About this report
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Foreword

Welcome to the second edition of *Evolving Insurance Regulation*. This publication is part of a series which focuses on the emerging regulatory developments currently facing the financial services industry and accompanies KPMG firms’ other publications on banking and investment management.

This year the focus extends from risk management and prudential change to insurance regulatory reform initiatives currently underway around the world, including the increased focus by many jurisdictions on the new consumer protection agenda and the likely implications of these reforms on the insurance sector.

At the beginning of 2011, many were hoping that the worst of the Global Financial Crisis (GFC) might be nearing an end. By contrast, 2011 further highlighted the fragility of the global economy.

The fiscal vulnerabilities of a number of Eurozone countries contributed significantly to continuing uncertainty in global markets. In turn, this has led to increased political volatility, social unrest and civil disturbance in many countries. While emerging economies in Asia and other regions continue to flourish, they nonetheless remain interconnected with the fortunes of western markets.

Given the unrelenting pace of reform, the strategic challenges facing insurers continue to build. The pressure confronting insurers can be broadly grouped into five key drivers: economic, regulatory, consumer, strategic and operational.

For many insurers, regulatory requirements will present challenges to their existing distribution models and cost structures.

Economic pressures

Insurers have been affected by the general economic malaise. Sluggish economic growth, enduring high inflation and the failure to resolve the Eurozone crisis continue to present extreme challenges. Much of the world continues to have historically low interest rates, impacting capital markets, bond prices and shareholder returns. Political and systemic risk has increased due to continuing Eurozone concerns and budgetary difficulties in the US. This instability is creating pressure for the banking system, particularly in Europe, where credit availability and liquidity remains an issue. This has a knock-on effect on the wider economy.

Insurers have significant challenges to face in 2012. The economic outlook remains uncertain and consumer expectations are higher than ever. Financial regulation is complex and interconnected and the unevenness of global requirements will ensure application remains problematic for many firms. However, for those insurers prepared to rise to these challenges, by transforming their business and embracing the new consumer agenda, the rewards could be great.
Regulatory pressures
The G20 and other political and supervisory bodies continue to drive financial services sector reform – both globally and at a local level. In response to many of these pressures and to country specific issues, supervisors have focused heavily on improving their respective structures and frameworks. The adoption of new International Association of Insurance Supervisors (IAIS) standards in October 2011 was a catalyst for many supervisors to commence reform, particularly in the Americas and Asia.

The US market is undergoing significant changes as a result of the Dodd-Frank Act (DFA) and from new developments arising from the Solvency Modernisation Initiative, such as the Own Risk and Solvency Assessment (ORSA). This is likely to introduce a step-change in risk management practices by US insurers.

In Asia, prudential issues and changes to International Financial Reporting Standards (IFRS) continue to be the main areas of focus for most firms. In Europe, insurance firms are continuing to invest in development of adequate infrastructure and systems to meet the extended 2014 Solvency II implementation date. In addition, a raft of new customer protection regulatory initiatives is due to be implemented, which will require firms to begin actively engaging in such reforms.

Strategic and operational pressures
Achieving operational excellence and improving balance sheet performance will be key strategic objectives for many firms in 2012. Following a tough year in 2011, insurers are reviewing their risk appetite limits, reassessing product lines and geographical exposure to vulnerable areas, while continuing to manage capital requirements and increasing transparency demands from regulators. This is all happening against a backdrop of a general skills shortage in the global insurance industry, where the demand for talent to respond adequately to these increased financial, risk and regulatory challenges is intense.

Maintaining and growing the business continues to be the key objective for most insurers. In many markets, consumer sentiment is at an all-time low. Historically stable consumer bases have been disrupted by poor practices and revolutionised in some markets by the step-change in distribution channels. Firms are becoming aware that they will need to re-structure their operations and develop new capabilities to meet rising customer expectations, while working within the bounds of regulatory constraints.

For many insurers, regulatory requirements will present challenges to their existing distribution models and cost structures. While insurers have endeavoured to enhance their customer proposition (for example through simplifying their product portfolio and pricing across multiple channels), achieving such aims has not always been easy. This will likely require a re-focusing on achieving internal operational efficiencies, to optimise capital, reduce cost structures and foster a customer-focused organisational culture.

Consumer pressures
The industry continues to face the challenges of generally low levels of consumer satisfaction and increased consumer uncertainty. In particular, pension provision is increasingly becoming a political and social issue in many regions. The GFC and recent consumer financial sector mis-selling scandals in some countries have weakened investor confidence in the market. For firms, this is a stark reminder that consumer protection goes beyond transparency in financial products to include the integrity of the sales process and consumer targeting.

The forthcoming customer protection regulatory initiatives are aimed at restoring consumer confidence, establishing greater harmonisation, increasing competition and creating a level playing field in financial markets. Regulators hope to achieve this by taking action against firms that mistreat their customers. This will focus on customer relations and the provision of the right incentives to curtail inappropriate selling practices.

Although the regulatory focus on consumer protection has, until recently, been largely Europe-centric, we expect this trend to extend across other regions in the near future, albeit manifesting itself differently. For insurers, consumer confidence and trust are essential to promote long-term financial stability, growth, efficiency and innovation within their firms. Insurance leaders face a series of tough judgement calls – particularly concerning the strength of their relationships with customers – and will need to develop new strategies to maintain competitive positions.
Executive Summary

Against the backdrop of the Eurozone and sovereign debt crises, 2012 is undoubtedly shaping up as a challenging year for insurers and financial markets generally. This publication examines ways for firms to balance the competing demands of both existing and new prudential requirements, in addition to the growing importance of consumer protection oversight.

Despite 2011 being a milestone year for global financial regulation implementation, the insurance sector is far from having a truly harmonised set of international regulatory requirements. This report provides an update on the latest developments in the IAIS, in particular their attempts to build a common framework for the supervision of Internationally Active Insurance Groups (IAIG). We examine proposals by the G20 and the Financial Stability Board (FSB) to improve financial stability and governance of the financial services sector – most notably the additional requirements on financial institutions deemed to be of Global Systemic Importance (G-SIFIs) – and analyse what further efforts could be undertaken to achieve greater efficiencies in this area.

The ASPAC Perspective provides a detailed overview of the important regulatory changes occurring in risk management and solvency, IFRS and consumer protection across the diverse Asia-Pacific region. Clearly the pace of change differs across markets in the region, but the overriding direction of travel for many Asian supervisors is the implementation of the IAIS Insurance Core Principles (ICPs). These were formally adopted in October 2011 and will prove challenging for both supervisors and firms to implement. We outline the progress being made in various jurisdictions and the likely challenges facing insurers in those markets.

From the plethora of legislation currently being proposed, we know that there will be a divergence of global and national regulatory agendas. Insurers need to act now to re-assess their business models and operating structures to be able to effectively manage the required changes. Risk and finance functions will be required to transform into dynamic and influential parts of the organisation. Strategic decision-making will need, more than ever, to be informed by quality and timely information derived from risk management systems and processes.
From the plethora of legislation currently being proposed we know that there will be a divergence of global and national regulatory agendas. Insurers need to act now to re-assess their business models and operating structures.

Evolving global solvency developments: beyond compliance and towards value creation explores the global solvency issues, providing insights into what this may mean for insurers going forward. It is clear that in an increasingly uncertain world, insurers will require a simple, high performing risk management system that is fully embedded within their respective firms and driving informed decision-making. Effective risk management has never been more important in building and sustaining a competitive advantage.

The move to improve risk management frameworks is not confined to European and Asian firms. Significant prudential and consumer protection developments are also occurring in North and South America. The Americas perspective outlines the likely changes across various markets and the expected impact such reforms will have for insurers in these countries. The impact of these changes will further influence the business models and operating structures of most insurers in these markets and our insights provide valuable information regarding the likely changes such initiatives may have.

The primary focus of supervisors in most jurisdictions for 2012 will continue to be concentrated on capital, liquidity and governance requirements. However, global policymakers, such as the G20, are increasingly turning their attention to issues such as customer protection as part of their financial services reform initiatives. The G20 has utilised the Organisation for Economic Co-operation and Development (OECD) to develop principles to address the conduct agenda. We analyse what impact moving the consumer protection agenda to the front line may mean for insurers and the likely changes required to strategic and operational models. These developments will be influential in how financial services companies do business in their markets with both clients and peers, especially as consumers themselves increasingly expect to receive informed, fair and efficient service when it comes to insurer customer relationships and products. We analyse the likely strategic implications of the consumer protection agenda and provide a detailed review of what increased consumer protection regulation could mean for insurers in terms of the products offered and distribution channels used.

While the speed of implementation of reform is likely to vary considerably across regions, the European Commission (EC) has been active in developing new consultation proposals on consumer protection. These are expected to be released in the first half of 2012, with significant implications for insurers. The EMA perspective analyses the important conduct changes likely to affect insurers, particularly the second Insurance Mediation Directive (IMD 2) and the Packaged Retail Investment Products (PRIPs) consultation. Though final rules are still being drafted, it is critical for companies to act now in assessing the strategic and operational impact such proposals may have across their businesses. These changes are likely to have significant implications for insurers’ products and distribution networks.

An update is provided on the latest South African developments, along with insights on the impact such proposals may have on insurers and wider financial services markets. This includes a detailed perspective of the South African market’s current regulatory changes. It is likely that many of the Solvency II initiatives legislated will have wider implications for insurers undertaking business on the African continent.

Of course, no analysis of the developments affecting the global insurance market would be complete without examining the continuing efforts by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) to progress and seek convergence on the IFRS insurance contracts project. Undoubtedly, this work will be an important component to ensure global consistency in the provision of financial information and reporting. In particular, the issue of insurance liability volatility and the presentation of such results remains a key area of debate around the globe.

The review of the latest accounting, valuation and disclosure developments provides a snapshot of the elements already agreed and those still to be resolved. We review the latest positions on a number of the key areas still being debated, such as discount rates, unbundling, reinsurance, residual margins and disclosure issues. An overview is also provided of the similarities and differences between the IAIS standard on valuation and the proposals currently advanced under IFRS, the impact of these developments on local markets, and US GAAP and regulatory convergence.

2012 will be a dynamic year. It’s time to get ahead of the regulatory change agenda – are you prepared?
The primary goal of ComFrame should be to establish a framework for better supervisory co-operation, allowing a more integrated and international approach.

Latest developments in the IAIS

IAIS completes major milestone
The IAIS, at their Annual General Meeting in Seoul on 1 October 2011, endorsed their Insurance Core Principles (ICPs). These new ICPs herald a new regulatory environment for insurers and supervisors, essentially requiring supervisory regimes worldwide to establish risk-based solvency requirements. This reflects a total balance sheet approach on an economic basis, addressing all reasonably foreseeable and relevant material risks.

These solvency capital reforms are supplemented by required enhancements in the role and activities of insurer risk management, which effectively link the front-end processes of accepting and monitoring risk more closely with the overall strategic goals and risk appetite at Board level.

For many jurisdictions, enacting such changes into local frameworks will require significant effort and the impact on the insurance sector is likely to be considerable, especially in less well-developed markets such as Eastern Europe, Africa, the Middle East and many parts of Asia and South America.

ComFrame begins to take shape
The IAIS continues to develop the ComFrame proposal – a comprehensive supervisory framework for the supervision of internationally active insurance groups (IAIGs) – and in July 2011 presented its initial concept paper.

The IAIS has outlined the aims of ComFrame as:

- Developing methods of operating group-wide supervision of IAIGs in order to make group-wide supervision more effective and more reflective of actual business practices;
- Establishing a comprehensive framework for supervisors to address group-wide activities and risks and also set grounds for better supervisory
co-operation to allow for a more integrated and international approach; and
• Fostering global convergence of regulatory and supervisory measures and approaches.

ComFrame is split into five modules:

Module 1: Scope of application
Module 2: Group structure and business from a risk management perspective
Module 3: Quantitative and qualitative requirements
Module 4: Supervisory process and co-operation
Module 5: Jurisdictional matters

Although there are various approaches used globally to supervise IAIGs, the situation still remains that no multilateral system is used by global supervisors to monitor IAIGs adequately. Some supervisors have taken a different approach by focusing heavily on a shareholding-centric model to analyse group structures.

As the international standard setter for insurance, the IAIS has so far developed a generic approach to building a global framework for the supervision of IAIGs, including developing the ICPs (of which some ICPs, such as ICP 23, specifically address group-wide supervision).

Notwithstanding, the IAIS still lacks a multilateral response to the supervision of IAIGs and ComFrame is intended to fill this void. Encouragingly, there was generally broad support from IAIS members and observers for the structure and outline presented in the concept paper released in June 2011. Many recognised that ComFrame needs to exist in order to address issues in the supervision of IAIGs and that the project is therefore a significant development in international insurance supervision.

Supervisors are now trying to provide further detail on the key components of ComFrame. However, differences among supervisors are beginning to surface, especially regarding solvency issues, for example:
• The use and scope of a total solvency sheet approach
• Should a consolidated or aggregated accounting measure be used?
• How should risks actually be measured?
• How can a common methodology on capital requirements be achieved?
• How can a common approach to stress and scenario tests be achieved?
• How can a common methodology to the supervisory assessment process be achieved?

It is clear from various meetings of the IAIS committees that a number of key concerns still remain among jurisdictions:
• What is the scope of an insurance group?
• What is the group capital assessment designed to achieve?
• How should solvency control levels be determined?
• Should ComFrame require different intervention levels?
• Should ComFrame require a single methodology in determining capital requirements, or should multiple methodologies be allowed? If so, how?
• Does ComFrame mean one group supervisor or multiple supervisors involved in the supervision of an IAIG? What are the legal implications arising?

KPMG continues to strongly support the overall aim of the IAIS: to foster global convergence of regulatory and supervisory measures and approaches to insurance supervision. The primary goal of ComFrame should be to establish a framework for better supervisory co-operation, allowing a more integrated and international approach. There are a number of key issues which remain to be addressed:

• What is a globally accepted level of policyholder protection?

If ComFrame is to achieve international convergence and consistency in supervisory requirements, one of the most important issues to resolve will be that of establishing an appropriate level of policyholder protection – or put another way, determining the risk appetite of supervisors with regard to the failure of an IAIG. An open and informed debate concerning minimum standards of global policyholder protection, and thereby capital requirements, is needed.

As the international standard setter for insurance, it would be a curious decision for the IAIS to advocate a new, globally accepted common framework and not articulate the level of policyholder protection it offers. In addition to discussion and agreement on the level of protection to which policyholders are entitled, more debate is needed on the components of an effective global group-wide supervisory regime, for example, the determinants of key tools for an effective insurance supervisory regime. Failure by supervisors to reach satisfactory conclusions on these important components will mean regulatory failure.

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• What is the role and future of the IAIS as an international standard setter?
  The GFC highlighted the uncertainty regarding the role, remit and ability of the IAIS to facilitate, or be involved in, any formal review process of an IAIG. Key lessons learned by the industry from the GFC were matters of IAIG data confidentiality and information and mechanisms to freely exchange sensitive information amongst supervisors.
  As the IAIS is developing ComFrame, greater clarity and articulation concerning its role and powers would be beneficial to both IAIS Members and Observers. For example, it remains unclear as to whether the principal aim of the IAIS is to increase the intensity of supervision of the largest and most complex global insurance groups, or whether the primary intention is to achieve greater global consistency. The first approach focuses on raising standards, and the latter focuses on wide and consistent application of minimum standards.

• What is the envisaged implementation of ComFrame?
  The path to implementation remains unclear. It has not yet been clearly articulated how ComFrame is envisaged to operate, for example, whether ComFrame is intended to perform like the Basel Accord for Banking (with the intention that individual countries will implement ComFrame into their local law and regulation and thereby replacing existing requirements) or whether a much looser supervisory arrangement is intended. Such uncertainty may slow the overall development of ComFrame. Resolution to such important matters should be given priority, especially as it is still unclear how ComFrame will interact with current supervisory structures.

• Can there be greater international co-operation amongst all standard setters?
  It is clearly important that the IAIS liaises closely with not only the Basel Committee for Banking and International Organization of Securities Commissions (IOSCO), but also the Joint Forum and the Financial Stability Board (FSB) and G20 forums, if it is to appropriately develop ComFrame. How IAIG supervision is envisaged to interrelate with other sectors such as banking and conglomerates is critical to avoid duplication and achieve maximum efficiencies from supervisory processes. Further consideration of how ComFrame would be ‘operationalised’ on a conglomerate basis would therefore be beneficial.

Systemic Risk
  In their latest publication, arising from the G20 Cannes Summit held in November 2011, the G20 and FSB have outlined their clear intention to apply capital surcharges and a Recovery and Resolution Plan (RRP) framework to all Significantly Important Financial Institutions (SIFIs) – including insurers. Additionally, the FSB is seeking national authorities to put common powers and tools in place for the resolution of insurers. This takes into account that these tools may need to differ from the powers and tools necessary to resolve banks and recognises that most national authorities already have powers in place to transfer the business of insurance undertakings. In November 2011, the IAIS released its preliminary findings and took a focused view of whether insurers could pose systemic risk – effectively being confined to the impact of non-core insurance activities such as credit protection and asset leverage. However, it remains to be seen whether the G20, FSB and national authorities will take a wider view. For example, the EU Crisis Management Directive is expected to apply to all credit institutions and could be followed by a similar Directive for insurers.
  In the meantime, the US authorities are expected to designate major insurers to be SIFIs, and to require them to undertake resolution planning. The Dodd-Frank Act contains provisions for non-bank financial institutions – which includes insurance firms designated by the Financial Stability Oversight Council (FSOC) as systemically important – to develop resolution plans.
It would be ineffective and disproportionate to apply a banking style RRP framework to the insurance sector.

Implications for firms

In KPMG’s August 2011 publication, *Recovery and Resolution Plans for Insurers – the need for a broader debate*, we articulated our view that a fundamentally different policy approach should be adopted for insurers, compared to the banking industry.

The report highlighted that given the significant differences between banks and insurance firms, it would be ineffective and disproportionate to apply a banking style RRP framework to the insurance sector. Instead, a much more pragmatic set of policy tools is required to achieve an enhanced supervisory framework for insurers.

To reflect the inherently different operating models and therefore systemic differences that exist between banks and insurers, policy options for recovery and resolution for the insurance sector should be de-coupled. For example:

- Insurers are not direct participants of the payments and settlement system
- Insurers are not dependent on short-term market funding, i.e. unlike banks, insurers do not borrow in the short-term to finance risks over the long-term
- The capital structure of the insurance industry does not lend itself to ‘run-on-the-bank’ type risks
- The matching principle of assets to liabilities has always been a cornerstone of most insurance asset-liability management practices
- Insurance supervisors, have a better understanding and insight into the intrinsic risk in business models and the activities of insurers through using catastrophe modelling
- Failure of an insurer’s particular strategic plan or strategy does not usually have the same immediate effects as it does in banking given the liquidity considerations involved
- The engagement of rating agencies and particularly their role in determining the level of reinsurance counterparty worthiness has had a moderating influence over the management and risk appetite of many insurers
- In some markets, such as the US the model of insurance regulation is such that more than one regulator is typically responsible for supervising a large insurer providing additional scrutiny and challenge
Building an appropriate policy framework – providing the link between RRPs and better risk management

A fresh approach by policymakers is required to properly address some of the weaknesses in insurance supervision learned from the GFC. Perhaps the greatest lesson learned is that all insurers, irrespective of notional designations as systemically important, need to ensure better risk management practices are applied. Importantly, from a supervisory perspective, the need to address the deficiencies of current supervisory risk management tools remains urgent.

Supervision needs to view an insurer’s risk management as a continuum. Using the continuum outlined above, one of the most effective supervisory tools available to supervisors in the assessment of risk management is the Own Risk and Solvency Assessment (ORSA). Additionally, allowing internal models would also provide further supervisory mechanisms to facilitate effective assessment of the risk management techniques, capital and solvency positions of supervised entities.

Our view is that the ORSA should be revised to take into account the lessons learned from the financial crisis. Many of the requirements set out in the IAIS Enterprise Risk Management for Solvency Purposes Insurance Core Principle (ICP 16) reflect, largely, the structure of requirements as prepared for the ORSA by the Solvency Subcommittee pre-GFC. This also largely applies for the Solvency II ORSA framework. We suggest that, given the lessons learned, the IAIS considers augmenting its current ICP 16 to provide a policy framework for FSB consideration which can provide a pragmatic and proportionate link between notions of RRPs and improved risk management for all insurers. By expanding the ORSA requirements, the conceptual framework of RRPs could be practically applied as part of the ORSA analysis that insurers would be expected to review and include, applicable to all firms. Specifically, a distinction can be drawn between policy options to take forward aspects related to recovery (which would provide a direct link with the ORSA), and issues pertaining to actual resolution, which should be considered separately by supervisors.

The following new analysis could be expected of insurers:

- Potential economic impact considerations:
  - The ORSA is a new policy tool being introduced requiring insurers to undertake an assessment of their own risks, complemented by an assessment of the capital required to meet such risks. The focus of this assessment could now incorporate risks posed to the wider economic environment. In some markets, supervisors are already moving...
The ORSA should be revised to take into account the lessons learned from the financial crisis.

towards requiring forward assessments of the financial condition of an insurer, under a range of scenarios. For example, in the UK, the Individual Capital Adequacy Standards (ICAS) requires extensive testing of capital, insurance, market, credit, liquidity and operational risks, in addition to other relevant risks such as reinsurance, strategic risks, and corporate governance risk. Such requirements will ostensibly be extended in Solvency II, (in the US via the ORSA requirements), and for those firms using an internal model – including the capital methodology proposed for calculating capital requirements. A widening of these existing and proposed supervisory tools to take account of potential economic impact considerations would largely complement the analysis performed. In this context, it would be a cost effective and proportionate method for the insurance industry.

Regulators will look to groups – particularly those in Europe – seeking internal model approval, to demonstrate they have a comprehensive understanding of their business, contractual arrangements, structures, capital and intra and extra group relationships. The extension of such analysis could require insurers to have mechanisms in place to restore the group in the case of solvency and/or going concern issues – or at least to consider such scenarios within their ORSA or internal model analysis – and in a worse case situation, to deconstruct the group in an orderly manner. To be in a position to affect appropriate mechanisms, insurers will need insight into the potential triggers. These are likely to require scenario analysis to understand the pressure points and the likely sequence of events.

It was also evident that many pre-GFC stress tests were not fit for purpose, as they were not designed for the type of extreme market event that occurred. Many firms’ stress tests failed to adequately consider the magnitude of shocks, the duration of the shock, risk concentrations and the extent of correlation (and contagion) between different positions, risk types and markets. Nevertheless, while there has been much discussion of the flaws and inappropriate usage of stress tests prior to the crisis, there has also been concurrent recognition that such tests must be an essential tool in building a resilient financial sector.

The challenge for supervisors and importantly, for firms, is to set tests which are appropriately severe and broad but not so implausible as to be of no use. As part of their ORSA analysis, firms should consider building in more hypothetical sets of assumptions for how exposures may change in light of unexpected shocks.

Risk appetite and strategy: At its basic level, risk appetite defines the level of risk a firm accepts. This is set from Executive and Board level and is intertwined with the company’s strategy. A poor risk appetite or risk tolerance setting and lack of goal clarity for the insurer can cause considerable financial distress. One of the lessons from the GFC has been that supervisors, and a number of insurance groups, were not cognisant of the inherent underlying risks, particularly those risks which may have systemic relevance. How risk appetite is effectively used and monitored is less well understood by supervisors, as this has not traditionally formed a key component of the financial statutory returns of most supervisory jurisdictions – in particular, how the risk appetite of an insurer fits with the strategic direction of the company.

A practical policy option available to supervisors is to formalise links between the strategic objectives and options of insurers with risk appetite, establishing formal reporting mechanisms. Extending such arrangements to, for example, instances of acquisitions and mergers, may also assist regulators to better assess the systemic relevance of firms, as well as enabling insurers to articulate potential impacts to the business model. These requirements could usefully form part of the ORSA set of requirements expected of insurers.

Greater focus on non-core insurance activities and off-balance sheet items: Part of the ORSA analysis should therefore be focused on examining the impact that non-core insurance activities and off-balance sheet items may have on the financial condition of the firm. Such an approach should adopt a total balance sheet approach, where the impact of the totality of the insurer’s material risks are fully recognised on an economic basis. The GFC demonstrated that failure to appropriately recognise the risks such activities can pose to a group highlights a material weakness in the overall risk management capabilities and functions of a group. Specific requirements of this nature could therefore form part of the broader ORSA requirements.

The investments ICP (ICP 15) already exists and essentially requires insurers to invest in assets with risks it can properly assess and manage. This especially concerns the use of more complex and less transparent asset classes and investment in markets or instruments that are subject to less rigorous governance or regulation. However, the current proposals are not specific on which assets may require further regulation, and it is clear from the
events of the GFC that further analysis would be beneficial. For example, consistent requirements relating to inherently risky financial instruments that are likely to require greater scrutiny by both firms and supervisors. These include: special purpose vehicles, hedge funds, derivatives, private equity, structured credit products, insurance linked instruments, and hybrid instruments that embed derivatives and dynamic hedging programs. A first step would be to require firms to undertake specific analysis of such instruments within their ORSA assessments, with particular regard to whether such assets lead to an increased systemic risk scenario.

Mandatory use of reverse stress testing:
The use of reverse stress testing, or test-to-destruction analyses (which identify scenarios that are most likely to cause an insurer to fail) should also form part of a firm’s overall risk management analysis and assessment and could therefore form part of the ORSA. The benefit of requiring such analysis is that it can provide both management and supervisors with the necessary information to assess the adequateness of the management actions proposed, in order to avoid business failure. This leads to an element of specific focus – that of resolvability and associated planning. Insurance failures are typically resolvable through an orderly run-off, but exceptions to this have occurred and remain plausible. There may therefore be a case for putting in place ex ante arrangements to ensure an orderly conclusion to various scenarios. Such developments would complement prudential requirements, but should not be seen as a replacement. Preventative action should remain integral to prudential regulation.

Requiring an analysis of the concentration of business written:
HIH, the Australian insurance group that ultimately collapsed in 2000, was a good example of the impact of its collapse being detrimental to the local insurance market in Australia. (HIH was the dominant provider of indemnity coverage to the building industry). However, the consequences of its collapse were not on a global scale. The failure of HIH starkly demonstrated the impact that a concentration of business underwritten in a particular market or segment can cause on the local economic system. The dominance of HIH’s professional indemnity business was allowed unchecked, amassing a disproportionate market share.
The analysis of whether the sudden withdrawal of such cover could give rise to any wider economic impact on the local market had not been fully appreciated. The introduction of measures to assess and determine market share criteria could be one option available to insurance supervisors, included within a firm’s ORSA. The inclusion of such analysis would likely expand the current focus of what is presently envisaged for most ORSA requirements. The forward-looking nature of the ORSA should provide an additional tool to assist insurance supervisors in better understanding the existing local market concentrations prevailing.

A market concentration analysis requirement would also allow firms to undertake discussions with their supervisors in advance of any stress environment, allowing for constructive dialogue to occur regarding a firm’s strategic objectives and marketing plans.

Establishing a better ladder of intervention:
The ladder of intervention provides an opportunity for regulators to establish a new control level, based on the risk assessment posed by insurers. This specifically assesses whether the insurer concerned presents any systemic risk to the local market. Such an intervention level could take the form of additional risk management requirements and be based on the insurer’s ORSA.

Enhanced corporate governance requirements:
Corporate governance is a key component of solvency. The GFC brought into relief ongoing shortcomings within the ability of many Boards in ensuring that the firm provides adequately against the risks being taken ensuring sufficient liquidity and solvency is retained. Board composition, role and effectiveness are a critical component of any insurer’s financial condition and therefore play a crucial role in prudential regulation. The GFC highlighted that poor decision-making at either Board or senior management level can contribute to financial malaise. Strengthening board competence requirements, including various risk and auditing subcommittees and applying increased assurance measures, are very likely to considerably strengthen the robustness of oversight functions within most firms.

Requiring demonstration of such analysis via the ORSA by key approved persons within firms, particularly in regards to complex financial transactions, could provide an additional layer of expertise and assurance for insurers to avoid some of the GFC experiences.

Formalising a Chief Risk Officer (CRO) role:
The role and structure of risk management has received considerable attention post-GFC. A consideration going forward is the need to enshrine its role with a distinct function or ‘line of defence’, which holds an aggregate view of risk across the insurer, independent of the business. Consideration could be given to the benefits of formalising the role of the Chief Risk Officer (CRO) at the head of the risk management function and their accountability for risk within the organisation. This is similar to the general direction of development in many markets, and within Solvency II, of an actuarial function. The formalisation of a CRO role and function could provide firms and supervisors with a level of enhanced independence and challenge for the risk function, including the veracity of risk decisions made. Ultimate responsibility for the ORSA would be maintained by the Board.

Expanding the ORSA requirements to include company culture and ethics:
Although potentially challenging, the notion of regulators playing a greater role in considering a company’s behaviours or ethics may be a necessary addition to effective supervision. Typically, a firm’s culture has not been the remit of regulation, but it is hard to argue that behavioural issues were not deeply rooted in many of the causes of the crisis. A company’s culture affects the leadership and strategy of the firm, and ultimately shapes decision-making. The emergence of news concerning excessive executive compensation may reflect society’s general belief that the financial sector is not as ethically sound as it could be. Excessive compensation itself was not a catalyst for the GFC, but it represents a culture of incentivised risk taking and a need for potential structural reform. It is therefore likely that further developments are necessary to embed more responsible attitudes and a change of culture within the industry. The industry, as well as regulators, need to be reflective of their role and responsibilities in the wake of the GFC. In light of these, examining ways to allow the ORSA to capture information about the company’s culture and ethics may therefore be a useful addition to the overall risk management framework.
Perspectives: ASPAC

There have been a number of important regulatory advances that are expected to have an impact in the region in the coming months and years. The region is experiencing increased transaction activity in the insurance sector, and many organisations are looking to capitalise on the potential growth opportunities. This year’s Perspectives: ASPAC section has been expanded to provide a more in-depth coverage of market and regulatory movements across the region, beginning with an overview of two key areas – Prudential Regulation and Customer Treatment. The country summaries provide further localised focus.

Prudential regulation: The impact of the new IAIS standards
The adoption by the IAIS of a new suite of Insurance Core Principles (ICPs) will have a significant impact on the form and extent of prudential regulation within the Asia Pacific insurance markets. In particular, the IAIS capital adequacy standard includes general requirements on the use of internal models to determine regulatory capital requirements (where this is allowed by the supervisor) which will herald a major step forward in the Asia-Pacific supervisory arena.

However, of all the new IAIS standards, the ICP on Enterprise Risk Management (ERM), ICP 16, is likely to be the most significant. The ICP requires supervisors to seek high standards of risk management and governance from insurers and, critically, supervisors are being encouraged to challenge the insurers they regulate on risk management issues. In particular, the IAIS ERM standard requires insurers to produce an ORSA, under which an insurer undertakes its own forward-looking self-assessment of its risks, its capital requirements and the adequacy of its capital resources. Many of these requirements are new to the Asia-Pacific region. We expect insurers across the region will need to substantially upgrade their ERM and capital management capabilities over the next few years.

Even though the ICPs currently take the form of high-level principles-based requirements, they nonetheless require all supervisors to enact the requirements into their local supervisory frameworks. If they do not, they risk receiving an adverse finding from the IMF/World Bank in their Financial Sector Assessment Programme (FSAP) reviews. There are some who argue that the ICPs do not go far enough – they do not, for example, require consistent calibration of capital requirements between countries. Nevertheless the ICPs are undoubtedly a step in the right direction.

Customer treatment: changing conduct of business
Models of consumer protection vary considerably in Asia Pacific, but generally it has not yet embraced the principles-based customer-centricity seen in the UK and parts of the EU. In Asia, many countries use an alternative model, with a focus on achieving customer protection through regulatory pre-approval of product designs and pricing. Current areas of regulatory focus include increasingly more stringent controls over data privacy impacting direct marketing and cross-selling (eg. between banking and insurance entities of a group), controls over multi-ties and who may sell insurance in bank branches, and increased disclosures.

Asia-Pacific regulatory developments – country focus
The following provides an update of key regulatory and market developments within the Asia-Pacific region, followed by a summary table of the main risk management and solvency, IFRS, and consumer protection activities within each market.

Australia
Similar to other markets covered in this section, natural catastrophes have received a lot of attention in Australia in the last 12 months. Larger Australian insurers were not only exposed to events in Queensland – many were also exposed to the Christchurch earthquake in New Zealand. As an example of possible regulatory reaction, flood cover may become mandatory for homeowner property insurance policies in Australia.

Insurers are also looking to streamline operations and increase operating efficiency to protect profitability, in an
industry faced with volatile investment markets, strong competition (price and churn), significant claims inflation for certain lines, and increases in reinsurance, regulatory and staffing costs.

Against this backdrop, insurers are in the process of understanding the new life and general insurance capital (LAGIC) standards, which are due for release this year. The Australian Prudential Regulation Authority (APRA; the prudential insurance regulator) has been very active in developing the LAGIC reform since announcing the overhaul of the capital framework in 2009. APRA is an active member of the IAIS, and LAGIC is expected to be compliant with the new ICPs.

**China**
As the insurance industry in China continues its rapid expansion, the regulatory environment needs to evolve to keep pace with the additional challenges created in a dynamic market environment. The China Insurance Regulatory Commission (CIRC; China’s insurance regulator) has spoken about the importance of managing the capital strain of new business. As with other regulators in the region and other IAIS members, the CIRC is keeping a close eye on international regulatory developments – in particular we have seen recent enhancements to ERM, and anticipated reforms to solvency capital standards in the medium-term.

**Hong Kong**
Hong Kong’s insurance industry continues to grow strongly, with growth rates in both the life and non-life sectors of above 10 percent in the first nine months of 2011. RMB-denominated products have seen particular growth, stemming from customer demand in Hong Kong for policies denominated in the appreciating Chinese currency. The Office of the Commissioner of Insurance (OCI; Hong Kong’s insurance regulator), may be replaced by an Independent Insurance Authority (IIA) as soon as 2013, which is expected to bring enhanced regulation of insurance companies and intermediaries. In the meantime, the OCI continues to outline short, medium and long-term insurance regulatory reform, and is regularly citing the recently adopted IAIS ICP standards as examples of the likely changes needed to be adopted at the local level including much talked about RBC reform.

**India**
The dramatic shift in the availability of products in the market has helped to fuel the Indian insurance market across the life, non-life, and health sectors. The numbers of policies sold in the past decade have risen significantly. Industry figures indicate that this has increased the total penetration of insurance (premium as a percentage of GDP) from 2.3 percent in 2001 to 5.2 percent in 2011. The Insurance Regulatory and Development Authority (IRDA; the insurance regulator), which is a member of the IAIS, has introduced a number of reform packages in recent years. This includes regulation on investments that insurance companies can make, risk management guidelines, and customer treatment regulation (in particular relating to the sales of unit linked insurance policies).

**Indonesia**
As in other Asia Pacific insurance markets, much attention is being placed on Indonesia as a country with significant growth potential. We have seen increased transaction activity and interest across both life and non-life sectors. Penetration levels are expected to increase as economic growth continues, and recent natural catastrophes in neighbouring countries are also expected to increase awareness for property protection.

The steep increases in minimum regulatory solvency capital requirements are expected to drive consolidation in the market.

**Japan**
To expand their footprint and in search of profitable growth, a number of Japanese insurers are keen to look for opportunities in overseas insurance markets, and in particular in the Asia Pacific region.

The earthquake in March 2011 impacted the domestic insurance market, particularly non-life insurers, and continues to influence the overall economy by way of the recovery plans. Post earthquake, insurers will be influenced directly by increases in the cost of reinsurance, a desire to restore an adequate level of reserves, managing earthquake insurance coverage limits, and so on. In addition, the recent Bangkok floods have had an impact on the Japanese non-life insurance market due to the location of many off-shore Japanese industrial operations.

Japan’s Financial Services Agency (FJSA, whose role includes that of the insurance regulator), is a member of the IAIS, and like many other jurisdictions in the region, we are expecting regulatory developments resulting from adoption of the ICPs in due course.

**Korea**
Seoul hosted this year’s IAIS Annual Conference. At the welcoming address of the conference, the Financial Supervisory Service (FSS; the
regulator) highlighted the growing interconnectedness in the global marketplace, stressing the importance of the various initiatives of the IAIS to promote a globally accepted framework for the safe and sound supervision of the insurance sector. The FSS also highlighted the area of micro-insurance as an important development for low-income populations.

Separately, Korea’s retirement pension market has grown significantly since the second half of 2010, where the new retirement pension has replaced the retirement insurance and retirement trust system that was terminated at the end of 2010. A relaxation of regulation on the sale of retirement pension products, as well as an expansion of tax incentives, has accelerated growth in this market.

**Malaysia**

Top of insurance Board concerns in the Malaysian marketplace are regulatory compliance, increased competition due to the liberalisation of the market, and a shortage in insurance resources as the industry continues to grow. Merger and acquisition activity continues to be buoyant, and Malaysia has recently seen the expansion of the Takaful market with the issuance of four new licenses in 2010.

Bank Negara Malaysia (BNM), the country’s insurance regulator, has a keen interest in emerging international regulatory developments including the newly adopted IAIS standards relating to investments, ERM, and capital adequacy.

**New Zealand**

The insurance industry in New Zealand is still managing the impact of the earthquake and subsequent aftershocks that struck Christchurch in February 2011. In particular, general insurers remain focused on evaluating the costs of the catastrophe, with knock-on effects on the pricing of policies in earthquake-prone regions and the reinsurance market.

At the same time, the New Zealand life and general insurance sectors are about to enter into a more focused regulated regime, since the September 2010 Insurance Act replaced the Insurance Act of 1908. The Reserve Bank of New Zealand, the insurance regulator, is currently processing all insurer provisional licence applications, which are required to be in place by 7 March 2012 in order to continue writing new business. Insurers will need to obtain full licences by 7 September 2013. This first-time regulation of the industry is expected to have its challenges, as both the regulator and insurers determine what is required.

**Philippines**

The Philippines insurance market is another market where there is an opportunity for insurers to take advantage of the expected growth in insurance penetration rates.

The top three concerns of Boards of insurers in the Philippines are currently profitability, regulatory compliance, and coverage and penetration, which match concerns in other key growth markets.

Increases in the minimum capital requirements are also expected to drive consolidation in the Philippines insurance market.

**Singapore**

The Monetary Authority of Singapore (MAS) keeps the insurance law and regulations under continuous review, and engages in industry-based consultation as it seeks to apply international regulatory developments and new local requirements in the local market.

The financial crisis provided valuable lessons on corporate governance, including the importance of effective risk-based oversight, monitoring of activities, and remuneration at Board level.
The MAS frequently shares information on regulatory developments in Singapore publicly on its website and at international meetings.

The market is poised for further reform as the MAS seeks to gather more granular information to help it to strengthen macroeconomic surveillance and insurance supervision. This includes the possibility of the implementation of a group supervisory regime, which could have wider impacts for Singapore-based groups or sub-groups.

The financial crisis provided valuable lessons on corporate governance, including the importance of effective risk-based oversight, monitoring of activities, and remuneration at Board level. The MAS’s Corporate Governance Council, established in 2010, has played a part in enhancing regulations in this area.

It is also expected that the MAS will release an ORSA consultation paper in the first half of 2012.

Taiwan
The Taiwanese insurance industry has undergone much change in recent times, and the market is now dominated by domestic participants but is attracting renewed interest from other firms based nearby in the region. Taiwanese insurers are growing their footprint in overseas markets, where we see recent investment in countries including China and Vietnam.

High savings rates in the country are positive for the life insurance industry, although the sector remains constrained by the negative interest spread issues under the sustained low interest rate environment. Life insurers in particular are, like others in the region, challenged in selecting assets with a similar long duration to their liability profiles.

The Taiwanese insurance regulator, the Insurance Bureau (IB), is a member of the IAIS. The IB, like their regional counterparts, has been in the process of studying the current regime with international developments such as Solvency II, FATCA, and IFRS 4 Phase II. The Taiwanese market is also keen to track changes to the US supervisory regime, to which Taiwan’s current RBC system takes reference.

Thailand
Despite the political uncertainty in Thailand over the last 18 months, the total insurance premium is forecasted to grow at over 20 percent in 2011. However, the Thailand floods in the second half of 2011 had a significant financial impact on the non-life insurance industry, with many insurers not meeting the capital requirements of the new Risk Based Capital (RBC) regime, introduced from September 2011. As a result of the floods and the introduction of the RBC regime, it is expected that there will be further capitalisation of the industry and possible consolidation of the 70 non-life insurers in the market. The Thai market has also generated interest from overseas investors.

One of the issues for life insurers is the Asset-Liability Management (ALM) risk charge under the new RBC system, as the limited investment options in Thailand make optimising asset portfolios difficult. As in other markets, we expect that enhancements to risk management regulation (as promulgated by the IAIS) will provide an important guide to regulators in the management of ALM.

Conduct of business is a continuing area of focus for the Office of Insurance Commission (OIC), the Thai insurance regulator, who over the past few years has required greater clarity over product disclosure and introduced agent qualifications and conduct standards. Some insurers may face issues from products sold in the past, particularly relating to the sales practices for non-guaranteed bonus policies.

Vietnam
The Vietnamese insurance industry is in a relatively early stage of development, and projections of future growth remain bullish for both life and non-life insurance sectors. The insurance market continues to generate much inbound interest, with some notable investments made in recent years. These are adding to the increasing talent pool, which insurers are keen to retain to support future profitable growth.

The Ministry of Finance (MoF), Vietnam’s insurance regulator, is a member of the IAIS, and is in due course expected to follow the State Bank of Vietnam (SBV), the banking regulator, which has developed a suite of detailed requirements for the banking sector.
Asia-Pacific regulatory developments – at a glance

The significant ASPAC regulatory developments across risk management and solvency, IFRS, and consumer protection are outlined below:

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<th>Country</th>
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<tr>
<td>Australia</td>
<td>New life and general insurance capital (LAGIC) standards are poised for release, and are proposed to be effective on 1 January 2013. These proposals are widely expected to increase capital requirements, including the option for a Pillar 2 supervisory capital adjustment, and increase the regulatory burden. These proposals will result in the introduction of a Three-Pillar approach to solvency, which is closely aligned with the EU requirements of Solvency II, and in particular include an Internal Capital Adequacy Assessment Process (ICAAP), which is similar to the ORSA as defined in the new IAIS ICP and as being implemented in Europe for example.</td>
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**IFRS/Financial reporting**

IFRS has been required for all private sector reporting entities since 2005 and so the Insurance Contracts Exposure Draft received considerable comment following its issue in July 2010, with comment letters issued by many constituents including APRA, the prudential regulator, and accounting, actuarial, and insurance industry representative bodies. Australian reactions to the Exposure Draft are particularly interesting because Australia is one of the few countries to have formulated its own standards for insurance accounting – whereas IFRS 4 only includes limited improvements to accounting for insurance contracts and disclosure requirements, AASB 1023 for General Insurance and AASB 1038 for life insurance, which address all aspects of the recognition, measurement and disclosure of life insurance contracts. These standards anticipate many of the key features of the Exposure Draft, by requiring a current valuation of both financial instruments and insurance liabilities, with the measurement of insurance liabilities updated at each reporting date – indeed to many Australian commentators certain aspects of the Exposure Draft feel like a step backwards. In our view the Australian market provides one of the best case studies of a ‘current current’ measurement model in practice.

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<td>China</td>
<td>We are anticipating changes to the current regulatory solvency capital standards to a more risk-based approach in the medium-term; the current approach remains similar to a European Solvency I-style volume approach. Regulation in the risk management and ERM arena was enhanced at the end of 2010, where the life and health sector is required to enhance governance of risk and establish a role equivalent to a Chief Risk Officer, and to adopt the quantitative measure of Economic Capital as a key risk management tool to be used within the business. These requirements are consistent with the IAIS ICP on ERM, and include items such as risk appetite and enhanced risk reporting. Similar ERM regulatory change is expected to include the non-life insurance sector in due course.</td>
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**IFRS/Financial reporting**

China’s national standards (New PRC GAAP) are substantially converged with IFRS. Like Australia, China is a country that, in the absence of a consistent international standard for insurance accounting has developed its own national standard.

Chinese insurers experienced a year of significant financial reporting change affecting their 2009 results when the Ministry of Finance, with the cooperation of CIRC, issued a package of pronouncements which substantially overhauled the accounting for insurance contracts, anticipating many of the changes that were expected from Phase II of the IASB’s insurance contracts project.

These changes require amongst other things that insurers: unbundle contracts if the insurance risk component can be separately identified and measured from other components, such as for unit-linked and universal life contracts; measure policy liabilities based on discounted expected future net contractual cash flows on a gross premium valuation basis – which includes a risk margin, plus a residual margin which is released to the income statement over the period of insurance coverage. Measurements are current and updated at each reporting period.

Comments on the IASB’s Exposure Draft largely focused on eliminating differences between the Exposure Draft and new PRC GAAP for insurers, such as challenging the use of a summarised margin approach and the treatment of contracts with Discretionary Participation Features, suggesting that the choice of technique to be used in estimating the risk adjustment should not be limited and proposing, unless impracticable, full retrospective restatement on initial adoption.

**Consumer Protection**

There are signs that relatively strict regulation on product design and pricing may be relaxed. This follows from trials of sales of variable annuities in 2011, and in the motor insurance market where trials of pricing reform of policies have been conducted. There are also plans to open up the compulsory third-party liability motor insurance market to foreign-owned insurers. These proposals may drive greater innovation around product variability and choice – although both the regulator and the market are keeping a close eye on the likely competitive pressures that a relaxation in the pricing controls may trigger.

The bancassurance channel has recently witnessed regulation, including a ban on insurance agents selling insurance policies in bank branches, and restricting the number of insurance partners per branch.
Country

Hong Kong

Regulatory solvency capital and risk management
The topic of RBC is a popular one in Hong Kong, and the market is expecting reform in the management of risk and enhancements to the assessment of solvency capital. The OCI is taking reference to the IAIS ICPs and other overseas developments, and has an aim of aligning Hong Kong with international practice; however, the regulator is keen to stress that implementation of proposed changes will follow only after a market assessment and there is no intention to simply copy from other jurisdictions.

IFRS/Financial reporting
Hong Kong has adopted national standards identical to IFRS, referred to as HKFRS, although in some cases transition arrangements and effective dates differ from IFRS. Close coordination between the Hong Kong Institute of Certified Public Accountants (HKICPA) and the International Accounting Standards Board is important to the success of achieving convergence of HKFRSs with IFRSs. The Council of the HKICPA has aligned the Institute’s due processes, including the timing of issuing exposure drafts, standards and interpretations, as close as possible to the IASB’s processes as a result of its convergence policy. Many of the insurers which operate in Hong Kong are affiliated with regional or global insurance companies and the development of the IASB’s Exposure Draft is being followed closely.

Consumer Protection
Regulatory solvency capital and risk management

Country

India

Regulatory solvency capital and risk management
The IRDA is proposing changes to investment options available to insurance companies, with the aim of improving flexibility in investment decisions. The IRDA’s ERM regulation calls for companies to establish a Risk Management Committee (RMC) with direct access to the Board, and defines a clear Chief Risk Officer role. Board certification was required from 31 March 2011 relating to compliance with the terms of reference of the RMC. Recent proposals to allow insurance firms with ten years’ operational history to raise funds on the equity markets has stirred some interest. The IRDA’s specific nod will be required before a company can proceed with obtaining other listing-related approvals.

IFRS/Financial reporting
Subsequent to the announcement of the proposal by the Institute of Chartered Accountants of India (ICAI) to converge the Indian accounting standards (Indian GAAP) with IFRS effective 1 April 2011, there has been significant debate among the standard setters, regulators, corporate India and professional accounting firms, on the roadmap to convergence, and its implications. India is converging with IFRSs, but at a date to be confirmed. The IRDA generally supports convergence with IFRS and is an active participant in the comment process. As a regulator, however, the IRDA lays strong emphasis on capital adequacy, solvency and risk management and may not necessarily accept all IFRS guidance from a regulatory reporting standpoint.

Consumer Protection
One of the major changes relates to rules on the sales of unit linked insurance plans (ULIPs). These changes were in part aimed at curbing the mis-selling of insurance policies as short-term investment products, which resulted in a decrease in volume of sales but in turn the industry placed a greater focus on cost control, customer focus and alternative distribution channels. Indeed, these changes have brought focus on building new and innovative products.
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<td>Indonesia</td>
<td>The Indonesian regulator is currently studying the newly adopted IAIS ICPs. There is discussion in the market that the regulator may apply enhancements in risk management and investments, although the market is awaiting the next regulatory move. That said, some insurers in the market are seeking to enhance areas such as ERM and are keen to learn from international best practice, ahead of the introduction of any specific regulatory change. Similar to the Philippines, Indonesia has introduced step-change increases in insurer minimum capital requirements, which we understand may result in consolidation in the industry. The increases in minimum capital requirements apply to conventional insurers and reinsurers, and there are separate requirements for Sharia insurers and reinsurers. Indonesia implemented IFRS 4 Phase I on 1 January 2012. Many insurers are implementing significant accounting and system changes in response, although some implementation issues are still being discussed. Overall, the convergence process to IFRS is ongoing, and a decision about a target date for full compliance with IFRS is expected to be made in either late 2012 or in 2013. In the area of customer treatment, we have seen draft regulatory proposals on disclosures and solvency related measurement. In addition, a new set of ‘Know Your Customer’ regulation has been issued.</td>
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<td>Japan</td>
<td>In terms of risk and capital, the JFSA plans to introduce new regulation in a similar vein to the EU’s Solvency II regime. The JFSA conducted a quantitative impact study (QIS) field-test two years ago, and is currently analysing the results and developing a more sophisticated version. Some Japanese insurers continue to actively track and research European solvency regulatory reform, including taking the step of communicating their views to the JFSA to feedback on local development. The Japanese government has said it is keen to learn from international best practice, including taking the step of communicating their views to the JFSA to feedback on local development. Japanese companies currently report under Japanese GAAP and before the announced delay a road map was put in place by the Japanese Financial Services Agency (FSA) that would have led to a decision in 2012 as to whether it would become mandatory for Japanese public companies to report under IFRS in 2015 or 2016. The government and the FSA have now abandoned the mandatory adoption for fiscal 2015 and are yet to make a final decision on whether or not to adopt IFRS. The FSA also said that in the event Japan decides to require IFRS there will be a transition period of five to seven years prior to mandatory adoption in order to allow companies sufficient time to prepare for a new reporting standard. According to Japanese news reports, the government is said to be keeping a close eye on the pending US decision whether or not to adopt IFRS and that it will make any further decisions over IFRS adoption on the back of the path the US decides to take. The Exposure Draft was issued prior to the announced delay and so received considerable comment from Japanese insurers, regulators and standard setters in particular focusing on the short-term fluctuations in profit or loss if the Exposure draft were to be adopted as a standard. In addition to these uncertainties, Japanese insurers were particularly concerned about harmonising accounting changes with other regulatory changes, particularly in the risk arena. The treatment of individual’s information is under strict regulation in Japan, where financial institutions are keen to maintain a close eye on this sensitive matter. Regulation in terms of claim and benefit payment is also strict in Japan, where (for example) we have seen regulatory action taken in recent years in response to certain ‘rider’ benefit claims that were not automatically paid by insurers.</td>
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<td>Korea</td>
<td>In the area of risk-based supervision, the FSS regime consists of a combination of components across three pillars. This includes RBC, the Risk Assessment and Application System (RAAS) and Risk Disclosure. The RBC regime was introduced in 2009, and there are current efforts in place to enhance the internal assessment of risk by encouraging the development of internal economic capital models, including regulatory model qualification and approval standards. These enhancements are in line with elements of the newly adopted IAIS ICPS on internal models. Future enhancements of RBC and the internal model are anticipated to be similar to the EU Solvency II standards.</td>
<td>Insurers, in common with other financial institutions and state-owned institutions, have been required to adopt IFRS from 2011. Interestingly, the MASB’s Exposure Draft was the subject of detailed comments from, amongst others, the Korea Accounting Standards Board and the Korea Accounting Institute, reflecting comments from a number of interested parties including the Financial Supervisory Service, and the Institute of Actuaries of Korea. Amongst comments raised was the need to maintain a consistent principle governing the discount rates to be applied in various international standards such as IFRS4 and IAS 19 on employee benefits, concerns about the increased volatility in insurers’ reported results, and the need for more detailed implementation guidance to aid comparability between insurers.</td>
<td>A FSS speaker at the recent 2011 IAIS annual conference hinted that, in the area of customer treatment, and with even more complex insurance products being developed, regulators should take care that customers retain the ability to make fully informed decisions. This points towards possible regulatory development ahead in Korea.</td>
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<td>Malaysia</td>
<td>Malaysia introduced an RBC regime for conventional insurers in 2009, and is planning on expanding this for Takaful operators in one to two years time. While maintaining an awareness of international regulatory developments in these areas, BNM retains a close eye on assessing the impact of new regulations in the local market, bearing in mind (amongst other factors) the state of readiness of local players. The industry awaits further announcements on risk and capital regulatory developments in due course. Regulation on insurance insolvencies was established in 2011, which is administered by an independent statutory body, Perbadanan Insurans Deposito Malaysia (PIDM), which was established under the Malaysia Deposit Insurance Corporation Act 2011.</td>
<td>During 2011 the Malaysian Accounting Standards Board (MASB) achieved a significant milestone, issuing a new MASB approved accounting framework, the Malaysian Financial Reporting Standards (MFRS Framework) in conjunction with the Board’s plan to converge with International Financial Reporting Standards (IFRSs) in 2012. The MFRS Framework is a fully IFRS-compliant framework and equivalent to IFRSs. Since convergence with IFRS was announced in 2008, various initiatives have been done to instil awareness amongst numerous stakeholders and other affected parties. Interestingly issues raised by the MASB in commenting on the IASB Exposure draft were the potential difficulty in determining reliable discount rates for long duration insurance contracts given the lack of long-dated risk free assets in certain markets and the potentially onerous nature of the disclosure provisions of the Exposure Draft. Reflecting important features of the local financial services market in December 2011 the MASB has issued discussion papers on the accounting implications of Takaful, Sukuk and Shariah-compliant profit sharing contracts. IFRS for takaful operators remains a relatively unknown quantity and there is much discussion as to what the Phase II proposals might mean for Takaful operators.</td>
<td>On the conduct of business side, a Takaful operational framework was issued in 2011 to govern matters such as product design and operational processes in this expanding sector. We also note proposals to relax regulation on the pricing of the motor insurance market in a step-by-step approach, which may drive further product innovation and diversity.</td>
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<td>New Zealand</td>
<td>In particular there is expected to be a more focused and frequent compliance process with enhanced solvency standards, and as a member of the IAIS the New Zealand regulator will not doubt be monitoring ICP requirements in this regard. Furthermore, the solvency standards are based on NZ IFRS4, and so any changes in the insurance accounting standards will require a re-think on solvency standards. Following new tax legislation that was introduced in July 2010, and in particular relating to tax liabilities rather than tax losses that the changes effect, life insurers are monitoring lapse rates and the</td>
<td>Sustainability of their profit margins. The Insurance Act of 2010 will require life insurers to establish statutory funds for their policyholders, where such funds do not yet exist.</td>
<td>New Zealand’s privacy and fair trade legislation was supplemented with additional Financial Adviser legislation in July 2011.</td>
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### Philippines

**Country**
Philippines

**Regulatory solvency capital and risk management**
A key market challenge at present is in managing the change of regulatory increases in required minimum capital and net worth, which are set in the context of an evolving RBC system. These changes may result in further consolidation in the industry, particularly for those companies facing mandatory capital increases.

As a member of the IAIS, the Philippine regulator will be aware of the new IAIS ICPs, which (for example) would require significant enhancements in the application and embedding of risk and capital management within insurers’ management business decision-making frameworks.

**IFRS/Financial reporting**
The Philippines has adopted IFRSs as Philippine Financial Reporting Standards with some transitional reliefs.

The Philippines Financial Reporting Standards Council monitors the technical activities of the IASB and invites comments on exposure drafts of proposed IFRSs as these are issued by the IASB, including the IASB Exposure Draft on Insurance Contracts.

**Consumer Protection**
On the customer treatment front, the Philippines is continuing with ongoing measures to amend the existing Insurance Code, which focuses on the growth of the Philippine Insurance industry and seeks to ensure a fair and equitable treatment of customers. The country already possesses a security fund mechanism, the purpose of which is to pay valid claims relating to insolvent insurance companies.

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### Singapore

**Country**
Singapore

**Regulatory solvency capital and risk management**
In particular in the risk and capital arena, the MAS is likely to supplement its existing risk management guidelines on core insurance activities with additional guidelines on ERM, based on a review of the IAIS ICPs and other overseas endeavours such as Solvency II. This may be of particular interest for groups operating out of Singapore, where the ICPs include provisions for group-wide frameworks, which could potentially widen the scope of impact beyond Singapore’s shores. The MAS has also strengthened insurer stress testing requirements as a key risk management tool, with requirements at senior management and Board level, having extended these requirements from life insurers to cover general insurers. An ORSA consultation paper is expected to be released in the first half of 2012.

**IFRS/Financial reporting**
The Accounting Standards Council of Singapore (ASC) adopts new International Financial Reporting Standards (IFRS). This usually occurs at about the same time. It consults locally and takes into account the local economic and business circumstances and context as soon as an exposure draft is issued.

The joint response of the ASC and the Institute of Certified Public Accountants of Singapore on the IASB Exposure Draft on insurance contracts highlighted a number of application challenges and the need for application guidance to amplify principle-based requirements in order to achieve the IASB’s objective of enhanced comparability between insurers.

Currently, the only significant IFRS of relevance to insurers not yet adopted in Singapore as an SFRS is IFRS 9 Financial Instruments, which is the same as the position in the European Union.

Singapore’s statutory accounting practices are generally in line with SFRS, with some significant differences. All properties and financial investments have to be carried at fair value and all non-life insurance liabilities are discounted at risk-free discount rates, with a risk adjustment (provision for adverse deviation) to achieve at least a 75 percent probability of sufficiency for each line of non-life insurance business.

Life insurance liabilities are accounted for using prescribed methods developed by the insurance regulators, with the result that life insurance liabilities are valued in a fairly consistent way across the life insurance industry.

**Consumer Protection**
Relating to customer treatment regulation, a notable change is the recent enhancements to the Policy Owner’s Protection Scheme, which provides compensation to insurance policy owners in the event of the default of a registered insurer. The MAS has also recently extended its focus on technology risk management and outsourcing, plus further strengthening of core investment requirements including safeguards to enhance investor protection.
### Vietnam

**Country**

**Regulatory solvency capital and risk management**

The IB has announced that they will gradually adopt the IAIS ICPs. This follows recent developments in regulation in the risk and capital arena, where the IB has enhanced the ERM regime in recent years. In October 2011, additional internal governance requirements were implemented. The IB also encourages companies to build economic capital models, and a system of stress and scenario tests is expected to be enhanced.

**IFRS/Financial reporting**

The IASB Exposure Draft sets out at some length the size and characteristics of the life insurance market in Taiwan, with total assets of NTD 10.81 trillion at the end of 2009. In contrast, the bond market in Taiwan was only some NTD 6 trillion at the end of 2009, with the government accounting for two thirds of bond issuance. Only 21 percent of bonds have maturities of 10 years or over. In addition to difficulties in matching the duration of their liabilities, in the current low interest rate environment, insurers face severe challenges from negative spreads on the guarantees which have proved so popular with customers. As a result, insurers in Taiwan have very serious concerns over the implementation of Phase II in the current low interest rate environment, particularly in the event of ‘big bang’ adoption. As well as the financial impact insurers are concerned that they will no longer be able to offer long duration products to their customers. Alternative proposals include retaining Phase I with the addition of a liability adequacy test.

### Thailand

**Country**

**Regulatory solvency capital and risk management**

The Risk Based Capital regimes became effective on 1 September 2011 with the first returns, as at 30 September 2011, being submitted by insurers at the end of December 2011. Due to the significant impact of the floods, some relief has been provided on the risk charges for flood related assets and liabilities for a period of approximately one year. No changes are expected to the framework until 2015, when we understand that the OIC will reconsider the risk charges and consider enhancements, particularly focused on stress testing and operational risk.

**IFRS/Financial reporting**

The Thai accounting framework is slowly moving to IFRS, with the major pending standards being IAS 39/IFRS 9, IAS 12 and IFRS 4 Phase I. We understand that IFRS4 Phase I will become effective in 2013. Although it is not intended to introduce IFRS 9 until 2016, as an interim measure the Federation of Accounting (FAP) will have available a version of IAS 39 which can be voluntarily adopted by all entities except banks.

### Taiwan

**Country**

**Regulatory solvency capital and risk management**

The Financial Supervisory Commission of Taiwan announced its roadmap for full adoption of IFRS in Taiwan, adopting a two phase approach, with insurance companies in the first wave, required to adopt IFRS starting in 2013. The response of the Life Insurance Association of the Republic of China on the IASB Exposure Draft sets out at

**IFRS/Financial reporting**

Over the last 2–3 years, the focus of the OIC has been on non-agency distribution channels, such as telemarketing, direct marketing and the use of mobile phones. Guidance issued by the OIC are quite prescriptive, such as specifying the script for telemarketing.

**Consumer Protection**

The IB has placed more emphasis on customer treatment issues in the recent past. This has included reform in companies engaged in telemarketing aimed at safeguarding the interests of consumers, the Personal Information Protection Act which spells out requirements on the collection, processing or use of personal information, and the Financial Consumers Protection Act which aims at protecting customers’ interests including in the resolution of disputes.
Evolving global solvency developments: beyond compliance, towards value creation

Around the world, many jurisdictions are beginning to reform their insurance requirements, providing insurers with a unique window of opportunity in which to transform their risk management and finance operations. Insurance risk management has historically focused on value protection, specifically reducing the incidence and severity of losses, lowering maintenance costs and informing investment and underwriting decisions. While these remain critical considerations, a forward-looking value creation approach is emerging. This more efficient and cost effective approach goes further to support business strategy and improve decision-making through enhanced information quality and understanding. Crucial in the current environment, this new approach can result in more optimal utilisation of capital.
Risk management: the value challenge

Over the last few years, the broader financial services industry has been focused on myriad issues and concerns, as the world attempts to come to terms with the economic crisis of 2007–2008, its immediate repercussions and the deepening crisis currently being experienced. The ability to determine which industries, services, or even products might offer safety and security is increasingly uncertain. As a result, investors are demanding much more certainty to win their investment allocation than was previously the case. It is therefore likely that insurers will not be able to rest on their compliance laurels, but rather be driven to look forward to the medium to longer-term, beyond compliance and drive value enhancing initiatives. As markets increasingly demand value creation in addition to regulatory compliance, insurers will need to build on their Solvency II programmes to optimise business performance and facilitate competitive advantage.

Solvency II in Europe provides a good case study of the progressive transformation that is beginning to emerge in risk and finance operations. The key lessons to be learned from the Solvency II experience will particularly benefit those insurers about to experience regulatory change in their home markets.

Two years ago, insurers began in earnest to set out their Solvency II implementation programmes against the original timeframe of 1 January 2013, considered stretching by many insurers and resulting in the scrapping of programmes to achieve ‘compliance’ or ‘compliance plus’ at best. The subsequent delay of a further year to the implementation deadline presents an opportunity for insurers to reassess what additional benefits could be driven from Solvency II developments, based on current implementation plans.

Solvency II requires the European insurance industry to change significantly. It has stipulated:

- The use of sophisticated risk and capital models in setting capital requirements and supporting decision-making
- High minimum standards in respect of governance structures, internal control, policies and data quality
- Transparency in approach and insight into an insurer’s solvency health through detailed public disclosure and private reporting to the regulator

In the UK alone, in excess of £2bn has already been spent by the insurance industry to prepare for these changes, designed to make companies more secure for policyholders and also reduce the potential systemic risk to the economy. However, in itself, the investment made by any individual organisation to meet these new regulations does not guarantee long-term survival; no matter how intelligent the build of an internal model may be, or how complex the assessment and measurement of risk, long-term commercial success will likely come to those that best adapt to the broader change of operating in a Solvency II environment, using this as a platform to seek competitive advantage and optimise their approach across all areas of the business.

Our recent Solvency II benchmarking survey (Checking the temperature of risk maturity – October 2011) illustrated that for the majority of insurers, consideration of the strategic impact of Solvency II is still very much in its early stages. Where this has been considered, focus has generally been on generating capital efficiencies through changes in legal entity structures or changing capital allocations and types to best fit the profile of the current business model. We expect to see this focus shift imminently to a more forward-looking perspective to consider the way the business is operated more holistically, from end to end.

Most commentary to date around Solvency II optimisation has focused on the minimisation of capital requirements. While this is a critical area of focus, we see capital optimisation as a much more relevant goal, taking into account what the leading insurers of the future need to look and act like and what needs to be done by these insurers to develop from their current state of compliance to become the natural selection of investors in the future. Two key areas requiring particular attention are the finance function and risk management.

Finance operations

Finance processes for insurers, particularly in the life sector, have historically been convoluted. There are large volumes of complex policy data sets, processed across multiple systems and platforms which were typically built pre-2000. These systems generally lack flexibility and do not facilitate the provision of information at the level of granularity required by finance to deliver insightful decision supporting management information across the required reporting bases. Typically, accounting and actuarial teams have operated in silos, with the accounting teams having little involvement in the calculation of technical liabilities, and the actuaries being subject to limited challenge, often as a result leading the development of [Solvency II] systems and processes. More often than not, new requirements have been met by new ‘workarounds’.

As markets increasingly demand value creation in addition to regulatory compliance, insurers will need to build on their Solvency platforms to optimise business performance and facilitate competitive advantage.
A flexible and open risk management ‘system’ forms the basis of a leaner risk operating model, reducing duplication of effort and inefficiencies.

Solvency II implementation challenges for finance functions need be set against this background. As Solvency II is a regulatory requirement, there is little flexibility in a number of key areas that traditionally present difficulties to insurers:

- Disclosures: Under Pillar 3 insurers will need to provide granular detail in all areas of the balance sheet and P&L attribution that is robust enough to bear regulatory scrutiny, including to some extent external audit
- Timetable: Quantitative Reporting Templates (QRTs) will be required within 6 weeks. An annual return will be required within 3 months, and the more sophisticated internal model calculations within 6 months
- Data: Data in scope for reporting must be ‘complete, accurate and appropriate’ and there must be complete traceability from reporting back to underlying data

We expect Solvency II to drive the finance focus of market leaders to shift away from a model where understanding historical numbers, challenging their quality and drawing out implications for the business going forward is the norm and takes 90 percent of finance time, to a model based on a dashboard of performance orientated metrics, supported by a single version of robust data, delivered by a team that invests the majority of its time in providing insight to inform business critical decisions.

To achieve this, we anticipate organisations will move towards a risk and finance Centre of Excellence model – high quality, business-focused professionals drawn from finance, actuarial and risk, forming a single, cohesive team functioning at the core of the business, seen as a key driver of value. A single source of data supports the analysis provided by this team, at a level of granularity that can be mined and presented as required. This data will then feed an integrated finance, actuarial and risk system. Key performance indicators (KPIs) will be redefined to focus on the metrics that matter most to stakeholders post Solvency II implementation, cutting through the raft of new granular information being released into the public domain as a result of the Solvency and Financial Condition Report (SFCR). The Board will have greater transparency on key performance drivers against these metrics through a suite of relevant, reliable and comprehensive Management Information (MI). The period end close process will become a largely automated affair, built into a comprehensive risk and control framework.

Some insurers have attempted to reflect this finance ambition to varying degrees in their Solvency II plans, while others are now considering what elements of this could be achieved either in the additional implementation year or in the medium-term. Those able to deliver this valuable finance focus will have a clear information advantage over competitors who will be left trying to piece together the historical numbers for reporting purposes.

Risk management
In essence, risk under Solvency II focuses on:
- Greater quantification and understanding of risk pricing
- Greater understanding of the internal management of risks and their impact on the decision-making process
- Greater transparency of risk information

For many, risk is still very much the domain of the few in the organisation who really understand its nuances and complexities. With risk and capital being central to management’s deliberations, optimised risk management can contribute directly to more intelligent risk-taking and general improvement in efficiency and effectiveness. For instance, more efficient use of capital and effective capital allocation (or lower capital requirements) can result directly from greater understanding and quantification of risk. Margins may also benefit from enhanced investment and underwriting results, an improved reinsurance structure and the identification of cost control opportunities.

A flexible and open risk management ‘system’ (RMS – overall risk framework) forms the basis of a leaner risk operating model, reducing duplication of effort and inefficiencies. A flexible and scalable system is also more likely to be adaptive to environmental changes and enable the organisation to remain ahead of competitors and to represent leading practice in the eyes of key stakeholders.

Those who can look to the longer term will drive real competitive advantage through the effective embedding of a transparent and persuasive risk culture throughout the decision-making process. The benefits of a comprehensive risk management framework will be achieved by those who not only fully understand the risks facing the business at present, but also what risks they may face in the future.

If business strategy can be matched to capital strategy, and also to the risk profile of the organisation, this will enable the more accurate prediction of cash-flow variations. Potential issues may then be more effectively planned for and, where possible, mitigated.

Where risk management disciplines are well aligned to business strategy, capital planning and product development processes, there will be a better understanding of the incremental
profit of each product line or business unit at a more granular level which may drive a much more complete understanding of the Risk Adjusted Return on Capital, facilitating the allocation of available capital towards the most strategically important and profitable products and businesses. This will generate a real improvement in shareholder value.

**Implications for firms**

- Optimal risk and finance structures have clear benefits for performance results, such as higher returns from risk-adjusted capital, improved capital allocation and an optimised business mix, distribution channels, customer segmentation and product development based on higher quality risk and value data.
- Superior management information can also be derived from a better understanding of risk-adjusted returns across lines of business and investment alternatives, as well as a clearer view of value drivers and destroyers.
- Prior to investing in the risk management system, management should undertake a diagnostic analysis in order to align risk management with the organisation’s strategic goals and the business model to identify opportunities for value creation.
- Specifically, it should consider efficiency, effectiveness and embeddedness. CROs and CFOs need to be fluent in articulating the value the RMS and finance systems add, not just protect.
- Firms should invest in achieving optimal outcomes. Compliance alone will not deliver benefits sought.

An effective RMS typically has the following key features:

- **Risk strategy and vision**: Long-term plan of how risk management effectively supports the achievement of the organisation’s goals.
- **Capital management**: Processes, procedures and systems for understanding the impact of risk on the organisation’s capital and utilising this information in its decision-making.
- **Risk appetite**: Articulation of the organisation’s tolerance for risk-taking to achieve its commercial objectives.
- **Risk governance**: Structure within which responsibility and accountability for risk management and oversight is defined and communicated throughout an organisation.
- **Risk operating model**: Structure within which risk management is delivered across the organisation, typically defined as three Lines of Defence.
- **Risk methodology**: Processes, procedures and systems for identifying, measuring, monitoring, managing and reporting risk.
- **Risk data, MI and reporting**: Information and associated storage and delivery mechanisms which provide management with a view of the organisation’s risks and how these are being managed.
- **Risk training and communications**: Processes by which the risk capability, understanding and awareness of the organisation’s people is developed and maintained.
- **Risk culture**: Embedded risk behaviours of the organisation.
- **Effectiveness review**: Internal processes by which the Board derives assurance that the framework is effective.
- **ORSA**: Forward-looking self-assessment of the organisation’s risks, capital requirements and capital adequacy.
The Americas as a region is undergoing its own structural reform of insurance solvency requirements. Countries within the region are setting or revising their own regulatory standards and are adopting timelines for implementation. Like the European experience of Solvency II, many of these regulations are yet to be written and adopted. This leaves the industry with a degree of uncertainty concerning steps to be taken towards implementation, what compliance looks like and the expected implementation time frames.

Prudential Regulation: The impact of Solvency Reform on the Americas
A key building block for many of these revised standards is the recently adopted IAIS Insurance Core Principles as set in October 2011. Throughout the region, requirements such as the ORSA process are new to countries, regulators and companies alike. At a time when many companies are faced with financial pressures from the wider economic environment, additional regulatory requirements are presenting a challenge to organisations, particularly when the requirements and benefits are not always clearly defined.

Consumer protection: The impact of reform on the Americas
Throughout the Americas there are differing regimes for market conduct – at the federal, state, or provincial level. In the more developed markets, consumer protection is high on the list of regulatory priorities and there have been a number of examples where regulators have been intrusive in putting right market conduct failures. The costs of such remediation have run into hundreds of millions of US dollars.

Americas regulatory developments – country focus
The following provides an update of key regulatory and market developments within the Americas region, followed by a summary table of the main risk management and solvency, IFRS and consumer protection activities within each market.

Argentina
The Argentine Insurance Regulator (SSN) is the body responsible for regulating insurance activity in Argentina, through the issuance of technical, accounting and administrative standards. This body has not yet issued any standards in relation to the notion of solvency, as it is understood in the international market. It has, however, set some requirements in relation to minimum capital and internal controls for accounting purposes.

The regulator has issued some internal control standards, whereby insurance companies are required to appoint an individual responsible for internal controls and an internal control committee aimed at monitoring the company’s internal controls on an ongoing basis. Insurance companies are also required to develop an annual internal control plan, to be approved by the Board of Directors, and issue regular reports on the observations arising from the internal process review. In addition, the provisions require insurance companies to have written and documented standards and procedures in place.

The Argentine insurance market is still highly fragmented and, as a result, the SSN does not grant any new licenses. The only way to access the domestic market is through the acquisition of shares of stock of an existing corporation (either in whole or in part) or a company under a run-off (which is technically inactive and has been duly granted a license that has been temporarily suspended).

Further reforms in the region include insurance companies in the domestic market being banned from placing reinsurance in foreign companies, except for some specific cases and with the prior authorisation from the Insurance Regulator. This new standard was adopted in September 2011,
but because of transition arrangements the new standard will not have full impact until June 2012. As a consequence, some foreign reinsurance companies are establishing operations in Argentina.

In October 2011, the Argentine Insurance Regulator surprised the domestic market again by introducing a new standard, where Argentine reinsurance companies are not allowed to place funds or make investments abroad, except for some specific cases and with the prior authorisation from the Insurance Regulator. In addition, it granted a 50-day term to repatriate the funds invested abroad. Until then, reinsurance companies were allowed to place all or part of their funds and make investments in foreign entities and instruments, although upon making certain technical calculations (such as minimum capital requirements and coverage of debts with insurance and reinsurance companies), they might only compute the related amount up to the limit set by the standards in force. This new resolution is in line with the Argentine government’s decision that it be again obligatory to settle and negotiate in the exchange market all foreign currency derived from the export of crude oil and its by-products, gas and mining operations. Furthermore, this new resolution will allow the insurance market in general to absorb a higher portion of both current and future public debt.

Bermuda

Both the Bermuda government and the Bermuda Monetary Authority (BMA) have a longstanding objective of maintaining Bermuda’s position as a leading financial service jurisdiction, with regulation at the forefront of international best practice. Bermuda’s insurance sector is unique, with two distinct elements – 1) the third largest reinsurance centre in the world, home to many internationally recognised insurance and reinsurance franchises; and 2) the leading captive domicile with over 60 years of history. These two market segments present very different regulatory risk profiles, a fact recognised by the BMA.

To date, the development of Bermuda’s regulatory framework has been focused largely on the commercial property casualty insurance sector (Class 3A, 3B and 4) with similar changes to be rolled out into the commercial life sector in 2012. Changes have been made to capital (Pillar 1) requirements, with risk-based capital measures (standard models and own models) and quality of capital tiers (eligible capital) introduced. Risk management and corporate governance enhancements (Pillar 2) have also been established through the introduction of a Code of Conduct, Own Risk Solvency Assessment (ORSA), risk returns and stress testing. Disclosure requirements (Pillar 3) continue to develop, with the introduction of additional regulatory filings as well as public financial statements – and there is still more to come. In addition, a group wide supervisory regime is in place and further development of the group supervisory regime will continue through 2012.

Although there are currently no proposals to change capital requirements, annual reporting requirements will be enhanced. This will be facilitated by an electronic filing process which will enable an efficient response from the market. This improved regulatory filing is designed to capture all reporting requirements for the sector in a single return. It includes:
The audited statutory financial statements (as currently required); supplemental unaudited financial data including investment, underwriting, reserving and collateral information (currently largely provided through an annual survey)
• A qualitative risk self-assessment
• A confirmation of compliance with other aspects of the license, including changes to controllers and the ability to continue to operate at current capital levels

This return has been constructed recognising the principles of a 3 pillar regime and is designed to enable the BMA to execute supervision in an effective and risk-focused way.

Brazil
In 2006, the National Council of Private Insurance (CNSP) introduced rules aligned to the risk-based capital framework. Minimum capital standards were established for insurers, composed of minimum capital, which should be met upon request for authorisation to operate. This minimum capital requirement is comprised for a Base Capital (BC) plus a variable amount called Additional Capital (AC).

Historically, calculation formulas have been regulated for the coverage of the insured against underwriting and credit risks. Insurance companies should at all times maintain a solvency requirement equal to or higher than the higher value between the Minimum Capital Requirement (MCR) and Solvency Margin (SM). Insurance companies have been encouraged to develop internal models for the measurement of amounts required to cover the insured against the various risk factors. The presentation of internal models, however, enables just the use of impairment factors to the amounts required, and they are not taken into account in the determination of Additional Capital (AC).

In the more developed markets, consumer protection is high on the list of regulatory priorities and there have been a number of examples where regulators have been intrusive in putting right market conduct failures. The costs of such remediation have run into hundreds of millions of US Dollars.

Canada
Canadian insurance solvency regulation has been following a path of evolution, rather than revolution. Canadian financial institutions survived the ongoing economic upheavals that began in 2008 without requiring government rescues, and Canadian regulators have been able to take a measured approach to regulatory change.

The Canadian regulatory framework for insurers already has many elements in common with those of Pillars 1, 2 and 3 of Solvency II. Even though Canada is not actively seeking ‘equivalence’, the federal regulator (OSFI) and provincial regulatory authorities have been active contributors to the IAIS and other global regulatory forums, and some of the terminology of Solvency II is appearing in regulatory communications and discussion papers. Some aspects, such as allowing greater use of an insurer’s own capital model for regulatory purposes, are likely to be slower in coming. This reflects both regulator and user caution about the reliability of complex models and the anticipation of significant measurement changes with the eventual introduction of the ‘phase 2’ IFRS insurance accounting standard.

In Canada, insurance market conduct requirements continue to be set and supervised by provincial governments. As a result, there continue to be differences between provinces which must be monitored and complied with by insurers. Personal automobile insurance continues to be a ‘hot button’ issue, with considerable attention from politicians on issues such as affordability, and possible discriminatory approaches to premium rates. Nevertheless no sweeping changes have been imposed by government or the courts, such as the UK’s ‘treating customers fairly’ initiatives, or the EU prohibition on using gender as a basis for determining premium rates.

Legislative and regulatory restrictions are also shaping the competitive environment. For example, while banks and other federally chartered deposit-taking institutions may own insurance underwriting subsidiaries, regulatory constraints have largely prevented them from using their branch networks to sell insurance, or from using their customer bases for direct marketing and cross-selling. Since Canadian federal laws regarding financial services are reviewed every five years, the banking sector will no doubt continue to challenge these and other restrictions in future reviews.

Insurance distribution is also impacted by Canada’s geography and regional differences. Independent agents remain a significant factor, particularly in non-life insurance. In fact, their marketplace leverage means that many insurers are reluctant to pursue alternate distribution channels, for fear of offending key agents who might move their business. Independent agents have also been very influential, along with the insurers themselves, in opposing insurance sales through bank branches.
Nevertheless, as methods and technology have improved, direct distribution channels such as affinity groups, call centres and the internet have made significant gains in market share. Consumers’ increased comfort with using self-service channels to research and purchase insurance products is a noteworthy trend. So far, regulators have not acted to increase restrictions on these methods, except to prevent banks from using the internet to circumvent restrictions on the use of their bank branches for the sale of insurance.

Chile
The Superintendencia de Valores y Seguros (SVS) has been improving the regulatory environment in Chile by adopting the International Financial Reporting Standards (IFRS); implementing the Risk-Based Supervision Model, which considers specific corporate governance standards for the insurance market and the best practices adopted internationally.

Changes in the regulatory framework are mainly focused on solvency. The goal is for insurers to have sufficient financial resources to meet their obligations and improve market behaviour, in order to protect the rights of policyholders. It also considers aspects such as fairness and transparency in the trade of insurance products and settlement and payment of obligations.

The SVS began the Solvency evaluation and design process in 2003; however, the implementation is expected to begin formally in the insurance market during 2012. The draft of the Law creates two foundations. One relates to the basic regulatory level with minimum solvency and capital requirements. The other relates to the complementary oversight level based on the principles or best practices of corporate governance and risk management. These two pillars are complemented by the market discipline of transparency and disclosures. Further amendments include:

- **Specific requirements to improve corporate governance, including higher requirements for accountability by the Board within the Company’s definition of risk management policies**
- **Creation of a register of external audit firms that can provide audit services to insurers**
- **Requirements for authorising existence and transfer of share ownership by insurance companies**

**Grand Cayman**
As at 30 November 2011, the Cayman Islands was home to 28 domestic insurance companies – 731 captives and 1 reinsurer. (The latter two categories representing gross premiums and assets under management of US$9.6bn and US$58.3bn, respectively.)

Over the course of 2010, the Cayman Islands Monetary Authority (CIMA) approved 31 new captive licenses, with 10 more in the pipeline, representing a 93 percent increase in captive license applications year-on-year. With the impending passage of regulations to support the new Law, these numbers only look set to increase.

In September 2010, the Cayman Islands Government passed Insurance Law 2010 (the ‘Law’). Designed not only to bring the jurisdiction’s domestic and reinsurance markets up to the highest international regulatory standards, the new Law is also business-friendly and includes a range of measures to support the growth and development of the international insurance and reinsurance markets in Cayman.

Developed in consultation with the private sector and following a comprehensive review of the existing legislation (Insurance Law, 2008 Revision), the new Law includes provisions to address global regulatory initiatives like Solvency II and aspects of the Dodd-Frank Act. It also seeks to address several recommendations made by the International Monetary Fund following a March 2009 assessment, including:

- **Adopting a risk-based approach to supervision**
- **Developing more effective tools to diagnose and monitor riskier licensees**
- **Further strengthening of the regulatory relationships with other regulators**
- **Developing appropriate capital and solvency requirements**

While Government efforts to finalise the insurance regulations underpinning Insurance Law 2010 are still ongoing, these regulations are now in the stage of final public consultation, so market participants are hopeful that their passage will soon be forthcoming.

Not only do they create new regulations regarding reinsurance companies (which may even include immigration incentives like 10-year working permits and a faster work permit application process), but they also implement prescriptive capital and solvency requirements for 3rd party writers (Cayman has opted out of a Solvency II equivalent framework) and updated reporting and application forms.

**Mexico**
In 2008, the Mexican Insurance regulator set up a project to reform the Insurance and Surety Bonds Law (ISBL), which will change the way in which institutions manage their businesses.
Timeline for regulatory implementation – Mexico

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The most recent anticipated timeline for adoption in Mexico is detailed in the diagram above. However, given the very recent legislative developments, these timescales are likely to be delayed further.

During the last three years, the Mexican insurance industry has been working to establish a regulatory framework similar to the European Solvency II approach.

This framework is not yet fully defined. Important components are missing, such as a standard model to determine the solvency capital requirement and the definition of the standards to build a solvency balance sheet. The analysis and regulatory consultation has however been performed. Moreover, some insurers have undertaken gap analysis projects based on a draft of ISB rules and have taken into account the principles established by the European framework for the undefined items.

Governance requirements in the region focus on the establishment of policies, standards and assessments related to risk management, internal control and actuarial functions and proper requirements of individuals.

The ultimate intention is to deliver a ‘three lines of defense’ model where the first line of defense would be the business unit, followed by internal control and ultimately internal audit. It is anticipated that a stronger system of governance, will facilitate a robust implementation of the various solvency components.

Peru

In light of international solvency developments, the Superintendent of insurance companies established the Basel 2 Special Committee – Solvency II. The aim is, within the context of the Peruvian insurance market, to evaluate the proposed solvency models, undertake an impact assessment on the market and better understand the regulatory framework that will be applied to align regulation and supervision to the best international practices and trends.

Currently the supervision of insurance companies is performed through a risk-based approach (market, technical and reinsurance). Particular attention is given to asset requirements and technical obligations.

Standards have been approved for contracting and managing reinsurance including a maximum limit for retaining general risks based on the regulatory net worth of the company. These standards also seek to understand unacceptable exposures and risks. The insurer’s reinsurance plan must be submitted to the Superintendent on an annual basis.

In order to adapt the regulatory framework to international standards, the regulations related to the Consolidated Supervision of Financial and Combined Conglomerates were updated, which helped improve the oversight of concentration limits for the consolidated group.

Additionally, a new regulation was approved for the rating of insurance companies to refine the rating process of supervised companies, implementing mechanisms that promote a level of independence between these firms and risk rating companies.
The state-by-state practice of insurance regulation in the US means that state insurance departments cover both prudential and market conduct regulations, which includes consumer protection. This allows for a holistic approach to insurance regulation and a full cycle of oversight.

United States
The state-by-state practice of insurance regulation in the United States means that state insurance departments cover both prudential and market conduct regulations, which includes consumer protection. This allows for a holistic approach to insurance regulation and a full cycle of oversight from product development, to management of the product throughout the life cycle, through to product maturity.

The US is going through its own regulatory reform. The Dodd-Frank Act established two key bodies within the areas of insurance regulation and consumer protection – the Federal Insurance Office (FIO) and the Consumer Financial Protection Bureau (CFPB). The FIO is not a rulemaking body, and at this stage has no powers to oversee the insurance industry in the US. It is, however, becoming more active internationally. It is a member of the IAIS and has started to enter the various international debates surrounding solvency reform, including Solvency II. Importantly, the FIO has been tasked with performing a study of the US insurance industry. This report was due at the end of January 2012, but has been delayed by a number of weeks. It is expected that the report will highlight areas of improvement for the industry. This will bring yet further regulatory change. The CFPB is investment and banking focused and currently has limited authority over insurance activities. As a consequence of recent reforms, market conduct and prudential standards remains the domain of state regulators. However, as this new body becomes established it will become clearer as to how the insurance industry may or may not become impacted, either directly or indirectly.

Insurance product sales within the US are made directly with the insurance company or through insurance producers. Insurance companies are licensed within the states they operate and for the products that they sell. Products must be filed within a state. Given the state-by-state regulatory model, the National Association of Insurance Commissioners (NAIC) seeks to harmonise the potentially fragmented system by producing model laws and guidance that could be adopted within each state. An accreditation process exists, which seeks to encourage states to adopt model laws and guidance. However, this process can take many years and not all states will adopt a new model law. As a consequence, insurance companies seeking to do business in the United States must understand each state’s requirements, in all 50 states as well as in US territories.

The US insurance industry is also going through its own solvency reform, spearheaded by the NAIC. The work being performed is referred to as the Solvency Modernization Initiative (SMI). This review is focused on a number of areas, including a review of the Risk Based Capital requirement; governance as it pertains to insurers; and group supervision, which is linked to the adoption of its own ORSA requirements.
Americas’ regulatory developments at a glance

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<tr>
<td>Bermuda</td>
<td>Bermuda is a first-wave country in the EU equivalence assessment process. The European Insurance and Occupational Pensions Authority (EIOPA) published its preliminary assessment of Bermuda’s regulatory framework in relation to Solvency II in August of 2011. The report itself distinguishes the approach that the BMA has taken for the Class 3A, 3B and 4 regimes and the Class 1, 2 and 3 regimes. In broad terms EIOPA concluded in its report that the commercial non-life sector was largely or partially equivalent (recognising that life-sector requirements will be introduced through 2012) and that remaining market segments were not. The primary caveat for the commercial sector was the need for an Economic Balance Sheet. The Bermuda framework uses GAAP as the basis for accounting and the BMA expect to use the revised insurance accounting standards as the basis for the Economic Balance Sheet.</td>
<td>The Bermuda solvency framework has historically used statutory accounting principles with the largest (re)insurers also required to file general purpose financial statements drawn up using any recognised generally accepted accounting principles (GAAP), including IFRS. As the BMA develops its solvency regime, the requirement for GAAP financial statements has been extended to include smaller commercial (re)insurers. The BMA have not indicated that this requirement will be extended to limited purpose insurers (ie. captives). The BMA is currently developing its economic balance sheet model. One option may be to use current GAAP with the addition of prudential filters. A consultation paper is expected in the first quarter of 2012. Given the significance of the IASB and FASB proposals for insurance contracts, the use of both IFRS and US GAAP in the Bermuda market and the ongoing development of Solvency II and the Bermuda solvency regime, it is likely that the development of IFRS will continue to be monitored closely by the regulator and the market.</td>
<td>During the first half of 2011, the Argentine Insurance Regulator promoted a major reform to the standards applicable to the reinsurance business in the domestic market. The reasons for any such reform would be associated with the serious observations made by the Financial Action Task Force (FATF) to Argentina in relation to the money laundering and terrorist financing issue. In addition, the Argentine Government is interested in having national reinsurance companies with the necessary technical, economic and financial capability to retain risks and foreign currency.</td>
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<tr>
<td>Argentina</td>
<td>In Argentina, the entities conducting business in the insurance industry (both insurance and reinsurance companies) are under the obligation to set a minimum capital amount. The minimum capital amount results from a technical calculation made on the basis of the highest fixed amount according to the line or lines with which the entity operates, a certain amount depending on the premiums issued over the last 12 months prior to the date of the calculation, or a certain amount depending on the losses incurred over the last 36 months prior to the date of the calculation.</td>
<td>The Argentine Securities and Exchange Commission (CNV) has determined that registered companies shall adopt IFRS as the basis for preparing their financial statements as from fiscal year 2012. Additionally, the Central Bank of Argentina (BCRA) has determined that banks and financial institutions shall adopt IFRS as the basis for preparing their financial statements as from fiscal year 2014, although such adoption might be delayed. At this time, however, the Argentine Insurance Regulator’s Office has issued no regulation in this regard.</td>
<td>The National Securities and Exchange Commission (CNV) of Argentina is working on a major reform of the country’s insurance regulations that includes the change to IFRS. The Argentine Government is interested in having insurance companies with the necessary technical, economic and financial capability to retain risks and foreign currency.</td>
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### Brazil

**Regulatory solvency capital and risk management**

Further elements in the structure of the insurance companies’ solvency regime in Brazil include:

- Binding of investments to coverage of technical provisions
- Restrictive rules for investment of free assets (non-restricted investments used in the coverage of technical provisions)
- Inspection Regime at group level

**IFRS/Financial reporting**

In Brazil, insurance companies are required to issue audited financial statements and consolidated financial statements, prepared in accordance with international accounting standards (IFRS).

IBRACON, the Brazilian institute of Independent Auditors, presented a detailed response to the IASB Exposure Draft which broadly welcomed the proposed measurement model as an improvement from the exit value model proposed in the IASB’s 2007 Discussion Paper.

As with many commentators, IBRACON identified the need to re-visit the transition arrangements proposed in the Exposure Draft, supporting full retrospective restatement except on the grounds of impracticability permitted by IAS 8.

**Consumer Protection**

In Brazil, market conduct regulation is very limited. The primary reason for this has been that insurance products have not traditionally seen strong demand. As macroeconomic factors stabilise, such as inflation and interest rates, we may see an increase in demand by consumers. This situation may drive an increase in market conduct requirements.

In addition, the Argentine Government is interested in having national reinsurance companies with the necessary technical, economic and financial capability to retain risks and foreign currency in the country.

### Canada

**Regulatory solvency capital and risk management**

OSFI has introduced fine-tuning changes to existing capital rules, without a stated intention of increasing overall capital requirements. Changes are being made to improve measurements of risks, or in some cases, to add an explicit measure of a risk not previously measured in the capital rules – for example, the addition of an interest rate risk margin for non-life insurers, effective in 2012. These changes will have the effect of increasing capital requirements for some insurers, and reducing them for others, based on their circumstances.

OSFI has also embarked on in-depth consultations with the both life and non-life insurers to develop a capital framework for the longer term, reflecting both future IFRS changes and more sophisticated approaches to risk.

**IFRS/Financial reporting**

The adoption of IFRS in 2011 has added another dimension for Canadian insurers. Unlike many jurisdictions, Canadian regulatory capital requirements are based on GAAP accounting rather than statutory accounting rules. The volatility resulting from fair market value measures has been very visible since 2008, particularly for insurance products with significant investment return guarantees. Still greater volatility can be expected under the proposed ‘phase 2’ IFRS insurance accounting rules, which increases the temperature of the debate about the IFRS proposals, since this would affect Canadian regulatory capital too. Having the same accounting and regulatory basis for capital has been considered an enviable situation by many, both within and outside Canada, but this could be hard to sustain in future unless the problem of volatility can be solved for regulatory capital as well as reporting of income. OSFI has indicated that it is reluctant to use regulatory capital measures that are less demanding than the accounting definition of capital. However, some insurers believe that this could result in a competitive disadvantage for Canadian insurers.

**Consumer Protection**

In Canada, insurance market conduct requirements continue to be set and supervised by provincial governments. As a result, there continue to be differences between provinces which must be monitored and complied with by insurers.
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<td><strong>Chile</strong></td>
<td>The draft of the law that creates the Risk – Based Monitoring System (SBR) for insurance companies, was filed with the Comisión de Hacienda de la Cámara de Diputados on 28 September 2011. The draft gathers the approaches developed by the IAIS (International Association of Insurance Supervisors); Solvency II developed by the European Union and international best practices adopted by OSFI in Canada, NAIC for insurance supervision in the US and APRA in Australia. Changes in the law include a new requirement for Risk-Based Capital (RBC), a system for assessing and measuring Solvency of insurers, a new investment regime, and other modifications to the Insurance Act consistent with the new supervision approach. The next activities that the SVS will consider: publication of the RBC methodology for consultation during the first half of 2012. During the second half of 2012 the SVS will focus on developing the standard formulas to be applied on a risk-by-risk basis to the new supervision model.</td>
<td>In 2007, the SVS began the evaluation process for adopting IFRS, with the creation of a task-force, and, in 2011, the SVS developed the necessary process for adopting IFRS, for accounting periods beginning on 1 January 2012. Insurance companies must submit the first set of financial statements as of 31 March 2012 prepared under IFRS to the SVS by 30 April 2012. The SVS has defined that IFRS adoption is based on IFRS as issued by the IASB amended or overruled by specific rules by the local regulator SVS such as the recognition of technical reserves, financial investments and real estate investments that depart from IFRS. Reflecting the growing importance of IFRS in Chile, the SVS issued comment letters on the IASB’s Exposure draft, Insurance Contracts. The response of the SVS focused particularly on the potentially negative impact arising from the Exposure Draft’s proposed use of current interest rates on the market for pensions annuities, which they noted represents more than 80 percent of life and non-life technical provisions in Chile, where the business model of the insurer is to earn a spread between the differential rate at which the annuities are sold and the investment return earned on the matching assets.</td>
<td>Chile does have market conduct legislation and self-regulatory standards. The Consejo de Autorregulación de las Compañías de Seguros (Insurance Company Self-regulation Council), is the entity in charge of ensuring that the standards of Good Corporate Practices Code are applied properly, and is aimed at developing an insurance market that is in line with the principles of free competition and good faith between companies and their customers. DEFENSOR DEL ASEGURADO (DdAI) (Insurance Ombudsman) is an autonomous independent private institution, whose objective is to solve potential issues that insurance policy holders may wish to rise in relation to insurance contracts or related service provision agreements entered into with one of the companies adhering to the system.</td>
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<tr>
<td><strong>Mexico</strong></td>
<td>The proposed solvency reform treats several topics in a similar way as the Solvency II European Directive does, and its purpose is also the same: the adequate protection of policyholders and beneficiaries by means of a sound and prudent management of the insurance business that guarantees the solvency of Institutions. This solvency regime encourages insurance companies to adopt a risk-based approach, which provides incentives related to the proper way to measure and manage their risks by reinforcing their governance systems, particularly regarding risk management, actuarial and internal control functions. Important changes in the determination of the company’s liabilities are required by this new framework, mainly those related to technical provisions and solvency capital requirements. A third component of this framework refers to disclosure requirements, which increases the information that the company has to disclose those publicly, particularly that related to the risks faced and its solvency condition.</td>
<td>Mexico is not currently adopting IFRS. However, some of the principles of IFRS are being built into its proposed Insurance Law. In addition, a task force has been working to merge accounting criteria issued by the regulator with local financial reporting standards, and the Mexican Accounting Board has been working to harmonize Mexican financial reporting standards with IFRS. Reflecting the growing interest in IFRS in Mexico, a working group including representatives from insurers, the regulator and accounting bodies issued a detailed comment letter on the IASB’s Exposure draft on Insurance Contracts, noting the importance of the ED given the objective of the local solvency reforms to achieve greater convergence with Solvency II. In particular, the response highlights concerns the earnings volatility derived from changes in the fair value of assets and liabilities, especially in combination with the application of IFRS 9, Financial Instruments, as well as concerns about divergence from the regulatory framework of Solvency II, in particular in the areas of investment contracts with discretionary participation features, for example, requirements for unbundling, the application of an adjustment for illiquidity to the discount rate and contract boundaries.</td>
<td>Market conduct requirements are currently being reviewed in Mexico. The first stage of this market-wide review is a product mapping exercise to identify the various insurance product features. Once this has been completed the regulator will determine the best way to adapt the current regime. The mapping work will include contractual agreements, investment components, other contractual benefits, features omitted from products, commissions, expenses, interest rates, pricing and distribution channels. Companies will have to be able to establish or adjust their policies, procedures, standards and methodologies according to the revised regulatory requirements, so as to align them to the regulatory framework.</td>
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<td>Peru</td>
<td>Superintendent of Insurance Companies of Peru established the Basel 2 Special Committee – Solvency II in order to evaluate the proposed international models and to assess their impact on the Peruvian market. The regulatory framework is being reviewed in light of new international standards, such as Solvency II. However, The Peruvian regulator does not yet have an implementation schedule for identified solvency reforms.</td>
<td>As of the current date, the US Securities and Exchange Commission (SEC) requires domestic registrants to prepare financial statements included in filings with the SEC in accordance with accounting principles generally accepted in the US (US GAAP). In 2007, the SEC issued a ruling that permitted foreign-domiciled registrants to file financial statements prepared in accordance with IFRS with a reconciliation to US GAAP. In November 2008, the SEC issued a roadmap for the potential adoption of IFRS by US domestic registrants and, subsequently, has issued periodic statements of support for a set of global accounting standards. The SEC also solicited comments on its proposed work plan and received more than 230 comments that demonstrated a diversity of views on the potential adoption of IFRS in the US.</td>
<td>As established in the current legislation in Peru, insurance companies freely determine the terms of policies, rates and other commissions, which are made available to the public. In 2011, a regulation on information transparency project and provisions applicable to insurance contracting was established.</td>
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<tr>
<td>USA</td>
<td>The NAIC continues with its review of US solvency standards through its Solvency Modernization Initiative (SMI). SMI reforms are aimed at areas such as the RBC solvency calculation and missing risk factors such as catastrophe risk, as well as areas that fail to clearly meet the international standards set by the IAIS ICP’s such as group supervision. To this end, the US progressed in its development of a US ORSA. US ORSA standards are near final but still need to be adopted by the States. ORSA will be a fundamental change for insurers and insurance groups with a focus on enterprise-wide risk management and group capital.</td>
<td>In the progress report on its work plan issued in 2010, the SEC set forth six specific areas relevant to SEC’s decision on adopting IFRS, including: • Areas most relevant for the SEC’s decision to adopt IFRS: 1. Sufficient development and application of IFRS and 2. Independence of standard setting for the benefit of investors • Transitional considerations: 1. Investor understanding/education regarding IFRS 2. Examination of how the US regulatory environment would be affected 3. Impact on issuers, such as changes to accounting systems, including evaluation for both large and small issuers and 4. Human capital readiness, such as education and audit capacity.</td>
<td>Market conduct regulations in the US cover areas like, complaint handling, financial promotion, disclosures, advice, rates and product filings. The NAIC announced on 19 December 2011 that in 2012 its Market Regulation and Consumer Affairs Committee would be leading its plan to improve market regulation and its ongoing commitment to maintain the highest level of consumer protection. Under Dodd-Frank, the Consumer Financial Protection Bureau was established. As this federal body begins to organise itself it will become clearer what impact there will be for the insurance industry.</td>
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Consumer confidence and trust is critical to promote financial stability, growth, efficiency and innovation over the long-term. The financial services industry is a mature, diverse and highly regulated market and traditionally, regulatory and supervisory frameworks adopted have focused heavily on developing appropriate prudential measures based on ensuring adequate solvency levels being maintained by insurers. However, major mis-selling episodes and the continuing Global Financial Crisis (GFC) highlighted that it is not only matters of solvency which are important; the role and oversight of consumer protection is being increasingly recognised by all supervisory jurisdictions as a major and equal objective.

For insurers, this is a stark reminder of the importance to ensure clear and concise information is provided to customers concerning financial services products and largely accounts for the supervisors’ increased role to re-establish responsible selling in institutional and retail sectors to regain consumer trust and confidence.

All of these developments demonstrate that, along with prudential requirements, consumer protection and conduct of business regulation are also moving into the spotlight. The diagram opposite illustrates key global regulatory policies currently put forward, highlighting the sectors in the financial services industry where they are likely to have the biggest impact.
Key global regulatory initiatives to impact insurers

Packaged Retail Investment Products (Funds, Banks, Insurers, Financial Advisers)
- Aims to put in place and update existing regulation for complex packaged products sold to the retail investment market, where products can take on differing forms but provide comparable functions
- Focus on providing standardised, pre-contractual information for packaged products to limit conflict of interest and promote fair distribution of products
- Product-focused regulation that will align sales rules of products across sectors

Dodd-Frank Act (Investment Managers, Banks, Insurers, Financial Advisers)
- Sets new standards including changes to rules on OTC derivatives and new registration requirements
- Created the Federal Insurance Office. It has no regulatory authority but will assist with the oversight of the insurance industry and have a place in international dialogue. Tasked with performing a study into the US insurance market, has a role in the potential designation of an insurer as a SIFI
- A raft of measures for banks including SIFI identification, transfer of powers from OTS to OCC. Increased Federal oversight and powers. Rules on proprietary trading activities
- Created the Consumer Financial Protection Bureau (CFPB) to further enhance consumer protection

Insurance Mediation Directive (IMD 2) (Insurers, Financial Advisers)
- Seeks effective regulation in the retail insurance market by improving the Single Market for insurance and reinsurance intermediaries objective put forward in IMD 1
- Expanded scope of regulation will also be applicable to direct insurance undertakings and not just insurance intermediaries
- Aims to limit conflict of interest issues by reviewing inducement and remuneration framework of sales rules

Corporate Governance (Investment Managers, Banks, Insurers, Financial Investment Advisers)
- The green paper put forward by the EC on corporate governance aims to establish best practice governance principles
- Principles illustrate the role and required demographics of the board as well as clearly specified duties of the directors
- Enhance the status of the CRO to strengthen the independence and authority of the Risk Management Function
- Co-operation between external auditors and supervisory authorities need to be strengthened so that authorities can benefit from their knowledge of the financial sector
- Supervisory authorities given the power to check the correct functioning and effectiveness of the board of directors
- Shareholder engagement should be improved if shareholder control of financial institutions is still realistic
- Conflicts of interest should at least be partly regulated by very clear rules rooted in law

Markets in Financial Instruments Directive (MiFID 2) (Banks, Investment Advisers)
- Enhance conduct rules with significant increase in conduct of business rules and investor protection

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The global issue – Consumer Protection

The fair treatment of customers is not a national or even regional issue anymore. The G20 Finance Ministers have expressed concern that without the restoration of consumer trust and confidence in financial services, the basis for global economic recovery may be limited. A commonly held view is that commercial companies and individual households have had to bear the brunt of the consequences of the financial crisis and that this has jeopardised growth.

On this basis the G20, in February 2011, requested the OECD to develop guidelines for advancing financial consumer protection through informed choices that include disclosure; transparency and education; protection from fraud, abuse and errors; along with recourse and advocacy. This approach is very similar to that pursued by the Financial Services Authority (FSA) in the UK since the early 2000s. In response, the OECD, in close co-operation with the Financial Stability Board and other international bodies and standard setters, developed a set of ten key principles which was endorsed during the November 2011 Cannes G20 meeting.

Summary of the ten key Consumer Protection principles

The OECD has advanced principles that should be integrated by supervisors into their broader regulatory framework; alongside prudential regulation, governance and competition policies.

The ten principles3 shown on the right are voluntary and designed to complement, not substitute for, existing international financial principles or guidelines that are already in force within member countries. The principles can broadly be classified into the three pillars of: protection, access and education. Principles are set on a global level and do not aim to address sector-specific issues dealt with by the relevant international organisations and the financial standard setters such as the International Organisation of Securities Commissions (IOSCO), Basel Committee on Banking Supervision (BCBS) and the IAIS. The principles may need to be adapted to specific national and sectoral contexts and should be reviewed periodically by relevant international bodies.

Principle 1
Legal and Regulatory Framework:

- Financial consumer protection should be an integral part of the legal, regulatory and supervisory framework and should reflect the diversity of national circumstances and global market and regulatory developments within the financial sector.
- Regulation should be tailored to the characteristics, type, and variety of the financial products and consumers, their rights and responsibilities and be responsive to new products, designs, technologies and delivery mechanisms.
- Financial services providers and authorised agents should be appropriately regulated.
- Relevant non-governmental stakeholders should be consulted when policies related to financial consumer protection and education are developed.

Principle 2
Role of Oversight Body:

- There should be oversight bodies explicitly responsible for financial consumer protection, with the necessary authority to fulfil their mandates and they require clear and objectively defined responsibilities and appropriate governance.
- Oversight bodies should observe high professional standards, including appropriate standards of confidentiality of consumer and proprietary information and the avoidance of conflicts of interest.

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Principle 3
Equitable and Fair Treatment of Consumers:
• All financial consumers should be treated equitably, honestly and fairly at all stages of their relationship with financial service providers.
• Treating consumers fairly should be an integral part of the good governance and corporate culture of all financial services providers.
• Special attention should be dedicated to the needs of vulnerable groups.

Principle 4
Disclosure and Transparency:
• Financial services providers and authorised agents should provide consumers with key information that informs the consumer of the fundamental benefits, risks and terms of the product.
• Appropriate information should be provided at all stages of the relationship with the customer.
• Standardised pre-contractual disclosure practices (eg. forms) should be adopted where applicable and possible to allow comparisons between products and services of the same nature.
• The provision of advice should be as objective as possible and should in general be based on the consumer’s profile considering the complexity of the product, the risks associated with it as well as the customer’s financial objectives, knowledge, capabilities and experience.

Principle 5
Financial Education and Awareness:
• Financial education and awareness should be promoted by all relevant stakeholders and clear information on consumer protection, rights and responsibilities should be easily accessible by consumers.
• Appropriate mechanisms should be developed to help existing and future consumers develop the knowledge, skills and confidence to appropriately understand risks, including financial risks and opportunities, make informed choices, know where to go for assistance, and take effective action to improve their own financial well-being.
• All relevant stakeholders should be encouraged to implement the international principles and guidelines on financial education developed by the OECD International Network on Financial Education (INFE).

Principle 7
Protection of Consumer Rights:
• Relevant information, control and protection mechanisms should appropriately and with a high degree of certainty protect consumers’ deposits, savings, and other similar financial assets, including against fraud, misappropriation or other misuses.

Principle 8
Protection of Consumer Data and Privacy:
• Consumers’ financial and personal information should be protected through appropriate control and protection mechanisms.

Principle 9
Complaints Handling:
• Jurisdictions should ensure that consumers have access to adequate complaints handling and redress mechanisms that are accessible, affordable, independent, fair, accountable, timely and efficient.
• Such mechanisms should not impose unreasonable cost, delays or burdens on consumers.

Principle 10
Competition:
• Nationally and internationally competitive markets should be promoted in order to provide consumers with greater choice amongst financial services and create competitive pressure on providers to offer competitive products, enhance innovation and maintain high service quality.
UK
Even though Consumer Protection principles were put forward recently by the G20, in the UK regulation has been in place for the better part of the last decade making the UK market one of the most advanced jurisdictions concerning consumer protection.

The following provides a brief overview of the consumer protection requirements, branded Treating Customers Fairly (TCF), implemented in the UK. We expect similar measures to be implemented across Europe over the next few years.

The objective behind the TCF initiative is to deliver improved outcomes for consumers and investors in dealing with companies in the financial industry. The Financial Services Authority (FSA) began to focus on TCF principles from 2001 and for the past three years, companies had to demonstrate to the regulator that they treat customers fairly as a matter of course. Failure to prove such commitment has led to companies being fined and the payment of compensation to disadvantaged investors. These principles aim to help consumers fully understand the features, benefits, risks and costs of the financial products they buy and also minimise the sale of unsuitable products by encouraging best practice before, during and after a sale.

The FSA, in 2006, outlined six core consumer outcomes that it wishes to see companies demonstrate as a result of the TCF initiative:

- **Outcome 1:** Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture
- **Outcome 2:** Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly
- **Outcome 3:** Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale
- **Outcome 4:** Where consumers receive advice, the advice is suitable and takes account of their circumstances
- **Outcome 5:** Consumers are provided with products that perform as firms have led them to expect, and the associated service is of an acceptable standard and as they have been led to expect
- **Outcome 6:** Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint

A consequence of Outcome 1 of the TCF requirements is that the regulator wants consumers to be confident that they do business with firms where the fair treatment of customers is an integral part of company culture. This invites two questions; what does a good culture entail and what are the benefits of a high performing culture?

The changes expected from new customer oriented regulation are likely to require insurers to adopt a more consumer focused agenda. Those firms seeking a real competitive advantage will unlikely achieve this desired state unless they significantly change their culture.

Culture is often considered ‘soft’ and ‘immeasurable’, therefore not worthy of a place at the forefront of strategic conversations, linked to profit estimates or of systematic and structured long-term investment. Culture is, put simply, “how we do things around here”; an effect that quite often happens without the conscious thought of individuals within the firm; but has resonating impacts for those outside the firm.

A high performing customer-centric culture is articulated and driven from the Board and Executive suite. Senior Managers follow the lead-by-example approach and in addition, enact the operational processes and systems that drive behaviours. It exists when each and every interaction with another person, internal or external, is considered a customer relationship.
Engagement wins the hearts and minds of employees, so they know they are supported and believe in the benefits they bring to customers.

**Customer trust**
A strong customer-centric culture is not about, ‘the customer being right’ it is a two-way beneficial relationship that results in a win-win outcome. The employee has the knowledge, skills and flexibility to meet, or adjust as required, the customer’s needs.

**Operational drivers**
The constructive elements of the culture foster and reward innovation, allowing interactions with customers to generate new ideas from conception to development. Firms that exhibit exceptional work practices generally attract the most talented employees; creating a self-perpetuating cycle of capability development as the talent base strengthens.

**Organisational resilience**
A high performing culture enables an organisation to respond effectively and adapt faster to external disruption. Risk is reduced through awareness, capability development and behavioural change to improve decision-making and risk mitigation across all three lines of defence.

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**An embedded customer-centric culture increases profit and minimises risk losses**

- **Customer-centric leadership**
- **Employee engagement**
  - Articulate vision
  - Clear lines of responsibility and accountability
  - Encourage staff development
  - Quality performance feedback

- **High performing, customer-centric culture**
  - Customer trust
    - Retain existing and attract new customers
    - Regain consumer trust and confidence
  - Operational drivers
    - Attract the best people
    - Innovative and desirable products
  - Organisational resilience
    - Minimise reputational risk
    - Adapt to external disruption

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The rising consumer agenda – Implications for firms

Though policymakers continue to debate the final details around implementation and adoption of guiding principles, a broad outline is already known. Looking through the principles put forward by the OECD it is clear that insurers will be increasingly affected by supervisors adopting a consumer agenda. Ultimately, market participants will be most concerned with the practical and operational challenges; we believe the mentioned principles will have significant implications for insurers across all aspects of their organisation.

For example, firms are likely to experience a significant impact on both their business and operating models. Firms will have to pay close attention to the regulatory requirements with regards to the consumer agenda put forward in order to identify opportunities in pursuit of a competitive advantage, as well as ensuring compliance.

Using KPMG’s Nine Lever approach detailed below, which illustrates the interaction between the business model (strategy) and operating model, the following summary provides our view on how the key consumer protection requirements are likely to impact the insurance market:

KPMG’s Nine Lever approach

Financial and strategic objectives

- Markets and competition
- Products and brands
- Customers and distribution

Core business processes

Operations and technology

Structure, governance and risk

People and culture

Measures and incentives

Business Model Revenues

Operating Model Costs
Insurers will need to take stock of existing and prospective regulatory requirements and their impacts on the strategic direction, cultural change and appetite initiatives within their organisation.

From a Business Model or Revenue opportunity perspective, implications include:

- Insurers and intermediaries of all sizes will have to take major decisions on how they sell, advise on and provide products to customers in order to identify potential advantages for value add given the new requirements.
- Business models will need to adjust to the changing regulatory and market landscape and insurers will need to take stock of existing and prospective regulatory requirements and their impacts on the strategic direction, cultural change and risk appetite initiatives within their organisation.
- Strategically, insurers will have to re-think their appetite for selling complex products as there may be additional cost implications associated with customer disclosure requirements.
- In addition, firms must take a strategic view of the type of corporate culture they need to promote and maintain, providing a customer focused environment with the tone being set from the top.

From an Operating Model or Cost Driver perspective, implications include:

- Initiating a corporate culture shift to ensure effective implementation of these new requirements.
- Reporting requirements will increase, especially in terms of post-sale reporting on products’ performance. This will likely require additional investment from firms, not only with regard to infrastructure and operations, but also with the implementation/update of forecasting methodologies.
- Firms will have to understand the implications of limiting post-sales barriers on their operations and systems as well as training requirements for staff.
- Going forward, client targeting and product design will have to be more precise as clients’ needs, investment aims and profiles will have to be appropriately matched with products provided to avoid undue mis-selling. This will likely require firms to introduce system changes, operational changes, enhanced testing requirements and update training provided to client-facing personnel.
- New rules focusing on the management of conflict of interest will significantly impact the distribution of insurance products in particular changes with regard to remuneration could change the functioning of the insurance market.
- Increased transparency and reporting requirements will result in significant infrastructure and systems investment. The biggest impact of this is likely to be on those market participants previously not under the scope of current requirements.
- Higher professional requirements will likely result in increased training cost for insurers’ client facing staff.
What can you do now?

This combination of changes will impact every part of your business. For insurers in particular, there will be fundamental decisions about which lines of business and products to continue with, how products will be distributed, through whom and where. All participants in the insurance market will be affected by consumer protection issues and regulation. The implications of higher costs and compliance complexity will be a strategic challenge for all firms. There are a number of steps firms can take now to position the business for advantage:

1. Know your business
The impact of these proposals will depend on the products you sell, distribution channels you use, your client base and your operational systems. Understanding the interaction of these will help you plan and react quickly to the rules and new opportunities.

2. Prioritise change
Identify processes and systems most likely to be impacted and prioritise issues which can be remediated quickly before embarking on implementing new requirements. These include:

   • Have you taken full account of the impact existing and prospective regulatory requirements might have on the strategic direction, cultural change and risk appetite initiatives within your company?
   • Have you considered the impact of these requirements on your business model, including the type and range of products you sell and advise on?
   • Do you have the necessary systems, data and reporting in place to meet these new regulatory requirements?
   • Have your client-facing staff been provided adequate training in terms of conduct and protection requirements when selling products and providing advice to clients?
   • Do you reinforce the appropriate protection requirements of staff through performance, reward and incentives?
   • Do your client-facing staff meet the minimum professional requirements as required?
   • Do you have the systems, data and reporting in place to meet these regulatory requirements considering annual updates and communication with clients?

3. Market positioning
Consider your role in the new market place. In future, will it be more sensible to become a distributor of own products and trim down other distribution channels? What additional services will clients require and what will be the impact on pricing models?

4. Join up the dots...
There are significant opportunities to be realised for firms that plan ahead across the regulatory spectrum and take an all-encompassing strategic approach to applying regulation; as opposed to an ad-hoc or short-sighted legislation-by-legislation compliance based approach. Therefore all regulatory requirements should be viewed as a once-off change project in order to avoid undue cost implications and implementation overlap.

ASPAC Perspective:
As we mentioned in the Perspectives: ASPAC section on page 14, models of consumer protection vary considerably in the region, but generally have not yet embraced the principles-based customer-centricity seen in the UK and parts of the EU. That said, we expect many jurisdictions in the region to develop and enhance customer
protection regulation, although some countries, like Australia, are already well advanced.

Many countries focus on achieving customer protection through controls on product pricing and design. There are signs, however, that some markets may be about to relax these controls.

In China, for example, following a successful trial in Shenzhen, we understand the CIRC is planning to implement pricing reform that will enable greater flexibility for insurers in setting prices, including the use of risk-based factors.

We are also witnessing the process of pricing reform in other jurisdictions, for example in the Malaysian motor insurance market, which is currently implementing the first rate increases for 30 years in the compulsory third party motor market. Further reform is expected in Malaysia where Bank Negara Malaysia has announced a target of 2016 for de-tarrifing motor premiums.

Alongside this reform, we expect further regulation focused on appropriate and sound corporate governance around the sales process and underwriting and pricing risk management, similar to that seen in other markets including Australia, Hong Kong and Singapore.

Not unsurprisingly, in the aftermath of the financial crisis, regulators in Asia in many ways reverted to their core aim of policyholder protection. Several policyholder protection schemes, with a goal of providing financial protection to policyholders in the event of the insolvency of an insurer, have recently been established or are in the process of being implemented, which add to the number of schemes already in place. This will bring many Asian jurisdictions in line with their international counterparts in more developed markets.

The financial crisis also highlighted, through significant policyholder losses in a range of financial products sold through insurance wrappers, as well as other more traditional insurance policies, the ever-present risk of mis-selling. As a result we have seen several regulators tighten up controls and educational requirements for agency-based and other insurance sales teams. This is expected to have a significant impact in certain countries where insurers rely significantly on their agency salesforces. In China, the regulators have introduced regulation in the bancassurance sector to reduce the risk of mis-selling, and going forward, we expect them to focus on policyholder rights, risk awareness and increasing disclosure to policyholders, as well as improved training of insurance sales staff within banks.

**Americas Perspective:**

In 2012 many regions within the Americas are set to see a continued focus on market conduct regulation. That said, market conduct regulation in some territories remains undeveloped. This is further complicated by differing regimes for market conduct already in existence; some at federal, state and provincial level. Consequently, there are varying states of maturity in terms of the level of consumer protection and the approach and focus can be very different when compared to other regions such as Europe.

This is often a reflection of macroeconomic factors. For example, long-term insurance savings products are not popular in countries with high inflation and low or negative real rates of return. Consumers do not have an appetite for less liquid products whose value may erode over time. Traditionally investors in these markets have looked to more liquid banking products, but as macroeconomic factors change, we may see a shift to insurance products and subsequently the further development of market conduct regulations. In addition, as the middle class grows and disposable income increases, the affordability and demand for insurance may increase.

Many jurisdictions within the Americas region appreciate that consumer protection requirements are a key component of any developed financial centre. Indeed, consumer protection is absolutely critical in maintaining consumer and investor confidence in the financial system. They provide investors with confidence that there are enforceable standards in which to do business and ultimately provide a degree of investor protection.

The IAIS 2011 summit put forward that more needed to be done in the area of market conduct highlighting that a good place to start was in the area of product disclosures. We therefore expect to see many more initiatives to commence this year and beyond.
In 2012 the EMA region will continue to witness significant regulatory action. Solvency II continues to be the dominant focus for most insurers within Europe, with policymakers trying to finalise critical aspects of the Directive requirements. At the same time, new consumer protection proposals have been trailed by the European Commission, which are likely to add more pressure for European insurers going forward. Meanwhile, specific UK and South African regulatory initiatives will drive other major changes in these countries.

**Solvency II update**

Despite various announcements of delays in Omnibus 2 and other related implementation issues, 2012 is expected to see the finalisation of most of the outstanding Solvency II framework rules and guidance. There are still a number of fundamentally important technical components of Solvency II where reaching agreement amongst the European Insurance and Occupational Pensions Authority (EIOPA), the European Commission, European Parliament and the industry are likely to prove difficult. For some markets, the final Solvency II proposals could have a real impact on their pension market and on the wider macro economy.

In particular, the final requirements on issues such as the matching premium and counter cyclical premium could materially impact many European firms’ capital requirements. In the UK, this could mean that annuities may need to be priced at such a level that consumers would find unacceptable, and potentially become uneconomical for insurance firms to offer. This in turn would be unwelcome news for pensioners, who could be forced to accept the investment risk on their pension savings, as insurers will increasingly be expected to offer unit linked pension products. Alternatively, firms may be forced to innovate further, for example, to offer more 'with-profit' varieties, such as variable annuities.

Unless the capital charges basis applied to asset classes is changed, many insurers may seek to move out of long-term corporate debt into lower risk (and therefore lower return) investments. Apart from the impact on policyholders’ returns, there are far-reaching impacts on the wider economy. Many European insurers have been significant investors in infrastructure and real estate investments, which provide reliable and stable cash flows, hence providing a good match to the cash outflows on annuity type products. By imposing high capital charges on these investment classes for regulatory purposes, the risk-adjusted returns may become unattractive and insurers needing additional solvency will likely choose to change their investment portfolios – potentially resulting in a significant withdrawal of funds, which could have an impact on the wider European growth agenda.

Re-examination of the European Commission’s proposals on charges on investment products, combined with another quantitative impact assessment exercise – albeit on a smaller scale than previous ones – would be prudent.

**Omnibus 2**

As the framework that amends the original Solvency II Framework Directive, Omnibus 2 is critical to the Solvency II journey, but has been subject to regular delays. As well as dealing with procedural matters, such as the creation of the EIOPA, it also drives a number of fundamental changes to the legislation passed, not least of which relate to transitional measures and the actual implementation date of Solvency II.

Solvency II still legally has an implementation date of 1 November 2012, which demonstrates the importance of publishing Omnibus 2 in its agreed final form in the very short term. Unfortunately, this does not look likely to happen, with regular delays announced in the Omnibus 2 approval timetable.

The remaining issues regarding Solvency II must be resolved in a manner that is appropriate to the market and those it seeks to protect, as well as the wider economy. Delays are causing great frustration in the industry. At this stage of the process, firms need clarity regarding the likely final rules, but virtually all of the latest official papers regarding Solvency II remain closely guarded. Insurers still face an enormous level of uncertainty on Solvency II, which is holding up their implementation plans, and there are a
number of key areas still open to change awaiting the finalisation of the level 2 implementing measures.

The delays to Omnibus 2 also mean that it is impossible to get an official Solvency II timetable. Given the proposed European Parliament vote in April, our best estimate on the likely timetable (assuming there is no further delay in implementation by firms beyond the current proposed date of 1 January 2014) is set out below. Further slippage is possible – some would say inevitable, and this perpetuates the uncertainty.

**EIOPA developments**

EIOPA has just closed its latest consultation process regarding the Own Risk and Solvency Assessment (ORSA) and draft Pillar 3 requirements of Solvency II.

**ORSA**

The notable feature from the ORSA consultation paper is that EIOPA have recognised that there is no single ORSA approach. EIOPA state that the guidelines focus on “what is to be achieved by the ORSA rather than on how it is to be performed” so are not directive in nature. From the outset, insurance supervisors established their intention to avoid prescriptive requirements on the ORSA to ensure they were not dictating the way that insurers operate, leaving firms to decide how best to address the requirements internally. A clear message for firms is that there is unlikely to be any further detailed guidance on the ORSA after the finalisation of this paper.

One significant step in the consultation paper has been to provide further detail on documentation and also the need to separate ORSA supervisory reporting from the Pillar 3 reporting. The paper refers to an ORSA supervisory report which can leverage an insurer’s own internal ORSA documentation, results and conclusions. Insurers will, however, have to determine for themselves the extent and quality of this report.

**Pillar 3**

Reporting and the ORSA have been the two areas where industry has most been most vocal that they need more clarity...
and moves to finalise these requirements will give some much needed certainty on the final shape of Solvency II. The recent Consultation deadline was 20 January 2012 – KPMG provided a detailed response to the Consultation, which can be found on kpmg.com.\(^4\)

Anecdotally, reporting has also been the Solvency II pillar which thus far has received the least attention from firms. One of the main proposals likely to be welcomed by smaller insurers will be the proposal to eliminate quarterly reporting of investments on a security-by-security basis, although it appears that many larger companies will still need to provide this information every quarter.

The publication of the Pillar 3 requirements marks an important milestone for the industry across Europe. In essence, the insurance sector is moving closer to having a transparent and consistent reporting method to provide timely and relevant information about the solvency and risk position of insurance companies.

**Consumer Protection changes**

It is not only in prudential regulation where significant change is occurring in the EMA region. In the EU for example, substantial changes are being made to the conduct of business requirements and the fair treatment of customers. The changes proposed are complex and involve multiple Directives. To limit the complexity, we focus on two significant conduct of business proposals being put forward – the Insurance Mediation Directive 2 (IMD 2) and the Packaged Retail Investment Products (PRIPs), which will complement the Consumer Protection requirements already enacted by some countries.

**Insurance Mediation Directive 2**

Insurance intermediaries play an important role in the distribution of insurance products. The existing Insurance Mediation Directive (IMD) is applicable to insurance and re-insurance intermediaries within the EU and aims to guarantee a high level of consumer protection. Insurers should review other sectors’ regulation to indicate the direction that sales rules and inducements will take. These include MiFID 2.

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The Directive has an established legal framework that introduces minimum professional requirements for all intermediaries across Europe and requires them to register with a competent authority in their Member States to facilitate cross-border activities. The Directive also institutes the provision of comprehensive information to consumers prior to the conclusion of any initial insurance contract and, if necessary, upon amendment or renewal of the contract.

The post-implementation review, initiated in 2005, summarised shortcomings in the way the market functioned, notably the difference in the interpretation of the Directive. The specific problems identified concluded that consumers often have insufficient/inadequate understanding of insurance products and their rights post-sale. In addition it was concluded that sellers have conflicts of interest.

The EU Commission is preparing legislative proposals and is expected to publish these in Q1 2012, with implementation from 2014. The Directive also institutes the provision of comprehensive information to consumers prior to the conclusion of any initial insurance contract and, if necessary, upon amendment or renewal of the contract. The following changes have been put forward as part of the consultation:

- **IMD 2** aims to put in place clear and effective rules on the management of conflicts of interest for the distribution of all insurance products and for intermediaries to be obliged to act honestly, professionally and in the best interest of their clients. The MiFID 2 proposals contain clear rules on conflict, transparency and inducements. The consultation paper suggests using these as a benchmark for the management of conflicts of interest, notably looking at remuneration and transparency (intermediaries and undertakings), as well as disclosure regarding remuneration.
- Under single passport principles, the legal framework for cross border insurance intermediation will be improved in relation to the notification process.
- Common principles will establish professional requirements for all sellers of insurance products.

**What are the implications for firms?**

- Increased transparency and reporting requirements will result in significant infrastructure and systems investment. The biggest impact of this will be felt by insurance undertakings previously not covered in the directive.
- Transparency requirements will have an impact on the annual reporting on products to customers and this will potentially result in additional investment costs around infrastructure, process and staff training.
- New rules focusing on the management of conflicts of interest will have a significant impact on the distribution of insurance products. In particular, the changes regarding remuneration could change the functioning of the insurance market.
- Given the new professional requirements, additional training investment will be required to ensure that those providing advice are appropriately qualified.
- There is potentially also great opportunities to be realised for firms with a cross border presence in the EU as the Directive aims to establish maximum harmonisation and the passporting process will be much smoother.
- Insurers should review other sectors’ regulation that will indicate the direction sales rules and inducements will take, these include MiFID 2.
- Insurance companies will have to strategically review the distribution of their products in order to identify potential advantages for value add given the new regulatory requirements and extended scope of the Directive.

**Packaged Retail Investment Products**

The European Commission’s Packaged Retail Investment Products (PRIPs) initiative focuses on the regulation for packaged products sold to the retail investment market. These mid to long-term products can take on various legal forms. In summary, the products are marketed directly to retail investors and entail a degree of investment risk. Examples include structured deposits, derivative instruments, and investment funds. Sellers and providers of these products to the retail market will be affected, including insurance companies, independent advisers, brokers, banks and asset management firms.

In most EU countries, information available to clients on products is perceived as poorly drafted and difficult to use. A customer’s ability to compare products is compromised by this.

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5. "A PRIP is a product where the amount payable to the investor is exposed to fluctuations in the market value of assets or payouts from assets, through a combination or wrapping of those assets, or other mechanisms than a direct holding." European Commission PRIPs Consultation 26-11-2010
6. Except in the UK where similar rules already exist
of interest further complicates the fair distribution of products, as brokers could have a dual role as advisers to clients and as a distribution channel for the insurers. This could potentially impair the objectivity of the advice they provide to their clients.

Further, current regulation around the single market is fragmented and inconsistent. A patchwork of uncoordinated regulation for these products has grown up at both national and European levels. This has led to significant differences in the level of standards between sectors. Some products and channels are not regulated at all in some countries.

The EU Commission has estimated the cost of implementation for banks and insurers to be between €350 and €550 million as a one-off expense with a further €110 million or €220 million in annual costs. For advisers and brokers the one-off cost is estimated to be between €50 and €125 million with a further €50 to €80 million in annual costs. It is expected that the European Commission will consult on PRIIPs in the first quarter of this year.

What are the implications for firms?

- Strategically, insurers will have to re-think their appetite for selling PRIIPs type products given the cost implications (pre-contract disclosure and sales rules), but also in understanding the impact a cultural and more customer focused environment will have on the overall business.
- Client targeting and product design will have to be more precisely matched as clients’ needs, investment aims and profiles will have to be appropriately matched with products provided to avoid mis-selling. This will require firms to introduce system changes, operational changes, enhanced testing requirements and update training provided to client facing personnel.
- Insurers should review other sectors’ regulation that will indicate the direction PRIIPs sales rules will take such as MiFID 2.
- Companies will have to review the implications of the legislation across a product lifecycle to identify pressure points from design to claims handling.
- In order to establish consistency across the market, provide adequate transparency for consumers and increase competition across the EU (highlighted as some of the main objectives for the review), regulators and companies will have to strike a fine balance between recognising intrinsic differences between types of PRIIPs and overburdening consumers with information.
- Current national regulation should be reviewed to determine links with the new proposals as correct alignment will be crucial to ensure harmonisation and level playing field objectives are met.

Other changes occurring within the EMA region

The UK ‘twin peaks’ model of supervision

Changes in the UK regulatory landscape took a significant step forward in May and June 2011, when the Bank of England (the Bank) and the Financial Services Authority (FSA) published documents outlining the approach to be taken by the new Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA). The new model will engender substantial changes, including the separation of prudential and conduct supervision for dual FCA/PRA regulated firms, and the introduction of new risk analysis approaches and tools.

The FCA: Significant new powers

In what may prove to be a wake-up call to parts of the financial services industry, the FCA will be equipped with a variety of powers to support its statutory duty to protect consumers from detriment. Among these is the ability to ban the sale of particular products from a given financial institution for up to 12 months, to take action over misleading adverts or promotions and to disclose disciplinary actions against individuals or firms at an earlier stage. It will also be able to initiate referrals to the Office of Fair Trading (OFT).

Greater market-wide review and policy intervention

One of the FCA’s priorities will be to provide higher-level views of the market and of the business models of individual firms as it seeks to identify potential risk areas for consumers. This is likely to signal a clear and unequivocal move towards sector and thematic supervision, together with increased use of the consumer redress process under s404 of the Financial Services and Markets Act (FSMA).

Two regulators: Twice the burden on firms?

A key concern is how the FCA and PRA might be able to work in concert. There are already multiple touch-points between the FSA and regulated firms and there is some concern that the formation of the PRA and FCA will make coordination and management of the interactions between firms and regulators even more complex, burdensome and expensive. The PRA and FCA may have the best intentions to work together wherever possible, such as on authorisations, in order to avoid overlap and duplication. However, the crux of the reform is to
Changes in the UK regulatory landscape took a significant step forward in May and June 2011, when the Bank of England and the Financial Services Authority published documents outlining the approach to be taken by the new Financial Conduct Authority and Prudential Regulation Authority.

The UK Retail Distribution Review experience – what next?

In the UK, the Retail Distribution Review (RDR) is less than a year away from implementation across the financial services industry. The new rules will come into force on 31 December 2012 and will represent a major change to the way retail investment providers and distributors do business and the relationship they have with their customers – particularly when providing advice.

Its key aims remain: increased disclosure around regulated advice; raised professional standards for retail financial advisers; and the removal of product bias through a ban on commission on advised packaged retail investments. Simple life products (eg. term life products with no investment element, non-life products such as travel/health insurance, mortgages, other loans (secured and non secured) and retail banking products like current accounts remain out of scope. Additionally, any non-advised sales – where customers do not receive advice, termed ‘execution only’ – are also out of scope for the new rules.

Impacted firms include distributors of retail investment products, such as independent and linked advisers, bancassurers and direct sales forces owned by life or other retail investment providers as well as the providers of products themselves such as life insurance companies, banks and asset managers. In addition, nominee platform firms are likely to be significantly affected by the rules in general and specific new rules that are shortly expected in relation to this class of business.

To prepare for the RDR implementation firms are making significant changes to comply with the new requirements such as removing commission from product charges and implementing raised professional standards, but also changes which will enable them to continue to trade, such as adviser/consultancy charging facilitation, and competitive strategies which firms adapt to new market dynamics that the RDR is likely to hasten.

Industry, political and consumer groups have voiced controversy over the RDR since it was conceived due to the likely impact on retail consumers who, once they are explicitly charged for advice for the first time, are likely to be put off by the charges and increasingly not have access to regulated financial advice as firms find them unprofitable to service. In addition, the adviser community has long been concerned by the likely impact on those advisers who feel forced out of the market by the cost of the new regulation and falling revenues.

Firms directly impacted by the RDR are facing an unprecedented level of business and operational change in 2012 due not only to this legislation, but also Solvency II, UK Pensions Reform and the pressure of tough economic conditions. Similar regulation is planned in Australia and in Europe; indeed in many ways a variant of the RDR is likely to have a wider impact than forthcoming European legislation such as MiFID 2 and PRIIPs. As a result, the UK industry is the centre of attention in 2012 as European and Global observers watch with interest to see how successfully the industry will adapt both commercially and operationally.
It is encouraging to note that the majority of participants already met the proposed new requirements in terms of the capital and solvency coverage ratio.

create two independent regulators. Despite sharing insights and analyses at the macro level, coordination on the ground might prove substantially more difficult to achieve. There is a real risk of independent visits and approaches, and a divergence of agendas over time, particularly in clearly overlapping areas such as firms’ corporate governance, senior management and systems and controls.

While the challenge for the FCA is to pre-empt issues relating to new products and distribution channels, the PRA’s challenge centres on the sustainability and resilience of each firm’s entire business model. This overlap, yet fundamental difference, in the scope and statutory objectives of the two regulatory bodies will ultimately mean two separate agendas with firms. The changes underway are far more significant than most in the industry currently appreciate. Financial institutions must stand back and think through their entire business through the lens of the new regulators. This includes strategy, business model, customer products and services, distribution, processes, risk appetite, governance and controls, and their overall impact on the financial system. Viewing the situation as ‘more of the same’ may leave many insurers exposed to a rude awakening.

South Africa

While most of Europe is involved in Solvency II, within the EMA region there have been considerable developments in Africa, South Africa in particular.

South Africa is also facing significant changes, having recently embarked on its Solvency Assessment and Management (SAM) project. SAM is effectively trying to meet the requirements of a third country equivalence assessment that will be outlined by Solvency II (appropriately adapted to South African circumstances) with a targeted implementation date of 1 January 2014. The proposed new regime will include a standardised and internal model approach for both the long-term and short-term insurance industries. Interim measures have already been introduced for non-life insurers in respect of the solvency capital requirements effective from 1 January 2012. The South African SAM project will feature many of the same requirements as Solvency II, for example, SAM will be based on the Solvency II capital adequacy (Pillar 1), risk governance (Pillar 2), and risk disclosure (Pillar 3) regime being implemented for European insurers and reinsurers. The Solvency II framework has been selected as a model given South Africa’s strong economic links with Europe, and will align the prudential regulatory framework for the insurance sector in South Africa to international standards being developed by the IAIS.

The SAM regime will mirror Solvency II requirements by establishing key responsibilities at the highest level of insurers’ governance structures, particularly for the Board of Directors and senior management. The core of the South African Financial Services Board requirements will mean insurers will need to develop systems to assess capital adequacy and capital planning, to implement systems of governance and the management of all risks, and to address reporting and disclosure requirements. Insurers are expected to have already made some progress in their SAM projects, as implementation is now only two years away. Encouragingly, substantial representation on behalf of industry in the project...
process is being sought by the Financial Services Board to ensure ultimate delivery of an effective solvency regime implementation for the South African insurance industry. Various SAM task groups, established to facilitate the development of the new regime, have already prepared numerous discussion documents that are used in the regulatory drafting process. At the time of publishing, the second draft of primary legislation is expected for comment. Secondary legislation is then expected to follow shortly thereafter.

The results of the first quantitative impact study (QIS 1), measuring the potential direct impacts of the proposed rules on insurers, were published by the FSB in December 2011. On an individual insurer level, the majority of insurers have shown an increase in available capital and capital requirements compared to current levels. The study further revealed that the median capital coverage ratio level will decrease under the new regime (see table above). It is encouraging to note that the majority of participants already met the proposed new requirements in terms of the capital and solvency coverage ratio.

The Financial Services Board will further investigate the potential impacts with a second QIS later in 2012, focusing on ring-fenced funds, contract boundaries, the treatment of tax and the solvency of groups.

As with Solvency II and all regulatory change of this nature, it will benefit insurers (and has already) to take part in the working groups being established to ascertain the likely impact of the regime on their business, understand what preparations are required, and use these forums to voice any concerns they may have.

There will be a parallel run of the standard approach scheduled for all insurers for year-ends ending in 2013. Although the new SAM regulations are still not finalised, insurers can refer to Solvency II text and EIOPA advice to the European Commission which provides a useful early indication of what the final requirements are likely to contain, even when these may be adapted to South African circumstances.

### Aggregate Capital Impact of SA QIS 1 on Respondents (R‘bn)

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<td>Current position</td>
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Financial reporting, valuation and disclosure – the latest developments

In the second half of 2010, the IASB released its Exposure Draft Insurance Contracts and the FASB issued a separate Discussion Paper containing its preliminary views on the proposals, which collectively marked the next phase to a global insurance accounting standard, which we refer to as ‘Phase 2’.
What is the problem?
Current IFRS 4 Insurance Contracts permit wide diversity in accounting and presentation by insurers. It permits, subject to limited improvements, insurers to carry forward their previous accounting policies in measuring insurance contracts prior to the adoption of IFRS, allowing diverse practices which may not provide a coherent framework for dealing with more complex contracts or resolving emerging issues with new types of insurance contract. Accounting methods have evolved from meeting the historical requirements of insurance regulators concerned with financial stability and policyholder protection rather than meeting the needs of investors and other capital providers.

As a result, accounting practices used by insurers are, currently, even permitted to be internally inconsistent within the same group. These differences impede comparisons between insurers and other financial institutions and arguably do not provide users of financial statements with information that is relevant and representationally faithful. This has become more pressing as IFRS has become widely accepted and as the insurance industry has globalised.

Consequently, many interested parties believe that it is important and urgent to replace IFRS 4.

What is proposed?
The Exposure Draft proposes a comprehensive measurement approach for all types of insurance contracts, although a modified version of that approach would apply for some short-duration contracts. The approach is based on the principle that insurance contracts create a bundle of rights and obligations that work together to generate a package of cash inflows (premiums) and outflows (benefits and claims). An insurer would apply to that package of cash flows a measurement approach that uses the following building blocks:
(a) A current estimate of the expected value of future cash flows to fulfil the contract
(b) A discount rate that adjusts those cash flows for the time value of money
(c) An explicit risk adjustment
(d) A residual margin that eliminates any profit arising on inception

The FASB has proposed an approach using three building blocks, combining the adjustment for risk and the residual margin into a single composite margin. For most short-duration contracts, a modified version of the measurement approach would apply:
• During the coverage period, the insurer would measure the contract using an allocation of the premium received, on a basis largely similar to much existing practice
• The insurer would use the building block approach – including discounting – to measure claims liabilities for insured events that have already occurred

How was the Exposure Draft received?
Comment letters on the Exposure Draft (ED) and the Discussion Paper are a matter of public record, and, while almost all respondents agreed that change was needed and indeed overdue, few could agree on its key components. While users generally support a current measurement model and a building block approach with a separate and explicit risk margin because they think it will give them a clearer picture of the profit drivers and earnings streams of insurers, many expressed concern that the proposed model is highly dependent on estimates and gives rise to volatile results, which will not be meaningful to users.

While most insurers think that the building block approach (or a variant of it) may be appropriate for measuring life insurance contracts, many think that the building block approach is overly complex for short-duration contracts. Many non-life insurers that apply US GAAP believe that the ED fails to recognise important distinctions between non-life and life insurance contracts. The current approach for non-life contracts based on unearned premiums is consistent with the basis of accounting for most non-life contracts used globally and many believe this approach is time-tested, readily understood, and should be retained, allowing a user of financial statements to readily understand the relationships between the premiums received to accept risk and the payments made to fulfil the obligation under these same contracts.

Where are we now?
The Boards have been working methodically through the observations on the Exposure Draft: KPMG’s IFRS-Insurance Newsletter provides a detailed update on the discussions and decisions each time the Boards meet. In commenting on the Exposure draft the industry has proposed compromises
that are broadly accepted by users, many of which, to date have been tentatively accepted by the Board.

Of the remaining issues, the most critical is undoubtedly that of volatility: increased volatility of results and financial position under the proposed model is a critical issue raised in almost all jurisdictions and by users, preparers and other interested constituencies.

Many insurers are concerned that the current measurement of insurance liabilities (specifically for interest rates) would, in effect, constrain them from measuring some financial assets at amortised cost as permitted by IFRS 9. While these concerns could be alleviated by measuring assets at Fair Value Through Profit or Loss (FVPL), many insurers suggest that this places them at a disadvantage compared to banks, which compete with insurers in attracting capital.

Under IFRS 9, whether assets are measured at fair value or at amortised cost, their measurement reflects the risk of non-performance by the issuer. In contrast the proposed measurement approach for insurance liabilities excludes the risk of non-performance by the insurer. As a result, fluctuation in credit spreads is not matched with corresponding changes in the measurement of the insurance liability. When changes in fair value are presented in profit or loss, the mismatch causes volatility in profit or loss. This effect is exacerbated during times of financial stress.

Another cause of volatility occurs when the measurement of insurance liabilities and the measurement of assets that an insurer holds to back those liabilities respond in different ways to changes in interest rates. This can occur either when an insurer has not matched the duration of the insurance liabilities with the duration of the assets that it holds (possibly because assets are not available with sufficiently long durations) or when the insurance contract includes minimum interest rate guarantees. The IASB has acknowledged the need to get the ‘volatility issue’ solved and eliminate accounting mismatches, accepting that:

- Changes in liquidity spreads that impact assets can be considered in discounting the liabilities through modelling of interest rates by a ‘top down approach’
- Appropriate modelling of interest rates for non-observable long durations should not simply reflect the extrapolation of volatile short-term interest rates
- Participating features typical for life insurance contracts can be modelled in a way where the values of investments on which the policyholders’ participation is based are mirrored in measuring the liabilities
- The impact of changes in some of the relevant parameters for measuring insurance liabilities can be buffered by the ‘residual margin’, a floating element of the liabilities which represents a form of deferred realised profit

However, this is a mélange of limited measures that does not eliminate all of the short-term volatility.

One solution proposed by some insurers would be to lock-in the interest rates used for discounting, corresponding to the amortised cost model used by banks – this was rejected by the IASB (a view supported by most analysts as well). An alternative compromise offered by the industry would be to use ‘current/current’ measurement in the balance sheet, i.e. valuing investments at fair value and discounting at a current rate for liabilities, but with potentially short-term and transient changes in value recognised directly in equity (so called ‘other comprehensive income’ or ‘OCI’), rather than in the profit or loss account. This would be supported by many users, who support a segregation of long-term movements which are a good indicator for performance, from short-term, market-driven volatility.

We consider it positive that the IASB has demonstrated its willingness to reopen IFRS 9 in order to bring financial instruments and insurance accounting into line, to agree the scope for considering targeted improvement to IFRS 9 Financial Instruments. The scope of the review will include expanded use of OCI or a third business model for some debt instruments.

So perhaps a compromise – and the potential conclusion of a saga that has been running for 15 years – may be in sight.

The table opposite summarises progress on the remaining six critical issues which the IASB and FASB identified in their January 2011 summary of comments received on the Exposure Draft (ED).
**Issue** | **ED proposals** | **Update to proposals**
--- | --- | ---
**Discount rate** | An insurer would adjust the future cash flows for the time value of money using a discount rate that is consistent with cash flows whose characteristics reflect those of the insurance contract liability. | Proposals in the ED have been tentatively confirmed. The Board tentatively decided to provide guidance regarding matters to be considered in determining the discount rate and clarified that the discount rate should reflect only the effect of risk and uncertainties that are not reflected in other building blocks in the measurement of the liability. The Boards tentatively decided that in applying the top-down approach to determining the discount rate:  
• An appropriate yield curve should be determined by an insurer based on current market information and reflecting current market returns for the actual portfolio of assets the insurer holds or for a reference portfolio of assets with similar characteristics to those of the insurance contract liability  
• The insurer should use an estimate that is consistent with the IASB’s guidance on fair value measurement, such as Level 3 fair values, if there are no observable market prices for points on the yield curve  
• Cash flows of the instruments should be adjusted in two ways so that they mirror the characteristics of the cash flows of the insurance contract liability. | • Type 1, which adjust for differences between the timing of cash flows to ensure that the assets in the portfolio (actual or reference) selected as a starting point are matched to the duration of the liability cash flows  
• Type 2, which adjust for the risks inherent in the assets that are not inherent on the liability. If there is no observable market risk premium, then the entity uses an appropriate technique to determine that the market risk premium is consistent with the estimate  
• An insurer using a top-down approach need not make adjustments for remaining differences between the liquidity inherent in the liability cash flows and liquidity inherent in the asset cash flows  
The IASB discussed whether changes in the discount rate should be recognised as an adjustment to the residual margin or in profit or loss in the period of change to the extent that the changes create an accounting mismatch – no decision was made.

**Residual vs. composite margin** | Proposals in ED have been tentatively confirmed. | In the FASB model, risk and uncertainty would be reflected implicitly through a single margin rather than in a risk adjustment. This alternative generally would not give rise to differences at inception but differences would arise in subsequent measurement of the insurance contract. | The FASB chair has indicated that the FASB would like to re-assess its decision on including a single margin in the context of a close-to-final accounting model. In the mean time the two Boards will continue to explore whether the two approaches can be made more comparable through disclosure.

**Remeasurement of the residual margin** | The IASB tentatively decided that the residual margin should not be locked in at inception. | The IASB tentatively decided that an insurer should remeasure the residual margin by:  
• Adjust the residual margin for favourable and unfavourable changes in the estimates of future cash flows used to measure the insurance liability, with experience adjustments recognised in profit or loss  
• Not limit increases in the residual margin | • Recognise changes in the risk adjustment in profit or loss in the period of change  
• Make any adjustments in the residual margin prospectively  
Part of the rationale for not unlocking changes in financial variables is to avoid creating an accounting mismatch with financial assets classified and measured at fair value.

**Unbundling** | If an investment or service component is not closely related to the insurance coverage specified in the contract then an insurer would unbundle and account separately for that component. | IASB members expressed their preference to measure explicit account balances as part of the insurance contract and to disaggregate them for presentation or disclosure. IASB members also indicated that they would like to explore an approach in which some other deposit components of insurance contracts could be disaggregated in the same way. However, no decisions were made. The FASB tentatively decided to separate explicit account balances from the insurance contract liability. |

**Presentation** | Under the ED, all income and expenditure from insurance contracts would be presented in profit or loss. | The Boards tentatively decided that an insurer should present premiums, claims, benefits and the gross underwriting margin in the statement of comprehensive income. The Boards will consider at a future meeting whether these items should be presented in the statement of comprehensive income separately from contacts measured using the building-block approach and those measured using the premium allocation approach. |

**Short-duration contracts** | The proposals contained a premium allocation approach for pre-claim liabilities of short duration contracts. | The premium allocation approach was intended to be a proxy for the building-block measurement model in the pre-claims period. Liabilities for claims incurred would be measured at the present value of the fulfilment cash flows in accordance with the general measurement model. The Boards tentatively decided to provide a practical expedient for discounting-incurred claims that are expected to be paid within 12 months of the insured event, unless facts and circumstances indicate that payment will no longer occur in 12 months. No decisions have been made to date on eligibility for the premium allocation approach. |
What remains to be done – and when might we expect a final standard?
The current IASB work plan, updated in December 2011, is targeting a revised Review Draft or Exposure Draft in Q2 2012. The ultimate timeline for a final IFRS will depend on whether the IASB issues a new ED before issuing a standard (which usually would require a 120-day or longer exposure period). Whether the IASB re-exposes partially or fully depends on the eventual extent of change from the original ED. We currently expect deliberations to run into Q2 2012, with a final IFRS before 2013 unlikely in the case of re-exposure.

The FASB is aiming for an ED in 2012. Another date we do not yet know with any certainty is when a standard might come into effect. Taking account of the above, and the minimum period of 3 years that many respondents have said that they will require to implement a new standard, we imply an effective date of 2016.

What should insurers be doing now?
As identified in KPMG’s recent survey, given the current uncertainty over the details and timing of the final proposals, many large insurers are ‘watching and waiting’ – focusing on assessing the high-level impact of the evolving developments, educating core stakeholders and lobbying the standard setters.

While detailed implementation planning requires a final standard, insurers are beginning work on assessing what resources and support they will need in critical areas, such as accounting, actuarial, IT, HR, product development and investor relations. They are also considering the implications for other project activity such as enhancements to management information and investment in more sophisticated asset-liability management.

What does this mean for insurance regulation?
Does this matter for insurance regulation? Arguably not, because one of the reasons that there is so much diversity in current insurance accounting is because this has been influenced by insurance regulatory reporting that has developed on a country-by-country, jurisdiction-specific basis. But this is starting to change.

The Solvency II framework is implementing uniform economic risk-based solvency requirements requiring maximum harmonisation across all EU Member States for the first time. Globally, the publication of the revised IAIS Insurance Core Principles in October 2011 marks an important milestone in the harmonisation of insurance supervision. ICP 14 on Valuation sets out common principles for the valuation of assets and liabilities for solvency purposes. The table below compares its key requirements with those of the IASB Exposure Draft, as amended, and IFRS more generally.

IAIS ICP 14

Methodologies for calculating items in general purpose financial reports are substantially consistent with the methodologies used for regulatory reporting purposes

A total balance sheet approach to be used in the assessment of solvency to recognise the interdependence between assets, liabilities regulatory capital requirements and capital resources

Technical provisions include a margin for risk

Recognition and derecognition principles may differ from those used for general purpose financial reporting

Insurance contracts may be recognised on either the bound date or on the inception date of the contract

Contracts for ceded reinsurance should be recognised and valued so as to correspond to the recognition of risks which they are mitigating

The purchase of reinsurance should not result in the de-recognition of technical provisions unless the purchase of that reinsurance results effectively in the extinguishment or novation of the insurance contracts

The valuation of assets and liabilities is undertaken on consistent bases

The valuation of assets and liabilities is undertaken in a reliable, decision useful and transparent manner

An economic valuation of assets and liabilities reflects the risk-adjusted present value of their cash flows. It may be appropriate to use an amortised cost method for economic valuation of assets and liabilities

The value of technical provisions and other liabilities does not reflect the insurer’s own credit standing

The valuation of technical provisions exceeds the Current estimate by a margin (MOCE)

The Current estimate reflects the expected present value of all relevant future cash flows that arise in fulfilling insurance obligations, using unbiased, current assumptions

Insurance contracts are subject to the following boundary constraints, if they exist:

- Contractual termination as extended by any unilateral option available to the policyholder
- The insurer having a unilateral right to cancel or freely re-underwrite the policy
- Both the insurer and the policyholder making a bilateral decision regarding continuation of the policy

The MOCE reflects the inherent uncertainty related to all relevant future cash flows that arise in fulfilling insurance obligations over the full time horizon thereof.

The valuation of technical provisions allows for the time value of money

The valuation of technical provisions makes appropriate allowance for embedded options and guarantees

IFRS

- Accounting methods designed to meet the needs of investors and capital providers, focused on capacity to generate future distributable cash flows, may not meet the needs of insurance supervisors, focused on policyholder protection and an economic view of the balance sheet

- Assets and liabilities are measured independently of each other, except as regards participating business

- In principle agree, but determination of risk margin may differ depending on supervisory requirements

- Insurance contract assets and liabilities recognised when the coverage period begins, with an onerous contact liability recognised in the pre-coverage period

- In principle agree as IFRS generally requires calibration of the insurance contract liability to the reinsurance premium

- For insurance contract liabilities

- For other liabilities

- In principle analogous to the risk margin

- Definition of contract boundary differs

- In principle – although detailed determination may differ, for example, Solvency II uses the concept of the matching premium rather than an illiquidity premium

- But amortised cost not permitted for insurance contract liabilities

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In some cases, these differences reflect a fundamental difference in philosophy, namely the purpose of financial statements but in some cases they reflect subtle differences in the solutions to complex issues – like the definition of the contract boundary. As the IAIS said in their comment letter on the Exposure Draft, “if the issues had been easy to resolve they would have been resolved many years ago.” Large or small, these differences have important practical implications – if methodologies used for calculating items in general purpose financial reports can be used for, or are substantially consistent with, the methodologies used for supervisory reporting purposes, with as few changes as possible, this is likely to reduce costs for regulated insurance entities and thereby policyholders.

Accounting results drive management behaviour and insurance supervisors should be concerned about accounting implications that may drive management towards conduct that is not in the interests of policyholders or which could pose a threat to their financial stability. Explaining two divergent outcomes especially when both claim to be ‘market consistent’ is likely to prove challenging – and is unlikely to enhance the transparency of the sector.

Insurance reporting is in need of a radical overhaul because it has grown up to be unduly dependent on insurance regulatory reporting. It would be a matter of great regret if the current reforms were inadvertently to lead to avoidable inconsistency because insurance regulators and accounting standard setters had each headed down the same path, trying to resolve the same problems, but had done so independently of each other.

The journey to a single high quality global accounting standard for insurance contracts is a long one – but it should not be never-ending. As the insurance accounting journey finally appears to be getting nearer to a conclusion, we believe that where regulatory requirements can be aligned with general purpose financial statements they should be. This is, after all, the premise that underpinned the original Framework for Consultation on Solvency II, which envisaged a solvency regime compatible with the accounting principles elaborated by the IASB. Remaining differences should be limited to areas that are clearly explainable, and are required to meet the differing needs of different constituencies.

Where regulatory requirements can be aligned with general purpose financial statements, they should be.
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<th>Abbreviation</th>
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<td>AC</td>
<td>Additional Capital</td>
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<td>Asset-Liability Management</td>
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<td>Association of Southeast Asian Nations</td>
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<td>Bermuda Monetary Authority</td>
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<td>CBRC</td>
<td>China Banking Regulatory Commission</td>
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<td>ComFrame Consumer Financial Protection Bureau</td>
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<td>CIMA</td>
<td>Cayman Islands Monetary Authority</td>
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<td>CIRC</td>
<td>China Regulatory Insurance Commission</td>
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<td>ComFrame</td>
<td>A comprehensive supervisory framework for the supervision of internationally active insurance groups</td>
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<td>DdA</td>
<td>Defensor Del Asegurado</td>
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<td>Dodd-Frank Act</td>
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<td>FOFA</td>
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<td>Fair Value Through Profit or Loss</td>
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<td>GAAP</td>
<td>Generally Accepted Accounting Principles</td>
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<td>JFSA</td>
<td>Japan Financial Services Agency</td>
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<td>LAGIC</td>
<td>Life and General Insurance Capital</td>
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<td>OCC</td>
<td>Office of the Comptroller of the Currency</td>
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<td>OCI</td>
<td>Other Comprehensive Income</td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>OFT</td>
<td>Office of Fair Trading</td>
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<td>Office of Insurance Commission</td>
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<td>ORSA</td>
<td>Own Risk and Solvency Assessment</td>
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<td>OSFI</td>
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<td>OTC</td>
<td>Over the Counter</td>
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<td>OTS</td>
<td>Office of Thrift Supervision</td>
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<td>MI</td>
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<td>Minimum Capital Requirement</td>
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<td>MiFID</td>
<td>Markets in Financial Instruments Directive</td>
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<td>MAS</td>
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<td>MOF</td>
<td>Ministry of Finance</td>
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<td>NAIC</td>
<td>National Association of Insurance Commissioners</td>
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<td>PFRS</td>
<td>Philippines Financial Reporting Standards</td>
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<td>SMI</td>
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<td>Argentine Insurance Regulator</td>
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<td>SVS</td>
<td>Superintendencia de Valores y Seguros</td>
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<td>TCF</td>
<td>Treating Customers Fairly</td>
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<td>ULIPS</td>
<td>Unit Linked Insurance Plans</td>
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We would like to acknowledge the contribution of our colleagues from across our global network who helped develop this report:

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