Industry Meeting on Quantitative Impact Study 2022

General Insurance Industry

May 2022

LifeWorks

Agenda

- Quantitative Impact Study (QIS)
- Proposed Capital Model for General Insurers
- QIS Submission
- Questions

Quantitative Impact Study

QIS Background

ICB considering Risk Based Capital (RBC) requirements for general insurers

Quantitative Impact Study (QIS) used as a tool to gather information and assess the impact of proposed RBC framework

New International Financial Reporting Standard (IFRS) for insurance effective 1 Jan 2023

Current QIS to address the new IFRSs

Objectives of the Quantitative Impact Study (QIS)

- Evaluate the impact of IFRS 17 & IFRS 9 on general insurers
- Recommend changes to proposed capital standards that reflect the new IFRSs
- Recommend changes to proposed capital standards based on analysis of QIS results
- QIS to be done on a “best efforts” basis

Note: The final capital framework may be different from the Company’s submission

QIS Approach

Capital Adequacy based on IFRS 4 financials

- Based on reported 2021 financials

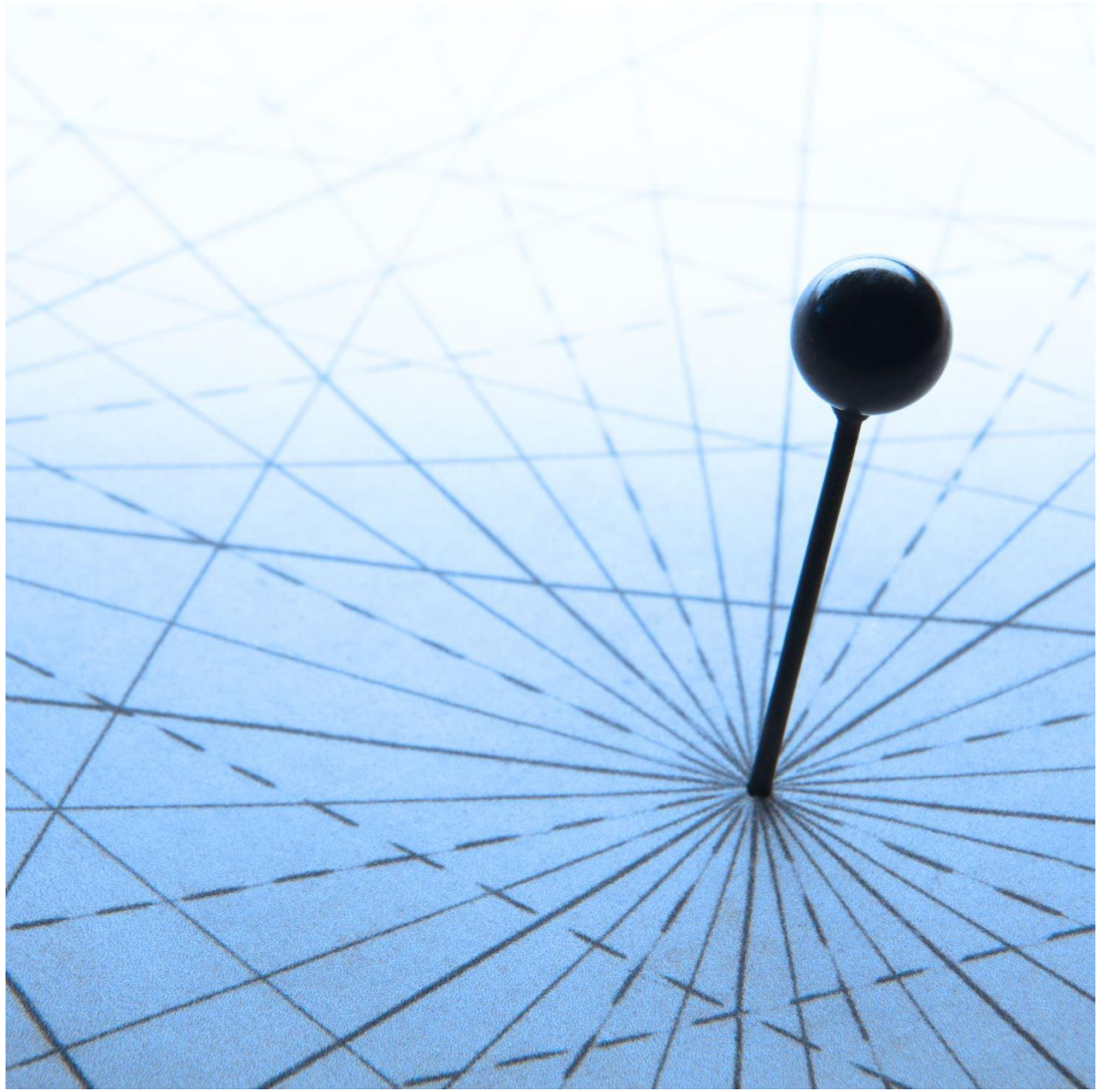
Capital Adequacy based on IFRS 17 financials

- Capital required for asset risks based on IFRS 9 asset values
- Capital required for liability risks based on IFRS 17 liability values

Quantitative Impact Study

In summary…

- QIS is a tool for gathering and analyzing information
- Current QIS to address new IFRSs
- Insurers are asked to submit 2 sets of results: based on reported 2021 financials and IFRS 17 financials



Available Capital

Available Capital

Largely the same approach as last QIS for Branch Capital and Domestic Capital

However, the changes to the accounting standard impact the amount of capital reported in an insurer's Statement of Financial Position (balance sheet).

Available Capital

Foreign Branches

- Initial Deposit (s.43, Insurance Act, 2005); *plus*
- Statutory funds held in trust (s.45(5), Insurance Act, 2005); *plus*
- Any excess assets in The Bahamas; *less*
- Total liabilities and reserves required in The Bahamas

Available Capital

Domestic Companies

- Sum of Tier 1 and Tier 2 Capital, less the deductions from capital
- Tier 1 Capital is comprised of the highest quality elements (e.g. ordinary shares and retained earnings)
- Tier 2 Capital is of lower quality elements but contributes to the company's strength (e.g. certain preference shares)

Available Capital: Tier 1 Capital

- \+ Ordinary shares
- \+ Certain preference shares
- \+ Contributed surplus
- \+ Revaluation reserves approved by ICB
- − Unrealized gains on assets included in retained earnings and revaluation reserves
- \+ Retained earnings/deficit
- \+ Non-controlling interest

Available Capital: Tier 2 Capital

Tier 2A

- Preference shares and financial instruments not included in Tier 1; limits apply
- Certain hybrid capital instruments
- Unrealized gains excluded from Tier 1; limits apply

Tier 2B

- Certain limited-life instruments; limits apply

Limits on Tier 2 Capital

Total Tier 2 capital must not be greater than net Tier 1 capital

Tier 2B capital must not be greater than 50% of Net T1 capital.

Unrealized gains on real estate limited to 20% of net Tier 1 capital

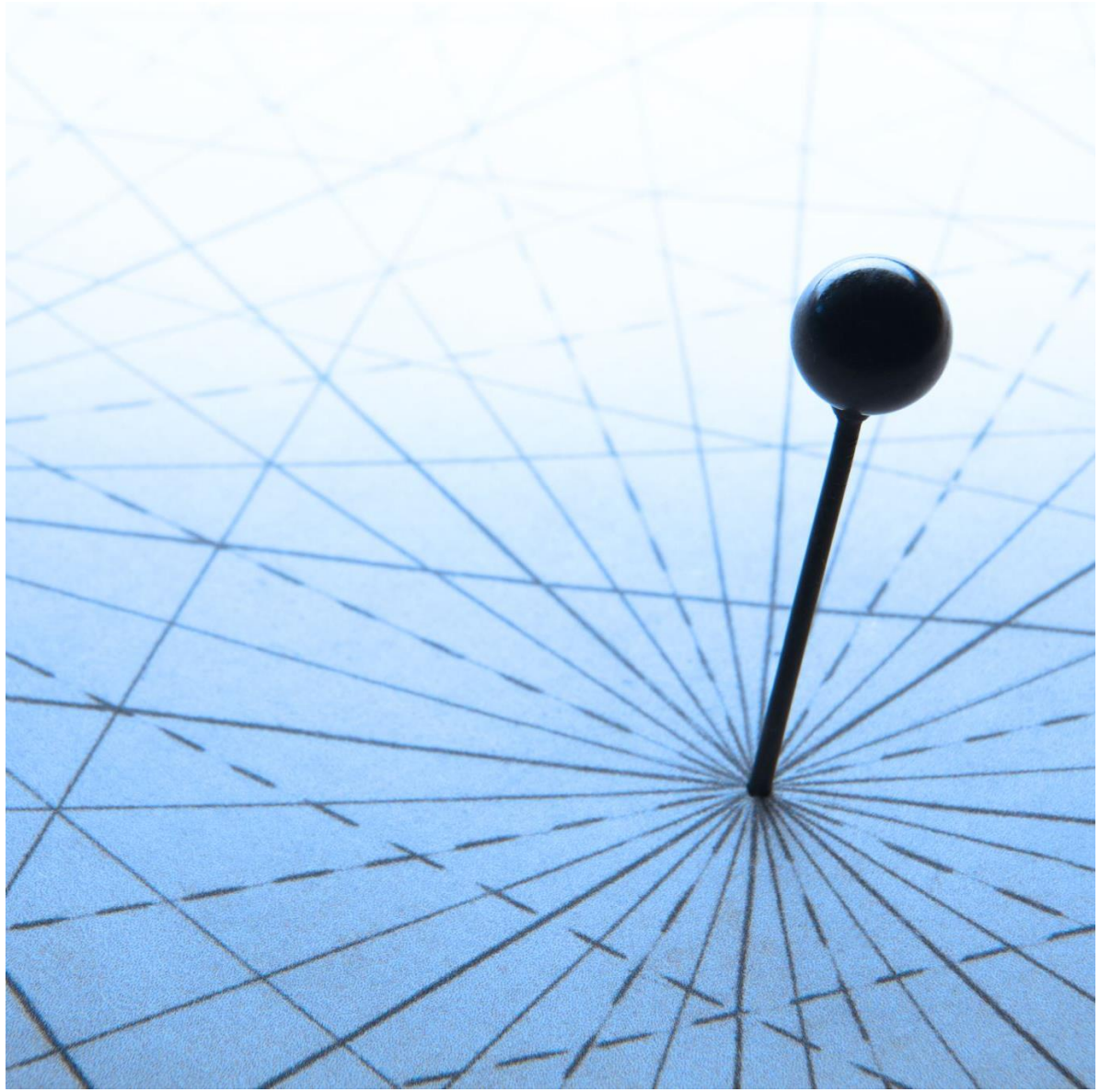
Deductions

- Goodwill and other intangible assets
- Back to back placements
- Pension plan assets
- Investment in financial subsidiaries

Available Capital

In summary…

- Same approach as last QIS, but one set of calculations will be based on IFRS 17 balance sheet
- Adjusted for changes in the actuarial liabilities determined in accordance with IFRS 17 requirements
- Adjusted for changes in assets in accordance with IFRS 9



Required Capital

Required Capital

Current Framework

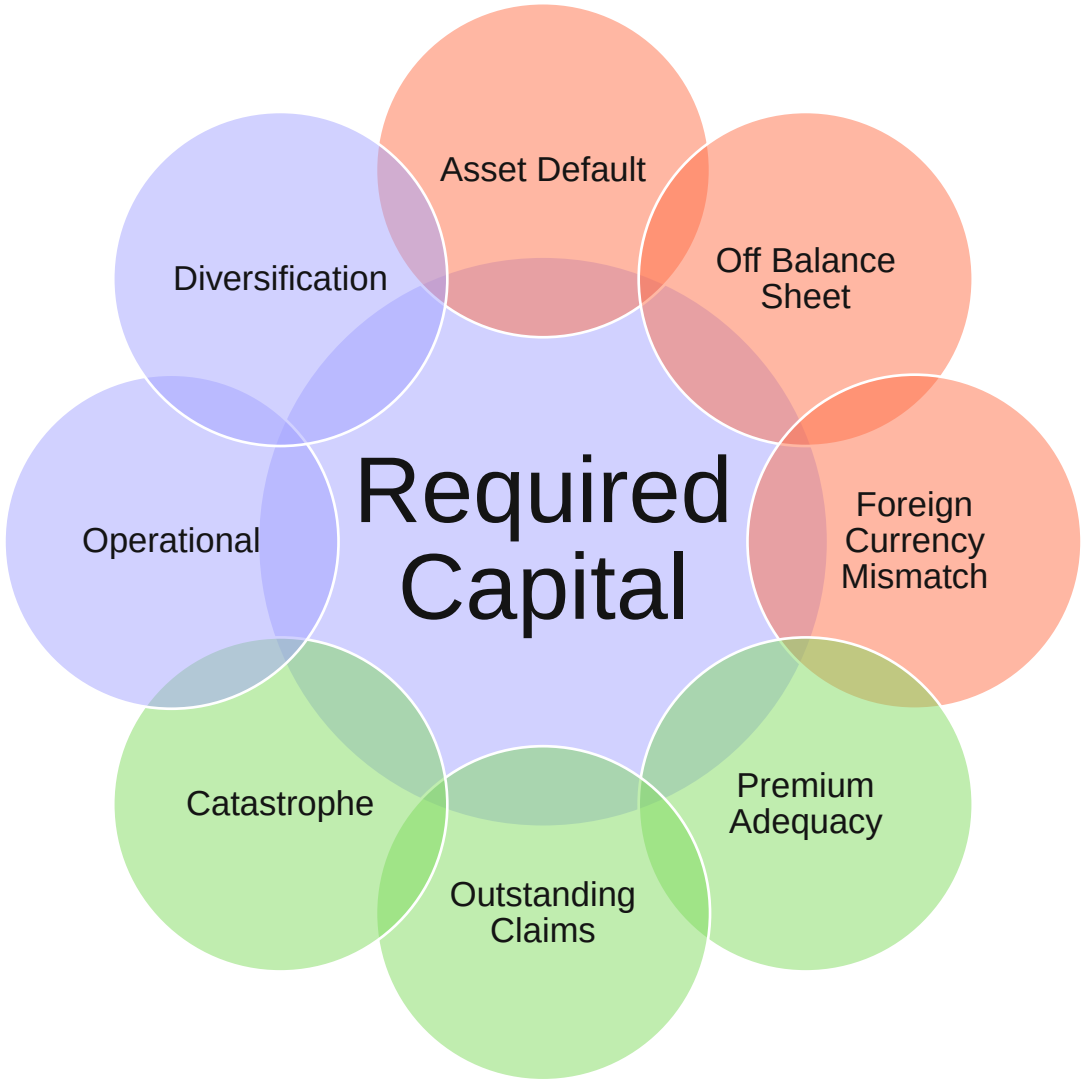
- Discount on assets
- % of premium requirement
- No separate operational risk and diversification credit components

Proposed RBC Framework

- Separate asset risk components
- Separate liability risk components
- Separate operational risk and diversification credit components

Required Capital

Liability Risks



Asset Risks

Asset Risks

Credit (Asset Default) Risk Charge

- Meant to cover the chance that companies or individuals will be unable to make required payments on their obligations
- Also includes volatility in values of equities, property and other assets

Asset Risks

Credit (Asset Default) Risk

- Sum of total assets for each class multiplied by risk factor
- Factors range from 0% to 100%
- Lowest for cash, government securities; highest for investment in related parties that are financial subsidiaries and deferred acquisition costs

Asset Risks

Credit (Asset Default) Risk

- Same approach, but risk factor applied to asset values net of IFRS 9 provisions
- Companies are asked to disclose their total IFRS 9 provision
- Factors for those assets impacted by IFRS 9 will be reviewed as part of the study

Asset Risks

Off Balance Sheet Risk Charge

- Meant to quantify risks associated with assets and liabilities that are not stated on the insurer’s balance sheet (e.g.letters of credit, derivatives)

Asset Risks

Off Balance Sheet Risk

- Risk factor applied to exposure amount
- Exposure amount is the face value for letters of credit and the replacement cost for swaps, futures, options and other derivatives
- Same for both calculations (i.e. under IFRS 4 and IFRS 17)

Asset Risks

Foreign Currency Mismatch Risk Charge

- Meant to cover risks associated with adverse changes in the exchange rate when assets and liabilities are denominated in different currencies

Asset Risks

Foreign Exchange Mismatch Risk

- Risk factor applied to net open FX position, converted to BAH$
- Factors vary based on the issuing country's Standard and Poor's credit rating

Asset Risks

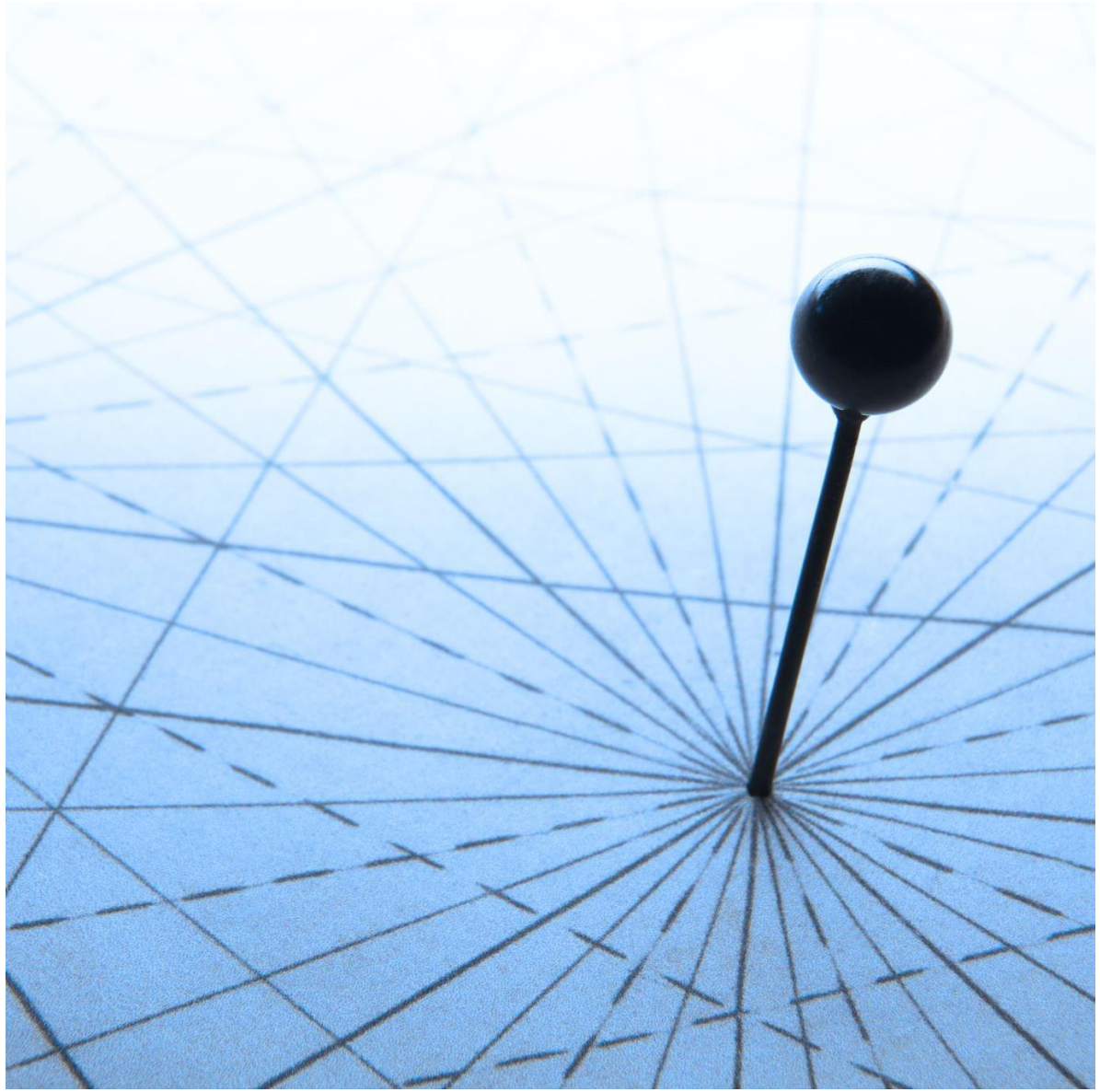
Foreign Exchange Mismatch Risk

- Same approach, but risk factor applied to net open FX position, determined using IFRS 9 assets and IFRS 17 liabilities and converted to BAH$

Asset Risks

In summary…

- Includes capital charges for asset default, off-balance sheet transactions and foreign currency mismatch risk
- Same approach as last QIS, but adjusted for changes in balance sheet in accordance with IFRSs

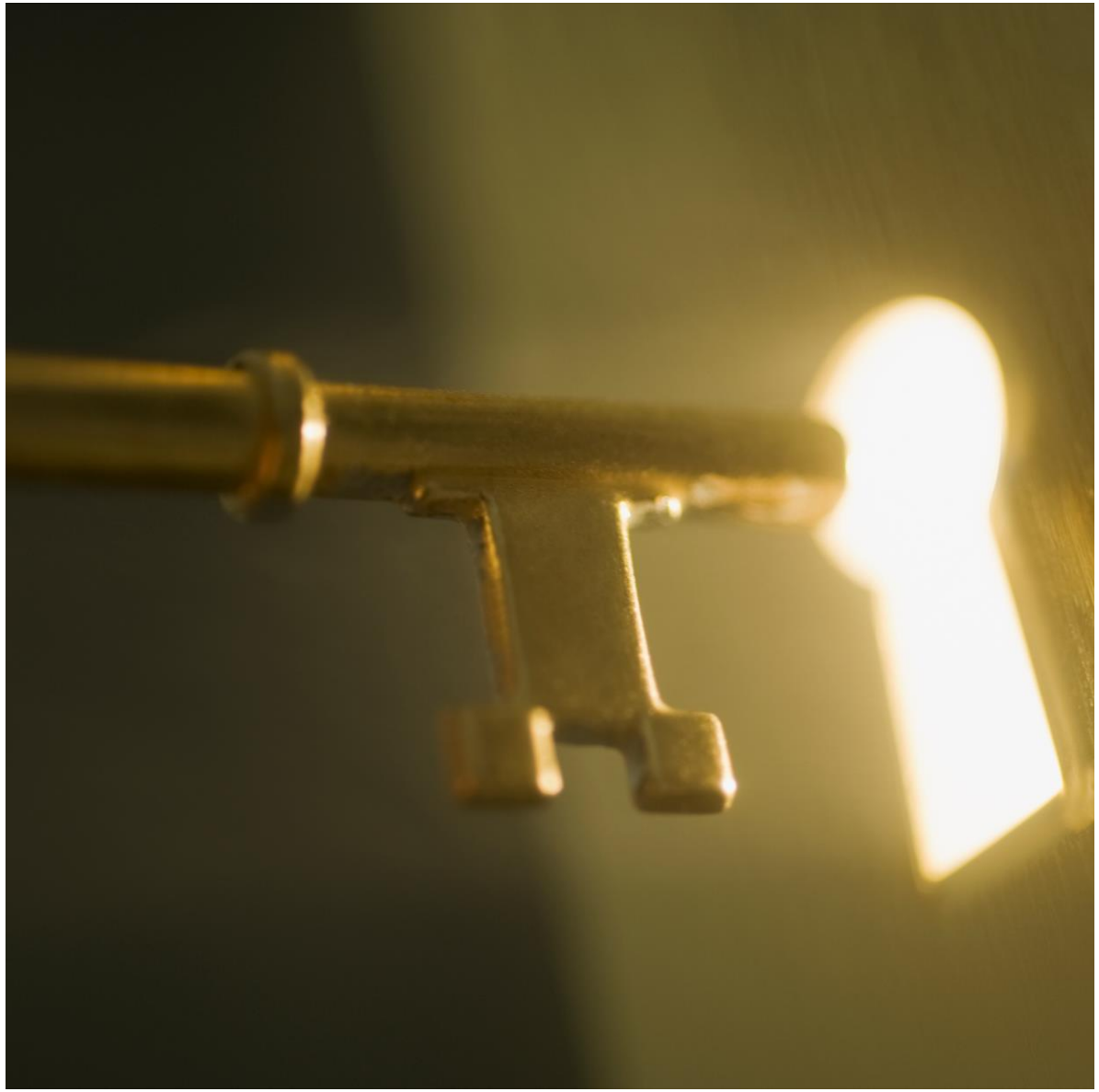


Liability Risks

Key Concept

- Under IFRS 17, an insurer may value insurance liabilities using the General Measurement Model (“GMM”) or the Premium Allocation Approach (“PAA”)

- PAA is simpler and can be used if insurance coverage is 1 year or less **or** if the PAA is a reasonable approximation to the GMM



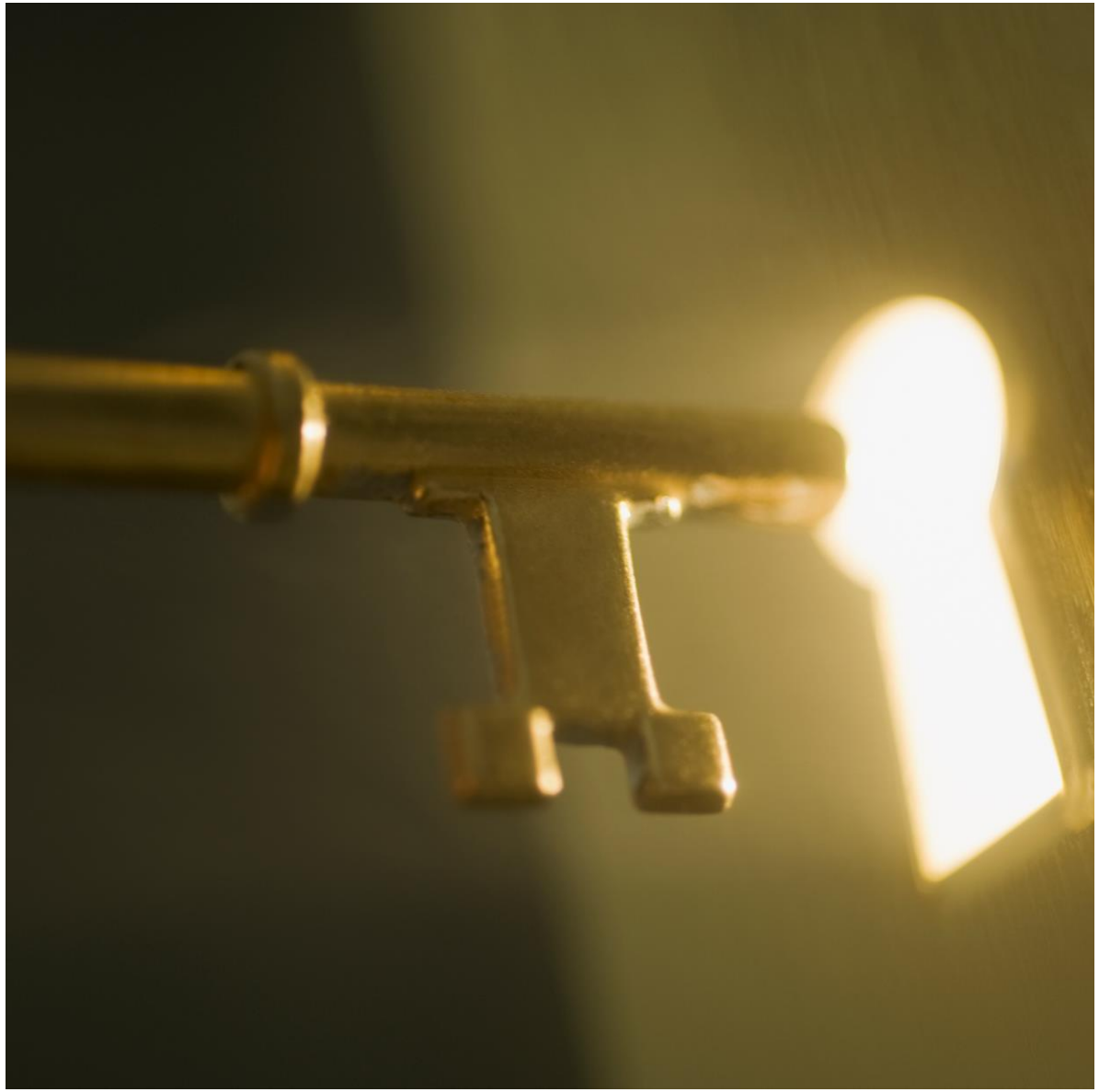
Liability Risks

Key Concept

- For the purposes of the QIS, where liabilities are to be determined the Premium Allocation Approach (PAA) is to be used

- Instructions include proxies that the insurer may use (**only for the purpose of this QIS)** in the event that the requested information is unavailable.

NB: Insurers should disclose whether they are using these proxies



Liability Risks

Premium Adequacy Risk Charge

- Meant to cover the risk that premiums are insufficient to cover the anticipated liabilities

Liability Risks

Premium Adequacy Risk

- Calculation 1: risk factor constant for all lines of business and is applied to IFRS 4 liability values
- Calculation 2: risk factor varies by line of business and is applied to IFRS 17 liability values

Liability Risks

Premium Adequacy Risk

- Risk factor applied to net unexpired coverage (excluding risk adjustment for non-financial risk), instead of net unearned premium

- For insurers who do not have access to this detail by line of business, use the largest line for this QIS

Liability Risks

Outstanding Claims Risk Charge

- Meant to cover the risk that provision for outstanding claims reserves are insufficient to cover the anticipated liabilities

Liability Risks

Outstanding Claims Risk

- Calculation 1: risk factor constant for all lines of business and is applied to IFRS 4 liability values
- Calculation 2: risk factor varies by line of business and is applied to IFRS 17 liability values

Liability Risks

Outstanding Claims Risk

- Risk factor applied to net liability for incurred claims (excluding risk adjustment for non-financial risk), instead of net outstanding claims reserve

Liability Risks

Catastrophe Risk Charge

- Meant to cover risks associated with liabilities due to catastrophic event(s)

Liability Risks

Catastrophe Risk

- Insurer can choose between Formula Based Method and Model Generated Method
- Under the Formula Based Method, the primary inputs for the capital risk charge are risk factor and net written premium by line of business

Liability Risks

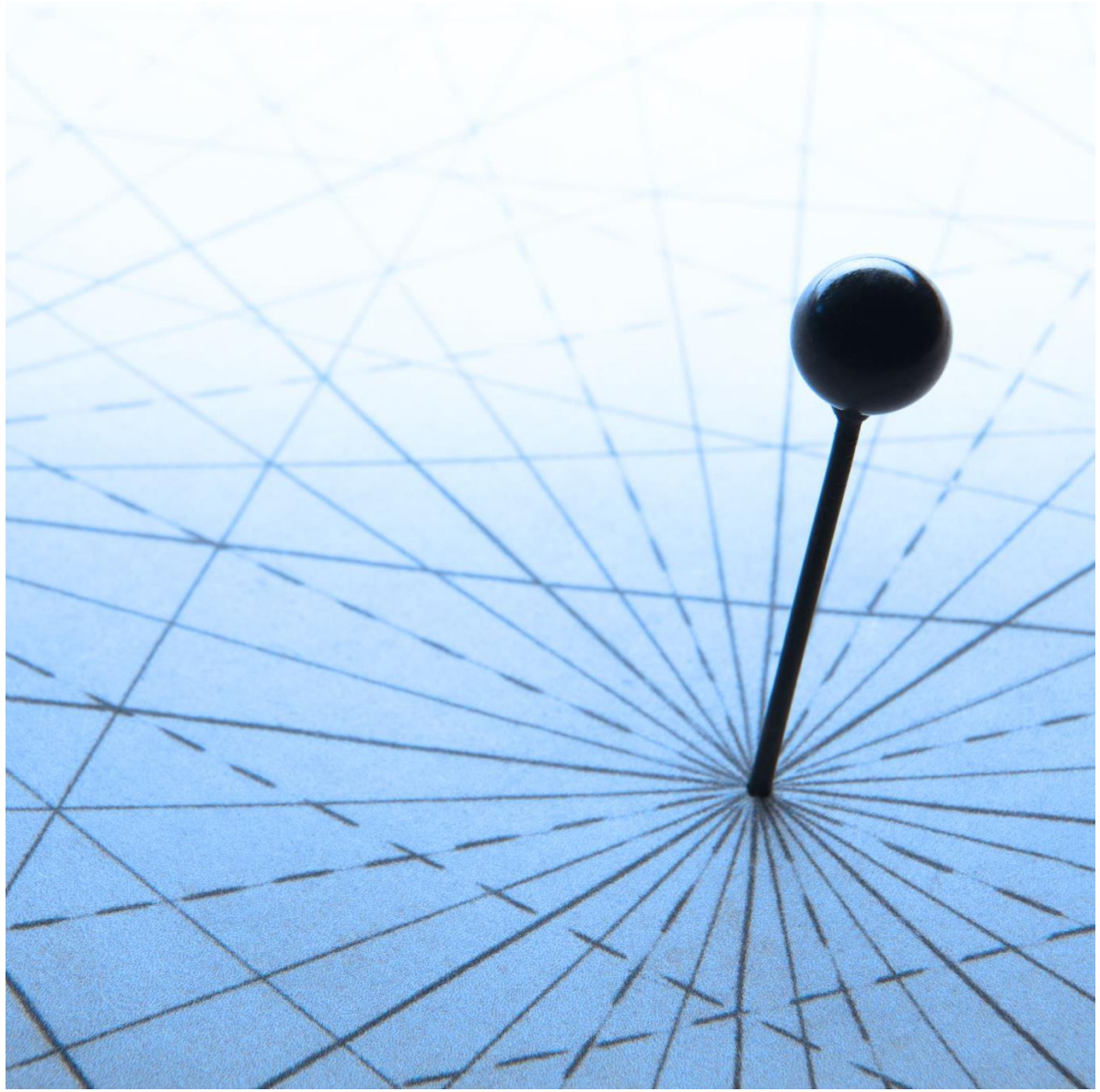
Catastrophe Risk

- Under the Model Generated Method, the capital charge is the greater of
- PML_{250} less Reinsurance collectible for Windstorm
- PML_{500} less Reinsurance collectible for Earthquake

Liability Risks

In summary…

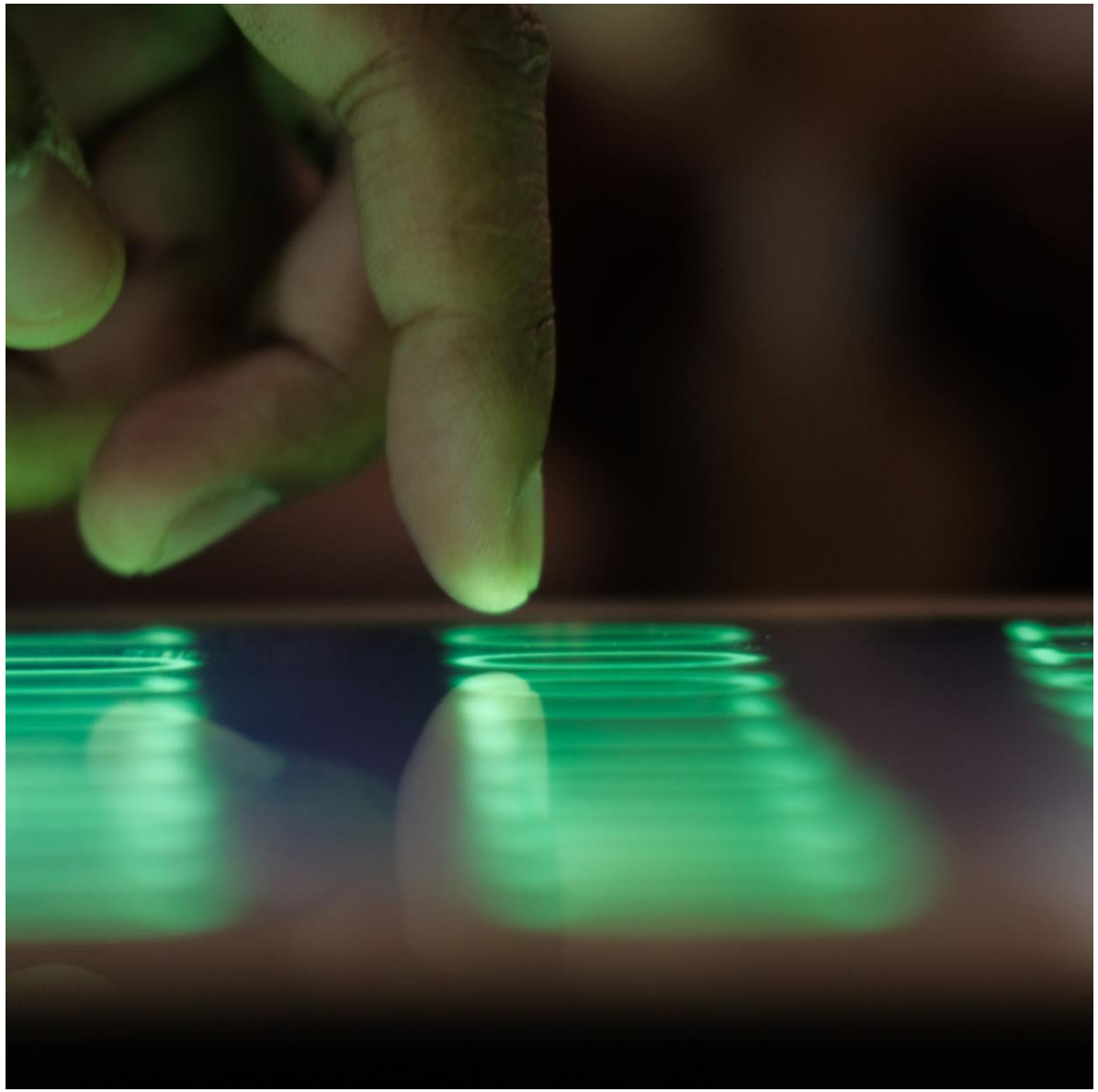
- Includes capital charges for premium adequacy, outstanding claims and catastrophe risk
- Adjusted for changes in liabilities in accordance with IFRS 17



Operational Risk

Operational Risk

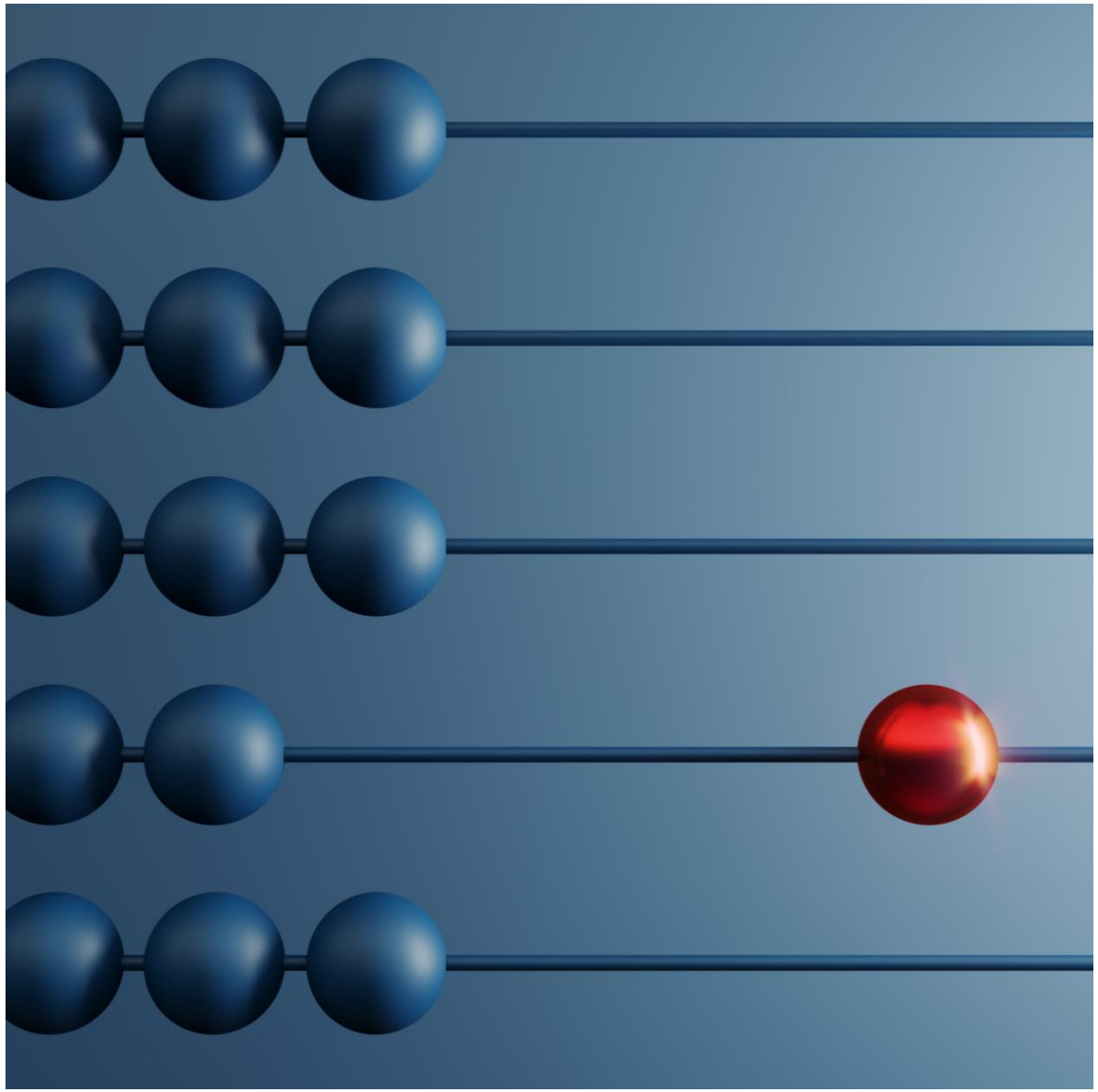
- Risk arising from inadequate/failed internal processes/systems, personnel, external events
- Capital requirement = 10% of the total required capital in respect of the other risks
- Automatically calculated in RBC spreadsheet



Diversification Credit

Diversification Credit

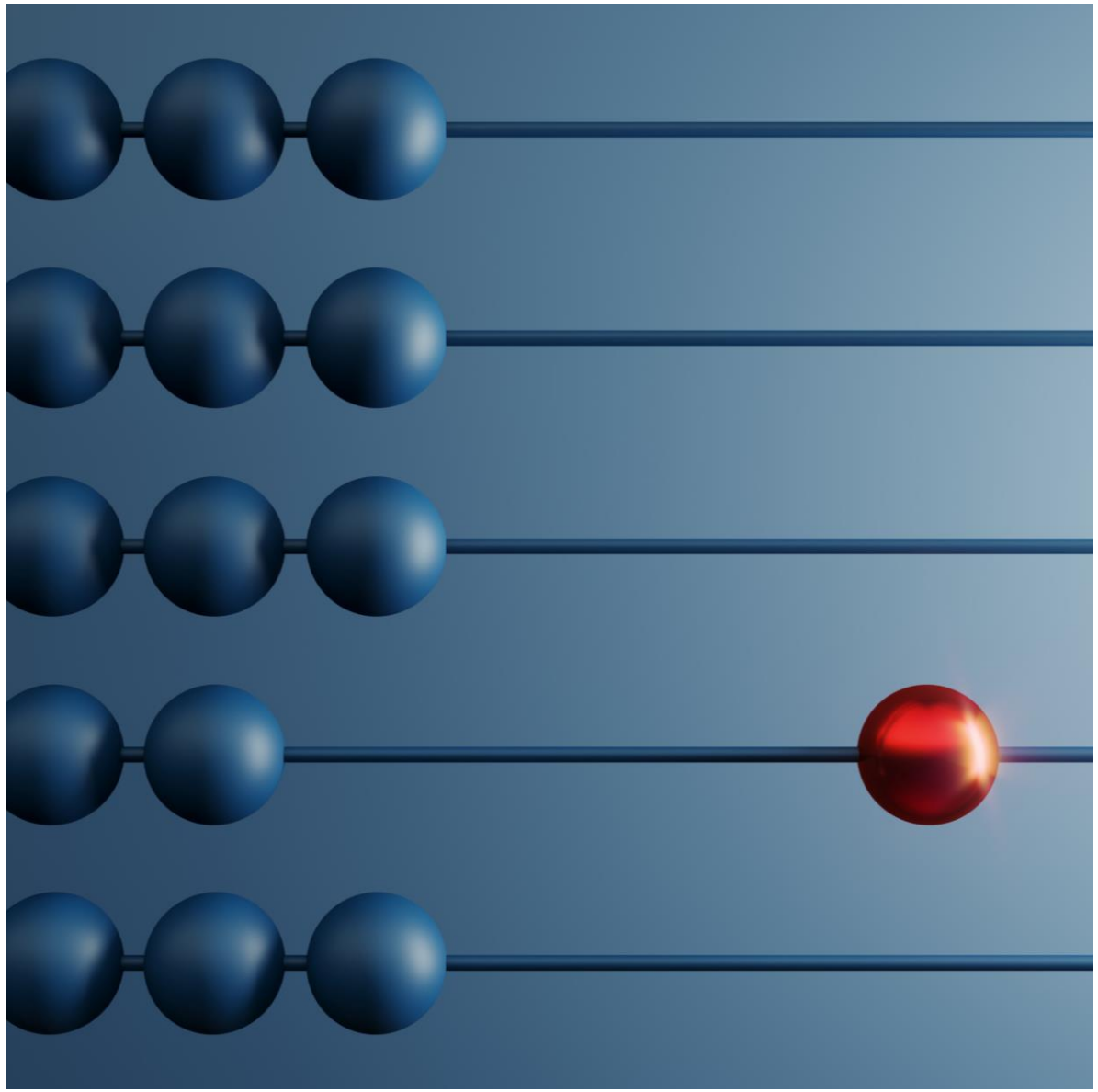
- Reflects that risks are not perfectly correlated
- Explicit credit is permitted between the sum of asset and liability risk requirements, so that the total capital required for these risks is less than the sum of the individual requirements



Diversification Credit

Diversification Credit

- Assumes a 50% correlation between asset and liability risks
- $(A + I) – (A^2 + I^2 + 2 * 50\% * A * I)^{1/2}$
- Automatically calculated in RBC spreadsheet



Summary of Changes

	Original Tabs	"IFRS" Tabs
Available Capital	Based on current financials	Based on IFRS 17 balance sheet
Required Capital		
Asset Default Risk	Based on current financials	Reflects IFRS 9 provision
Off Balance Sheet Risk	Same for both calculations	
Foreign Currency Risk	Based on current financials	Based on IFRS 17 balance sheet
Premium Adequacy Risk	Based on current financials. Single factor for all lines of business.	Factor varies by line of business and is applied to the IFRS 17 liability
Outstanding Claims Risk	Based on current financials. Single factor for all lines of business.	Factor varies by line of business and is applied to the IFRS 17 liability
Catastrophe Risk	Based on Formula Based and Model Generated Methods	
Operational Risk	Formula based. Automatically calculated.	
Diversification Credit	Formula based. Automatically calculated.	

Regulatory Capital Ratio

Risk Based Capital (RBC)

ICB considering RBC requirements for general insurers

Transitioning to a more granular approach that considers the size and degree of risk taken by the insurer

Insurer hold capital in proportion to its risk

Risk Based Capital (RBC)

Current Framework

- Discount on assets
- % of premium requirement
- Operational risk and diversification not considered

Proposed RBC Framework

- Separate asset risk components
- Separate liability risk components
- Separate operational risk and diversification credit components

Components of the Capital Adequacy Calculation

Available Capital

- Capital Available – Branch
- Capital Available - Domestic

Asset Risk

- Asset Default
- Off Balance Sheet
- Foreign Currency Mismatch

Liability Risks

- Premium Adequacy
- Outstanding Claims
- Catastrophe

Other Components

- Operational Risk
- Diversification Credit

Regulatory Capital Ratio

$$\text{Capital Ratio} = \frac{\text{Available Capital}}{\text{Required Capital}}$$

Regulatory Capital Ratio

Minimum Capital Ratio (MCR) 120%

Prescribed Capital Ratio (PCR) 150%

Target Capital Ratio (TCR) Above 150% set by insurer

Regulatory Capital Ratio	Supervisory Action
Below MCR	Most severe regulatory intervention including suspension of registration
Between MCR and PCR	Require insurers prepare a plan to raise capital above TCR

Additional Information about Submission

Required Disclosures

- Whether or not the insurer used Schedule 2 approximations
- IFRS 17 Balance Sheet
- Reconciliation of the insurance contract liabilities from IFRS4 to IFRS 17
- Gross Premiums and Gross Sum Insured, not reduced to reflect reinsurance by line of business
- Net Premiums and Net Sum Insured, which reflect the full deduction for reinsurance without application of the limit placed in Regulation 92 by line of business

General insurer submission by June 30, 2022

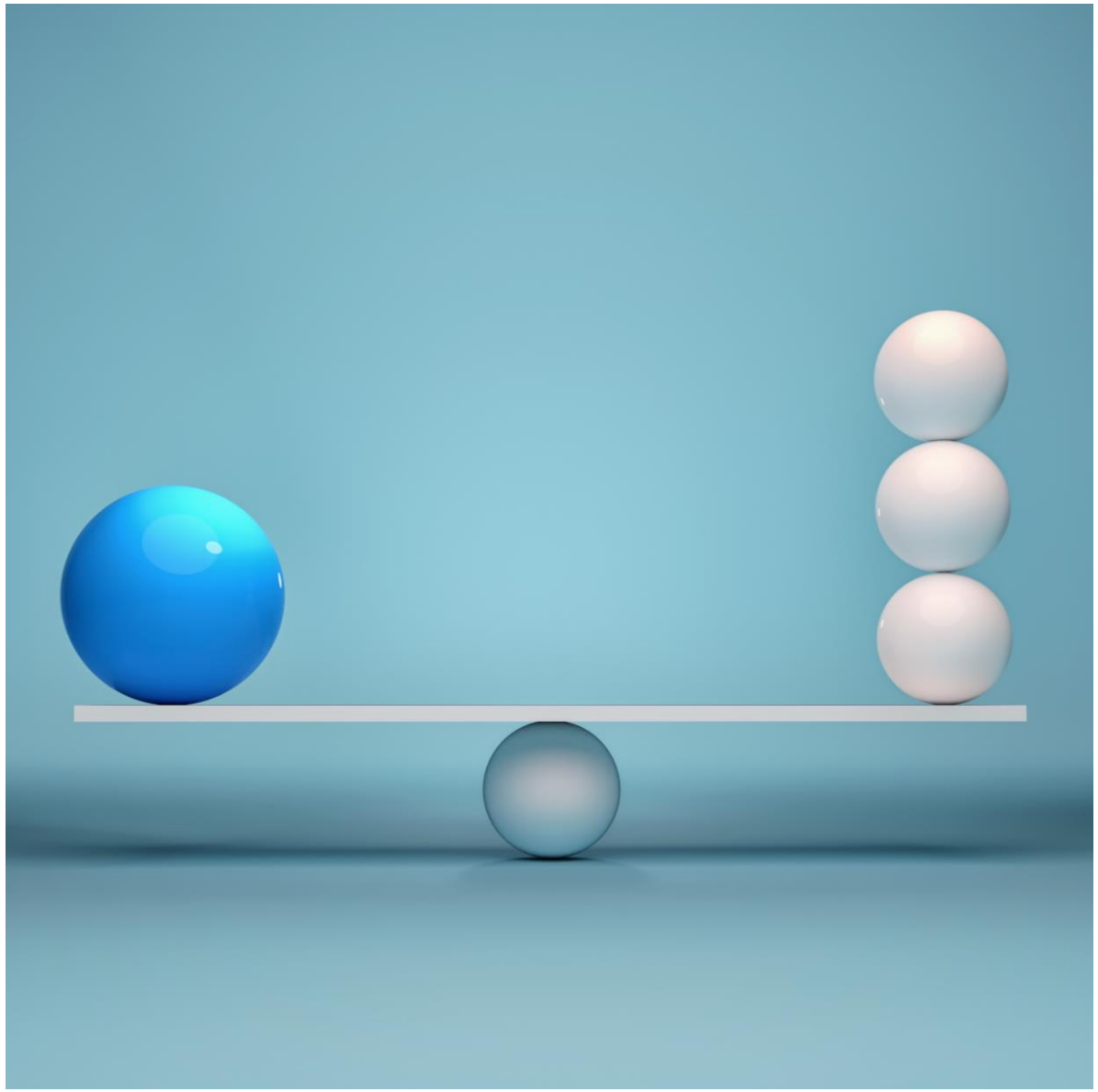
RCR calculations as at YE 2021 based on reported financials

RCR calculations as at YE 2021 based on IFRS 17 financials

Main Points

Available Capital, Required Capital and Capital Ratio will be affected by transition to new accounting standards

Goals of the Quantitative Impact Study: To quantify the impact of these changes on the industry and to adapt the proposed RBC framework



Thank you.

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