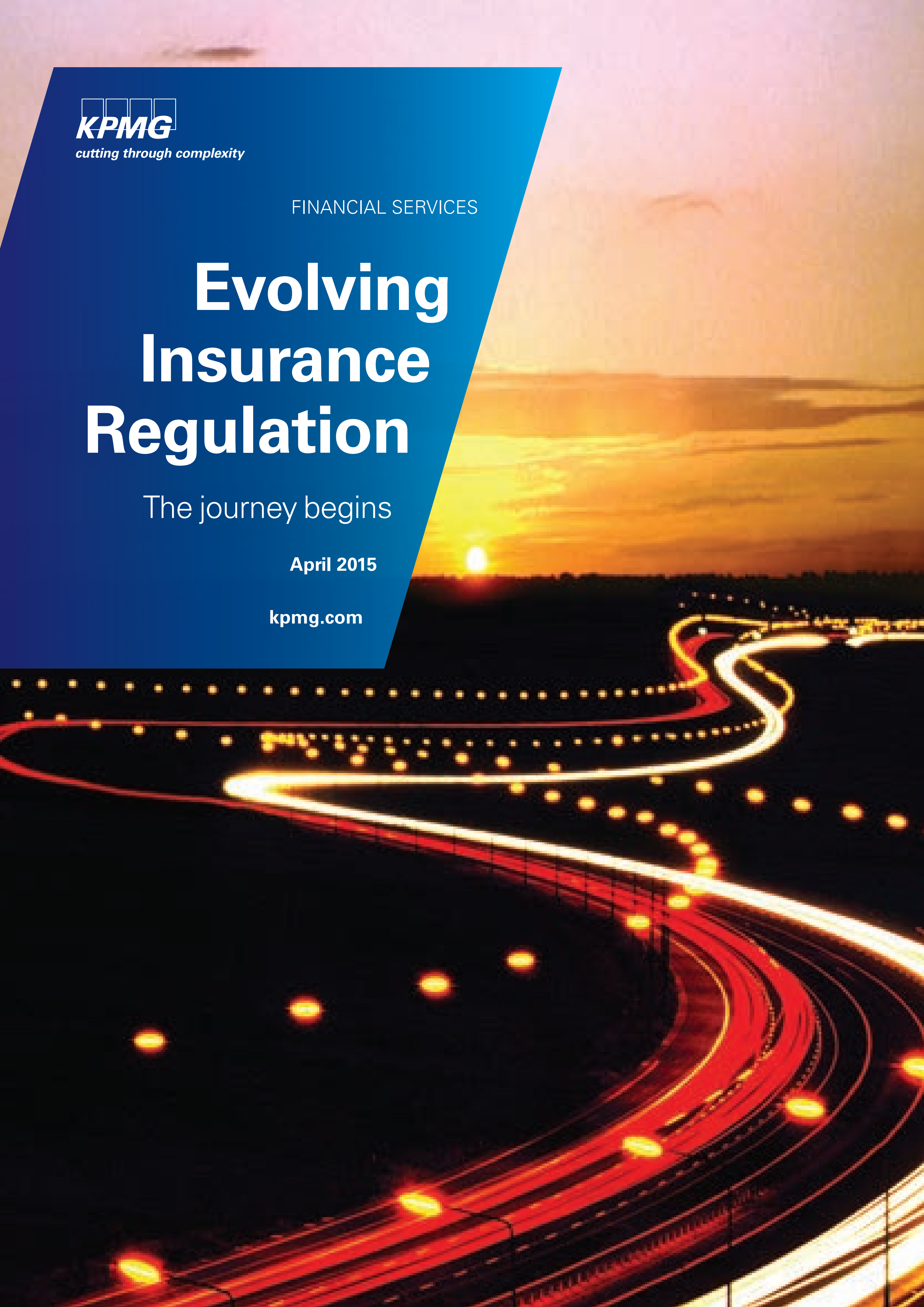
FINANCIAL SERVICES

Evolving Insurance Regulation

The journey begins

April 2015

kpmg.com



ABOUT THIS REPORT

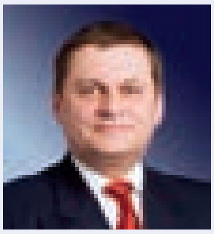
This report is part of a regional series developed by KPMG's network of regulatory experts. The insights are based on discussion with our member firms' clients, our professionals' assessment of key regulatory developments and through our links with policy bodies in each region.

For other regional reports, please contact fsregulation@kpmg.co.uk or see www.kpmg.com/regulatorychallenges

GLOBAL INSURANCE LEADERSHIP TEAM

Gary Reader
Global Head of Insurance and EMA region Coordinating Partner
KPMG in the UK

Laura Hay
Americas region Coordinating Insurance Partner
KPMG in the US



Simon Donowho
ASPAC region Coordinating Insurance Partner
KPMG in China

Frank Pfaffenzeller
Joint Global Insurance Audit Lead
Partner
KPMG in Germany

Frank Ellenbürger
Joint Global Insurance Audit Lead
Partner
KPMG in Germany

Brian Daly
Global Insurance Tax Lead
Partner
KPMG in Ireland

Ferdia Byrne
Global Insurance Actuarial Lead
Partner
KPMG in the UK

Rob Curtis
Global Insurance Regulatory Lead
Executive Director
KPMG in Australia

Mary Trussell
Global Innovation and Emerging Markets Lead
Partner
KPMG in Canada

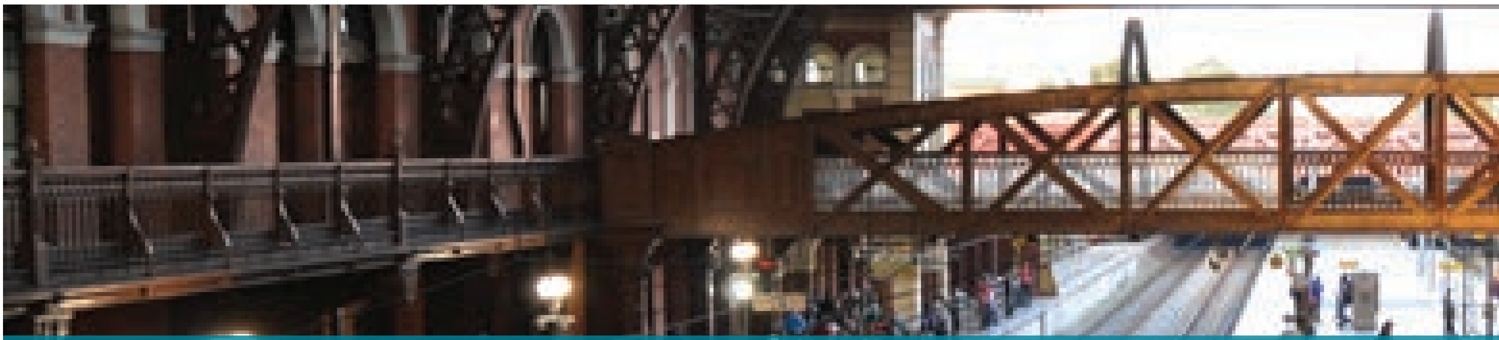
Sam Evans
Global Insurance Deal Advisory Lead
Partner
KPMG in the UK

Mike Walker
Global Insurance Restructuring Lead
Deal Advisory
KPMG in the UK

Mark Longworth
Global Insurance Management Consulting Lead
Partner
KPMG in the UK

Matt Mccorry
Global Insurance Risk Consulting Lead
Partner
KPMG in the US

"2015 is seeing international developments dominate regulatory change in the insurance industry. By being proactive and engaged in these fast-moving and important developments, insurers can meet the challenges and stay ahead of the game."



Foreword

Jeremy Anderson
Chairman KPMG's Global Financial Services practice

Gary Reader
Global Head of KPMG's Insurance practice

Welcome to the fifth edition of Evolving Insurance Regulation. We have been reporting for a number of years on how insurance regulation continues to evolve, with ongoing regulatory developments – particularly at the global level and the impact such changes will have for insurers. However, the recent (December 2014) release by the International Association of Insurance Supervisors of its consultation paper on the proposed new global insurance capital standard, the implementation of Solvency II, and the expected completion of IFRS 4 Phase 2 potentially mark the birth of a new era in global insurance regulation.

Given the importance of these developments to the international community, we have explored the potential implications with leading regulators and chief risk officers from some of the largest global insurance groups this year. We share with you their unique insights, views and perspectives on some of the key challenges and opportunities which exist in the development of a global regulatory framework.

This year we have also expanded our coverage of ongoing developments at regional and local levels as the amount of regulatory change is unprecedented. We consider the cross sectoral influence in the areas of risk management and consumer protection, as well as considering the impact of accounting developments.

At a glance – Global implications for insurers

- Supervisors are increasingly looking beyond the boundary of the regulated insurer to the wider group and holding company operations. New governance, reporting and capital requirements will be enacted around global requirements.
- Systemic concerns are not abating and additional G-SIIs are likely to be named and subject to increasingly intrusive requirements. Expansion of the requirements to domestically significant insurance operations is likely to follow.
- Insurance critical functions are viewed as part of essential services which must be maintained or run down in an orderly fashion. Insurers will need to invest more in resolution and contingency planning as a result.
- Boards must be able to demonstrate that their risk governance procedures, especially in regards to risk culture, permeates all levels of operations, sales and management.
- Conduct regulation will continue to increase and will be expanded to product design, marketing and incentive policies.

The journey begins

The release in December 2014 of the International Association of Insurance Supervisors (IAIS) consultation paper on a risk-based global insurance capital standard (ICS) marks a significant milestone in the journey towards consistency in the assessment of global insurance groups. Unlike banking, the insurance sector does not have a global regulatory framework, resulting in bespoke regulatory requirements in each jurisdiction. While the ICS will only apply to international groups, we have long supported any move to reduce duplication and inconsistency in regulatory requirements. Unfortunately, we are concerned that the ICS, as presently proposed, could just add another layer of complexity and does little to address this issue, since its application is solely at the group level and legal entity regulatory requirements will be unaffected.

Quantitative Capital Requirements

As proposed, the ICS will form part of the quantitative capital requirements that will apply on a group-wide, consolidated basis to around 50 of the largest international insurance groups. The Financial Stability Board (FSB) has provided the IAIS with a mandate to develop the ICS and the IAIS had originally committed to do so by 2018, but has recently announced that the 2018 standard will be an interim standard. The IAIS will continue to work on the ultimate goal of full comparability, but for the moment recognizes that more time is needed to reach that objective.

Prior to this December release, the enhancements in global solvency supervision have primarily been directed at the nine Global Systemically Important Insurers (G-SIIs). To that end, the IAIS consulted on its proposals regarding the Basic Capital Requirement (BCR) in July 2014 (finalized October 2014) and, in September 2014, published the principles for the development of Higher Loss Absorbency (HLA) requirements (consultation on which is now expected mid-2015). These developments arose from the events of the Global Financial Crisis, where the FSB, acting on a mandate from the G20, sought better supervisory outcomes for all systemically important financial institutions and requested the IAIS (as the insurance international standard setter) to develop an appropriate insurance response for the supervision of G-SIIs. We have generally endorsed these recommendations.

Feeling the impact

The ICS, by contrast, will apply to all Internationally Active Insurance Groups (IAIGs) and not just the G-SIIs. Due to its broad application, the ultimate form of the ICS remains worryingly unclear. While the ICS should move the industry one step closer to achieving convergence and establishing clear standards for capital and risk

"As proposed, the ICS will form part of the quantitative capital requirements that will apply on a group-wide, consolidated basis to around 50 of the largest international insurance groups."

"While we have generally endorsed the IAIS' responses to capital and systemic risk, we have also maintained the view that consistency in group supervisory approaches, especially as regards achieving similar outcomes from supervisory colleges, is perhaps even more paramount."

management, it is very likely that further regulatory reform may be required to ensure that it is consistent and results in a framework that can be effectively implemented.

In particular, the practical application of ICS by supervisors will be as important as the requirements themselves. The relationship between the ICS at group level and local regulatory requirements at solo level will be critical. Since the ICS will not apply at a legal entity level, groups will face additional challenges in managing both solo and group requirements. Further, the fact that the standards set a minimum standard will mean that local supervisors must demonstrate that their own groups regime is at least as strong as the ICS or locally headquartered groups will face an additional layer of reporting requirements, coupled with confusion as to which becomes their binding requirement. This overlap raises the very real prospect of inconsistent application of the ICS and divergent group capital standards across geographies, running counter to the IAIS's aim of promoting global convergence, consistency and reduction of capital arbitrage. Such an outcome would be most unfortunate.

The debate continues

Further, insurance groups will want to ensure that inefficiencies and duplication are not inadvertently built into the new requirements. Consideration amongst regulators concerning important issues, such as capital target criteria, time horizon and measurement basis, will be required. We remain active participants in encouraging a mature and engaged debate within the insurance sector regarding these key issues.

Similarly, it will be critically important that the ICS incorporates consistent valuation principles for assets and liabilities and a consistent definition of qualifying capital resources that are meaningful across all markets and which do not create undue balance sheet volatility. The failure of the IASB and FASB to converge on a single accounting standard for insurance has increased the difficulty of this task.

As Solvency II in Europe has demonstrated, achieving significant regulatory reform is often difficult, can involve protracted negotiations and consume extensive resources and costs. This made the deadline for finalization of the ICS by December 2016 appear overly optimistic - especially as detailed and thorough industry participation and involvement is expected, including years of quantitative field testing. We applaud the IAIS for recognizing that a longer timeframe may be required to ensure all stakeholders can effectively address the challenges involved if a single group capital requirement is to be established.

While we have generally endorsed the IAIS' responses to capital and systemic risk, we have also maintained the view that consistency in group supervisory approaches, especially in regards to achieving similar outcomes from supervisory colleges, is perhaps even more important.

Greater consistency still required

A global ICS will require greater consistency in approaches to group supervision. If the IAIS is to achieve its convergence goals, it is likely that regulatory changes to introduce or refine group-wide supervision may be required in some markets. For example, there are significant differences between the US 'windows and walls' approach and the European group supervisory approach under Solvency II. Within Europe, the ICS developments will present an opportunity for a debate on the role of the European Insurance and Occupational Pernsions Authority (EIOPA) in relation to the group-wide supervision of European IAIGs. We support broadening EIOPA's remit to facilitate an enhanced centralized oversight role, particularly regarding group-wide supervision activities

for these groups. In the meantime, countries in Latin America, Africa and Asia are looking to both Europe and the IAIS for guidance on reforms.

The International Monetary Fund (IMF) and World Bank's Financial Sector Assessment Program (FSAP) based on the Insurance Core Principles (ICP) are doing much to encourage changes in the areas of risk-based supervision, better governance and increasingly conduct risk, all of which we support.

Currently, however, there is little consistency in conduct regulation and consumer protection measures, either within Europe or across global geographies. Such inconsistency in regulatory approaches is unhelpful, especially as what drives regulatory action (particularly in times of crisis) is often dictated by the need to protect local policyholders. For example, Europe has the opportunity to address this through the establishment of a consistent European-wide policyholder protection scheme to provide policyholders with greater protection against conduct risks as well as prudential risks. While Solvency II will ensure that all insurers within Europe are prudentially sound, compensation to policyholders is more likely to arise from failures in the way business is conducted.

Key insights

To provide additional perspectives, this year we sought the views from some of the world's leading regulators and industry practitioners concerning the ICS and related implementation issues. Their insights are outlined on pages 36 to 45. It is clear from our interviews that while there is support for greater consistency and convergence in international insurance requirements amongst all stakeholders, significant concern exists amongst CROs regarding the prospect of an ICS and importantly, how the global framework is to be implemented. Our interviews provide great insight into current thinking and future direction of insurance regulation – immensely relevant given we are on the cusp of witnessing the birth of a new era of global supervision.

"Immensely relevant given we are on the cusp of witnessing the birth of a new era of global supervision."

Contents

Executive
Summary: a global perspective

> "In this edition, we highlight the latest IAIS initiatives and other industry developments and analyse the impact that such changes may have on the insurance sector and outline how firms can best prepare themselves to meet these new challenges."

International developments dominate regulatory changes

The last few years have seen the IAIS lay the foundation for change through the establishment of the Insurance Core Principles (ICPs), the identification of G-SIIs and the development of its Common Framework (ComFrame) relating to the supervision of Internationally Active Insurance Groups (IAIGs). Even though these proposals have done much to improve insurance supervision, the establishment of a single capital standard has continued to be a divisive issue. In spite of the strong differences in opinions on ICS, during 2014 the IAIS took significant steps towards the development of a group-wide capital standard through the publication of the basic capital requirement (BCR), which will apply to the nine G-SIIs, and the release of its first consultation on a risk-based insurance capital standard (ICS).

In this edition, we highlight the latest IAIS initiatives and other industry developments and analyse the impact that such changes may have on the insurance sector, outlining how firms can best prepare themselves to meet these new challenges.

ComFrame

A stable version of ComFrame was released in 2014 as the basis for both qualitative and quantitative field testing to continue throughout this year. Thirty-six companies are participating in the tests, including all G-SIIs. A revised version of ComFrame will be released for consultation at the end of 2015.

- **Insurance Core Principles and latest Financial Sector Assessment Program developments**

The International Monetary Fund (IMF) completed six new FSAPs using the 2011 ICPs during 2014. Through these, it continued to push for more active regulation of intermediaries, pro-active enforcment in the area of market conduct, and improved group supervision. At the same time, the IAIS has been conducting self-assessment peer reviews as a basis for further guidance and revisions to the ICPs. We summarize the FSAPs in this chapter and provide details in the specific country updates.

- **Global Insurance Capital Standard**

The IAIS consultation paper on the global insurance capital standard (ICS) focuses heavily on the standard formula to be used, delaying decisions on the use of internal models and mutual recognition into 2016. Using a total balance sheet approach as a starting point, the IAIS has proposed a market-adjusted valuation approach, although it is also collecting data on a GAAP plus adjustments basis. We explore these proposals in detail.

- **Regulation for G-SIIs**

Although no additional G-SIIs were named in 2014, the process has begun to reassess the selection methodology particularly through an examination of critical functions. These functions will also be essential to the recovery and resolution planning that is now being required of G-SIIs. The main development in 2014 was the release of the Basic Capital Requirement (BCR), a factor based methodology which will become effective in 2015. We review this approach in depth. The IAIS is now beginning work on a Higher Loss Absorbency (HLA) calculation to be applied in 2019. The primary objective is to look at higher charges for non-traditional and non-insurance risks.

Perspectives from key regulators and chief risk officers on global developments

KPMG asked prominent regulators and CROs to comment on the direction insurance regulation is taking and the prospects for the future. Highlights of the discussion can be found on pages 38 to 47, and cover the chances of achieving a global capital standard, its role as a Basel III type accord, the possibility of requiring recovery and resolution plans for domestic systemically important insurers, the performance of supervisory colleges and the future of insurance regulation.

Regional regulatory developments

- **Americas region**

Although the changes taking place in the Americas vary greatly between North and South America, often the same issues are being addressed and moving in a similar direction.

In the United States, the National Association of Insurance Commissioners (NAIC), Federal Insurance Office (FIO) and Federal Reserve Board (FRB) are cooperating on the development of a group capital standard, but "Team USA" is far from finding a common approach. In the meantime, spurred by the 2015 FSAP of US financial regulation, the NAIC continues to implement changes to laws regarding Own Risk and Solvency Assessment (ORSA), group supervision, corporate governance, and market conduct. However, adoption by the states is uneven and will take several years.

Canada, having just completed its 2014 FSAP, is working to address concerns raised regarding risk management, conduct of business and group supervision, while Bermuda is completing its reforms for Solvency II equivalence.

Latin American countries, especially Mexico, Chile and Brazil are instituting risk focused solvency systems. There is less conduct risk activity as of yet in these countries, but it is being discussed.

"In the United States, the National Association of Insurance Commissioners (NAIC), Federal Insurance Office (FIO) and Federal Reserve Board (FRB) are cooperating on the development of a group capital standard, but "Team USA" is far from finding a common approach."

> "Regulators, led by the Financial Stability Board (FSB), are pushing companies to develop a corporate risk culture, including a clearly defined risk appetite framework."

- **Asia-Pacific (ASPAC) region**

Across the Asia-Pacific region, 2014 witnessed increased supervisory attention to risk-based supervision, corporate governance, group-wide supervision, non-insurance activities, and data reporting. In 2015 this region will see a continued regulatory push to developing economic valuation frameworks and improving risk management frameworks.

- **Europe, Middle East and Africa (EMA) region**

The looming effective date for Solvency II dominates all activity in Europe. Level 2 delegated acts (now known as Commission Delegated Regulation 2015/35) were approved in January 2015 and Member States will transpose the directive requirements into local requirements by the end of March, prior to opening for the various approval applications on 1 April 2015. Equivalence decisions are now expected to be released in 2015 in two waves.

In Africa the focus has been on implementing the Insurance Core Principles. Health insurance and micro-insurance continue to be areas of focus. South Africa is undergoing significant changes in both market conduct and prudential regulation. The Twin Peaks Model will go into effect this year.

Conduct risk – The evolving nature of conduct risk and regulatory expectations

Once a subset of operational risk, conduct of business risk is now being addressed as an independent discipline. The IMF and others are pushing for a more pro-active approach to conduct risk, including data collection on complaints, on-site inspections, and product and marketing regulations. We explore the impact this is having. The IAIS is expanding its guidance in the area and involving consumer groups in the process. Conduct supervisors are becoming better organized, allowing them to share their tools and models internationally. In 2014 a number of jurisdictions made substantial changes in the conduct area as detailed in our regional reports. The overall result is that insurers will increasingly need to have a 'customer first' approach.

Risk management insights – The rising importance of risk culture

Regulators, led by the Financial Stability Board (FSB), are pushing companies to develop a corporate risk culture, including a clearly defined risk appetite framework. In this chapter we explore these regulatory changes and best practices firms should consider in responding to them. We look particularly at risk culture as the central factor in risk management.

The impact of accounting changes on regulation

The International Accounting Standards Board (IASB) was hoping to complete the insurance contracts standard by late 2015 or early 2016, but has recently delayed this and the timetable is currently unclear. Its work will continue without the US Financial Accounting Standards Board (FASB). The IASB still has work to do to finish on time, including the thorny issue of participating contracts and final decisions on volatility and coordination with IFRS 9. As a result, it now appears that IFRS 4 Phase 2 is unlikely to be released in time to be used by the IAIS as the valuation basis for its 2018 interim capital standard although there may eventually be some convergence.

The year ahead

No one can dismiss the massive impact that global regulation and global organizations are having on the shape of local supervision. Entities such as the G-20, the FSB, the OECD, the IAIS, the IMF and the World Bank are all driving change in local regulation. Whether those changes will result in a single capital standard is not clear, but all other aspects of insurance regulation are converging from solvency and governance requirements to risk management and conduct issues.

In the next year the sector will see more focus on the actual operational issues of companies including structure, compensation, marketing, and products themselves. We have highlighted some of these developments in the chapters on conduct and risk. Much of the reform in insurance since the crisis has been driven by banking regulation, but in the future we are likely to see marketing, disclosure and compensation requirements emanating from securities regulation instead.

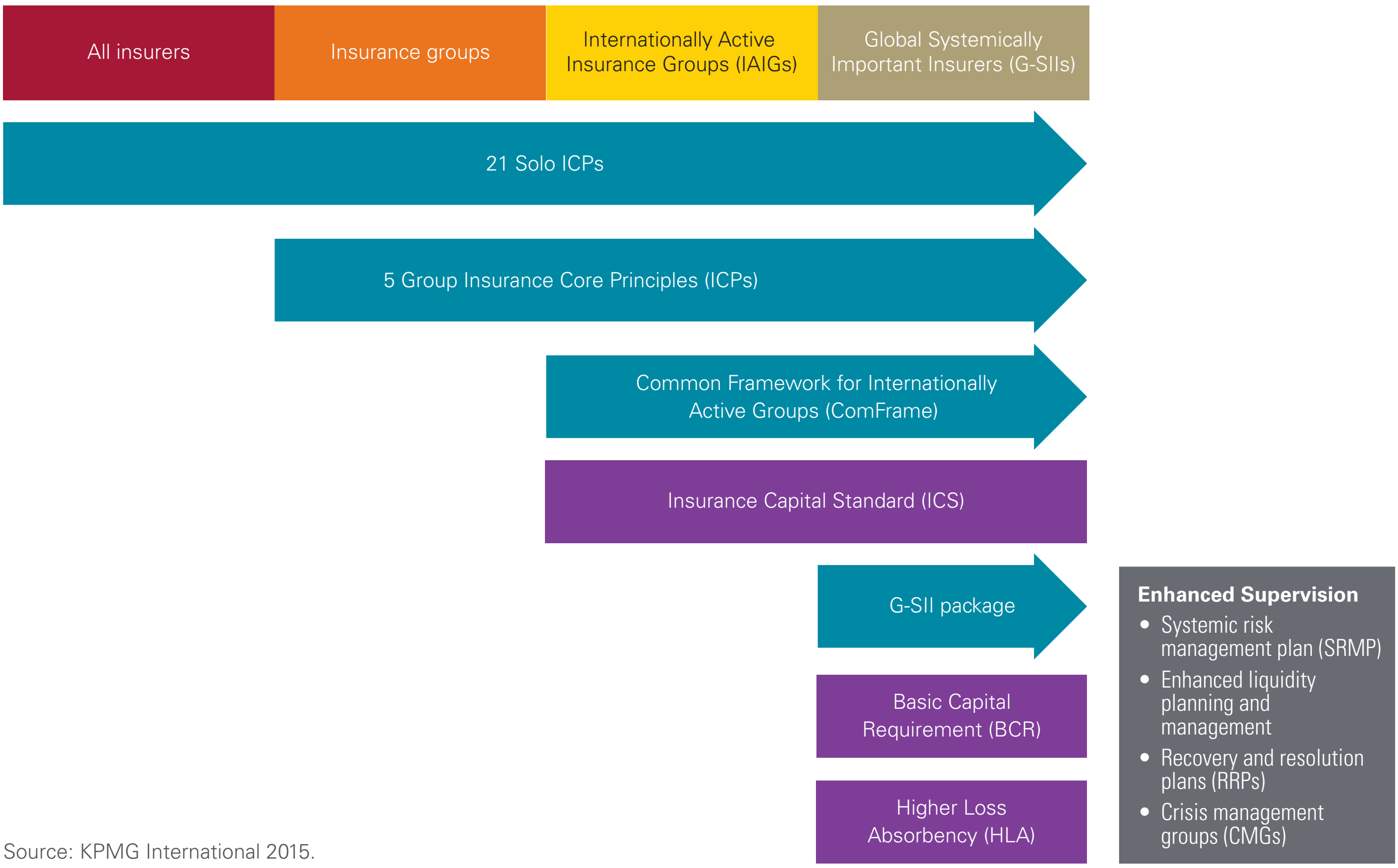
What is clear is that these proposals herald significant change and will usher in a new era of global supervision. **Are you prepared?**

International developments dominate regulatory changes

2015 will see the continuation of a number of key initiatives being advanced by the IAIS and the FSB. These initiatives are being developed in parallel, although they are at various stages of maturity. In this section, we assess the impact these key proposals may have on insurers, especially in regards to ComFrame, the Insurance Core Principles – including the latest update on the IMF's FSAP activities, the global insurance capital standard, G-SIIs and the development of the basic capital requirement.

While ComFrame applies at both solo and group level, the BCR, HLA and ICS requirements will only be applied at group level. G-SIIs are subject to additional enhanced supervision and recovery and resolution plans. This can be viewed in Figure 1 below.

Figure 1: Application of ComFrame and IAIS capital initiatives to different types of firms/groups



Source: KPMG International 2015.

ComFrame

The development of ComFrame began in 2009, building upon and expanding the existing insurance core principles. The work involved defining the scope of ComFrame (all IAIGs, which are themselves defined based on size and jurisdictional reach), establishing both the standards that must be met by those IAIGs and the group supervisory requirements. As such, ComFrame represents the globally accepted requirements for the supervision of IAIGs with a specific emphasis on group-wide supervision.

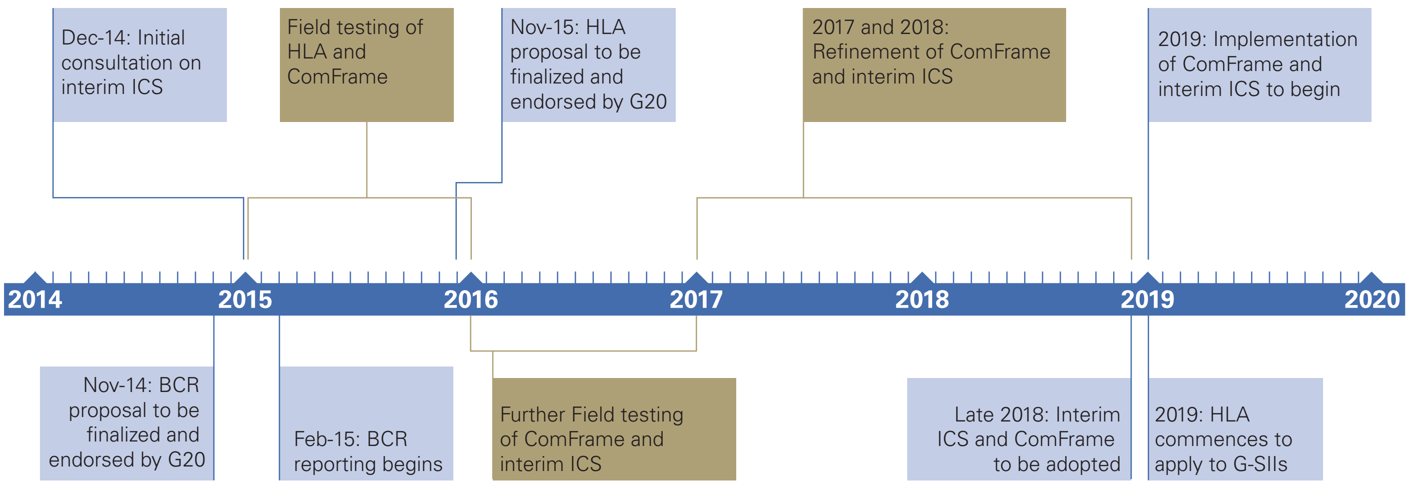
In June 2014, the IAIS released a "stable version" of ComFrame for the purposes of field testing the concepts and the capital calculations. With 36 insurance companies participating in the tests over the next three years, the results will be used to adjust both the quantitative and qualitative features of ComFrame before it comes into effect in 2019.

The qualitative tests aim to understand the gaps that may exist between current supervisory practices and the provisions of ComFrame and the potential incremental costs of implementation. The quantitative review aims to establish the valuation methodology, calibration and capital requirements for ComFrame.

Testing is taking place in several phases. The first quantitative phase, which ran from March to August 2014, looked at valuation and stress tests. These results informed both the determination of the BCR, which was released in final form in October 2014, and the ICS. The next phase was a qualitative review of corporate governance, investments and risk management issues which began in October 2014. In 2015, there will be additional qualitative and quantitative tests. With the recent decision by the IAIS to lift the 2019 deadline for ICS, there is likely to be an interim capital standard effective in 2018 while work on an ultimate convereged standard continues over several more years.[1] The ultimate goal of a single ICS will include a common methodology by which one ICS achieves comparable, i.e. substantially the same, outcomes across jurisdictions.

The current timeline of the various IAIS activities is shown below:

Figure 2: Current timeline of various IAIS activities



Note: As reported in the March 2015 IAIS Newsletter.

1. IAIS Executive Committee decision February 2015

> The IAIS ICPs are high-level principles-based standards whereby members of the IAIS (predominantly most of the world's national regulators) are expected to implement the ICPs into their national supervisory frameworks.

Scope of Group Supervision

Two of the main open issues in ComFrame have been the definition of an insurance group and the level of authority a group-wide supervisor has over portions of the group, particularly the head of the insurance group and non-insurance activities.

The IAIS has decided that the group-wide supervisor must have "direct" powers at the level of the head of the insurance group.[2] These changes are now being incorporated into revisions of the ICPs and are reflected in the September 2014 version of ComFrame. This detailed authority will include:

- Direct power to request information from the head of the insurance group, including information on subsidiaries relevant to the overall risk of the IAIG
- Direct power to conduct on-site inspections at the head of the insurance group
- Direct power to request formal discussions with members of the governing body, senior management and key persons in control functions of the head of the insurance group without regard to which legal entity within the group employs them
- Direct power to perform fit and proper assessments of members of the governing body, senior management and key persons in control functions of the head of the insurance group.

IAIS Working Definitions for ComFrame[3]

Insurance Group: Two or more legal entities under common control, of which at least one is an insurance legal entity, and the primary function of those taken together is insurance.

Head of the Insurance Group: The legal entity that controls the insurance group.

The Head of the IAIG: The entity that controls or exerts dominant influence over the insurance group. It is usually the ultimate parent or, if the insurance group is a subset of a conglomerate, the head of the insurance group within the conglomerate.[4]

Insurance Core Principles and latest FSAP activities

The IAIS ICPs are high-level principles-based standards whereby members of the IAIS (predominantly most of the world's national regulators) are expected to implement the ICPs into their national supervisory frameworks. Failure to do so risks receiving an adverse finding from the IMF/World Bank who conduct Financial Sector Assessment Program (FSAP) reviews, which principally assess the extent to which national supervisory frameworks are consistent with the ICPs.

There are currently 26 ICPs which can be divided into five broad categories covering:

- Supervisory powers and measures
- Solvency
- Group supervision, cooperation and crisis management
- Conduct of business, intermediaries and fraud prevention
- Corporate governance and public disclosure

2. IAIS Insurance Group Working Group, December 2014
3. Ibid.
4. IAIS ComFrame September 2014

Table 1: Five categories of the ICP core principles

Supervisory Powers and Measures	Solvency	Group Supervision, Cooperation and Crisis Management	Conduct of Business, Intermediaries and Fraud Prevention	Corporate Governance and Public Disclosure
ICP 1 Objectives, Powers and Responsibilities of the Supervisor	ICP 13 Reinsurance and Other Forms of Risk Transfer	ICP 3 Information Exchange and Confidentiality Requirements	ICP 18 Intermediaries	ICP 5 Suitability of Persons
ICP 2 Supervisor	ICP 14 Valuation	ICP 23 Group-wide Supervision	ICP 19 Conduct of Business	ICP 7 Corporate Governance
ICP 4 Licensing	ICP 15 Investment	ICP 24 Macroprudential Surveillance and Insurance Supervision	ICP 21 Countering Fraud in Insurance	ICP 8 Risk Management and Internal Controls
ICP 6 Changes in Control and Portfolio Transfers	ICP 16 Enterprise Risk Management for Solvency Purposes	ICP 25 Supervisory Cooperation and Coordination	ICP 22 Anti-Money Laundering and Combating the Financing of Terrorism	ICP 20 Public Disclosure
ICP 9 Supervisory Review and Reporting	ICP 17 Capital Adequacy	ICP 26 Cross-border Cooperation and Coordination on Crisis Management		
ICP 10 Preventive and Corrective Measures				
ICP 11 Enforcement				
ICP 12 Winding-up				

Source: Insurance Core Principles Standards Guidance and Assessment Methodology, October 2011 revised October 2013.

As can be seen from Table 1, there is a strong focus within the ICPs towards prudential matters, with just the one ICP (19) on conduct of business, which contains 13 high level principles-based standards (see conduct chapter for further details).

The Financial Sector Assessment Program

As part of the response to the global financial crisis, the IMF and World Bank FSAP reviews of different countries' financial sectors have become more important. In those countries whose financial systems have been deemed by the IMF to be systemically important (see Table 2), FSAP assessments are now mandatory and should occur every five years. For other jurisdictions, this remains a voluntary process.

Table 2: Systemically important financial countries and year of assessment

Systemically Important Financial Countries and Year of Assessment

Australia (2012)	***Denmark (2014)***	Ireland (2006)	Netherlands (2011)	Sweden (2011)
Austria (2013)	*Finland (2001)*	**Italy (2013)**	*Norway (2005)*	**Switzerland (2014)**
Belgium (2013)	**France (2012)**	**Japan (2012)**	***Poland (2013)***	Turkey (2011)
Brazil (2012)	Germany (2011)	**Korea (2014)**	Russian Federation (2011)	United Kingdom (2011)
Canada (2014)	**Hong Kong SAR (2014)**	Luxembourg (2011)	**Singapore (2013)** United States (2015)	**United States (2015)**
China (2011)	India (2012)	Mexico (2011)	**Spain (2012)**	

Source: Country list from IMF, 'Mandatory Financial Stability Assessments under the FSAP,' 24 September 2014.

Note: The countries shown in italics were only added to the list in January 2014. Assessment of countries in bold were based on the revised 2011 ICPs.

These reviews include an emphasis on considering the extent of compliance with relevant international standards, which for the insurance business means an assessment of compliance with ICPs. The result has been that we have seen a global drive among regulators over recent years to meet ICP compliance, which is a theme that comes through in our country analysis later in this paper. In addition to the mandatory reports, the IMF and World Bank also conduct voluntary assessments of countries upon request.

In our 2014 report we summarized the results on the first ten FSAPs completed using the ICPs as revised in 2011. This year we include six additional countries whose reviews were published in 2014/2015. The new reports indicate a continued emphasis on onsite inspections, disclosure, market conduct, and active supervision of intermediaries. Several of the reports also look more closely at regulatory oversight of intra-group transactions and investments. One interesting issue raised in the Swiss review relates to the need for increased supervision of third country branches of reinsurers.

ICP Revisions

In 2015 the IAIS will propose revisions for a number of ICPs based on the self-assessment process undertaken by the IAIS over the past five years. In order to minimize confusion for the FSAPs, the IAIS has decided to cluster the revisions together. IAIS working groups are currently developing changes for ICPs 3, 4, 5, 7 , 8, 23, and 25 which will be amended in 2015. ICPs 1, 9, 10, 11, 12, and 26 will be changed in 2016, and ICPs 2, 6, 13, 14, 15, 16 ,17, 18, 19, 20, 21, 22, and 24, will be revised in 2017.[5]

5. IAIS March 2015 Newsletter

Table 3: KPMG Overview of 2014 FSAP Results

ICP/country*	Switzerland	Canada	Hong Kong	Denmark	South Africa	United States
Supervisory Powers and Measures						
1 Powers	3	2	2	2	2	1
2 Supervisor	3	1	1	1	1	1
4 Licensing	2	3	3	3	2	2
6 Control	3	3	3	3	2	3
9 Reporting	2	2	2	2	2	2
10 Correction	3	3	3	3	3	3
11 Enforcement	3	3	2	3	3	3
12 Winding Up	3	3	3	2	1	3
Solvency						
13 Reinsurance	2	2	2	3	2	3
14 Valuation	3	2	2	3	2	1
15 Investment	3	2	3	2	2	3
16 ERM	3	2	1	2	1	2
17 Capital Adequacy	3	2	1	2	2	2
Group Supervision, Cooperation and Crisis Management						
3 Info Exchange	3	3	3	3	3	2
23 Groups	3	1	1	2	1	1
24 Macroprudential	2	3	2	1	2	2
25 Coordination	3	3	3	3	3	2
26 Crossborder	3	3	2	2	2	2
Conduct of Business, Intermediaries, and Fraud Prevention						
18 Intermediaries	1	2	2	2	3	2
19 Conduct of Business	1	1	1	1	2	2
21 Anti-Fraud	2	3	3	1	1	3
22 AML	3	3	3	1	1	2
Corporate Governance and Public Disclosure						
5 Suitability	2	3	2	2	3	2
7 Corporate Governance	3	3	2	2	1	1
8 Risk Management	2	3	2	1	1	2
20 Disclosure	1	1	2	2	1	3
Total	65	62	56	54	49	55

3 Observed 2 Largely Observed 1 Partially Observed 0 Not Observed

Source: KPMG 2015.

*Please note that although Korea was reviewed in 2014, the detailed scoring of their compliance was not published in the IMF report. We have included a section on ICP compliance within the geographical analysis of our regional updates, which includes an update on the findings of associated FSAP reviews. Korea is covered in those sections.

Global Insurance Capital Standard

There have been two key developments in the ICS journey during 2014 – the establishment of the ICS guiding principles and publication at the end of the year of a consultation document. The ICS is intended to be more risk sensitive, and therefore more complex, than the Basic Capital Requirment (BCR) that was finalized in October 2014 as we describe later in this report, and the ICS will apply to around 50 IAIGs, not just the nine G-SIIs.

In September 2014, the IAIS released a set of high level principles that will guide the development of the ICS over the coming years (see following Table).

Table 4: ICS Guiding Principles

1	Consolidated group-wide standard with a globally comparable risk-based measure of capital adequacy for IAIGs and G-SIIs.
2	Main objectives are protection of policyholders and to contribute financial stability.
3	Become the foundation for the HLA for G-SIIs.
4	Reflects all material risks to which an IAIG is exposed.
5	Ensure comparability of outcomes across jurisdictions, providing increased mutual understanding and greater confidence among group-wide and host supervisors.
6	Promote sound risk management by IAIGs and G-SIIs.
7	Promote prudentially sound behavior while minimizing inappropriate procyclical behavior by supervisors and IAIGs.
8	Balance risk sensitivity against simplicity.
9	Remain transparent, particularly with regard to the disclosure of final results.
10	Capital requirement is based on an appropriate target criteria which underlies the calibration.

Source: IAIS Consultation on Risk Based Global Insurance Standard, 17 December 2014.

On 17 December 2014, the IAIS released a consultation document requesting feedback on its first draft proposal on the ICS. This initial proposal has effectively opened for discussion a variety of options that may be adopted to determine the ICS capital requirement. Key elements of the paper include liability valuations, qualifying capital resources and approaches to measuring risk. Even though the IAIS has now removed a firm deadline for implementation of the ICS, it has said it will continue to field test the proposals as outlined in the paper and to develop an interim standard based on that field testing. Over 1600 pages of comments were received in response to the consultation.

The consultation paper anticipates that the ICS will be implemented as a regulatory Prescribed Capital Requirement (PCR)[6] under which the supervisor will only intervene on capital adequacy grounds if the group's capital falls below the required level, although this assumption is queried in the consultation paper.

The IAIS is considering the addition of a backstop capital measure which will serve to supplement the ICS, but will be less risk sensitive and simpler than the ICS. This capital measure is expected to be very similar to the BCR and would broadly reflect the level of risk inherent within an insurance company based on its size. This measure may also be adopted as a notional floor to the ICS ensuring that a basic level of capital is always met (in essence, acting as an MCR).

The diagram below illustrates the four key elements of the ICS that were addressed in the consultation paper:

Figure 3: Four key elements of the Insurance Capital Standard

Source: KPMG International 2015.

6. In the IAIS' core principles, the PCR is the higher regulatory intervention point, while a Minimum Capital Requirement (MCR) serves as the lower intervention level.

ICS valuation approach

The IAIS will require a consolidated group balance sheet as its starting point for the quantitative insurance capital standard. As such, this approach will necessitate a method for estimating insurance contract liabilities on a comparable basis across all jurisdictions in which the group has insurance operations.

Subsequent to the field testing exercise undertaken in 2014, the IAIS has decided that a market adjusted valuation approach will be the initial basis for developing the ICS standard methodology, similar to the one developed for the BCR calculation, because it increases comparability and risk sensitivity.[7] At the insistence of the US regulators, a country's generally accepted accounting principles (GAAP) with regulatory adjustments will also be considered as an alternative valuation, which would be developed through a planned field testing exercise.

The purpose of this second option is to allow IAIGs to easily achieve a market adjusted valuation by making incremental and quantifiable adjustments to their local jurisdictional GAAP valuation. The adjustments required will be based on principles and will require reconciliation between a market adjusted and jurisdictional GAAP valuation approach. However, there may not always be a simple relationship between the two, particularly if the underlying valuation is based on significantly different methodologies. For life assurance there is the added complication that for financial statements drawn up under International Financial Reporting Standards (IFRS) and some GAAPs, certain insurance contracts will have been reclassified as investment contracts for financial reporting, but will need to be included within the regulatory insurance provisions. Both these factors may be significant impediments to the adoption of a GAAP with adjustments approach.

A key issue hampering the development of a global valuation approach is that there is currently no single insurance accounting standard across jurisdictions. The International Accounting Standards Board (IASB) was expecting to complete the insurance contract standard by late 2015 or early 2016, but has recently delayed this and the timetable is currently unclear. This will mean the IAIS has to move forward with its proposals without this standard. At the moment, the market adjusted valuation approach being developed by the IAIS broadly reflects where the IAIS believes global developments on insurance accounting standards are heading. The IAIS has also highlighted its intention to engage with international bodies including the IASB, Financial Accounting Standards Board (FASB) and the International Actuarial Association (IAA) to encourage development of complementary standards. As such, it is expected that there will be refinement of the ICS valuation approach over time, particularly if valuation approaches across jurisdictions converge over time.

Margin Over Current Estimate

In its consultation document, the IAIS asked about the feasibility of introducing a margin over current estimate (MOCE) within the ICS as an additional component to the market adjusted liability valuation. However, the IAIS is yet to decide on a definition, treatment

7. A decision has been made to no longer field test an economic valuation approach because of the difficulty in gaining comparability.

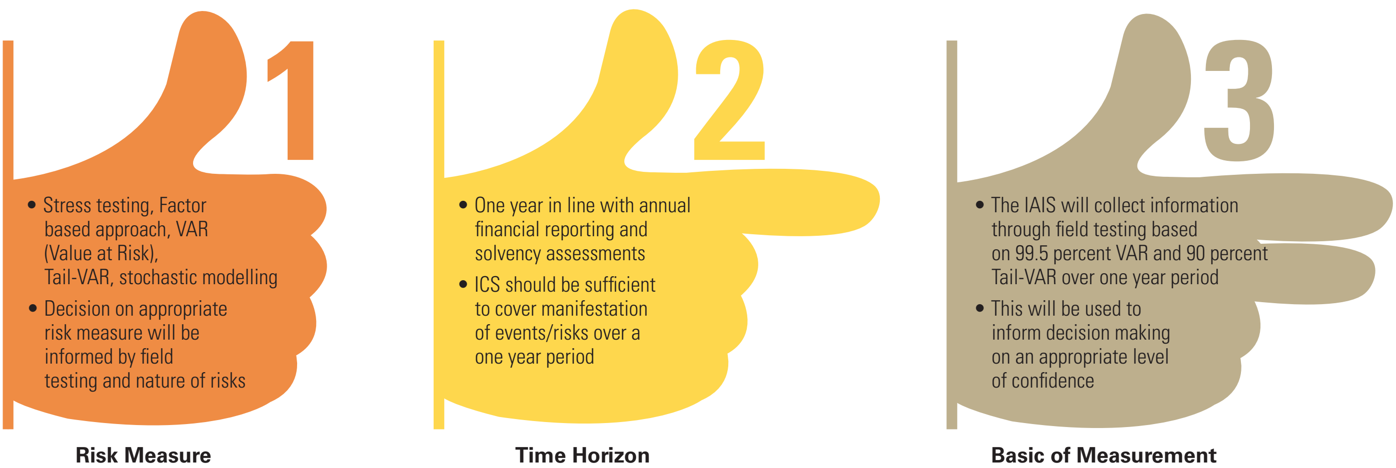
(i.e. whether it will be included as part of liabilities or as part of capital resources) and calculation basis for the MOCE. The MOCE is normally a margin held in addition to the current estimate of insurance contract liabilities, largely for the purpose of covering the inherent uncertainty within those obligations. Incorporating a MOCE within the current estimate of liabilities would effectively result in the deferral of profit emergence into the future. In Solvency II, the margin is calculated by using conservative actuarial assumptions for liability valuations.

ICS confidence level

Another key aspect of the ICS capital requirement that remains unresolved and is likely to be the most contentious issue is the level of confidence that will be targeted. In this regard, jurisdictions across the world have adopted varying practices for regulatory purposes. The IAIS has decided to calibrate the ICS to cover the capital required over a one year time horizon, but has not defined the target level. At this stage, the IAIS has indicated tentatively that, as part of the field testing exercises, it will collect data based on 99.5 percent Value at Risk (VaR) and 90 percent Tail-VaR (TVaR) over a one year time horizon. The purpose for collecting data at this high level of confidence is to allow flexibility when calibrating the ICS capital requirement. In particular, it will provide a better understanding of the tails of the loss distribution curve.

Further, depending on the approach taken to measure the risks and determine the capital requirement, the factors/stresses applied will need to reflect the level of confidence that is being targeted.

Figure 4: Key considerations of the ICS capital requirement



Source: KPMG International 2015.

Measuring Risk

The IAIS intends that the ICS capital calculation will build on the BCR methodology, but will be more risk sensitive and, therefore, more complex than the BCR. The IAIS proposal suggests that the ICS capital requirement will reflect the material risks illustrated in the Table below.

These risks broadly reflect the major risks that are encountered by insurance companies. Any risks that are not quantified as part of the ICS capital requirement, which is the main focus of the ICS currently, such as group risks as well as liquidity risks, are to be addressed qualitatively within ComFrame.

The ICS capital requirement will be determined based on the impact to qualifying capital resources resulting from manifestations of the following risks:

Table 5: Risks and definitions

Categories of risk	Key risk	Scope/definition: Risk of adverse change in the value of qualifying capital resources due to
Insurance risk	Mortality risk	Unexpected changes in the level, trend or volatility of mortality rates
	Longevity risk	Unexpected changes in the level, trend or volatility of mortality rates
	Morbidity/disability risk	Unexpected changes in the level, trend or volatility of disability, sickness and morbidity rates
	Expense risk	Unexpected changes in liability cash flows due to the incidence of expenses incurred
	Lapse risk	Unexpected changes in the level or volatility of rates of policy lapses, terminations, renewals and surrenders
	Premium risk (non-life)	Unexpected changes in the timing, frequency and severity of future insured events (to the extent not already captured in morbidity or disability risk)
	Claim reserve/revision risk (non-life)	Unexpected changes in the expected future payments for claims (to the extent not already captured in morbidity or disability risk)
	Catastrophe risk	Unexpected changes in the occurrence of low frequency and high severity events
Market risk	Interest rate risk	Unexpected changes in the level or volatility of interest rates
	Equity risk	Unexpected changes in the level or volatility of market prices of equities
	Real estate risk	Unexpected changes in the level or volatility of market prices of real estate or from the amount and timing of cash-flows from investments in real estate
	Spread risk	Unexpected changes in the level or volatility of credit spreads over the risk-free interest rate term structure
	Currency risk	Unexpected changes in the level or volatility of currency exchange rates
	Asset concentration risk	The lack of diversification in the asset portfolio
Credit risk		Unexpected counterparty default, including their inability or unwillingness to meet contractual obligations in a timely manner
Operational risk		Operational events including inadequate or failed internal processes, people and systems, or from external events. Operational risk includes legal risk, but excludes strategic and reputational risk

Source: IAIS Consultation Paper: Risk-based Global Insurance Standards, 17 December 2014.

The IAIS has considered various approaches to determining the ICS capital requirement that range in complexity. The methods under consideration include a factor based model, stress testing, stochastic modelling and structural modelling or some combination of these approaches.

1) The factor-based approach is similar to the approach decided for calculating the BCR, wherein specified charges are applied to particular exposures to determine the capital required. Most exposures would be balance sheet items.

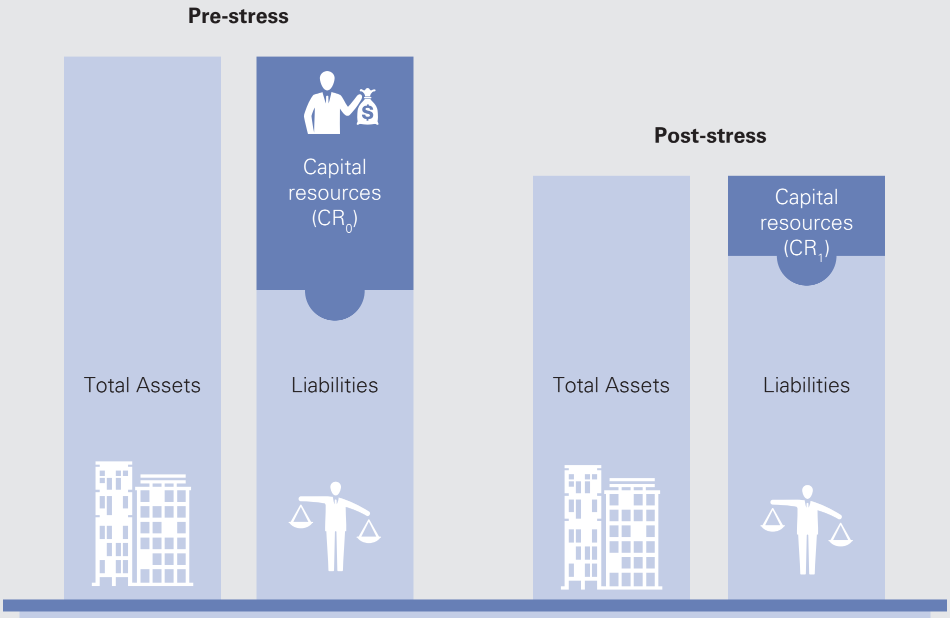
2) Stress testing involves estimating the adverse impact on capital resources from stresses that are applied to balance sheet items. Each stress is intended to reflect the manifestation of a specific risk and the adverse impact on capital resources reflects the capital required. Figure 5 illustrates how a balance sheet might change and impact capital resources under a stressed scenario.

3) Stochastic modeling involves estimating the distribution of the change in capital resources over time through stochastic processes. A distribution is estimated for each type of risk being considered and this is aggregated across all risks to obtain the required distribution. Statistical tools can then be used to estimate the impact on capital resources at various confidence levels.

4) Structural modeling involves using causal relations specified using a combination of statistical data and qualitative causal assumptions. These assumptions often have implications that can be tested against observations.

> "The IAIS has considered various approaches to determining the ICS capital requirement that range in complexity. The methods under consideration include a factor based model, stress testing, stochastic modelling and structural modelling or some combination of these approaches."

Figure 5: Capital resources in stressed scenarios



Source: IAIS Consultation Paper: Risk-based Global Insurance Standards, 17 December 2014.

> "The risk categories reflected in the proposed ICS capital requirement are not completely correlated and there is potential for diversification benefits to exist. Recognition of diversification benefits both within and between types of risks needs to be allowed for as part of the ICS capital requirement. Further, under stressed conditions, it is anticipated that the level of diversification between risks may decrease, and additional capital may be required to retain the same level of confidence."

Bearing in mind that one approach may not be suitable for all risks, the methodology will be adjusted to the risk that is being quantified. The IAIS has provided some guidance as to what approach might determine the charges associated with each of risk (see Table 6).

Table 6: IAIS approach to determine changes associated with risk

Risk/Sub-risk	Potential approach		
	Factor-based	Stress	Other
Insurance risks			
Mortality		●	
Longevity		●	
Morbidity/disability		●	
Lapse		●	
Expense Risk		●	
Premium	●		
Claim reserve/revision	●		
Catastrophe			●
Market risks			
Interest rate		●	
Equity		●	
Real estate		●	
Currency/FX		●	
Asset concentration	●		
Credit risk	●		
Operational risk	●		

Source: IAIS Consultation Paper: Risk-based Global Insurance Standards, 17 December 2014.

Allowance for Diversification

The risk categories reflected in the proposed ICS capital requirement are not completely correlated and there is potential for diversification benefits to exist. Recognition of diversification benefits both within and between types of risks needs to be allowed for as part of the ICS capital requirement. Further, under stressed conditions, it is anticipated that the level of diversification between risks may decrease, and additional capital may be required to retain the same level of confidence.

The IAIS has identified three basic approaches within the consultation document to address how diversification of risks might be calculated:

1) The first approach assumes that all risks are fully dependent and that all risk charges can be added together to get the capital requirement. This is a conservative approach that results in the highest capital requirement for a specific level of confidence.

2) The second approach assumes varying degrees of correlation between the risks and this is captured through an assumed correlation matrix. The risk charges are aggregated through a variance covariance matrix to determine the capital requirement.

3) It is anticipated that the third approach will involve modeling the correlations and dependency structures between each of the various risk types (for example asset risks), including their risk drivers (for example inflation, interest rates and equities etc.). An assumption for the underlying distribution of the risks will be required and may also involve the use of copulas to help model the correlation structures and therefore allow for diversification.

The diagram below illustrates an assumed covariance matrix that can be used to aggregate the various risks and allow for diversification:

	Risk 1	**Risk 2**	**Risk 3**	**Risk 4**	**Risk n**
Risk 1	1	X_{12}	X_{13}	X_{14}	X_{1n}
Risk 2		1	X_{23}	X_{24}	X_{2n}
Risk 3			1	X_{34}	X_{3n}
Risk 4				1	X_{4n}
Risk n					1

Source: IAIS Consultation Paper: Risk-based Global Insurance Standards, 17 December 2014.

> The IAIS has separated Tier 1 capital into two categories to reflect the difference in quality between various Tier 1 financial instruments. Tier 1 items for which there is no limit include common/ordinary share capital and financial instruments for which there is a prescribed limit include non-cumulative perpetual preferred shares or certain hybrid instruments.

Capital Resources

As the ICS capital requirement is likely to be set at the PCR level, all IAIGs will need to hold qualifying capital resources that are at least equal to their ICS capital requirement. The IAIS has decided that the capital resources must meet specific criteria in order to qualify as regulatory capital. In particular, the capital resources must provide for loss absorbency on a going concern, in adverse circumstances and during winding-up for the purposes of policyholder protection and financial stability.

Qualifying capital resources are segregated into the following four broad categories based on the quality of the capital, amongst other considerations.

1) Tier 1 financial instruments for which there is no limit
2) Tier 1 financial instruments for which there is a limit
3) Paid-Up Tier 2 financial instruments
4) Non-Paid-Up Tier 2 financial instruments.

The IAIS has separated Tier 1 capital into two categories to reflect the difference in quality between various Tier 1 financial instruments. Tier 1 items for which there is no limit include common/ordinary share capital and financial instruments for which there is a prescribed limit include non-cumulative perpetual preferred shares or certain hybrid instruments. Tier 1 financial instruments that are in excess of a prescribed limit may be considered for inclusion in Tier 2. The purpose of this limit is to constrain the inclusion of certain financial instruments in Tier 1 capital resources for the purpose of calculating the ICS Ratio, which will be seen as a key measure. It is defined as total qualifying capital resources divided by the ICS required capital amount.

Tier 2 capital resources may also include some other forms of lower-quality financial instruments including subordinated debt. Capital instruments that would not count for either Tier include cumulative preference shares and short duration instruments. Recognition of non-paid up Tier 2 capital should be subject to approval from supervisors and it converting to an instrument or element eligible for classification in Tier 1 capital resources or paid-up Tier 2. There will also be regulatory adjustments applied to Tier 1 and Tier 2 capital.

Furthermore, specific balance sheet items are excluded from core capital. This includes items such as intangible assets, goodwill, deferred tax assets net of deferred tax liabilities, and direct investment in own assets.

Implications for IAIGs

Similar to the experience with Solvency II, the proposals currently are described at a very high level, making it difficult to determine what the group solvency position would look like on an ICS basis. Nevertheless, IAIGs should review the proposal carefully and respond on any significant points relevant to their business now, to allow this to be considered by the IAIS before the field-test basis is finalized. More importantly than this even, IAIGs, especially those groups that are not already participating in the field-testing exercises, should plan to participate in both the 2015 and 2016 field tests, if possible.

The evidence from the Solvency II quantitative impact studies (QIS) demonstrates that testing group requirements is significantly more onerous than testing requirements applied at a solo level, and the ICS field test will be further complicated by the fact that none of the solo entities within the group will be subject to its requirements. IAIGs should ensure that their plans for the field-test are sufficient to allow them to determine which parts of the group (if any) give rise to significant stresses, to enable them both to provide additional narrative feedback to the IAIS and to plan their own responses before the interim or final ICS goes live.

Regulation for Global Systemically Important Insurers

In November 2014, the FSB maintained its original list of nine G-SIIs that were identified in 2013. A decision to identify the status of reinsurers was postponed pending development of an appropriate methodology by the IAIS. It is expected that the G-SII assessment methodology will be further developed by November 2015 to address all insurance, reinsurance, and financial activities of global insurers.

The list of the G-SIIs identified as a result of the 2014 G-SII assessment exercise can be seen in Table 7. Classification as a G-SII results in additional supervisory measures being applied to the group, covering:

- Enhanced supervision,
- Effective resolution
- Higher loss absorbency (HLA) capacity.

Table 7: Current list of G-SII (FSB 2014 assessment)

• Allianz SE
• American International Group, Inc.
• Assicurazioni Generali S.p.A.
• Aviva Plc
• Axa S.A.
• MetLife, Inc.
• Ping An Insurance (Group) Company of China, Ltd.
• Prudential Financial, Inc.
• Prudential Plc

Source: FSB 2014 Update of List of Global Systemically Important Insurers, 6 November 2014.

Enhanced supervision generally means tailored regulation with greater supervisory resources being applied. This includes direct supervision of the holding company, development of a systemic risk management plan (SRMP) and enhanced liquidity planning and management, focusing on the group risk profile, to reduce both the probability and impact of its failure.

Effective resolution considers what specific measures would be required to ensure that the group could effectively be resolved without significant impact on the wider economy. Key elements involve the need to ensure that critical economic functions could continue if the group were to fail, resolvability assessments and the establishment of recovery and resolution plans (RRPs). Given the systemic nature of the group, crisis management groups (CMGs) will also be established to enhance the preparedness for, and facilitate the resolution of, a cross-border financial crisis affecting the group.

HLA capacity refers to additional capital requirements applied to the group which are intended to reduce the risk of failure, pass potential costs of failure back onto the groups themselves and ensure that supervisory authorities can intervene at an earlier stage if the group's financial position deteriorates or significant risks start to crystallize.

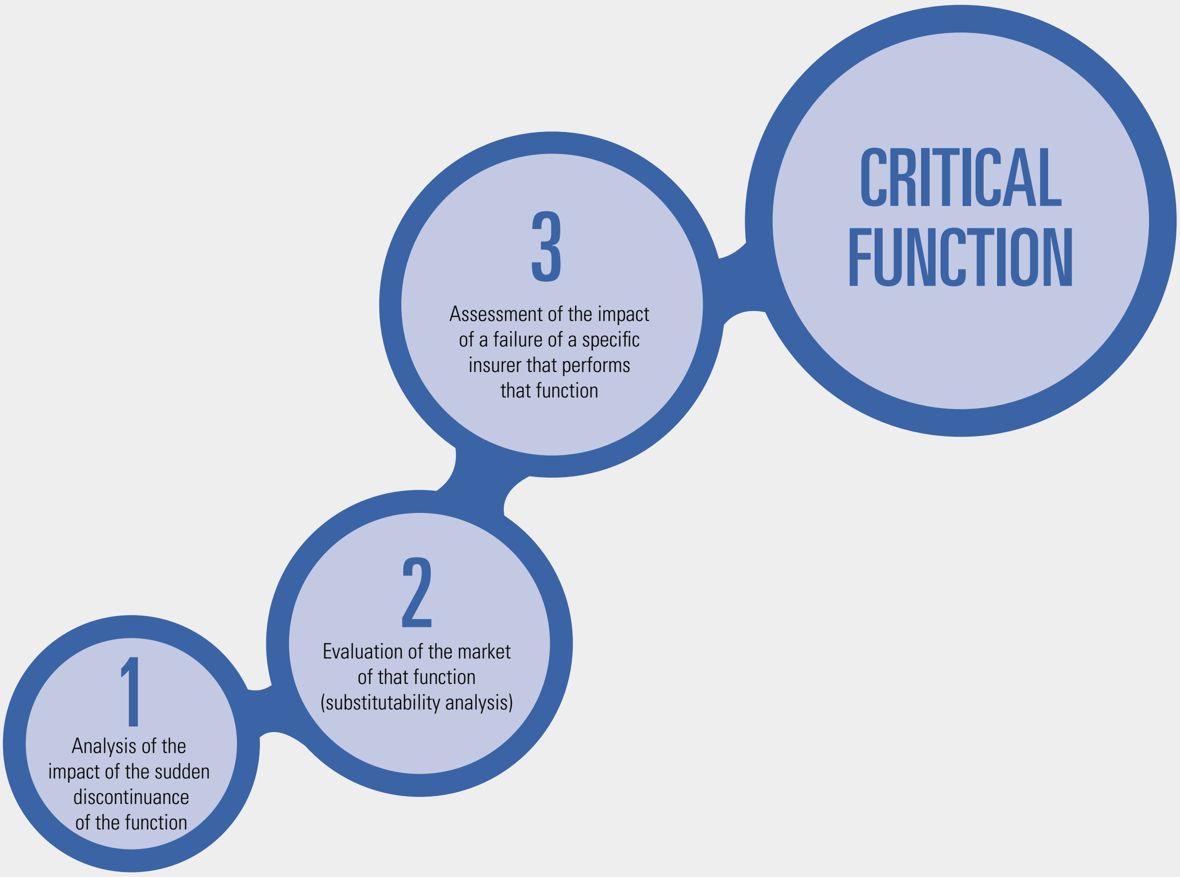
Enhanced supervision – Systemic Risk Management Plan

The SRMP is required to explain how the G-SII plans to manage and mitigate/reduce their systemic risks. The first step in this process is obviously understanding which elements of their business activities should be regarded as systemic, which may be different from the Non-Tradition Non-Insurance (NTNI) activities that were part of the G-SII classification process. This assessment requires the G-SII to identify their critical functions and services and to provide evidence that failure of their group would not lead to the disruption of these services nor any resulting contagion to the wider economy.

As the G-SIIs were required to submit their SRMP by the end of July 2014, much of the first half of 2014 was spent in developing these plans. Since then the discussion process with the group supervisor has been on-going, considering whether these address the risks appropriately.

Identification of critical functions

The FSB released in October 2014, a consultative document on guidance to help insurers identify critical functions. In this document, the FSB described a three step process (which can be undertaken in any order) that involves the following key considerations:



Critical functions go far beyond than the NTNI activities of the group. The broad categories are shown in Figure 6 (although the paper also includes a long list of potential critical functions). These cover a significant range of activities that many insurers would regard as part of their core activities.

Critical economic functions provided by insurers are likely to differ across jurisdictions in terms of their impact, which will make the substitutability component a key aspect of the analysis. Furthermore, the criticality of an economic function will depend on the circumstances of each individual insurance company, in terms of the size and market share of each company, amongst other things.

However, the FSB's starting point is that insurers may provide a wide range of critical economic functions, and the importance of the loss of these functions should be assessed in terms of the impact, not just on the rest of the financial sector, but also on the real economy.

Examples of functions identified by the FSB that could be critical are shown in Figure 6.

Figure 6: Examples of critical functions identified by the FSB

Source: FSB's paper on Recovery and Resolution Planning for Systemically Important Insurers: Guidance on Identification of Critical Functions and Critical Shared Services consultation document, October 2014.

Insurance coverage vital for maintaining economic activity (such as employer liability insurance, professional indemnity insurance and shipping and airline insurance), insurance products that help individuals go about their daily lives (such as motor liability insurance, building and flood insurance and medical insurance) and policies providing financial security (such as annuities and savings funds) can all fall within the assessment of critical functions.

Insurance companies also play a significant role in investing and lending to the real economy and could play a greater role as countries look more to the private sector to finance major infrastructure projects. Failure of an insurer could therefore have adverse impacts on financial markets, resulting from large asset disposals and a lack of new investment or lending. Similar market disruption could arise if the insurer invested heavily in derivatives and other securities.

Interestingly, given the failure yet to classify any reinsurer as a G-SII, failure of a major reinsurance arrangement is identified as a critical function, as it has the potential to cause significant disruption through associated impacts on insurers and their activities.

By identifying critical insurance functions that can have adverse economic impacts, it is evident that the FSB is breaking away from the emphasis placed solely on NTNI activities. Arguably, this could call into question the emphasis placed on NTNI activities in terms of determining the systemic importance of insurers, and therefore the applicable capital requirements. We expect some of this debate to be reflected in the revised identification methodology for G-SIIs to be published in 2015.

> The IAIS and FSB have continued work to develop RRP frameworks which will apply to systemic insurers. The intention is that this will not only apply to the G-SIIs, but ultimately also to those insurers that are identified as systemically important at a domestic level. The underlying intention is that resolution authorities should be able to resolve these insurers without exposing taxpayers to loss and to minimize economic disruption.

"The IAIS and FSB have continued work to develop RRP frameworks which will apply to systemic insurers. The intention is that this will not only apply to the G-SIIs, but ultimately also to those insurers that are identified as systemically important at a domestic level. The underlying intention is that resolution authorities should be able to resolve these insurers without exposing taxpayers to loss and to minimize economic disruption."

Effective resolution – Recovery and Resolution Plans

The IAIS and FSB have continued work to develop RRP frameworks which will apply to systemic insurers. The intention is that this will not only apply to the G-SIIs, but ultimately also to those insurers that are identified as systemically important at a domestic level. The underlying intention is that resolution authorities should be able to resolve these insurers without exposing taxpayers to loss and to minimize economic disruption.

These groups will be required to have in place a robust governance structure to support their RRP. This includes responsibilities allocated to and in respect of all business units, identifying all senior executives responsible for developing and maintaining the RRP and integration of the RRP into the overall governance processes.

The first RRP reports were due to be submitted by 31 December 2014.

Basic Capital Requirement (BCR)

A key milestone on the path to developing a global ICS was achieved in November 2014 when the G20 Brisbane Summit approved the BCR proposal developed by the IAIS.

The final proposal was a year in the making and the outcome of two public consultation periods and a field testing exercise which included participation from several insurance groups, including all nine G-SIIs. The BCR has been developed in line with its key guiding principles (see Figure 7) established at the outset by the IAIS. Measured against these principles and, given the short timeframe for development, the IAIS rightly view the BCR as a successful milestone toward the development of the ICS.

Confidential reporting of the BCR will begin in 2015, the results of which may be used by the IAIS to further refine the calculation methodology.

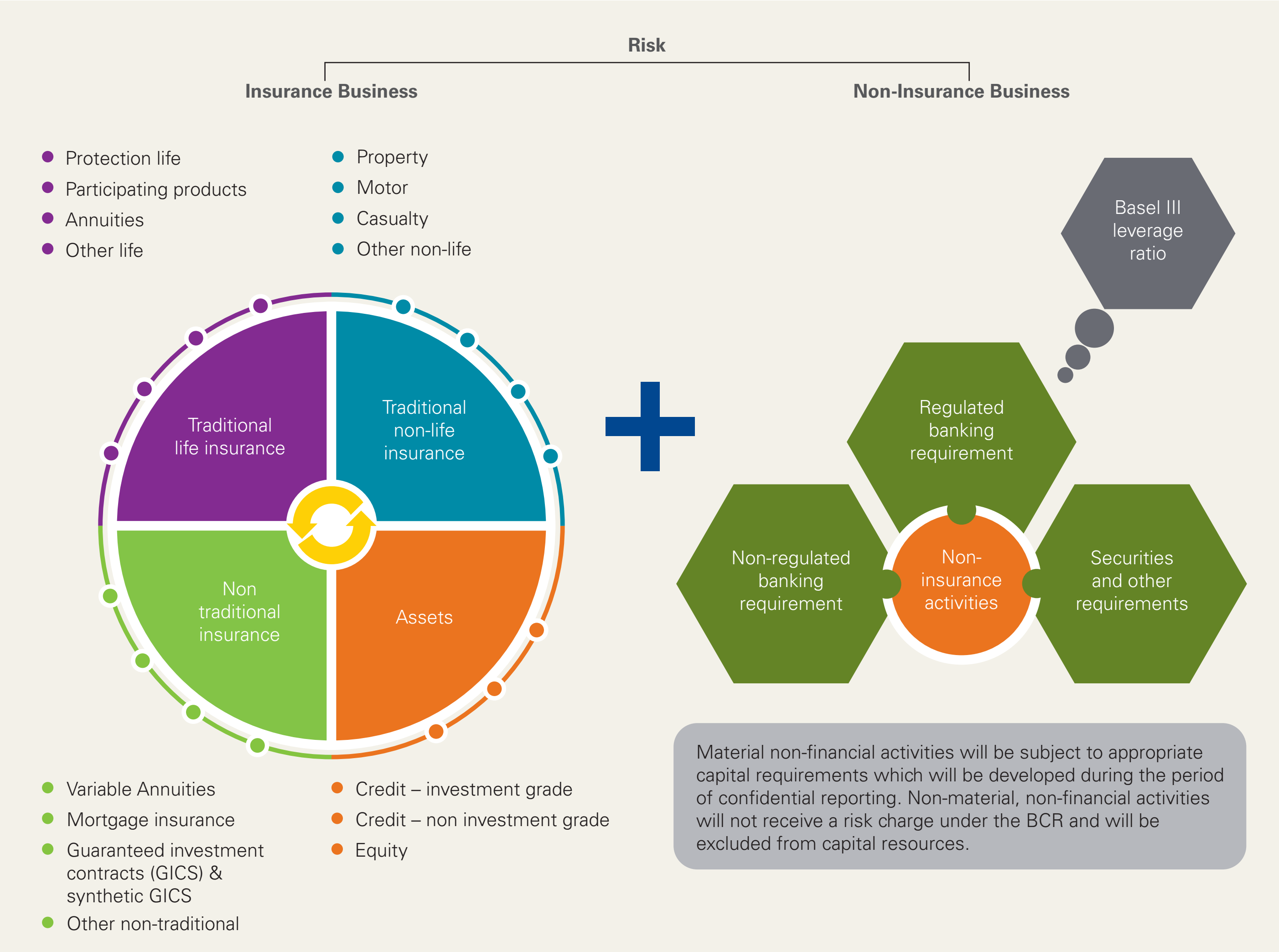
Figure 7: Guiding principles of BCR development

Source: IAIS Basic Capital Requirements for Global Systemically Important Insurers, 23 October 2014.

Required Capital

The BCR capital charge can be segregated by business activity. More specifically, this can be broken down into an insurance capital component based on the insurance businesses the group operates, an asset charge component based on the type of asset holdings and a charge for all non–insurance financial and non-financial activities. Figure 8 illustrates the components of the BCR.

Figure 8: Components of the basic capital requirement



Source: KPMG International 2015.

> The BCR for insurance and asset risks are calculated through a factor based model designed to capture the main categories of risk that impact G-SIIs. The model consists of 15 factors or charges that correspond to various products which are applied to exposures to obtain the BCR.

The BCR for insurance and asset risks are calculated through a factor based model designed to capture the main categories of risk that impact G-SIIs. The model consists of 15 factors or charges that correspond to various products which are applied to exposures to obtain the BCR. The size of the factors are currently prescribed by the IAIS and were calibrated through the field-testing exercise conducted in 2014. (These factors are provided in the Table below). For most products, the regulatory balance sheet would provide the information required to calculate both the required capital and qualifying capital (see Table 8).

Table 8: Required capital and qualifying capital

BCR segment	Proxy measure for risk exposure	Factor	Factor value
Traditional Life (TL)			
Protection life	Net Amount At Risk	a_1	0.06%
Participating products	Net Current Estimate	a_2	0.6%
Annuities	Net Current Estimate	a_3	1.2%
Other life	Net Current Estimate	a_4	0.6%
Traditional Non-life (TNL)			
Property	Premium Measure	b_1	6.3%
Motor	Net Current Estimate	b_2	6.3%
Casualty	Net Current Estimate	b_3	11.3%
Other non-life	Net Current Estimate	b_4	7.5%
Non-Traditional (NT)			
Variable annuities	Notional Value	c_1	1.2%
Mortgage insurance	Risk in Force	c_2	4.0%
GICS & Synthetic GICS	Notional Value	c_3	1.1%
Other non-traditional	Net Current Estimate	c_4	1.3%
Assets (A)			
Credit – investment grade	Fair Value	d_1	0.7%
Credit – non investment grade	Fair Value	d_2	1.8%
Equity, real estate & non-credit investment assets	Fair Value	d_3	8.4%

Source: IAIS Paper: Basic Capital Requirements for Global Systemically Important Insurers 23 October 2014.

For most insurance products, the regulatory value of the liabilities is used as the exposure measure and is determined by the net current estimate of liabilities (CEL) valuation approach. The IAIS details a market adjustment methodology to determine the value of the liabilities and prescribes a discount rate that is to be used to ensure consistency across jurisdictions. For assets, the exposure is the value of the assets and is measured on a fair value basis.

Market adjusted methodology

A market adjusted methodology is adopted to calculate the current estimate of liabilities (CEL). The CEL represents the present value of the mean of the distribution of future cash flows and has the following characteristics:

- Probability weighted average of the present value of future cash flows associated with insurance contracts using the IAIS prescribed term structure of interest rates. Margins are not included as part of the CEL and the projected cash flows should include the following:
  - Benefit payments
  - All expenses including investment expenses, administration expenses, acquisition expenses and other expenses
  - Premiums received
  - All other cash flows.
- The CEL should be based on up to date and realistic assumptions to project all future cash flows for the life of each policy, with the projection period determined by reference to the contractual boundaries of each policy.
- Embedded options and guarantees (such as minimum investment returns, surrender options or other policyholder options) should be included in the cash flows.
- Policy behavior should also be taken into account, particularly with regard to changes to the amount, timing and nature of benefits.
- Management actions can be taken into account to the extent that they can reasonably be expected to be carried out in the future.

Qualifying Capital Resources

The qualifying capital resources are determined on a consolidated group-wide basis and are classified as either core or additional capital. Core capital is defined as those financial instruments having the following characteristics:

- No fixed maturity, not retractable by the holder and not redeemable within the first 5 years
- Fully paid up with no fixed servicing costs; distribution can be cancelled without risk of default; non-cumulative
- Free from charges, claims or other hindrances and do not include a right to compulsory payments
- Requires that redemption be subject to review/ approval from the supervisor.

Additional capital is defined as having the following characteristics

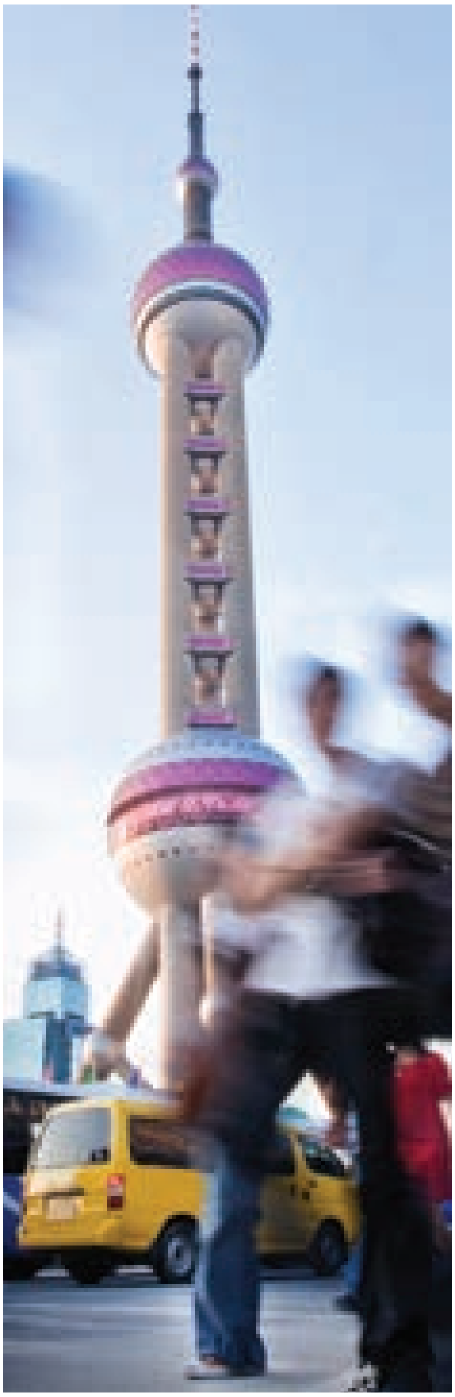
- Initial maturity of at least 5 years, with the following conditions
  - Notional amount of instrument amortized on a straight line basis over the final 5 years to maturity
  - Requirement for G-SII to suspend redemption if it is, or would be, in breach of its capital requirements if the instrument is/were to be redeemed
- Redemption is subject to review by the supervisor
- Holder has no right to accelerate repayment of future coupon or principle payments except in certain bankruptcy.

Furthermore, specific balance sheet items are excluded from core capital, including items such as goodwill, intangible assets, deferred tax assets net of deferred tax liabilities, cross holdings, direct investment in own assets and other items. The terms core capital and additional capital may be amended in future to tie in with the new tiered capital definitions used within the ICS consultation document.

A key measure of the BCR is the BCR Ratio, determined as total qualifying capital resources divided by required capital. For the purposes of determining this ratio, qualifying additional capital resources cannot exceed 50 percent of required capital.

Higher Loss Absorbency (HLA)

Having finalized the BCR approach, the IAIS will refocus its efforts on developing the methodology to calculate the HLA that will be applied to all G-SIIs. Upon implementation of ComFrame and the ICS, all G-SIIs will be required to hold capital in excess of the ICS plus the HLA. The impact of the decision to delay a final ICS beyond 2019 will impact the HLA which needs to be in place by that date. The IAIS has not yet provided guidance in this area.



The IAIS is concerned about the systemic risk posed by G-SIIs, particularly because of the rising macro-financial linkages between insurance activities and the financial sector. As such, the IAIS' primary objective is to require G-SIIs to reduce or ring-fence their NTNI activities.

The HLA capital requirement is primarily targeted at the NTNI aspects of their business. It is anticipated that the HLA capital requirements will need to be met by core capital that is able to cover losses at all times.

In September 2014, the IAIS released a set of principles that will guide the development of the HLA (see Table 9).

Table 9: HLA Principles

No.	HLA Principles
1	Outcomes should be comparable across jurisdictions.
2	The HLA should reflect the drivers of the assessment of G-SII status.
3	The HLA should internalize costs of failure or distress of a G-SII that would otherwise result in costs to the financial system.
4	HLA should remain valid in a wide variety of economic conditions.
5	The HLA assumes that G-SIIs are going concerns.
6	The HLA capital requirement is to be met by the highest quality capital.
7	The design of the HLA needs to be pragmatic and practical, balancing granularity and simplicity.
8	The HLA should be consistent and over time applicable for insurance and non-insurance entities.
9	The level of transparency, particularly with regard to the final results provided and the use of public data, should be optimized.
10	The HLA will be refined in light of experience and data gathered by the IAIS in the course of Field Testing exercise.

Source: IAIS, Higher Loss Absorbency Principles, 22 September 2014.

Implications for G-SIIs

- The valuation basis adopted for all assets is fair value and for insurance liabilities is the current estimate of liabilities. There is currently no uniform valuation approach for assets and liabilities for either regulatory or accounting purposes, so insurers in some markets will need to develop a valuation methodology based on these prescribed requirements. In light of IFRS and the move toward global insurance liability valuation standards, it would make sense to adopt a consistent valuation approach where possible.
- It remains unclear what the target level of confidence the BCR is being set at, however, it appears to be in the range of 85–90 percent VaR. It is unlikely that this will cause much concern for G-SIIs, as most would already hold group capital levels above this amount. This was confirmed by the field-testing exercise conducted in 2014.
- As part of the field-testing conducted by the IAIS, 8 G-SII participants reported total qualifying capital resources of 427 percent of the proposed BCR on average and core qualifying capital resources of 376 percent on average. For all 34 volunteers that participated in the field-testing exercise, these figures are 404 percent and 355 percent respectively.[8] This indicates that most insurers are well capitalized relative to the level of capital implied by the BCR. However, if the target level of confidence were to be increased (upon developing the ICS and the HLA), this may result in political tension across various jurisdictions.

Figure 9: Allocation of capital charge

Source: IAIS Basic Capital Requirements for Global Systemically Important Insurers, 23 October 2014.

- Looking forward, there still remains significant uncertainty regarding the practical application of the BCR and local jurisdictional requirements.
- The level of sophistication adopted in developing the BCR was carefully balanced against its purpose of maintaining simplicity and comparability across jurisdictions. As such, due to its simplicity, the BCR does not appear to be sensitive to various risk types but rather acts as a gauge of the 'level of risk' to determine capital levels.

Table 10: Risk Addressed within the BCR Framework

Asset risks	✓
Liability risks	✓
Operational risks	✗
Asset/Liability matching	✗
Allowance for Diversification	✗
Insurance risks/claims risk	✗
Interest rate sensitivity/risk	✗
Liquidity risk	✗

8. IAIS Basic Capital Requirements for Global Systemically Important Insurers, 23 October 2014

KEY INSIGHTS AND PERSPECTIVES FROM LEADING REGULATORS AND CROs ON GLOBAL DEVELOPMENTS

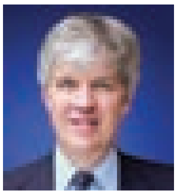
This year as part of our report on *Evolving Insurance Regulation*, KPMG interviewed leading regulators and insurance company CROs from around the world regarding their views on developments towards a global capital standard, policyholder protection levels, group-wide supervision and colleges, systemic risk and recovery and resolution plans, and the future of global standards, including cross-sectoral consistency in regulatory requirements.

Key findings

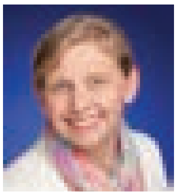
Both industry practitioners and regulators saw value in greater international consistency and harmonization of insurance requirements, but raised concerns as to whether this could be achieved in practice. They also expressed continued strong support for supervisory colleges, ongoing cooperation and engagement by supervisors, and a desire for greater IAIS focus on supervisory activities going forward.

The panel of regulators were very aware that the implementation of the ICS still requires much more understanding and debate amongst supervisors and industry, particularly regarding how global standards may coexist alongside local requirements. All participants agreed more dialogue is required as to whether the ICS should be a framework in which different regulators work within the broad parameters set or whether these new standards will require changes to local solvency requirements.

FROM INDUSTRY, WE SPOKE TO REPRESENTATIVES OF SOME OF THE LARGEST GLOBAL INSURANCE GROUPS, NAMELY:



Hugh Graham
Chief Risk Officer
AIA Group



Sue Kean
Group CRO
Old Mutual Group

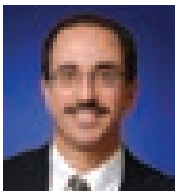
Axel Lehmann
Group CRO
Zurich Insurance Group

The CROs particularly expressed their desire for:

- More dialogue on future proposals of the new capital standards currently being developed
- Greater consistency with international accounting standards, especially regarding valuation and
- More open dialogue and debate on issues such as the appropriate level of policyholder protection for the new ICS.

Vision

One of our key questions asked what the 'vision' for ComFrame should be. We asked whether ComFrame should operate in a similar manner to a Basel Accord framework, whereby existing local requirements would be amended to adopt the new international standard, or whether ComFrame should be a high-level framework which jurisdictions would align themselves towards in order to reach similar outcomes, without necessarily changing existing solvency requirements.



Stan Talbi
Group CRO
MetLife

FROM THE REGULATORY COMMUNITY, WE SOUGHT PERSPECTIVES FROM BOTH SIDES OF THE ATLANTIC, NAMELY:

Gabriel Bernadino,
Chair, EIOPA

Kevin M. McCarty,
Insurance Commissioner,
State of Florida

Several CROs saw benefits in having an ICS that could be applied globally, with Axel Lehmann citing a number of advantages, such as:

- Help overcome fragmentation amongst supervisory jurisdictions
- Achieve better consistency, especially in reference to accounting standards and
- Assist regulators, as well as insurance firms, to have a common language, particularly as many stakeholders mean the same thing but often speak with a differently vocabulary.

Hugh Graham *(HG)* commented: *'It makes sense for the insurance industry to have a minimum capital standard against which all participants can be benchmarked. This should encourage a level playing field, promote a certain level of protection for policyholders and thus reduce systemic risk.'*

However, *HG* also cautioned that the '*standard should be a benchmark and not a binding constraint; ultimately individual regulators should set standard that suit their jurisdictions*', while **Stan Talbi** (*ST*) reflected the views of many of his peers by saying: '*In the push for a common international framework, all the supervisors have dug their heels in and are saying they won't change their regime, so it looks like the ICS will be another reporting requirement*'. Similar sentiments were echoed by **Axel Lehmann** (*AL*): '*the insurance capital standard should not come over the top of existing requirements – so should be a framework that is flexible enough and provides a transition plan, providing a consistent framework that can be applied locally but not added to existing requirements… In practical terms, this could mean having an ICS as a measure, but using the Swiss Solvency Test as the actual regulatory requirements'.*

Sue Kean (*SK*) observed that it was not clear what extra protection a global standard would bring and voiced another key concern of CROs saying: '*No one wants an environment where businesses are being piled up with multiple measures, for example, accounting and from a risk management perspective where such differences can add to pricing issues and costs become additive*'. She also raised specific concerns about the impact on developing countries.

Kevin McCarty (*KM*) acknowledged that there was a level of confusion as to ComFrame. He elaborated, '*It is unfortunate that a project as important as ComFrame, including the BCR and especially the ICS, has struggled with a lack of clarity as to the meaning and intent of important concepts and foundational principles, e.g. comparability, group, etc. In the push to gain acceptance for ComFrame, the strategy seemed to be allowing ComFrame to be "All things to all people." Parties have been interpreting these ideas in different fashions, and it has made the development process more complicated than I think it could have been.*

My thoughts all along are that ComFrame and its attendant tools and principles should be a framework that allows for a higher degree of supervisory transparency and clarity for those complex financial organizations that are assuming risks across the globe. I never envisioned, nor could I be supportive of, a single prescriptive solvency regime for all insurers but rather a framework that would allow supervisors, and other stakeholders, to understand risk in an insurer based on their existing or enhanced jurisdictional requirements. If enhancements are needed, such as the work we have been doing (at the NAIC and in conjunction with our colleagues at the FIO and FRB), then it should be done within the jurisdictional framework.'

These views were similar to CROs with *AL* saying, *'For now, it is important to find the common middle ground, such as in regards to valuation and capital standards between countries to help foster a global framework. Such an outcome would be better than what we have now.'*

In contrast to the general views expressed, **Gabriel Bernardino** (*GB*) was much more positive in that he thought '*the ultimate goal should be that Comframe, including the International Capital Standard (ICS), becomes an international minimum standard that national or regional standards should comply with. The ultimate goal should be to develop a single ICS based on a common methodology by which we can achieve substantially the same capital requirements across jurisdictions, avoiding regulatory and capital arbitrage and improving the effectiveness of the supervision of internationally active*

"It makes sense for the insurance industry to have a minimum capital standard against which all participants can be benchmarked. This should encourage a level playing field, promote a certain level of protection for policyholders and thus reduce in systemic risk."

– Hugh Graham,
AIA Group

insurance groups. Going forward, all jurisdictions should be open to make adjustments to their systems in order to ensure convergence with the ICS. Insurance groups should be subject to only one group capital regime.'

Policyholder protection

For a number of years, it has been difficult for stakeholders to engage in the debate regarding the appropriate level of capital for ComFrame and, correspondingly, policyholder protection, in the absence of a clear view from the IAIS.

The CROs raised a number of key concerns on calibration, including uncertainty concerning different methods, compensation schemes (*'the biggest area missing in all of the global discussions, conduct risk*' (*SK*)) and the issue of Treating Customers Fairly (TCF), reserving policies and '*how you could wind down an insurance company in an orderly fashion*' (*AL*). Some CROs thought it was '*too early to have a view on calibration*' (*ST*) and that '*the focus should be on activities rather than the enterprise itself in setting additional capital*' while *HG* acknowledged that '*there are arguments for and against different levels of capital*'. *AL* believes that '*policyholder protection should be a key consideration*', suggesting that '*regulatory capital should always be a minimum and something around investment grade is likely to be the right level*', while *ST* raised the risk that, '*as there are not enough firms to properly calibrate, the ICS may result in higher risk charges then should otherwise be the case*'.

From a regulatory perspective, *KM* acknowledged the potential controversy and added that '*within acceptable parameters, the key role of the supervisor is to ensure that the insurance promise made is a promise good. If there is an issue with a particular insurer, there needs to be a resolution framework, such as the US network of guaranty funds, in place that allows for the workout of the issue while maintaining the sanctity of the insurance promise made in the contract. I also think you will find that this is a common view among solvency regulators operating within a functional regulatory framework. If, on the other hand I were part of an integrated financial regulator, I might be more persuaded toward an "acceptable" level of risk to be borne by policyholders in the desire for financial stability in the large. How much risk and so forth is a question that seems to me to be dependent on the structure of these organizations and their role within a particular economic jurisdiction. Within ComFrame, my obvious bias would be toward a policyholder protection focus at least as robust as that which we currently provide'.*

GB stated that '*a risk-based prudential standard needs to have clear and transparent target calibration criteria for capital requirements. Furthermore, other high-level elements need to be appropriately reflected in the ICS development: risk sensitive valuation consistent with the information provided by the financial markets; total balance sheet approach; explicit recognition of risk diversification; consideration in capital requirements of all the material risks to which the group is exposed; and, allowance for the use of different levels of sophistication (from the basic requirements up to internal models).*'

Achieving global and especially US cooperation

It has been widely acknowledged that progress towards an international capital standard by the IAIS has been difficult given the bespoke nature of insurance supervision globally and the perceived strength of existing regulatory requirements in many jurisdictions, notably the US. These sentiments were reflected by *HG* who commented that '*some regulators may feel that a single capital standard is not warranted: solvency supervision at the legal entity level has worked well for them*'.

"Within acceptable parameters, the key role of the supervisor is to ensure that the insurance promise made is a promise good."

– Kevin M. McCarty,
Insurance Commissioner,
State of Florida

> The clarification to the Collins amendment to Dodd Frank would now require the Fed to accept each company's accounting standard if GAAP is not used. This means a statutory accounting basis for mutual companies regulated by the Fed by virtue of their ownership of Savings and Loans.
>
> **– Stan Talbi,** MetLife

The complexity of issues involving the US was underscored by *ST* who noted that: '*To get the US on board, you'd have to have a capital regime that is US statutory accounting or US GAAP based. However, a US statutory based system is difficult for other firms internationally and so it would likely have to be GAAP-based or provide a conversion mechanism to GAAP. The clarification to the Collins amendment to Dodd-Frank would now require the Fed to accept each company's accounting standard if GAAP is not used. This means a statutory accounting basis for mutual companies regulated by the Fed by virtue of their ownership of Savings and Loans*'.

Another difficulty highlighted by the CROs in achieving a global framework is that '*the underlying balance sheets are different. You end up with confusion rather than convergence – given underlying accounting bases are so different. It presumes the underlying is similar, which it isn't'* (*SK*). Further, '*a market consistent basis is not an approach that US firms like due to the volatility – i.e. being market-based – it doesn't make sense to show that volatility given liabilities are relatively illiquid and relatively long-term*' (*ST*). Meanwhile, *AL* suggested two ways to address such issues: '*Firstly, everyone needs to be on the same boat regarding the overall discussion, and secondly, we need to move along and continue to make progress and those who want to be involved can be involved. Maybe different trains and different speeds are required*'.

GB stressed the importance of regional cooperation. '*I believe that the development of an ICS in the insurance sector is necessary and achievable. All jurisdictions around the globe, coming from more mature markets like the EU and the US, but also from emerging markets in Asia, Latin America and Africa, need to work together to ensure improved convergence over time. The setting up of an ICS is a fundamental objective for financial stability, as stated by the Financial Stability Board.*' *GB* also recognized the special efforts being made between the EU and US supervisors. '*I would like to mention the important contribution of the EU-US Insurance Project to an increased mutual understanding and enhanced cooperation between the EU and the US on insurance regulation and supervision. This project is delivering concrete products and outcomes, proving that convergence is possible over time.*

KM provided the US regulatory perspective: '*Do I think a standard, global risk-based capital regime is achievable? Maybe at some point in the future, but I think the US's healthy scepticism of such a standard is likely fairly common in other well-functioning jurisdictions. As a result, I don't think there will be a universal appetite to adopt a global capital standard yet. We will all have to see what comes out of the current IAIS work and how well it suits our markets or improves our supervisory efforts. To suggest anything else is, I think, overly aspirational. I do think, though, that the NAIC should consider a group capital standard for IAIGs perhaps including a confidence level, which could provide a bridge across the regions and different capital standards. I would note that state regulators are working along several lines, including close collaboration with our Federal colleagues, to develop a US group capital framework'.*

Recovery and Resolution Plans for Domestic Systemically Important Insurers

The FSB's *Key Attributes for Global Systemically Important Financial Institutions* G-SIFIs has raised the need for recovery and resolution plans and the issue of whether analysis pertaining to 'recovery' elements should nonetheless be a standard risk management requirement for insurers.

The CROs were uniformly of the view that '*from a risk management perspective,* *knowing what your options are as to cash and capital in the event of a crisis is useful and all companies should have this*' (*ST*) and that techniques such as reverse stress testing were useful, especially as '*Directors of an insurance company … are very interested in how the institution will protect itself or ultimately realize its obligations to policyholders in a variety of stressed conditions'* (*HG*).

However, many expressed the view that while '*recovery analysis elements do seem quite helpful … as is often the case, a lot of nervousness from firms is that certain things will get mis-used by supervisors*' (*SK*). *AL* further cautioned that '*there should not be form over substance*', stressing that '*firms always find a way to manage a wind down without an RRP*', while *ST* observed that '*these RRPs are very specific to legal entities rather than taking a wider risk view*'. *SK* further raised the point that '*some of the reverse stress tests are geared up to 1 year frameworks, which is fine for regulators and examining the immediate impact on the balance sheet, but not for shareholders who take a longer view. Management also need a longer time horizon to properly undertake management actions*'. *ST* also observed that '*an insurer can take 20-40 years to wind down. This is a long time. The requirements for resolution should reflect that significant fact'*.

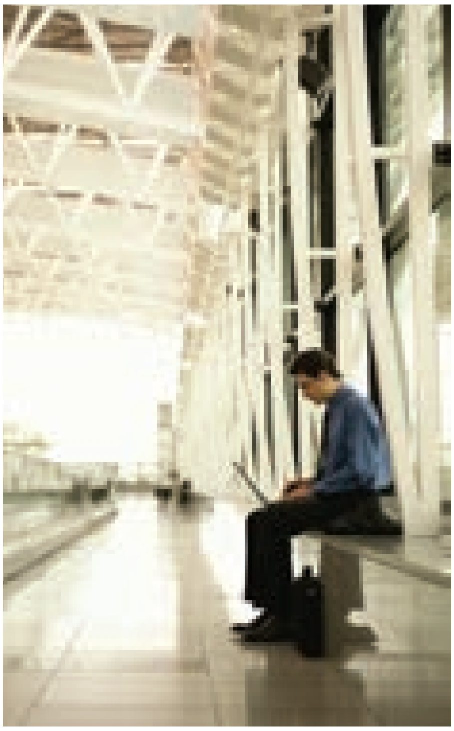
Similar views were echoed by *KM* who said '*the definition of systemic risk should remain narrowly focused on avoiding "economic havoc" and should not be expanded to include market disruption. A failure of a large company might require supervisory intervention, but that does not mean it is systemically risky. We need to remain conscious of the cost of regulation, such as the requirement for resolution plans, since those costs are ultimately borne by the policyholders'*.

GB noted that *'the key attributes are aimed very specifically at the G-SIIs rather than the broader population of insurance groups, nevertheless there are aspects of formalized Recovery and Resolution planning that have broader applicability. "Recovery" planning would undoubtedly be an important element in good risk management whereby all undertakings would have a clearer understanding of the potential options available to them to deal with a stressed situation. The need to engage in this activity and its expected sophistication should be viewed, as always, in terms of proportionality – simpler business models do not raise the same issues as more complex business models.*'

Group-wide supervision and colleges

The CROs were generally supportive of the supervisory college process believing '*it is helpful to get a common view of the group amongst our supervisors*' (*AL*) and '*the more engagement the better*' (*HG*). However, it was noted that while some groups have had good experiences, others have not – even to the extent that there have been '*variations within a country*' (*SK*). *ST* stated that '*If the supervisors can get comfortable with the overall risk profile and capital position of the group, I'd like to see it result in more capital fungibility between legal entities and allow capital to flow more freely where it may not be needed in its current location but may currently be restricted from moving freely*'.

Other CROs also expressed the view that differences between local and group supervisors needed to be clarified – '*for example, what powers do supervisors have within the college? In essence, the group supervisors have responsibilities and powers in relation to group supervision and the others are responsible for their own local entities. More clarity is therefore required on how these colleges should function and perform and of course, MMoUs are needed'. A lot of firms are preparing for colleges now. This is resulting in more senior resources being used to present at, and more material being prepared for, the colleges by firms. There are also some multiple information*



“So, overall, it’s an important role and, equally important as we move into ComFrame and a level playing field, it should not just be about capital, but how the information is used to better achieve supervisory outcomes.”

– Sue Kean,
Old Mutual Group

requirements from supervisors going to local entities, which becomes inefficient and costly. So, overall, it’s an important role and, equally important as we move into ComFrame and a level playing field, it should not just be about capital, but how the information is used to better achieve supervisory outcomes (*SK*). Similarly, *AL* noted that ‘*collaboration, trust and integration is something for the supervisors to address*’.

From a regulatory perspective, *GB* believed that ‘*colleges of supervisors have made good progress in the last years and have been fundamental to increase the exchange of information between supervisors worldwide, moving towards a more common analysis and measurement of risks. This evolution will benefit from the development of the ICS, which will create a common language of risks, capital requirements and capital resources. KM* shared similar views that ‘*supervisory colleges have become more effective as the process has grown and matured*’.

Conglomerate supervision

In terms of conglomerate supervision, we asked our respondents whether they could see different sectors coming together to apply a common approach to capital and risk requirements or whether they would continue to have their own respective requirements going forward.

The CROs were reasonably consistent in their view that ‘*financial services sectors are quite different to one another*’ (*AL*) and that ‘*there should not be a common approach because the risk factors are very different. Maturity transformation with banking is quite different. Insurers don’t have the same liquidity issues. There is some commonality between banks and insurers, such as stress tests and even liquidity in the broader sense, but the liability profile for insurers is very different for insurance policyholders – so some commonality in approach makes sense at a broad level but the approach to capital should be different*’ (*ST*).

Such sentiments were echoed by *HG* who noted that while *‘it is very tempting to see some form of economic capital model as a universal panacea which can be applied to any business in any market … these models are complex, potentially volatile and cannot necessarily capture all the risks and potential benefits associated with a business. In the case of conglomerates you need to think about the risk profiles particular to different types of financial services when evaluating their riskiness. For example, the liquidity risk profile for banks and insurers is completely different: where a bank needs to keep its balance sheet fairly liquid, an insurance company can take more liquidity risk – how do you present that robustly in a single model?’*

SK also suggested that ‘*Sub-colleges, or sub-groups for some sectors might be a better approach than just one group-wide conglomerate approach. However, I recognize that local supervisors are wanting to get a group-wide ORSA, though I think the banking impact is questionable. For example, the underlying accounting is so different between banking and insurance, and the approach to capital is different between the sectors, including the underlying asset valuation basis. As a further illustration, accounting for banks’ bad debts and impairment restricts how far into the future you can look when determining bad debt provisions for each year, but with insurers, we’ve had reserving concepts for some time which require technical provision to reflect the expected eventual liability. So, for credit risk, I think you would need to have a different approach to capital between insurance and banking capital if the accounting differs. Also, at the end of the day, I do wonder what value this will end up being, given the potential confusion that may arise. Understanding cross concentrations may be helpful, but a common capital standard across sectors will be difficult – and* *besides, in practice not many integrated conglomerates remain these days anyway'.*

Similarly, *AL* noted that '*the time of putting everything together is over – there should be horses for courses – though you can have some common themes – such as the treatment of sovereign risk weights across sectors. In this regard, there should be consistent regulatory treatment and there should be commonality in approach, for example, in regards to equity risk weights – the asset treatment across sectors should be treated similarly. Similarly, confidence intervals across sectors could also be harmonized – but not necessarily an integration of those frameworks'.*

From a regulatory perspective, *GB* was of the view that *'Convergence in the supervisory approaches of the different financial sectors is a very appealing concept and we have been witnessing a clear trend towards a more consistent treatment of similar risks. That facilitates the mutual understanding between supervisors and therefore simplifies conglomerate supervision. Furthermore, ensuring that similar risks are treated in the same way, avoids incentives for capital arbitrage by market participants, limiting the concentration of risks in those sectors where they are treated in a more benevolent way.*

However, I do believe that this convergence should only develop to the extent that the specificities of business models are properly recognized. In fact, the specificities of the insurance business and its inherent risks make it very difficult to obtain reasonable results through the application of a capital framework which has been designed with a banking mind-set. And the same applies for the banking sector. Despite its potential appeal, we should move away from the concept of applying one single standard across all financial sectors, as it will produce sub-optimal results for all of them.

The specificities of the insurance business models make it very different from banking business. And the capital framework must be sensible to these specificities, dealing appropriately with features such as the very long term nature of a substantial portion of insurance business and also creating the right incentives for proper risk management, which is a fundamental element of insurance.'

KM expressed similar views and stated that '*I think you may see more convergence in thought on methods and measures, but as far as common capital and risk requirements, I think there will always naturally be some differences across sectors. I say this because I think it is short-sighted to think of risk as an absolute; they should be viewed in a portfolio context. A risk that could be seriously inappropriate or damaging within one portfolio may actually be a good fit within another. As a crude example, overnight funding arrangements are a good fit in many banks and as such would have an appropriate capital charge. That same agreement could be a very bad fit for a life or annuity provider however. We need to look for comparability of outcomes in assessing risk and the ability of companies to perform in times of stress. If we gain a common understanding of risk, we will have come a long way'.*

IAIS developments and the future of insurance supervision

As a final question to our respondents, we asked what changes in insurance supervision would they like to see or consider necessary, given the IAIS is now entering its 21st year as a global standard setter for insurance. A number of different responses were received.

HG outlined three areas of focus he would like to see:

'1. Continue to promote common standards and best practice across the industry.

> "Despite its potential appeal, we should move away from the concept of applying one single standard across all financial sectors, as it will produce suboptimal results for all of them."
>
> **Gabriel Bernadino,** Chair, EIOPA

"Important though the subject is, we should try not to let the issue of capital dominate discussions…capital offers protection in a crash to make sure no one gets hurt. I want to make sure we don't have a crash in the first place."

–Hugh Graham,
AIA Group

If nothing else the whole ComFrame discussion has got different players talking about the issues and pooling their experience.

2. Important though the subject is, we should try not to let the issue of capital dominate discussions…capital offers protection in a crash to make sure no one gets hurt. I want to make sure we don't have a crash in the first place and to that end I welcome the opportunity to share ideas with regulators and other industry participants – the IAIS is a useful forum for that.

3. In that vein, I would also like to see the IAIS promote wider discussion of the industry and its role in society. In particular the virtuous circle of providing a safety net in the form of protection and savings products and using the premiums from those products to invest in the development of the countries in which we operate should be considered as part of a wider discussion on policyholder protection. I think the IAIS can influence the development of regulators as partners as well as overseers, rather like the Second Line in fact'.

Other CROs like *ST* were of the view that '*the IAIS should be more of a standard setting body, providing guidance to regulators for what acceptable standards should look like. I think there may be some gaps for some insurance group holding companies and for non-regulated activities, especially where many don't have a group supervisor such as in the US, and the IAIS could play a role here'.*

SK stated that *'some of the basics from the Insurance Core Principles, such as establishment of the regulator, no political interference, professional secrecy, need to cover conduct and prudential regulation etc. are really helpful. Core principles have achieved a lot. However, I think it's lost its way a bit, for example, by focusing too much on things which may not be achievable. Reaching a final decision is also limited as the IAIS works on a consensus basis. However, if you're a smaller country, then a lot of the IAIS framework is useful due to the ICP requirements and analysis undertaken by the IMF with its Financial Sector Assessment Program. The question remains though for the ICS, is this going to be a conceptual model or be like a Basel framework?'*

AL was of the view that *'the whole discussion around the global financial crisis and systemic risk has shown perhaps that the IAIS has not had the same clout as others. We need a highly credible voice that can speak for the insurance industry and what the real issues are that the sector faces. In dealing with central bankers and politicians, an increased profile with credible dialogue is needed. Further, enhancement and convergence in the regulatory world is continuing – for example, capital standards, regulatory requirements – and there is a sharp focus generally on the supervisory and regulatory agenda. However, I think there is too much coming into insurance from banking, whether that be from political pressure or in response to that sector's conduct issues. The aim for the insurance sector should be policyholder protection and this is what insurance regulation should be focused on.*

Putting the customer at the heart is good but for the state itself through for example conduct regulators to have this as an agenda is perhaps interesting. Competition should be there, no question – but should regulators be drilling down into everything an organization does? Is this not what executive management and the board are responsible for doing? Certain roles and responsibilities are unclear in this regard and the focus for regulators should squarely be on capital and liquidity management.'

Providing a regulatory perspective, *GB* shared his view that *'In the coming years I would like to see the IAIS developing as a truly international standard-setter. It is crucial that international standards in insurance are developed at the level of the IAIS. The IAIS made a very ambitious commitment and of course a lot of effort will be required in order to fulfil this commitment, including at organizational and governance levels. Going forward I see a constant challenge for insurance supervision in adapting to a more globalized market. Furthermore, insurance regulation and supervision will need to cope with the fundamental changes in insurance business models that we will witness in the coming decade, fuelled by the low interest environment, the digitalization of financial services and emerging threats like cyber-attacks.'*

KM added, *'Moving forward, I would like to see the IAIS not only continue its standard setter role, but also to evolve into more of a support organization for insurance supervisors, whether it is in helping to implement best practices in jurisdictions seeking help, or acting as a technical support clearinghouse for accounting and regulatory understanding among member supervisors'.*

> "It is clear from our interviews that both industry practitioners and regulators recognize the value in achieving greater international consistency and harmonization of insurance requirements. Simiarily, there was strong support for the continuation of supervisory colleges and ongoing cooperation and engagement by supervisors with each other. Generally the consensus was that the college process should in itself lead to a convergence of regulatory practices over time."

KPMG Perspective

It is clear from our interviews that both industry practitioners and regulators recognized the value in achieving greater international consistency and harmonization of insurance requirements. Simiarily, there was strong support for the continuation of supervisory colleges and ongoing cooperation and engagement by supervisors with each other. Generally the consensus was that the college process should in itself lead to a convergence of regulatory practices over time.

Notwithstanding these sentiments, concerns were raised as to whether this could practically be achieved, particularly in relation to how the new global standards would interact with local laws. The need to recognize the regional differences in insurance products, exposures and the distinctions between insurance and other financial sectors was also considered to be necessary preconditions for an effective global framework. It remains unclear from the current ICS consultation paper how such issues will be addressed, but the decsion to allow more time for the debate may help resolve some concerns raised by the interviewees.

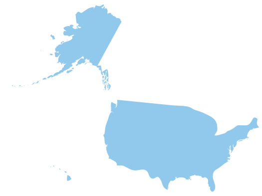
The uncertainty surrounding these issues is unhelpful, especially considering the IAIS has commenced the process of developing a framework before reaching an agreed implementation commitment from regulators, which includes not yet having consensus concerning the appropriate level of policyholder protection. Such outcomes raise the very real prospect of duplicate or contradictory regulations emerging which seemingly goes against the overriding aim and expected benefits of achieving greater consistency and harmonization of requirements by having an ICS.

REGIONAL **REGULATORY** DEVELOPMENTS IN **AMERICAS**

Changes in the Americas vary between the north and the south, but both continents are moving toward increased group supervision, a risk focused approach to regulation, and expanded consumer protection.

North America

US



The US regulatory system is globally unique due to the different roles of federal and state bodies, which can make the legislative process challenging.

State insurance regulators have primary responsibility for insurance supervision, but their work is coordianted through the activity of the National Association of Insurance Commissioners (NAIC). The NAIC directs changes to insurance regulatory requirements through amendment of its model laws, but it has no power to directly impose these reforms on the various states. However, its accreditation program (under which states are fully assessed every five years regarding adoption and implementation of the model laws) does create a strong incentive for enactment of the NAIC model laws.

The Federal Insurance Office (FIO) sits within the US Department of Treasury and has the authority to monitor all aspects of the insurance sector, including representing the USA on prudential aspects of international insurance matters. It also advises on important national and international insurance issues, but does not have any supervisory role, which remains with state regulators.

The Federal Reserve Board (FRB) has consolidated oversight over any non-bank entity designated as systemically important (currently AIG, Prudential Financial and Met Life) and any insurance holding company that operates a federally chartered thrift institution. The insurance groups for which the FRB is the consolidated supervisor hold approximately one-third of US insurance industry assets.

ICP compliance

The April 2015 FSAP report cites significant improvements since the 2010 FSAP, including the FIO's role in setting priorities and the FRB's role extension to include insurance. However, it also states that additional work is needed regarding the valuation standard for life insurance, group capital standards, governance, risk management, market conduct and intermediary supervision. The report recommends strengthening FIO's role to bring about convergence on uniform high standards of regulation and comprehensive market oversight.

Prudential developments – National Association of Insurance Commissioners (NAIC)

The NAIC has initiated many changes over the past year to implement more comprehensive supervision for insurance holding companies and groups. The key elements of these reforms are covered below.

Group Supervision

In 2010, the NAIC adopted changes to its Model Holding Company System Regulatory Act requiring additional reporting from insurance groups including investments, purchases, guarantees, management agreements, and distributions.

> "The April 2015 FSAP report recommends strengthening FIO's role to bring about convergence on uniform high standards of regulation and comprehensive market oversight."

Recent changes to the Model Act also give the commissioner authority to act as the group-wide supervisor, with amendments including:

- Clarification regarding selection of a group supervisor for an IAIG, with criteria including place of domicile of the largest insurer within the group, location of the executive offices, and whether another supervisor is acting as the group-wide supervisor.
- The specific duties to be performed at the group level, including assessing the enterprise risks; requesting information on governance, capital, and inter-company transactions; and communication and coordination with other regulators.

Corporate Governance

During 2014, the NAIC adopted the Corporate Governance Annual Disclosure Model Act to address issues raised in the 2010 FSAP and the FIO's Modernization Report. This act requires insurers to disclose their corporate governance practices to their lead state regulator. At a minimum, the disclosure is required to address the insurer's corporate governance framework and structure; policies and practices of its board and significant committees; policies and practices of senior management; and oversight of critical risk areas. The first annual disclosure is due by 1 June 2016.

The NAIC also adopted revisions to the Annual Financial Reporting Model Regulation to incorporate an internal audit function requirement for large insurers (writing more than US$500 million in annual premium) in accordance with ICP 8 requirements. The function is required to be organizationally independent from management and must report annually to the audit committee.

Enterprise Risk Management

For two years, the NAIC has been testing its Own Risk and Solvency Asessment (ORSA) requirements, with over a third of the states having adopted the model law. The ORSA requirements apply to any individual US insurer that writes more than US$500 million of annual direct written and assumed premium, and/or insurance groups that collectively write more than US$1 billion of annual direct written and assumed premium. Initial reports are due in 2015. The NAIC has also developed an ORSA Guidance Manual to provide guidance to the insurer and insurance groups in completing their ORSA reports.

The ORSA has two primary goals: to foster an effective level of ERM at all insurers and to provide a group-level perspective on risk and capital, as a supplement to the existing legal entity view. Insurers are expected to:

- Regularly (no less than annually) conduct an ORSA to assess the adequacy of its risk management framework, and current and estimated projected future solvency position

- Internally document the process and results of the assessment
- Provide a confidential high-level ORSA Summary Report annually to the lead state commissioner if the insurer is a member of an insurance group and, upon request, to the domiciliary state regulator in which the group does business.

A new Enterprise Risk Report (Form F) has also been introduced for firms to identify and report their enterprise risk. These model law changes have been adopted in around half of the 50 states.

Group Capital

Group capital requirements are perhaps the most difficult challenge for the US regulatory system to address. The NAIC, FIO and FRB have been developing a group capital proposal aimed at meeting the ICS standard set by the IAIS. The FRB hopes to be able to use the eventual standard as a basis for its consolidated capital requirement.

The NAIC has adopted principles for a US capital standard, which include:

- The main objective of a U.S. Group Capital Proposal (GCP) is for the protection of policyholders. Well-capitalized IAIGs also support the goals of financial stability.
- The GCP aims at comparability of outcomes across jurisdictions and among IAIGs, which will enable increased cross-border supervisory cooperation and collaboration.
- The GCP is a consolidated group-wide standard at the level of the insurance group that provides for a risk-based measure of capital adequacy. The level of consolidation is generally at the financial holding company level that is immediately above the insurance entities.
- The GCP reflects all known material risks.
- The GCP aims to minimize pro-cyclical outcomes.
- The GCP reflects an appropriate balance between risk sensitivity and simplicity.
- The GCP reflects appropriate target criteria for the regulatory capital calculation.
- The GCP respects the jurisdictional accounting requirements (for example, GAAP, IFRS, or other comprehensive bases of accounting).

All parties have been particularly strong in saying that any group capital requirement in the US must be based on US GAAP (or statutory accounting if no GAAP report is filed) which is not consistent with the IAIS's proposed market-adjusted valuation approach outlined in the ICS consultation document. As a result, the IAIS is field-testing both options.

Currently the NAIC is examining two options for setting a group capital requirement: one using cash flow stress testing and the other an enhancement of the current risk based capital (RBC) system. The proposed "RBC Plus" system would retain the current US GAAP valuation basis, use a consolidated rather than aggregated approach, and retain current segmentation. The largely factor-based methodology would lend itself to verifiable and auditable information. The cash flow concept would follow the general methodology of asset adequacy testing. It would use internal models approved by the regulators and include all risks shown in the ORSA. The NAIC is also considering a combination of the two approaches, described as a hybrid approach.

"Group capital requirements are perhaps the most difficult challenge for the US regulatory system to address. The NAIC, FIO and FRB have been developing a group capital proposal aimed at meeting the ICS standard set by the IAIS. The FRB hopes to be able to use the eventual standard as a basis for its consolidated capital requirement."

Principles-Based Reserving for Life Insurance (PBR)

The NAIC continues to push for adoption of its new principles-based reserving (PBR) system for life insurance, relying upon an insurer's internal risk modeling to calculate reserves. To implement PBR, state legislatures must adopt both the Standard Valuation Model Law that was approved by the NAIC in 2009 and the 2012 revisions to the NAIC Standard No Forfeiture Law. PBR will only be operational once it has been adopted in at least 42 US jurisdictions, accounting for 75 percent of US life insurance premiums combined. To date 20 states have enacted principles-based reserving.

Reinsurance Reform

For several years, non-US reinsurers have been pushing to reduce or eliminate collateral requirements in the US and to simplify the state-by-state authorization process for reinsurers. In 2011, the NAIC modified its Model Reinsurance Collateral Law, renaming it the Credit for Reinsurance Model Law. The next year the Reinsurance Task Force was charged with developing a process to evaluate qualified jurisdictions. That process for developing and maintaining the list of qualified jurisdictions was adopted in August 2014. Once certified in a lead state, reinsurers from a qualified jurisdiction will be eligible for reduced collateral requirements and will also have the option of passporting among US states. Around half of the states now have adopted the model law changes, and the NAIC is now considering making the reforms necessary for accreditation, which could see more states comply.

There are currently seven qualified jurisdictions (Bermuda, France, Germany, Ireland, Japan, Switzerland and the UK) and the NAIC has adopted a common application for certifying reinsurers.

However, FIO has noted that application of the model law has not been uniform in structure or implementation and the Model Reinsurance Collateral Law relies heavily upon assessments of reinsurers' creditworthiness by credit rating agencies, rather than on risk-based empirical factors. FIO therefore continues to seek a federal covered agreement (see below) to address the collateral issue.

Prudential developments – Federal Insurance Office

During 2014, FIO has continued to work on implementation of the recommendations in its 2013 report, *How to Modernize and Improve the System of Insurance Regulation in the United States*.

The Dodd-Frank Act authorizes the Secretary of the Treasury, jointly with the US Trade Representative (USTR), to negotiate and enter into a "covered agreement" with one or more foreign governments, authorities, or regulatory entities regarding "prudential measures with respect to the business of insurance or reinsurance."

One priority for FIO has been the EU-US Project which FIO formed in 2011 to increase mutual understanding between the US and Europe regarding insurance regulation. The EU-US Project updated its 2012 recommendations in July 2014, calling for a broad covered agreement between the jurisdictions in the areas of collateral reform, group supervision, and professional secrecy. These three areas are critical to any European equivalence decision for the US under Solvency II. Both the FIO and the European Commission have incidated they expect to begin negotiations by May 2015 on the agreement.

In the meantime, the FIO is proceeding in other areas. In 2014, it:

- Continued to push for renewal of the Terrorism Risk Insurance Act (TRIA) which was approved in January 2015, and the national flood insurance program.

- Supported adoption of the National Association of Registered Agents and Brokers Reform Act of 2013 (NARAB II). FIO intends to monitor life insurance sales and the number of life insurance agents and brokers to ascertain whether policymakers should consider efforts beyond NARAB II to facilitate agent licensing and access to retirement security through life insurance and annuity products.
- Continued to urge states to develop a uniform and transparent solvency oversight regime for the transfer of risk to reinsurance captives.
- Continued to work on consumer issues including: access to insurance and affordability, unclaimed life property, suitability of annuities, and portability of automobile insurance for servicemen.
- Promoted uniformity in producer licensing laws.
- Investigated cyber-risk issues in insurance.

Prudential developments – Federal Reserve Board

The FRB joined the IAIS as a member in 2014 and is serving on several key committees, including capital development.

Being responsible for the oversight of the US systemically designated insurers, the FRB is in a position to chair several regulatory colleges and has said it is committed to tailoring its supervisory framework to the specific business lines and risk profiles of the groups it oversees. Efforts to date have focused on strengthening firms' risk identification, measurement and management, internal controls, and corporate governance.

The FRB is currently developing a capital standard for non-bank SIFIs, following stress tests conducted in late 2014. The Insurance Capital Standards Clarification Act of 2014 specified that statutory accounting principles can be used by the FRB in overseeing insurance groups. The FRB now has latitude to move beyond the bank capital standards and is working with the NAIC and FIO to explore a group capital requirement for US international groups as mentioned above.

Conduct of business and consumer protection

Market conduct issues in the US are also regulated at the state level. Although there are model conduct laws adopted by the NAIC, there is less uniformity in the conduct area than in prudential supervision. FIO in its *Way Forward* report identified a number of areas for action regarding consumer protection and market conduct, asking the NAIC to consider the best way to address these concerns. The NAIC has responded by developing a national database of information regarding market conduct complaints and improving the market conduct examination process. The NAIC is also considering including market conduct in its accreditation process.

The NAIC Market Conduct Examination Standards Working Group has also adopted health reform-related market conduct examination standards relating to prohibition of excessive waiting periods and health reform-related market conduct examination standards relating to essential health benefits. The NAIC will also soon adopt market conduct examination standards for the health reforms in the federal Affordable Care Act.

> "The NAIC Market Conduct Examination Standards Working Group has also adopted health reform-related market conduct examination standards relating to prohibition of excessive waiting periods and health reform-related market conduct examination standards relating to essential health benefits. The NAIC will also soon adopt market conduct examination standards for the health reforms in the federal Affordable Care Act."

Bermuda

"Regulation now comprises a risk-based capital measure and a transparent financial reporting requirement for companies with significant third-party exposures and a 'Code of Conduct' setting out governance and risk management principles for all insurance companies licensed by the BMA."

Recent international developments in regulation and growth in the Bermuda market have resulted in the Bermuda Monetary Authority (BMA) enhancing its regulatory regime to protect both public interest and the reputation of Bermuda as an insurance centre. Regulation now comprises a risk-based capital measure and a transparent financial reporting requirement for companies with significant third-party exposures and a 'Code of Conduct' setting out governance and risk management principles for all insurance companies licensed by the BMA.

ICP compliance and Solvency II equivalence

The BMA has adopted a risk-based approach to regulation, incorporating the revised IAIS core principles, allowing for greater oversight of companies with riskier profiles.

On 19 December 2014, EIOPA released consultation paper EIOPA-CP-14/042 on *Equivalence assessment of the Bermudian supervisory system in relation to articles 172, 227, and 260 of the Solvency II Directive*. This report was an update to the report issued in 2011. EIOPA's final report was issued on 10 March and the equivalence decisions now reside with the European Commission. Background to equivalence is provided in the Europe section of this publication.

In relation to the articles, EIOPA determined that the Bermuda supervisory system was largely equivalent across insurers of Classes 3A, 3B, 4, C, D and E with caveats listed out relating to each article. The caveats vary in degree and nature, with Classes 3B and 4 looking closest to full equivalence. The BMA has been addressing these caveats through the issuance of additional consultation papers, with the economic balance sheet (EBS) changes potentially the most significant.

Prudential developments

In December 2014, the BMA released a consultation paper outlining their EBS framework, which is a principles-based approach accompanied by supporting guidelines. The proposals in this paper apply to Bermuda commercial insurers and insurance groups or Bermuda groups for which the BMA is the group supervisor.

The BMA proposes embedding the EBS Framework as part of the Capital and Solvency Return (C&SR), and it would then form the basis for the insurer's Enhanced Capital Requirement (ECR). Insurers would still be required to provide statutory financial statements as currently required under the Insurance Act 1978 until such time as the BMA revises the statutory basis of financial reporting.

The BMA will also be making amendments to the prudential standards governing solvency requirements for the affected insurers and insurance groups. The C&SR will include a new EBS Schedule containing a balance sheet whose components would be valued using the EBS principles previously consulted upon.

Many of the existing Schedules in the C&SR which refer to the present statutory balance sheet will be adjusted to refer to the EBS Schedule.

Final rules will be made and are intended to come into force on 1 January 2016 for insurance groups, Class 4 and 3B insurers, while for Class 3A insurers the rules will come into force on 1 January 2017, although the BMA is proposing advancing this date to 1 January 2016.

It is intended that Class C, D and E life insurers will also submit EBS results for reporting periods ending 31 December 2015 with their usual statutory reporting in 2016. This should include insurance technical provisions on current valuation principles. Additionally, valuations for insurance technical provisions on EBS principles should be submitted as supplementary information in 2016 on a voluntary basis, but this supplementary reporting should be included in 2017 and 2018 filings.

Conduct of business and consumer protection

As part of its Code of Conduct, the BMA requires domestic retail insurers to establish and maintain procedures to ensure compliance with its market conduct guidance. This includes Board approval for a policy statement on the treatment of policyholders, with disclosure requirements that are designed to protect policyholders both before and after entering into a contract.

Canada

> Canada became one of the first countries to implement ORSA when its requirements became effective in 2014, with first reports due at the end of 2014. Quarterly reporting of key risk metrics for capital and risks will begin in 2015.

The Canadian life insurance industry is dominated by a few major domestic companies, with foreign companies diminishing with the sale of some Canadian operations previously owned by foreign companies back to domestic players. While consolidation has largely run its course for life insurance, there is still considerable opportunity for more merger and acquisitions transactions in general insurance, which is much less concentrated.

Canadian insurance regulators continue to strengthen local regulatory practices to align even more closely with the ICPs. While most of the larger insurers are subject to solvency regulation at the federal level, by The Office of the Superintendent of Financial Institutions (OSFI), a number of smaller insurers are regulated by a province, with provincial regulators also becoming more closely aligned with the ICPs. For example, Alberta and British Columbia have substantially adopted the same regulatory requirements as OSFI.

Market conduct matters are regulated by each province, and the trend to close alignment with the ICPs continues in this area too.

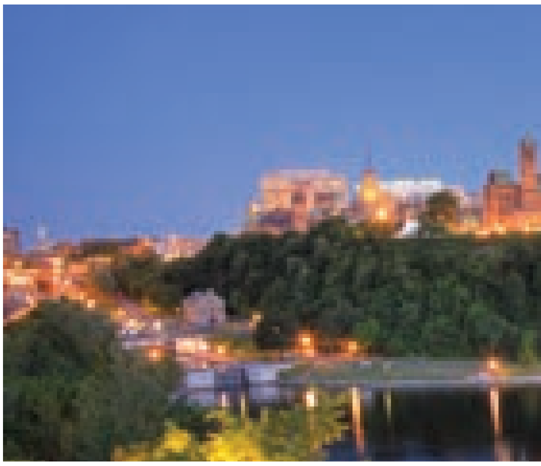
ICP compliance

The IMF issued its FSAP assessment report in February 2014. Overall, they found that OSFI has a high level of compliance with the ICPs, supported by robust prudential supervision. The main development drawn out in the overall summary related to the scope for implementing a more consistent regime of group-wide supervision, including both prudential and market conduct requirements. Going forward, the IMF recommended that OSFI be empowered to take supervisory measures at the level of the holding company and require broader disclosures at the group level.

Prudential developments

OSFI continues to update the minimum capital regime and promote improved risk management practices through measures such as introducing ORSA requirements. Key developments include:

- ***Regulatory Risk Management:*** In November 2014, OSFI issued its revised Guideline E-13 – *Regulatory Compliance Management*, replacing the previous guideline entitled *Legislative Compliance Management*. The new Guideline requires an enterprise-wide framework for regulatory risk management controls.
- ***ORSA requirement implemented:*** Canada became one of the first countries to implement ORSA its



requirements became effective in 2014, with first reports due at the end of 2014. Quarterly reporting of key risk metrics for capital and risks will begin in 2015.

- ***Canadian regulatory capital requirements:*** The standard model for capital continues to evolve, with active industry consultation and field-testing. This process has led to changes that go beyond simple recalibrations, with specific capital measurements of operational risk and credit for diversification being introduced. However, acceptance of internal capital models by regulators appears likely to be gradual.

Conduct of business and consumer protection

Canadian insurers have not had to confront major consumer complaints or the "loss of trust" issues prevalent in many other jurisdictions in recent years. Nevertheless, the influence of international standards developments, driven by the ICPs, has not stopped with corporate governance, risk management and capital regulation.

The ICPs related to insurers' conduct of business and the use of intermediaries are also affecting market conduct regulation. Provincial financial service regulators are responsible for market conduct by insurers, and are showing interest in the Organization for Economic Co-operation and Development (OECD) papers on *Principles on Financial Consumer Protection*, including concepts such as Treating Customers Fairly (TCF) and Customer Outcomes. This appears to be leading to a more demanding market compliance environment for Canadian insurers, including a need for a robust conduct risk framework.

Auto insurance continues to be a hot spot for regulators, insurers and consumers, with consumer concerns over affordability coupled with insurer concerns over controlling claims costs, including reducing their exposure to fraudulent claims.

Latin America

Argentina

> "The national government is working on a Bill to reform the current insurance law, which would provide a new legal framework to the business, although the wording of the draft Bill is still unknown and advances towards convergence to IFRS are not expected in the short/mid-term."

The total number of insurers has dropped from 230 to 180 in the past decade, with the most significant decline being felt by life insurers and annuity providers, which fell from 73 to 55 insurers. The top 20 companies account for half of total annual premiums.

The Argentinian insurance industry's future is somewhat uncertain due to the impact of the economy's deceleration and the high level of inflation, which negatively impacts on insurance business (for example outdated insured amounts, higher administrative expenses, continued impact on cost structures and financing and interest rate issues). Increased market activity levels will depend on increased supply of products and services in sectors driving growth and on a rise in the penetration rates in less explored segments (such as life insurance).

The local reinsurance market, created in 2012, is also consolidating. However, reinsurance operators are concerned because although the Superintendencia de Seguros de la Nación (SSN) has acted to streamline the process to control, supervise and approve the purchase of foreign currency to be remitted abroad (required for the payment of retrocession premiums), the limited quotas of foreign currency endanger the continuity of coverage due to delay in payments.

ICP compliance

The national government is working on a Bill to reform the current insurance law, which would provide a new legal framework to the business, although the wording of the draft Bill is still unknown and advances towards convergence to IFRS are not expected in the short/mid-term.

During 2012, and as requested by the national government, the SSN introduced the "National Strategic Insurance Plan (PlaNeS) 2012-2020" which has three aims: help the market grow, protect the insured, and improve the control capacity of the supervisory board. Two years after its introduction, this has seen following outcomes:

- The SSN has shown greater activity in terms of insured's support and assistance.
- On Voluntary Retirement Insurance, the SSN, jointly with the Association of Life and Retirement Insurance Companies, are working on a project called "Hoy por mañana", whereby they are seeking to mitigate the financial imbalance that individuals may suffer between their productive and passive stages of life.
- Tax benefits updates for life insurance was a long postponed issue, but has recently been included in the agenda of the Ministry of Economy.

The SSN continues working to launch a massive advertising campaign aimed at raising awareness among the population to increase the penetration rate of non-mandatory insurance products.

Additionally, a meeting between the Word Bank and the SSN was held, within the framework of PlaNeS 2012-2020,

to show the progress made in various work areas. The presentation by World Bank representatives referred to the Risk-based Supervision Project. They introduced a preliminary Risk-based capital model applicable in Argentina, as well as group supervision and early warning systems. Topics discussed at the meeting focused on risk-based supervision, on site examinations, risk categories, inherent and residual risk and qualitative assessment.

During the second half of 2014, the SSN issued anti-fraud regulations, requiring companies to set their own rules on anti-fraud policies, procedures and internal control, and to abide by them.

Prudential development

Up to now, the SSN has not issued any standards in relation to the notion of "solvency" as it is understood in the international market; however, it has set some requirements in relation to minimum capital and internal controls for accounting purposes.

Conduct of business and consumer protection

Insurance agents and brokers are the primary distribution channel for Argentine insurers, although bancassurance continues to grow as an alternative distribution channel (mainly for life, motor and personal accident insurance).

The sale of insurance products by banks is supervised by the SSN, which has recently issued new regulations requiring banks to obtain SSN's authorization to offer this service. In addition, banks shall:

- Register as entities that sell insurance products
- Appoint an individual responsible for this service (who shall have knowledge of the insurance field) within their organization
- Train the personnel involved in each of the points of sale and
- Keep records (in line with those of the corresponding insurer) of sales made (issuances) and losses.

"During the second half of 2014, the SSN issued anti-fraud regulations, requiring companies to set their own rules on anti-fraud policies, procedures and internal control, and to abide by them."

Brazil

"Brazil has the largest insurance market in Latin America. The market continues to be dominated by bancassurers, supplemented by national and international insurance companies and there were no significant changes to its composition during the year."

Brazil has the largest insurance market in Latin America. The market continues to be dominated by bancassurers, supplemented by national and international insurance companies and there were no significant changes to its composition during the year.

2014 was a challenging year for the Brazilian economy with high inflation and low GDP growth. Although the growth in total insurance premiums was lower than in 2013, it remained higher than the increase in GDP, indicating that insurance remains a developing sector with growth potential coming from the bancassurance sector and increased penetration rates. One economic variable that has had a significant impact on the insurance industry has been the volatility of the short-term, and especially the long-term, interest rates which continued in 2014. Changes to accounting rules, and the quantum of the changes in relatively short time periods, have meant that management has been focused on understanding the impacts on profit and capital and how these can be minimized.

There were no changes in the number or scope of the three insurance specific national regulators:

- Previc is responsible for closed, private pension plans
- ANS is responsible for health insurance and
- SUSEP is responsible for all other types of insurance and re-insurance.

However, a new superintendent of the Superintendence of Private Insurance (SUSEP) was appointed in early 2014, which is likely to bring substantial changes to the regulator in the coming months and years.

ICP compliance

The most recent FSAP was undertaken in 2012. In this review the following ICPs were classified as 'not observed':

- ICP 16: Enterprise Risk Management for Solvency Purposes
- ICP 23: Group Wide Supervision and
- ICP 26: Cross-border Cooperation and Coordination on Crisis Management.

A further five were classified as being only 'partly observed'. In its strategic goals (which were last updated in July 2014), SUSEP included the constitution of a committee and the elaboration of a plan of action to improve observance of the ICPs, with a goal of improvements to the classification of two ICPs per year in each of 2014 and 2015.

Recent comments by the Superintendent of SUSEP indicate that the regulator is looking to develop a more technological approach to supervision, the surveillance of macro-economic factors and the assessment of their impact on individual insurers. This would be another step in the alignment of SUSEP's practises with the ICPs.

Prudential developments

The solvency capital regime in Brazil has undergone significant changes since 2010 and is now more risk sensitive with specific capital requirements for subscription risk, credit risk and operational risk in force at the end of 2014 and also a requirement for liquid assets of at least 20 percent of the minimum capital requirement. At the end of 2014 SUSEP issued a resolution defining the calculation for market risk and a phased-in approach for its inclusion in the determination of capital requirements, which is expected to have a significant impact on insurance minimum capital requirements.

Another significant change in 2014 related to external audit requirements. SUSEP introduced the requirement for a specific, annual 'actuarial audit' in addition to the biannual audits of the financial statements. According to the regulations, this actuarial audit should cover, among other things:

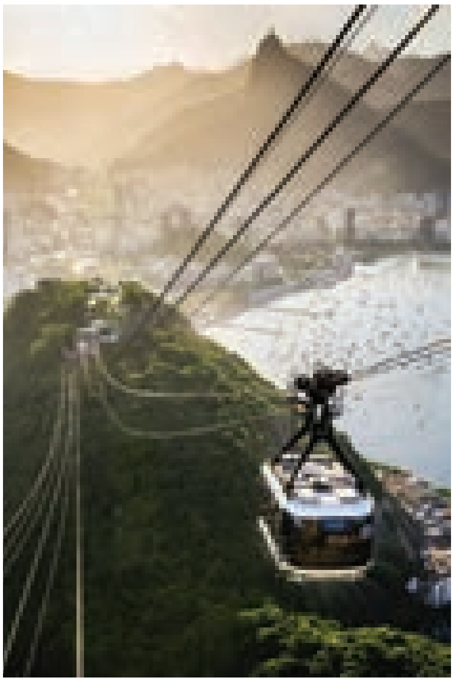
- The adequacy of the technical reserves
- The data, assumptions and methodologies used in the calculation of the minimum capital requirement
- The quality of other data sent to SUSEP in regulatory returns.

At the same time SUSEP also introduced auditor rotation requirements for both the actuarial audit and the financial statement audit that mean that regulated entities will have to change auditors every five years.

Conduct of business and consumer protection

Bancassurance and insurance brokers are the primary distribution channel in the Brazilian market. All brokers need to be registered with SUSEP but they are not subject to its regulations and the supervision and disclosure requirements applicable to these brokers were observed as being 'thin' in the 2012 FSAP report. In early 2015, SUSEP updated its requirements for broker registration but has not made further significant headway in addressing the observations made in the FSAP report.

Customer protection is, however, a significant concern of SUSEP as evidenced by the tightening of regulations around extended guarantee insurance (which is often sold with electro-domestic products) which included requirements for specific risk coverage, a defined period in which the customer can cancel the insurance coverage and requirements in relation to the information that must be given to the client. There was also a regulation released at the end of 2013 in relation to the sale of insurance policies via the internet, which seeks to ensure the protection of the client's data as well as establishing minimum amounts of information that must be provided to the clients before and after the purchase of products via this channel.



Chile

2014 was a very challenging year for the insurance market in Chile due to the effects generated by certain macroeconomic variables, such as the value of US dollar, the decrease in the Government notes interest rate, tax reform and the large earthquake that hit the Northern zone of Chile in the city of Iquique.

ICP compliance

While Chile is not one of the mandated countries for FSAP review against the new ICPs, the local regulator has been enhancing the standards related to corporate governance and supervision based on risk. The regulator has also been very active in regulating financial conglomerates (involving insurance companies, banks and other investment companies), seeking to mitigate liquidity and contagion risks and independence issues.

Prudential developments

Recently, the Chilean regulator, the Superintendence of Securities and Insurance (SSI), issued a third update of the Risk-Based Capital framework methodology to measure and quantify risk-based capital. The SSI also introduced other changes in regulations relating to the recognition in the financial statements of reinsurance fees and commissions, and the use of a rate vector for the asset sufficiency test (AST) and for the calculation of the cost equivalent rate for pension-related life annuities.

The update to the RBC framework is mandatory for the insurance market, and the results are required to be submitted no later than 29 May 2015. In this third version, the SSI has continued to calibrate the standard formula and capital factors, with the purpose of generating incentives for the industry, in terms of investment, insurance product offerings and risk management; focusing on the required solvency levels for the protection of policyholders and encouraging healthy sector developments.

Conduct of business and consumer protection

Recent changes were made to insurance legislation in Chile, seeking modernization with an aim to reach international standards. There are different views on the effects of these changes. The government highlights that the change will bring fairness through mandatory minimum standards that will benefit insurance consumers by providing a framework of judicial certainty about rights and obligations. Collective insurance contracts, including those acquired by banks and employers, will have a direct benefit, receiving better protection. The approved legislation also defines basic terms in the insurance business, clearly establishes the different insurance types and outlines the minimum requirements for an insurance contract, all of which should enhance the communication to consumers.

Mexico

The insurance market in Mexico comprises around 100 insurance companies and branches, with around 60 percent of the market comprising subsidiaries of foreign groups.

A new law for insurance and surety companies has been introduced, replacing two very old laws: The General Law of Insurance Institutions and Mutual Societies (1935) and the Federal Surety Institutions (1950) and their various amendments. The new Insurance and Surety Institutions Law (LISF) was published on 4 April 2013 and it enters into force on 6 April 2015. The most important objective of the LISF is to implement a framework similar to Solvency II in Mexico, with transitional arrangements meaning that certain quantitative and disclosure requirements do not become effective until 1 January 2016.

Considering that the aim of the legislative strategy is to ensure firms' solvency, it is conceivable that this could lead to market consolidation and the possibility of new entrants, attracted by increased competition, resulting in the market becoming dominated by higher quality firms.

ICP compliance

The last FSAP review was undertaken in 2011. According to the National Insurance and Surety Commission, the level of compliance with the ICPs is already around 93 percent, but implementation of the LISF will see this level increase to 97 percent.

Prudential developments – Regulatory capital

The new risk-based regulatory capital framework introduced by LISF will be implemented gradually, starting with the new pillar 2 corporate governance requirements from 6 April 2015.

During the first two years, the market will have to determine its risk based capital according to the standard formula using software provided by the regulator. After this period, companies will be able to submit requests for approval of an internal model, requiring a two year parallel testing period.

Regarding technical provisions, all companies must register the methodologies they intend to use based on the best estimate liability plus risk margin, by no later than the end of September 2015.

A full 2015 closing position will be required under the new LISF requirements.

Prudential developments – Risk management and governance

As well as strengthening the capital and solvency regime, the LISF also introduces measures aligned with Solvency II's pillar 2 requirements, including a more flexible approach to investments and strengthening of corporate governance, focused on risk management with an increased level of transparency and disclosure.

> "The new Insurance and Surety Institutions Law (LISF) was published on 4 April 2013 and it enters into force on 6 April 2015. The most important objective of the LISF is to implement a framework similar to Solvency II in Mexico."

Another major change in the LISF is the creation of "Surety Insurance" (allowing its use for securing obligations and providing compensation to the insured for damages suffered as a result of breach of contract) and an adjustment to the micro insurance regulatory framework. This change was possible because the insurance and surety market has developed the technical capacity to successfully move towards risk-based management. Also the actuarial and accounting professions have the necessary professional guild strength to drive the development and adoption of best practices that are necessary to implement the new regulatory model.

The main challenges in the implementation of the LISF are:

- Understanding of the technical requirements and the new procedures required to determine the technical provisions and solvency capital requirement
- Development of a culture of transparency and information disclosure as a basis for expanding public confidence in these financial services
- The internalization of the risk management process as part of the system of corporate governance and business management.

Conduct of business and consumer protection

As shown above, the focus of insurance regulatory reforms has been on the prudential side, and there are no new developments to report on the conduct side.

REGULATORY DEVELOPMENTS IN ASIA-PACIFIC (ASPAC) REGION

Changes have continued across ASPAC towards developing economic valuation-based frameworks. This is increasing pressure on insurers to develop economic capital models. It is also leading to a much greater regulatory focus on improving risk management frameworks and group-wide capabilities.

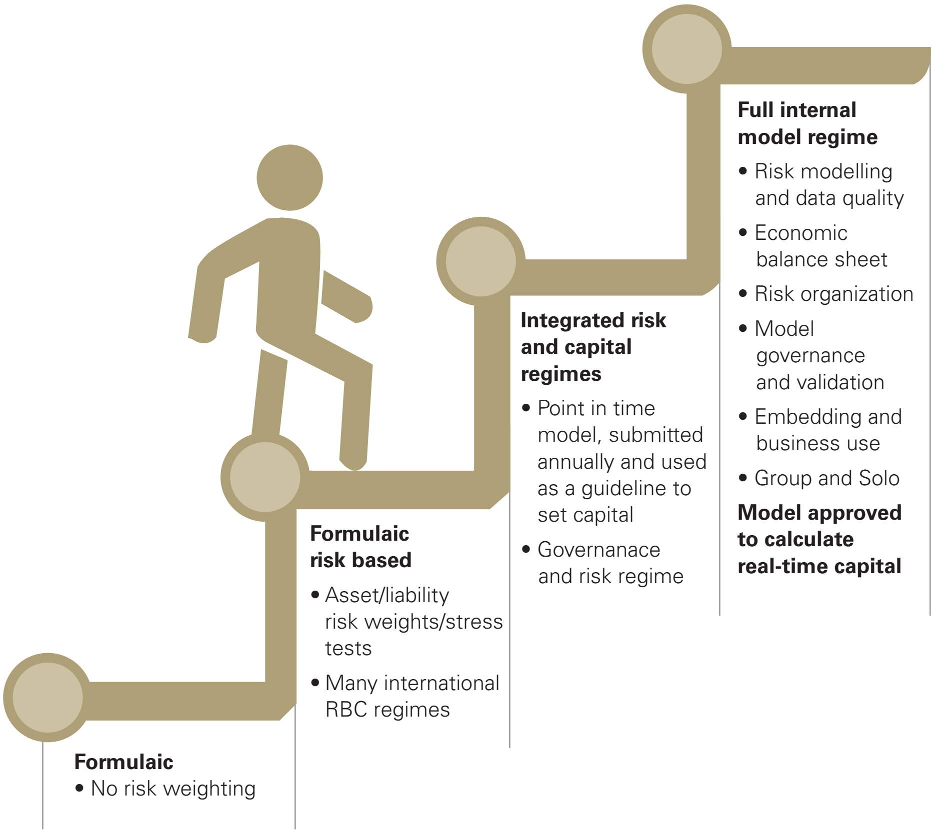
Across the Asia-Pacific region, 2014 witnessed increased supervisory attention in the following items, and these reforms will continue throughout 2015:

- More risk-based supervision and changes in how supervisors conduct both off-site and on-site supervision
- Greater focus on Board and Senior Management relating to compliance and risk assessments
- Increased focus on group-wide supervision and systemic issues
- More detailed reviews of off-balance sheet and non-insurance business exposures
- Greater scrutiny of an insurer's outsourcing policies for key roles and functions
- Additional data requests of insurers, with the objective of enhancing macro-prudential surveillance.

The changing landscape that is now occurring across the region mirrors the experience of other jurisdictions and is reflected in Figure 10.

> Across the Asia-Pacific region, 2014 witnessed increased supervisory attention, and these reforms will continue throughout 2015.

Figure 10: Developments in Asia following global regulatory developments
From risk based capital to risk based supervision



Risk based capital regimes take many and different forms – from risk weighted formulaic solvency calculations through to full risk based supervision and approved internal models

Source: KPMG International 2015.

Australia

“In recent years aggregators have entered the market, challenging the established distribution channels, in particular for health insurance.”

The general and life insurance segments in Australia are dominated by a few large players that have maintained their market position during 2014. There is no restriction on foreign ownership of insurance companies, subject to compliance with the Insurance Acquisitions and Takeovers Act, Financial Sector Shareholdings Act and Foreign Acquisitions and Takeovers Act.

Distribution is dominated by direct sales, broker and agency channels. The market clearly distinguishes between general, life and health insurers. Only a few insurers act across all segments.

An Australian Financial Services license is generally required to distribute insurance products. In recent years aggregators have entered the market, challenging the established distribution channels, in particular for health insurance.

The regulatory environment has experienced a year of change, with the landmark developments being the Australian Prudential Regulation Authority (APRA) cross industry *Risk Management Prudential Standard* (CPS 220) and the development of the Level 3 Conglomerate Framework. More broadly, APRA remains focused on capital, governance and risk management practices. There have not been any material insurance developments from Australia's corporate and competition regulators during 2014.

The final recommendations following a major Financial Systems Inquiry (FSI) commissioned by the Australian Government were released in December 2014. The FSI was charged with examining how the financial system could be positioned to best support Australia's economic growth, with a particular focus on fostering efficiency and competition. While the Government is expected to respond in the first half of 2015, the Australian insurance industry is likely be faced with enhanced conduct, remuneration and disclosure measures (in relation to their dealings with policyholders and financial advisors).

ICP compliance

The last FSAP assessment took place in 2012, showing a high level of compliance with ICPs generally. Since then, significant enhancements of the regulatory regime have taken place.

Prudential developments – regulatory capital

APRA's new risk-based regulatory capital framework for the insurance industry (often referred to as Life and General Insurance Capital (LAGIC)) was introduced in January 2013 and follows a similar three pillar approach to Solvency II. Every insurer has now completed at least one financial year under the new capital standards and has prepared an Internal Capital Adequacy Assessment Process (ICAAP) Summary Statement (equivalent to ORSA) and an ICAAP Report (which provides a detailed breakdown of capital performance in the preceding financial year). ICAAPs are subject to periodic independent review over a three-year period and there is evidence of some insurers already addressing this requirement.

As part of the LAGIC requirements, Australian insurers have adopted the Basel III Capital definitions. There was a strong level of capital issuances in the Australian market in 2014 with many lower grade capital issuances including Basel III's debt to equity conversion provisions. These issuances can only be converted to full equity capital upon a determination of non-viability by APRA and they have tended to trade at low premiums above their former vanilla counterparts.

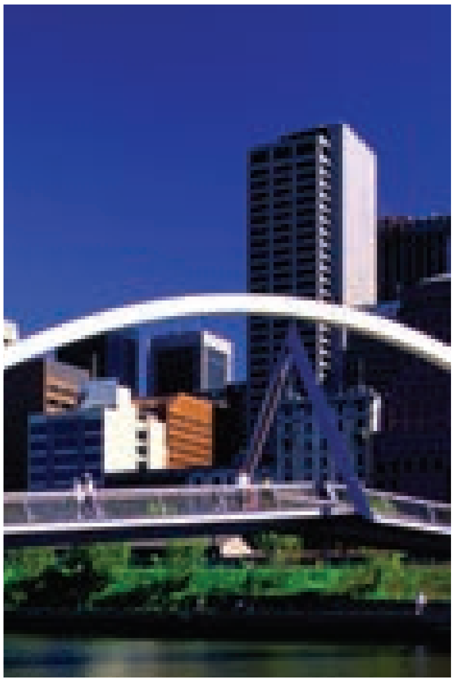
Whilst the Australian insurance market does not have any G-SIIs, it is likely to have several domestically systemic insurers, although identification of these is still in the elementary stages. KPMG expects that the major and highly specialized Australian insurers are likely to be captured. These insurers may be required to hold higher levels of capital in addition to undertaking recovery and resolution plans, in line with the approach for the banking sector, which focused on the need for higher loss absorbency and recapitalization capacity.

Prudential developments – risk management and governance

In January 2014, APRA released a package of final cross-industry risk management requirements (known as CPS 220) which became effective from 1 January 2015. These apply to Authorized Deposit-Taking Institutions, general and life insurers, authorized non-operating holding companies, and single industry groups. The standard's objective is to ensure consistent application of its risk management requirements across the regulated industries, with APRA's approach based on a three lines-of-defence risk governance model.

The key requirements are:

- APRA requires a designated person to be responsible for the risk management function. This person must have the appropriate authority within the company to be able to sufficiently challenge senior management and provide comprehensive risk analysis and reporting.
- CPS 220 precludes the Appointed Actuary from being the CRO, CEO, CFO or Head of Internal Audit.
- CRO must have a direct reporting line to the CEO and Risk Committee.
- CRO may also have responsibility for the compliance function.
- Insurers may engage the services of an external service provider to perform part of the risk management function where they can demonstrate that the risk management function meets certain requirements.
- Boards required to form a view regarding risk culture within their organizations to ensure alignment with risk appetite strategy and the broader risk management framework (where external and internal audit and other risk professionals may be utilized).



> "APRA has identified eight such conglomerates, all of which are expected to have sufficient capital to meet the proposed capital standard without any significant actions required. Implementation date will depend on the final recommendations from the FSI."

- Prudential standard on Governance (CPS 510) requires separate Risk and Audit Committees of the Board.
- Alternative arrangements may be applicable to smaller and less complex institutions (subject to APRA approval).

Prudential developments – group supervision

In August 2014, APRA released its new conglomerate prudential standards applicable to groups comprising entities operating in more than one APRA-regulated industry and/or in one or more non-APRA-regulated sector. These groups are referred to as Level 3 groups and the Level 3 Framework has been designed to ensure that supervision adequately captures the risks to which the conglomerate is exposed that may not be captured under the existing framework.

APRA has identified eight such conglomerates, all of which are expected to have sufficient capital to meet the proposed capital standard without any significant actions required. Implementation date will depend on the final recommendations from the FSI.

Health insurance

There is an active health insurance market in Australia and these have previously been regulated by The Private Health Insurance Administration Council (PHIAC), rather than APRA.

The PHIAC's new Capital Adequacy and Solvency Standards came into effect from 31 March 2014, which, it says, resulted in freeing up over $1 billion of regulatory capital. Changes were made to:

- Better address the key risks faced by health insurers
- Improve insurers' engagement with those risks
- Improve the quality of information available to support PHIAC's regulation of the industry.

From 1 July 2015, the prudential regulation of health insurance will fall under the control of APRA, which could result in further harmonization with APRA's suite of capital and risk management prudential standards.

Conduct of business and consumer protection

The FSI report made specific mention of consumer and conduct issues. Recommendations relevant to the Australian insurance sector include:

- Strengthening product issuer and distributor accountability
- Introduction of product intervention powers
- Facilitation of innovative disclosure
- Aligning interests of financial firms and consumers
- Raising the competency of financial advisors
- Improving guidance and disclosure in general insurance.

The FSI noted that the conduct recommendations build on recent changes such as the Future of Financial Advice and product disclosure reforms. The recommendations promote market discipline and aim to reduce calls for future significant changes to the regulatory framework.

China

The China insurance sector has continued its remarkable growth momentum, with significant premium income growth in all of the non-life, life and health sectors. In August 2014, the State Council (China's central government cabinet) announced a plan and ten macro policy measures to boost growth in the insurance sector, aiming to increase premium income to 5 percent of Gross Domestic Product (GDP) by 2020 (up from 3 percent in 2013). In response, the Chinese Insurance Regulatory Commission (CIRC) has accelerated its *free up the front end, strengthen the back end* regulatory reform agenda (i.e. liberate product pricing, investment and distribution restrictions, while shoring up solvency, governance and conduct), resulting in the rapid development of the China Risk Oriented Solvency System (C-ROSS), a new three-pillar risk and solvency framework.

Product developments include more innovative catastrophe insurance (where the first catastrophe insurance bond issuance is expected shortly) and mandatory catastrophe reserves for agriculture insurance (with a new mandatory agriculture insurance pool established in November 2014). In November 2014, the State Council issued an opinion to encourage development of the commercial health insurance market, with new regulations to grow existing critical illness insurance programs and tax incentives for other commercial health insurance expected to follow. Health insurance, along with marine insurance, is also an area of the Shanghai Free Trade Zone opportunity.

In order to promote the development of captive insurance companies, CIRC recently published its first regulation regarding the formation, parent company qualification, finance, and reinsurance of captive insurers.

A new rule issued by CIRC in April 2014 has relaxed the funding and ownership requirements for insurance merger and acquisitions, although the foreign ownership limits in China continue to be:

- 50 percent for a life insurer
- 100 percent for a non-life insurer
- 24.99 percent for investment in a domestic insurer and
- 19.99 percent individual investment limit for an insurer to retain its designation as a domestic insurer.

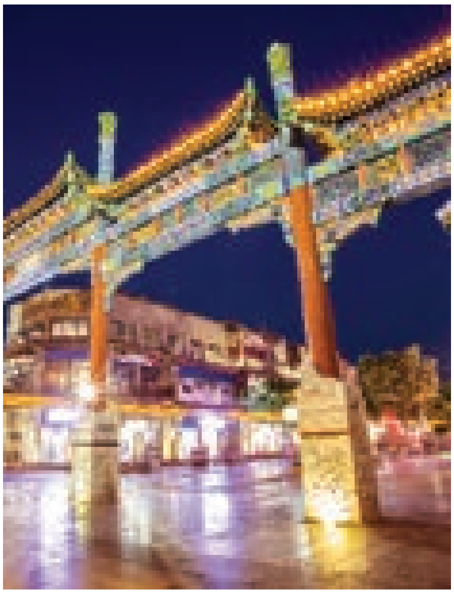
In addition, the regulator has relaxed the control over outbound investment by the insurance sector, as part of the country's overall *going-out* strategy. This has been showcased by the recent purchases of landmark real estate assets in global financial hubs (e.g., London and New York City) as well as the acquisition of European and American insurers by Chinese insurers.

Finally, in January 2014, the CIRC established the China Insurance Information Technology Management Company, Ltd. (CIITMC) to establish an industry-wide IT platform and data standards, centralize the collection and processing of insurance policy and claim data, and provide related value added services to the industry and consumers.

ICP compliance

The last FSAP assessment took place in 2011, which highlighted significant areas for development, which the CIRC has been moving to address, especially through its *free up the front end, strengthen the back end* regulatory reform agenda mentioned above.

"In January 2014, the CIRC established the China Insurance Information Technology Management Company, Ltd. (CIITMC) to establish an industry-wide IT platform and data standards, centralize the collection and processing of insurance policy and claim data, and provide related value added services to the industry and consumers."



Prudential developments

CIRC has adopted a rigorous consultation process for C-ROSS, which includes 15 research projects, 17 consultation papers and multiple industry quantitative impact studies (QIS). The main rules of the new solvency system were published in February 2015 and, simultaneously, the industry entered the transitional period (expected to be one year). Based on the latest QIS results, the new solvency capital regime should maintain the industry's overall solvency level but will be more reflective of individual risk profiles and ERM program quality, which is considered essential to developing a healthy insurance sector.

More emphasis is being placed on Pillar 2 (qualitative measures) and Pillar 3 (market discipline mechanism) to tailor for the emerging insurance market conditions. In order to encourage the industry to enhance its ERM programs, the result of an insurer's ERM quality assessment can impact the final minimum capital requirement. From a global context perspective, G-SIIs and IAIGs have also been considered in the C-ROSS regime, with additional capital requirements expected for both domestic and global systemic firms.

In order to curb certain aggressive market activities, the CIRC has also issued new rules governing insurance groups, the non-insurance business entities controlled by insurers, related party transactions, as well as the sales of short-term high cash value life products.

Conduct of business and consumer protection

Primary distribution

CIRC is imposing stricter qualification requirements for professional sales forces and is in the middle of an ambitious 3-year program to improve irregularities in the agency channel. The direct channels have maintained very strong growth momentum, particularly internet sales, which has recorded in excess of 100 percent per annum premium growth. A consultation concerning new regulations on internet distribution of approved life, accidental and health, property, and credit products is underway.

For bancassurance, a new regulation jointly issued by CIRC and the China Banking Regulatory Commission (CBRC) has encouraged sales of protection products and introduced consumer protection measures such as longer grace periods and more disclosure requirements on investment linked products sold to elderly and low income customers.

Product pricing

The de-tarification of motor insurance has regained momentum. More flexible pricing schemes that incorporate more effective rating variables but penalize excessive sales commission are scheduled to be piloted in six provinces in May 2015. Following the removal of the 2.5 percent pricing interest rate cap for traditional life products, more freedom to price participating, universal life, unit linked, and annuity products are expected shortly.

Consumer protection

The consumer agenda is high on CIRC's priority list. In November 2014, CIRC issued new guidance to enhance insurance consumer protection. Specific measures on insurance product policy provisions, mis-selling, claims handling, consumer privacy and information protection, product disclosures, as well as enforcement have been introduced.

Hong Kong

Currently there is no restriction on foreign ownership in Hong Kong which contributes to the dominant role played by foreign insurers in the market. In response to the high levels of competition and future expected growth in the market, a number of M&A activities have been observed in recent years and we continue to see new market entrants. Regulatory developments and the continued increase in cooperation between Hong Kong and mainland Chinese insurance authorities, most recently evidenced in the form of a cooperation agreement against cross-boundary insurance fraud, may also drive M&A activity in the future.

In December 2014, the Hong Kong government commenced public consultations on a voluntary health insurance scheme and a review of regulation of private healthcare facilities aimed at reducing the burden on the public healthcare system. The impact on the healthcare insurance market is not yet known, although many insurers have publicly indicated their support of the reforms.

After almost four years of public and industry consultation, 2014 saw the Insurance Companies (Amendment) Bill being gazetted and presented to the Legislative Council for first reading, marking a key milestone in insurance regulatory reform with the proposed establishment of an Independent Insurance Authority (IIA). The IIA will be responsible for regulating insurance companies and insurance intermediaries, including their financial stability and sales conduct. As a financially independent body, it will be in a stronger position to supervise and regulate the market. A number of the proposed changes set out below are dependent on the establishment of the IIA, which is targeted to take effect in 2016.

ICP compliance

In July 2014 the IMF published its FSAP assessment of Hong Kong. The report found a high level of observance of the ICPs where "*Strong and robust supervisory practices compensate for many of the legal regulatory gaps*

"In December 2014, the Hong Kong government commenced public consultations on a voluntary health insurance scheme and a review of regulation of private healthcare facilities aimed at reducing the burden on the public healthcare system. The impact on the healthcare insurance market is not yet known, although many insurers have publicly indicated their support of the reforms."

> 2014 saw a continued increase in regulation relating to the product design, internal approval, marketing literature and sales processes of investment linked products.

noted by the assessors". The IMF were very supportive of a number of projects currently underway to target the existing gaps, namely plans for the IIA to be independent of government, the move towards a RBC framework for supervising solvency, the intention to formulate a regulatory regime for insurance groups, a move to direct supervision of intermediaries and legislative changes relating to conduct of business and corporate governance.

Prudential developments

The current solvency capital regime in Hong Kong is rules-based and the capital requirement is a simple calculation based on volume and size measures.

In September 2014, the Office of the Commissioner of Insurance (OCI) consulted on the framework for a RBC solvency regime aimed at aligning with the ICPs. The consultation paper set out the principles of a three pillar framework and introduced the concept of a group supervisory requirement for the Hong Kong market. The impact on required capital will not become clear until the second half of 2015 or 2016 when detailed rules are consulted on and impact studies undertaken.

The OCI has not disclosed a targeted effective date for the new regime. However given the need for extensive industry consultation and legislative changes, it is unlikely to take effect before 2019, with earlier implementation of risk management and corporate governance requirements and the relaxation of asset management rules possible.

Following the announcement in January 2012 of final proposals for the establishment of a Policyholder Protection Fund, the Government is currently drafting the enabling legislation before it can go through the legislative approval process.

Conduct of business and consumer protection

Insurance agents and brokers are the primary distribution channel for Hong Kong insurers, although bancassurance continues to grow as an alternative distribution strategy as insurers look to diversify away from agency business models.

Banks in Hong Kong are limited to being an insurance agency for a maximum of four insurance providers. Most leading banks in Hong Kong already have long-term insurance partners in place, meaning there is significant competition between insurers when new opportunities come to market, particularly where the bank offers exclusivity of distribution.

The sale of insurance products by banks is supervised by the Hong Kong Monetary Authority (HKMA). Certain products, most notably investment linked products, are subject to authorization by the Securities and Futures Commission (SFC) in terms of their offering documents, illustration documents and marketing materials.

2014 saw a continued increase in regulation relating to the product design, internal approval, marketing literature and sales processes of investment linked products with the OCI, HKMA and the SFC all issuing updated guidance for insurers and banks to follow. The tightening of regulation over the last two years, particularly around disclosing commissions, has led to a noticeable decrease in sales of such products, particularly through bancassurance channels. In December 2014, the HKMA issued a first circular in respect of sales practices for non-linked term insurance products with the OCI expected to issue guidance for insurers in 2015.


裕華
YUE HWA
CHINESE PRODUCTS
商務印書館

India

The Indian insurance market experienced a period of uncertainty after a new set of product regulations were introduced in 2013 for both unit-linked and non-linked insurance products. The insurance industry has taken some time to calibrate to the new set of guidelines.

A stable government at the centre has improved the sentiment in the stock market. The Reserve Bank of India (RBI) announced a cut in interest rate by 25 basis points on 15 January 2015. The RBI added that it could cut interest rates further should inflation continue to ease, while it would also monitor the government's progress on fiscal consolidation.

Prudential developments

After months of political wrangling, India has finally passed its Insurance Laws (Amendment) Bill 2015, raising the foreign ownership limit in the sector to 49 percent.

Some of the key points of this Ordinance are:

- Increase in the composite cap of foreign investment (all forms of foreign investments including foreign portfolio investments) to 49 percent from the current 26 percent.
- Lloyd's can establish a branch office for conducting reinsurance business in India. Once the eligible members of Lloyd's satisfy the eligibility criteria specified by the Insurance Regulatory and Development Authority (IRDA), they may be allowed to operate their business through a Lloyd's branch.
- 'Health insurance business' has been specifically included as a separate category in the definition of Indian insurance company. Capital requirement for health insurance companies is retained at USD16.67 million[9] (INR1,000 million).
- IRDA has been advised to facilitate and frame adequate regulations to aid the entry of multinational insurance brokers so that they can provide an added impetus to the Indian insurance and re-insurance sector.
- Certain flexibilities have been extended to IRDA in order to better cater to changing dynamics within the insurance industry. Some of these are related to commissions paid and expenses incurred towards remuneration of agents and intermediaries, defining new insurance intermediaries, etc.
- Penalties for non-compliance with the provisions of Insurance Act and regulations have been enhanced, with an emphasis on minimising scope for subjective interpretation and suitable mode of appeals to the Securities Appellate Tribunal incorporated.

Conduct of business and consumer protection

RBI issued the final guidelines on 15 January 2015 enabling entry of banks into insurance broking. IRDA had issued IRDA (Licensing of Banks as Insurance Brokers) Regulations, 2013 in July 2013. Thereafter RBI had issued Draft Guidelines for public comments

9. Assuming 1 USD = INR 60

in November 2013 and after taking into account comments received from various stakeholders, RBI issued the final guidelines on this matter on 15 January 2015.

To date, the banks have been distributing the insurance products through corporate agency model and could only sell products of one life insurer and one general insurer whereas, under the broking model, banks can now sell products of multiple insurance companies.

Indonesia

> "Insurance companies must be owned by an Indonesian citizen and/or Indonesian legal entity or Indonesian citizen and/or Indonesian legal entity together with foreign citizen or foreign legal entity with an insurance background. Foreigners and a foreign entity can only own an insurance company through the Indonesia capital market/stock exchange."

Interest in the Indonesia insurance market has increased over recent years, but following the introduction of the new Insurance Law, which became effective on 17 October 2014, there has been a slowdown as more certainty is needed regarding the restrictions on foreign ownership. This new law is expected to bring significant changes to many areas of Indonesia's insurance sector, with the Indonesian government being charged with clarifying a number of aspects in the implementation of government regulations, which should be issued within 30 months.

Key points of the new law are:

- Insurance companies must be owned by an Indonesian citizen and/or Indonesian legal entity or Indonesian citizen and/or Indonesian legal entity together with foreign citizen or foreign legal entity with an insurance background. Foreigners and a foreign entity can only own an insurance company through the Indonesia capital market/stock exchange.
- It has introduced the concept of a single presence policy in the insurance sector, where a person or a legal entity can only be the controlling shareholder of one life insurance entity, one general insurance entity, one reinsurance entity, one sharia life insurance entity, one sharia general insurance entity and one sharia reinsurance entity. These restrictions do not apply to the Indonesia state-owned enterprises. Existing shareholders have three years to comply.
- The Government must establish a policyholder protection fund within three years, and all insurance companies must become a member of the new policyholder protection scheme.
- A sharia business unit of an insurance company should be disposed of as a separate sharia insurance/reinsurance entity within ten years after the new insurance law becoming effective, or when the Tabarru' fund and the unit holders' investments reach 50 percent of the total of insurance funds, Tabarru' fund and the investments of the insurance company.

ICP compliance

Indonesia is not one of the mandated countries for FSAP review against the new ICPs.

Prudential developments

In addition to the changes in the legal framework outlined above, the Indonesia Financial Services Authority (OJK) has issued a series of new regulations in 2014 governing insurers in Indonesia. The most significant in terms of compliance effort required are set out below:

Good corporate governance

The new Good Corporate Governance regulation was issued in April 2014 with a six-month transition period. The new requirements include the appointment of a compliance director, independent

commissioners and sharia supervisory board members, as well as the need for regular self-assessment of good corporate governance practice.

Enterprise Risk Management

In August 2014, OJK issued a new regulation that is similar to the requirement for ERM in other jurisdictions. It requires insurers to perform a self-assessment of own risk (which includes strategic, operational, assets and liabilities, management, governance, funding and insurance risks). The insurance supervisor is also required to conduct risk-based supervision based on these regulations. The first self-assessment occurred at the end of February 2015 for the 2014 year-end position.

Conduct of business and consumer protection

The OJK has issued a regulation concerning *Alternative Dispute Settlement Institutions in the Financial Services Sector* and two circular letters in relation to consumer protection in the financial services sector. These regulations became effective in August 2014, with the aim to establish a fast, low-cost and fair scheme of dispute settlement in the financial services sector.

Japan

> "In recent years, the JFSA has continued to improve its supervisory approach taking examples from other regulators globally. Both the Supervisory Department and Inspection Department are working together to integrate their on-site and off-site monitoring process. Their current approach has focused on discussions with financial institutions about best practices and collection of information, rather than detailed inspections."

One of the most significant business changes of the year was the revision in May 2014 to the Japanese Insurance Business Law to facilitate the ownership by Japanese insurance companies of foreign financial institutions. Japanese insurance companies are not permitted to own subsidiary companies whose activities fall outside the following categories:

- Financial business
- Dependent business (business which is peripheral but essential to insurance operations, such as investments, advertising, employee welfare with the main customers being the insurance companies themselves)
- Venture business and companies under reorganization and rehabilitation
- Holding companies for the above type of businesses.

An exception has existed for some time in respect of the acquisition of foreign insurance companies where the target owns other business that do not feature on the list above. This enables acquisition, provided all non permitted business are disposed of within five years from the date of acquisition. The revision to the law now applies the same exception to both foreign non-insurance financial institutions and non-insurance financial companies. This will make it much easier for Japanese insurance companies to acquire foreign businesses.

On a regulatory angle, the regulator, the Japan Financial Services Agency (JFSA), has announced their new 2014-2015 financial monitoring policy for financial institutions. Specifically for insurance companies, there are now four areas of focus (three last year) - the development of an adequate claims payment framework, enhancement of improved risk management, enhancement of customer protection and convenience and, new this year, the enhancement of governance.

In recent years, the JFSA has continued to improve its supervisory approach taking examples from other regulators globally. Both the Supervisory Department and Inspection Department are working together to integrate their on-site and off-site monitoring process. Their current approach has focused on discussions with financial institutions about best practices and collection of information, rather than detailed inspections.

ICP compliance

Japan was one of the first FSAP reviews undertaken against the new ICPs. A number of recommendations were made relating to the JFSA's ongoing work to strengthen its insurance regulatory framework. Since that time, further improvements regarding ICP compliance have taken place.

Prudential developments

Japan has implemented a RBC-based solvency regime, both on a stand-alone and group basis with the risk amount calculated on a factor-based approach.

In February 2014, the JFSA enhanced areas around integrated risk management, including ORSA, in their Inspection Manual/Supervisory Guidelines with insurance companies to comply with the ICPs. It has

conducted integrated risk management governance interviews (previously referred to as Enterprise Risk Management interviews) for insurance companies every year since 2012. The JFSA has now requested that insurance companies submit their first ORSA reports on a trial basis while it considers how to fully roll out ORSA as part of the supervisory regime.

The JFSA is also in the process of developing a new economic-based solvency regime and is now reviewing the field testing results from the exercise conducted in 2014. Results will be published in May 2015.

Conduct of business and consumer protection

As part of the JFSA's focus on customer protection in its monitoring policy, in May 2014, the JFSA revised the rules around the conduct of sales of insurance products in the Japanese Insurance Business Law. The revision requires that insurance companies and sales agencies:

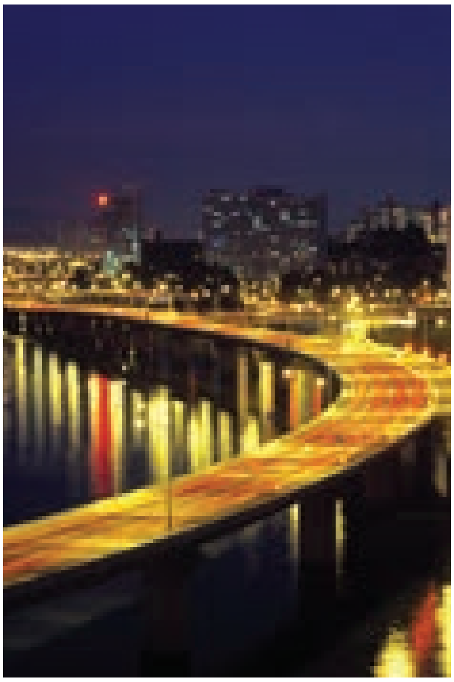
- Ascertain customers' needs and purpose
- Propose appropriate insurance products that meet the customers' needs and purpose
- Provide adequate information to allow the customers to make an informed decision regarding their purchase.

In addition, the JFSA now requires sales agencies to develop an adequate governance framework in relation to the sale of insurance products, in line with insurance companies.

The JFSA also revised the Supervisory Guidelines in January 2014 to clarify the definition of what constitutes an employee of an insurance agency. According to the revised Supervisory Guidelines, employees are defined as those who are directly employed by insurance agencies and conduct sales of insurance products under their direct supervision. As a result, outsourced sales personnel can no longer conduct sales of insurance products.

"The JFSA is also in the process of developing a new economic-based solvency regime and is now reviewing the field testing results from the exercise conducted in 2014. Results will be published in May 2015."

Korea



According to the OECD Insurance Statistics 2013, Korea is the world's sixth largest insurance market by premium income, with the third highest level of insurance penetration (13.7 percent from the same report).

Supervision of the insurance industry in Korea is the responsibility of the Financial Services Commission (FSC) and the Financial Supervisory Service (FSS). The FSC delegates inspection and supervision activities to the FSS.

In response to the low interest rate environment, insurance companies have amended their investment portfolios to move into alternative investments. The FSS responded by easing investment restrictions and lowering risk factors for some classes of investments in the RBC calculation.

ICP compliance

The FSAP review report was published in May 2014 and was based on the regulatory framework in place in April 2013. This reported a high level of observance of the ICPs and a regulatory structure which, although complex, is well developed compared to international norms. A particular area highlighted for further development relates to group requirements. A number of the larger groups are becoming more international, so group measures need to be developed. Shortcomings were noted in the use of historic costs in the valuation area, weak controls on investments, the lack of a group capital requirement, and the need to better identify emerging risks.

Prudential developments

During 2014, the FSS enhanced its RBC standard, applying a higher confidence level, elaborating a risk coefficient and reflecting longevity risk. The FSS has also been encouraging insurers to develop their own risk evaluation model (internal model) rather than simply using the standard model provided. There are also plans to improve the Liability Adequacy Test system to meet international standards prior to implementation of the revised insurance contracts accounting standard.

To supplement current risk related regulation, FSS is focusing on the internal processes of risk management, rather than the risk factors themselves, including risk management structures and reporting hierarchy, risk management processes, and recovery and resolution plans. The FSS is also considering implementing an ORSA requirement by 2017.

Conduct of business and consumer protection

The disclosure of personal information from financial institutions has been an issue in Korea recently. The FSS has responded by increasing the penalty and forcing insurance companies and other financial institutions to organize prevention structures and processes.

Malaysia

The life insurance industry remains dominated by foreign providers, while domestic firms control the general insurance industry. In 2009, foreign ownership limits were raised from 49 percent to 70 percent for branches of foreign insurance companies. Foreign equity above 70 percent is considered on a case-by-case basis. Malaysia has a strong takaful insurance market.

The agency channel is the dominant distribution channel, while bancassurance and direct sales have grown in popularity since the removal of restrictions around entering into such arrangements. The recently enacted Financial Services Act and Islamic Financial Services Act have prohibited several business practices – for example composite licenses are no longer allowed. These acts may also have an impact on future overseas activity, for example requirements on minimum surplus of assets over liabilities for foreign branches and other prudential rules.

ICP compliance

The IMF conducted its FSAP of Malaysia in 2013, with the level of observation of the ICPs found to be good. Deficiencies related to the formalization of expectations into current guidelines, clarifying approaches in certain areas, enhancing transparency, and expanding the regulatory toolkit. Pending legislation was seen to be addressing risk management and group supervision issues.

Prudential developments

Malaysia has operated an RBC framework since 2009. Traditional insurers have to maintain a capital adequacy ratio above the Supervisory Target Capital Level (STCL) of 130 percent. Takaful operators also need to follow this capital requirement with the same STCL.

Conduct of business and consumer protection

There have been two significant developments in the conduct arena during 2014. Firstly, in February 2014, the Bank Negara Malaysia (BNM) announced the results of its consultation on a concept paper on Life Insurance and Family Takaful Framework (LIFE Framework) and plans to move away from the tariff-based regime in the general insurance industry towards a free market system in 2016.

An important aim of the Life Framework was to enable further diversification in insurance delivery channels as a way to improve the quality of advice, enhance choice and value for consumers and increase the insurance and takaful penetration rate from the current 54 percent to 75 percent by 2020. The initiatives proposed in the framework include partial removal of operating cost limits, diversification of distribution

"The life insurance industry remains dominated by foreign providers, while domestic firms control the general insurance industry. In 2009, foreign ownership limits were raised from 49 percent to 70 percent for branches of foreign insurance companies. Foreign equity above 70 percent is considered on a case-by-case basis. Malaysia has a strong takaful insurance market."

> "Motor tariff rates are regulated by BNM, although they have not been revised for more than 30 years, resulting in loss ratios in the order of 200-300 percent. These tariffs are being revised over a period of four years (2012 to 2015), with a view to insurers being able to set their own premium rates, differentiated in accordance to the perceived risk profile in 2016."

channel and strengthening market conduct practices. A number of the proposed reforms have been put in place during 2014. These include:

- Lowering of the minimum capital requirement for financial advisors from 1 January 2015
- Expanded list of minimum qualifications to become a financial advisor's representative from 1 September 2014
- Proposed qualifying and continuing professional development programs for financial advisors
- Introduction of a balanced scorecard framework for the remuneration of agents and advisors, beginning with investment-linked products
- Expansion of the range of products that a financial advisor can represent to clients.

Motor tariff rates are regulated by BNM, although they have not been revised for more than 30 years, resulting in loss ratios in the order of 200-300 percent. These tariffs are being revised over a period of four years (2012 to 2015), with a view to insurers being able to set their own premium rates, differentiated in accordance to the perceived risk profile in 2016.

New Zealand

The general and life insurance markets continue to be dominated by a small number of insurers, with the top five insurers in each sector accounting for approximately 75 percent to 80 percent of the market. Authorization to conduct insurance business is required from the Reserve Bank of New Zealand (RBNZ).

ICP compliance

New Zealand's solvency standards were introduced in 2011, and were developed having regard to other countries solvency standards and IAIS guidance. As such these standards are still relatively new, and whilst, there have been a number of refinements, as discussed below, there are no immediate plans to change the current solvency regime. New Zealand is not one of the mandated countries for FSAP review against the new ICPs.

Prudential developments

The RBNZ's focus has turned to supervision and on-going monitoring and compliance, as was evidenced by the number of policy initiatives released during 2014.

In 2014, the RBNZ consulted with the industry on a variety of matters pertaining to solvency, including the treatment of Guarantees and Financial Reinsurance for Life Insurance Business. These consultation papers culminated in the release of a revised suite of Solvency Standards in December 2014. The revised Standards came into effect on 1 January 2015, except for certain provisions relating to reinsurance. Insurers will be required to calculate their solvency margin under the revised Solvency Standards from their 2015 balance sheet date.

At present, there is little publicly available information regarding insurers' financial performance, and what is available, is not readily comparable. The RBNZ proposes to amend this by collecting insurer data on a quarterly basis in the form of a Quarterly Insurer Survey. Per the RBNZ's December 2014 Insurance Industry Update, under the implementation timeline, voluntary practice submissions were due to commence in February 2015, followed by compulsory submissions in May 2015. However in the RBNZ update released on 12 March 2015, we note that the RBNZ has extended the period for practice submissions through to 5 June 2015, with formal reporting to commence for periods ended 30 September 2015. In due course, we understand that the RBNZ intend to publish industry data in summary form.

In the second half of 2014, the RBNZ undertook a thematic review of risk governance across 17 licensed insurers. This review was completed by 31 December, 2014, with the 17 licensed insurers being issued with individual feedback letters. Subsequent to this, the RBNZ made the review findings publicly available in their report entitled, "Review of findings on the quality of the risk governance of insurers" released on 9 March 2015. Overall, the RBNZ note that whilst risk governance is still a work in progress, they are pleased with the quality of risk governance amongst the insurers sampled, confirming that their reliance on self-discipline has, to date, been generally well placed.

Conduct of business and consumer protection

The regulatory focus on conduct risk has focused on the banking sector, which has seen considerable law reform. To date, there has been little such development in the insurance sector, which as yet has no single clear piece of legislation which addresses conduct matters. This means that although the conduct concept is widely understood, it is challenging to pin down from a compliance perspective.

"The general and life insurance markets continue to be dominated by a small number of insurers, with the top five insurers in each sector accounting for approximately 75 percent to 80 percent of the market."

Singapore

"The Monetary Authority of Singapore (MAS) is a fore-runner of regulatory change in the ASPAC region and adopts a consultative approach. Several consultation papers on a wide range of regulatory issues have been issued in recent years and have now been brought into law."

Singapore has a very well developed insurance sector and, with no restrictions on foreign ownership, many overseas groups are represented.

The likely creation of the ASEAN Economic Community (AEC) in 2015 is expected to provide opportunities within the financial services sector as a whole. The liberalization in the movement of goods and services in the ASEAN regions could promote greater flow of business activities and investments and naturally, a greater demand for insurance services in the region. In addition, the AEC also aims to progressively liberalize and substantially remove restrictions in the ASEAN regions financial services sector by 31 December 2020. This could lead to an influx of more foreign players into the region, increasing competitive pressure, resulting in smaller insurers being forced to merge with others or close down. Multi-national insurers with their financial strength and expertise would have the opportunity to benefit from a more integrated market.

The Monetary Authority of Singapore (MAS) is a fore-runner of regulatory change in the ASPAC region and adopts a consultative approach. Several consultation papers on a wide range of regulatory issues have been issued in recent years and have now been brought into law. Many other insurance regulators and insurers in the ASPAC region have a close eye on the changes implemented in Singapore, which act as a potential precedent for future change elsewhere in the region.

ICP compliance

Since the last FSAP on Singapore in 2013, which found the level of observation of the ICPs to be very high, further improvements were made in 2014 in the areas of public disclosures, conduct, technology risk management, outsourcing, ERM and ORSA.

Prudential developments

In 2014, MAS issued details of its new enhanced risk based capital regulatory calculations (RBC 2). This paper included a number of new proposals, particularly in the areas of calibration of required capital, alignment of available capital components with those in MAS' capital adequacy framework for banks, two capital requirements and introduction of a matching adjustment for life business. A full scope QIS exercise was conducted to fully understand the impact of RBC 2 as part of the consultation. We expect MAS to conduct further QISs before finalising these proposals.

Under the RBC 2 proposals, insurers will be required to hold sufficient financial resources to meet the total risk requirements which correspond to a VaR of 99.5 percent confidence level over a one-year period as the higher supervisory intervention level (the PCR). The lower MCR supervisory intervention level will be set at a VaR of 90 percent confidence level over a one-year period. This will provide greater clarity to insurers on MAS' expectations on the type of corrective actions required, and the urgency with which they should be taken when either of these levels is breached. The MAS also continues to require all insurers to perform a series of prescribed stress tests on an annual basis to determine the robustness of their capital positions.

In addition, enhanced ERM standards came into force on 1 January 2014 and the largest insurers in Singapore submitted their first ORSA reports to the MAS before the end of 2014 – the smaller insurers are due to follow and submit their ORSA reports before the end of 2015.

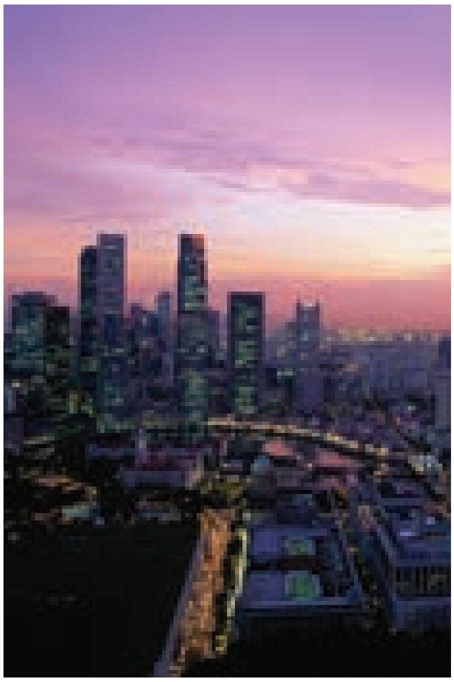
Conduct of business and consumer protection

Agents and brokers continue to dominate the insurance distribution channels in Singapore, although bancassurance and direct/online sales are becoming increasingly utilized.

On 2 October 2014, the MAS released a consultation paper on legislative amendments to the Financial Advisors Act and Insurance Act to implement the policy proposals under the Financial Advisory Industry Review. The proposals aim to raise the standards and professionalism of the financial advisory industry, increase compliance checks, adjust agent remuneration structures and encourage greater efficiency in the distribution of life insurance and investment products through an aggregator website. The key legislative changes included:

- Higher continuing professional development training for financial advisors
- More stringent conditions on licensed financial advisory firms
- New minimum base capital requirements for advisor firms
- Introducing a balanced scorecard framework for remuneration of financial advisors
- Measures aimed at lowering costs for consumers, for example through the level of disclosure on aggregator websites and offering a class of life insurance products to be sold directly to consumers without commissions.

The Personal Data Protection Act 2012 (PDPA) came into effect in 2014, with its provisions all in force by 2 July 2014. This has prompted systems changes in distribution functions. The PDPA establishes a data protection law that comprises various rules governing the collection, use, disclosure and care of personal data. It recognizes both the rights of individuals to protect their personal data, including rights of access and correction, and the needs of organizations to collect, use or disclose personal data for legitimate and reasonable purposes. The Life Insurance Association is in the process of developing a Code of Practice for Life Insurers and a Code of Conduct for Tied Agents of Life Insurers on the PDPA.



Taiwan

"The third reading of the "Offshore Banking Act" commenced allowing the insurance industry to establish international insurance subsidiaries in the territory of the Republic of China."

The Taiwanese market has seen the local regulator, the Financial Supervisory Commission (FSC) push for the "Insurance Industry Competitiveness Program" which comprises the following key initiatives expanding business and improving business efficiency (such as encouraging the development of micro insurance to protect disadvantaged groups):

- Responding to the needs of an aging society (such as encouraging investment in pension insurance funds and the care industry)
- Improvements to more appropriately respond to the regulation of internet sales:
  - Improving the effectiveness of financial funds (such as allowing a wider range of funds to enhance the rate of return and differential pricing rates allowed by guaranty funds to encourage capital strengthening)
  - Stronger role in the Asian Market (such as the development of an international insurance business market and relaxation of regulations to encourage foreign mergers and acquisitions)
- Innovation of new products (such as natural disasters and parametric weather insurance).

ICP compliance

In specific relation to ICP 16, Insurance companies in Taiwan are encouraged to develop the quantitative techniques of Economic Capital (EC) and an Own Risk and Solvency Assessment (ORSA) to enhance their capital management according to "Insurance ERM Practice Manual". However, the timetable for introduction of the EC/ORSA regime in Taiwan is still uncertain.

Prudential developments

Due to the "Insurance Industry Competitiveness Program" performed by the FSC, there are several significant developments:

- Enhanced business performance through differential management
  - On 16 January 2015, the third reading of the Insurance Act amendments occurred which updates the immediate corrective action mechanism, covering insurance capital adequacy and breach consequences allowing the Insurance Commissioner more powers to effectively deal with possible insolvencies.
- Development of an international insurance business market
  - The third reading of the "Offshore Banking Act" commenced allowing the insurance industry to establish international insurance subsidiaries in the territory of the Republic of China.
- Allow a wider range of funds to enhance the rate of investment return
  - Amended Regulations Governing Foreign Investments by Insurance Companies has been introduced

to enhance the efficiency of the insurance industry's use of funds and to encourage the insurance industry to develop related insurance products.

– Amendments to the "Regulations Governing Derivatives Transactions Conducted by Insurance Companies" were also introduced aimed at enhancing the effectiveness of the insurance industry to engage in derivatives transactions.

Regarding solvency capital, due to the legacy negative interest spread issue in Taiwan, the Actuarial Institute of The Republic Of China requested all life insurers to calculate the fair value of in-force liabilities at the end of September every year on the basis of the IFRS 4 Phase II exposure draft. Furthermore, all life insurers are required to submit a report to show if the insurance liabilities booked are sufficient.

Conduct of business and consumer protection

The bancassurance channels have become the primary mode of distribution in recent years.

The third reading through the Legislative Yuan "Financial Consumer Protection Act" amendment on 16 January 2015, sets out violations against the financial interests of consumers and grants the competent authorities power to adopt a warning to stop the sale of goods and to stop businesses trading. They can also impose fines and/or revoke licences.

Thailand

> "The Office of Insurance Commission (OIC) is currently in the process of finalising its 3rd Insurance Development Plan covering the strategic objectives for the period from 2015 through to 2020. The overall aim is to strengthen and build confidence in the Thai insurance market in preparation for the liberalization under the World Trade Organization and the ASEAN Economic Community."

It is generally acknowledged that strengthening and consolidation of the insurance market is needed, particularly within the non-life sector. The regulatory focus over the last five years has been on introducing and developing the risk based capital regime, enhancing the qualifications required to operate in the market and encouraging the implementation of effective corporate governance frameworks.

The Office of Insurance Commission (OIC) is currently in the process of finalising its 3rd Insurance Development Plan covering the strategic objectives for the period from 2015 through to 2020. The overall aim is to strengthen and build confidence in the Thai insurance market in preparation for the liberalization under the World Trade Organization and the ASEAN Economic Community. The strategic direction of the plan is:

1. *Enhance the overall industry standard and enforce corporate governance*
   - Raise the qualifications to operate as an insurer such as increasing the minimum capital levels, more stringent 'fit and proper' qualifications and increased foreign ownership participation.
   - Enhancing corporate governance and transparency of disclosure.
2. *Improving insurers' efficiency and promoting a competitive environment*
   - Enable the industry to operate more competitively which would involve, amongst other things, allowing the introduction of innovative products and de-tariffication.
3. *Establishing a new image for the insurance industry through providing awareness and attracting talent*
   - Improve the public profile of the industry so that the benefits of insurance are better understood as well as attract better talent.

ICP compliance

Thailand is not one of the mandated countries for FSAP review against the new ICPs, however, the OIC performs an annual self-assessment against the ICPs and they have undertaken a number of recent initiatives to improve compliance specifically in the following areas:

- Enhancing the Supervisory Review and Reporting Process for both onsite and offsite monitoring
- Undertaking a review to enhance the risk based capital regime and
- The development of stress testing frameworks.

Prudential developments – Regulatory capital

The OIC continues to review the Risk Based Capital Regime that was introduced in September 2011. The objective of the review was multifaceted covering the following:

- Update of the risk charge parameters
- Addressing certain gaps in the original regulations
- Considering the feasibility of introducing risk charges for operational, catastrophe and mass surrender

- Increasing the overall confidence level of the framework from the original 95 percent VaR.

Market testing was performed in mid-2014 and the results are still under review by the OIC and the industry. One of the key discussion points is the level of confidence that will be applied. At this time, no implementation date have been announced, but it is possible that the requirements may be implemented piecemeal.

Simultaneously, the OIC has been working with the industry to implement stress testing frameworks for both the life and non-life industry. Quantitative assessments have been performed and are under review.

Prudential developments – minimum capital requirements

In late 2014, the OIC announced its intention to increase the current minimum capital levels as follows:

- Life: from Baht 50 million to Baht 500 million over 3 years and to Baht 1 billion over 5 years
- Non-life: from Baht 30 million to Baht 300 million over 3 years and to Baht 500m over 5 years
- Health: from Baht 30m to Baht 100 million over 3 years.

The legislation and timing of the implementation of the regulation is not yet known, however, this will likely have a significant impact on the non-life market since many of the smaller companies are family owned.

Prudential developments – risk management and governance

During 2014, the OIC issued a number of guidelines and regulations to improve the overall control environment and corporate governance of insurers. The most significant points were:

- The requirement to establish an Audit Committee with two independent directors
- Internal audit are required to report directly to the Audit Committee;
- A compliance department is required to be set up which reports either to the Board or the Audit Committee
- Processes, procedures and controls are required to be established over the receipt and payment of cash
- Guidelines were issued over independence requirements of directors, formation of risk committee, investment committee, nomination committee and remuneration committee.

These regulations and notifications served to provide, enforce and guide previous guidelines issued by the OIC.

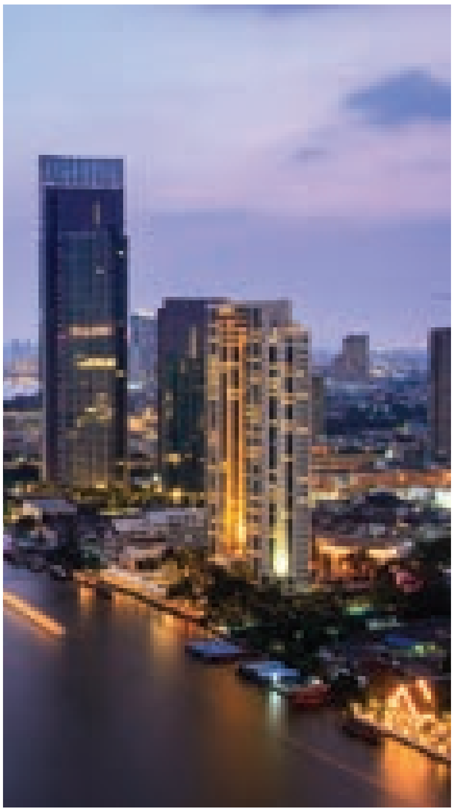
Conduct of business and consumer protection

The discussion on deregulation of pricing is still ongoing between the OIC and the industry. However there is currently no consensus on a timeframe or the extent to which pricing, commission and the product approval process will be liberalized.

The strengthening of the regulations over bancassurance marketing/ selling practices in 2013 has not had a significant impact on growth.

Health insurance

Whilst it is possible to apply for just a health insurance license, most insurers do not specialize in the segment. Awareness of the need for health coverage is growing and similarly, as the population is aging we have seen some life insurers offer annuities however the overall premium is low.



Vietnam

"In response to the decreasing trend of lower market interest rates, the Ministry of Finance (MOF) revised the calculation basis of valuation interest rate applicable to life insurance companies in December 2014 and this revised calculation basis will be applied from February 2015."

2014 saw good growth in the insurance sector, which is expected to continue in the coming years due to the current low market penetration and GDP growth in Vietnam.

In response to the decreasing trend of lower market interest rates, the Ministry of Finance (MOF) revised the calculation basis of valuation interest rate applicable to life insurance companies in December 2014 and this revised calculation basis will be applied from February 2015.

In the long-term, the insurance sector will be restructured, with aims to consolidate the operations of weak and inefficient insurance companies and to improve corporate governance standards in line with international practices in three key areas: capital adequacy, risk management and information transparency.

ICP compliance

Vietnam is not one of the mandated countries for FSAP review against the new ICPs.

Prudential developments

The current capital regime in Vietnam is rule-based with requirements of minimum capital levels for each type of business (life insurance, non-life insurance, health insurance and reinsurance) and minimum levels of solvency margin, using a simple calculation methodology.

In December 2014, the MOF issued a Circular providing guidance on assessment and rating of insurance companies. Based on the results of supervision ratios/indicators, insurance companies are classified into different groups and appropriate measures are taken based on the rating result for each group.

Conduct of business and Consumer protection

Agency is still the main distribution channel in Vietnam; however, a number of initiatives on alternative distribution channels (including on-line and bancassurance) have been launched/focused on by insurance companies.

In 2014, the MOF issued a Circular regulating the bancassurance activities which are both supervised by the State Bank of Vietnam (banks) and the MOF (insurance companies). This Circular has specific training requirements for banking staff involved in bancassurance activities to avoid mis-selling insurance products to customers.

REGULATORY DEVELOPMENTS IN EMA REGION

(INCLUDING CENTRAL AND EASTERN EUROPE, MIDDLE EAST AND AFRICA)

We are now in the final year before Europe's insurance industry has to comply with Solvency II. Given its influence on the evolution of regulatory regimes across the globe, we start this year's review by looking at the regulatory developments in Europe.

Europe

European Economic Area (EEA)

It would be hard these days to find someone who is unaware of the major revamp of insurance prudential regulation that is taking place in Europe. Solvency II will replace 14 existing directives (commonly referred to as Solvency I) with a new risk based set of prudential requirements, which will for the first time mean a single harmonized, robust prudential framework applying to all but the very smallest European insurance firms.

Prudential developments - Solvency II

While some observers have thought Solvency II has been a long and arduous journey, there can be no remaining doubt that the 1 January 2016 implementation date will be met.

The final directive has been approved for some time, and Member States had a deadline of 31 March 2015 to transpose these requirements into their local regulatory regime. On 18 January 2015, the level 2 delegated acts (officially now the Commission Delegated Regulation 2015/35) also entered into force. As these are made as regulations, not as a directive, they apply throughout the Member States automatically without the need to be transposed.

The remaining aspects that complete the Solvency II package are the implementing technical standards (ITS) and guidelines and equivalence decisions.

Implementing technical standards

The ITS are prepared by EIOPA and approved by the European Commission. These cover purely technical matters and are legally binding once approved.

EIOPA sent the first wave of ITS (which related to various approvals processes that will be required from 1 April 2015) to the Commission on 31 October 2014 and the Commission made these as Commission Implementing Regulations on 19 and 24 March 2015.

Consultation on the second and final wave of ITS closed on 3 December 2014, with responses due by 2 March 2015. EIOPA aims to send these to the European Commission on 30 June 2015 with a view to approval being provided by 30 September 2015, which is considerably shorter than the first wave process took.

Guidelines

The guidelines are prepared by EIOPA and require no further approval. Unlike the ITS, the guidelines operate on a so-called 'comply or explain basis'. This means they are issued to national supervisory authorities who must then make every effort to comply with the guidelines, but where they are unable to do so, they must explain the reason for non-compliance to EIOPA. The national authorities have two months from the issuance of the guidelines in final form to confirm their intentions regarding compliance. Once the national authority has confirmed its intention to comply, insurance companies in their jurisdiction will be required to comply with their implementation of the guidelines to the extent they are applicable to them.

This 'comply or explain' approach could result in some divergence in limited aspects of the regime. However, the experience from the preparatory phase guidelines suggests that there will be a high level of compliance. For those guidelines, there was an overall compliance rate of 93 percent, with over 90 percent of the guidelines in each paper complied with by all authorities.

"It would be hard these days to find someone who is unaware of the major revamp of insurance prudential regulation that is taking place in Europe. Solvency II will replace 14 existing directives (commonly referred to as Solvency I) with a new risk based set of prudential requirements, which will for the first time mean a single harmonized, robust prudential framework applying to all but the very smallest European insurance firms."

The first set of guidelines (which mainly related to the quantitative requirements) was finalized by EIOPA on 27 November 2014 and the 'comply or explain' period opened with the publication of the translated versions on 2 February 2015. At the time of writing, the national competent authorities are in the process of confirming their extent of compliance with these guidelines. Early indications are that compliance will be at a very high level.

Consultation on the second wave of guidelines ended on 2 March 2015. EIOPA are aiming to publish the final guidelines in July 2015 to allow sufficient time for national authorities to have completed their 'comply or explain' assessment before Solvency II goes live. A decision regarding audit requirements in relation to disclosures is still awaited, but otherwise this will complete the Solvency II package with the exception of the final equivalence decisions (see below).

2014/15 requirements

Reference was made above to preparatory phase guidelines. These relate to the period from 1 January 2014 to 31 December 2015 and we covered these in last year's edition of this publication. Across Europe, significant amounts of work have been undertaken by both the insurance industry and their regulators to meet these requirements.

The first Own Risk and Solvency Assessment (ORSA)-style reports (which for the preparatory phase are named Forward Looking Assessment of Own Risks (FLAOR)) were submitted in 2014 and a second filing will be required in 2015. This exercise has provided insurers with much greater awareness of the level of effort involved in producing such reports, with many Boards stating that they found the exercise useful. As well as providing greater depth of understanding about their risk profiles, the exercise has in many cases highlighted key areas of development for 2015 (such as enhancing stress and scenario testing and projection of capital). A common message coming back from the initial reviews by a number of supervisory authorities, is that insurers need to bear in mind that the intended audience for the report should be the Board and not the regulator, so it must address the Board's needs first and foremost.

More importantly, the requirement to submit extracts of the quantitative reporting templates (QRT) and narrative reports that will be required under Solvency II gave a much needed push to insurers' pillar 3 efforts. Although some European countries have moved ahead of the preparatory phase requirements, the first reporting required relates to the financial year ended on or after 31 December 2014, where submission to the local supervisors is required within 22 weeks for solo information and 28 weeks for group information. Quarterly filings are also required in respect of the quarter ended 30 September 2015 within 8 weeks for solo information and 14 weeks for group information. Significant work has been undertaken by insurers to ensure that they have the necessary information to produce the required QRT and narrative reports, although the latter has generally received less attention than the former.

Pillar 3 reporting in the preparatory phase is an area where there is divergence of supervisory approaches, with a number of national authorities requiring some form of auditor assurance, at least in respect of the Solvency II balance sheet. For example, the Belgium regulator requires a report from the auditors of factual findings on whether the quantitative and narrative information has been reported in accordance with EIOPA guidelines and the UK regulator has put in place a two step process to firstly consider whether a firm's basis of preparation complies with the Solvency II framework as it currently stands and then an audit opinion on whether the completion of a subset of the QRT required in the preparatory phase comply with that basis of preparation.

Internal models

A survey undertaken by Solvency II Wire in November 2014,[9] revealed that there are around 175 applications across Europe to permit insurers to use their own internal model to calculate the solvency capital requirement instead of applying the standard formula approach. The UK leads the way with around 45 applications.

On 4 December 2014, EIOPA released a Common Application Package for Internal Models, aimed at ensuring consistency in the supervisory approval process across Member States.

Equivalence

Equivalence relates to the recognition of non-European insurance prudential regulatory regimes within the Solvency II regime. There are three affected areas:

- The treatment of reinsurance contracts placed with non-European reinsurers
- Enabling an insurance company that is subject to that regulatory regime to be included within the group solvency calculation on a local regulatory basis (provided approval is also granted for it to be aggregated on a solo basis, rather than included as part of the consolidated group)
- Reliance on the group supervision performed under equivalent group requirements.

On 30 January 2014, EIOPA issued its final advice to the European Commission regarding the equivalence status of Bermuda, Switzerland and Japan (reinsurance only). These were the only countries that originally requested equivalence assessments and significant effort has been spent in amending local regulatory requirements, where potentially non-equivalent outcomes may have otherwise been observed, to bring them up to Solvency II standard. EIOPA's opinions can be summarized as follows:

"On 4 December 2014, EIOPA released a Common Application Package for Internal Models, aimed at ensuring consistency in the supervisory approval process across Member States."

Table 11: EIOPA recommendations regarding equivalence status

	Reinsurance	Solo insurer	Group requirements
Switzerland	Equivalent once amendment to the disclosure regime is implemented	Equivalent	Equivalent once amendment to the disclosure regime is implemented
Bermuda (insurers classified as Classes 3A, 3B, 4, C, D and E only)	Largely equivalent, but a number of caveats (see below) for certain classes especially long term insurance.		
Japan	Largely equivalent – the most significant concern relates to technical provisions although (as noted in the Japan section of this paper) development of a new economic-based solvency regime is in progress which EIOPA believes should address this concern.	Not applicable	Not applicable

Source: KPMG International 2015.

9. (http://www.solvencyiiwire.com/internal-model-pre-applications-2014/1582332)

> In terms of the transitional arrangements, during 2014 EIOPA worked on the assessment of the supervisory regimes of Australia, Brazil, Chile, China, Hong Kong, Israel, Mexico, Singapore and South Africa, as well as determining how it should assess the Canadian regime for provisional equivalence.

There are several areas in the Bermuda report which have been assessed as partially equivalent and for some classes of insurer these will not be resolved before Solvency II goes live, inspite of recent changes by the Bermuda Monetary Authority. The most significant caveats relate to:

- The solvency regime (all classes) due to the recognition of multiple valuation bases. This is expected to be addressed when a proposed revision of the valuation standards is implemented (1 January 2016 for classes 3B/4; 1 January 2017 for class 3A; and 1 January 2018 for life)
- Valuation standards for life insurers – material uncertainties remain around the framework being developed
- Lack of financial statements for Class C/D insurers
- Lack of provisions requiring Class C/D insurers to maintain available statutory capital and surplus that equals or exceeds the minimum solvency margin – expected to be in place by the end of 2015
- Public disclosure, where current regulation and plans for public disclosure are less extensive than Solvency II. There are currently no public disclosure requirements applicable to Class 3A or life insurers; for Classes 3B, 4 and groups, there is a wide range of exemptions possible.

At the time this document went to print, the Commission had not released its equivalence decisions. From these papers, Switzerland appears best placed to gain full equivalence status, and it remains to be seen how the Commission will view the caveats in the Bermuda and Japan reports. Even if it were to decide that it was unable to grant full equivalence, including for all classes of Bermuda entities for which equivalence was sought, in our view the reports demonstrate sufficient progress to enable these regimes to qualify for temporary/provisional equivalence.

In terms of the transitional arrangements, during 2014 EIOPA worked on the assessment of the supervisory regimes of Australia, Brazil, Chile, China, Hong Kong, Israel, Mexico, Singapore and South Africa, as well as determining how it should assess the Canadian regime for provisional equivalence (which is only relevant to the inclusion of non-European insurers within the group solvency assessment), given this does not require supervisory co-operation. The European Commission has indicated that it will introduce delegated acts on provisional equivalence in April 2015 and temporary equivalence in September.

Conduct of business regulation

Consumer protection must address two key needs:

- Sound management, robust governance and robust solvency position (Solvency II)
- Appropriate information for customers on the conditions, costs and risks of the products they buy, ensuring they are treated fairly and receive value/service for money.

Work in the second of these areas mainly revolves around the recast Insurance Mediation Directive, now named Insurance Distribution Directive (IDD) and the Regulation on Product Information Documents for packaged retail and insurance-based investment products (PRIIPs). During 2014, progress was made in both these areas with the PRIIPs directive finalized in November and published in the Official Journal on 9 December.

Progress on IDD has been slower, with 2014 seeing a number of redrafts, but no final directive. In the meantime, the adoption of the recast Markets in Financial Instruments Directive (MiFID2) has meant changes need to be introduced into the existing IMD relating to the identification, prevention, management and disclosure of conflicts of interest.

EIOPA issued its consultation paper on 1 October 2014, largely replicating the requirements established in the MiFID Implementing Directive, although noting that it may need to develop further guidelines at a later date to ensure consistent application across Member States. It sent its final recommendations to the Commission on 4 February 2015. Key recommendations are that both insurance intermediaries and insurance undertakings:

- Identify potential conflicts of interest arising in the course of insurance distribution activities, with minimum criteria proposed
- Establish a conflicts of interest policy that is appropriate to the nature, scale and complexity of their business. This must specify procedures to be followed and procedures adopted in order to manage such conflicts. The policy must be reviewed on at least an annual basis.

Although the IDD will permit disclosure to customers where conflicts of interest cannot be sufficiently managed to ensure that customer detriment cannot arise, the paper emphasizes that this should be seen as "a step of last resort".

Currently, there is no harmonized approach in this area across Member States, so the proposals will have differing impacts across the European Union countries, and some countries have moved to introduce elements of the requirements early. A key consideration for some countries will be the requirement to remove any direct link between the remuneration of one party and the revenues of another party where this could permit conflicts of interest. Although EIOPA emphasizes that they do not intend to prohibit commission-based distribution models, this may necessitate a review of current arrangements ahead of the IDD proposals.

To supplement the work underway on the Key Information Document for PRIIPs, consumer testing will be undertaken to assess whether this will provide helpful information. EIOPA also intends to develop a set of key risk indicators to facilitate risk-based supervision of conduct of business.

However, equally if not more importantly are a firm's culture and strategy, which is discussed in a separate section of this publication.

In other developments, in December 2014 EIOPA produced its third consumer trends report, based on information gathered from national supervisors. The following main trends were identified, although these did not exist in all Member States. A number of these should be addressed by IDD, but others could result in further initiatives next year to address these concerns:

- Insufficient transparency in or misleading advertising/marketing/sales literature
- Inconsistent information disclosure
- Focus on price within advertising material for non-life products and not the terms and conditions
- Enhanced point of sale information required to provide fair and balanced information that is not misleading
- Poor product disclosure/selling practices when insurance has been bundled with another product, resulting in a lack of awareness that an insurance product has been acquired

- Restrictions/exemptions meaning the product is poor value for money
- Mis-selling
- Conflicts of interests and sales incentive schemes
- Inappropriate policy switching (for example from guaranteed to products with lower/no guarantees)
- Claims handling weaknesses (such as inappropriately refused claims and delays in payment)
- Low level of financial literacy amongst consumers.

European stress test

On 30 November 2014, EIOPA's European insurance stress test exercise centered on both adverse market and insurance industry scenarios. A separate exercise was also conducted to assess the impact on life insurers who are most affected by the low interest rate environment of either an elongated period of low, or of a sudden reversal in, interest rates.

Much of the media coverage following the release of the results on 30 November centred on the 14 percent of companies that could not cover their solvency capital requirement (SCR) at the end of 2013, rather than EIOPA's first bullet in its own press release – that the insurance sector is in general sufficiently capitalized in Solvency II terms.

However, overall statistics can present a distorted picture and these 14 percent of companies only accounted for 3 percent of assets. This may be due in part to the variances in the level of participation across insurance markets, with the three largest insurance markets (UK, Germany and France) achieving in the order of 50 – 60 percent coverage with few participants, whereas some of the smaller European insurance markets had coverage of nearer 100 percent.

A particular problem with the exercise was that it only tested the standard formula calibration of the solvency capital requirement (SCR) and not the impact on internal models. As stated in the Solvency II section above, there are around 175 full or partial internal models being applied for across Europe, which is likely to include many of the participants. The 14 percent figure cited above may have been significantly lower had firms been permitted to use their expected Solvency II SCR basis. This is likely to be the case for the only Top 30 European insurer that was unable to meet its SCR. For the rest of the Top 30, over 60 percent showed coverage in excess of 150 percent of SCR after the stress event.

Stress test results

The insurance scenarios tested were extreme, but on average, none of these reduced capital levels by more than 10 percent.

The market stress results were distorted by the simplifying approach of not recalculating the SCR post stress (which would happen in reality) and a significant number of the smaller firms that participated not making use of the long-term guarantees (LTG) measures that would be available to them. The true position in such extreme events would therefore be stronger than the results reveal.

Unsurprisingly, insurers are most exposed to a combination of both asset values decreases and low interest rates. However, even under such extreme conditions and without the mitigants available to them, while there was a significant reduction in the SCR ratio, policyholder liabilities would still be covered.

Low yield environment

The impact of the low yield environment has been recognized as a concern for some time and the results reconfirm this. However, while a significant proportion of firms would fail to meet their SCR (24 percent under the continuation scenario and 20 percent under the sudden reversal scenario) they also show that it would take around a decade of low interest rates before some insurers could become potentially unable to meet all policyholder payments. This would allow most insurers time to respond to the new norm and develop action plans to reduce any customer detriment. Where this is a particular issue for a local market, local regulators have undertaken further work to assess the seriousness of the issue and the action they need to address.

Insurers should consider the potential impact of the findings on their own businesses. This will include the extension of reverse stress testing to more fully consider the impact on their business model, policyholders and the wider economy, and to determine the mitigating actions that would be available. In some respects, a first step towards recovery plans.

Table 12: EIOPA Stress Test: Unbundling the headlines

14 percent of companies fail to cover their SCR

- Participation levels varied significantly (the three largest insurance markets – UK, Germany and France – achieved 50–60 percent coverage from few participants, smaller markets had coverage nearer 100 percent). This distorts the overall statistics
- These companies only account for 3 percent of European insurance assets.
- The exercise only tested the standard formula calibration of the SCR. If the 175 full or partial internal models being applied for across Europe had been allowed, the failure rate could have been significantly lower.
- This is likely to be the reason why one Top 30 European insurer that was unable to meet its SCR. For the other 29, over 60 percent had an SCR ratio in excess of 150 percent.

Sector is exposed to a "double hit" stress combining asset value decreases and low risk-free rate

- The market stress results were distorted by the simplifying approach of not recalculating the SCR post stress and a significant number of the smaller firms not making use of the long-term guarantees (LTG) measures available to them. The true position in such extreme events would therefore be stronger than the results reveal.
- The "double hit" scenario would be extreme conditions, yet despite the factors above, while there was a significant reduction in the SCR ratio, policyholder liabilities would still be covered.
- The insurance scenarios tested were extreme, but none of these reduced capital levels by more than 10 percent.

In a prolonged low yield scenario, 24 percent of insurers would not meet their SCR

- The impact of the low yield environment has been recognized as a concern for some time and the results reconfirm this.
- However the results also show that it would take around a decade of low interest rates before some insurers could become potentially unable to meet all policyholder payments. This would allow time for most insurers to respond to the new norm and develop action plans to reduce any customer detriment.

Overall, the results demonstrate the strength of the European insurance sector

Source: KPMG International 2015.

Recovery and resolution planning

Whilst a banking recovery and resolution directive was passed in April 2014, there remains as yet no such directive for insurers. The work conducted in 2012 on a possible framework for the recovery and resolution of financial institutions other than banks may have stalled, but it certainly has not gone away. However, it is unclear whether insurers will remain within its remit, as the description included in the Commission's work plan for 2015 dated 16 December 2014 now describes this as a "Proposal to create a European framework for the recovery and resolution of systemically relevant financial institutions such as Central Clearing Counterparties".

Notwithstanding this apparent change in stance, some national authorities look likely to proceed with some form of contingency planning requirements for at least those insurers deemed to pose a systemic risk nationally. For example, in the UK a new Fundamental Rule was introduced during 2014 that requires all regulated firms (irrespective of sector) to "prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services".

In its advice to insurers, the UK Prudential Regulatory Authority stated that "Insurers should provide to the PRA on request all information needed to perform an assessment of their resolvability". Where significant barriers to resolvability are identified, the PRA expects insurers to propose and implement adequate changes to reduce these, setting out credible steps to maintain or restore their business to a stable and sustainable condition in the event of stress. However, it should be noted that the PRA is currently operating on an 'on request basis' and its discussions with insurers regarding resolution plans will vary depending upon insurers' systemic importance, proximity to failure, or other reasons such as major transactions being contemplated.

Switzerland

The regulatory environment in Switzerland in 2014 was characterized by multiple regulatory initiatives, all of which may have significant impacts on insurance companies. The main trends of last year can be summarized as follows:

- The adoption of international standards by Switzerland
- The spill-over-effect of banking law into the insurance domain
- Strengthening consumer protection laws.

The increasingly international nature of regulation has impacted the Swiss market, in particular, the growing powers of supra-national bodies such as the IAIS. Standards of supervision and insurance risk management are being set at the global level and the Swiss Financial Market Supervisory Authority (FINMA) will comply with these in order to retain its position as a globally respected supervisor. The wave of consumer protection legislation from the European Union provides opportunities but also poses challenges for distribution units, compliance departments, product development, and as such is a subject for urgent Board level consideration.

ICP Compliance and Solvency II equivalence

In 2014, the IMF completed its Financial Sector Assessment Program of the Swiss prudential system. As expected, the level of compliance with the ICPs was very high, but there were still a few significant recommendations including the need for more on-site inspections, direct supervision of intermediaries and increased disclosures. As in several other recent FSAPS, the reviewers urged FINMA to develop a stronger market conduct.

One surprising item in the FSAP was the suggestion that FINMA increase its supervision of the branches of third-country reinsurers, since the IAIS does not have a standard regarding oversight of branches. In 2013, the IAIS released an Issues Paper on *The Supervision of Cross-Border Operations through Branches*, which explored current supervision rules, but did not recommend one approach.

Switzerland is a candidate for full equivalence under Solvency II. EIOPA's assessment of the Swiss compliance with Solvency II was very positive, but there remain concerns that recent political issues around foreign workers might result in problems in Parliament when the equivalence delegated acts are presented.

Prudential

A partial revision of the Insurance Supervision Ordinance (ISO) is expected to become effective on 1 July 2015. There were a number of reasons to revise the current ISO:

- The lessons learnt from the financial and economic crisis
- The equivalence assessment of the Swiss Solvency Test (SST) by EIOPA
- The FSAP.

The changes to the ISO will affect the areas of solvency, qualitative risk management and disclosure. Parallel to that, adjustments will be made in the areas of insurance technical reserves, tied assets, intermediary supervision and to certain sector-specific provisions.

> "Switzerland is a candidate for full equivalence under Solvency II. EIOPA's assessment of the Swiss compliance with Solvency II was very positive, but there remain concerns that recent political issues around foreign workers might result in problems in Parliament when the equivalence delegated acts are presented."

The current ISO permits use of equivalent solvency measurement methods, whereas the new ISO will require all insurance companies in Switzerland to follow the SST. With regards to qualitative risk measurement, an ORSA requirement will be introduced, a compliance function will be established and a framework for liquidity will be imposed.

Conduct of business and consumer protection

MIFID 2 / FIDLEG

As stated in the Europe chapter, MiFID 2 adds consumer protection provisions to IMD in relation to the distribution of "insurance-based investment products". However, the consultation draft of the Swiss Financial Services Act (FIDLEG) affects the insurance industry directly, as it covers all providers of financial instruments. If this scope is unchanged in the final legislation, insurance companies as well as insurance intermediaries in Switzerland will have to address a range of strategic questions and thoroughly plan for the implementation of the FIDLEG rules.

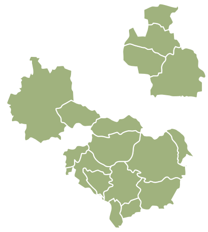
However, there is still a high uncertainty regarding the timing and the final content of the legislation.

Automatic Exchange of Information

Switzerland has been under increasing pressure for more tax transparency ever since the global financial and economic crisis and the resulting considerable financing needs of various countries. The OECD took a decisive step toward international tax transparency when it presented the future standard for the Automatic Exchange of Information (AEoI) on 13 February 2014.

Insurance companies have to carefully consider the impact of AEoI on their clients, business processes and IT-Infrastructure. AEoI is not FATCA 2.0. For those insurance companies with a significant customer or investor base outside their home country, AEoI means a big increase in the volume of data to be collected and reported to the local tax authority. Regularization, IT-Infrastructure as well as data quality, privacy and data protection are key factors for an effective implementation of the standard.

Central and Eastern Europe (CEE) region



The CEE region covers 18 countries[10] of different sizes with diverse market and economic development. However, these countries follow similar paths – transitioning from centrally run socialist regimes, some to then passing through European Union accession and the need to transpose European laws, while others have reached a "mature" phase in their integration into Europe.

Motor third party liability business is the most important line of business in most CEE countries and there have been a number of developments that have helped increase premium levels, including liberalization of the market and freeing market competition (Croatia), a new Civil Code which will likely increase disability benefits (Czech Republic) and new regulations applicable from 1 January 2015 (Romania). Romania also changed the rules relating to admissible assets to cover technical reserves with effect from the same date.

Most of the CEE insurance markets are dominated by subsidiaries of groups based outside the region, although this year has seen some evidence of subsidiaries becoming branches of European insurers. This may be part of group plans to increase group efficiency in a Solvency II world, although it is too early to tell whether this trend will continue.

It appears that the Bulgarian supervisory model might change, with the possible integration of two supervisory authorities, Bulgarian Central Bank and Bulgarian Financial Supervision Commission, having been publicly discussed since the last parliamentary elections in October 2014.

ICP compliance

None of the CEE countries is on the list of countries subject to mandatory FSAP review for the insurance sector. Harmonization with European directives is a higher priority than ICP compliance.

Prudential developments

In Romania, EIOPA, the European Commission and local supervisor are carrying out a Balance Sheet Review exercise during the first half of 2015. A representative sample of the insurance market (13 largest companies) was selected to be reviewed for all assets (not only those covering technical provisions) and all liabilities by an independent reviewer. The scope of the exercise is to test the insurance market against predefined stress scenarios and assess the readiness of the Romanian market for Solvency II compliance.

Elsewhere, in line with EIOPA preparatory guidelines, supervisors require action from insurance companies ahead of Solvency II implementation. For example, in Lithuania and Romania, firms have to submit a FLAOR/ORSA policy and report by January 2015. In addition, firms in Lithuania shall submit a second run of FLAOR during 2015. In the Czech Republic and Hungary, firms are required to follow timetables that include a range of steps leading up to 1 January 2016.

New rules are currently being considered in Serbia, which would reflect capital levels set out in the existing Solvency I directives, rather than Solvency II.

"Most of the CEE insurance markets are dominated by subsidiaries of groups based outside the region, although this year has seen some evidence of subsidiaries becoming branches of European insurers. This may be part of group plans to increase group efficiency in a Solvency II world, although it is too early to tell whether this trend will continue."

10. According to KPMG classification the region covers: Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Romania, Serbia, Slovakia and Slovenia.

Conduct of business and consumer protection

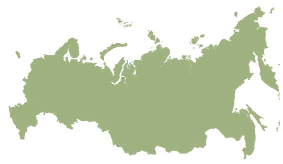
With no maximum harmonization measures in the consumer protection area currently in existence at European directive level, national rules in this area differ across the region.

In the Czech Republic, distribution is dominated by so called Multi-level firms Their biggest motivation tends to be sales volume and commission levels, which can act to the detriment of quality of sale, with multi-level firm networks seen switching their clients from one company to another. In response, the supervisor has recently introduced rules for insurers aimed at enhancing the quality of sales advice and distribution generally. These rules will have a significant impact on their internal control systems, quality monitoring and information disclosure, so these are currently under hot debate. Beyond that, the Czech Insurance Association adopted its self-regulation standard regarding information disclosure to clients. In addition, a new law on intermediaries is under way which will enlarge the scope of the requirements (for example to include employees of insurance firms involved in distribution of insurance products).

The Association of Hungarian Insurance Companies introduced self-regulation related to quality of sale and they have agreed how to calculate and present costs related to unit-linked products. Recently, new provisions have been incorporated into the Act on Insurance regarding life insurance commissions, which will become effective in 2015. These will limit the level of life insurance commissions and prohibit payment of any commission that exceeds the premium paid by the policyholder.

In Poland, insurers lost recent court decisions related to 'surrender charges' on unit-linked policies, which could result in insurers suffering losses, as these decision set precedents for all policyholders.

Russia



Since the establishment of the "mega-regulator" under the Central Bank of Russia (September 2013), there have been many legislative changes introduced, such as development of new sector accounting rules (transitioning from Russian GAAP to IFRS, including an analysis of catastrophe events), updates to solvency requirements, mandatory actuarial valuation and revision of limits and tariffs applying to compulsory motor third party liability business (CMTPL). Most of the changes are considered to have positive effects on the market.

ICP compliance

Although in the 2011 FSAP a formal assessment of compliance with IAIS principles was not undertaken, the FSAP did indicate that the supervisory framework departed from international standards in a number of areas. Licensing did not require insurers to have the necessary operational infrastructure, in the form of internal controls and risk management functions. The range of individuals to which fit and proper requirements apply was limited. Also, the supervisory agency did not have the power to disqualify key managers, including auditors and actuaries, who do not comply with the fit and proper requirements. While cooperation and information-sharing appeared to function, the home-host notifications and other relevant cross-border cooperation activities were not mandatory for the supervisory agency. Group-wide supervision was not incorporated in the regulation and presents a major risk to the objectives of supervision, given the importance of group activity. Preventive and corrective actions were missing from the current supervisor powers. Since then efforts have begun to address these concerns.

Prudential developments

As mentioned above, the new insurance accounting standard introduced a requirement for mandatory actuarial valuation of insurers' performance. This requirement was brought into actuarial standards from November 2013 (the Law on Actuarial Activities (FS-293)) and is applicable from 1 January 2015. This actuarial opinion will be appended to insurers' financial statements, which are published online.

On 1 September 2014, the Central Bank of Russia proposed a draft directive "*On calculating regulatory equity/liabilities ratio for insurers*", which will change the calculation of the standard solvency ratio:

- For life insurance, the standard solvency ratio will be set at 4 percent of the life reserve net of reinsurance, with an additional charge for capital at risk (for death risk) [Similar to Europe's Solvency I directives]
- For non-life insurance, the revised basis will be closer to Solvency II methodology, with very close alignment to its standard formula requirements for non-life underwriting risk, considering the net written premium, net loss reserve and standard deviations for premium and reserve risks, assessing combined premium and reserve risk for each accounting group and taking into account correlation between accounting groups in their portfolios.

"On 1 September 2014, the Central Bank of Russia proposed a draft directive "*On calculating regulatory equity/liabilities ratio for insurers*", which will change the calculation of the standard solvency ratio."

- An equalization reserve is added for some accounting groups.

In November 2013, State Duma enacted the Law on Actuarial Activities (FS-293), which became effective from 1 January 2015. This requires insurers to undertake mandatory actuarial valuations and requires the actuarial opinion to be appended to insurers' financial statements. These actuarial opinions can only be provided by responsible actuaries, with efforts being made to increase their number

Conduct of business and consumer protection

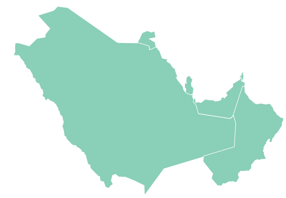
The revision to CMTPL limits and tariffs can be summarized as follows:

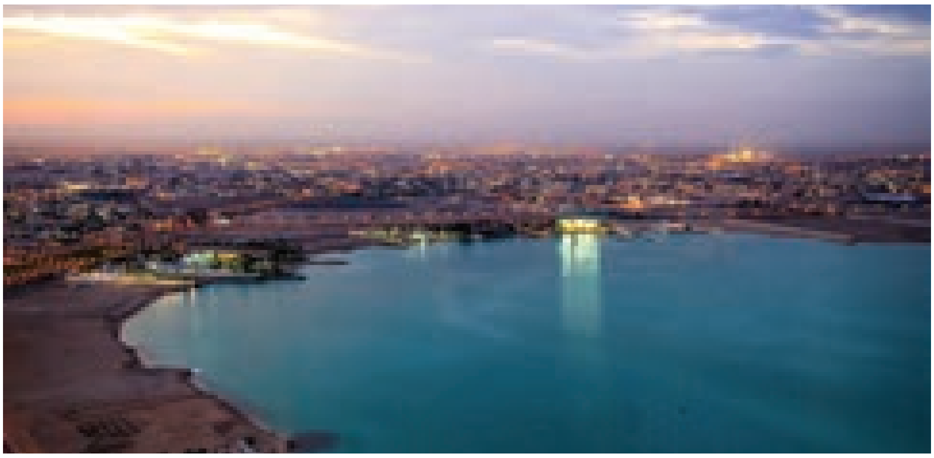
- Property damage: Prior to 1 October 2014, the CMTPL limit was 120 RUB'000. This was increased to 400 RUB'000 on 1 October and then increased again ten days later by a further 23-30 percent. The proposed base tariff is within the corridor of 2440-2574 RUB (previously 1980 RUB).
- Injuries and death: The CMTPL limit will be increased to 500 RUB'000 on 1 April 2015, although there is no change to CMPTL tariffs expected.

These changes could potentially have a negative effect on the CMTPL loss ratio, taking into account high court charges and the level of fraudulent claims following the extension of the Consumer Protection Law to the insurance industry in 2012.

Middle East

Gulf Cooperation Council (GCC)





The insurance sector in the GCC region comprises six counties: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia (KSA), and United Arab Emirates (UAE). Generic developments are covered in the following paragraphs, followed by specific country developments.

ICP compliance

Regulatory change has started to pick up pace across the region with implementation of the ICPs and overall modernization of the insurance sector. Since the last edition of this report, UAE has become the latest country in the region to take steps towards modernization of insurance sector regulation. However, there are also initiatives in the pipeline in Saudi Arabia. In Qatar, with the transfer of insurance sector regulation to the Qatar Central Bank (QCB), there are indications that new regulations in compliance with ICPs are likely to be issued soon with an aim to enhance and modernize the sector.

Prudential developments

Most of the insurance supervisors in the region now require insurers to submit a Financial Condition Report on their solvency condition taking into account current financial status and an assessment of the ability to survive future risk scenarios.

Conduct of business and consumer protection

Shari'a-compliant insurance products such as Takaful continue to dominate the landscape in the middle-east region. The Central Bank of Bahrain (CBB) has introduced new regulations mainly focusing on the Takaful sector.

"Most of the insurance supervisors in the region now require insurers to submit a Financial Condition Report on their solvency condition taking into account current financial status and an assessment of the ability to survive future risk scenarios."

Kingdom of Bahrain

"Bahrain's solvency capital framework is not yet risk-based. However during 2014, the CBB issued amendments to its Rulebook that were mainly focused on the Takaful and Retakaful sector."

Bahrain has a leading Takaful (including Retakaful) sector, which is one of the fastest growing segments of the industry. However, the regulator needs to take steps to enhance insurance regulation with a view to regaining its position as a leading jurisdiction of choice, a global financial center and providing an international standard of infrastructure, regulatory environment and necessary support for innovative solutions.

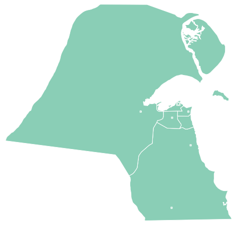
Bahrain's solvency capital framework is not yet risk-based. However during 2014, the CBB issued amendments to its Rulebook that were mainly focused on the Takaful and Retakaful sector.

The key changes impacting the Takaful/Retakaful sector included:

- Assessment of solvency requirements at firm level rather than takaful fund level
- Requirement for firms to inject capital and notify the CBB immediately if capital falls below the minimum fund
- Prohibition of performance fees and variable wakala fees for the Takaful Operator.

However some of the amendments also apply to the wider insurance sector, such as requirements for Financial Condition Reports.

State of Kuwait



Kuwait is one of the smaller insurance markets in the GCC region and it is dominated by domestic insurers.

It is the only country in the GCC that is not a member of the IAIS and is the only one without an independent insurance regulator. Discussions to establish an independent insurance supervisor and modernize insurance regulations remain in progress.

Sultanate of Oman

Domestic insurers represent the bulk of the insurance market in Oman.

In terms of regulatory developments, Royal decree No. 39/2014 was issued on 12 August 2014, amending certain provisions of the Insurance Companies Law. These include:

- Minimum capital requirement doubled to RO 10million, with a three year transitional period for existing insurers
- At least 40 percent of shares must be listed on the Muscat Stock Market within 3 years
- Separate legal entities required to be established for life and general business for entities currently operating as composite insurers.

The new requirements are expected to be positive for Omani insurers because it will improve their access to capital market funds, strengthen their capital, make them more transparent and enhance the financial strength of the insurance market. The increased capital requirements may encourage consolidation among some of the smaller players, as well as pose a barrier to new entrants, which could aide market stability in the medium-term.

> "The new requirements are expected to be positive for Omani insurers because it will improve their access to capital market funds, strengthen their capital, make them more transparent and enhance the financial strength of the insurance market."

State of Qatar

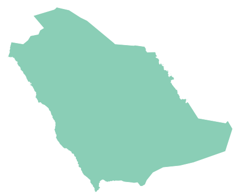
> "For most insurers, the current wave of change will present challenges to their business models, cost structures and the way in which they communicate with stakeholders."

The Qatar insurance sector is vibrant, growing and highly competitive and looks set to benefit in the lead up to the 2022 World Cup, with major infrastructure and construction projects across the country. The insurance sector generally is taking steps to enhance insurance regulation with a view to developing a global financial centre and providing international standard infrastructure, regulatory environment and necessary support for innovative solutions.

Significant regulatory changes will come through the QCB's introduction of its regulatory framework for insurers, which is widely expected to be based on the ICPs. The Qatar Financial Centre Regulatory Authority (QFCRA) is also continuing its efforts to align Qatar with international practice, with amendments to the QFCRA Prudential Insurance Rulebook (based on ICPs) having come into effect on 1 January 2015.

For most insurers, the current wave of change will present challenges to their business models, cost structures and the way in which they communicate with stakeholders.

Kingdom of Saudi Arabia (KSA)



The recent plunge in oil prices and a supply glut in the global market have had a negative impact on Saudi Arabia's GDP growth. The Saudi Arabian insurance industry has grown in the past few years, mainly owing to consistent economic expansion within the country. Future growth is expected from the dynamic demographics of Saudi Arabia, with high consumption rates and public spending on infrastructure projects remaining the key catalysts.

Regulatory changes are likely to be drivers of growth, as was seen when the Saudi Arabian Monetary Authority (SAMA) announced mandatory health insurance in 2006 and compulsory third party insurance in 2007. In 2014 another mandatory insurance was implemented with the Council of ministers deciding that '*All high-risk facilities and activities as well as crowded places belonging to the government or private agencies, and run by private companies or establishments, are obliged to provide third party cooperative insurance*'. SAMA also has plans to introduce mandatory third party liability cover for organizations carrying out hazardous activities in residential areas.

In June 2014, SAMA announced draft corporate governance regulations, which is a big step towards high standards of governance in the insurance industry. However in KSA (as in other GCC countries) the premium rates are not underwritten, but are based on competitiveness decisions. It is expected that actuarial-led reserve setting, monitoring and reporting (in order to enhance reserve adequacy and provide a benchmark for insurers in price setting) will become a key focus for regulators.

United Arab Emirates (UAE)

UAE is one of the largest and most dynamic insurance markets in the GCC. The introduction of shari'a-compliant insurance products such as Takaful has substantially changed the landscape in the Middle-East region, particularly the GCC. Products compliant with the Islamic laws like Takaful are an important growth driver for the UAE insurance sector.

At present, there is no solvency capital requirement (SCR) applied to onshore entities. However a proposed instruction (which is not yet implemented) will change this, establishing the following requirements:

- The SCR shall be calculated on the presumption on a going concern basis
- The SCR shall be calibrated to ensure that all quantifiable risks that a company is exposed to are taken into account. For existing business, this will cover unexpected losses only. Business which is expected to be written over the following twelve months must also be included
- The SCR shall correspond to the VaR subject to a confidence level of 99.5 percent over a one-year period. It shall cover at least the following risks:
  - Properties and Liability underwriting risk; family underwriting risk; health underwriting risk; market and Liquidity risk; credit risk; and operational risk
- The Solvency reporting information shall include the following, at a minimum:
  - Total capital available including the capital structure
  - Solvency margin required as per the solvency regulations
  - Own funds broken down by basic and ancillary
  - Details on model and assumptions applied
  - Valuation principles applied for solvency purpose
  - System of governance applied by the company
  - The business that the company is pursuing
  - Details on risk faced and risk management system.

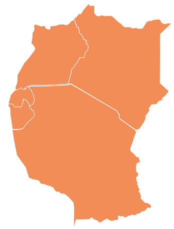
Offshore insurance entities are required to maintain a minimum level of capital resources in accordance with chapter Four of Prudential – Insurance Business Module.

Group capital adequacy may also be implemented in the future.

"UAE is one of the largest and most dynamic insurance markets in the GCC. The introduction of shari'a-compliant insurance products such as Takaful has substantially changed the landscape in the Middle-East region particularly the GCC. Products compliant with the Islamic laws like Takaful are an important growth driver for the UAE insurance sector."

Africa

East African Community (EAC)



The EAC covers five countries: Kenya, Uganda, Tanzania, Rwanda and Burundi. Since its establishment in 2000, there have been intense efforts by the EAC secretariat to foster regional growth and harmonization. The EAC Financial Sector Development and Regionalization Project I (FSDRP 1) was established to lay the foundation for financial sector integration among EAC countries.

The insurance regulators for the EAC countries are: Insurance Regulatory Authority (IRA) in Kenya and Uganda, Tanzania Insurance Regulatory Authority (TIRA) in Tanzania, National Bank of Rwanda (BNR) in Rwanda, and Insurance Regulatory and Control Agency (IRCA) in Burundi.

ICP compliance

None of the EAC countries is on the list for mandatory FSAP review. However, EAC insurance supervisors have been making significant changes to build compliance with ICPs in order to comply with the proposed EAC risk-based law which is pending finalization. A recent review by KPMG of the five EAC countries' insurance regulatory frameworks' compliance with ICPs revealed that the principles and associated standards are recognized to varying extents in each country. The countries are also at varying stages of implementing their insurance regulatory frameworks and their respective insurance industries are at different stages of maturity. The outcome of the KPMG review was the development of a harmonized insurance policy framework and draft bill for the five EAC partner states based on ICPs.

Kenya is in the process of enacting a new risk-based insurance act. To support this move, the IRA acquired an Electronic Regulatory System which will increase efficiency in returns submission, data validation and increase quality of information released by the IRA. Kenya has issued guidelines in the areas of risk management and internal controls, actuarial function, external auditors and reinsurance.

Uganda has embarked on the process of preparing new prudential returns, new solvency framework, corporate governance and risk management and in Rwanda, the Financial Sector Development Program II mentions the adoption of risk-based supervision for the insurance sector.

The insurance harmonization efforts in EAC present a good opportunity for regulators to develop a consistent regulatory framework that allows better risk management within insurance companies.

Prudential developments

Solvency measures are currently simple and formulaic in each country, with no risk-based solvency assessment or inclusion of non-insurance risks.

Conduct of business and consumer protection

The EAC countries have embraced technology to handle consumer complaints and education, with each supervisor having a section of their website dedicated to this. In addition, Tanzania has established an ombudsman service for handling disputes arising between insurance consumers and insurance registrants' business in the country. In Kenya, the Consumer Protection Department assists in resolving consumer complaints.

The proposed EAC insurance policy framework recommends that in order to improve consumer protection, all EAC countries should either establish an office of the "Insurance Ombudsman" to resolve disputes arising from insurance consumers and licensees in the industry or for such a body to be established at a regional level.

Ghana

Ghana is currently experiencing a challenging economic environment, with debt levels increasing and declining revenues due to falling commodity prices, contributing to depreciation of the Cedi against major foreign trading currencies and a rise in consumer price indicators. However, the discovery of oil is gradually transforming the economy. The insurance industry is expected to benefit from this as a recent protocol between the insurance regulator, the National Insurance Commission (NIC) and the Petroleum Commission mandates companies in the petroleum sector to cede their insurance business locally. The introduction of agricultural insurance (currently covering maize but expected to be extended to other crops and livestock) and the implementation of compulsory insurance of commercial buildings are also expected to grow the insurance industry.

Against this backdrop, the Ghana insurance industry has seen strong growth in both the life and non-life insurance sectors, although insurance penetration in the country remains low at around 1.4 percent with less than 5 percent of the population having an insurance product, according to an official survey. Growth in the non-life sector has been driven by a combination of enhanced public education, development of innovative new products and increased use of alternative distribution channels.

Ghana launched its micro insurance regime in February 2013 which the NIC hopes will increase the level of insurance penetration in the country. Several micro-insurance products are now being offered, such as education, funerals, family, credit, accident and hospitalization. The products are specifically targeted at the low-income population and are designed to meet specific characteristics (including affordability and accessibility), with policies expressed in clear language.

Foreign participation in Ghana's insurance market is mainly by large African insurance companies from Nigeria, South Africa and Ivory Coast through local subsidiaries. However, a number of European insurance companies are now expanding their presence to capitalize on the economic growth prospects and political stability.

ICP compliance

Ghana is a member of the IAIS, so the NIC has regard to ICPs in developing new legal and regulatory requirements. NIC regulatory directives set out general requirements for corporate governance and requires insurers to establish risk management strategies and policies. It also requires technical provisions to be based on actuarial methods, with solvency computations based on ICPs.

In terms adequacy requirements, a new insurance bill includes adoption of capital-based requirements (as opposed to a solvency margin approach). Although the solvency requirement will not be risk-based, the language in the bill is designed to enable the NIC to adopt risk-based capital adequacy requirements at a future date.

Prudential developments

The minimum paid up capital requirement has been increased threefold to GHC 15 million to encourage mergers and acquisitions as the NIC seeks to ensure stability and strengthen insurers' ability to underwrite large risks. Additionally, the

"Ghana is a member of the IAIS, so the NIC has regard to ICPs in developing new legal and regulatory requirements. NIC regulatory directives set out general requirements for corporate governance and requires insurers to establish risk management strategies and policies. It also requires technical provisions to be based on actuarial methods, with solvency computations based on ICPs."

NIC has directed insurers to deposit 10 percent of the minimum capital requirement in an escrow account with Bank of Ghana in a move to ensure sufficiency of resources to absorb liquidity shocks.

In 2013, work commenced on a draft insurance bill to address limitations to the existing Insurance Act, which dates from 2006. Once approved, this will address both prudential and consumer related matters. Key aspects of the bill are included below and in the conduct section that follows. The draft bill would also prioritize licensing for specialized insurers dealing in micro-insurance and agriculture insurance.

From a prudential aspect, the bill and various regulatory directives will require insurance companies to put in place new governance systems and risk management frameworks, with strengthened internal control requirements and oversight functions in respect of compliance/risk management, actuarial function and internal audit. Reporting structures between these oversight functions and the board will need to be clearly articulated.

From 31 December 2015, insurance companies will need to estimate their incurred but not reported (IBNR) claims using an actuarial based method (currently taken as 20 percent of outstanding claims). Audit firms will also need to have access to actuarial resources to enable them to assess adequacy of technical provisions.

The NIC will also adopt a more risk-based approach to supervision, ranking insurance companies based on technical provisions, policies, procedures and practices in place to mitigate enterprise-wide risk.

Conduct of business and consumer protection

One of the most significant reforms has been the introduction of a "No Premium No Cover" policy from 1 April 2014. This requires all insurance companies to collect premiums upfront before providing insurance cover, preventing the sale of products on credit to customers. This arose from NIC concerns about the high levels of outstanding premiums and provision for bad debts and concerns that the low level of recoveries could threaten the sustainability of the insurance industry.

The NIC also developed new guidelines (effective 1 August 2014) to compel insurance companies to pay claims that have been established as genuine within seven days in an effort to boost consumer confidence that had been badly affected by claims redemption challenges.

The Ghana Insurers Association is also building a database to detect and prevent fraud in the insurance industry. The project, dubbed the Ghana Insurance Industry Database and supported by the NIC, aims to provide market data to improve the service delivery of insurance companies in the country. The data will be stored in a central repository and include information on existing policy risk and claims collected from all insurers. This is currently being piloted in the motor insurance industry, but depending on its success, will be expanded to cover the entire industry in the next three years.

Nigeria

Nigeria is now the largest economy in Africa and one of the 20 largest economies in the world. It also has the largest insurance market in the West Africa sub-region, although the penetration rate is below 1 percent. Insurance is principally sold through brokers and agents.

Growth in life business has been driven by the introduction of the Market Development and Restructuring Initiative, which mandates group life insurance for companies. About 70 percent of the life business falls into this category, with individual life constituting 20 percent and group pension 10 percent.

Historically, there have been low levels of overseas insurance groups operating in Nigeria; although there are some signs that interest is increasing as insurers seek to take advantage of the low penetration rates.

ICP compliance

The insurance regulator, National Insurance Commission (NAICOM), is a member of the IAIS so is mindful of ICP compliance and has plans to implement the provisions of ICP 16 on Enterprise Risk Management for Solvency Purposes and ICP 17 on Capital Adequacy, subject to maintenance of the minimum regulatory capital base.

NAICOM plans to enforce the provisions of its guideline for developing a risk management framework for insurers and reinsurers (issued in 2012) in the near future.

Prudential developments

As stated above, there are planned changes relating to ICP 16 and 17. However the current solvency calculation is relatively simple.

Conduct of business and consumer protection

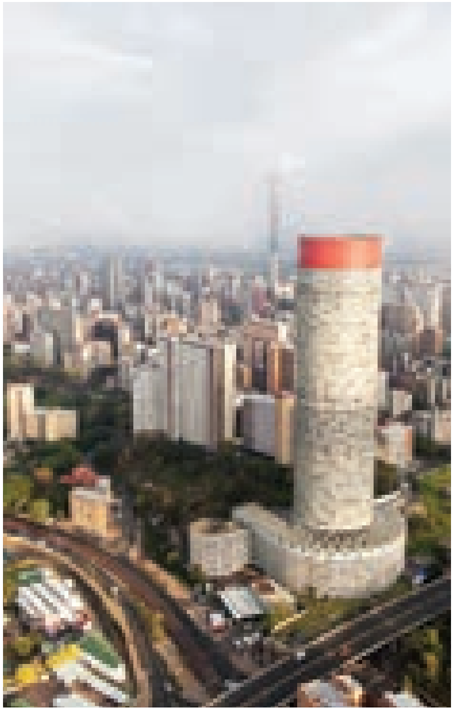
NAICOM has had a Customer Complaint Bureau to help resolve disputes arising from non-settlement of claims since 2009. In addition, the Insurance Consumers Association of Nigeria , which was set up by insurance consumers and works with NAICOM to encourage the general public to buy insurance products, also serves as a pressure group for consumers to appeal to the insurance companies to be fair in their relationships with them.

Currently, NAICOM is in the process of issuing a Market Conduct Guideline, which aims to engender consumer confidence in the sector as well as deepen penetration rates. This guideline is expected to provide the potential policyholder with the opportunity to understand more fully the contract terms, their rights and entry and exit rules before entering into the contract. It is also expected to include a two-week 'cooling period' to enable policyholders to withdraw from an insurance contract without loss.

NAICOM is also developing a consumer education strategy to enhance consumers' understanding of insurance products, which is expected to be finalized in the second quarter of 2015.

"Nigeria is now the largest economy in Africa and one of the 20 largest economies in the world. It also has the largest insurance market in the West Africa sub-region, although the penetration rate is below 1 percent. Insurance is principally sold through brokers and agents."

South Africa



The system of supervision of insurance in South Africa is undergoing significant change, with South Africa moving to a twin peaks model of supervision, with the South African Reserve Bank (SARB) taking over responsibility for the micro and macro prudential regulation of all financial institutions, while the reconstituted Financial Services Board (FSB) will become the Market Conduct Authority. Current expectations are that the enacting Bill will be tabled in Parliament before the end of June 2015.

For the insurance industry this marks a significant change, as the FSB has been both the prudential regulator and conduct supervisor. The SARB historically acted as the prudential regulator for banks. Bancassurers play a significant role in the South African insurance market, so it is hoped that the move to a consolidated prudential regulator should improve macro prudential supervision.

Meanwhile the local business of insurance continues to show some growth, but the difficult economic climate is driving expansion into new markets and product innovation. There may be particular challenges ahead for medical insurers, as regulators seek to harmonize the rules applying to medical schemes (which are unable to underwrite and select members based upon risk criteria) and medical insurance (which can).

Legislation currently divides the South African insurance market into separate life, non-life and health sectors. While the life and non-life underwriting activities are run as for-profit industries, the health sector is generally not-for-profit and it is the administrators of medical schemes that make the profits in the health sector. The proposed regulations, if enacted, would result in most health insurance being underwritten on the same principles applied by medical schemes (i.e. no risk selection allowed). They also aim to align commission payable by insurers on their health offerings with those of the medical schemes industry, as well as prescribed benefits.

ICP compliance

Developments across both market conduct and prudential regulation aim to keep the industry on par with the most well regulated insurance markets in the world, whilst ensuring compliance with international standards.

In 2014, the IMF completed an FSAP of the FSB-SA. The report noted planned changes underway regarding corporate governance, risk management, conduct of business reporting, financial disclosures, and consumer protection and encouraged the FSB to move quickly to implement these changes. The FSAP further recommended action to protect policyholders in a winding-up through either a policyholder protection scheme or change in priority of payments and to develop better crisis preparedness plans.

Prudential developments

Prudential regulation of the insurance industry is moving ahead strongly with the continuing development of Solvency Assessment and Management

(SAM). SAM is a risk-based regulatory framework for prudential supervision, following a three-pillar approach: capital requirements; risk management and governance; and reporting. SAM has been developed with the intention that South Africa will be granted temporary equivalence under Solvency II.

The current planned implementation date of SAM is 1 January 2016. From 1 July 2014, insurers have been required to prepare parallel regulatory reporting. In 2015, the quantum and complexity of this reporting will increase.

The regulator recently released, for public comment, its preliminary views following a review of the capital requirements for insurers that reinsure their risks locally as opposed to with foreign reinsurers. The regulator also considered whether to allow branches of foreign reinsurers to operate in South Africa. If the proposals are implemented, a locally incorporated reinsurer will have less punitive capital requirements when compared to branches of foreign reinsurers.

Conduct of business and consumer protection

The FSB, since 1 January 2014, has expected insurance companies to demonstrate compliance with Treating Customers Fairly (TCF) principles. This regime is an outcomes-based regulatory approach that seeks to ensure that specific, clearly articulated fairness outcomes for financial services consumers are delivered by financial institutions. Incorporating experiences from other jurisdictions, the regulator has included both proactive and reactive measures within the regulatory framework. Increased activity from the regulator has seen many insurance companies reacting with enthusiasm to ensure that their TCF programs are in place and well evidenced. The regulator has to date not yet issued any significant fines relating to TCF.

Since the implementation of the Financial Advisory and Intermediary Services Act in 2002, the regulation of intermediated services has been constantly amended, tweaked and improved. These changes have continued to improve the professionalism of intermediary services, disclosure to clients and quality of service.

More recently, organizations that "enter into, vary and renew policies" or "approve and settle claims" on behalf of insurers (so-called binder entities) have received significant attention. The binder regulations seek to regulate contracting provisions, payments for performing binder functions and the governance of these relationships. Amendments proposed during July 2014 will address "emerging undesirable practices and regulatory gaps" that have become known since the regulations were first published in 2012.

The binder regulations are bolstered by the draft Retail Distribution Review (RDR) paper released during November 2014. RDR aims to amend archaic commission and remuneration structures to promote better customer service in the intermediated insurance space. RDR will significantly change and clarify the types of intermediary services offered. It will also change relationships between product suppliers and intermediaries, as well as remuneration structures.

A detailed review of consumer credit insurance practices is underway. Following a project, led by government and to which affected regulatory bodies contributed their views, a technical report was issued during July 2014. The report highlighted the key focus areas that will drive regulatory change in this area.

In the retail space, product innovation has focused on providing incentives for customer loyalty. Certain direct life insurers are offering cash back on life risk products; others are offering premium re-rating based upon good behavior (notably telematics in the motor area). Playing off powerful brands in the retail market, insurers are also using white labeling to sell to new markets. Pressure to innovate in the digital space is increasing and cyber-crime insurance is a new hot-topic amongst insurers and intermediaries. Regulators are actively following these developments with a view to introducing regulatory oversight, where required.

Conduct risk – The evolving nature of conduct risk and regulatory expectations

Globally, conduct risk remains one of the most bespoke characteristics of insurance regulation with each country prescribing different requirements and treatment of consumer expectations, leaving many insurers uncertain as to how best to approach the management of conduct risk within their organizations. The development of a twin peaks approach separating conduct issues from prudential supervision has likely increased the diversity in approaches.

In response, the IAIS has tried to set standards for conduct risk and has recruited a number of the freestanding conduct supervisory authorities into the IAIS membership.

As stated earlier in this paper, there is a single ICP that covers conduct of business which was adopted in 2011. As the box on page 122 shows, the standards contained within ICP 19 are set at a high principles-based level, which may help explain why there has been less movement globally towards convergence in conduct of business regulation than solvency regulation. But the IAIS is beginning to further delineate its conduct approach. The IAIS recently released application papers to assist in understanding the supervisory role, including a 2014 paper entitled *Approaches to Conduct of Business Supervision*. The IAIS is now preparing a guidance paper on Conduct of Business Risk, which it hopes to complete by the end of 2015.

In addition to the IAIS, two other networks are helping push for increased global activity. The OECD has a Task Force on Financial Consumer Protection, which maintains a listing of tools available for supervisors and identifies emerging challenges in the area of consumer protection. The OECD also provides secretariat support to the International Financial Consumer Protection Organization (FinCoNet), an international organization of supervisory authorities with responsibility for financial consumer protection.

Finally, we have seen movement in the US, Canada and Europe to increase harmonization of local conduct rules in the various states, provinces and Member States, even though the primary responsibility continues to rest at the local level.

"We have seen movement in the US, Canada and Europe to increase harmonization of local conduct rules in the various states, provinces and Member States, even though the primary responsibility continues to rest at the local level."

> "The supervisor requires insurers and intermediaries to ensure that, where customers receive advice before concluding an insurance contract, such advice is appropriate, taking into account the customer's disclosed circumstances."

ICP 19 Conduct of Business:

Fair Treatment of Customers

- 19.1: The supervisor requires insurers and intermediaries to act with due skill, care and diligence when dealing with customers.
- 19.2: The supervisor requires insurers and intermediaries to establish and implement policies and procedures on the fair treatment of customers that are an integral part of their business culture.

Pre-sale Process

- 19.3: The supervisor requires insurers to take into account the interests of different types of customers when developing and marketing insurance products.
- 19.4: The supervisor requires insurers and intermediaries to promote products and services in a manner that is clear, fair and not misleading.
- 19.5: The supervisor sets requirements for insurers and intermediaries with regard to the timing, delivery, and content of information provided to customers at point of sale.
- 19.6: The supervisor requires insurers and intermediaries to ensure that, where customers receive advice before concluding an insurance contract, such advice is appropriate, taking into account the customer's disclosed circumstances.
- 19.7: The supervisor requires insurers and intermediaries to ensure that, where customers receive advice before concluding an insurance contract, any potential conflicts of interest are properly managed.

Policy Servicing

- 19.8: The supervisor requires insurers to:
  - service policies appropriately through to the point at which all obligations under the policy have been satisfied
  - disclose to the policyholder information on any contractual changes during the life of the contract
  - disclose to the policyholder further relevant information depending on the type of insurance product.
- 19.9: The supervisor requires that insurers have policies and processes in place to handle claims in a timely and fair manner.
- 19.10: The supervisor requires that insurers and intermediaries have policies and processes in place to handle complaints in a timely and fair manner.
- 19.11: Legislation identifies provisions relating to privacy protection under which insurers and intermediaries are allowed to collect, hold, use or communicate personal information of customers to third parties.
- 19.12: The supervisor requires insurers and intermediaries to have policies and procedures for the protection of private information on customers.
- 19.13: The supervisor publicly discloses information that supports the fair treatment of customers.

The evolving nature of supervisory practice

Many supervisors are evolving their approach to conduct risk supervision to encompass specific new powers including the ability to prevent the release of high-risk products or to withdraw misleading financial promotions. An example of such change is EIOPA's initiative on product governance, product suitability, appropriate selling practices and better information for consumers as detailed in the EMA section of this report.

Other key tools include:

- New assessment methodologies
- Firm-wide assessments
- A focus on prevention
- Evaluation of risks across the product lifecycle
- More aggressive enforcement tools and
- Sector-wide intervention.

Similar to the new regulatory approach to risk management, conduct risk supervision will seek to change the culture of firms. Increasingly supervisors want to move beyond merely reviewing company policies and frameworks. They are now assessing whether firms are operating in the customer's interests in decisions. It is not just about tone from the top that they seek, it is tone throughout the firm – particularly the 'tone from the middle' where often issues can arise.

The IMF and the World Bank have been looking closely in the Financial Sector Assessments at conduct issues and have urged jurisdictions to implement active oversight and enforcement programs. They are urging supervisors to more closely supervise intermediaries, including requiring disclosure of interests and documented policies and procedures. The reports also urge increased funding for conduct activities and greater use of onsite inspections. The 2014 IMF reviews all mentioned the need for supervisors to address product design and promotion materials, going as far as recommending that supervisors have the authority to ban certain products.

"The IMF and the World Bank have been looking closely in the Financial Sector Assessments at conduct issues and have urged jurisdictions to implement active oversight and enforcement programs."

The key challenges for insurers

There have been many examples in the past few years in which errors in conduct compliance have resulted in substantial fines for financial services firms. In the UK, our experience with some firms suggests that for every £1 spent on compliance, up to as much as £16 has been spent on remediation.

The primary responsibility for managing conduct risk should be with those who face it when making day-to-day or strategic decisions - namely the front line. However, managing conduct risk is the responsibility of all parts of a firm and often, specific functions are accountable for establishing the framework around conduct risk. There are variances in where this function reports into, for example, some are direct to the CEO and some are to a Board level CRO. Some firms have established specific committees with the primary purpose of governing conduct risk, while others have utilized existing frameworks.

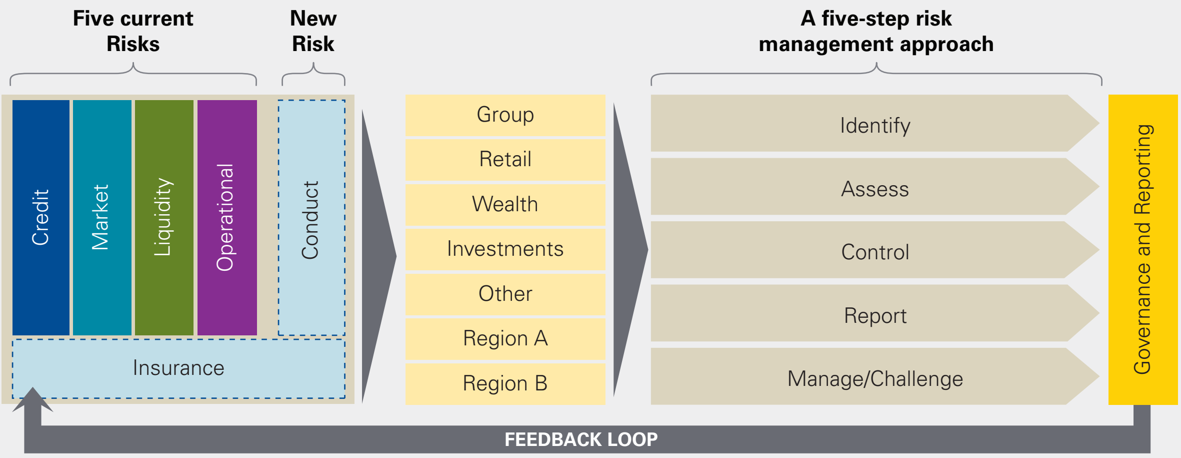
Globally, however, for many insurers management of conduct risk is still early in transition and for some, it is at a very early stage. Developing a conduct risk appetite that drives decision-making is a necessary first step in addressing compliance. Such statements could include a combination of quantitative and qualitative tolerance statements and metrics.

Figure 11: Key challenges facing insurers

Source: KPMG International, 2015.

For some time, insurers have focused heavily on principal risks such as insurance, credit, market and liquidity risks; with conduct risk sometimes being a subset of operational risks - particularly in instances where risks crystallize into incidents and issues. However, many insurers are now viewing conduct risk as a new risk type, separate from operational risk. The introduction of this as a new risk category inevitably impacts the management of existing risks in the areas where they interact. Figure 12 illustrates this dynamic.

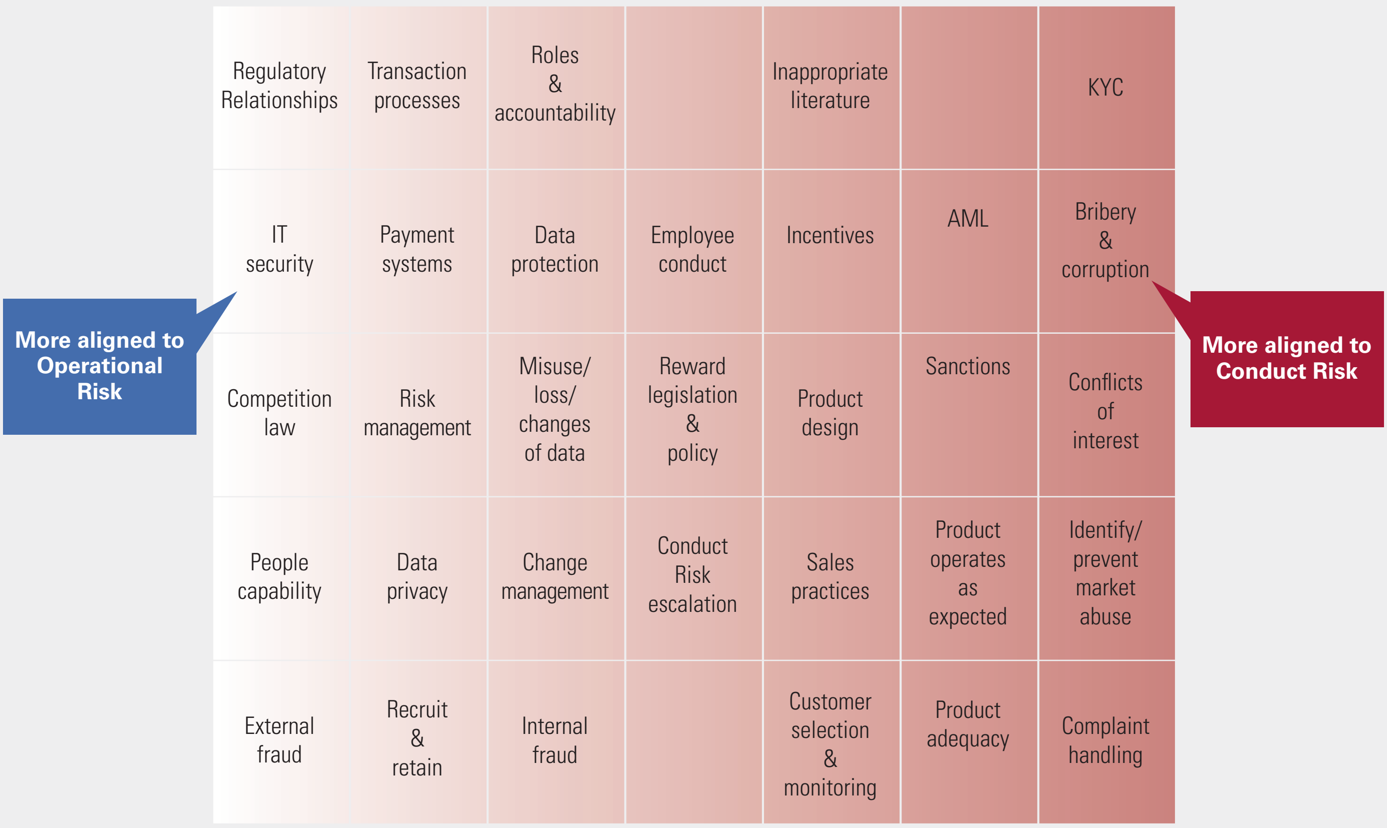
Figure 12: Fit within the Enterprise Risk Framework



Source: KPMG International 2015.

As conduct risk becomes an important risk category in its own right, the definitions of Operational and Conduct risk mean that there is a clear potential for overlap. In order to manage the overlap, decisions will need to be made about how to handle each individual risk. Possible options are shown in Figure 13.

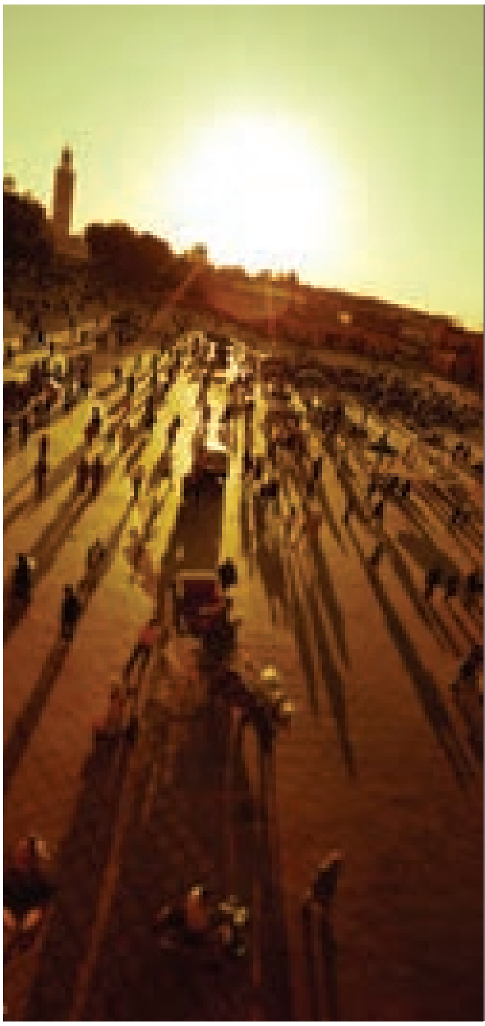
Figure 13: Boundaries with operational risk



Source: KPMG International 2015.

It should be noted that some firms also opt for dual reporting rather than trying to separate individual types of risk. However, whichever model is chosen, some realignment of existing risks will be necessary between operational and conduct risks, including risk control frameworks, risk control assessments and policies that control specific risks (for example people policies).

In addition, where relevant, specific capital requirements for conduct risks may also need to be set separately and fed into the overall risk capital calculations.



Implications for firms

Regulators are moving towards a forward-looking, proactive, and judgement-based supervisory approach. This increased focus on consumer outcomes means that regulators are not just interested in the control environment, they are interested in firms' business models and strategies (for example, consideration of the key drivers of profit and whether consumers are being treated fairly in the sale of these products). They will seek to identify potential risks to consumers at the very highest levels of decision-making. In particular:

- Firms will need to understand that conduct risk considerations impact many areas of their business including enterprise level governance, specific lines of business that deal directly with the consumer, data, process and systems throughout core and business support functions.
- Firms will need to demonstrate that consumers are central to their strategy and business and that they deliver fair consumer outcomes.
- As part of the strategic planning process, a measured conduct risk assessment should be undertaken to ensure that the strategy could be modified, if required, before conduct issues arise.
- Insurers will need to challenge their business models and strategies to identify the drivers of their conduct risks.
- Importantly, firms will need to ensure that supervisory concerns are met otherwise they risk supervisors using pre-emptive supervisory tools, for example, that may directly influence an insurer's strategy.
- Senior Executive and management will therefore need to review their business through a different lens and take the opportunity to review historic decisions and the customer consequences of them.

The rising importance of risk culture

The effects of the global financial crisis continue to reverberate within the regulatory community as supervisors increasingly turn their attention to risk culture and gaining a better understanding of how boards and management can more effectively manage their strategic and operational risks. The value of a strong culture, an insurer's assessment of their own organization's risk culture, and the practical steps that can be taken to improve current risk practices in the organization now need to be key priorities for firms.

In October 2014, New York Federal Reserve Bank President, William Dudley,[11] warned senior financial executives to act now. "If those of you here today as stewards of these large financial institutions do not do your part in pushing forcefully for change across the industry, then bad behavior will undoubtedly persist. If that were to occur, the inevitable conclusion will be reached that your firms are too big and complex to manage effectively. In that case, financial stability concerns would dictate that your firms need to be dramatically downsized and simplified so they can be managed effectively. It is up to you to address this cultural and ethical challenge."

The IAIS has also been examining governance issues and effective structures and cultures within companies. In October 2014 the IAIS published an issues paper on '*Approaches to Group Corporate Governance: impact on Control Functions*'. This paper describes one of the key characteristics of good governance as being "the ability to promote a sound risk and compliance culture across the group."

The IAIS also conducted a self-assessment peer review on the governance ICPs in the first half of 2014. Standard 8.4 reads: *The supervisor requires the insurer to have an effective compliance function capable of assisting the insurer to meet its legal and regulatory obligations and promote and sustain a corporate culture of compliance and integrity.*[12] The review highlighted that many supervisors need to distinguish between a legal function and a function focused on compliance in the sense of ICP 8. Following the review, the IAIS Expert Team suggested that the IAIS reiterate the importance of a compliance function in an insurer's overall governance framework and that it provide more guidance on the nature of such function. The IAIS is reviewing ICP 8 and will in all likelihood include more detail on risk appetite and risk culture in line with the recent work of the FSB.

Finally, the OECD is revising its 2004 corporate governance principles. Proposed changes will include:

- More language on international cooperation
- A new section on shareholder rights
- A new chapter on incentives, disclosure, and high frequency trading
- New requirements on disclosure and transparency including sustainability reporting, disclosure of beneficial ownership, political donations, related party transactions

"The IAIS has also been examining governance issues and effective structures and cultures within companies. In October 2014 the IAIS published an issues paper on '*Approaches to Group Corporate Governance: impact on Control Functions*'. This paper describes one of the key characteristics of good governance as being "the ability to promote a sound risk and compliance culture across the group.""

11. Workshop on '*Reforming culture and behavior in the financial services industry*', New York Federal Reserve Bank, New York, 20 October 2014.
12. Insurance Core Principle 8, Risk Management and Internal Controls, IAIS, Basel, October 2011.

> "The OECD will be issuing thematic peer reviews on board practices, the role of institutional investors, related party transactions, board nominations and elections, supervision and enforcement, and risk management and corporate governance."

- A section on the responsibilities of a board, including risk management systems, direct board reporting, internal audit function, remuneration, and tax-planning strategies.

In preparation, the OECD will be issuing thematic peer reviews on board practices, the role of institutional investors, related party transactions, board nominations and elections, supervision and enforcement, and risk management and corporate governance.

Effective Risk Appetite Framework

The New York Federal Reserve warning followed the release by the FSB of its "*Principles for an Effective Risk Appetite Framework*" (Principles), finalized in November 2013[13], and a framework for assessing risk culture in April 2014.[14]

The FSB's Principles set out key elements for:

- An effective risk appetite framework (RAF)
- An effective risk appetite statement
- The consideration of risk limits
- Defining the roles and responsibilities of the board of directors and senior management.

The FSB noted that "establishing an effective RAF helps to reinforce a strong risk culture at financial institutions, which in turn is critical to sound risk management." The FSB further stated that "a sound risk culture will provide an environment that is conducive to ensuring that emerging risks that will have material impact on a firm, and any risk-taking activities beyond the firm's risk appetite, are recognized, escalated, and addressed in a timely manner."

In addition to providing an outline of the roles and responsibilities for an entity's Board of Directors, the Principles include guidance for senior management positions, including the CEO, CRO, CFO, business line leaders and legal entity-level management, and internal audit.

For an "effective RAF" to influence conduct risks, it should:

- Establish a process for communicating the RAF across and within the financial institution
- Be driven by both top-down board leadership and bottom-up involvement of management at all levels
- Act as a defense against excessive risk taking
- Allow the risk appetite statement to be used as a tool to act as a basis upon which the board, risk management and internal audit functions can effectively and credibly debate and challenge management recommendations and decisions.

Risk Culture

The FSB's "*Guidance on Supervisory Interaction with Financial Institutions on Risk Culture: A Framework for Assessing Risk Culture*" (Framework)[15] includes "foundational elements that contribute to the promotion of a sound risk culture within a financial institution" and identifies for supervisors "core practices and attitudes that may be indicators" of an institution's risk culture. These foundational elements of a sound risk culture include risk governance, risk appetite, and compensation; however, the FSB stressed the list of indicators is not "exhaustive" and that looking at one indicator in isolation would "ignore the multi-faceted nature of risk culture."

13. Financial Stability Board, *Principles for an Effective Risk Appetite Framework*, 18 November 2013. http://www.financialstabilityboard.org/wp-content/uploads/r_131118.pdf?page_moved=1
14. Financial Stability Board, *Guidance on Supervisory Interaction with Financial Institutions on Risk Culture: A Framework for Assessing Risk Culture*, 7 April 2014. http://www.financialstabilityboard.org/wp-content/uploads/140407.pdf?page_moved=1
15. Financial Stability Board, Guidance on Supervisory Interaction with Financial Institutions on Risk Culture: A Framework for Assessing Risk Culture, April 2014. http://www.financialstabilityboard.org/wp-content/uploads/140407.pdf

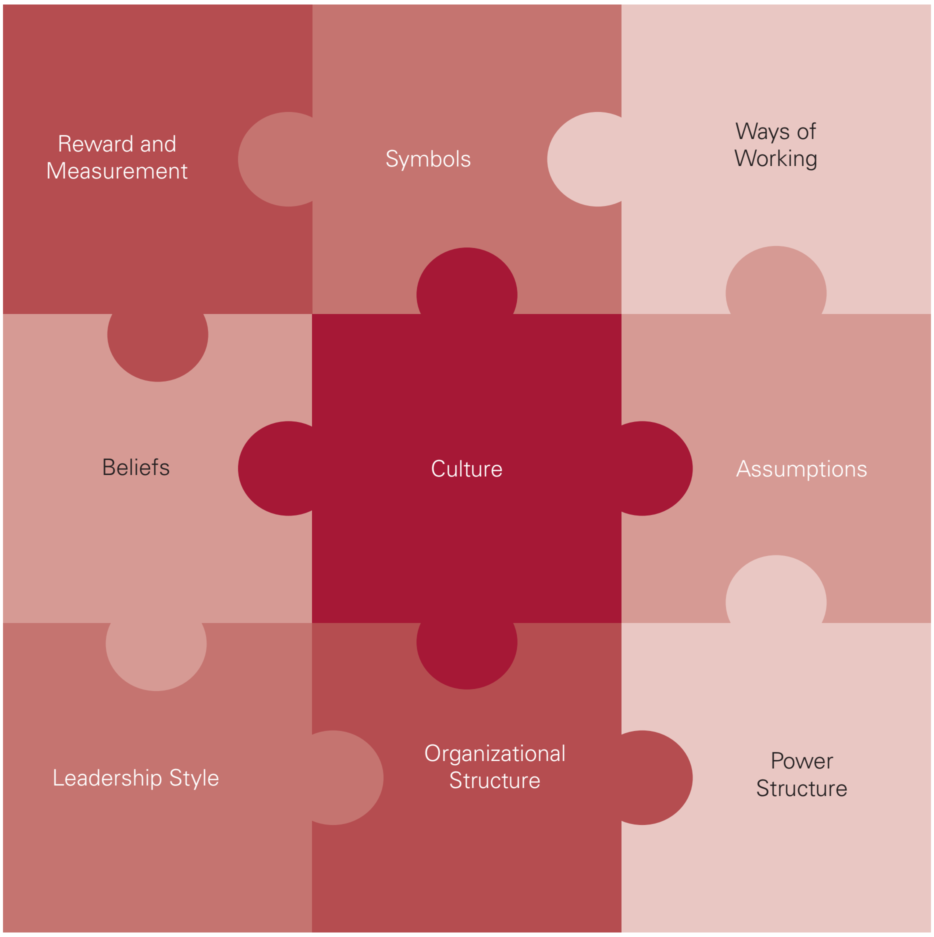
The FSB Guidelines state that "supervisors should satisfy themselves that risk cultures are based on sound, articulated values and are carefully managed by the leadership of the financial institution." This is a key reason why many supervisors are now examining risk culture in considerable depth looking for clear evidence that an appropriate dialogue around risk and the overall risk culture is taking place, and that those considerations are occurring at the right level within the organization.

Despite this push, it can be challenging to articulate what risk culture actually means. We have defined risk culture as the manner in which decision makers at all levels within an insurer consider and take risks. A strong risk culture implies a shared set of objectives that encourages people to be conscious of risk, to understand the trade-offs between risk and reward, and to make decisions about risk that are in the interests of the whole organization rather than the individual.

While we discuss risk governance and risk appetite in this chapter, the third issue - compensation - will grow in importance during the next year. Having nearly completed its work in banking, the FSB will specifically look at insurer compensation and its links to risk management, beginning with public consultations in May 2015.

Attitudes towards risk taking are an integral part of overall cultural profile and, consequently, reflect the key elements of an insurer's performance, as can be seen in Figure 14.

Figure 14: Key elements of insurers' performance



Source: KPMG International 2015.

> "The prevailing view amongst many supervisors is that without an appropriate 'risk culture', a robust, effective risk management framework is unlikely."

The global financial crisis demonstrated that some insurance groups accepted risks (sometimes unknowingly) far in excess of their boards' and other stakeholders' expectations, leading to significant losses. Many of these failings were the result of poor cultural attitudes and behaviors towards risk.

Reflecting this concern, supervisors are realising that an effective risk culture is at least equally as important as stringent regulatory compliance. The prevailing view amongst many supervisors is that without an appropriate 'risk culture', a robust, effective risk management framework is unlikely. Importantly, regulators are signalling a move from a focus on process to a focus on behavior. The challenges this creates for the industry in terms of demonstrating practice is in line with supervisory expectations will be key.

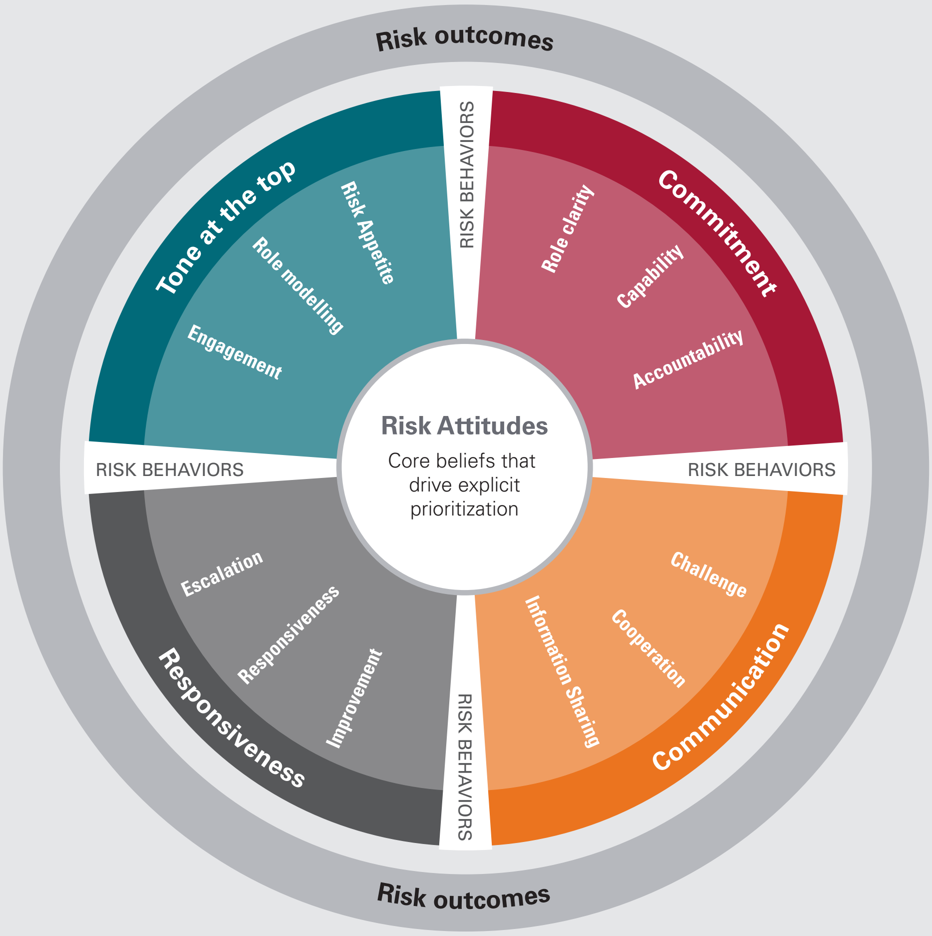
Many insurers are beginning to recognize that as their risk management processes mature, their failure to promote and maintain a robust risk culture means these processes will be ineffective and unsustainable in the medium to long term. A strong risk culture, where people act in the interests of the whole organization rather than a narrower set of interests, is critical to the way in which an insurer creates and protects value.

A strong risk culture possesses several characteristics:

- It delineates the organization's risk appetite, defines a risk management framework and ensures that these are understood and embraced by the whole organization
- It enables threats or concerns to be identified and escalated in a timely manner
- It increases clarity and transparency over individuals' responsibilities towards risk taking and risk avoidance
- It promotes a culture of continuous [risk related] improvement and learning from experience
- It aligns individual and organizational interests, increasing the prospect that corporate objectives will be achieved.

Through our studies of organizations with a robust risk culture, we have observed four key risk attitudes.

Figure 15: Key Risk Attitudes



These key risk attitudes can be further defined as follows:

Figure 16: Key risk attitudes

Tone at the top	A strong risk culture is driven from the top by the board and executive management
Communication	Employees are active in sharing information across the organizations and feel safe in escalating issues as they arise
Responsiveness	Employees understand their responsibilities for risk management and how to apply the risk management strategy
Commitment	Employee incentives are aligned to the overall objectives of the organization

Source: KPMG International 2015.

Culture equals actions, not policies or further documentation

As risk management matures, risk managers may struggle to realize the benefit of their existing risk management frameworks because no matter how good their risk management approach is, execution depends on the actions of employees. Few insurers have invested the resources necessary to truly understand and improve their employees' risk management behaviors.

As noted previously, however, there is a growing realization in boardrooms, executive suites and stakeholder groups that, without a strong risk culture, an insurer's investment in risk processes and frameworks will be neither effective nor sustainable. When embedded, an effective risk culture demonstrates distinctive characteristics. These characteristics can be shown to impact across a wide set of dimensions to improve the efficiency and effectiveness of decision-making and create value sustaining outcomes.

Table 13: Risk culture dimensions and value creation

Element	Dimension		
Tone at the Top	**Clarity** • Employees understand the organization's risk management strategy and approach.	**Role Modelling** • Management sponsor and lead risk management activities.	**Enforcement** • Management reward desired behavior and take action when inappropriate risks are taken.
Communication	**Openness** • Flow of risk information up and down organization • Individuals willingness to share good and bad news.	**Involvement** • Flow of communication on risk between groups/departments. • Involvement of the right people to identify, assess and mitigate risks.	**Insight** • Understanding of the risk profile, risk appetite and capacity at various levels, including individual, team, department and company.
Commitment	**Leadership** • Perception of the tone set by executives through encouragement of good risk management behavior and reflected through decision making.	**Motivation** • Belief in the value of risk management. • Alignment of rewards and KPIs with good risk management behavior.	**Learning** • Work environment's support for risk management learning and development. • Focus on continuous improvement for risk management.
Responsiveness	**Adherence** • Conformity with policies and procedures. • Alignment of behavior with the spirit of risk management.	**Responsiveness** • Timeliness of response. • Accountability for managing risks.	**Competency** • Feeling of adequacy/confidence in managing risk.

Source: KPMG International 2015.

Key actions insurers can take to improve their risk culture

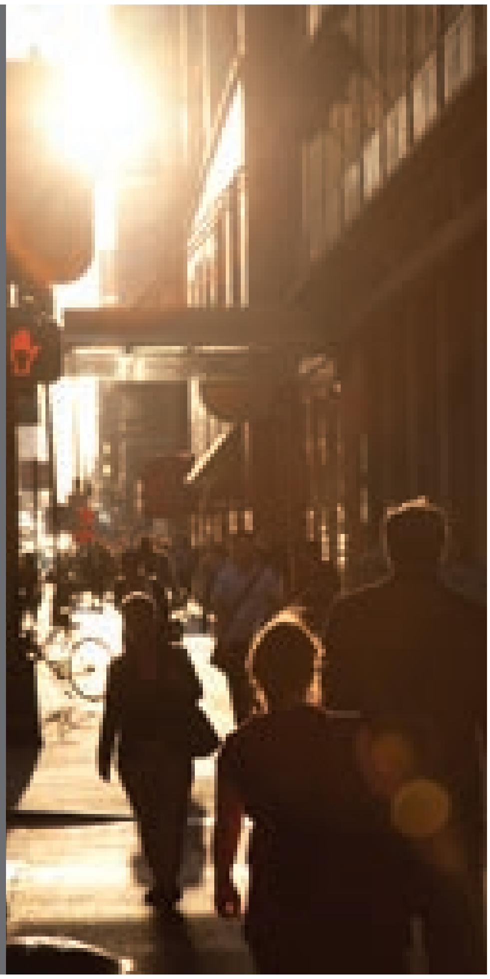
Few insurers excel in every aspect of their risk culture. The best ones, however, focus on constant improvement. They understand that expectations and standards for how they manage risks are high and that the benefits from strong risk management are compelling. Importantly, successful insurers understand that people create value. Driving positive changes in behavior aligns with creating shareholder value.

The benefits from having a strong risk culture are clear:

- Fewer surprises around performance and volatility
- Confidence and trust in the organization's integrity and resilience and
- Stronger and more robust stakeholder relationships.

Implications for insurers

- Boards should be able to articulate the desired features of an effective risk culture for their organization (i.e. the elements of risk culture that they wish to see in their company) and compare this to the actual existing features that might presently reside to assess the gap(s) that may exist.
- Boards should be capable of identifying features of risk culture that they do not want to see in their organization.
- Boards should be able to demonstrate the initiatives that have been undertaken in the organization over the past 12 months to promote and assess the desired risk culture, and importantly, know what measures need to be taken to influence the risk culture in the organization going forward.
- Boards must ensure that risk, finance and business lines and operational functions work together effectively to form a coherent strategy to achieve earnings stability, solvency and sustainable growth. In this regard, an appropriate risk appetite should be defined, well-articulated and appropriate for the organization.
- Boards must ensure that risks are being comprehensively and reliably identified, measured, managed and controlled in a manner consistent with the organization's risk appetite.
- Boards must be able to demonstrate that all staff understand and abide by the risk management framework relevant to their areas of responsibility.
- Boards must ensure that the remuneration arrangements for all staff create incentives to promote the long-term financial soundness of the organization.



The impact of accounting changes on regulation

As the international developments chapter of this publication shows, the IAIS is moving towards a market consistent basis of valuation for both assets and liabilities to underpin the determination of regulatory capital for its new BCR and ICS assessments. One of the most significant challenges for the IAIS has been that there is no consistent basis of accounting applied across jurisdictions – either for regulatory or financial reporting purposes.

Application of a harmonized financial reporting framework would have significant advantages for both the IAIS's work and the practical application of the final requirements. With this in mind, we consider below the latest position regarding international efforts to create a global insurance accounting standard and how this may interact with the IAIS's work.

There are signs that the International Accounting Standards Board's (IASB) *Insurance Contracts* project (IFRS 4 Phase 2) might be finally drawing to a close after many years of deliberations. A revised exposure draft was issued for public comment in June 2013, with the Financial Accounting Standards Board (FASB) issuing a separate exposure draft containing its proposals based on a similar model. Since then, the FASB has changed the direction and scope of its insurance project and is now considering only targeted improvements to current US GAAP, so the IASB has continued its project alone.

Under current International Financial Reporting Standards (IFRS), insurance contract liabilities are typically measured in accordance with accounting policies grandfathered from other accounting regimes (for example US GAAP or UK GAAP). Many unlisted insurance companies continue to report under their local GAAP requirements, rather than IFRS. Additionally, non-uniform accounting policies may be used in consolidated IFRS financial statements if this was permitted under the group's previous accounting policies, such as in UK GAAP. Consequently, there is little comparability between different insurance groups. For the first time, IFRS 4 Phase 2 will require consistent accounting for insurance contracts, providing the ability to analyse results more meaningfully.

Current expectations are that IFRS 4 Phase 2 will not be issued before the end of 2015, suggesting an effective date of no earlier than 1 January 2019. Some insurers may consider early adopting the new insurance contracts standard to align with the effective date of IFRS 9 *Financial Instruments* (1 January 2018), although this might not be practical for many insurers. The new insurance contracts standard will be one of the most complex standards issued by the IASB and its implementation will not be straightforward, particularly for those that issue long-duration insurance contracts.

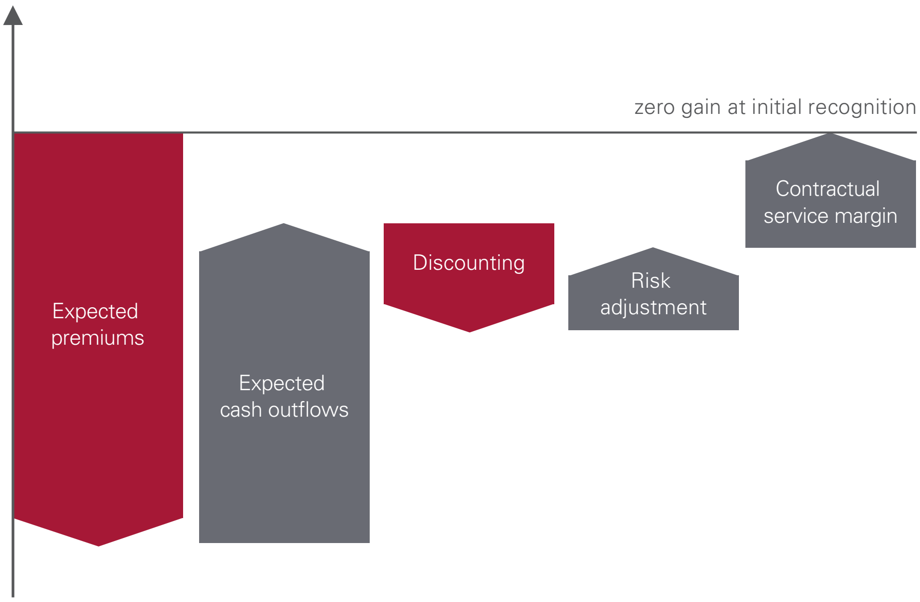
Regardless of the timing of practical application of the standard, it is clear that the IAIS cannot wait for the final version of IFRS 4 Phase 2 if it is to meet its own challenging timeline for production of the ICS proposals. However, it could revise its proposals, where meaningful to do so, to ensure greater harmonization between accounting and regulatory valuation bases at a later date. For this reason, it is important that the changes to be introduced by IFRS 4 Phase 2 are understood from a regulatory, and not just an accounting, perspective.

Measurement basis

Under the new standard, the starting point for measuring an insurance contract liability will be the expected future cash flows for fulfilling the contract. The fulfilment of the obligation is based on the entity's perspective (fulfilment value, not exit value or fair value).

In measuring an insurance contract liability, the expected future cash inflows less outflows (building block 1) are discounted to reflect the time value of money (building block 2). A risk adjustment that reflects the uncertainty about the amount and timing of the cash flows (building block 3) is added to the discounted expected future cash flows. These three 'building-blocks' are re-measured at each reporting date using current information. If the sum of the three building blocks is a net asset, a contractual service margin (CSM) is added at the inception of the contract to remove any day-one gains.

Figure 17: Proposed measurement model



Source: KPMG International, April 2015.

> The new standard does not prescribe how to determine the discount rate, but rather provides a broad objective: being consistent with observable current market prices for instruments with cash flows whose characteristics are consistent with those of the insurance contract in terms of timing, currency and liquidity.

The CSM represents the unearned profit at the inception of the contract. It is recognized over the coverage period in a systematic way that best reflects the remaining transfer of services provided under the contract. The claims settlement period is not included.

At subsequent measurement, the CSM is adjusted both for changes in future cash flows and changes to the risk adjustment that relate to future coverage and other future services, provided that the CSM does not become negative. Consequently, there is no impact on net income or equity.

The new standard does not prescribe how to determine the discount rate, but rather provides a broad objective: being consistent with observable current market prices for instruments with cash flows whose characteristics are consistent with those of the insurance contract in terms of timing, currency and liquidity. Depending on the type of entity and insurance contract, and the methodology adopted to determine the appropriate discount rate (or rates), a number of different discount rates might be applied. The disclosure requirements for discount rates, or ranges of discount rates, are intended to achieve transparency and market discipline.

For short-term contracts, in particular one-year insurance contracts, the new standard will permit the application of a simplified approach for pre-claims liabilities that is broadly consistent with unearned premium under current accounting practices for short-term duration contracts.

Post-claims liabilities, with certain exceptions, are measured using the building block approach. Profit will be recognized earlier than under most current accounting models, because post-claims provisions are generally not discounted, although if the risk adjustment exceeds the effect of discounting, which may be the case in particular for liability insurance, profit will be recognized later.

Participating contracts

The treatment of participating contracts is the IASB's last critical challenge in its Insurance Contracts project. To the extent that the amount, timing or uncertainty of the cash flows arising from an insurance contract depends wholly or partially on returns on underlying items (participating contracts), the discount rate should reflect that dependency. However, the relevant guidance in the exposure draft is complex and in some circumstances inconsistent and difficult to apply. During 2014, the IASB has been considering alternative approaches; however so far no decisions have been taken. It remains to be seen how the building block approach and the presentation requirements will be modified so that they can be applied to this kind of business.

Key concerns

A key concern for the insurance industry is the extent to which volatility may arise in profit or loss from short-term interest rate fluctuations, which many believe would be inconsistent with the long-term nature of insurance business. The standard will provide an option to present changes in insurance liabilities arising from changes in discount rates either in other comprehensive income (OCI) or in profit or loss. If the OCI option is adopted the effect of unwinding the discount rate would be presented in profit or loss using the locked-in rate at contract inception. This would achieve a stable presentation in profit or loss, which would be mirrored by the treatment of financial assets classified as Fair Value through OCI (FVOCI) under IFRS *9 Financial Instruments.*

However, many investments held by insurers may not meet the criteria for classification as FVOCI (for example derivatives, structured products or those with participating rights), and even if it were possible to classify all financial assets as FVOCI it would still not be possible to remove all sources of volatility arising from economic or accounting mismatches. Alternative approaches are still being discussed regarding how to determine the unwinding of discount in profit or loss for participating contracts.

Insurers are also concerned that the effective date of IFRS 4 Phase 2 will now be later than the effective date for IFRS 9 and the IASB has recently been considering whether the proposed transition requirements in IFRS 4 Phase 2 need to be made more flexible. However, this would not address concerns about having to make two significant changes to key accounting policies in quick succession, the additional costs that would be incurred, and the challenge of explaining the impact of the changes to users of the financial statements.

The IASB's proposals include a new presentation for the statement of profit or loss and OCI. Under current accounting practices, earned premiums is a key volume measure. In the new presentation this measure will be replaced by a revenue measure that is based on concepts in the new *Revenue Recognition* standard (IFRS 15) issued in May 2014. Under the new requirements, insurance revenue for life and health insurance will be significantly different from the current earned premiums measure, because the timing of recognition differs and all investment components will be excluded.

For ceded reinsurance, a CSM is determined for the reinsurance asset when the asset is first recognized to remove any gain or loss. Reinsurance premiums are reduced by ceding commissions that are not contingent on the occurrence of claims on the underlying contracts. As a result, for proportional reinsurance the reinsurance asset will not necessarily equal the reinsurer's share of the gross insurance contract liabilities. Profit recognition from the underlying insurance contracts and the reinsurance contract could therefore diverge (for example in an onerous portfolio) if losses from the underlying insurance contracts are anticipated and recognized at their inception.

KPMG Perspective

The IASB has made good progress in 2014 and has brought the publication of IFRS 4 Phase 2 closer to realization.

Providing an option to present volatility resulting from short-term interest rate fluctuations in OCI is more consistent with many insurers' long-term business models. However, a solution that best reflects the interaction between insurance liabilities and related assets for participating contracts has yet to be determined.

From our perspective, key areas of interest within the current proposals and their related impacts include:

- The extent to which the final standard includes options or requirements that would enable volatility to be removed from profit or loss and equity. For example, if changes in financial assumptions and the values of minimum guarantees due to short-term interest rate fluctuations are presented in profit or loss or could be offset against the CSM, volatility would be reduced.
- Insurers will need to have certainty over the measurement requirements in IFRS 4 Phase 2 before implementing IFRS 9. However, a final assessment of whether the IASB has comprehensively considered the interaction between the two accounting bases can only be made after the discussions on participating contracts have been completed.
- The requirement to calculate and maintain the CSM, both at transition and subsequently, will represent the most significant operational challenge for insurers, because there are no similar requirements in most current accounting models.
- The presentation of the statement of profit or loss and OCI and the new insurance revenue measure will represent a significant change to current practices and business metrics.

The IAIS is continuing development of an ICS, even though it has left open the date for finalization of a standard. As the initial basis to develop an example of a standard method, a market-adjusted valuation approach will be used that appears similar to the approach discussed by IASB. Differences may result with respect to the objective and treatment of the MOCE and the yield curve for discounting. As an alternative, the IAIS is still considering a "GAAP valuation approach" with the intention to enable IAIGs to determine comparable capital needs using local jurisdictional GAAP as a starting point, with incremental and quantifiable adjustments made therefrom.

Abbreviations

AEC	ASEAN Economic Community
AEoI	Automatic Exchange of Information (Switzerland)
ALM	Asset Liability Management
APRA	Australian Prudential Regulation Authority
ASEAN	Association of Southeast Asian Nations
ASPAC	Asia and Pacific Countries
BCR	Basic Capital Requirement
BMA	Bermuda Monetary Authority
BNM	Bank Negara Malaysia
BNR	National Bank of Rwanda
BWP	Botswana Pula
C-ROSS	China Risk Oriented Solvency System
CAP	Common Application Package for Internal Models
CAR	Capital Adequacy Ratio
CBB	Central Bank of Bahrain
CBO	Central Bank of Oman
CBRC	China Banking Regulatory Commission
CEE	Central and Eastern Europe
CEL	Current estimate of liabilities
CEO	Chief executive officer
CFO	Chief financial officer
CIITMC	China Insurance Information Technology Management Company
CIRA	Commercial Insurer Risk Assessment
CIRC	China Insurance Regulatory Commission
CISSA	Commercial Insurers Solvency Self Assessment
CMA	Capital Markets Authority
CMGs	Crisis Management Groups
CMPTL	Compulsory motor third party liability business
ComFrame	A comprehensive supervisory framework for the supervision of internationally active insurers
CPI	Consumer Price Index
CRO	Chief Risk Officer
CSM	Contractual service margin
C&SR	Capital and Solvency Return (Bermuda)
DIFC	Dubai International Financial Centre
D-SIFI	Domestic Systemically Important Financial Institution
EEA	European Economic Area
EAC	East African Community
EBS	Economic Balance Sheet
EC	Economic Capital
ECR	Enhanced Capital Requirement (Bermuda)
EIOPA	European Insurance and Occupational Pensions Authority
EMA	Europe, Middle East and Africa
ERM	Enterprise Risk Management
FAIR	Financial Advisory Industry Review
FASB	Financial Accounting Standards Board
FIDLEG	Swiss Financial Services Act
FinCoNet	Financial Consumer Protection Organization
FINMA	Financial Markets Supervisory Authority (Switzerland)
FIO	Federal Insurance Office (US)
FLAOR	Forward Looking Assessment of Own Risks (Europe)
FRB	Federal Reserve Board (US)
FSA	Financial Services Authority
FSAP	Financial Sector Assessment Program
FSB-SA	South Africa Financial Services Board
FSB	Financial Stability Board
FSC	Financial Services Commission (Korea), Financial Supervisory Commission (Taiwan)
FSDRP	Financial Sector Development and Regionalization Project
FSI	Financial System Inquiry
FSOC	Financial Stability Oversight Council
FSS	Financial Supervisory Service (Korea)
FVOCI	Fair Value through Other Comprehensive Income
FVTPL	Fair Value Through Profit or Loss
G-SIIs	Global Systemically Important Insurers
GAAP	Generally Accepted Accounting Principles
GCC	Gulf Cooperation Council
GCP	Group capital proposal
GDP	Gross domestic product
GICS	Guaranteed investment contracts
GSSA	Group Solvency Self Assessment
HKMA	Hong Kong Monetary Authority
HLA	Higher Loss Absorbency
IAA	International Actuarial Association
IAIGs	Internationally Active Insurance Groups
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board

IBNR Incurred but not reported
ICAAP Internal Capital Adequacy Assessment Process (Australia)
ICPs Insurance Core Principles
ICS Insurance capital standard
IDD Insurance Distribution Directive (Europe)
IFRS International Financial Reporting Standards
IFSA Islamic Financial Services Act
IIA Independent Insurance Authority (Hong Kong)
IMF International Monetary Fund
IRA Insurance Regulatory Authority (Kenya and Uganda)
IRCA Insurane Regulatory and Control Agency (Burundi)
IRDA Insurance Regulatory and Development Authority (India)
ISO Insurance Supervision Ordinance (Switzerland)
ITS Implementing technical standards (Europe)
JFSA Japan Financial Services Agency
KSA Kingdom of Saudi Arabia
LAGIC Life and General Insurance Capital (Australia)
LISF Insurance and Surety Institutions Law (Mexico)
MAS Monetary Authority of Singapore
MCR Minimum Capital Requirement
MiFID Markets in Financial Instruments diective (Europe)
MMoU IAIS Multilateral Memorandum of Understanding
MOCE Margin Over Current Estimate
NAIC National Association of Insurance Commissioners (US)
NAICOM National Insurance Commission (Nigeria)
NAMFISA Namibia Financial Institutions Supervisory Authority
NARAB National Association of Registered Agents and Brokers Reform Act
NBFIRA Non-Bank Financial Institutions Regulatory Authority
NIC National Insurance Commission (Ghana)
NTNI Non-traditional non-insurance
OCI Office of the Commissioner of Insurance (Hong Kong)
OCI Other Comprehensive Income
OECD Organization for Economic Co-operation and Development
OIC Office of the Insurance Commission (Thailand)
OJK Indonesia Financial Services Authority
ORSA Own Risk and Solvency Assessment
OSFI Office of the Superintendent of Financial Institutions (Canada)
PBR Principles-based reserving
PCR Prescribed Capital Requirement
PDPA Personal Data Protection Act (Singapore)
PHIAC Private Health Insurance Administration Council (Australia)
PRA Prudential Regulatory Authority (UK)
PRIIPs Packaged retail and insurance-based investment products (Europe)
QCB Qatar Central Bank
QFC Qatar Financial Centre
QFCRA Qatar Financial Centre Regulatory Authority
QIS Quantitative Impact Studies
QRT Quantitative reporting templates
RAF Risk appetite framework
RBC Risk-Based Capital
RBI Reserve Bank of India
RBNZ Reserve Bank of New Zealand
RDR Retail distribution review (South Africa)
RRPs Recovery and resolution plans
SAM Solvency Assessment and Management (South Africa)
SAMA Saudi Arabia Monetary Agency
SARB South African Reserve Bank
SCR Solvency Capital Requirement
SELIC National Reference Interest Rate
SFC Securities and Futures Commission (Hong Kong)
SMI Solvency Modernization Initiative
SRMP Systemic risk management plan
SSN Superintendencia de Seguros de la Nación (Argentina)
SST Swiss Solvency Test
STCL Supervisory target capital level
SUSEP Superintendence of Private Insurance (Brazil)
TCF Treating Customers Fairly
TIRA Tanzania Insurance Regulatory Authority
TRIA Terrorism Risk Insurance Act
TVaR Tail value at risk
UAE United Arab Emirates
UIC Uganda Insurance Commission
USTR US Trade Representative
VaR Value at risk

Acknowledgements

We would like to acknowledge the contribution of our colleagues from across KPMG's global network of member firms who helped develop this report:

Americas region

Robert Kasinow
Director
KPMG in the United States
T: +1 973 912 4534
E: rkasinow@kpmg.com

Carl Groth
Managing Director
KPMG in the United States
T: +1 973 912 4873
E: chgroth@kpmg.com

Richard Lightowler
Managing Director
KPMG in Bermuda
T: +1 441 295 5063
E: richardlightowler@kpmg.bm

Neil Parkinson
Partner
KPMG in Canada
T: +1 41 6777 3906
E: nparkenson@kpmg.ca

Lorena Lardizabal
Senior Manager
KPMG in Argentina
T: +54 11 4891 5645
E: llardizabal@kpmg.com.ar

Ricardo Anhesini
Partner
KPMG in Brazil
T: +55 11 2183 3141
E: rsouza@kpmg.com.br

Luciene Teixeira Magalhães
Partner
KPMG in Brazil
T: +55 11 2183 3144
E: ltmagalhaes@kpmg.com.br

Roberto Muñoz Galaz
Partner
KPMG in Chile
T: +56 2 2798 1233
E: rmunoz@kpmg.com

Ana María Ramírez
Partner
KPMG in Mexico
T: +52 55 5246 8624
E: anamariaramirez@kpmg.com.mx

ASPAC region

Rob Curtis
Executive Director
KPMG in Australia
T: +61 3 9838 4692
E: rcurtis1@kpmg.com.au

Hoa Bui
Partner
KPMG in Australia
T: +61 2 9335 8938
E: hbui@kpmg.com.au

Julian Braganza
Senior Consultant
KPMG in Australia
T: +61 2 9455 9883
E: jbraganza1@kpmg.com.au

Simon Donowho
Partner
KPMG in China
T: +852 2826 7105
E: simon.donowho@kpmg.com

Walkman Lee
Partner
KPMG in China
T: +86 10 8508 7043
E: walkman.lee@kpmg.com

Bo Huang
Senior Manager
KPMG in China
T: +861 08 5085 999
E: bo.huang@kpmg.com

James Anderson
Partner
KPMG in Hong Kong
T: +852 2143 8572
E: james.anderson@kpmg.com

Estella Chiu
Partner
KPMG in Hong Kong
T: +852 2847 5035
E: estella.chiu@kpmg.com

Clarice Yen
Partner
KPMG in Hong Kong
T: +852 2522 6022
E: clarice.yen@kpmg.com

Naresh Makhijani
Partner
KPMG in India
T: +91 22 3090 2120
E: nareshmakhijani@bsraffiliates.com

Shashwat Sharma
Partner
KPMG in India
T: +91 22 3090 2547
E: shashwats@kpmg.com

Elisabeth Imelda
Partner
KPMG in Indonesia
T: +62 21 574 2333
E: elisabeth.imelda@kpmg.co.id

Susanto
Partner
KPMG in Indonesia
T: +62 21 574 2333
E: susanto@kpmg.co.id

Takanobu Miwa
Partner
KPMG in Japan
T: +81 3 3548 5101
E: takanobu.miwa@jp.kpmg.com

Ikuo Hirakuri
Partner
KPMG in Japan
T: +81 3 3548 5101
E: ikuo.hirakuri@jp.kpmg.com

Ryuji Takahashi
Partner
KPMG in Japan
T: +81 3 3548 5125
E: ryuji.takahashi@jp.kpmg.com

Sung Min Cho
Partner
KPMG in Korea
T: +82 2 2112 0499
E: sungmincho@kr.kpmg.com

Jae Beom Choi
Partner
KPMG in Korea
T: +82 2 2112 0213
E: jaebeomchoi@kr.kpmg.com

WanKong Mok
Partner
KPMG in Malaysia
T: +60 3 7721 3388
E: wmok@kpmg.com.my

Kay Baldock
Partner
KPMG in New Zealand
T: +64 9362 5316
E: kbaldock@kpmg.co.nz

Ceri Horwill
Partner
KPMG in New Zealand
T: +64 9367 5348
E: cerihorwill@kpmg.co.nz

Frank Dubois
Partner
KPMG in Singapore
T: +65 6411 8187
E: fdubois@kpmg.com.sg

Kam Yuen Lau
Partner
KPMG in Singapore
T: +65 6213 2550
E: kamyuenlau@kpmg.com.sg

Paul Brenchley
Director
KPMG in Singapore
T: +65 6411 8402
E: paulbrenchley@kpmg.com.sg

Phoebe Chung
Partner
KPMG in Taiwan
T: +886 2 8101 6666
E: phoebechung@kpmg.com.tw

Albert Gau
Partner
KPMG in Taiwan
T: +886 2 8101 6666
E: agau@kpmg.com.tw

Grinni Hsiao
Partner
KPMG in Taiwan
T: +88 628 101 6666
E: grinnihsiao@kpmg.com.tw

Noel Ashpole
Partner
KPMG in Thailand and Myanmar
T: +66 2 677 2794
E: nashpole@kpmg.co.th

Phuc Truong
Director
KPMG in Vietnam
T: +84 8 3821 9266
E: pvtruong@kpmg.com.vn

Europe Middle East and Africa

Janine Hawes
Director
KPMG in the UK
T: +44 20 7311 5261
E: janine.hawes@kpmg.co.uk

Joachim Kölschbach
Partner
KPMG in Germany
T: +49 221 2073 6326
E: jkoelschbach@kpmg.com

Adeel Mushtaq
Senior Manager
KPMG in Bahrain
T: + 973 1722 4807
E: adeelmushtaq@kpmg.com

Gerdus Dixon
Partner
KPMG in South Africa
T: + 27 8 2492 8786
E: gerdus.dixon@kpmg.co.za

Simon Nicholas
Director
KPMG in Isle of Man
T: +44 1624 681002
E: snicholas@kpmg.co.im

Sara Ellison
Sr. Marketing Manager
KPMG in the UK
T: +44 20 73112342
E: sara.ellison@kpmg.co.uk

Jimmy Masinde
Director
KPMG in East Africa
T: +254 709 576 295
E: jmasinde@kpmg.co.ke

Cecilia Awoye
Senior Manager
KPMG in Ghana
T: +233 302 770454
E: cawoye@kpmg.com

Amanor Dodoo
Partner
KPMG in Ghana
T: +233 302 770454
E: adodoo@kpmg.com

Anthony Sarpong
Partner
KPMG in Ghana
T: +233 302 770618
E: asarpong@kpmg.com

Jackline Chibai
Senior Manager
KPMG in Kenya
T: +254 202 806000
E: jchibai@kpmg.co.ke

Rachel Wangari
Associate
KPMG in Kenya
T: +254 202 806000
E: rachelwangari@kpmg.co.ke

Bisi Lamikanra
Partner
KPMG in Nigeria
T: +234 127 18962
E: bisi.lamikanra@ng.kpmg.com

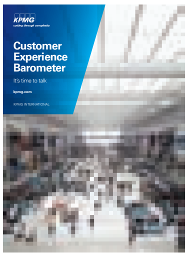
Kabir Okunlola
Partner in Nigeria
KPMG in Nigeria
T: +234 1271 8955
E: kabir.okunlola@ng.kpmg.com

Gerdus Dixon
Partner
KPMG in South Africa
T: +278 2492 8786
E: gerdus.dixon@kpmg.co.za

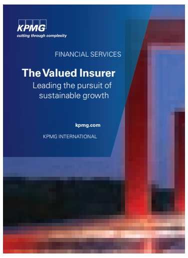
Publications

KPMG member firms provide a wide-ranging offering of studies, analysis and insights on the financial services industry. For more information, please go to kpmg.com/financialservices

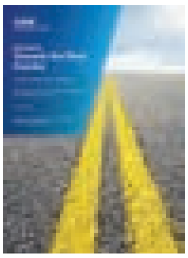
Transforming Insurance: Securing competitive advantage
October 2014
Transforming Insurance delivers a vivid picture of the global insurance landscape, as market players respond to the digital and technological changes that are transforming all aspects of their business. Based on extensive research and interviews with clients and KPMG professionals.



Customer Experience Barometer
May 2014
Based on an in-depth survey of 5,000 consumers across five major markets and key service sectors (banking, general insurance, life insurance, e-retail, utilities), the data provides a unique view into the areas that customers deem most important to their experience.



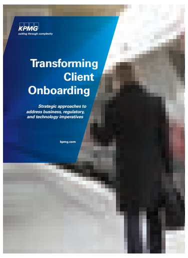
The Valued Insurer: Leading the Pursuit of Sustainable Growth
June 2013
This publication offers unique insight and opinion on emerging customer trends and channel developments in the Insurance sector. We explore the four critical attributes we believe underpin an insurers ability for success now and into the future.



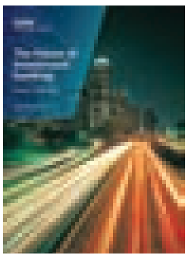
Towards the Final Frontier
January 2014
This report examines key business implications for insurers to consider regarding the current insurance accounting proposals.

Evolving Banking Regulation - Part 1
From Design to Implementation
March 2015
The first in the series, this report examines recent and forthcoming banking regulation and sets the stage for further chapters.

Frontiers in Finance
Winter 2014
Substantial progress has been made in stabilizing the financial sector since the crisis 6 years ago. Yet a great deal remains to be done. The focus of this issue of Frontiers in Finance is navigating change and transformation. In the issue we address the complex financial services landscape and some of the principal transformation issues senior executives are struggling with today.



Client onboarding
August 2014
Client onboarding in financial services needs top be fixed. By definition, it is a process by which a market participant determines, through detailed examination of related risks, whether to do business with a counterparty. But the process in place is anachronistic in today's digital, lightening quick world.



Future of investment banking
April 2014
Investment banking has always been a cyclical business, replete with periods of prosperity and contraction. This time, however, it is different. In our view, the market has fundamentally changed. Powerful forces continue to alter the investment banking landscape in a manner and degree never before witnessed.

Financial Services
Regulatory Center of Excellence

KPMG's Financial Services Regulatory Centers of Excellence, our firms' leading global regulatory experts, provide practical insights into the implications stemming from the raft of regulatory change and the direction of developments around the world from the G20, Basel III, Solvency II, EU initiatives and the Dodd-Frank Act to name a few. Risk and regulatory professionals across KPMG's Global Network of member firms help financial institutions identify risks, understand new compliance requirements and support implementation ahead of time, from early warning indicators to resolution and recovery planning. Building and enhancing systems and controls while optimizing the management of regulatory capital. Key areas of focus include:

- Regulatory risk and capital buffers
- Governance and supervision
- Customer and markets

To learn more, visit KPMG International's Regulatory Challenges page on www.kpmg.com

---

KPMG's Global Financial Services practice has more than 34,000 partners and professionals across our global network of 155 member firms, providing audit, tax and advisory services to the retail banking, corporate and investment banking, investment management and insurance sectors. Each one of our professionals brings ideas, innovation and experience from across this vast network, to the benefit of each of our financial services clients around the world. We serve leading financial institutions with practical advice and strategies backed by world class implementation. We believe our commitment to the industry, our sector specific insights and our passion for serving our member firms' clients to the very best of our abilities help us stand out.

We welcome the opportunity to discuss how KPMG member firms can help you achieve your business objectives.

InsuranceRisk AWARDS 2014
WINNER
Best consulting firm

Awarded for innovative thinking and ground-breaking approaches to solving the risk management challenges that face the insurance industry.

Contacts

Jeremy Anderson
Chairman Global Financial Services
KPMG
T: +44 20 7311 5800
E: jeremy.anderson@kpmg.co.uk

Gary Reader
Global Head of Insurance and EMA Coordinating Partner
KPMG in the UK
T: +44 20 7694 4040
E: gary.reader@kpmg.co.uk

Laura Hay
Americas Coordinating Insurance Partner
KPMG in the US
T: +1 212 872 3383
E: ljhay@kpmg.com

Simon Donowho
ASPAC Coordinating Insurance Partner
KPMG in China
T: +852 2826 7105
E: simon.donowho@kpmg.com

Rob Curtis
Executive Director and Global Insurance Regulatory Lead
KPMG in Australia
T: +61 3 9838 4692
E: rcurtis1@kpmg.com.au

Robert Kasinow
Director and Americas Insurance Regulatory Lead
KPMG in the United States
T: +1 973 912 4534
E: rkasinow@kpmg.com

Janine Hawes
Director and European Insurance Regulatory Lead
KPMG in the UK
T: +44 20 7311 5261
E: janine.hawes@kpmg.co.uk

www.kpmg.com

kpmg.com/socialmedia

kpmg.com/app

Download on the App Store

Designed by Evalueserve.
Publication name: Evolving Insurance Regulation – The journey begins
Publication number: 132293-G