GC BRIEFING

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FAST FOLLOWERS: ADVANCEMENTS IN ASIA PACIFIC (RE)INSURANCE REGULATION: EXECUTIVE SUMMARY

In the world of business and product innovation, much research has been devoted to the pros and cons of being a "first mover" or "fast follower." As the name describes, the first mover commits money and research in order to bring its products to market first and capture the higher margins early adopters are willing to pay. By contrast, the fast follower avoids the uncertainty and expense associated with product research and pounces only after a sure hit is discovered.

With the exception of Australia, much of Asia has adopted a fast follower approach to insurance regulation. Often without the resources or market maturity enjoyed by European and North American regulators, Asia Pacific (APAC) countries are able to assess various methods and best practices before adapting them to local markets.

Many recent updates to regulations in the region are or will be enacted to bring regulations in line with the International Association of Insurance Supervisors' (IAIS) Insurance Core Principles (ICP), International Financial Reporting Standards (IFRS) and Solvency II.

In this report, we provide an assessment of the development of solvency requirements and regulatory initiatives that are impacting (re)insurers in the APAC region.

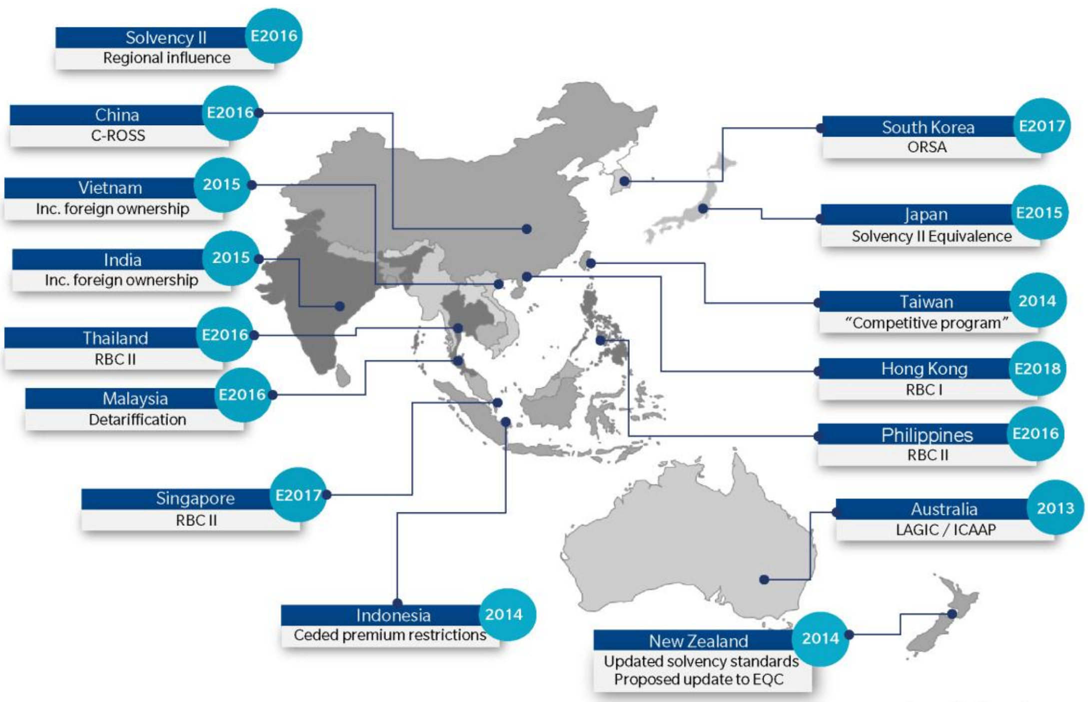
Motivations for these solvency / regulatory developments include:

- Improve resiliency post catastrophic loss
- Increase oversight in a post-Great Recession world
- Follow best practices from the banking and international insurance sectors
- Satisfy domestic political pressures.

APAC is a diverse mix of countries encompassing nearly one third of the earth's landmass and one half its population. Given the broad spectrum of economic and regulatory sophistication across the region, the approach has varied on a country-by-country basis as each regime adapts solvency principles to their own needs and political realities.

As the graphic below highlights, nearly every country in the region has recently enacted or is planning far-reaching changes to solvency and other regulations.

F-1 | RECENT REGULATIONS



Source: Guy Carpenter

Directionally, most country regulators are taking steps to build more robust regulatory and solvency frameworks:

- South Korea, Taiwan and Malaysia are in their second round of risk-based capital (RBC) schemes — Japan is in its third round.
- Australia and Malaysia have implemented Internal Capital Adequacy Assessment Process (ICAAP) requirements while Singapore and Japan are among the countries considering an Own Risk and Solvency Assessment (ORSA) framework.
- Australia, Indonesia, Japan, Philippines, Taiwan and New Zealand have specific catastrophe risk-related solvency requirements.
- Japan is seeking third-country equivalence status for Solvency II for reinsurance business. China, Hong Kong and Singapore have also expressed interest.
- Hong Kong is moving to its first RBC framework, anticipated in 2018.
- China's Insurance Regulatory Commission (CIRC) is instituting sweeping changes through its three-tiered China Risk Oriented Solvency System (C-ROSS) framework that will dramatically impact how (re)insurers conduct business.

The chart below illustrates the sophistication hierarchy of regulatory regimes in the region compared to global best practices.

F-2 | REGULATION SOPHISTICATION SCALE

* Indicates anticipated location on scale after implementation of pending regulations

Source: Guy Carpenter

Solvency II's reach and influence is being felt in Asia Pacific as some countries are positioning for Solvency II third-country equivalence status. This would reduce the administrative burden and improve the competitive position of domestic markets writing business in Europe. Most recently, Australia was recognized with provisional equivalence for solvency calculation on June 5, 2015 for a period of 10 years. It is believed China, Hong Kong and Singapore are also interested in Solvency II equivalency.

The Japanese Financial Services Agency is seeking to achieve equivalence only for domestic reinsurance companies writing business in Europe (Article 172 of Solvency II). This will allow Japan-domiciled reinsurers to assume business in Europe without collateral requirements for unearned premium or reinsurance recoverables. Further details can be found in the Japan section of this report.

Following international standards, several regulators in the region now include specific catastrophe charges in solvency calculations as well as ORSA or ICAAP requirements. This is a recent development, largely spurred by the 2011 catastrophe losses and an interest in Solvency II equivalency.

T-1 | CATASTROPHE RISK FACTORS AND ICAAP / ORSA SUMMARY

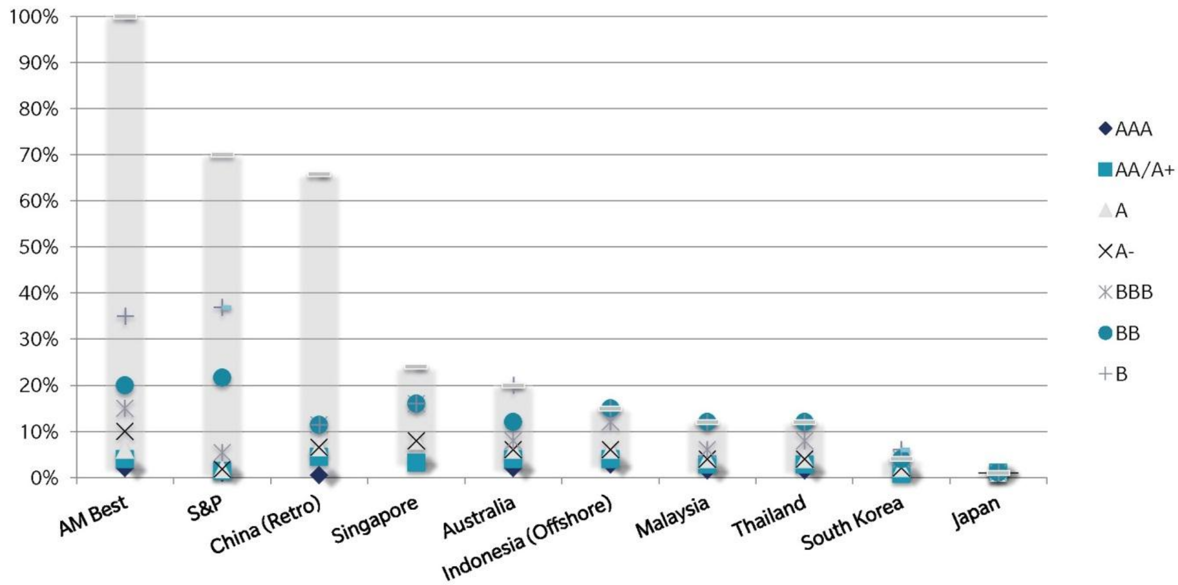
Country	Catastrophe Risk Measurement	ORSA / ICAAP Requirement
Australia	1:200 all peril (OEP)	✓
China	None (To be included under upcoming C-ROSS)	✓ (forthcoming)
Hong Kong	None (Anticipated under upcoming RBC I)	
India	None	
Indonesia	1:250 event (OEP)	✓ (forthcoming)
Japan	Greater of 1:70 wind or 1:200 EQ (OEP)	
Malaysia	None	✓
New Zealand	1:1,000 years (OEP)	
Philippines	5% of aggregate net retained insured values for EQ or wind & flood (zones A or B), whichever is higher	
Singapore	None (To be included under upcoming RBC II)	✓ (forthcoming)
South Korea	None	✓ (forthcoming)
Taiwan	Greater of 1:250 EQ or 1:100 wind event (OEP)	
Thailand	None	✓ (forthcoming)
Vietnam	None	
Bermuda	1:100 TVaR aggregate (AEP) (anticipated increase to 1:200)	✓
EU and SII equivalent	1:200 AEP (anticipated 2016)	✓
USA	1:100 AEP or OEP (anticipated 2016)	✓
A.M. Best	Greater of 1:100 wind or 1:250 EQ (OEP) + 2nd event stress test	
S&P	1:250 aggregate (AEP)	

Source: Country regulatory agencies, Guy Carpenter analysis

Some countries have instituted rules that may potentially hinder the development of a healthy, profitable insurance market.

The Indonesian regulator's recent steps to reduce capital outflows, with a focus on reinsurance premiums ceded to international reinsurers, remain highly debated. The Indonesian regulator has also encouraged all domestic reinsurers to obtain an international rating in order to improve competitiveness with foreign reinsurers. However, it is anticipated that high cessions to other unrated, domestic companies may increase credit risk charges and thereby pressure capital adequacy ratios. As noted in the following chart, A.M. Best and S&P credit charges on reinsurance recoverables are much higher than those of most domestic solvency schemes.

F-3 | REINSURANCE DEFAULT RISK CHARGES UNDER VARIOUS REGIMES



Note: C-ROSS does not use international ratings to calculate counterparty risk charge for reinsurance.

Source: Guy Carpenter analysis, country regulatory documents

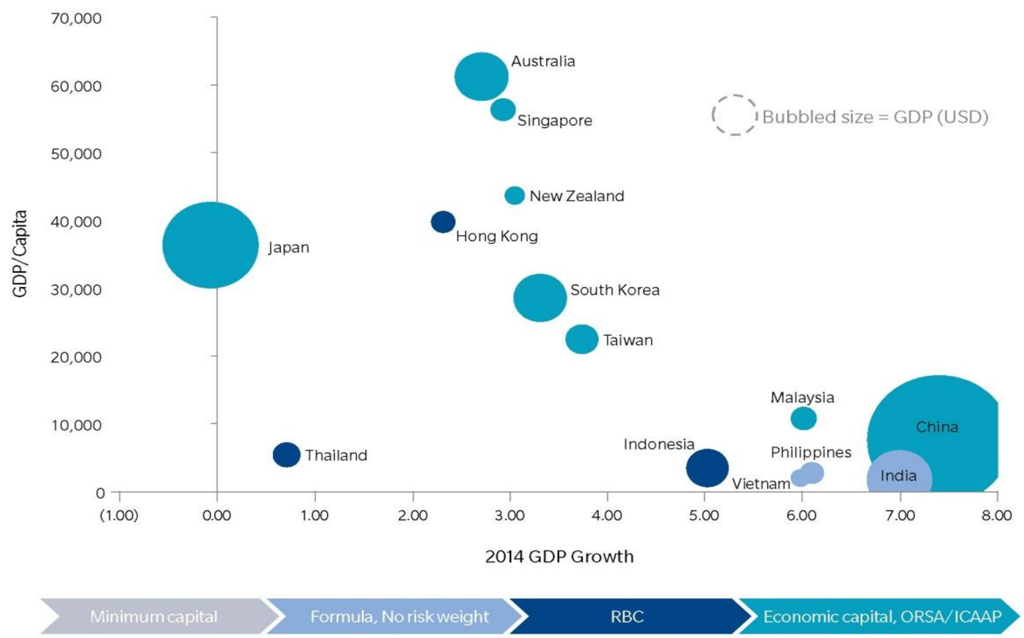
The Philippines, in addition to a basic RBC framework, has instituted a minimum paid-up capital requirement that is set to increase every two years until 2020. The policy applies uniformly across the industry regardless of premium volume, line of business or geographic scope and therefore its impact is more strongly felt by smaller carriers.

Generally, the more advanced economies across the APAC region have robust insurance regulatory frameworks. With the exception of Hong Kong, each country over USD 10,000 gross domestic product (GDP) per capita has or is moving towards an economic capital and/or ORSA/ICAAP requirement (see exhibit F-4).

In less-developed countries, the focus continues to be on educating consumers on the value of insurance and increasing insurance penetration.

The full report details recent solvency and regulatory developments on a country-by-country basis. Heraclitus' aphorism comes to mind and is particularly apt when it comes to insurance regulation in the APAC region: *the only thing that is constant is change.*

F-4 | ASIAN ECONOMIES AND INSURANCE REGULATION IN PERSPECTIVE



Source: Economist Intelligence Unit, Guy Carpenter Analysis

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