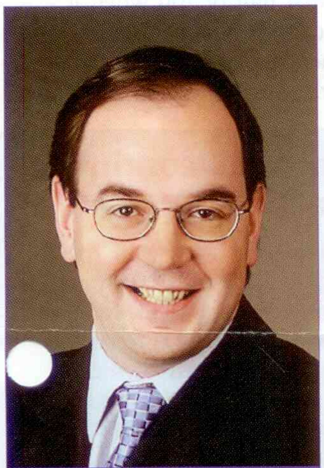
Recent reserve and regulatory capital developments in Asia Pacific



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Management of regulatory capital strain continues to be a high priority for life and health carriers across Asia. Since our last article in *Asia Insurance Review* by SCOR in June 2012, the following are a summary of noteworthy developments.

Singapore

The release of consultation paper P11[1] in June 2012 by the Singapore Monetary Authority set the agenda for an ambitious fast track overhaul of the risk based capital (RBC) framework for Singapore domiciled insurers. The strategic choice made clearly positions Singapore as one of the fast adopting Asian regulators in moving to a "next generation" RBC framework. This contrasts with the pace so far of other regional centres including Hong Kong.

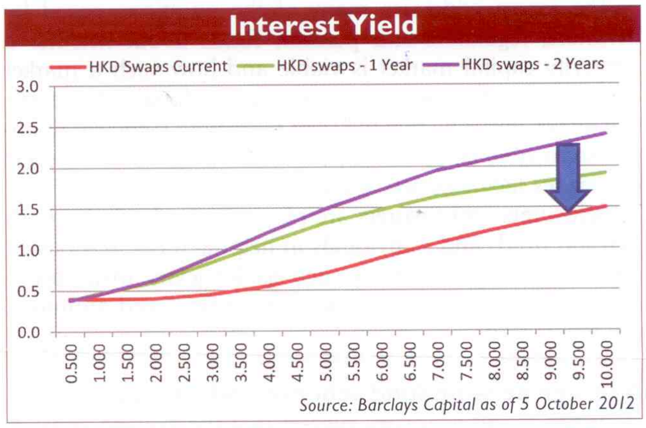
The precise impact of the change in regime will be established through quantitative surveys set to run starting from first quarter of 2013. Parallel use of new and old rulesets will arise for 2013 with final implementation in 2015 of the basic new framework, with further refinement of capital through the use of internal models to follow thereafter. Relative to the timeline of Solvency II implementation in Europe, this is rapid development.

The consultation paper emphasises evolution rather than revolution in the development of the new capital standards. The stakes are nonetheless high for market participants to ensure the potential benefits of a more complex regulatory capital model translate to tangible benefit for those who make the significant investment to develop rigorous internal economic risk models around which their business will be managed.

Hong Kong

The continuing low interest rate environment as seen in the Interest Yield exhibit of contracting long-term yields is causing upward pressure on statutory liability levels for guaranteed savings policies as the expected contribution of future interest earnings on assets backing reserves continues to decline.

This is not just a phenomenon for Hong Kong carriers of course. Some further interim regulatory relief is likely to be sought by market participants – relatively small differences in expectation for reinvestment yields and appropriate provision for liquidity premiums have a significant impact when base rates are at such low levels. The further use of structured reinsurance solutions is also likely to factor into carriers' plans for capital management.



Source: Barclays Capital as of 5 October 2012

China

The regulation of capital motivated reinsurance by the China Insurance Regulatory Commission (CIRC) is currently under review with specific guidance on acceptable forms of structure to be promulgated likely no later than early 2013.

Based on our understanding of market consultations undertaken to date, the emerging regulations will define more explicitly the "safe harbours" for the form of reinsurance that will be pre-approved as a valid source of reserve and RBC relief. There will likely be restrictions on the use of cash deferred structures. Both coinsurance and modified coinsurance will likely be the preferred structures going forward. As carriers prepare for yearend regulatory filing, we expect a continuing pattern of structured reinsurance to fill ongoing regulatory capital strains.

The path for movement to a next generation model for solvency standards will follow a slower pace than that of Singapore, with no material near term changes envisaged by the CIRC.

Global macro-economic outlook

The outlook for interest rates, the pace of economic recovery and potential for inflation development continues to be highly uncertain, with US and European central banks further easing conditions to underpin the basis for economic recovery.

The resulting low cost of funds is good for rebuilding bank balance sheets but very challenging for insurers to generate the required spread above risk free rates on policyholder' investments that is needed to fund the investment return promises to policyholders and that covers internal costs. Life insurers are feeling the pinch with strong pressure from ratings agencies to maintain a disciplined approach to ALM and not to take further unrewarded asset risk, yet with sales growth (and earnings recovery) challenged by low yields that can be offered on the critically important savings side of the business. Maintaining a strong regulatory and rating agency capital position remains critical to ensuring flexibility of operation in these challenging times.

This article was sponsored by the Insurance Risk and Finance Research Centre.

1 MAS' Consultation paper on RBC review may be found at: http://www.mas.gov.sg/