



Singapore
Actuarial
Society

The SAS response to the: Consultation Paper on Enterprise Risk Management

25th February 2013

Agenda



- Background and Scope
 - Responses by Proposal
 - Next Steps
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- Note: All Participants are expected to have read the proposed response paper and have it with them to refer to.

Background & Scope

- The ERM Committee, on behalf of the SAS, conducted a meeting on 6 February to review the ERM Consultation Paper and provided our responses

General Comments

- MAS has issued a number of CPs in the last few weeks. These CPs are interconnected and we should not look at each CP in isolation
- The MAS CPs/guidelines align closely with the IAIS requirements. Different CPs address different aspects of the IAIS requirements and each with its own tight timeline of implementation (within the next 2 years). In totality, the full requirements that insurers need to abide can be very burdensome

Background & Scope

General Comments specifically to ERM CP

- The emphasis on documentation and onerous reporting requirements with very tight timeline could be perceived by company Senior Management and the Board of Directors as merely a compliance exercise
- This is counter intuitive as the purpose of the MAS issuing the ERM guidelines would be to raise the risk awareness and improve the ERM culture for the whole insurance industry, not ticking-the-box exercise
- The value of ERM will be diminished as long as it is perceived as a compliance exercise
- Communication on risk information should be enhanced but it does not necessarily mean more onerous reporting requirements

Proposal 1

- **ERM requirements to all registered insurers, except captive insurers and marine mutual insurers.**
- The consideration of whether to include an insurer in the scope of ERM requirements should be based on the concept of proportionality and materiality, but this proposal does not address this
- It is still important for captives and marine mutual insurers to have sound ERM framework and internal control measures. For example, if a captive runs into trouble due to poor internal controls, it will affect its parent company as well
- Captive insurers – they “*underwrite in-house risks*”. How about open captives who also write outside risks?
- Marine mutual insurers – they “*underwrite risks belonging to members of their association*”. If so, should Lloyd’s syndicates be included as well? (Note also that mutual insurers are not excluded from Solvency II regime)
- Are there other regulations/guidelines governing captive insurers and marine mutual insurers separately?
- Would excluding certain insurers in the ERM scope change the competitiveness and level playing field of the insurance industry?

Proposal 2

- **MAS allows insurer to rely on its group's ERM framework to meet the ERM requirements, subject to insurer's own assessment of the relevance of the risk identified and techniques employed to measure the risks.**
- No comments

Proposal 3

- **MAS proposes to require each insurer to establish ERM framework to provide for identification and quantification of risks under a sufficiently wide range of outcomes, using techniques appropriate to nature, scale and complexity of the risks and are adequate for risk and capital management, and for solvency purposes. Such risks include insurance, market, credit, operational, liquidity and group risks. ERM framework shall be supported by accurate documentation.**
- To quantify correlation and interdependencies of risk categories would be challenging for many insurers.
- More guidance on what MAS means by ‘sufficient ‘ range of outcomes (e.g. Solvency II scenarios?) as well as the ‘techniques’ for identification and quantification
- Not all risks are quantifiable.
- How do we assess group risk? It is not practical to assess every aspect of group risk outlined in page 16 of the CP.
- To propose that risks to be quantified only to the extent possible and practical. Risks that are not quantifiable, they should be assessed qualitatively.
- To include model risk in scope.
- Under section 3.8, requirements on documentation should be proportional to the nature, scale and complexity of the risks concerned (i.e. to address only material risks).
- The linkage between ERM framework and RBC2 framework is unclear.

Proposal 4

- **MAS proposes to establish and maintain a risk tolerance statement which sets out its overall quantitative and qualitative risk tolerance limits, taking into account its financial strength and long term business goals.**
- Consistency of definition / terms used, e.g. Is risk tolerance statement same as risk appetite statement?
- Terms used in the CPs should be clearly defined. (e.g. “risk tolerance limits” was not defined).

Proposal 5

- **Requirement on risk management policy, including underwriting and investment risks; risk retention, risk management strategies including reinsurance and use of derivatives, diversification and ALM; processes and methods for monitoring risk; relationship with risk tolerance limits, capital management and corporate objective and strategy.**
- What is the difference between 5(a) and 5(b)?
- The risk management policy should also cover the risk management framework and structure.

Proposal 6

- **A quarterly review of the ERM framework to ensure responsiveness to changes in risk profile, including mechanisms to incorporate new risks and new information on regular basis. There should be in place a feedback loop to ensure insurer monitor and respond in a timely manner to changes in risk profile.**
- ERM framework should not change frequently, so need not be reviewed on quarterly basis
- Instead, we propose quarterly review of material risks and significant changes in risk profile through Risk Management Committees

Proposal 7

- **MAS proposes each insurer to perform its ORSA annually. When undertaking its ORSA, each insurer will be required to document the rationale of the decisions, considerations and assumptions made; calculations related to its decisions; and action plans arising from its ORSA. ORSA should identify relationship between risk management and the level, quality and availability of financial resources.**
- OK with annual ORSA
- However, it is unclear how annual ORSA ties in with once-in-three years reporting for tier 2 companies.
- If insurers have already providing their local ORSA for their group submission, can the same report be used for MAS submission?

Proposal 8

- **MAS proposes to require each insurer, as part of ORSA, to determine overall financial resources to manage its business; base actions on consideration of economic capital, regulatory capital requirements and financial resources; assess quality and adequacy of capital resources to meet regulatory and EC requirements.**
- Economic Capital is possibly the best measures of measuring/ managing risk and capital, and it is something organizations should be working towards.
- However, EC should not be made mandatory for all insurers (see Proposal 9), given other priorities of ERM in the near term.
- We propose to review EC as mandatory requirements only in later stage, perhaps to align with next phase of internal model proposal in RBC2.
- If economic capital is not mandatory, the wording of Proposal 8 will need to change accordingly
- Clarify whether “regulatory capital requirements” refers to MCR or PCR under the RBC2 framework

Proposal 9

- **Allow insurers to adopt a simplified approach to economic capital calculations based on nature, scale and complexity of their business and risks. The reasons should be clearly articulated and justified in ORSA.**
- Does this mean that the calculation of EC for insurers become mandatory?
 - Not all companies have the resources to invest in an economic capital model (ECM), even if it is a simplified one
 - Companies may not have the resources to monitor and maintain an ECM
 - Using an (over-)simplified ECM may not reflect the correct risk profile of the insurer
- Also, we should focus on other important aspects of ERM (e.g., clear articulation of risk appetite, tolerances, and building an understanding of risk within the organization) which can add more value in the near term than building ECMs.
- For smaller companies, the cost of investing in capital modeling could be prohibitive compared to the benefits they stand to reap.
- The SAS is of the view that economic capital should not be mandatory for all insurers.
- What about reliance of other form of capital model (e.g., S&P capital model)?

Proposal 10

- **MAS proposes to require, as part of continuity analysis, to identify likely causes that may result in its business failure through the use of reverse stress testing and take necessary actions to manage this risk.**
 - **“Business failure” means (a) solvency position failing below requirement; (b) capital position below any internal target; or (c) insurer being wound up.**
 - **Insurers shall maintain contingency plans and procedures for use in a going concern or winding-up situation.**
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- Has “internal target” become a mandatory requirement?
 - Definition of “business failure”: Failing internal target does not necessarily mean business failure. It merely means a red flag. You can’t possibly breach (a) & (c) before (b), which makes (b) redundant.
 - Reverse stress testing – is this a generally understood concept, with techniques which are applied in a fairly consistent manner by all actuaries undertaking it?
 - Dual reporting requirements for stress testing?
 - Who should be signing off the 2 separate reports – actuary or CRO?

Proposal 11

- **MAS proposes to require Tier 1 insurer to submit its latest ORSA report, together with minutes of Board's approval, on annual basis. First report to be submitted by 30 Apr 2014 and annually thereafter. For Tier 2 insurer, first report to be submitted by 30 Apr 2015 and by 30 Apr of every third year thereafter (next report by 30 Apr 2018).**
- The requirements for Tier 1 is more onerous and with tighter deadline. Will this affect the level playing field in the industry?
- Does the ORSA report also need external auditor's opinion and sign off?
- Tier 2 companies have to perform ORSA annually (as in Proposal 7) but only require to submit an ORSA report every 3 years. Do Tier 2 companies need to write an ORSA report annually?

Proposal 12

- **MAS proposes to require insurance groups to submit a Group ORSA on an annual basis. Deliberation of the Group ORSA report is required by the Board in control of the insurance group.**
- Dual ORSA reporting requirements for insurance groups, and with same timeline for submission. Can companies combine the two into one report?
- Definition of Group: Does Group mean insurers with ultimate parent companies based in Singapore? What about sub-groups (i.e. companies with regional office based in Singapore but with Head Office located outside Singapore)?
- There seems to be inconsistent use of the word 'group' within the CP.

Proposals 13

- **MAS proposes to issue a new Notice on ERM and implement the requirements from 1 Jan 2014.**
- Tight timeline of implementation
- ERM framework and risk culture takes time to build in each company
- The SAS is of the view that it is fine for the requirements to come into effect on 1 Jan 2014 so long as the first reports are due later than currently proposed.
- The SAS proposes that the ERM timeline should align with RBC2 implementation timeline

Additional comments

Part I – Mandatory Requirements

Qualitative requirements which have been included as mandatory requirements:

- 19. “Accurate documentation”
- 23. “Clearly address the relationship”
- 24. “Policy is clearly defined and understood”
- 28. “Clear guidance”
- 31. “Reliable information”
- 32. “Good quality information”
- 42. “Relevant actions the insurer could realistically take”

This is language more appropriate in a Guideline than in legislation, which is what a Notice is and it is possible for an insurer to be sanctioned on a matter of interpretation. These subjective elements should be taken out of the Mandatory Requirements. They may be included and elaborated in the Non-Mandatory Standards, and insurers may be supervised based on these standards.

Additional comments

Part II – Non-Mandatory Requirements

Paragraph 67

- The term “**internal models**” makes a sudden appearance in this paragraph, undefined and without reference to any other legislation (e.g. it may be defined in the revised Valuation and Capital Regulations to be promulgated after the RBC2 Review).

Next steps

- The consolidated recommendations and actions proposed will be posted on the SAS website, and submitted to MAS by end Feb.
- ERM Committee has set up some working parties (WP):
 - Operational risk WP - *chaired by Julien Parasie*
 - Diversification benefits WP - *chaired by Jim Qin*
 - ORSA WP (new) - *chaired by Raymond Cheung*
- We are **CALLING for VOLUNTEERS** to join these WPs. Please call us if you need more information. We need your support!!

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