New Financial Regulations for Insurance and Takaful Insurance Companies - An Overview

Milliman Academy Workshop

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20th May 2015

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AGENDA

Overview of the new Financial Regulations

Investment & Asset Valuation Requirements

Solvency Requirement

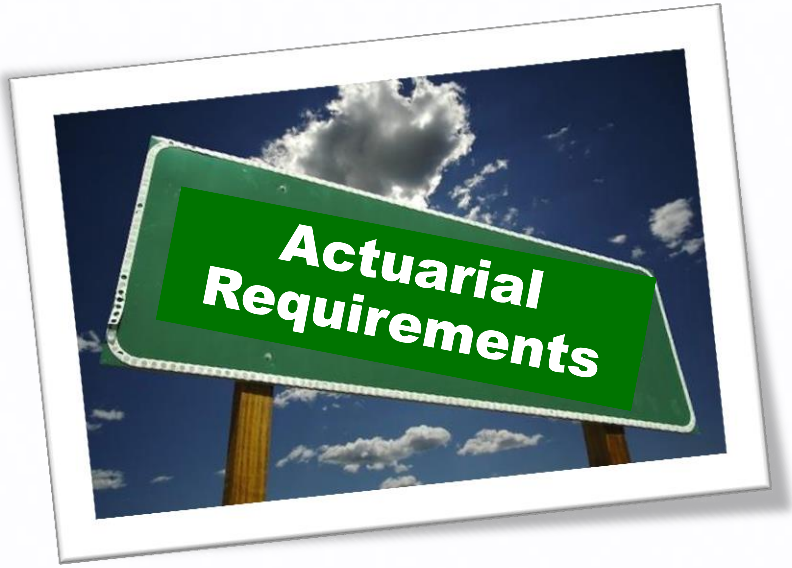
Technical Provision Requirements

Impact of new UAE Regulations on Companies ERM

Financial Regulations: A Legal Perspective

Open Discussions and Q&A

Closing Remarks



BROAD OVERVIEW OF THE NEW FINANCIAL REGULATIONS

Broad Overview

The regulation framework in its entirety puts in place all the critical components for a **full risk based approach to regulation**, whilst at the same time focusing on improving the self-regulation of each company by requiring internal risk management practices and procedures.

Some of the key components of the new regulations include, but are not limited to:

- Several of the requirements of the new regulations are actuarial in nature. In many cases, certification by an actuary is a stated requirement of the regulations, while in others, the skills, knowledge and understanding of an actuary would greatly benefit the company in complying with the requirements.

- Use of International Financial Reporting Standards (IFRS) to bring the UAE in line with global accounting standards;

Broad Overview

- Improved data reporting standards using a comprehensive financial reporting tool able to expand the data required in key areas. This should improve the quality of data available and facilitate its use, thereby giving companies better understanding and risk based regulatory oversight of their operations;

- Broad investment risk management categories to manage investment risks such as diversification, concentration, counterparty, market, interest rate risks, matching with liability profile while allowing companies to maximize their returns for all stakeholders (i.e., policyholders, participants and shareholders) and carrying out strategic asset allocation and encouraging maximum investments within the UAE;

- Strong Board of Directors level of involvement in all areas of risk management;

- Significant focus on development of industry technical skills by requiring actuaries to be involved in all key areas of financial reporting (including reserving and solvency assessments), pricing, reinsurance, investment models and risk management;

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Broad Overview

- Full transparency of financial results, with strong requirements for adequate technical provisions;
- Consistent approach for both conventional companies and Takaful operators, while recognizing the necessity for Takaful operators to also comply with Shari'a law;
- Improved communication between Company management, the Board of Directors and the IA using new or strengthened reports on Investment Risk Analysis, Technical Provision Analysis, Financial Condition, etc.
- Emphasis on solvency of all companies, building on the Minimum Capital Requirement established in the Law by adding a Solvency Capital Requirement and a Minimum Guarantee Fund which is broadly based on the principles of Solvency II (in Europe) and Risk Based Capital (in the USA)

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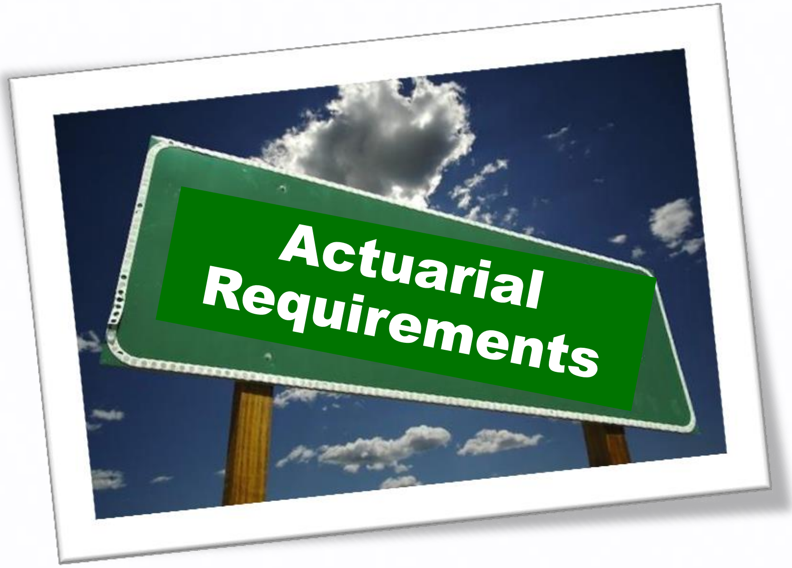

ACTUARIAL OVERVIEW OF THE NEW FINANCIAL REGULATIONS

Overview of Actuarial Aspects

- Basis of Investing the Rights of Policyholders
- Solvency Margin and Minimum Guaranteed Fund
- Basis of Calculating the Technical Provisions
- Determining the Company’s Asset Valuation
- Organizing and Maintaining Records
- Accounting Books and Records
- Financial Reporting

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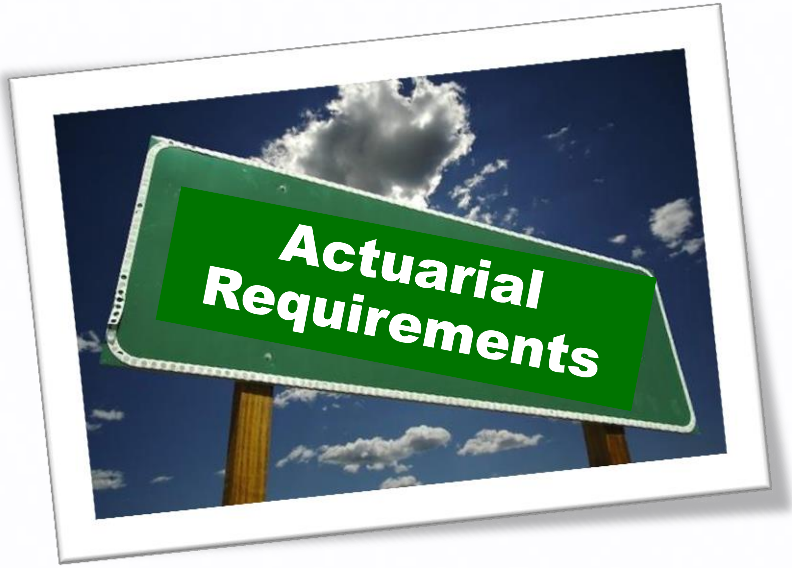

INVESTMENT REQUIREMENTS

Requirement 1: Basis of Investing the Rights of Policyholders

- Improve asset profile of Insurers by reducing exposures to high risk assets – Stable profile & lower volatility

- Rules allow for flexibility with a risk management framework
  - Up to 50% outside UAE with appropriate sovereign rating.
  - But maintain investments equivalent to UAE technical provisions within UAE
  - Technical provisions on UAE policies based on Gross UPR & Net OSLR/IBNR intended to encourage investment of premiums inside UAE
  - No **requirements** to sell invested assets

- Annual risk analysis report with risk appetite set by the board.

- Separate strategy for Life and Non-Life Business.

- Appropriate procedures to monitor adherence to asset limits and exposures.

- ALM to reflect nature and duration of the insurance and reinsurance liabilities.

- Mark-to-Market OR Mark-to-Model valuations

Admissible Asset Criteria

Type of Invested Asset	Maximum Limit for aggregate exposure in a particular asset class	Sub-limit for exposure to a single counter-party
Real Estate	30%	No Sub Limit
Equity instruments in listed and not listed companies within UAE.	30%	10%
Equity instruments issued by companies listed and not listed outside UAE.	20%	10%
Government securities/instruments issued by the UAE and/or by one of the Emirates in the UAE.	100%	25%
Government securities/instruments issued by (A) rated countries.	80%	25%
Cash and deposits with Banks in the UAE (e.g. current account, demand deposits, term deposits, notice deposits, certificates of deposit, etc.)	Minimum 5%	50%
Loans secured by life policies (excluding unit-linked funds' related policies) issued by the Company.	30%	No Sub Limit
Derivatives or complex financial instruments to be used for hedging purposes only.	1%	No Sub Limit
Secured loans, deposits with non-banks, debentures, bonds & other debt instruments which are rated strong or very strong by reputed and independent rating agency.	30%	20%
Other Invested Assets	10%	No Sub Limit

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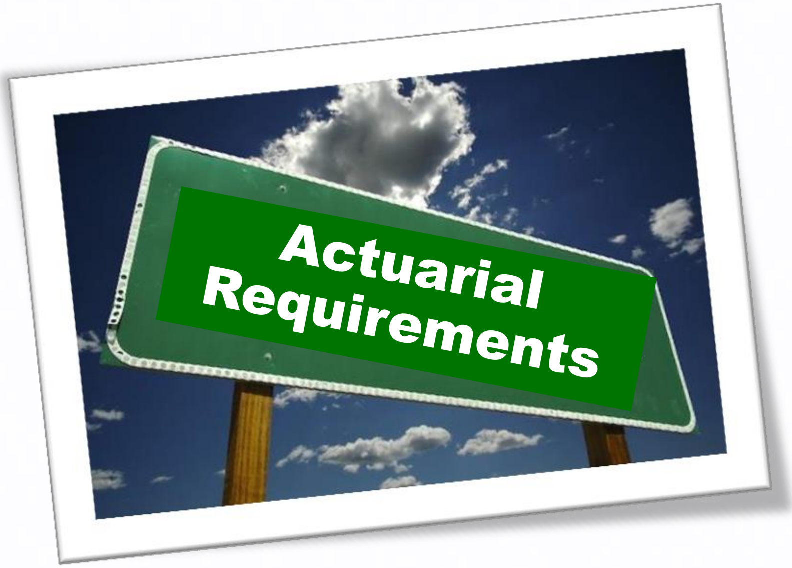
Requirement 1: Investment Risk Analysis Report

Overview:

- The Company shall submit to the Authority an annual risk analysis report which is certified by the Actuary. The report must cover:
  - A summary of the overall investment strategy
  - An analysis of the investment portfolio
  - Analysis of the Market and Liquidity (Investment) Risk and Credit Risk, including scenario / stress testing
- The Company shall also submit a quarterly report; it does not need to be certified by the Actuary.
- When ‘mark-to-market’ is not possible, the Company must use ‘mark-to-model’ to measure the value of investments. If the model used is developed by the Company, that model must be certified by the Actuary.



SOLVENCY REQUIREMENTS

Requirement 2: Solvency Template Certification

<u>Overview:</u>

- The Company shall submit to the Authority the solvency template and related information on an annual basis in relation to solvency, including the validation certification of the solvency template by the Actuary and External Auditor and endorsed by the Chairman of the BoD.
- The Company shall submit to the Authority a report regarding the Solvency Capital Requirement certified by the Actuary on a quarterly basis, within a period of (45) days from the quarter end.
- The solvency template, developed by the Insurance Authority, will cover Underwriting Risk, Market and Liquidity (Investment) Risk, Credit Risk, and Operational Risk.

Solvency Requirements

- Solvency Template (3 solvency "triggers")
  - MCR – fixed floor based on the Law
  - MGF – risk based minimum based on RBC / Solvency I
  - SCR – risk based minimum based on Solvency II
  - MGF & SCR are key risk based measures which can be lower or much higher than MCR
  - Expect the solvency calculations to evolve

Solvency Requirements
Evolution of the Solvency "Triggers"

**New Company
(Start Up)**

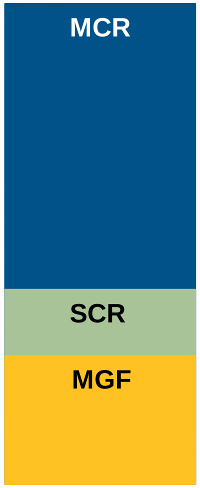
MCR – Company needs more than minimum for start up in order to sustain operations while investment in systems & operations precedes premiums (drain on Own Funds)

MGF – Based on minimum amounts by type of business (need capital even for 1 policy)

SCR – Until premiums, technical provisions, investments grow, capital requirement is low

Solvency Requirements
Evolution of the Solvency "Triggers"

Young Company (1-2 Years Old)



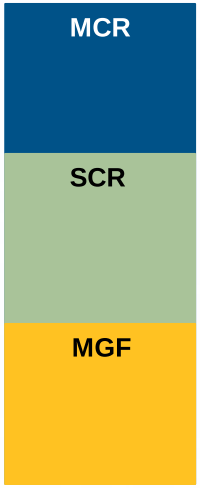
MCR – Company needs more than minimum for start up in order to sustain operations while investment in systems & operations precedes premiums (drain on Own Funds)

SCR – As premiums, technical provisions, investments, etc. grow, capital requirement will overtake MGF

MGF – As premiums & technical provisions grow, capital requirements by type will exceed minimum amounts

Solvency Requirements
Evolution of the Solvency "Triggers"

**Growing Company
(3-5 Years Old)**



MCR – Investment in systems & operations should no longer be a drain on Own Funds

SCR – As premiums, technical provisions, investments, etc. grow, capital requirement will continue to grow with them

MGF – As premiums & technical provisions grow, capital requirements continue to grow

Solvency Requirements
Evolution of the Solvency "Triggers"

Maturing Company (6-10 Years Old)

SCR – As premiums, technical provisions, investments, etc. grow, capital requirement will eventually exceed MCR

MCR – Will never change

MGF – As premiums & technical provisions grow, capital requirements continue to grow, but at a slower pace than SCR

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Solvency Requirements
Evolution of the Solvency "Triggers"

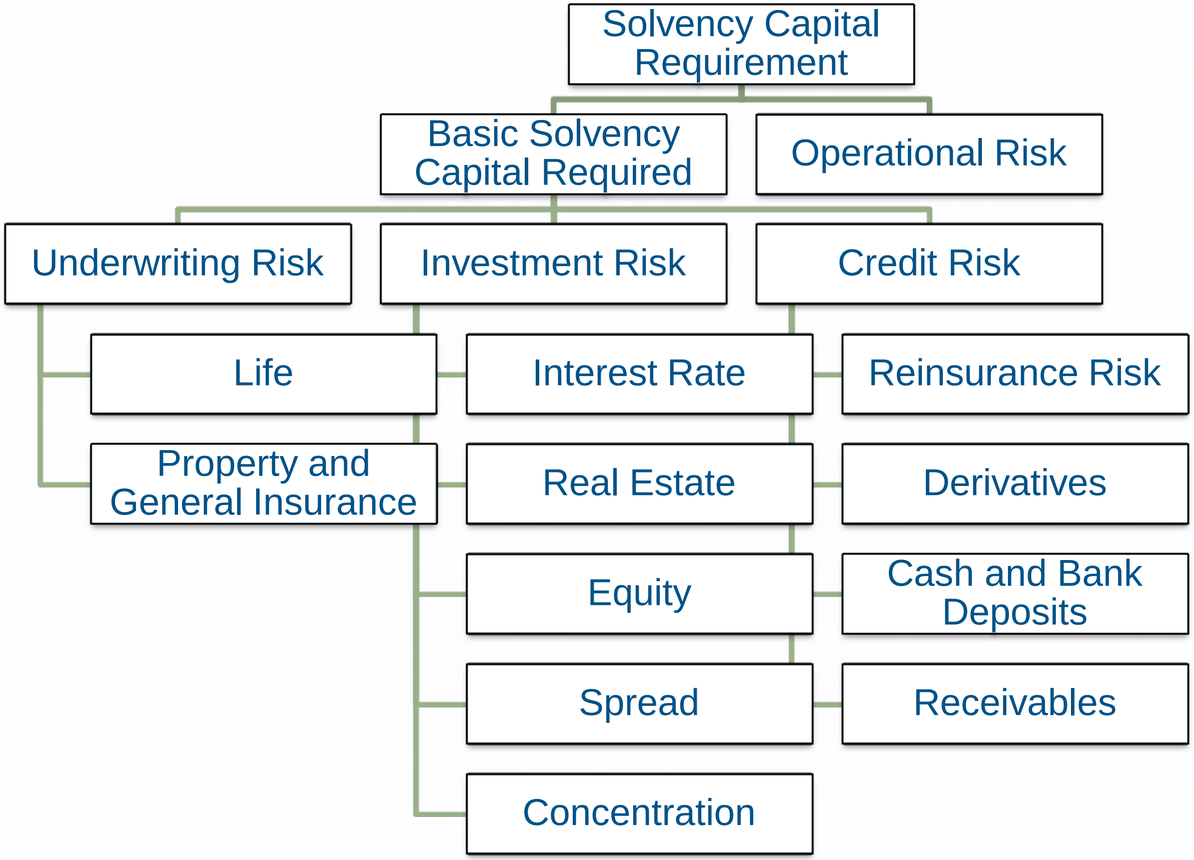
Leading Company (10+ Years Old)

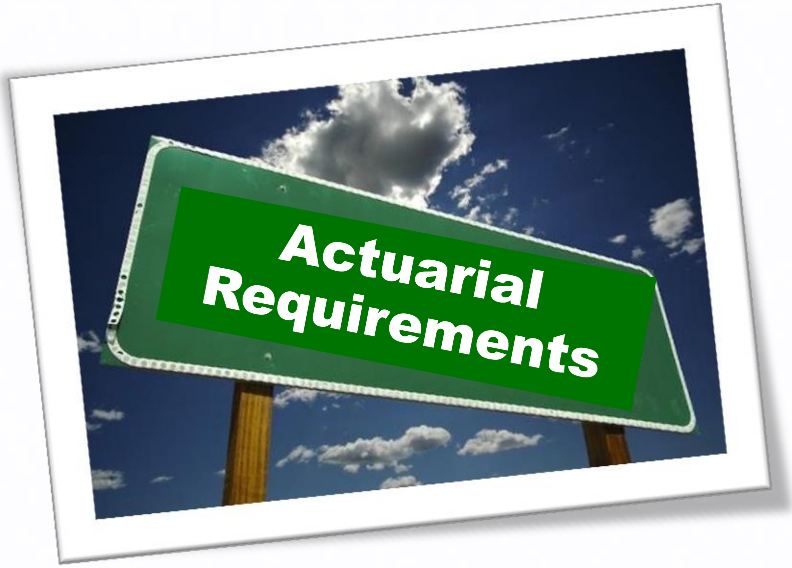
SCR – For market leaders SCR can significantly exceed MCR

MGF – Can never be less than 1/3 of SCR

MCR – Will never change

Diagrammatic Explanation of Solvency





RESERVING REQUIREMENTS

Requirement 3: Valuation of Technical Provisions

Overview:

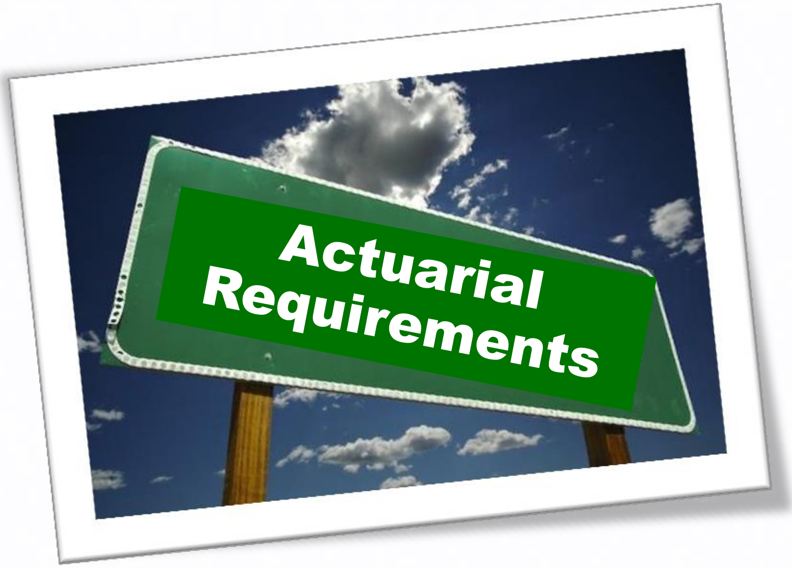
- The Board of Directors shall appoint an Actuary who is registered by the Authority. The Actuary shall review and approve the Company's Technical Provisions, both gross and net of reinsurance.
- The Company shall report quarterly to the Authority the details of the Technical Provisions which is certified by the Actuary. The end of year report must be authenticated by the External Auditor and endorsed by the Chairman of the Board of Directors.
- The Actuary shall provide the Insurance Authority with an annual report that presents the immediate or future risks facing the Company. The report must be reviewed by an External Auditor.
- The regulations discuss specific aspects of the valuation process, including the review of data, the methodology applied, the estimation of trends, and tests of credibility.
- The Actuary's report on the estimation of reserves should cover the following (at a minimum): Company Overview, Data, Methodology, Back-Testing, Results, Certification.

Required Technical Provisions

- Unearned Premium Reserve (UPR)
- Unexpired Risk Reserves (URR)
- Outstanding Loss Reserves (OSLR)
- Incurred But Not Reported Reserves (IBNR)
- ALAE & ULAE
- Mathematical Reserves
- Claim Development in eForms will monitor quality of technical provisions over time

Calculation of Technical Provisions Mathematical Reserves (Life)

- **Calculation of the Mathematical Reserve**
  - The valuation method shall take into account all prospective contingencies under which any premiums (by the policyholder) or benefits (to the policyholder/beneficiary) may be payable under the policy, as determined by the policy conditions. The level of benefits takes into account the **reasonable expectations of policyholders** (with regard to bonuses, including terminal bonuses, if any) and any established practices of the Company for payment of benefits.
  - The Actuary shall not make allowance for any future lapse, surrender, making paid up or revival of a contract where such an allowance would result in a decrease in the liability in respect of that contract.
  - **Explicit allowance for future expenses** is required for all contracts under which no future premiums are receivable where these are not provided by disclosed margins in the valuation rate of interest.
  - Where a net premium method is used it is permissible to take credit for the difference between the gross premium and the valuation net premium in assessing the provision to be made for meeting the expenses likely to be incurred in the future in fulfilling the existing contracts, but only to the extent allowed by global actuarial standards.
  - Sensitivity to assumptions used should be provided.



DETERMINING THE COMPANY'S ASSET VALUATION REQUIREMENTS

Requirement 4: Asset Valuation Requirements

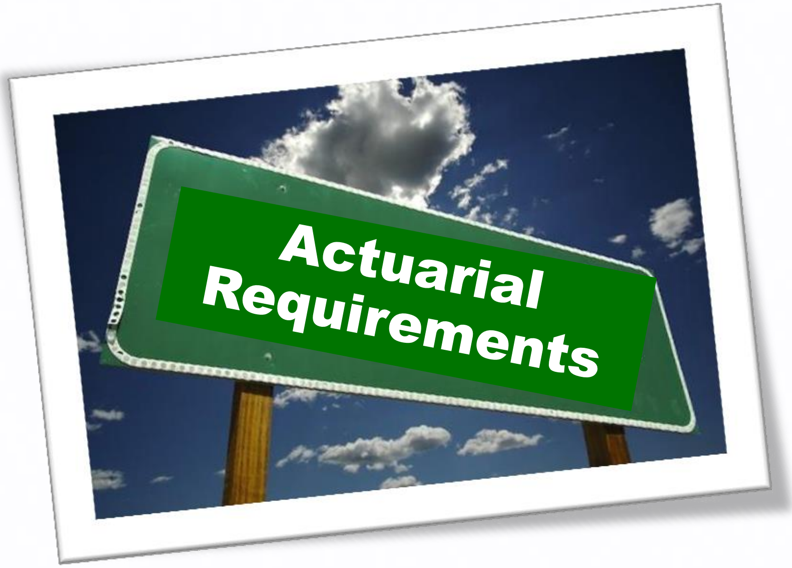
- **Asset invested in accordance with the ‘prudent person principle’.**

- **Assets covering SCR, MCR & MGF shall be invested to ensure security, quality, liquidity & profitability.**

- **Investment linked Life products where policyholder bears the risk:**
  - Technical reserves closely represent the units Or assets
  - Guarantees adequately provisioned.

- **Prescribed approach to valuing assets (Real Estate , Securities, Equities ,Derivatives, Others) for the purposes of calculating solvency margins**

- **Admissible Asset “penalties” for:**
  - Investments outside of limits (guidelines)
  - Reinsurance Receivable > 90 days past due
  - Reinsurance Recoverable < A rated
  - Insurance Receivables > 90 days past due
  - Salvage & Subrogation > 90 days past due



RISK MANAGEMENT REQUIREMENTS -1

Risk Management Requirements

- **Organizing and Maintaining Records -Data and Documentation**

➢ Report concerns regarding any material failures
➢ Company must waive confidentiality
➢ Insurance Authority can order examination by external Actuary
➢ Must maintain files for 10 years

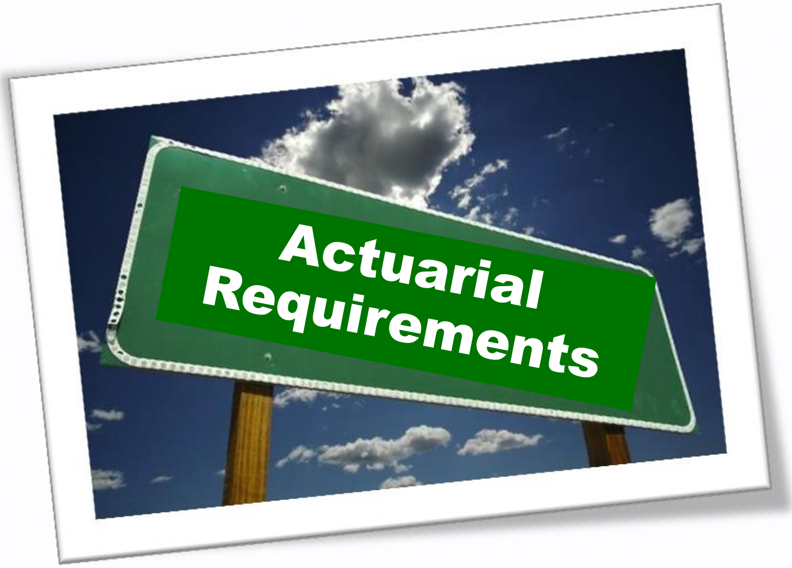
- **Accounting Books and Records**

➢ Role of internal auditor defined
➢ IFRS Standards

Requirement 5&6 : Risk Management

Overview:

- The Actuary shall, in the presence of immediate or future risks facing the Company that would hinder the Company from fulfilling its short term and long term liabilities, submit a report on a timely basis directly to the Company's Board of Directors.



RISK MANAGEMENT REQUIREMENTS – 2
FINANCIAL REPORTING

Requirement 7: Financial Forms

<u>Overview:</u>

- The company is required to complete, on a quarterly basis, extensive financial forms currently being redesigned by the Insurance Authority. These forms cover the standard financial statements, as well as analysis of solvency, investments, premiums, expenses, reinsurance, etc.

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Benefits of the New Financial Reporting Forms

- **Risk Management** – There is a wealth of useful information to help management understand and manage risk
- **Technical Provisions** – Details of technical provisions to help understand current and future profitability
- **Expense Management** – Detailed expense breakdown for improved expense management
- **Business Management** – New type of business details allow for common types of insurance products (e.g., Motor vs. Medical) to be reviewed and managed more effectively
- **Capital Management** – Automatic calculation of SCR, MGF and Admissible Equity for timely capital management and transparency of risk issues which drive capital requirements
- **Transparency** – Use of current international accounting standards (IFRS) will make reported results more transparent and comparable to competitors
- **Risk Transfer** – Details for Direct, Assumed, Ceded, Gross and Net of Reinsurance will help companies analyze quality and effectiveness of their risk transfer programs

Benefits of the New Financial Reporting Forms

- **Bilingual** – Easily convert between Arabic & English
- **Quarterly Focus** – Allows for automatic calculation of year to date and rolling 4 quarter results and annual change
- **Data Quality** – Data integrity checks to improve overall industry data quality (Not available yet in current Beta release)
- **Management Dashboard** – A summary of key ratios and statistics will help both company management and the IA to quickly review results and trends in results over time (Not available yet in current Beta release)
- **Data Automation** – The forms are designed to be converted into a database which will speed updates for companies, comparisons and analysis of results for the industry (future enhancement)

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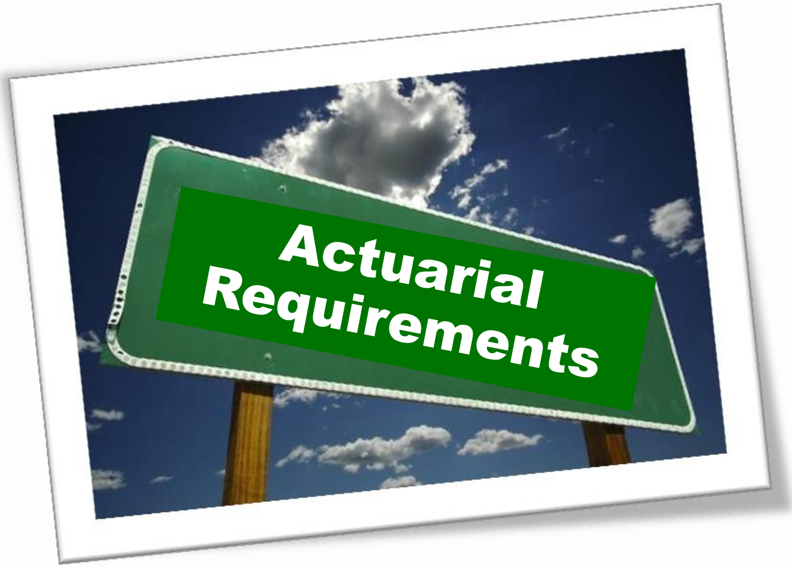

FINANCIAL CONDITION REPORT

Requirement 5: Financial Condition Report

Overview:

- When required by the Authority, the Company shall submit to the Authority a **Financial Condition Report (FCR) which is certified by the Actuary** and endorsed by the Chairman of the Board of Directors. The requirements of the FCR should include, but is not limited to:
  a) An actuarial certification of the Technical Provisions
  b) A risk-based analysis of the investment portfolio, strategy and management process;
  c) An analysis of the Solvency Capital Requirement
  d) Evaluation of its reinsurance structure and management process
  e) A risk-based analysis of the underwriting policies and procedures of the Company
  f) Evaluation of the pricing policies and procedures of the Company
  g) Evaluation of the Enterprise Risk Management policies and procedures

Actuarial role in all functions!

Actuaries are required in all functions within a insurer's risk management framework

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Takaful Regulations - Overview

- Mirror reflection of the conventional regulations in most areas
- Segregation of participants funds from shareholder asset
- Shareholders and Participants Risk Fund combined used for SCR
- The entire shareholders fund is available to provide Qard.
- Qard write-off in 3 years
- Assets earmarked for Qard must be accounted for separately and valued in accordance with Asset Valuation instructions.
- The right to recoup Qard is not an asset for the purposes of the Shareholder Fund.
- Qard is to be treated as receivable and considered in calculation of SCR / MGF as an unsecured and uncovered loan.
- Need for Shariah Compliance in all aspects (Investments, Sharia Committee/Controller)
- Wakala/Mudaraba Models Accepted
- Maximum Wakala Fees of 35% of GWP
- Shareholders fund is to bear all operational, administrative and general expenses for the business.
- A policy for determining the surplus / deficit must comply with AAOIFI standards and be approved by the Shari'a committee

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