OLDMUTUAL

Risk based capital and its importance for insurers

12 November 2018

DO GREAT THINGS EVERY DAY

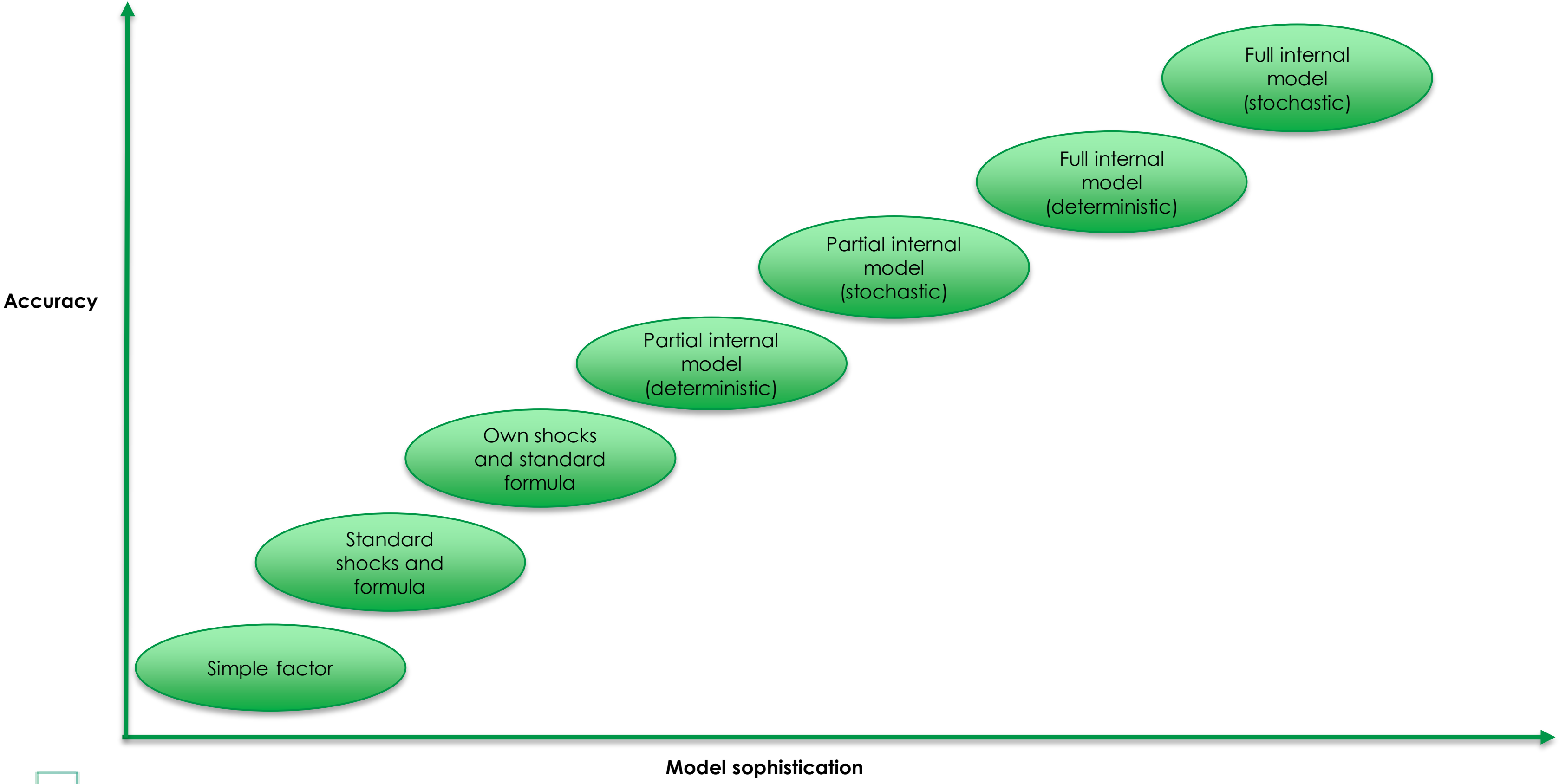
Agenda

The RBC journey

No Solvency Standard	Factor-based solvency standard	Risk-based solvency standard	Internal model based solvency standard

Global points of reference

Capital Models



Is there a best capital regime, or just a better one?

Some characteristics to consider

1. Comparisons
2. Probability of solvency
3. Liability basis
4. Asset basis
5. Relevance
6. Credit for risk mitigations, e.g.
   i. Reinsurance
   ii. Management actions
   iii. ALM
   iv. Internal governance and controls
7. Early warning
8. Cost effective
9. Scope of risks covered
10. Monitoring and consequences of breaches

Also consider

1. Impacts on asset classes
2. Impacts on product classes
3. Systemic risks
4. Equivalence
5. What happens if there is an insolvency?

Capital regimes

1. Fixed amount
2. Tiered fixed amount
3. Function of premiums and or reserves
4. Market based solutions
5. Reliance on a profession to self govern
6. Risk based capital

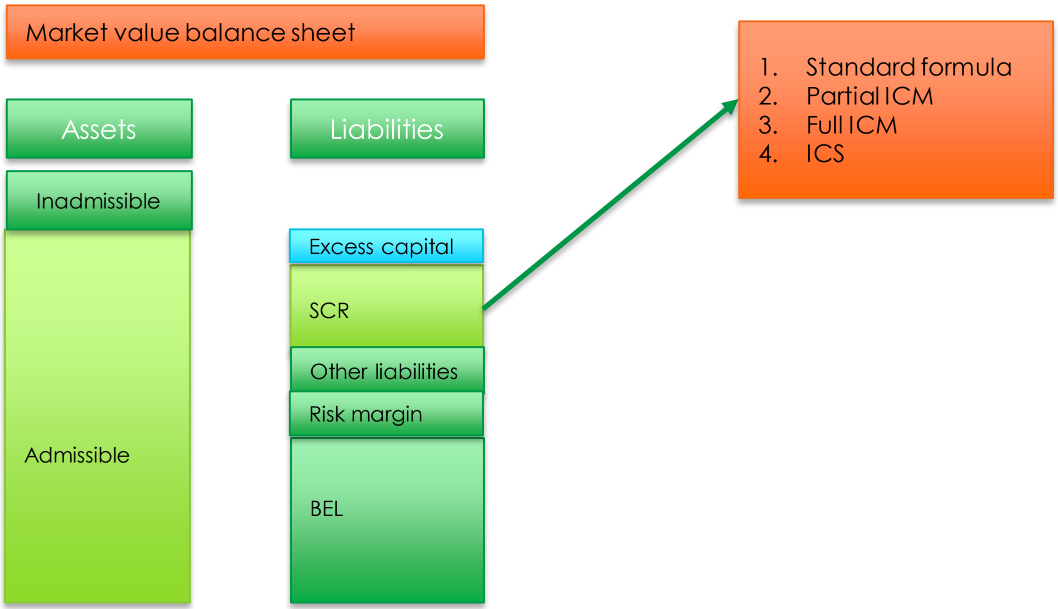
RBC regime - overview

What is a risk based capital regime?

1. It is a component of an effective ERM framework
2. There are many different versions of RBC methodology
3. It isn't just a capital calculation, usually 3 pillars, e.g. SAM, S2, C-Ross

Pillar 1	Pillar 2	Pillar 3
Capital requirements Assets Liabilities NAV SCR	**Supervisory review** Corporate governance Risk management ORSA	**Market conduct** Reporting and disclosure
Quantitative	Qualitative	Transparency

RBC regime – exploring Pillar 1



RBC regime – exploring Pillar 2

1. **Corporate governance framework**
   i. Applies to pension funds, companies, etc.
   ii. Ensures effective governance
   iii. Board constitution
   iv. Board fit and proper
   v. Board compensation
   vi. Board transparency
   vii. Committees

2. **Risk management framework**
   i. Models of risk management
      a) Three lines of defence: "interaction between lines"
      b) Offence and defence model: "confrontation"
      c) Policy and policing model: "hands-off"
      d) Partnership model: "independence"

   ii. Risk management time horizon: S2 requires a 99.5% probability of solvency over 1 year, is this the same as withstanding a 1 in 200 year event?

   iii. Risk management strategy
      i. Objectives
      ii. Risk exposure identification (current and future risks) leading to a risk profile: how much risk are you currently taking
      iii. Risk appetite = f(risk tolerance, risk capacity), how much capital do you have and what is your loss aversion
      iv. Risk appetite should be consistent with risk management strategy and business plan
      v. Risk classification
      vi. Risk preference statements
      vii. Risk management policies

   iv. Risk management: accept, reduce, remove, transfer

RBC regime – exploring Pillar 2

3. **ORSA**
   i. Purpose:
      a) to ensure that the insurer is adequately capitalized, and has access to additional sources of capital if needed, to deal with a wide range of future scenarios
      b) Assess the overall solvency needs of the insurer taking into account the specific risk profile, risk appetite and business strategy
      c) Assess future compliance with financial soundness requirements
      d) Assess the significance of future deviations in risk profile
      e) Evidences that the Board has considered the risks and solvency of the business
      f) Establishes the link between risk and capital

   ii. Requirements:
      a) Insurer must demonstrate that ORSA is aligned with the risk profile of the insurer and that it is used in the capital planning and management of the insurer
      b) Must assess the current and likely future financial soundness of the insurer across a range of scenarios
      c) Must justify the use of an ICM rather than the standard formula
      d) Must address reasonably foreseeable and relevant material risks
      e) Must identify the relationship between risk management and the level and quality of capital available and needed
      f) Assess future changes to the insurer's risk profile under stressed conditions
      g) Must be conducted over a longer time frame than conventional risk assessments and justify choice of period
      h) Verified by independent appropriately qualified persons
   iii. Owned by the Board

RBC regime – exploring Pillar 3

Public disclosures
Confidential disclosures

The benefits of an RBC regime?

Benefits society as a whole
1. Global Financial Crisis
2. Systemic risks and integrity of the financial system
3. Protects the "real economy" from the "financial economy"

Reputational risk
1. Intermediary
2. Regulator
3. Management
4. Board
5. Brand

Financial risk
1. Policyholder
2. State
3. Creditors
4. Tax payers

Trust in the industry

Insurer's operations
1. Survival
2. Business model is to price risk and thus take on risk or transfer risk
3. Efficient capital allocation
4. Informs business strategy
5. Encourages insurers to focus on risk and use more sophisticated tools
6. Informs dividend policy

Closing comments

1. Calibration
   i. Data
   ii. Changing economic regimes
   iii. Lack of derivatives
   iv. Correlations/diversification
   v. Bond yield curve

2. Internal capital model
   i. Cost
   ii. Comparability
   iii. Relevance
   iv. Resourcing: regulator, industry
   v. Spurious accuracy
   vi. Integration with business strategy

3. Fair values, market consistency and price discovery
4. Recognizing illiquidity
5. Risk free assets
6. Is the life industry ready
7. Transition period
8. **ORSA**

The benefits of RBC are wide ranging – choose the appropriate implementation

THANK YOU