (ALM)
 - Manage risk & business under coordinated decisions



Solvency Purpose

General purpose
financial reporting

(Should reflect economics
of businesses)

(Starting point) : Efficiency

- Many resources (e.g. audit) were already used for accuracy & reliability
- Widely accepted

(Prudential filter) : Adjustment for different purposes

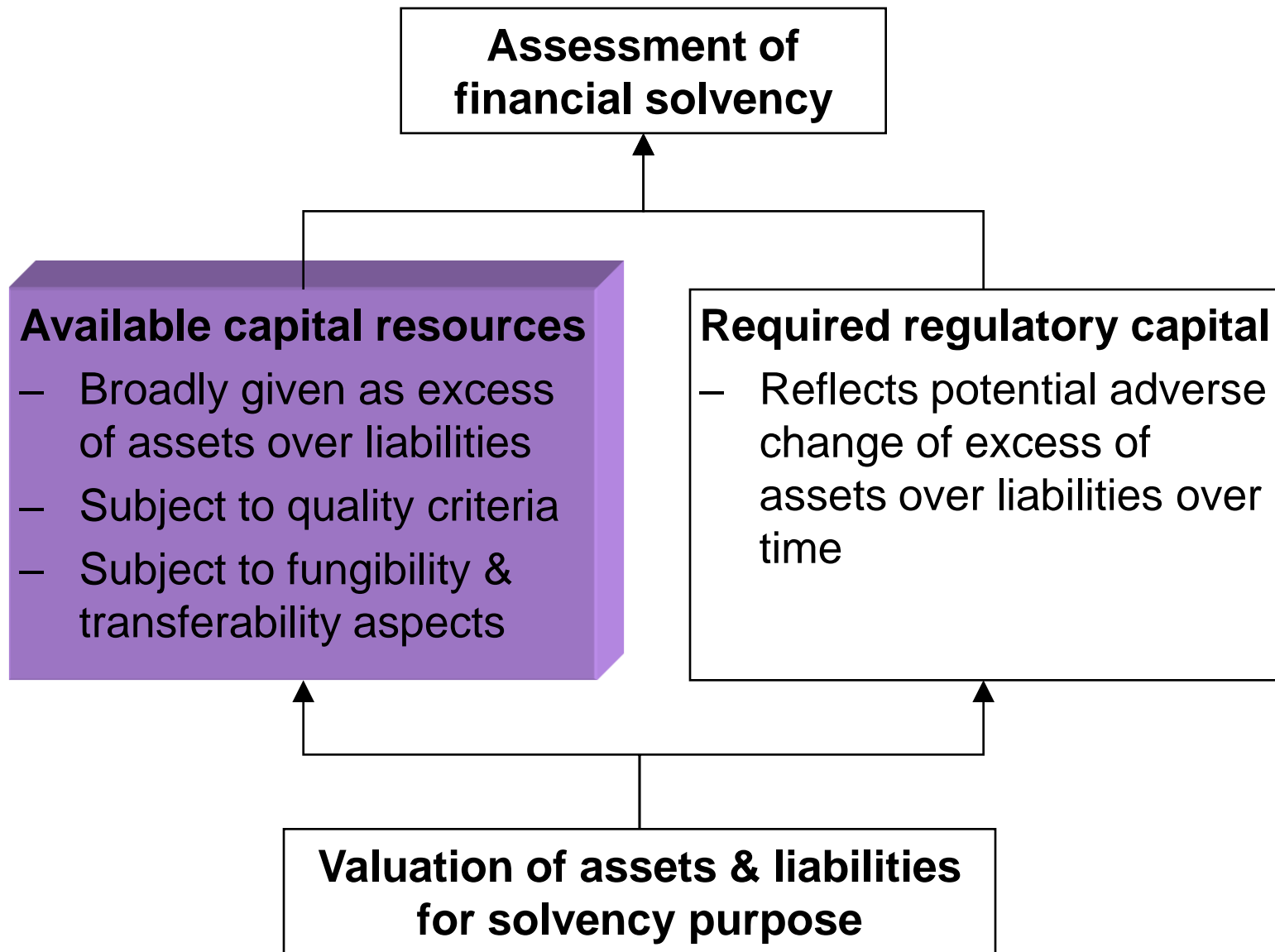
- Often in conservative direction

Regulatory purpose
reporting & requirements

(Should serve to protect
policyholders)



Agenda





Role of Capital

- Serve as safety cushion against adverse environment & financial fluctuation
 - Reduce probability of insolvency
 - Reduce losses to policyholders in event of insolvency
- Enhance safety & soundness of insurance (& other financial) sector
 - Macroprudential perspective
- Meet strategic & operational needs of capital
 - Start-up, growth (into new products, market segments etc.)
 - Allocation of capital for decision & performance review

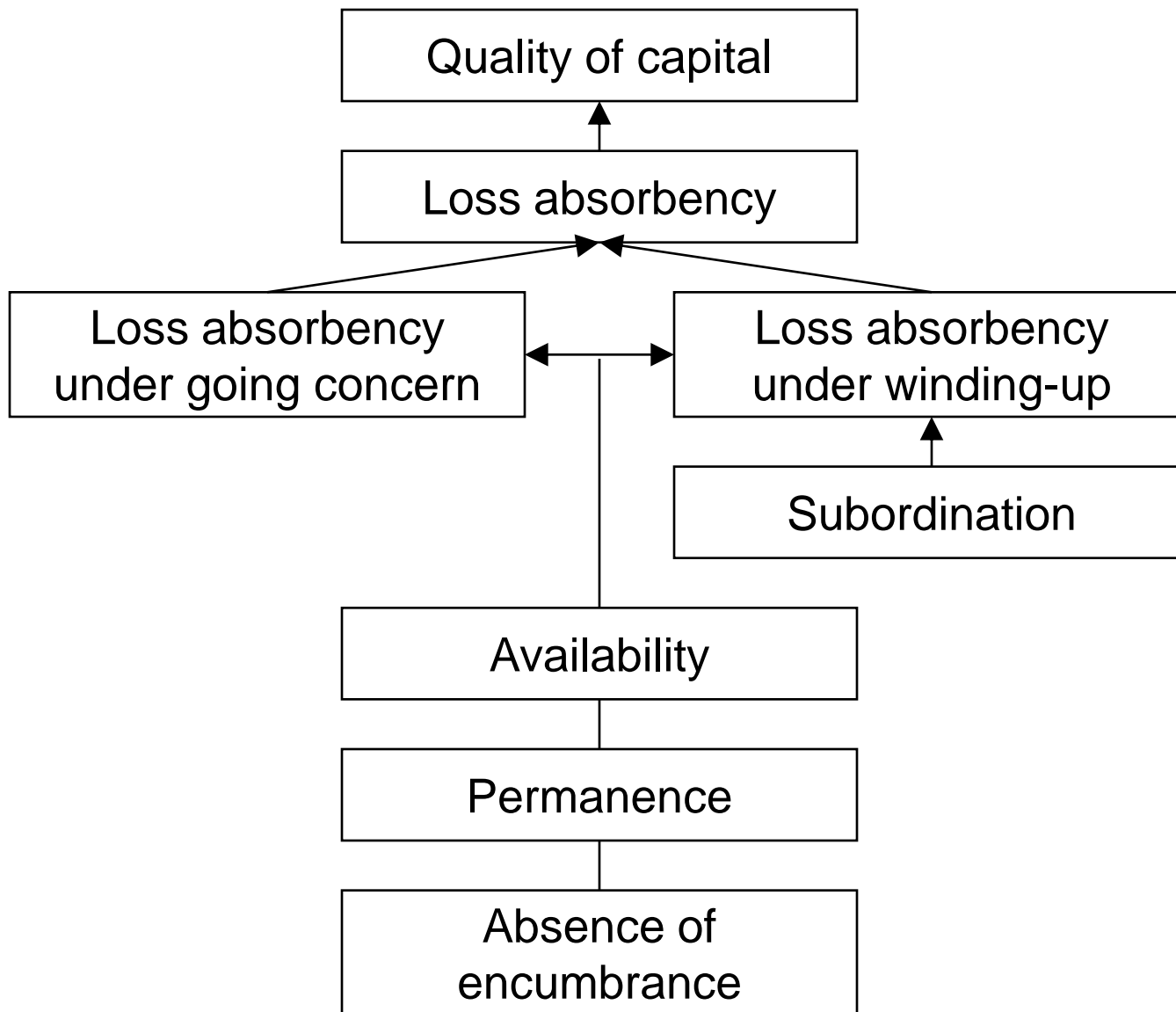


Different Perspectives

- Going concern
 - Carry on business as going concern and continue to take on new business
- Run-off
 - Stop new business and manage only existing business until settled or expired
- Winding (Break)-up:
 - Stop new business and settle or transfer existing business as soon as possible



Quality & Suitability of Capital Resources





Quality & Suitability of Capital Resources

Subordination

- To what extent and in what circumstances is capital element subordinated to policyholders rights?

Availability

- To what extent is capital element fully paid & available to absorb losses?

Permanence

- How long is capital element available?

Encumbrance

- To what extent is capital element free from mandatory payments or encumbrances?



Adjustment for Solvency Purpose

- Certain types of liabilities (+)
 - e.g. subordinated debt
 - Act buffer to reduce loss to policyholders
- Contingent assets (+)
 - e.g. letters of credit, members' calls by mutual, unpaid element of partly paid capital
- Certain types of assets (–)
 - e.g. intangible assets, deferred tax assets
 - Realisable value under winding-up may be significantly lower than economic value under going concern
 - Adjustment through deduction of capital resources or addition to capital requirements

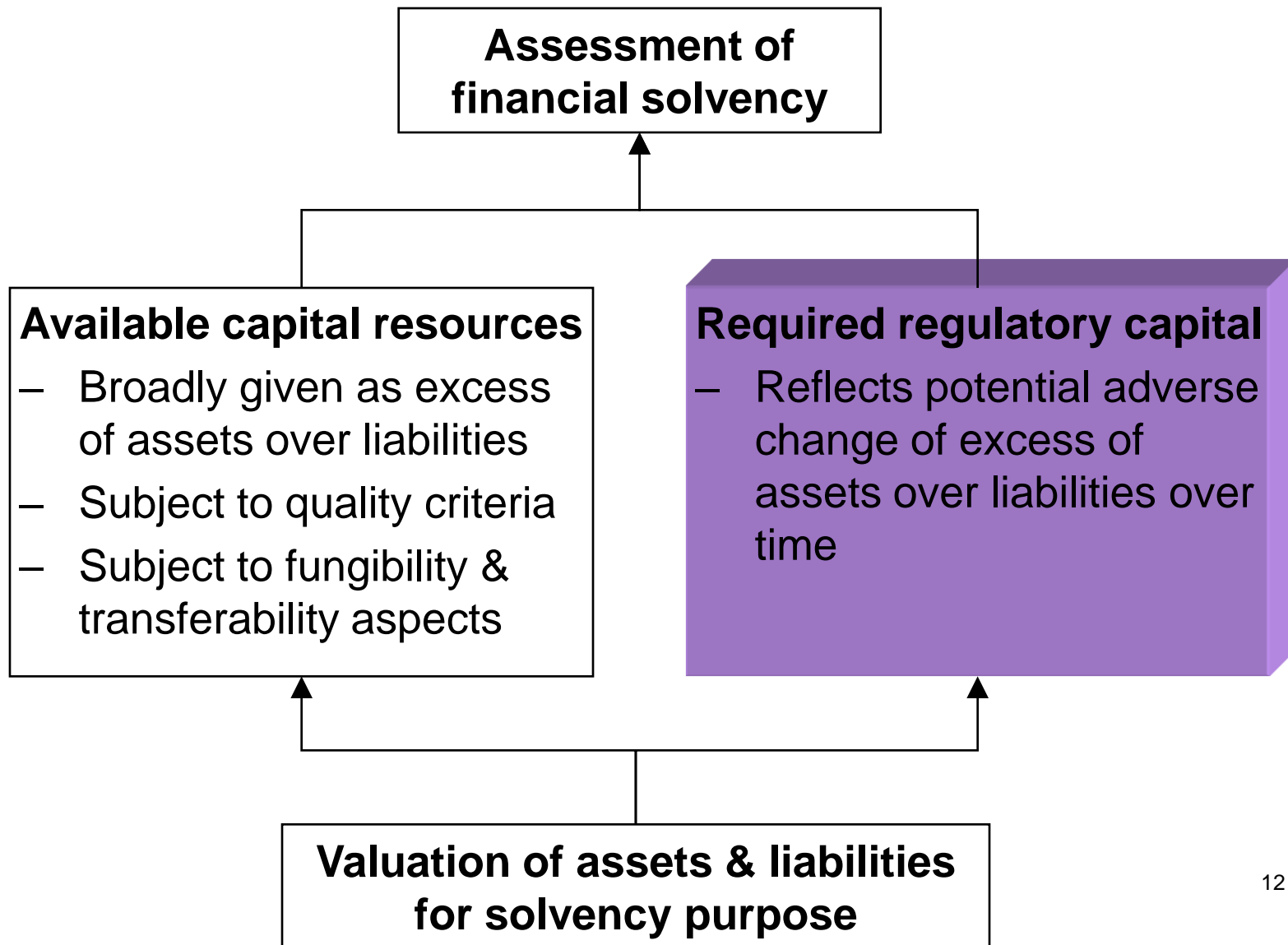


Group Issues

- Multiple (Double) gearing
 - Insurer invests in capital instrument of parent, subsidiary or another group entity
- Intra-group creation of capital
 - Insurer holds shares in or makes loans to another entity, which holds capital instrument of insurer
- Fungibility & transferability
 - Is “single integrated entity” view appropriate?
 - Legal constraints in jurisdictions
 - Conflict of interests between entities, especially in times of stress

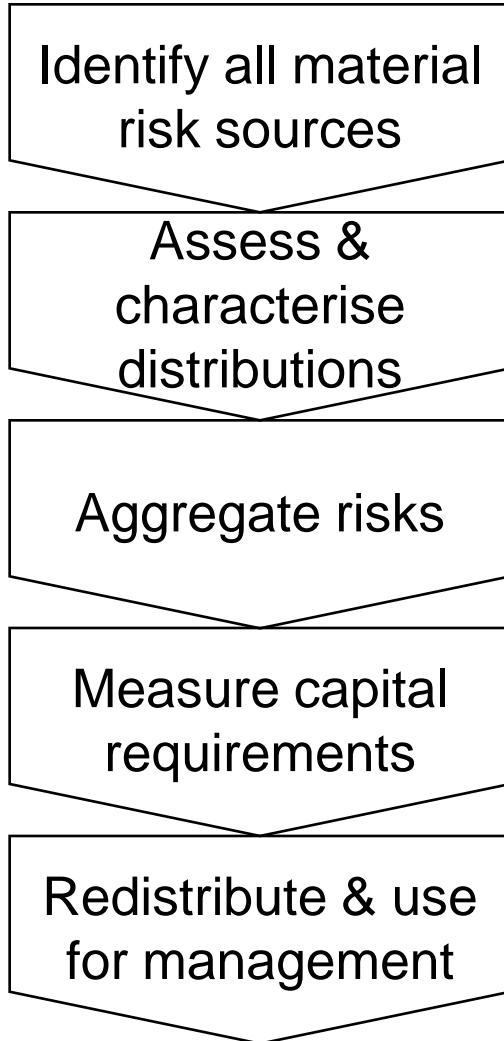


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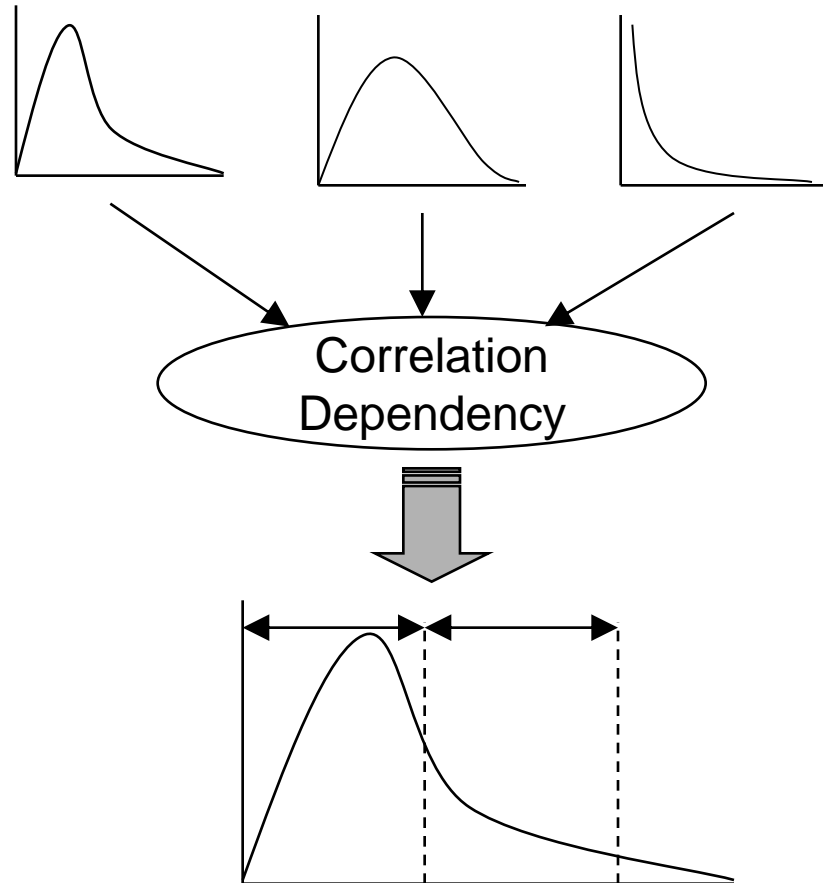




Process

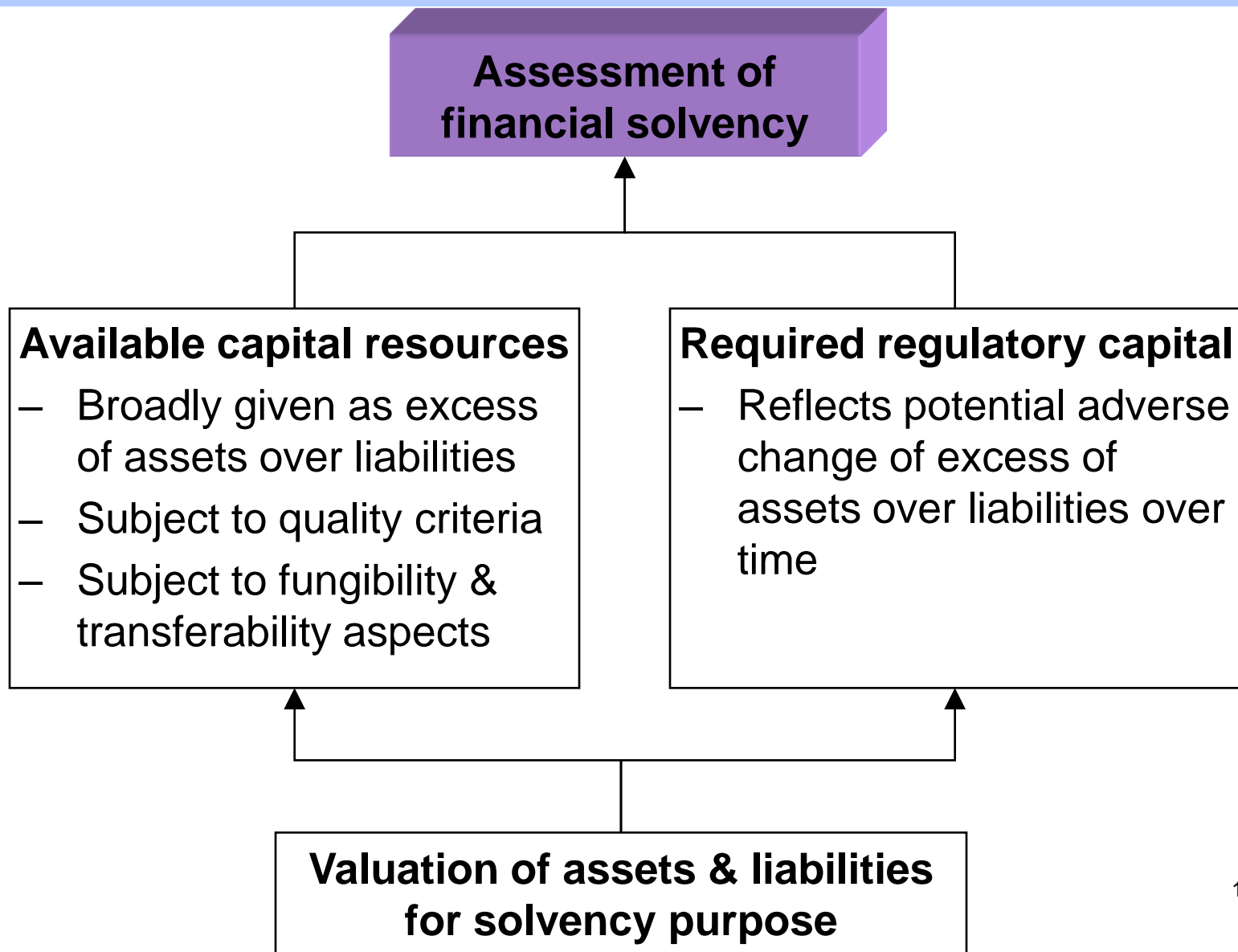


Underwriting, credit, market, operational, liquidity etc,





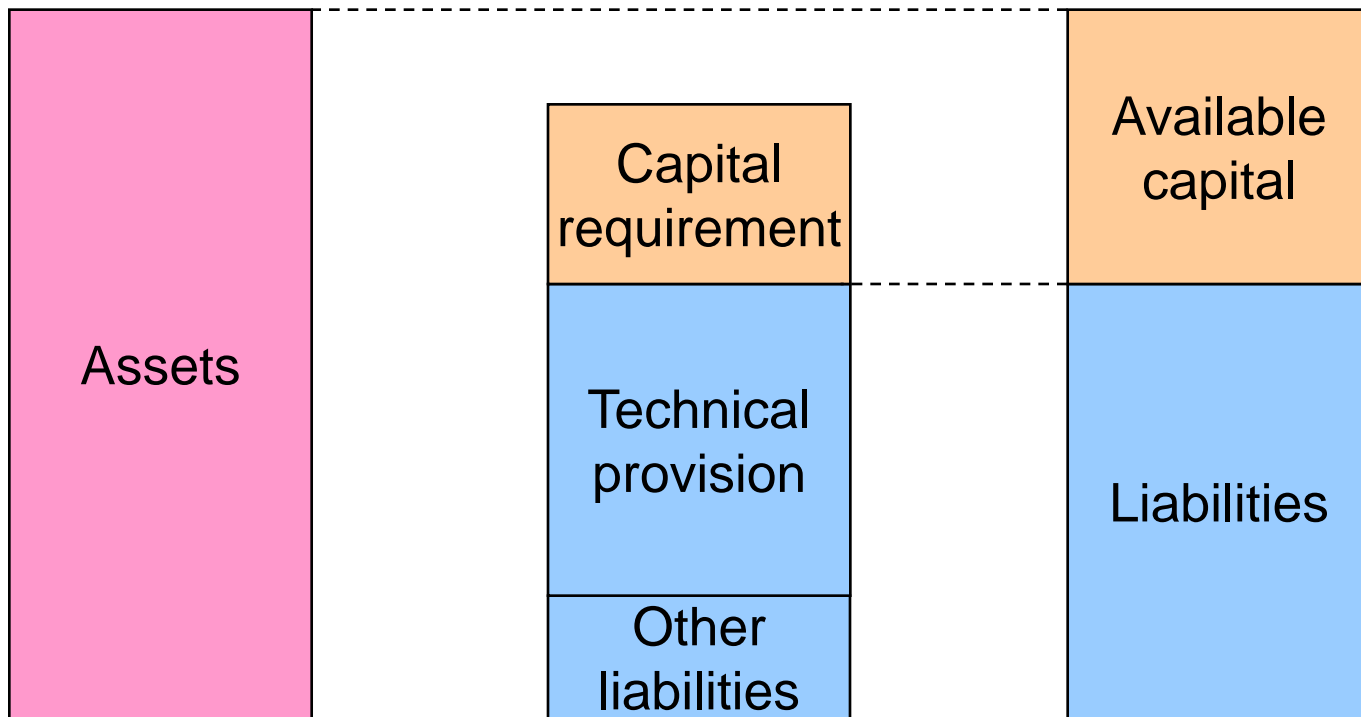
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Demand vs. Supply

- Supervisory assessment of financial position
 - Could be different from public financial reporting due to prudential filter





Solvency Control Levels

Ladder of intervention

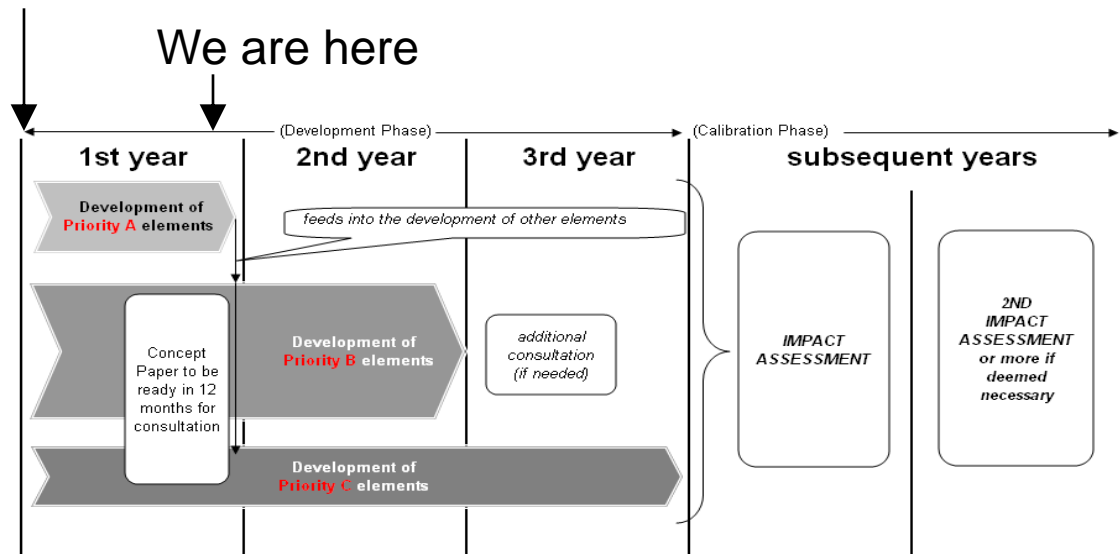
- Prescribed Capital Requirement (PCR)
 - Above PCR, supervisor would not intervene on capital adequacy grounds
- Minimum Capital Requirement (MCR)
 - If breached, supervisor would invoke strongest actions, in absence of corrective actions
- Additional control levels
 - Range of different intervention actions between PCR & MCR



Recent Development – Insurance Sector

- Regional & country-level
 - Solvency modernization initiative (US)
 - Solvency 2 (Europe)
 - Latin America, Asia & Oceania etc.
- Global
 - Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame)

1 July 2010





Recent Development – Other Financial Sectors

- Joint Forum: “Review of the Differentiated Nature and Scope of Financial Regulation”
 - Cross-country & cross-sectoral harmonisation to reduce regulatory arbitrage
- Basel Committee on Banking Supervision (BCBS): “Basel 3”
 - Higher quality of capital
 - Better coverage of risks
 - Leverage ratio
 - Liquidity standards
- Financial Stability Board (FSB)
 - Enhance regulation & supervision
 - Systemically important financial institutions (SIFIs)



¡Muchas gracias!



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