



Insurance Capital Review

Seminar

Life Insurance

IAAust ICA FSC - Sydney

9 June 2011

- Major themes from consultation
- Capital base
- Discount rates
- Capital charges
 - Insurance risk
 - Operational risk
 - Asset risk
- Questions

Major themes from consultation



- Proposals were overly complex
- Proposals were overly conservative
- Proposals were pro-cyclical
- Impact varied widely between companies
- Minor impact on investment linked funds

- **Adjusted policy liabilities**
 - Combine all non-discretionary business for TV minimum
- **Inadmissible assets**
 - Goodwill in genuine arm's-length investments will be admissible
 - Tax benefits associated with termination values might become admissible
- **Quality of capital**



- **Derived from CGS yields**
- **Extrapolate by reference to other instruments**
- **Liquidity premium in certain circumstances**
 - For immediate annuities & fixed term/rate (with TV reducible to APRA minimum) & funeral bonds
 - Set as a constant for QIS2 (30 bps)
 - Aim to use a prescribed formula in standards (yet to be developed)



- Random mortality & morbidity
- Future mortality & morbidity
- Mortality and morbidity event
- Longevity
- Lapses
- Servicing expenses
- Correlations
- Repricing
- Short term losses



- **Event stress**

- One event stress affecting both mortality and morbidity
- Minimum event stress is a pandemic scenario spread over 2 years

- **Repricing**

- Allow repricing from 12 months after reporting date
- But not in response to random or event stresses

- **Termination values**
 - Remove stressed termination values at reporting date
 - Stressed TVs still apply 12 months from reporting date
 - Broader product groups reduce impact of TVs
- **Reduced correlation factor**
 - Future mortality/morbidity reduced from 50% to 25%
- **Increase risk sensitivity**
 - Lapse stress is no longer a prescribed amount

Revised formula

- $\alpha \times (\max\{GP, NL\} + |\Delta|)$

where:

- α is 3% for risk, 0.25% for non-risk (2%, 0.15% reinsurers)
- GP is gross premium income
- NL is net adjusted policy liabilities
- $|\Delta|$ is the change item based on premiums and/or claims

- Depends on ‘size’ and change in ‘size’ over 12 months
- Separate charges for risk and non-risk business
- Lower charges for reinsurers
- Change item
 - Extra capital charge for rapid growth or decline
 - Measured using premiums and claims
 - Threshold increased from 10% to 20%
 - Charge only applies to excess over threshold

- **Seven asset risk modules**
 - Real interest rates
 - Expected inflation
 - Currency
 - Equity
 - Property
 - Credit spreads
 - Default risk
- **Aggregated using a correlation matrix**
- **Stresses apply to all admissible assets**

- **Real interest rates and expected inflation**
 - Simplify by removing duration dependent factors
 - Reduce impact at shorter durations
 - Reduce pro-cyclicality by limiting stresses (max 200 bps for real interest rates)
 - Remove dependence on inflation assumption

	Real interest rates	Expected inflation
+	0.3 x nominal rate	125 bps
-	0.25 x nominal rate	100 bps



- **Volatility**

- Simplify by moving equity volatility into equity module
- Reduce pro-cyclicality by changing equity volatility stress to +15 per cent
- Remove interest and currency volatility stresses



- **Credit spreads**
 - Improved risk sensitivity
 - Separate category for re-securitised assets
 - Separate default and spread stresses
 - Semi government debt stepped up one counterparty grade



- **Default risk**
 - Simplify by removing the requirement to use stressed reinsurance assets and OTC derivatives
- **Correlation matrix**
 - Increase some factors to improve consistency



- **Aggregation benefit**
 - Correlation factor reduced from 50% to 30% for QIS2
- **Methodology**
 - Participating and other discretionary business
 - Tax assets
- **General fund**
 - \$10m minimum, with offsets



Questions?