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# Risk Based Supervision: Impact, Effects and Next Steps

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14 April 2018



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## Agenda

1. Key principles of RBS
2. RBC in East Africa
3. QIS 1 (Kenya)
4. Qualitative Effects
5. Next Steps

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# Introduction

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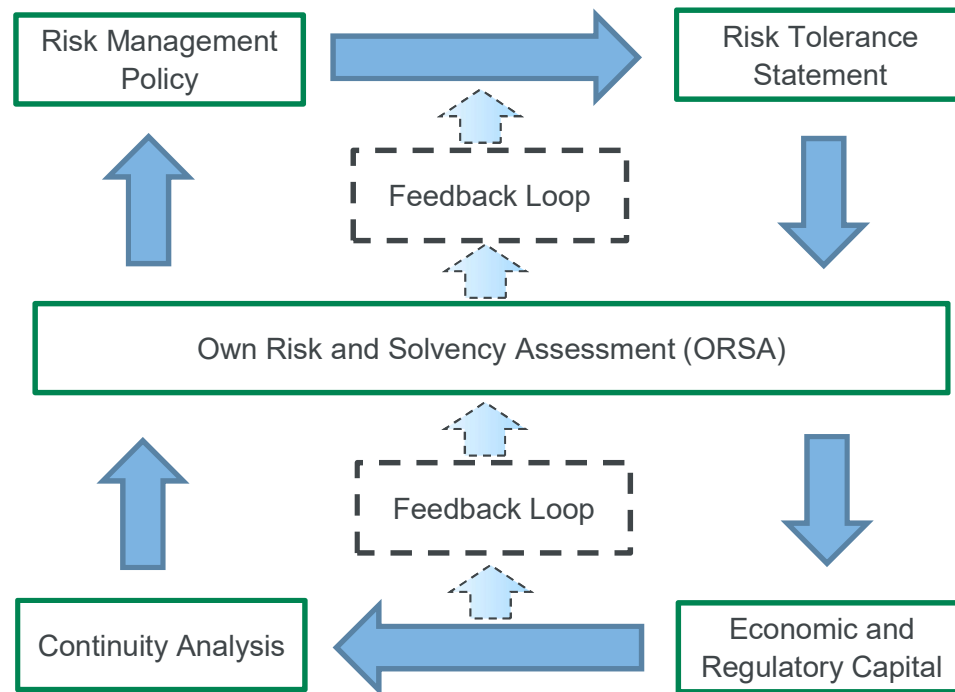
## What is risk based supervision?

- Risk based supervision (RBS) requires supervisors to review the manner in which insurers are identifying and controlling risks.
  - A risk based supervision approach assesses the probability and severity of the material risks to which insurers are subjected to.
  - It assesses the effectiveness of the controls in reducing the probability of risk events occurring or the severity if they do occur.
- contrasted with *rules-based regulation* or compliance-based supervision,
  - is a method of regulation which involves checking for and enforcing compliance with rules – legislation, regulations or policies – that apply to an entity.

# RBS

- A prerequisite for good RBS is knowledge of the institution, its industry and operating environment.
- These can all be observed by creating a risk profile of an institution:
  - institution's activities
  - risks in those activities
  - quality of risk management (day-to day management and Oversight)
  - capital required to support operations

## Insurance Core Principle 16



### ERM for Solvency Purposes

- Focuses on the link between risk management and the management of capital adequacy and solvency
- Does not prescribe a specific aspect which is to be applied compulsorily.



# ICP 16...

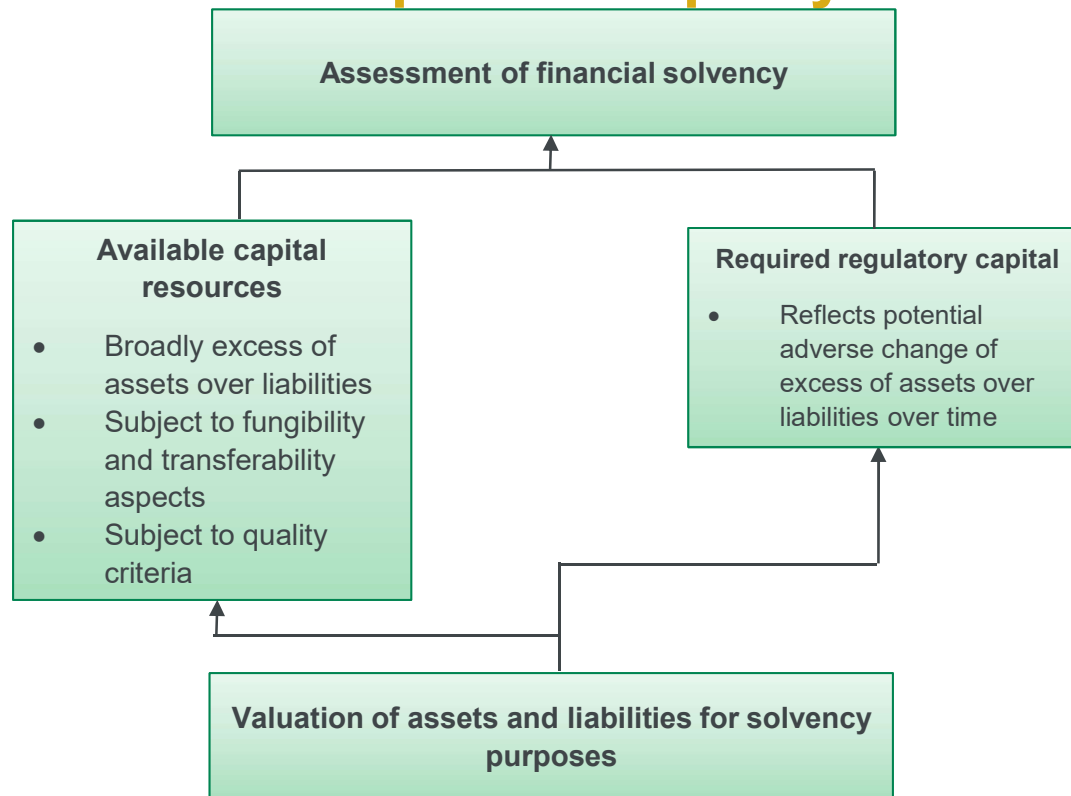
## ICP 16 – ERM for Solvency Purposes

- Requires insurers to address or relevant and material risks
- Recognises the importance of an ERM framework in underpinning robust insurance legal entity and group-wide solvency assessment
- ERM that follows this principle is expected to enhance confidence in assessing the insurer's financial strength

## ORSA / ICAAP

1. Determine overall financial resources required given risk tolerance and business plans
2. Base risk management decisions on consideration of economic capital, regulatory capital requirements & financial resources
3. Assess quality and adequacy of capital resources.

# ICP 17 – Capital Adequacy



Established at a sufficient level so that in adversity, an insurer's obligations to policyholders will continue to be met as they fall due & requires that insurers maintain capital resources to meet regulatory capital requirements

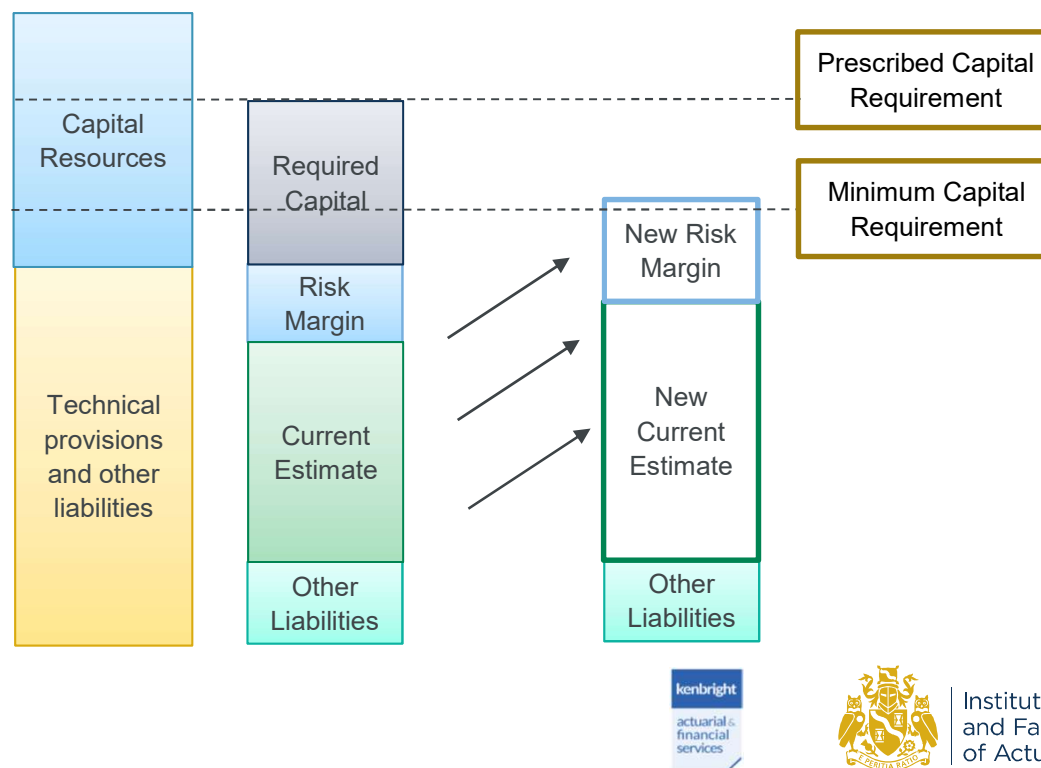
A total balance sheet approach ought to be used in the assessment of solvency

- to recognise interdependence between assets, liabilities, regulatory capital requirements and capital resources and
- to require that impacts of relevant material risks are appropriately and adequately recognised.



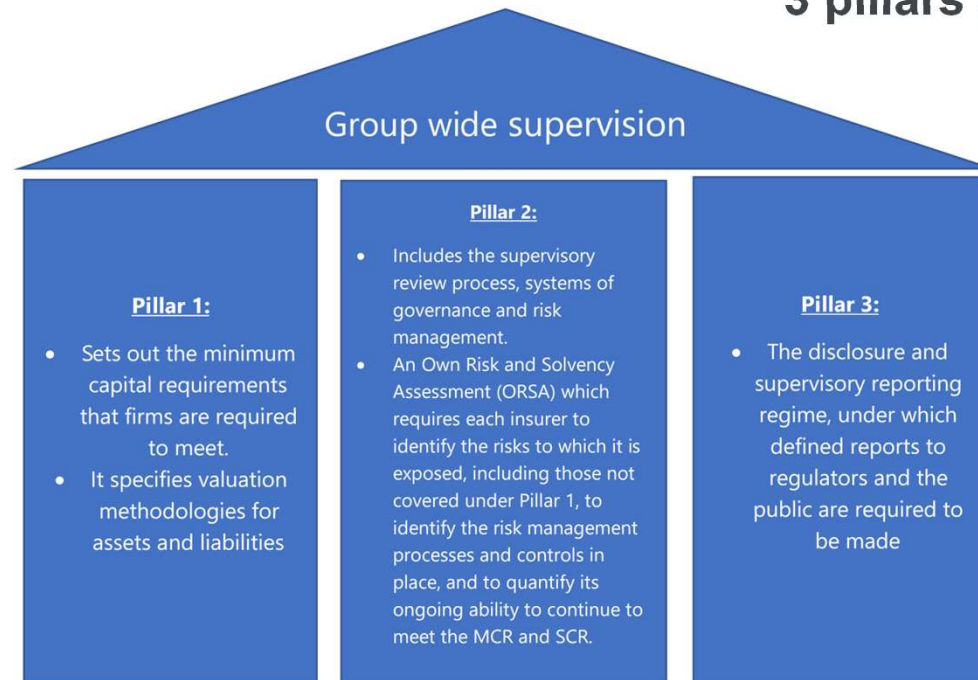
## ICP 17... ctd.

- Solvency controls
  - PCR
  - MCR
- Regulatory capital requirements ought to be established in an open and transparent process
  - Objectives and bases ought to be explicit



# Solvency II

## 3 pillars and a roof





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# RBC in Africa

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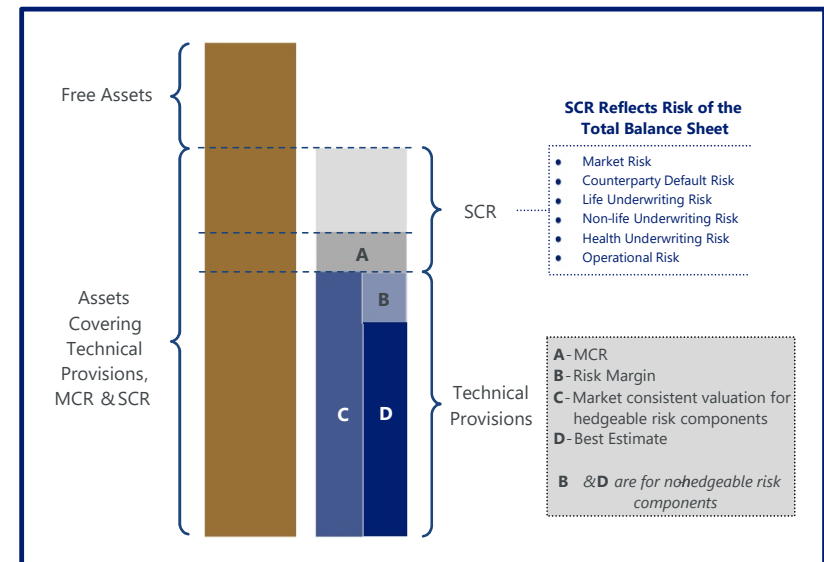
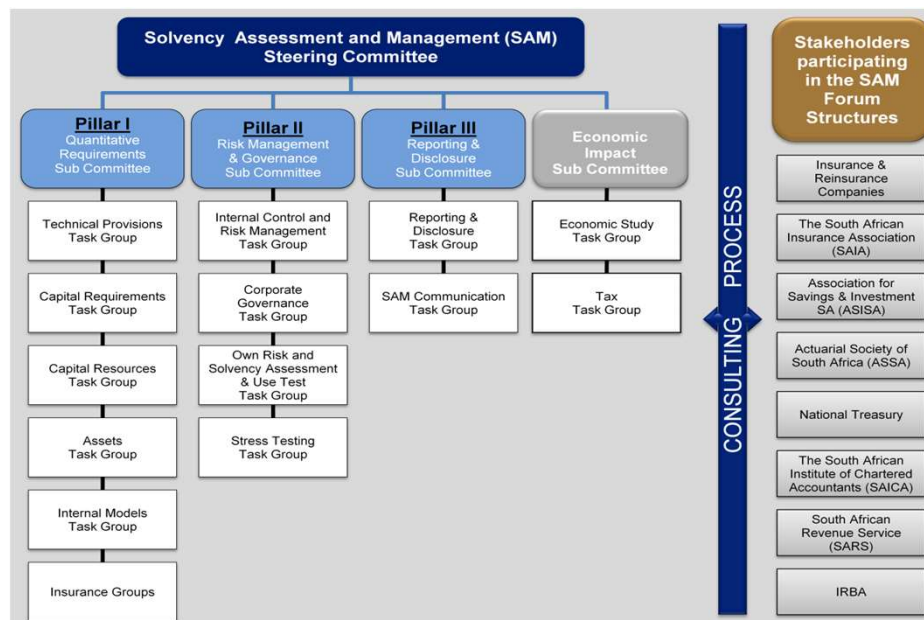
## African Trends – RBS

Country	Current Approach	Intended date	Regulator	Key Gaps
South Africa	Three pillar SAM approach (based on solvency II)	July 2018	FSA	
Kenya	RBC is legislated but not fully functional	2020	IRA	Group supervision Pillar II
Uganda	Use of rules based regime with intention to move to RBC		IRA Uganda	TBA
Tanzania	Use of rules based regime with intention to move to RBC		TIRA	TBA
Rwanda	Use of rules based regime with intention to move to RBC		Reserve Bank of Rwanda	TBA

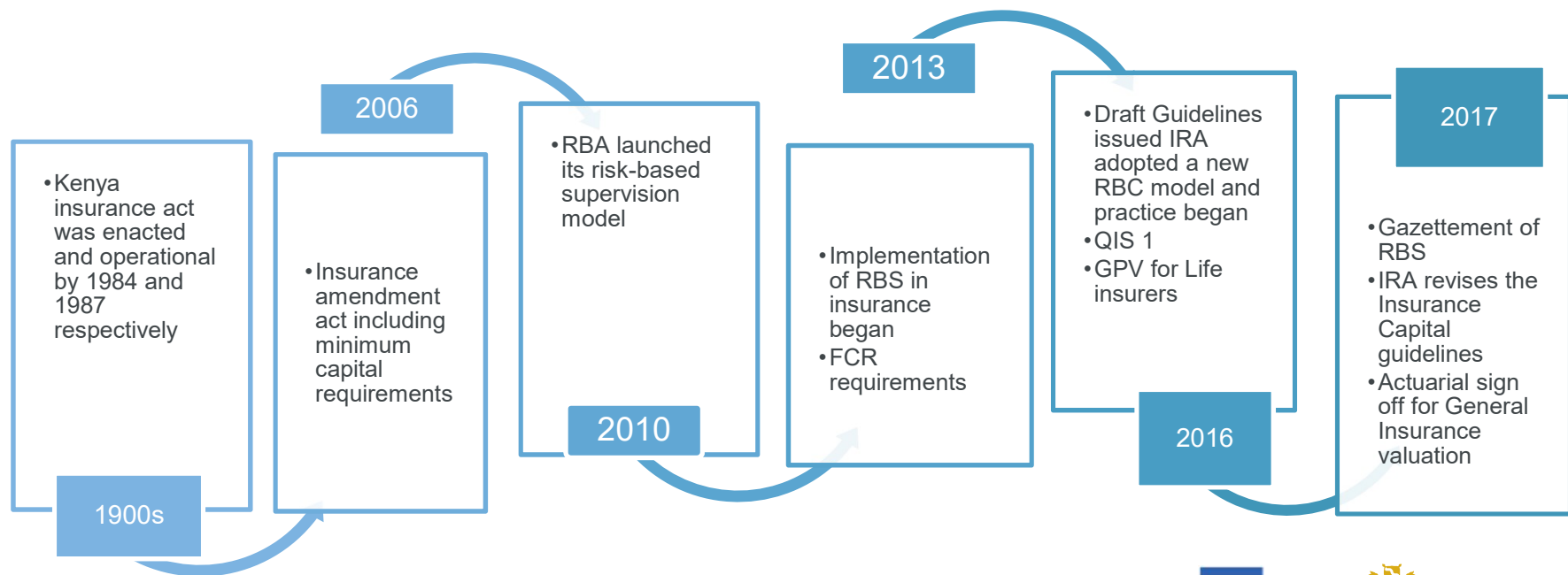
## African Trends - RBS

Item	South Africa	Kenya
Capital requirements are sensitive to all the risks being run	Yes	Yes
Advanced risk management requirements	Yes	No
Three lines of defense model and control functions	Yes	Yes
ORSA/FCR is required by the framework	Yes	Yes
Regulatory internal models are allowed	Yes	No
Disclosure to stakeholders	Yes	Partial
Boards and senior management show an understanding of risks in depth	Yes	No

# SAM (Solvency Assessment and Management)

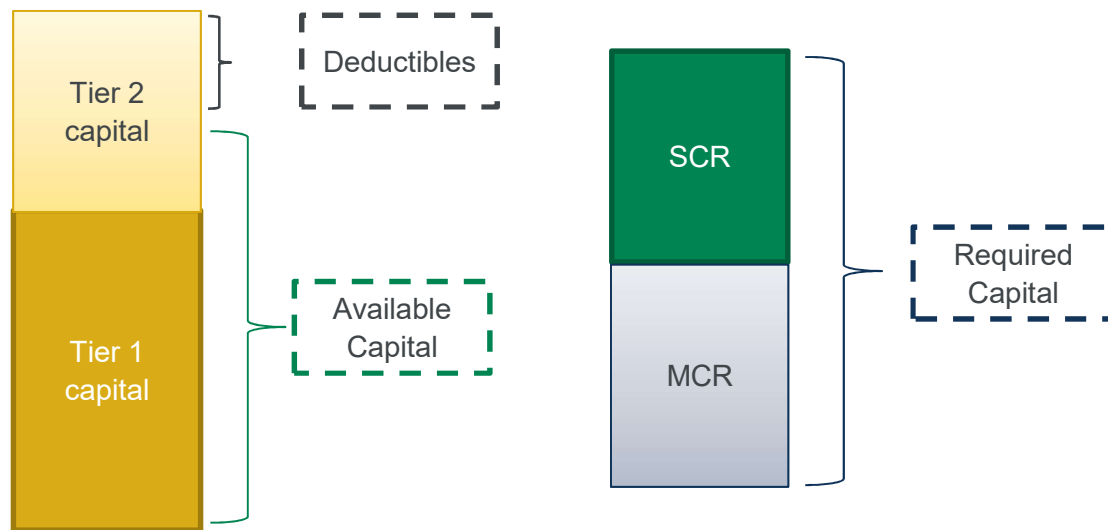


# Insurance Capital Development in Kenya

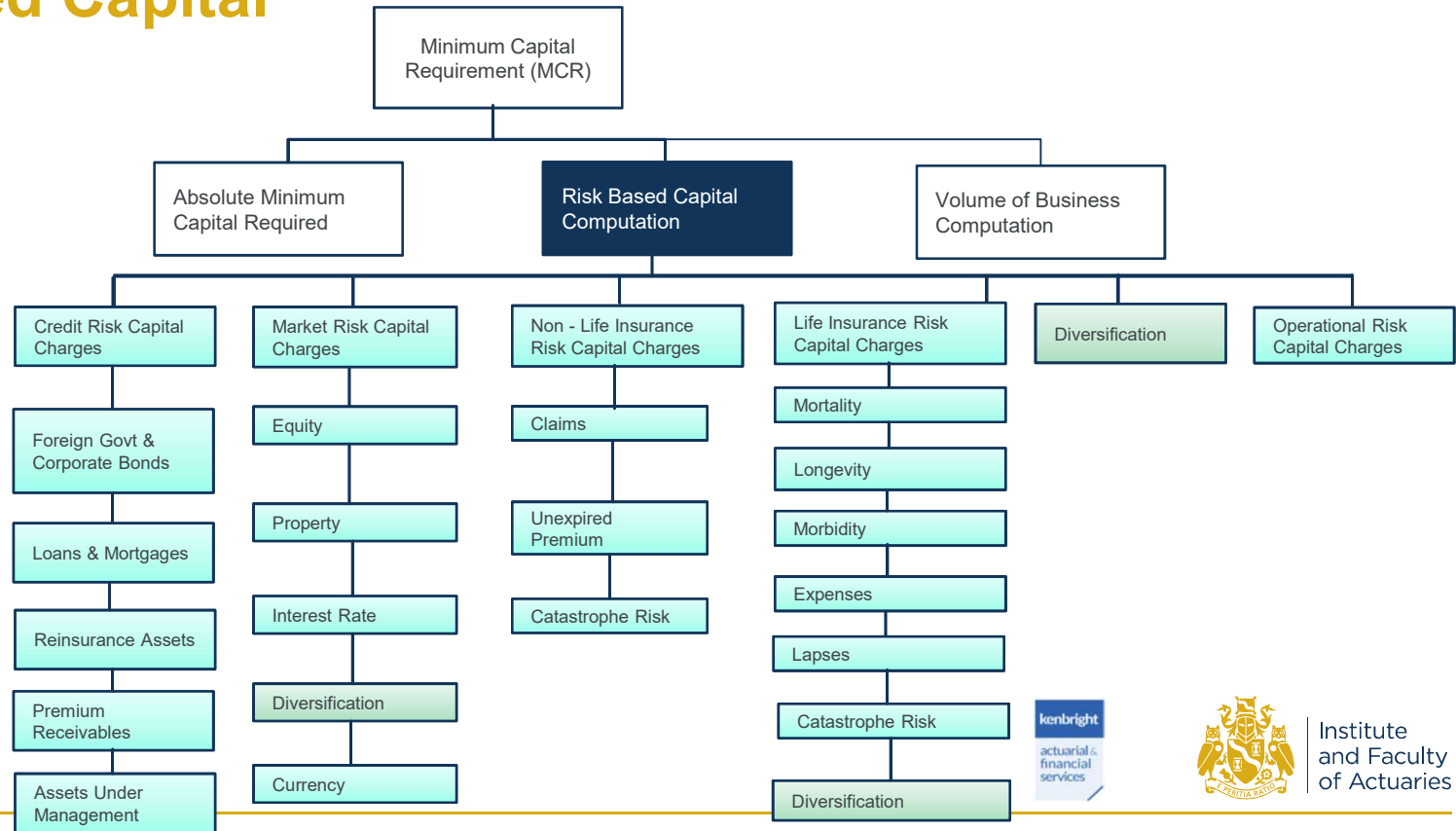




## Capital Adequacy Computation – KE model



# Required Capital





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## QIS 1 Results

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# Industry Participation

## Participants' Market share

*(Based on IRA Industry statistics at 30<sup>th</sup> June 2016)*

KE - Life & General QIS 1 : Response by GWP & NAV			
Component	General Insurers	Life Insurers	Total
Gross Written Premium	78%	91%	84%
Net Assets	79%	92%	86%

KE - Life & General QIS 1 : Response by Category of Insurer			
Companies	General Insurers	Life Insurers	Total
Submitted	23	20	43
Pending	13	6	19
Total Companies	36	26	62

# Industry Participation

## Number of participants by category

Industry Classification		General Insurers	Life Insurers	Total
All Insurers	Large	4	3	7
	Medium	7	9	16
	Small	25	14	39
	All	36	26	62
Industry Participants		General Insurers	Life Insurers	Total
Participants	Large	4	3	7
	Medium	6	8	14
	Small	13	9	22
	All	23	20	43
Participation Rate		General Insurers	Life Insurers	Total
Large		100%	100%	100%
Medium		86%	89%	88%
Small		52%	64%	56%
All		64%	77%	69%

## Key Findings

- Capital adequacy has dropped significantly
  - **General:** 220% to 131%
  - **Life:** 292% to 124%
- Increase in capital to achieve 100% CAR
  - **General:** KES 2.8Bn
  - **Life:** KES 1.5Bn
- Increase in capital to achieve 150% CAR
  - **General:** KES 9.9Bn
  - **Life:** KES 6.3Bn

## Key Findings

- Capital deductions were more than 10%
  - **General:** 18%
  - **Life:** 14%
- Insurers are not using Tier 2 Capital

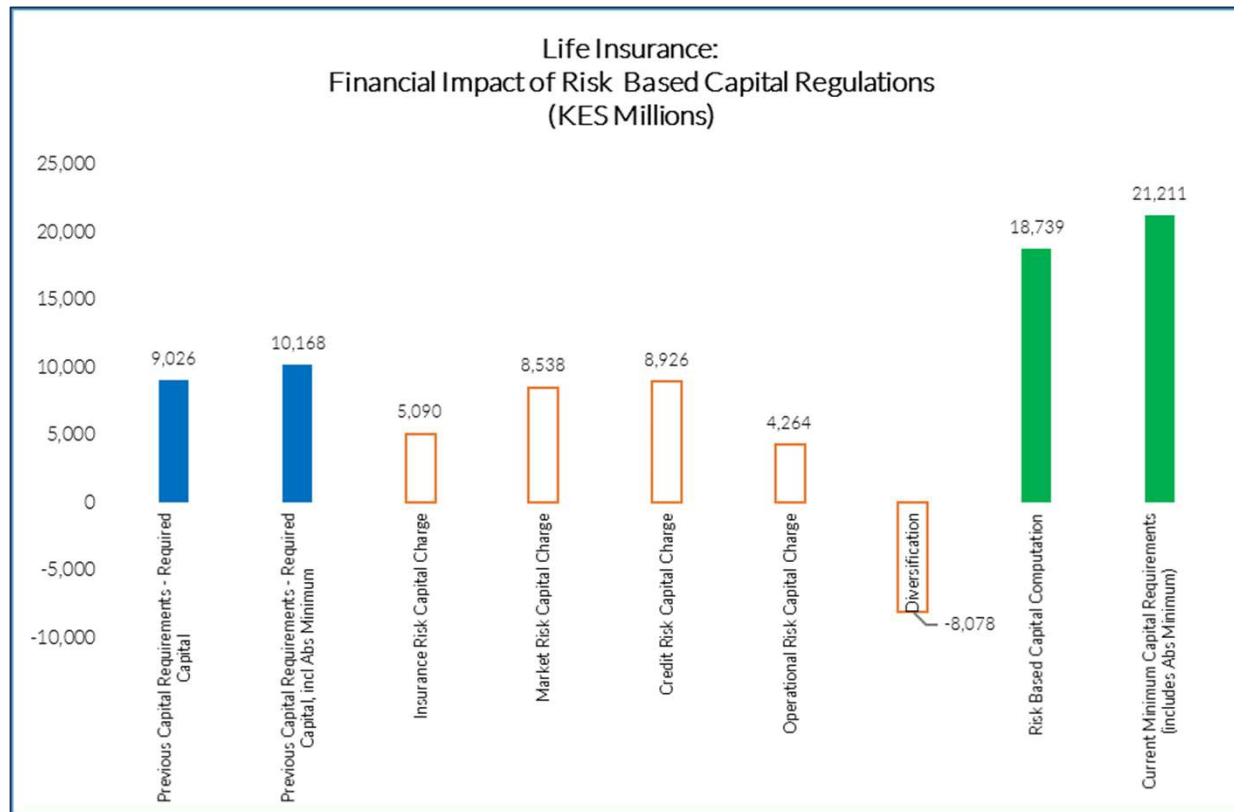
Heavy reliance is placed on the accuracy of the submissions provided for the study.





## Life Insurance Results

# Financial Impact



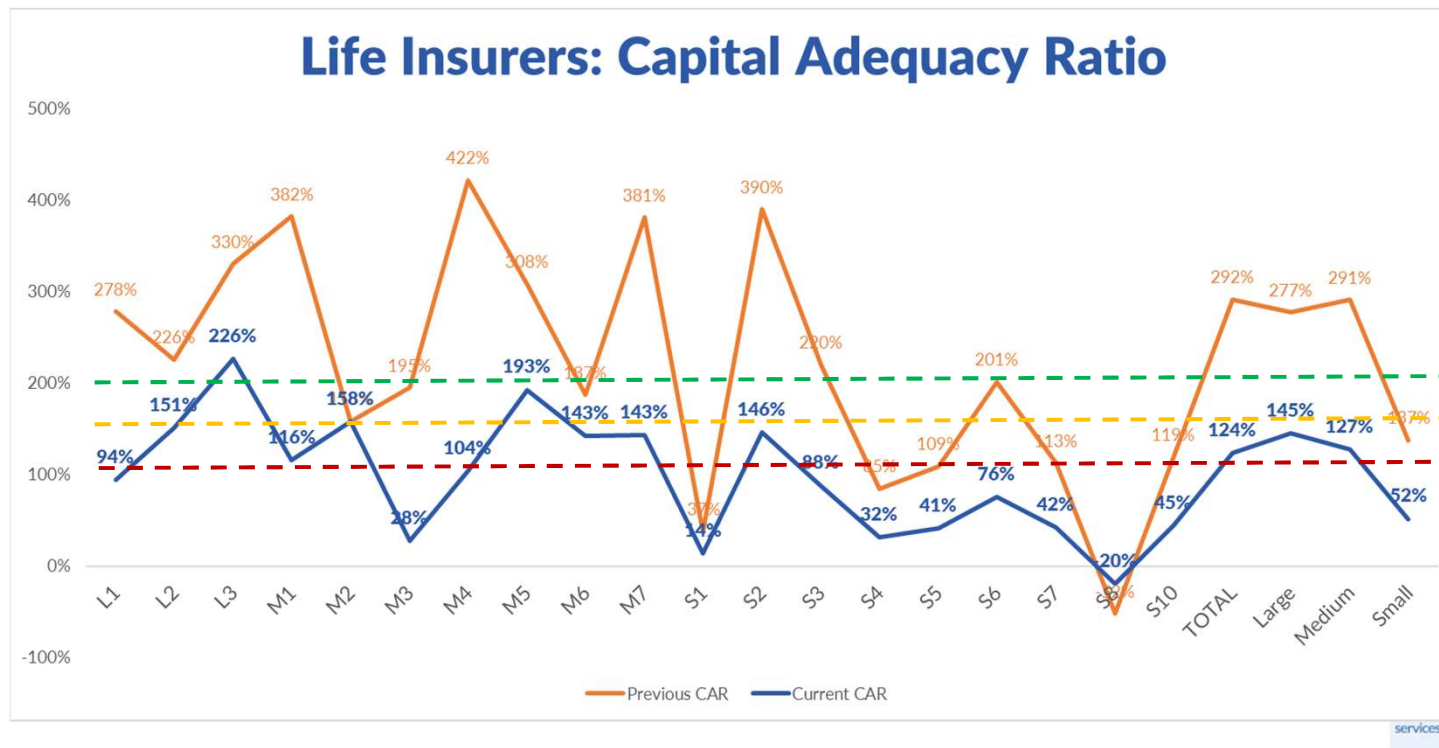
**Required Capital increased from KES 10b to 21b**

## Financial Impact for Life Insurers

KE - LIFE: IMPACT OF RBC ON AVERAGE INSURER (KES Millions)				
	Average RBC Computation	Average Previous Capital Requirement	Impact of RBC (KES)	Impact of RBC (%)
<b>All</b>	<b>937</b>	<b>508</b>	<b>429</b>	<b>84%</b>
Large	3,787	1,982	1,806	91%
Medium	777	358	419	117%
Small	129	151	-22	-15%

The average required capital as per the RBC computation is KES 0.9b compared to KES 0.5b in the previous regime. Large & medium insurers have seen a more significant impact from the proposed calculation

# Capital Adequacy Ratio

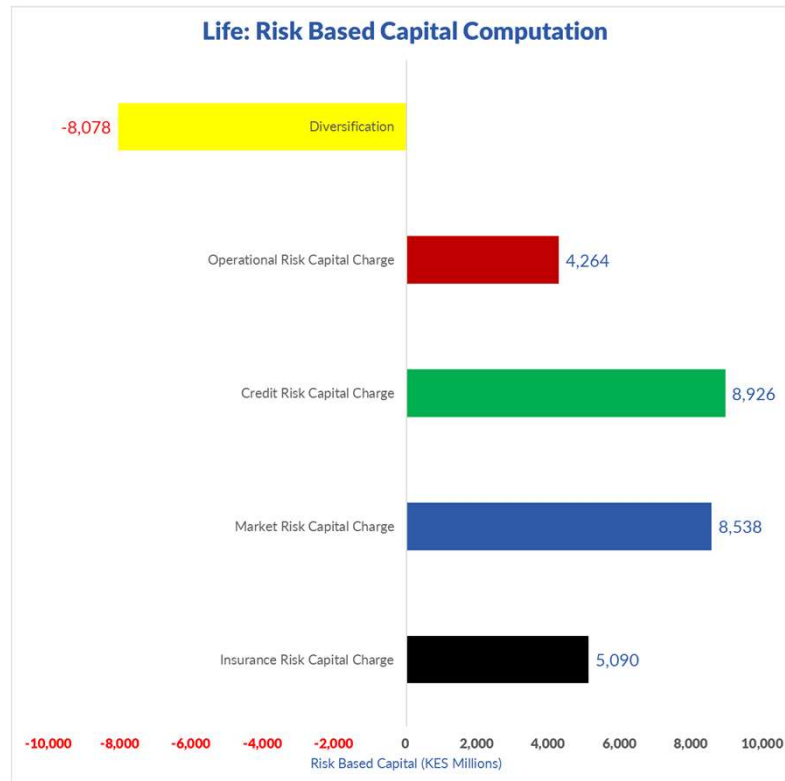


**CAR  
Reduced  
from  
292% to  
124%**



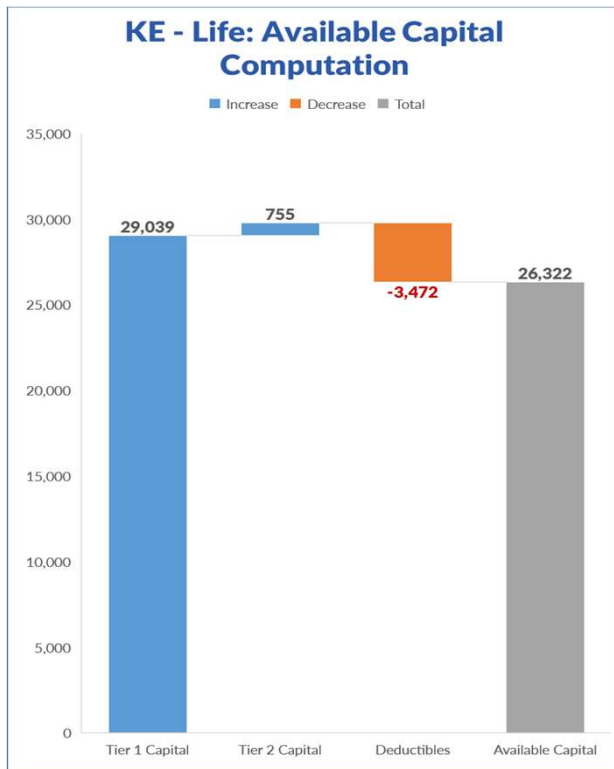
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# Risk Based Capital Computation

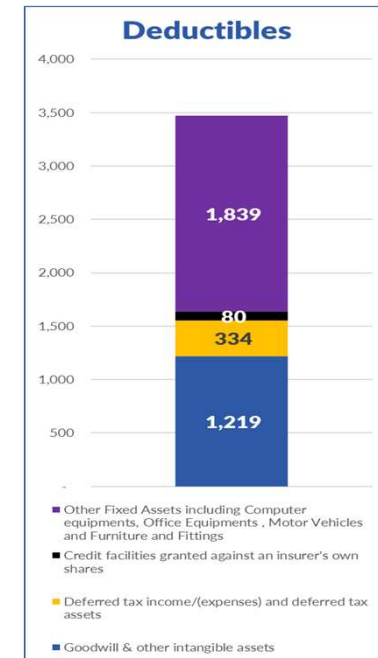


The highest charge relates to failure of credit & market risk

# Available Capital Computation



On average 88% of the capital is available for capital adequacy because of deductibles of KES 3.5b

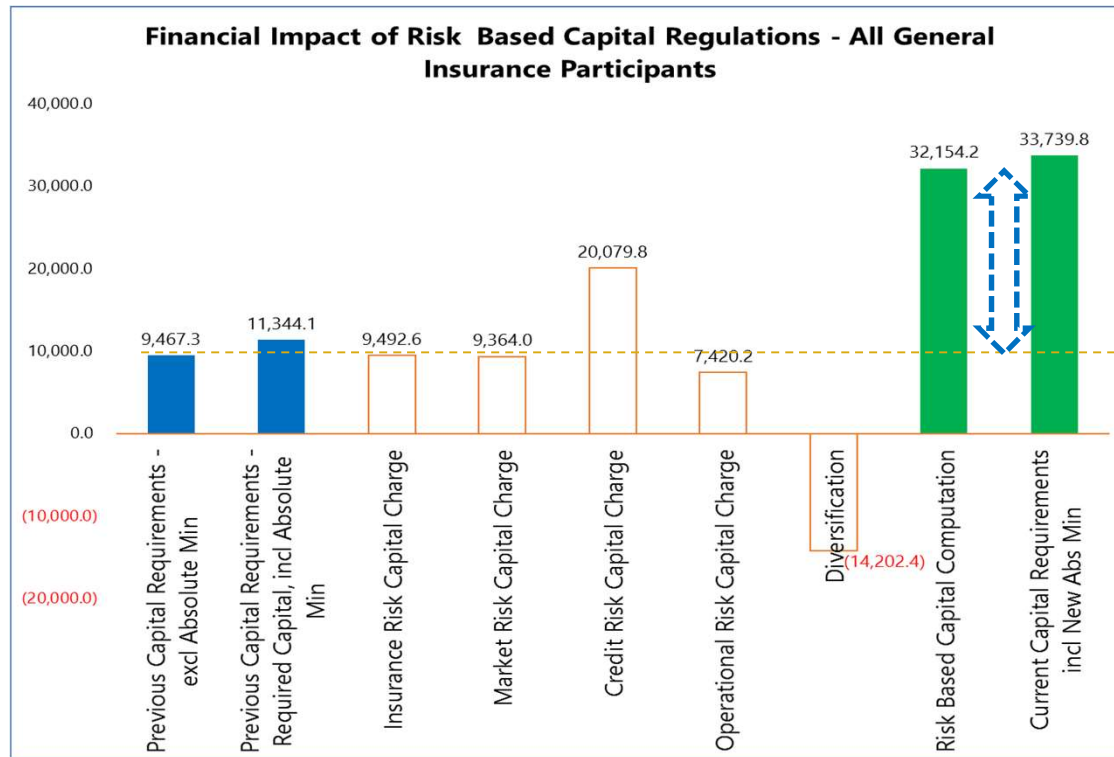




# General Insurance Results

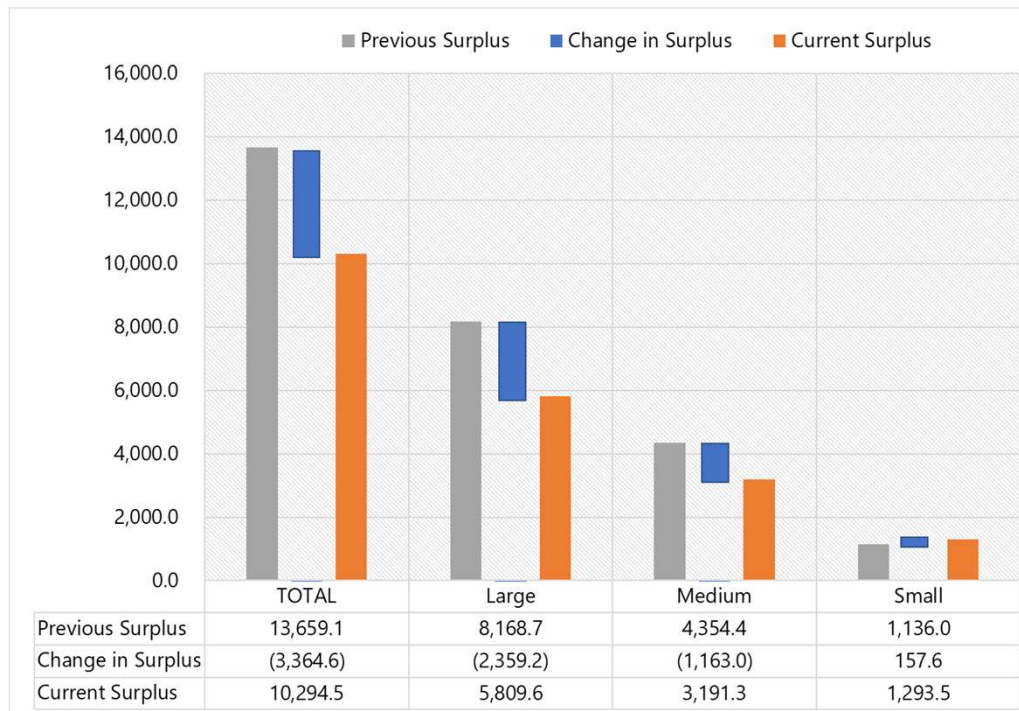


# Financial Impact



**Required Capital increased from KES 11.3b to 33.8b**

## Financial Impact



**Surplus  
decreased  
from KES  
13.7b to  
10.3b**

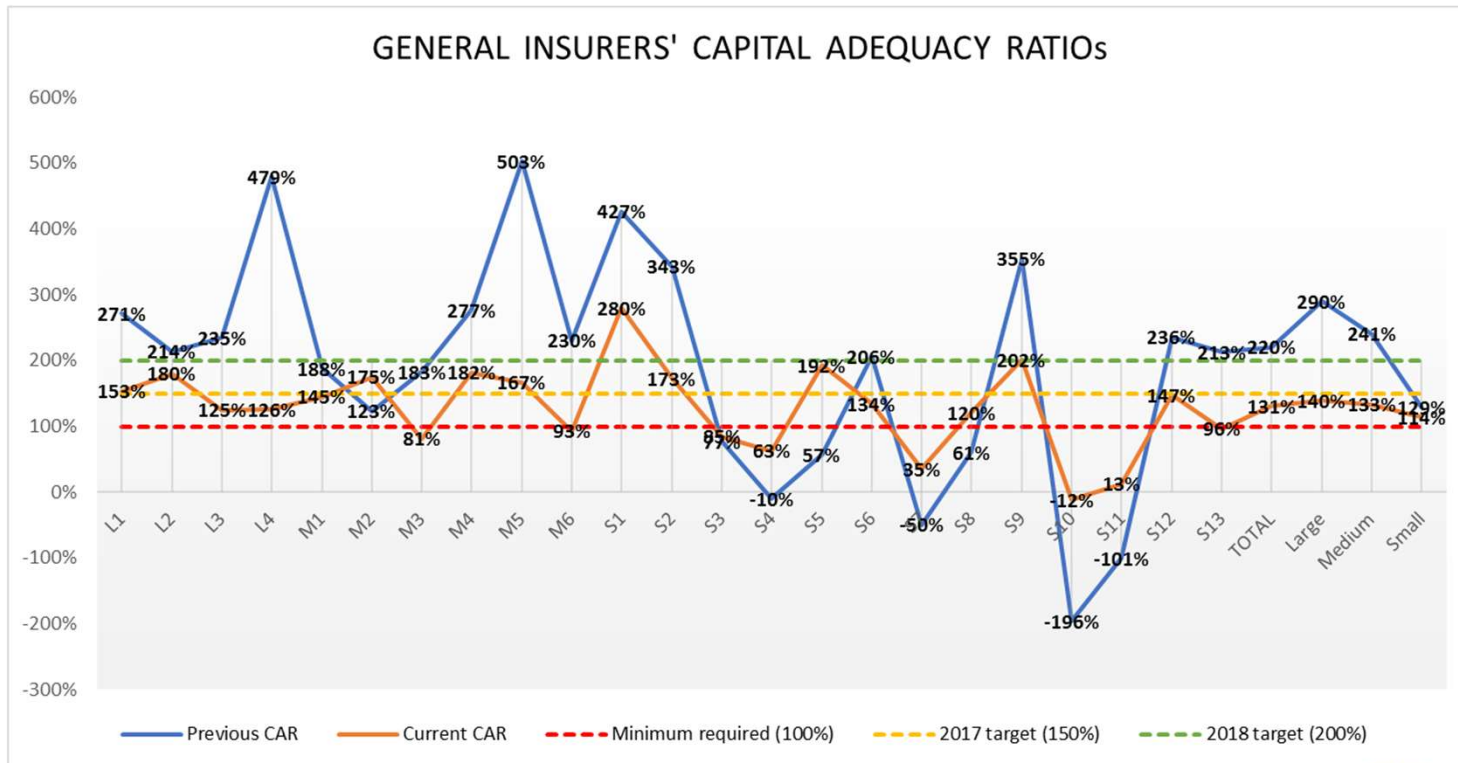
## Financial Impact

KES Millions	Average RBC Computation	Average Previous Capital Requirement	Impact of RBC (KES)	Impact of RBC (%)
<b>TOTAL</b>	<b>1,398</b>	<b>493</b>	<b>905</b>	<b>183%</b>
Large	3,677	1,073	2,603	243%
Medium	1,613	516	1,097	213%
Small	598	304	293	96%



The average required capital as per the RBC computation is KES 1.4 Bn compared to KES 0.5 Bn in the previous regime.

# Capital Adequacy Ratio

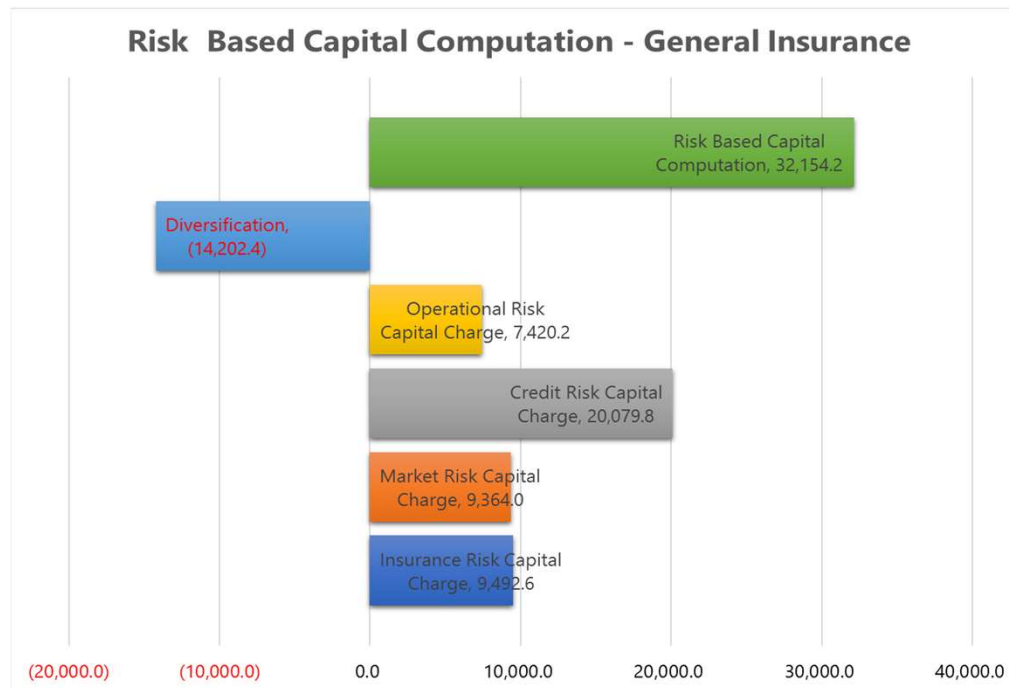


**CAR  
Reduced  
from  
220% to  
131%**



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# Risk Based Capital Computation



The highest charge relates to failure of counterparties

## Available Capital Computation

KES Millions	Tier 1 Capital	Tier 2 Capital	Deductibles	Available Capital	Impact of Deductibles	Proportion of Tier 1
<b>TOTAL</b>	<b>48,486</b>	<b>4,895</b>	<b>(9,347)</b>	<b>44,034</b>	<b>(21%)</b>	<b>91%</b>
Large	20,927	2,027	(2,439)	20,516	(12%)	90%
Medium	13,888	1,888	(2,908)	12,868	(23%)	91%
Small	13,671	980	(4,000)	10,651	(38%)	94%



The impact of deductibles is more significant for smaller insurers compared to the market.



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# Qualitative Impacts

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# Key Impacts on Insurers

## Positive

- 1.Improved credit risk management (75%)
- 2.Elevated view of capital management and solvency (58%)
- 3.Better understanding of risk profile and drivers for the business (58%)
- 4.Increased prudence in balance sheet management (50%)
- 5.Improved governance and risk culture (25%)
- 6.Improved reinsurance management (17%)
- 7.Provides comfort to customers in terms of how business is being done (8%)
- 8.Change in employee value proposition to include company's capital position (8%)
- 9.Focus on quality of business and profitable growth (8%)

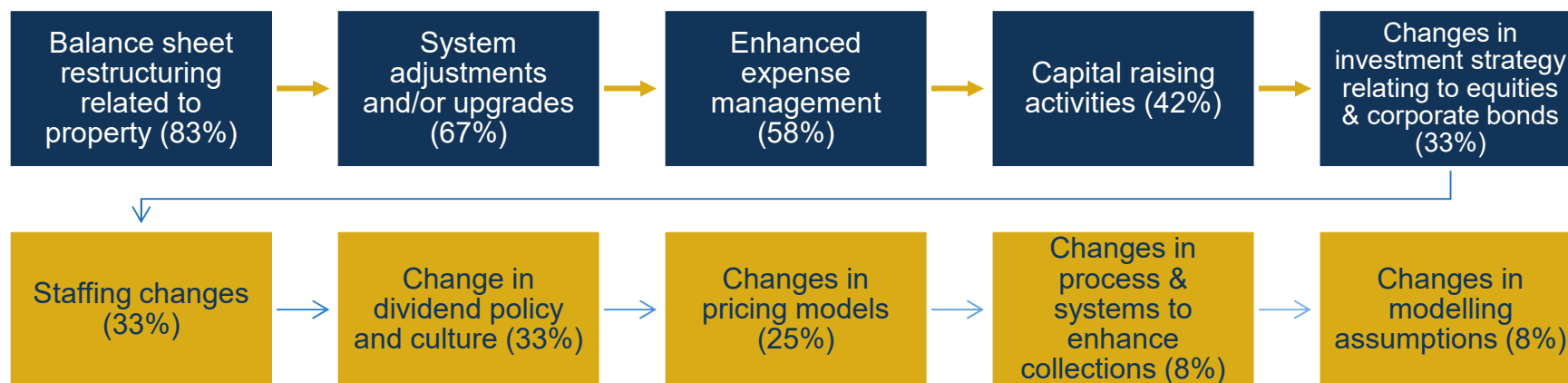
## Neutral

- Rethinking product and business strategy based on levels of capital requirements (67%)
- Influence on IPS and ALM (25%)
- Changes in intercompany lending culture (17%)
- Stricter reinsurance terms and reinsurer involvement in pricing (8%)
- Increased supervision and scrutiny from the regulator (8%)

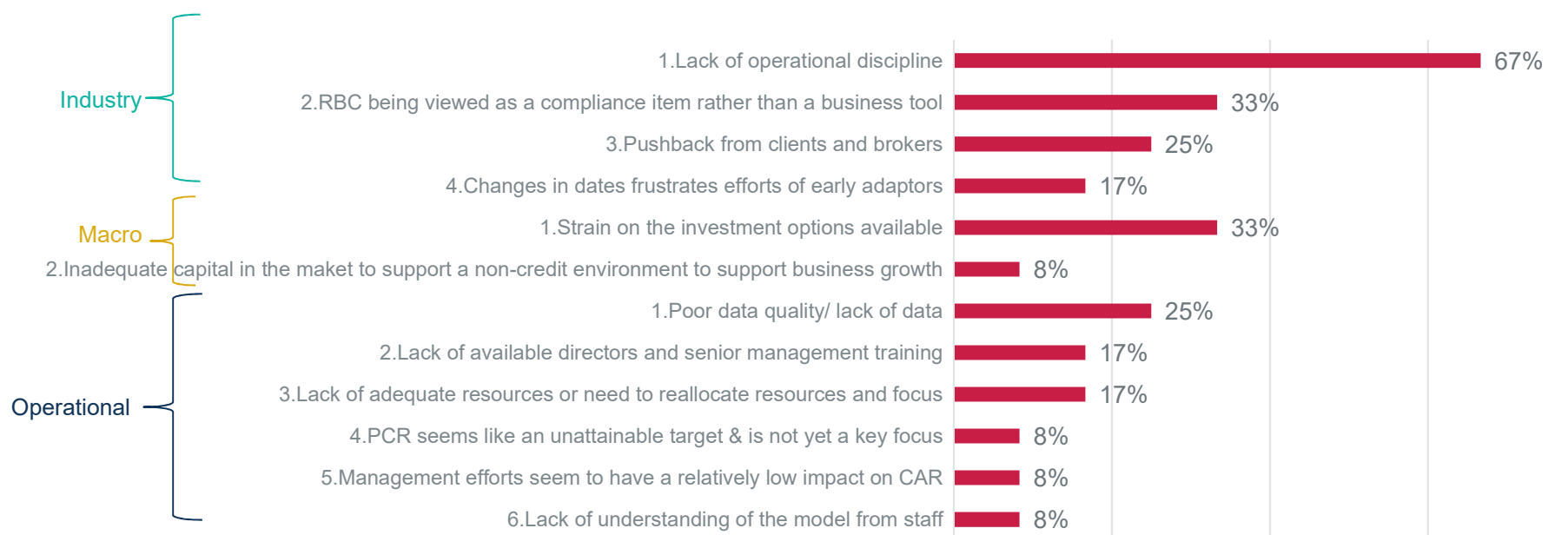
## Negative

- Apprehension especially at the initial stages (25%)
- Increased costs of running business (17%)
- Challenges in business acquisition through imposing cash and carry (8%)
- Change in the view of stability of the organisation where solvency was adequate in the previous regime (8%)

## Changes resulting from RBC / RBS



# Key challenges encountered



# Key challenges encountered





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## Next Steps for RBS

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## How can the industry be strategic in its efforts

- Views from some practitioners... (small panel discussion)
- Collaboration between stakeholders
- Ongoing QIS
  - Focus on parameterization and business response to key gaps and potential threats

# Questions

# Comments

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