

Off-site Supervision and Early Warning Systems



Lone Mørup

2nd International Insurance Supervision Seminar on
Core Supervisory Issues

8 August 2006



Agenda

- 1. Introduction**
2. The Insurance core principles
3. Assessing capital adequacy and regulatory compliance
4. Prudential reporting
 - Frequency and types of information
5. Processing and risk assessment
6. Structured early warning systems



1. Introduction

- Risk based supervision
 - Planning and execution of supervisory activities are influenced by an evaluation of the probabilities and/or impact of non-compliance with legislation
 - Depend on the systemic importance, nature, scale and complexity of the business (proportionality)
 - Allows for prioritisation of supervisory activities



1. Introduction

- Supervisory methods
 - Off-site supervision
 - On-site inspections



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2. The Insurance core principles

Contents	ICPs
5. Ongoing supervision	ICP 11: Market analysis
	ICP 12: Reporting to supervisors and off-site monitoring
	ICP 13: On-site inspection
	ICP 14: Preventive and corrective measures
	ICP 15: Enforcement or sanctions
	ICP 16: Winding-up or exit from the market
	ICP 17: Group-wide supervision



2. The Insurance core principles

- Insurance core principle 12
 - The supervisory authority receives necessary information:
 - to conduct effective off-site monitoring
 - to evaluate the condition of each insurer as well as the insurance market





2. The Insurance core principles

ICP 12, Essential criteria

- The supervisor:
 - Sets requirements for scope and frequency of financial and other information
 - Requires audit reports
 - Should not distort the market in favour of or against any particular form of enterprise
 - Sets additional information requirements when needed
 - Requires solo and group wide information



2. The Insurance core principles

ICP 12, Essential criteria

- The supervisor requires information:
 - On financial condition and performance
 - On off-balance exposures
 - On outsourced functions



2. The Insurance core principles

ICP 12 Essential criteria

- The supervisor requires
 - Responsibility of senior management
 - Correction of any inaccurate information and impose sanctions for deliberate misreporting
- The supervisor maintains a framework for on-going monitoring



2. The Insurance core principles

ICP 12, Advanced criteria

- The supervisor regularly reviews reporting requirements
- The supervisor requires insurers to report promptly material changes that affect the evaluation of their condition



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3. Assessing capital adequacy and regulatory compliance

Purpose of off-site (and on-site) supervision

- Protecting policyholders and beneficiaries
- Issuing licenses and monitoring that conditions for the license are met
- Evaluating the risk profile and the capital strength of insurers
- Evaluating insurers' compliance with legislation and taking remedial action



3. Assessing capital adequacy and regulatory compliance

- Most supervisory work done off-site
- Cost efficient
- Allows for comparisons
- The assessment should include cooperation with other supervisors where relevant



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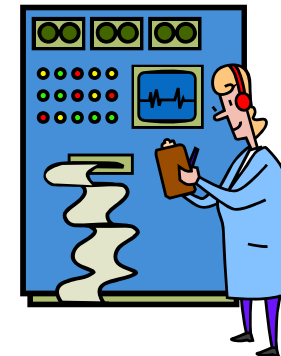
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4. Prudential reporting

Off-site supervision is based on

- Regular reporting
- Ad hoc reporting
- Applications
- Market information
- Other ad hoc information





4. Prudential reporting

- Reporting should allow supervisors to assess
 - The risk profile
 - Underwriting risk
 - Market risk
 - Credit risk
 - Operational risk
 - Liquidity risk
 - The capital strength
 - The organisation
 - Processes and procedures
 - The business



4. Prudential reporting

Example of reporting requirements

- Regular reports
 - Annually:
 - Annual accounts and annual report (statutory and supervisory)
 - Auditors report (external and internal auditor)
 - Paid claims provisions
 - Biannually:
 - Accounts
 - Capital and risks (e.g. stress testing)



4. Prudential reporting

- Regular reports
 - Quarterly:
 - Insurance provisions and assets
 - Business plans and quarterly accounts for newly licensed companies
 - Reinsurance cover – Annually
 - Liquidity reports – ad hoc
 - Actuarial statement and report – Annually



4. Prudential reporting

- Applications
 - New licenses and change of licenses
 - Fit and proper
 - Exemptions (prior approvals)
- Market and other ad hoc information
 - Consumer complaints
 - News in the press
 - Rumors



4. Prudential reporting

- Audit reports may provide information on
 - Auditors' observations
 - Compliance with reporting requirements
 - Accounting procedures and internal controls
 - Any non-compliance with legislation
 - The adequacy of internal guidelines and procedures
 - Compliance with internal guidelines and procedures
 - Group relations and intra-group transactions
 - The reinsurance programme and reinsurance settlement procedures
 - Technical provisions
 - Etc.



4. Prudential reporting

- Manual/computerised reporting
- Manual/computerised storing
- Set format for regular reporting
- Publicly available information/supervisory reporting
- Should allow for comparison over time and for benchmarking



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5. Processing and risk assessment

- Line officer
 - Each insurance company may be assigned a line officer
 - The line officer performs the risk assessment
 - He/she may draw on in house expertise
 - The line officer may also perform on-site inspections



5. Processing and risk assessment

- Risk assessment
 - Assessment of the overall risk profile and capital strength of all insurers should be made at least once a year
 - ... and ad hoc as necessary
 - Based on reported information
 - To be used in prioritising of supervisory activities



5. Processing and risk assessment

- Tools for risk assessments
 - Internal ratings using predefined criteria covering all major risk areas, including
 - The insurance business
 - Assets
 - Reinsurance
 - Profitability
 - Solvency
 - Standardised stress tests
 - Benchmarking
 - Exception reporting
 - Subjective evaluation by line officer



5. Processing and risk assessment

- Supervisory action following the risk assessment
 - Require more information
 - Provide risk information
 - Meeting with board of directors and/or management
 - Meeting with auditors
 - Require auditors to report on specific matters
 - On-site inspection
 - Require more frequent reporting
 - Require the insurer to adapt the risk profile
 - Require other corrective action
 - Ultimately, withdraw license



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6. Structured early warning systems

- Signal that the insurer is or may shortly be breaching key financial parameters
- Should be interpreted in the light of the whole situation of the insurer
- Early warning systems include stress testing, sensitivity analysis and scenario analysis conducted by insurers
- Standardised stress tests may be used for benchmarking purposes
- Automated exception reporting



6. Structured early warning systems

- Quantitative early warning indicators
 - Low capital strength relative to the risk profile (underwriting, provisioning, reinsurance, market, credit and operational risk)
 - Rapid growth
 - Declining profitability
 - High expenses and low profitability
 - Sudden increase in technical provisions
 - Dramatic decrease in technical provisions
 - Significant divergence from budgets and business plans
 - Concentrated investments, particularly in related entities
 - Consumer or intermediary complaints



6. Structured early warning systems

- Qualitative early warning indicators
 - Change in strategy
 - Changes to or delays in implementing business plan
 - New classes of business/sources of business
 - Crude underwriting strategy (pricing and risk selection)
 - Failure to implement supervisory requirements
 - Non-cooperation with supervisor
 - Delays in producing supervisory information



6. Structured early warning systems

- More qualitative early warning indicators
 - Poor quality information
 - Poor response to audit reports or management letters
 - Vulnerability to legal or fiscal changes
 - Mergers or acquisitions
 - Reinsurance arrangements inconsistent with normal practice or with unclear rationale
 - Excessive bonus or unusual remuneration or incentives



6. Structured early warning systems

- Example of stress testing for non-life (to identify potential problems)
 - Cat cover
 - Catastrophe scenario for a severe windstorm (or other scenario of a catastrophe that may happen in your country)
 - The estimated loss may be compared with the storm cover, if reported to the supervisor, or the loss may be compared to the solvency surplus



6. Structured early warning systems

- Example of stress testing for non-life (to identify potential problems) (cont.)
 - Claims provisions
 - Stress the claims provisions by estimating the expenses related to already incurred claims
 - The calculations can be based on different actuarial triangle methods
 - Stress the claims provisions by calculating the effect of a 10 % rise in the average size of claims
 - Stress the claims provisions by calculating the effect of a rise in the number of claims by 10%



6. Structured early warning systems

- Example of stress testing for life (to identify potential problems)
 - Biometric risks
 - Evaluate changes in assumed longevity and disability intensity
 - Change (decrease/increase) in the mortality intensity of 10 per cent. It corresponds very roughly to change in longevity of 1 year.
 - Increase in the disability intensity of 10 per cent.



6. Structured early warning systems

- Example of stress testing for assets
 - 12 % stock price decrease
 - 0,7 per cent point change in long term interest rates
 - 8 % real estate decrease
 - Currency risk, credit risk and counterparty risk
- 30 % stock price decrease
- 1 per cent point change in long term interest rates
- 12 % real estate decrease
- Currency risk, credit risk and counterparty risk
- The first scenario “corresponds” roughly to the capital requirement of a bank with identical investments
- The second scenario is an early warning indicator



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Off-site Supervision and Early Warning Systems

- Any questions?

