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Weather the Storm: The Latest Insurance Solvency Capital Updates across Asia Pacific

Volume 2: Are You Business-Ready for the New Solvency Regime?

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Executive Summary

Insurance markets in Asia Pacific are going through an era of rapid change in their regulatory solvency regimes, albeit at a different pace across the region. In the past few years, markets including Australia, Chinese Mainland and Singapore have transitioned into a new solvency regime which is akin to Solvency II. Other markets including Hong Kong SAR, Japan, Korea, Malaysia, New Zealand and Thailand are embarking on their journey to a new solvency regime.

Despite the different levels of progress, these regulatory changes all have a far-reaching impact on the level of capital held by the insurance industry and is a topic of focus by a myriad of stakeholders including regulators, investors, credit rating agencies and the general public.

In Volume 1 of this series, we provided an update on the solvency regime developments in each of the insurance markets in Asia Pacific and Deloitte's observations on the market trends under formation. This article is Volume 2 of this series where we zoom in on two focus topics:

Operationalisation of a new solvency regime focuses on the operational challenges brought by the new solvency regimes and solutions to these challenges.

Internal Capital Adequacy Assessment Process ("ICAAP") developments in Australia outlines the developments in the Australian insurance market in response to ICAAP (akin to Own Risk and Solvency Assessment or ORSA under other regimes) and the key success factors for the implementation of enterprise risk management.

With the significant business impact brought by the new solvency regimes, solvency reporting can no longer be treated as a compliance exercise. A business-ready insurer shows the following traits:

1. Stay on top of its solvency results and outlook in a timely manner
2. Embed solvency into business decision-making
3. Provide top-down management support to drive enterprise-wide business embedding and applications

These will require setting the **right objectives for the operationalisation** of the new solvency regime to materialise the business benefits beyond regulatory compliance, and ongoing engagement with business stakeholders to build up a **risk culture** appropriate for the business.

Section 1: Operationalisation of New Solvency Regimes

As summarised in the regional market updates, a number of markets in Asia Pacific are going through a major change in solvency regime, mostly developed based on international standards such as ICS and Solvency II. This evolution presents both operational challenges given the more complex calculation requirements and business challenges arising from the increased volatility in solvency.

Most markets have been through several rounds of Quantitative Impact Studies and so insurers in each of those markets are able to produce solvency results under the new regimes albeit not necessarily yet under the tight reporting timelines they will face when the new regimes go live. Operationalising the new regime and embedding it into business-as-usual ("BaU") activities, however, further requires another level of sophistication.

What does operationalisation of a new regime entail? The Deloitte Solvency Reporting Maturity Grid highlights the four key elements of a fully-operationalised new solvency regime in the contemporary business context.

Table 1. Deloitte Solvency Reporting Maturity Grid

Maturity Dimension	Description of Maturity Dimension	Minimum Compliance	Business-Ready
Production Speed	The ability to produce solvency results and analyses in a timely manner to enable business decision-making	Typically within 2 months	Typically within 1 month
Process & Controls	A robust process and controls framework for the production of accurate and reliable solvency results for regulatory reporting and business decision-making	Significant degree of manual adjustments and end-user computing with proper documentation and established controls	Minimal use of manual adjustments and end-user computing. Reasonable degree of automation in processes
Analytical & Forecasting	The ability to provide in-depth analyses of the solvency results and business drivers as well as to answer "what-if" questions in a timely manner to support timely business steering from management as well as any requests/questions from regulators on their solvency positions during significant market shock events	Meet minimum requirements for regulatory compliance	Exceeds regulatory compliance. Meet most analytical and forecasting requests from management
Business Applications	The integration of solvency results into business operations and processes including product pricing, investment decisions, asset-liability and capital management, enterprise risk management, integration with other financial and risk metrics for a holistic and consistent set of management information	Solvency results and metrics are minimally embedded in business applications	Solvency results and metrics are embedded in most business applications

Our view is that meeting regulatory reporting requirements is a bare minimum. A well-prepared insurer would set out an implementation plan to be business-ready to fully embed solvency and its related metrics in all business processes, always stay on top of its solvency position and outlook, understand and be able to react to the key underlying drivers to enable timely business decision-making.

Operationalising a new solvency regime: Challenges & potential solutions

The challenges around operationalising a new solvency regime are mainly driven by its much more complex calculation and reporting requirements. The new requirements place new demands on areas including reporting data, systems, processes and business applications.

Challenge	New Requirements	Impact	Potential Solutions
Data	• A wider range of data at an increased granularity level for reporting – e.g. asset data, financial data, policy data etc. • Some reporting data may have a reliance on third party data suppliers – e.g. asset data may come from market data providers, creating challenges to the timing of data availability, data processing and validation and communications	• Additional and more complex data extraction, cleansing, transformation, reconciliation and grouping of data from multiple system sources • Compressed production timeline due to additional data processing and potential delays of supply by third-party vendors • Increased production costs due to time and effort required for reconciliation of solvency reporting data with data under other reporting bases	• Formulate a data strategy and establish robust data governance and management capabilities to cope with the data challenges • As asset data requirements under the new solvency regimes are generally more onerous, a process should be set up to consolidate asset holdings data from multiple sources, perform checks and data enrichment and to populate Pillar 3 reporting templates. Insurers can either set up an in-house asset data warehouse or use external providers to provide this service to reduce reporting timeline pressures • The data warehouse can also be extended to cover liability data, claims, reinsurance arrangements etc. However, setting up such a warehouse is complex, involves significant costs and could take a couple of years to put in place. If an insurer goes down this route, it is also important for the data warehouse to be flexible to allow for any changes in regulations before the new regime goes live and/or increased regulatory demand
Reporting Systems	• More complex valuation techniques such as stochastic modelling for insurance liability valuation • Larger number of system runs for the calculation of required capital involving a series of stress tests • The ability to answer "what-if" questions in a timely manner	• Compressed production timeline due to the much larger amount of complex calculations • Potential system upgrades and/or new investments to i) boost computational speed; ii) meet new calculation requirements; iii) enable stronger analytical and visualisation capabilities • Technology costs are expected to increase due to these investments and the higher costs of BaU reporting	• Leverage models used for Solvency II and/or ICS reporting, if any, for the new capital regime. This could significantly reduce the operationalisation burden for some insurers • The model and system solutions should also be designed and built to be agile and scalable to meet future changes in regulations and business strategy • Automation solutions should be explored especially for insurers who currently rely heavily on Excel-based and/or manual processes. Potential solutions consist of using cloud computing and introducing automation to speed up the heavy model run process, i.e. preparation, running and results extraction.

Challenge	New Requirements	Impact	Potential Solutions
 Reporting Processes	• A new set of reporting processes arising from the vastly different calculation and reporting requirements • New governance and controls frameworks to mitigate the new risks in reporting processes caused by more complex calculation processes and systems	• A new working day timetable for more efficient processes to meet the compressed production timeline • Revamped governance, reconciliation and internal controls framework to mitigate new risks in reporting processes and to meet regulatory and audit requirements	• Perform a gap analysis to identify new processes required and pain points • Based on findings from the gap analysis, redesign the reporting processes and put in place a working day timetable acceleration plan with relevant milestones to capture the work required to meet regulatory timelines. This plan will capture automation and process improvements mentioned above, e.g. the use of an Analytic Process Automation ("APA") which enables end-to-end automation of a data analytics process. An APA such as Alteryx could be used to speed up the Matching Adjustment ("MA") process under HKRBC as the MA calculation requires heavy processing of large volumes of data typically in different formats from multiple sources and such data is usually processed using Excel macros, which can be opaque and inefficient. The inefficiency is further magnified by the iterative nature of the MA calculation. • Establish a robust internal control framework and documentation that meets audit standards. Methodology as well as process and controls documentation will need to be updated to meet audit standards
 Business Applications	• Cross-departmental collaboration for solvency reporting – e.g. Actuarial, Finance, Risk, supported by IT and business functions • Redesign of management information metrics to integrate solvency results with other financial metrics for holistic and consistent management information • Embedding of solvency results into business processes such as product pricing, investment decisions, risk management etc.	• A new or redefined Target Operating Model ("TOM") setting out the required skill sets, number of resources, and different options of operations • Top-down initiative to embed the new solvency regime into all business processes, together with bottom-up design of BaU activities. • Change management of distribution channels and other stakeholders such as auditor, investors	• Redesign TOM around capital reporting, risk management and risk governance framework: what actuaries, finance and risk teams should do and how they work together as a team • Plan ahead for new skill sets and resources required before supply becomes limited • To embed the new regime into the business, leverage of lessons learnt and experience from other capital regimes (e.g. Solvency II) provide relevant reference points – see next section for examples.

Operationalisation Experience: Lessons learnt from regimes that have gone live

This section summarises the trends and developments with respect to embedding a new solvency regime into an insurer's business processes based on a number of solvency regimes that had gone live in the past few years.

- Greater use of risk-based indicators with an appreciation/understanding of the differences between economic capital, regulatory capital and accounting metrics
- Certain asset strategies used under Solvency II may become attractive under new capital regime e.g. Real assets and alternative credit could be used to meet crediting rates and high guarantees and improve diversification. A wide range of strategies are available here such as infrastructure, real estate or other asset backed debt, unsecured debt, high yield, leveraged loans etc. Consideration will need to be given to whether new asset classes fit within the insurer's risk appetite, the greater governance and oversight needed, knowledge internally and among senior management of new asset classes, any regulatory challenge on more complex investments
- Similarly ALM, capital management and reinsurance practices used in other regimes should be explored to optimize the balance sheet under the new regime
- Transform the Management Information ("MI") produced through use of an analytical and visualization tool (e.g. Microsoft Power BI) which interacts with data from different sources including the cloud and can create customized dashboards. This gives senior management the ability to quickly analyse the insurer's balance sheet particularly during stress conditions to assist them with real-time decision making
- Close engagement with the regulator. It is important for an insurer to work more closely with the regulator to explain results, keep the regulator updated on any material changes in business, new asset class entry, large transactions e.g. reinsurance deals, M&A activity

What's next?

Operationalisation of a new solvency regime is often taken as a regulatory compliance exercise and the amount of implementation work for achieving business-readiness is often underestimated (as we have seen with Solvency II). Despite the challenges and costs of operationalisation, a business-ready insurer sets itself apart from its competitors by always staying on top of its solvency position and outlook and being able to react to the key underlying drivers for timely business decision-making. With the significant investments insurers have made in their reporting systems and data during IFRS 17 implementation, layering the implementation of the new solvency regime will achieve the greatest business benefits.

Before moving ahead with implementation, taking the time to define where you want to be in the longer term, i.e. meeting minimum compliance or being business-ready, will provide a basis to create an implementation roadmap that fits your organisation's strategic objectives. With this longer goal in mind, an effective readiness assessment can be carried out to identify levers that can be pulled and gaps that need to be filled in light of the investments made on IFRS 17 and other reporting bases. Findings from such a readiness assessment exercise can then provide inputs to implementation option analysis, an implementation roadmap and a business case supporting the implementation plan.

We would stress that a head start on planning and early stakeholder engagement is critical in defining success under the new regimes.

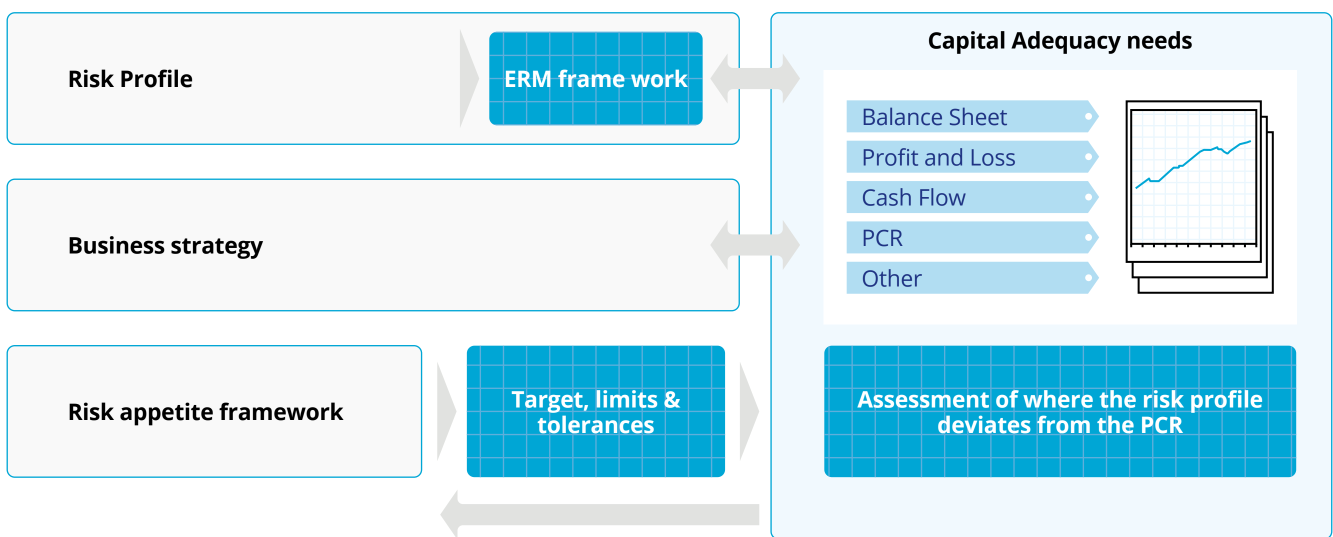
Section 2: Internal Capital Adequacy Assessment Process ("ICAAP") in Australia

The Australian prudential regulator ('APRA') introduced the Life and General Insurance Capital **Internal Capital Adequacy Assessment Process** (LAGIC ICAAP) framework effective from 1 January 2013 (alongside with the harmonisation of the capital adequacy standards), after a couple of years of close industry consultation.

The ICAAP is 'Pillar 2' of the three-pillar capital and risk management framework, equivalent to ORSA under Solvency II, and involves the interlinkage of the risks taken on (risk profile), the risks the insurer was willing to accept (risk appetite), and its business strategy.

This section outlines the lessons learnt by the Australian market around the ICAAP framework and the impact on the insurance industry to provide some food for thoughts for markets that have just commenced on their adoption of the Pillar 2 Qualitative Requirements of the solvency framework.

ICAAP framework



The ICAAP framework was introduced to help address issues APRA had noted through its supervisory review of Insurer practices in respect to risk and capital management at the time, including:

- Lack of a clear statement or understanding of risk appetite;
- Low levels of engagement by the Board in setting the risk appetite;
- Lack of analysis using stress testing or scenario analysis to set the risk appetite; and
- A disconnect between the risk appetite statement and its translation into operational management.

Key lessons learned from the Australian experience

Some of the key lessons to implementing the Australian ICAAP successfully include:

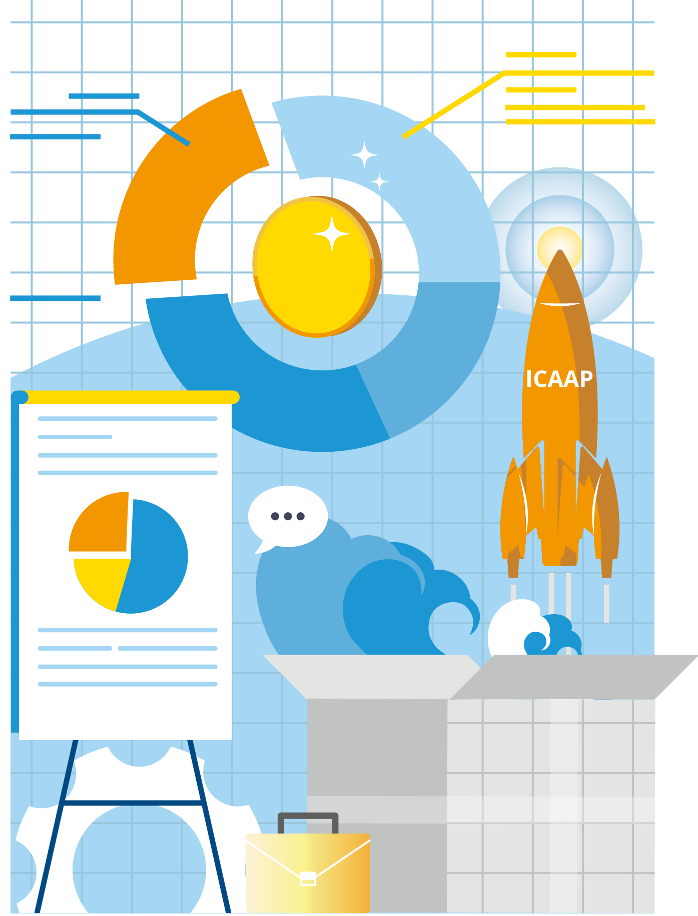
- **Making it useful for risk and capital management decision making** – it should not be just a compliance process. Early planning with a focus on the target state is critical to ensure the redundant effort in minimalised, and the business benefits of the ICAAP are achieved earlier. It is important to recognise that it is not always necessary to target the 'optimised' state for each and every category of the ICAAP, rather this should be dependent on the insurer's size, complexity, and risk appetite ambitions.
- **'No regrets' implementation** – identify the discrete projects that can be completed prior to the effective date of the change. The global harmonisation trend for capital standards and frameworks suggests that leveraging the relevant lessons from other industries and markets is highly relevant. Starting earlier ensures access to key local market resources.
- **Engage stakeholders early over multiple sessions** – have a clear change management plan for the Board and Senior Stakeholders. The ICAAP change in Australia saw a clear shift in responsibility of capital and risk management to the Board, which required education and robust engagement sessions to be developed.
- **'Evidencing' (or usage) is not a one year task** – Mature ICAAPs are able to show, for a risk event, that it can evidence how the actions of the company from Board to its operations team has integrated the risk framework with the way its capital is planned for and managed. Evidence can include the suitability of the capital metrics reported and used, whether the metrics and its implications are understood and used appropriately as management tool, whether there was sufficient and timely Board challenge and discussions with Senior Management on aspects of recent ICAAP development and most importantly that the ICAAP was reviewed and updated appropriately in response to those risk profile changes (e.g. updated triggers, responsibilities)
- **Business benefits** – insurers who road-tested their ICAAPs through 'fire drills' were best able to identify the gaps earlier, and hence address them. These insurers were able to then make risk-intelligent decisions that was transparent and agreed between the Board and Management, and therefore balance and adjust their growth plans with their risk and capital appetite.

Impact of ICAAP on insurance business

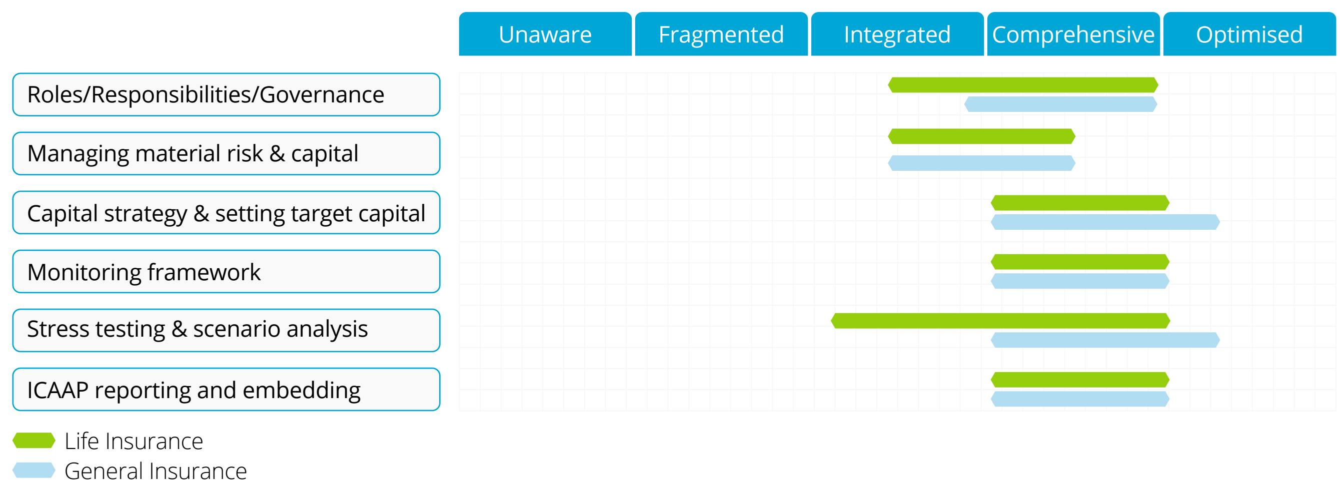
The changes to the conduct of the ICAAP is now relatively mature for Australian life and general insurers. This has been pushed along actively through APRA's supervisory review processes since its introduction. Some of the tangible business and organisational impacts included:

- **Capital optimisation reviews** – with both Pillar 1 and Pillar 2 changes occurring at the same time, insurers conducted optimisation reviews and updated their policies particularly around investment and asset strategies (to optimise asset risks and asset concentration risks), target capital and diversification allowances, capital allocation metrics for management reporting and KPIs. It was also important to understand and put in place management strategies around the insurance risk charges, as overall the capital was more risk-sensitive.
- **Greater ownership and engagement with the Board,** particularly in the setting of stress and scenario testing strategies through regular workshops
- **Greater clarity on roles and responsibilities.** The 'lines of defence' operating model was clarified between actuarial, risk, and finance functions, with some structural changes as a result. A 'ladder of intervention' for when capital levels fall below certain levels was developed and documented.
- **Greater awareness of non-financial risks.** The ICAAP required that insurers consider the material risks not covered by the explicit regulatory capital charges, such as assessments of strategic risks, reputation risks and compliance risks. Proxy measures were developed to monitor these risks over time and which became more visible to both management and Board.

In the last 5 years, the insurance industry's ICAAP has matured considerably, particularly after various rounds of industry stress testing including more recently in respect of a COVID-19 and economic downturn industry scenario. This has seen the maturity levels now broadly reaching an integrated-comprehensive stage. Larger insurers tend to have more mature ICAAPs, partly due to their ability to leverage the banking ICAAPS as many of them were owned by banks during this time.



Large insurer industry ICAAP maturity by key category



*Based on Deloitte's analysis and market observations.

Across the insurance industry,

- ICAAP are reasonably well developed and mature in the areas of Board ownership and involvement, Board and capital monitoring, scope and content (prudential guidance compliance), documentation/design of capital triggers, and development of the types of stresses and scenario testing (and related modelling capability).
- ICAAP practice is more varied in the areas of the assessment of the feasibility (including timing) of the management actions in a stressed scenario and other capital recovery planning. Larger insurers, who tend to be the ones chosen to participate in industry stress testing exercises in the past, are better developed in this area.
- In more recent years, we started to see scenario tests include impact analysis of emerging regulatory (conduct risk and 'social license' considerations particularly off the back of the 2018/2019 Australian Royal Commission into Misconduct in the Financial Services Industry) and technology /cyber related risks. There has strong demand for and upskilling of the second and first line of defence risk and compliance skillsets within insurers.

Looking ahead for Australian life and general insurers

APRA is now turning its attention to insurer recovery and resolution planning. Recovery planning is a natural extension of the ICAAP and focusses on the insurer's operational plans during an actual stress scenario i.e. escalation procedures, trigger frameworks, recovery options, scenario analysis, communications and disclosure plans.

For insurers without a recovery plan, it should be noted that this is an iterative process with continuous development into future years as part of the risk management framework process. Implementation effort is dependent on how complex the financial institution is, but it may take 6mths-8mths elapsed for the development of an initial Board approved recovery plan and first reiteration of fire drill. Some Australian insurers have already started the journey as part of the operationalisation of the ICAAP, however many need development in a number of key areas such as the need for better early warning indicators and fire drills conduced on recovery options to test how effective the plan is in coordinating the crisis.

APRA has released the first set of consultation papers on the proposed prudential standard on 2 December 2021, with further guidance and industry consultation over 2022. The standard is expected to be made effective 1 January 2024 for insurers. Deloitte Australia Actuarial will be publishing a sequence of short client newsletters on implications over 2022.

Conclusion

The focus topics in this volume have pointed to a number of universal themes in the space of regulatory solvency regimes:

Operational and business challenges. The move to the new frameworks introduces operational and business challenges to insurers in all markets, urging them to rethink about their operating model for solvency reporting and business strategies around products, investments, asset-liability management in response to the increased volatility in the solvency position under the new frameworks.

Opportunities to realign with business objectives. Despite the challenges presented by the new frameworks, the pro-active insurers will seize the opportunity to revisit and realign their business objectives in light of the requirements under the new solvency regimes as well as the new global accounting standard IFRS 17. We expect insurance companies' Key Performance Indicators will be updated in light of the new changes to equip management with appropriate information for business steering and decision-making.

Successful adoption requires top-down support. We expect the adoption of the new solvency regimes will result in enterprise-wide changes beyond the solvency reporting functions. Changes in business strategies will affect the organisation left, right and centre. Top-down support will be critical for driving successful adoption and across-the-board changes within the organisation.

Contact us

Australia:
Caroline Bennet
cbennet@deloitte.com.au
+61 3 9671 6572

Chinese Mainland:
Eric Lu
erilu@deloitte.com.cn
+86 20 2221 5666

Hong Kong SAR :
Simon Dai
simondai@deloitte.com.hk
+852 2238 7348

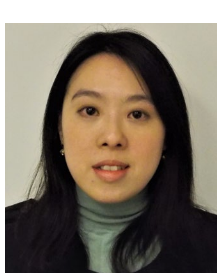
India:
Shrenik Baid
shrenikbaid@deloitte.com
+91 22 6245 1120

Japan:
Hirohisa Mikogami
hirohisa.mikogami@tohmatsu.co.jp
+81 90 6538 4332

Korea:
Sung Wong Jee
sujee@deloitte.com
+82 2 6676 3838

New Zealand:
Richard Beauchamp
rbeauchamp@deloitte.co.nz
+64 9303 0709

South East Asia:
Siang Thnia Lim
sianglim@deloitte.com
+65 6232 7411



Taiwan (China):
Ophelia Au Young
oauyoung@deloitte.com.hk
+852 22387084

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