Workshop on the new UAE regulations

Impact of new UAE Insurance regulations on insurance companies' ERM

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Disclaimer

Agenda

1. Risk profile and ERM capabilities

2. New regulations and their impact

3. Impact on industry performance

4. Some final thoughts

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Risk profile varies by market and by company

RISK PROFILE

HIGH RISK
MODERATE RISK
LOW RISK
MINIMAL RISK

RISK PROFILE DEPENDS ON:

- Line and type of business
- Market profile (growth, competition etc)
- Investments
- Liquidity
- Operating environment (regulation, legislation etc)
- etc

Matching risk profile to ERM capabilities

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RISK PROFILE		RISK MANAGEMENT CAPABILITY
HIGH RISK	⟷	SUPERIOR
MODERATE RISK	⟷	STRONG
LOW RISK	⟷	GOOD
MINIMAL RISK	⟷	WEAK

Matching risk profile to ERM capabilities

A company's risk management capability needs to meet its risk profile

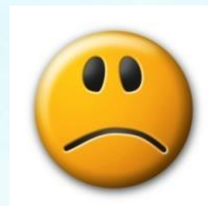
RISK PROFILE

HIGH RISK

MODERATE RISK

LOW RISK

MINIMAL RISK



Risk management capability well below company's risk profile

RISK MANAGEMENT CAPABILITY

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GOOD

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Matching risk profile to ERM capabilities

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Risk management capability well above company's risk profile

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2. **New regulations and their impact**

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The new UAE regulations

1. Basis of investing the rights of policyholders
2. Solvency Margin and Minimum Guarantee Fund
3. Basis for calculating technical provisions
4. Determining the company's Assets that meet the Accrued Insurance Liabilities
5. Records which the company shall maintain
6. Principles of Accounting Books
7. Accounting policies to be adopted

...and their impact on companies' Risk Profile and ERM capabilities

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MOSTLY DIRECT IMPACT

POTENTIAL INDIRECT IMPACT

Legend

Direct impact

Indirect impact

1. Basis of investing the rights of policyholders
2. Solvency Margin and Minimum Guarantee Fund
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1. Basis of investing the rights of policyholders AND
4. Assets that meet the Accrued Insurance Liabilities

KEY PROVISIONS OF NEW REGULATIONS

- Introduction of new limits per category of investment
- Companies must have investment and risk management polices which will be in line with the company's risk appetite
- Assets need to match the insurance liabilities assumed
- Companies will establish investment committee
- Need to document Contingency funding
- Companies to conduct stress testing
- Investment for Accrued Liabilities to be in line with "prudent person" principle

ELEMENTS OF RISK PROFILE

Investments	Liquidity
HIGH RISK Low rated fixed income Concentrations, illiquid High % in equities Speculative derivatives	**HIGH RISK** Investment portfolio illiquid No outside sources of liquidity Mismatch in liquidity available vs. liquidity demands of product portfolio
MEDIUM RISK Mostly highly rated Mostly liquid Moderate % in equities Minimal speculation	**MEDIUM RISK** Relatively well matched asset/liability portfolio Riskier assets matched to surplus Liabilities more protected from surrender charges
LOW RISK Mostly highly rated Mostly liquid Moderate % in equities Minimal speculation	**LOW RISK** No upcoming debt maturities Strong cash/cash flow available Sticky liabilities less likely to surrender

POTENTIAL IMPACT ON ERM

- Companies forced to define <u>proper</u> risk appetite
- Companies establish <u>independent</u> investment committees

IMPACT ON RISK PROFILE

- Significant de-risking of some investment portfolios
- Improved liquidity

2. Solvency Margin and Minimum Guarantee Fund

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KEY PROVISIONS OF NEW REGULATIONS

- Introduction of new Solvency Template for calculation of regulatory / solvency capital
- Minimum Capital Requirement (MCR) not linked to riskiness of operations
- Minimum Guarantee Fund (MGF) and Solvency Capital Requirement (SCR) linked to the new Template
- Companies obliged to have in place a documented risk management framework
- Companies to submit Solvency Template annually – template to be validated by the Actuary

CURENT MARKET PRACTICE

- Few companies have capital management tools (capital, ALM, cat-models)
- In most cases capital requirements are defined as "solvency capital" requirements
- Some cases whereby capital models are the responsibility of technical staff alone

POTENTIAL IMPACT ON ERM

- Gradual improvement of understanding of riskiness of investment operations
- Possibility of companies adopting new Template as internal capital model

OR

- View new regime as an additional inconvenience

3. Basis for calculating Technical Provisions

KEY PROVISIONS OF NEW REGULATIONS

- Companies to appoint Actuary who is registered by the Authority.
- The Actuary to:
  - Review and approve the Technical Provisions
  - Assess the quality of the data
  - Provide the IA with annual report with current and future risks
  - Be professionally liable for the advice
- The Company shall report quarterly to the Authority and submit annually to the IA

ELEMENTS OF RISK PROFILE

Data quality

HIGH RISK

Poor data quality
Data outdated
Inappropriate for decision

MEDIUM RISK

Some data missing
Some data miscoded/bulk

LOW RISK

High quality data
Obtained quickly
Adequate for decision
Regular testing of data

POTENTIAL IMPACT ON ERM

- In the medium-to-long term companies can develop the ability to link pricing with experience. This can lead to review of:
  - Risk appetite
  - Strategy

IMPACT ON RISK PROFILE

- Improvement in data quality
- Independent verification of data

5. Records which the company shall maintain
6. Principles of Accounting Books
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KEY PROVISIONS OF NEW REGULATIONS

- Retention of records for at least 10 years
- Accounting to be in accordance with IFRS for all companies
- Quarterly and annual audited reporting (quarterlies with "limited review" of external auditors)

ELEMENTS OF RISK PROFILE

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POTENTIAL IMPACT ON ERM

- Only as a side-effect

IMPACT ON RISK PROFILE

- May arise out of introduction of IFRS and difference in valuation of both assets and liabilities

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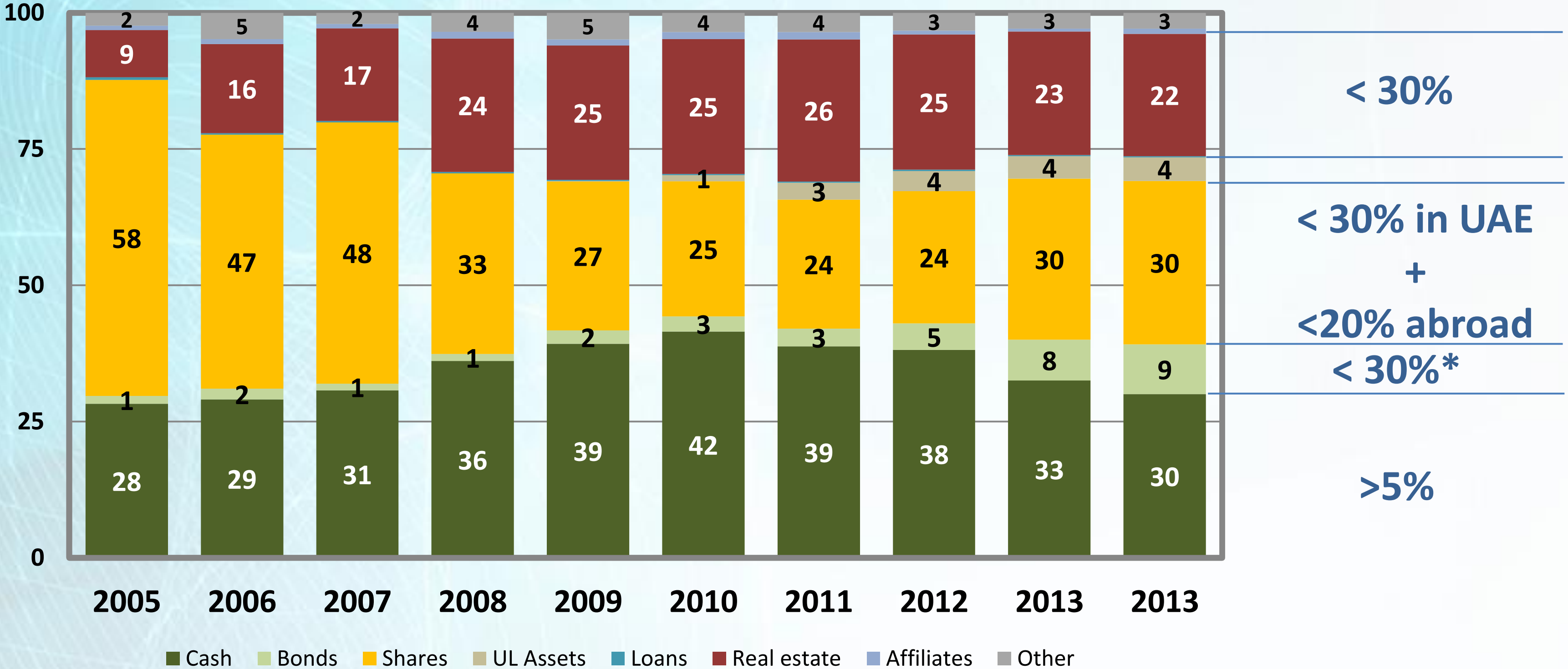
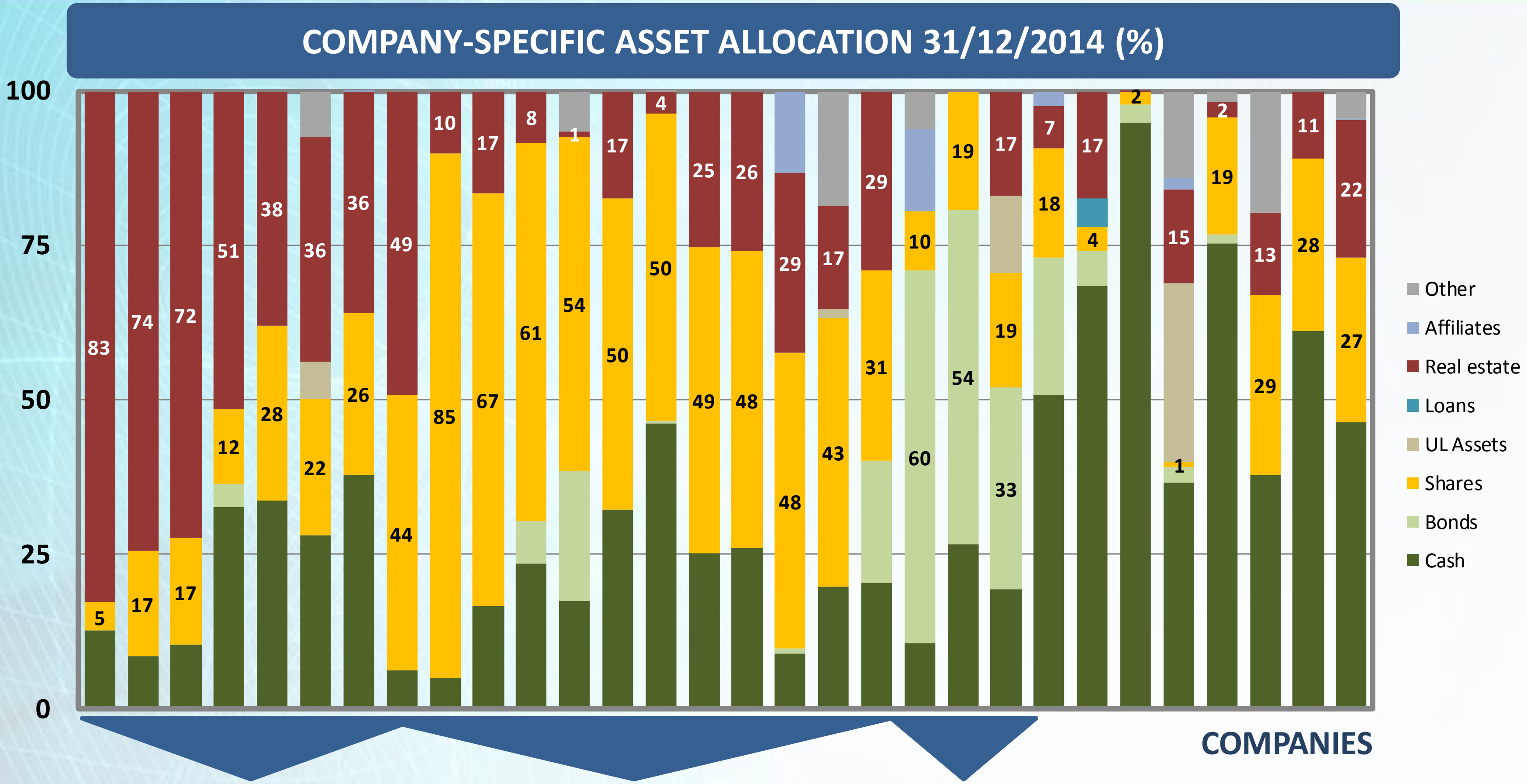
No impact on asset allocation for the industry as a whole



Source: AM Best - Statement File Global

* For Government Bonds the limits are:
- 100% for UAE Government issues and
- 80% for other “A” rated sovereigns

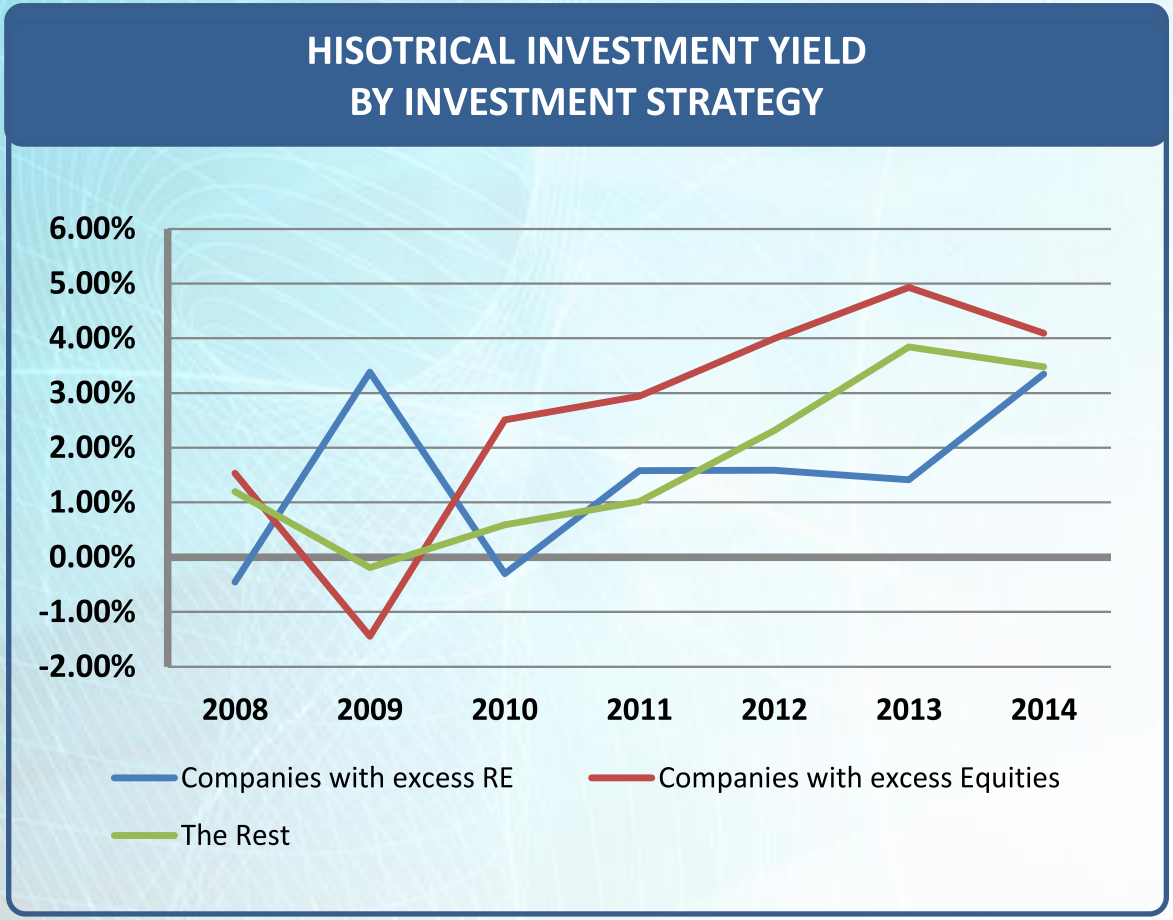
Significant impact for several companies



EXCESSIVE REAL ESTATE	EXCESSIVE EQUITIES	EXCESSIVE BONDS (?)
8 companies	12 companies	3 companies

Source: AM Best - Statement File Global

Asset reallocation will reduce investment volatility



Source: AM Best - Statement File Global

- Reallocating assets to comply with new regulation will reduce investment volatility
- Some companies will have to realise capital losses due to the illiquid nature of both Real Estate and local Equity markets
- However, this is unlikely to be the main driver for renewed focus on technical profitability

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Story of two companies

	COMPANY "A"	COMPANY "B"
GWP	100,000	100,000
Claims reserves	380,000	380,000
Reinsurance	XoL	Q/S
Effective cession rate	5% of GWP 2% of claims reserves	98% of GWP 98% of claims reserves
Rationale	Consistent with our risk appetite	Consistent with our previous practice

Question: Which of the two strategies should the regulatory regime encourage?

Story of two companies

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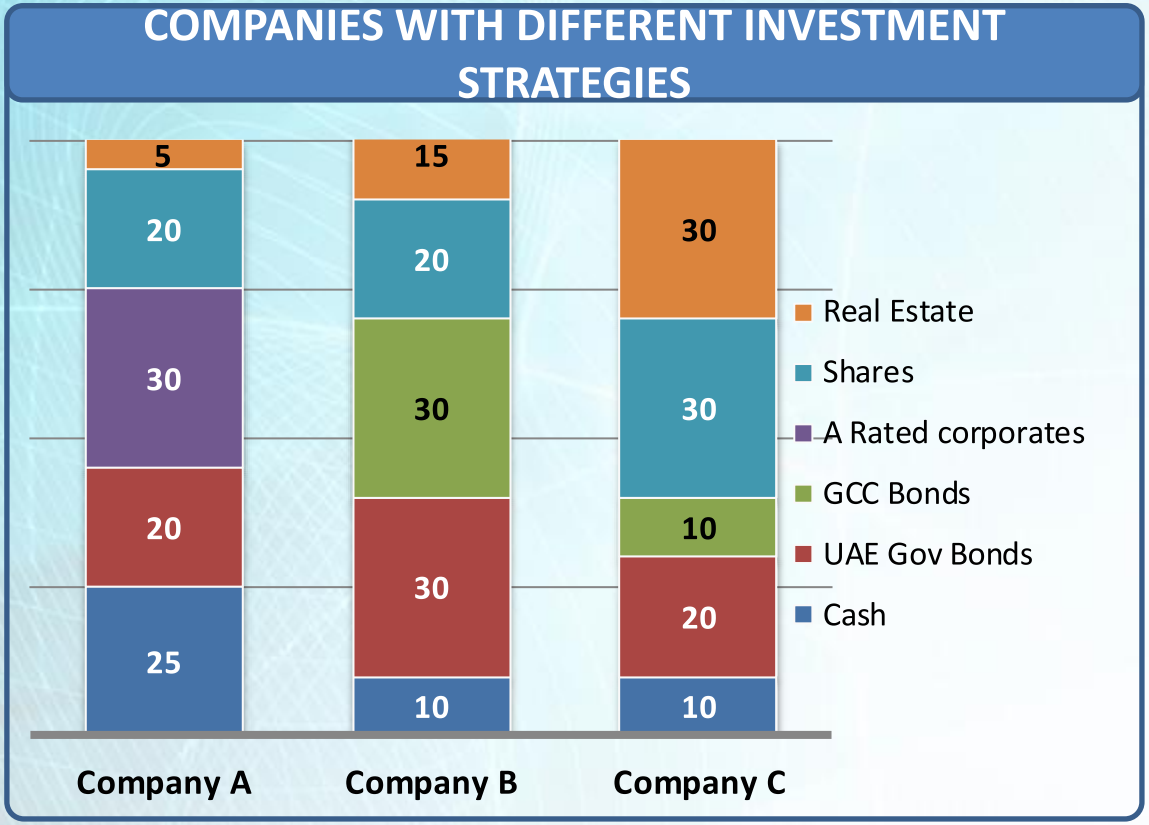
Risk factor = 2.088% !

RESULTS OF THE SOLVENCY TEMPLATE

U/W risk NL	74,480	38,000
U/W risk Life	0	0
Investment Risk	0	0
Credit Risk	1	9,820
BSCR	74,480	39,248
Operational Risk	11,400	11,400
SCR	**85,880**	**50,648**
MGF	**28,627**	**16,833**

Story of three companies



- All three strategies are acceptable under new regime
- Key factors in decision making:
  - Availability of capital
  - Regulatory capital requirements
- Company B likely to have the lowest regulatory capital requirements for its investments (dependent on liquidity charges)

Hurdles to implementation

- Available skill set in the market could result in IA and the companies depending on advisors for a long time
- Entrenched practices and opinions among current insurance Board Members
- Market inertia

FAILURE TO IMPLEMENT WILL BE WORSE THAN NEVER HAVING ISSUED THE NEW REGULATIONS