Monetary Authority of Singapore

RESPONSE TO FEEDBACK RECEIVED – PUBLIC CONSULTATION ON ENTERPRISE RISK MANAGEMENT FOR INSURERS

1 Introduction

1.1 On 23 January 2013, the Monetary Authority of Singapore ("MAS") issued a consultation paper setting out the proposed Enterprise Risk Management ("ERM") requirements to be applied to the insurance industry. MAS had proposed to effect these requirements via a Notice ("ERM Notice").

1.2 The consultation period closed on 28 February 2013. The list of respondents is in Appendix A. MAS would like to thank all respondents for their contributions.

1.3 MAS has carefully considered the feedback received and comments that are of wider interest, together with our responses, are set out below.

2 ERM and RBC 2[1]

2.1 A number of respondents enquired how the regulatory capital framework, in particular RBC 2, will be incorporated with the ERM requirements set out in the consultation paper. Some respondents also suggested for the rollout and implementation of the ERM Notice to be aligned with RBC 2's implementation.

MAS' Response

2.2 RBC 2 will be a quantitative framework that establishes the common regulatory capital requirements to be applied across the industry. MAS expects an insurer, as part of its ERM, to go beyond focusing only on meeting minimum regulatory capital requirements, to form its own opinion of its capital adequacy by taking into account all material risks that it faces. While the quantitative RBC 2 framework seeks to be robust and comprehensive, an insurer's ERM framework comprises both qualitative and quantitative aspects, and is specifically tailored to each individual insurer's risk profile, tolerance and strategy. Thus, it enables the insurer's capital management to be more responsive to changes in its risk profile.

2.3 As part of its ERM framework, an insurer is required to perform an Own Risk and Solvency Assessment ("ORSA") and have risk and capital management processes in place to monitor the level of its financial resources. The ORSA is required to take into account its economic capital as well as MAS' regulatory capital requirements. Hence, economic capital should reflect an insurer's own assessment of its capital adequacy for the purposes of its own internal capital management (such as setting of internal targets or risk tolerance) and making of risk management decisions.

2.4 MAS would like to highlight that it will not, at present, be accepting economic capital in lieu of regulatory capital requirements. Where the economic capital differs from its regulatory capital requirements, an insurer should understand and be able to explain the reasons for the differences as part of good ERM.

[1] As set out in the Consultation Paper on Review on Risk-Based Capital Framework for Insurers in Singapore ("RBC 2 Review").

2.5 A robust ERM framework should be able to take into account changes in an insurer's environment readily, including new regulatory requirements introduced. Hence, there is no need for the implementation of ERM requirements to be aligned with that of RBC 2.

3 Scope of Applicability of ERM requirements

3.1 Three respondents sought clarifications on the applicability of the ERM requirements to insurance subsidiaries and branches. Three other respondents also enquired if the ERM requirements would apply to reinsurers.

<u>MAS' Response</u>

3.2 With the exception of captive insurers and marine mutual insurers, the ERM requirements will apply to all registered insurers[2], regardless whether they are incorporated locally or abroad.

3.3 The existing regulatory requirements, such as fund solvency and capital adequacy requirements, asset management requirements, stress testing and risk management guidelines are equally applicable to both locally incorporated insurers and foreign-incorporated insurers. For risk management and capital management, it is likewise prudent to subject both subsidiaries and branches to the same requirements.

4 Reliance on Group's Framework

4.1 Two respondents enquired on the definition of "group" as referred to under Proposal 2 of the consultation paper.

4.2 Respondents also enquired on the extent of reliance which they can place on their head office or parent company's ERM framework, including reliance on the ORSA report produced by the head office / parent company / group. Others sought clarification on the need to submit a group ORSA report if reliance is placed on the group's ERM framework.

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[2] This refers to all insurers registered under section 8 of the Insurance Act (Cap 142), which includes reinsurers.

MAS' Response

4.3 The definition for "group," which has been set out in footnote 3 of the consultation paper, means the group of companies, in accordance with the accounting standards made or formulated under the Accounting Standards Act, to which the insurer belongs.

4.4 Proposal 2 seeks to minimise duplication of effort by allowing a registered insurer to adopt its group's ERM framework to fulfil the requirements set out in the ERM Notice. This may, for instance, include the group's risk management policies, ORSA or economic capital model. The Singapore operations should demonstrate that consideration has been given to its own circumstances, activities and risks under its group's ERM framework, and that the necessary processes, controls and reporting systems are in place. This should be commensurate with the nature, scale and complexity of the risks for the Singapore operations.

4.5 Insurers may choose to submit the ORSA report conducted by its group, parent company or head office in order to meet the requirements placed on the insurer in Singapore under the ERM Notice, so long as the report contains relevant information on the Singapore insurer and is suited to the nature, scale and complexity of the risks faced by the insurer. There is no requirement for an insurer to submit the group ORSA report unless the insurer has been designated for group-wide supervision by MAS.

5 Clarification on Group Risks

5.1 Respondents sought clarification on the intended scope of "additional risks arising due to memberships of a group" in Proposals 2 and 3 of the consultation paper. Some respondents suggested limiting the scope of such group risk to intra-group transactions/businesses.

MAS' Response

5.2 In assessing the additional risks arising from membership of a group, MAS expects insurers to assess such group risk only insofar as they pertain to the insurer in Singapore. Group risk "includes the risk that the insurer may be adversely affected by an occurrence (financial or non-financial) in another entity of the group it belongs to. It also includes the risk that the financial stability of the group as a whole or of any of the individual insurance entities within the group, being adversely affected by an event in any one of the entities in the group, a group-wide occurrence or an event external to the group" (paragraph 16 of Appendix 1 of the consultation paper). Hence, such risk may come about from sources other than intra-group business. MAS expect insurers to identify such risks and put in place the necessary mitigating measures. MAS will engage the industry to provide guidance on the consideration and treatment of group risk.

6 Treatment of Non-quantifiable Risks

6.1 Several respondents provided feedback that not all risks can be reasonably quantified and sought clarification on the treatment of such risks.

MAS' Response

6.2 Where risks are not readily quantifiable, the insurer should make a qualitative assessment of such risks. The assessment should be sufficiently detailed for risk management purposes. This has been set out in paragraph 55 of Appendix 1 of the consultation paper.

7 Establishing Correlations between Risks

7.1 Several respondents commented that setting correlation assumptions between risks can be a highly complex process and sought clarification on MAS' expectations on the matter.

MAS' Response

7.2 An insurer's ERM framework should be commensurate with the nature, scale and complexity of its operations. Thus, for larger insurers with more complex risk profiles, the correlations between different types of risks should be addressed as far as practical, taking into account the impact of such correlations.

8 Risk Tolerance Statement

8.1 Respondents enquired on the difference between “risk tolerance” and “risk appetite”. Several respondents also enquired if guidance would be provided on the derivation of a risk tolerance statement.

MAS’ Response

8.2 As mentioned in paragraph 26 of Appendix 1 of the consultation paper, a risk tolerance statement defines the overall quantitative and qualitative risk tolerance limits, and takes into account all relevant and material categories of risk and their inter-relationships. Qualitative risk tolerances could describe the insurer’s preference for, or aversion to, particular types of risk, especially for those risks that are difficult to measure. Quantitative risk tolerances are the numerical limits set for the amount of risk that the insurer is willing to take. The risk tolerance statement may be adapted from the insurer’s risk appetite, which sets the overall principles that an insurer follows with respect to risk taking, given its business strategy, financial soundness and capital resources.

8.3 The risk tolerance statement should be set by the insurer’s board of directors with due consideration of the Singapore operation’s circumstances such as business and risk profile, risk management practices as well as regulatory and economic capital requirements.

9 Risk Management Policy

9.1 Two respondents enquired if the risk management policy can make reference to policies and guidelines maintained by other departments/functions within the insurer.

MAS’ Response

9.2 MAS will allow cross-referencing to other policies or guidelines within other departments and/or functions of the insurer to be part of the overall risk management policy. The risk management policy could also be a collection of the stand-alone guidelines and policies on various risk management areas within the insurer. Documentation should be clear as to what policies the risk management policy covers or refers to.

10 Frequency of Review of ERM Framework

10.1 Many respondents were of the view that a quarterly review of the ERM framework, as stated in Proposal 6, would be too onerous and unnecessary.

MAS' Response

10.2 To clarify, a full review of the ERM framework on a quarterly basis will not be required. Instead, we expect insurers to have mechanisms to incorporate new risks and information and to review the risk profile, at least once every quarter.

11 Computation of Economic Capital

11.1 Some respondents sought clarification on the computation of economic capital. There were also suggestions for economic capital computation to be a non-mandatory requirement till the industry has developed their capability in this area. Two respondents further suggested for the use of other capital models to be allowed. Some respondents sought more clarification on the adoption of simplified economic capital calculations, in particular on the use of regulatory capital as a basis for economic capital. One respondent also felt that there is insufficient time to develop a robust and meaningful economic capital model.

MAS' Response

11.2 MAS would like to highlight that at present, MAS will not be evaluating the economic capital models of insurers, nor will MAS accept economic capital in lieu of regulatory capital requirements. Economic capital should reflect an insurer's own assessment of its capital adequacy for the purposes of its own internal capital management (such as setting of internal targets or risk tolerance) and making of risk management decisions.

11.3 MAS recognises that some insurers have yet to develop capabilities for computing economic capital. An insurer may thus choose to start off with regulatory capital, before eventually developing its own internal economic capital model should it deem it useful given its nature, scale and complexity of business. However, the insurer should be aware of any relevant and material risks it faces which are not explicitly quantified under the regulatory capital framework, and make an internal economic assessment of the capital required to cover such risks. There should be adequately detailed documentation of the assessment done, in line with the nature, scale and complexity of the insurer's risks.

11.4 Should an insurer choose to develop its own economic capital model, the insurer will need to fine-tune its approach for assessing economic capital over time as it gains more experience through back-testing and building up its data and reporting systems. Insurers should also demonstrate an awareness and understanding of the shortcomings of the model.

12 ORSA and Existing Stress Testing Requirements

12.1 Respondents provided feedback that the requirements under Proposal 10 overlapped with the current stress testing requirements. Ten respondents also commented that a breach of internal capital target should not be deemed as a business failure and suggested for the definition of business failure to be revised accordingly.

MAS' Response

12.2 MAS would like to clarify that, as elaborated in the Consultation Paper, following the implementation of the ERM Notice, the stress testing requirements under the stress testing notice (and circulars) will be revised to focus on prescribed scenarios while self-selected scenarios, including stressed-to-failure scenarios, are to be part of an insurer's ORSA. Hence, there will be minimal overlap between the ERM requirements and the stress-testing requirements.

12.3 MAS agrees that a breach of internal target may not necessarily be an indicator of business failure, and the ERM Notice has been amended accordingly.

13 Ownership and Assurance of ORSA Report

13.1 Respondents enquired on who the owner of the ORSA report is and whether an external auditor's opinion and sign-off is required on the report.

MAS' Response

13.2 To clarify, the board of directors and senior management are to be responsible for the ORSA process, and the ORSA report is to be deliberated and approved by the board of directors.

13.3 MAS will not require that the ORSA report be signed off by an external party. Rather, an insurer's ORSA is primarily meant to aid and guide its own business and strategic planning as well as capital management process. Hence, the insurer should determine for itself, based on its own needs, whether to engage the service of external professional consultants to augment its ORSA.

14 Effective Date of Implementation and Date of Submission of ORSA Report

14.1 Several respondents felt that the implementation deadline of 1 January 2014 and the deadline for submitting the ORSA report by 30 April of the relevant year that it is due were too tight. It was suggested that the ORSA report submission date be aligned with the insurer's planning and budgeting cycle rather than the regulatory reporting cycle.

MAS' Response

14.2 MAS recognises that establishing an effective and comprehensive ERM framework takes time. MAS is not expecting all insurers to have a "perfect" ERM framework on 1 January 2014. However, MAS expects to see endeavours made by all insurers to achieve significant progress in enhancing their ERM frameworks by the implementation deadline. All insurers are required to have the key elements of an ERM framework in place by 1 January 2014. Most of these key elements of the ERM framework have been previously addressed in the Guidelines on Risk Management (effective since 2007) as well as Guidelines on Corporate Governance for Banks, Financial Holding Companies and Direct Insurers Which Are Incorporated in Singapore (effective since 2005), which insurers are expected to observe. Furthermore, significant insurers are already expected to establish independent enterprise-wide risk management systems under the Insurance (Corporate Governance) Regulations 2005, and hence should already have many of the key elements in place. Insurers should lay out a road map and milestones of how they intend to fulfil the requirements and enhance their framework over time. MAS will be working with all registered insurers on the submitted ORSA reports, so that quality and details of submissions improve over time.

14.3 Considering that the primary purpose of the ORSA is to be a tool for the insurer's business planning and internal capital management, the suggestion to align the ORSA report submission date with the insurer's business planning cycle is reasonable. MAS has revised the requirements such that insurers will be required to submit their board-approved ORSA reports no later than 2 weeks after the Board's approval of the report. The first ORSA report for Tier 1 insurers is to be submitted on or before 31 December 2014. All other insurers should submit their first ORSA report to MAS on or before 31 December 2015.

15 Scope of Applicability of ERM Requirements for Insurance Groups

15.1 A few respondents sought clarification on the scope of applicability of Proposal 12. Several respondents enquired on whether there was a need for a registered insurer to submit its ORSA report, if the insurer is part of an insurance group designated for group-wide supervision by MAS, given that the group ORSA report would also cover the ERM framework of the registered insurer.

MAS' Response

15.2 To clarify, Proposal 12 only applies to insurance groups which have been designated for group-wide supervision by MAS. MAS will be issuing a Consultation Paper on Enterprise Risk Management for Financial Holding Companies soon.

15.3 For a registered insurer which is part of an insurance group designated for group-wide supervision by MAS, the registered insurer may make use of the Group ORSA report, provided the required details specific to the registered insurer is clearly documented in the group ORSA report. This is in line with Proposal 2 of the consultation paper.

Appendix A

List of Respondents to the Consultation Paper on Enterprise Risk Management for Insurers

1. Allianz Global Corporate & Specialty AG, Singapore Branch
2. AXA Insurance Singapore Pte Ltd
3. Asia Capital Reinsurance Group Pte Ltd
4. Life Insurance Association of Singapore (“LIA”)
5. Manulife (Singapore) Pte Ltd
6. Odyssey Reinsurance Company, Singapore Branch
7. Pacific Life Re Ltd, Singapore Branch
8. Prudential Assurance Company Singapore (Pte) Limited
9. QBE Insurance (International) Limited
10. SCOR Global Life SE - Singapore Branch
11. SCOR Reinsurance Asia Pacific Pte Ltd
12. Singapore Actuarial Society (”SAS”)
13. Singapore Reinsurance Association (”SRA”)
14. Singapore Reinsurance Corporation Limited
15. Swiss Reinsurance Company Ltd, Singapore Branch
16. Tenet Sompo Insurance Pte Ltd
17. The Toa Reinsurance Company Limited (Singapore Branch)
18. Towers Watson
19. United Overseas Insurance Limited

Six respondents have requested for anonymity.