A summary of the public consultation on CP 2013/01: Proposed Amendments to Insurance Business Rules 2013

Overview

The Consultation Paper (CP) 2013/01: *Proposed Amendments to Insurance Business Rules* was released for public consultation on 18 April 2013. The formal consultation period closed on 30 May 2013. This document summarises the comments received as well as further comments made by firms during follow-up meetings. It also provides the Qatar Financial Centre (QFC) Regulatory Authority's responses to this feedback as reflected in the final amendments rules that were released on 28 October 2013.

The QFC Regulatory Authority received written feedback on CP 2013/01 from eight respondents during the formal consultation period. Further discussions on the revised proposals took place with all the respondents before the QFC Regulatory Authority finalised these rules.

This Summary of Public Consultation published by the QFC Regulatory Authority reflects its commitment to maintaining a transparent dialogue with the local insurance industry and an accountable policy-making process. Policy feedback on other major regulatory changes may be published in the future when deemed appropriate.

The QFC Regulatory Authority wishes to thank all the respondents for their comments and proactive engagement throughout the public consultation.

Background

CP 2013/01 set out key proposals to strengthen the QFC Insurance Business Rules (PINS) and enhance conformity to the revised insurance core principles endorsed by the International Association of Insurance Supervisors. PINS contains the prudential regime applicable to insurers authorised in the QFC.

The proposed changes followed an internal review that assessed the continued adequacy of the PINS framework against international best practices and worldwide market practices to ensure it remains prudentially sound and fit-for-purpose.

The proposed changes also support the ongoing development of the QFC as a leading finance and business centre in the region and the continued expansion in the level of activity of QFC insurers.

The QFC Regulatory Authority sought feedback on the following main policy proposals:

- **capital adequacy**, including new insurance concentration and operational risk capital requirements, streamlined and recalibrated risk components of the prudential capital framework, and nominal limits on the concentration of investment exposures;
- **enterprise risk management**, including a requirement that the insurer's governing body be involved and approve an annual risk and solvency self-assessment;
- **valuation**, including new rules and further guidance relating to actuarial techniques, methods and assumptions used to value an insurer's assets and liabilities;
- **investments**, including enhanced asset-liability matching requirements as well as asset admissibility and prudent investments criteria; and
- **insurance groups**, including enlarged supervisory powers for the QFC Regulatory Authority to request information from insurers that are members of a group.

Who should read this document?

This document is relevant to all QFC insurers and other firms considering doing insurance business in the QFC. It may also be of interest to persons providing business support services to insurers, such as external actuaries, auditors and legal advisers, and to insurers operating in the State of Qatar and elsewhere in the GCC region.

The QFC Regulatory Authority will be following up with QFC authorised insurers to monitor their progress towards the timely implementation of the new regulatory and supervisory requirements.

Summary of comments received and final rules

The following sections review the responses to the questions posed in CP 2013/01 and summarise the QFC Regulatory Authority's views on this feedback as well as its final policy decisions as reflected in the Insurance Business (Risk Management, Capital Adequacy and Miscellaneous) Amendments Rules 2013 (the "final rules").

Capital adequacy – insurance concentration and operational risk charges

CP 2013/01 proposed that the coverage and risk sensitivity of the capital adequacy model in PINS be broadened to include an insurance concentration risk component and operational risk requirement as part of its risk-based capital requirements. Generally the feedback received did not raise strong concerns about the inclusion of these new risk categories for better risk coverage.

In relation to operational risk, however, most respondents felt that the proposed surcharge of 15% of the sum of an insurer's investment risk requirement and insurance risk requirement was excessive and higher than other jurisdictions where there is a similar stand-alone charge.

QFC Regulatory Authority response

The implementation by firms of the proposed insurance concentration component is considered straightforward and the QFC Regulatory Authority is not proposing further changes in the final rules.

In relation to operational risk, the QFC Regulatory Authority recognises that in many jurisdictions there is limited information and quantitative data readily available to assess robustly the nature and scale of firms' exposures to unexpected operational losses. The management of operational risk continues to evolve in Qatar, so proposals in this area should take a measured approach and be more directly linked to the scale of firms.

Further impact analysis and international benchmarking carried out by the QFC Regulatory Authority suggest that while the proposed charge representing 13% of a firm's overall regulatory capital requirement was not unreasonable, it fell in the higher end of the spectrum. For standard formula calculations similar to that in PINS, the operational risk charge typically represents around 7% of a firm's total capital requirement. The international approaches to building operational risk capital used by other insurance regulators also vary widely.

On further reflection, the QFC Regulatory Authority considers that there is a sound basis for changing the method for calculating the operational risk requirement that meets its regulatory objectives while recognising the evolving experience of managing operational risk. It now proposes to link operational risk more directly to business volume. In the final rules, the operational risk requirement is 2% of the higher of:

- the insurer's gross written premiums over the previous 12 months; or
- the insurer's (gross) technical provisions.

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The trend in this new regulatory capital charge will be monitored closely and analysed by the QFC Regulatory Authority as more data becomes available in the future.

Capital adequacy – additional amendments

CP 2013/01 proposed the merger of the existing credit and volatility risk components of the capital model into an asset risk component, which would also be sensitive to the quality of the regulatory framework applicable to reinsurance counterparties when determining capital.

The responses were generally supportive of the enhanced risk sensitivity and simplifications of the framework for asset risk. However there was concern that the proposed charge on unpaid premiums did not differentiate between customers with different counterparty grades while PINS currently does. The proposed change was immaterial for insurers with retail customers (since they are unrated) but firms whose major customers are rated corporates could see an increase in their capital requirements under the new regime.

CP 2013/01 also proposed replacing the current base capital requirement for reinsurers of US$ 20 million with a common base capital requirement of US$ 10 million applicable to both direct insurers and reinsurers operating in the QFC. There were no comments on this proposal.

QFC Regulatory Authority response

The QFC Regulatory Authority considers that the issue of capital charges on unpaid premiums is a valid concern and an unintended consequence of its proposals. Therefore the final rules contain different weighting factors for unpaid premiums depending on the rating of the counterparty. This is consistent with the current approach in PINS and only affects insurers with premiums receivables from rated customers.

Investment concentration limit

CP 2013/01 proposed a new investment concentration limit so that an insurer's investments do not lead to a concentration of exposures to a counterparty or asset class exceeding 25% of the insurer's eligible capital. The limit was introduced to induce an adequate degree of asset diversification and prevent insurers from building a significant concentration of large exposures to single counterparties.

During the consultation, it was noted that a low threshold could induce firms to switch part of their portfolios to lower quality instruments and/or counterparties. Some firms also argued that investments are a business decision that should be left to the company to decide, and that the QFC Regulatory Authority should continue to rely on prudential capital charges rather than nominal limits to discourage unduly concentration of investments. Firms also sought further clarifications as to the types of assets that would be subject to the proposed limit.

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QFC Regulatory Authority response

After undertaking further impact analysis, the QFC Regulatory Authority proposes to apply the ceiling only to investments representing a concentration of exposures to single or related counterparties. This nominal limit is the smaller of:

- 20% of a measure of *applicable assets*, or
- the insurer's eligible capital,

where *applicable assets* is defined as the insurer's total assets less reinsurance receivables, deferred acquisition costs, fixed assets, intangible assets and other assets that are not held for investment purposes.

The QFC Regulatory Authority considers that this revised definition will be more robust from a financial stability standpoint since it will avoid unintended procyclicality in insurers' prudential requirements. By excluding its proposed application to asset classes, the revised approach also has more regard to the depth and sophistication of regional capital markets and the relative scarcity of investment grade securities. The QFC Regulatory Authority intends to keep the investment concentration limit under review as the local market for investments grows in both volume and sophistication.

Enterprise risk management

CP 2013/01 introduced a new requirement for an insurer's governing body to undertake and sign off an annual own risk and solvency assessment ("ORSA"). As guidance and to assist firms to undertake their ORSA, CP 2013/01 provided a (non-exhaustive) list of scenarios illustrating worst-case situations that firms may want to consider in the analysis.

The responses generally welcomed the forward-looking aspects of the ORSA and some firms indicated that they were already undertaking similar self-assessments. During the meetings, some insurers sought further clarification on the QFC Regulatory Authority's expectations concerning its implementation and the timeframe for completion of the first ORSA.

QFC Regulatory Authority response

The proposals in CP 2013/01 pertaining to enterprise risk management and ORSA are reflected without changes in the final rules.

Valuation and investments

CP 2013/01 provided greater clarity with regard to the adequacy and permissibility of actuarial techniques, methods and assumptions used by QFC insurers to calculate risk margins and value assets and liabilities. It also revised the definition of acceptable discount rate used to calculate technical provisions and strengthened asset-liability matching requirements to minimise mismatch

risks. In terms of investments, CP 2013/01 proposed admissibility criteria with respect to assets held to cover technical provisions and set out prudent criteria to direct the insurer's investment activity.

QFC Regulatory Authority response

While no substantial comments were provided by the industry, the QFC Regulatory Authority improved the drafting and guidance to rule 8.5.1 relating to the discount rate. The other proposals are reflected without changes in the final rules.

Group supervision

CP 2013/01 set out enhancements to the regime governing group-wide supervision including more general powers for the QFC Regulatory Authority to request and receive in a timely manner information that it considers appropriate for the supervision of an insurer that is member of a wider group.

Respondents did not raise major concerns with the proposals but sought further clarity on the circumstances in which the proposed powers would be used by the QFC Regulatory Authority.

QFC Regulatory Authority response

There have been no material changes to the previously proposed group provisions. Rather, the final rules clarify the operation of certain requirements and include improved guidance and examples. In the final rules, all group provisions are in Chapter 10 for ease of reference.

Commencement date

CP 2013/01 did not propose a specific commencement date but rather sought views on the appropriate lead time required for firms to revise and adjust internal systems to comply with the new rules. Most responses suggested that at least one full accounting year was needed to make all the necessary changes to their valuation methods, internal policies and procedures, reporting systems, investments, capital resources and business plans to prepare for the rules.

QFC Regulatory Authority response

In view of the feedback received, in the final rules the QFC Regulatory Authority has determined 1 January 2015 as the commencement date to allow sufficient lead time for firms to implement the new requirements.

During the transitional period, the QFC Regulatory Authority will continue to work with firms as they make the transition to the new framework in order to address any implementation issues as and when they arise.