ALIGNMENT OF EAST AFRICAN REGULATION TO THE IFRS17 STANDARD

Elias Omondi
Senior Manager – FSD Africa

Status of Regulatory Approaches in East Africa

- Most countries in the East Africa region are improving, or intending to improve risk based supervisory approaches, their governance and risk management regulations

- The countries in East Africa have been reviewing their current financial reporting and disclosure requirements

- Some countries have acquired an electronic regulatory system for financial reporting and disclosures.

- East African Community (EAC) have been working together to integrate and coordinate the insurance sector in East Africa and has drafted an EAC insurance bill for more synchronized insurance legislation in the future

Why risk-based approaches to capital?

For development:

- Compliance based rules constrain innovation, limit investment in technical skill development, and create a regime where blaming the rules is the default excuse for poor performance.
- More risk-based approaches encourage insurance market development providing flexibility, encouraging technical skills, and incentivizing management to find solutions to challenges by adjusting their business operations.

For efficiency:

- More risk-based approaches use less of a “one size fits all” approach with hidden dormant capital adding cost.

For effective supervision:

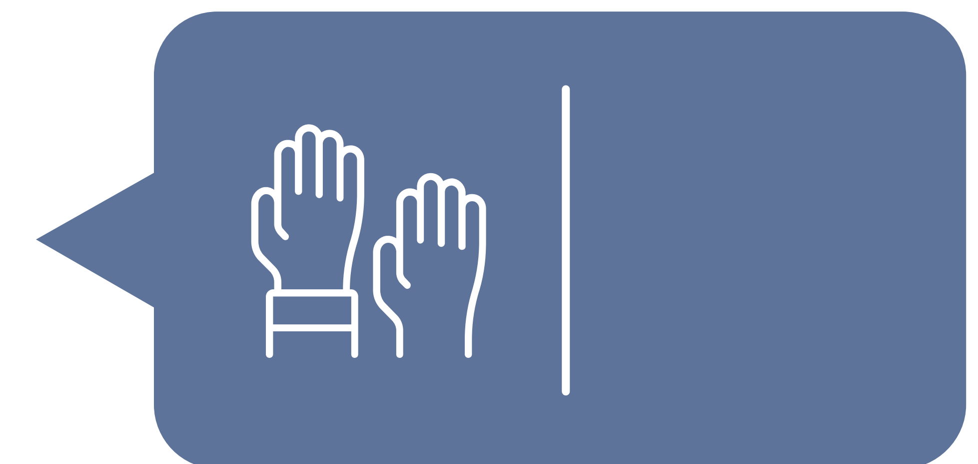
- A more risk-based approach facilitates fair comparisons between insurers and over time, supporting risk-based ratings structures and proportionate intervention ladders.

THE CASE FOR RBC

Existing approach did not adequately assure solvency and protection of consumers - Linking the regulatory required capital to the risk profile of the insurer

Deliberate intention to be proactive – assess risk and assure solvency beyond a point in time - Risk Profiling

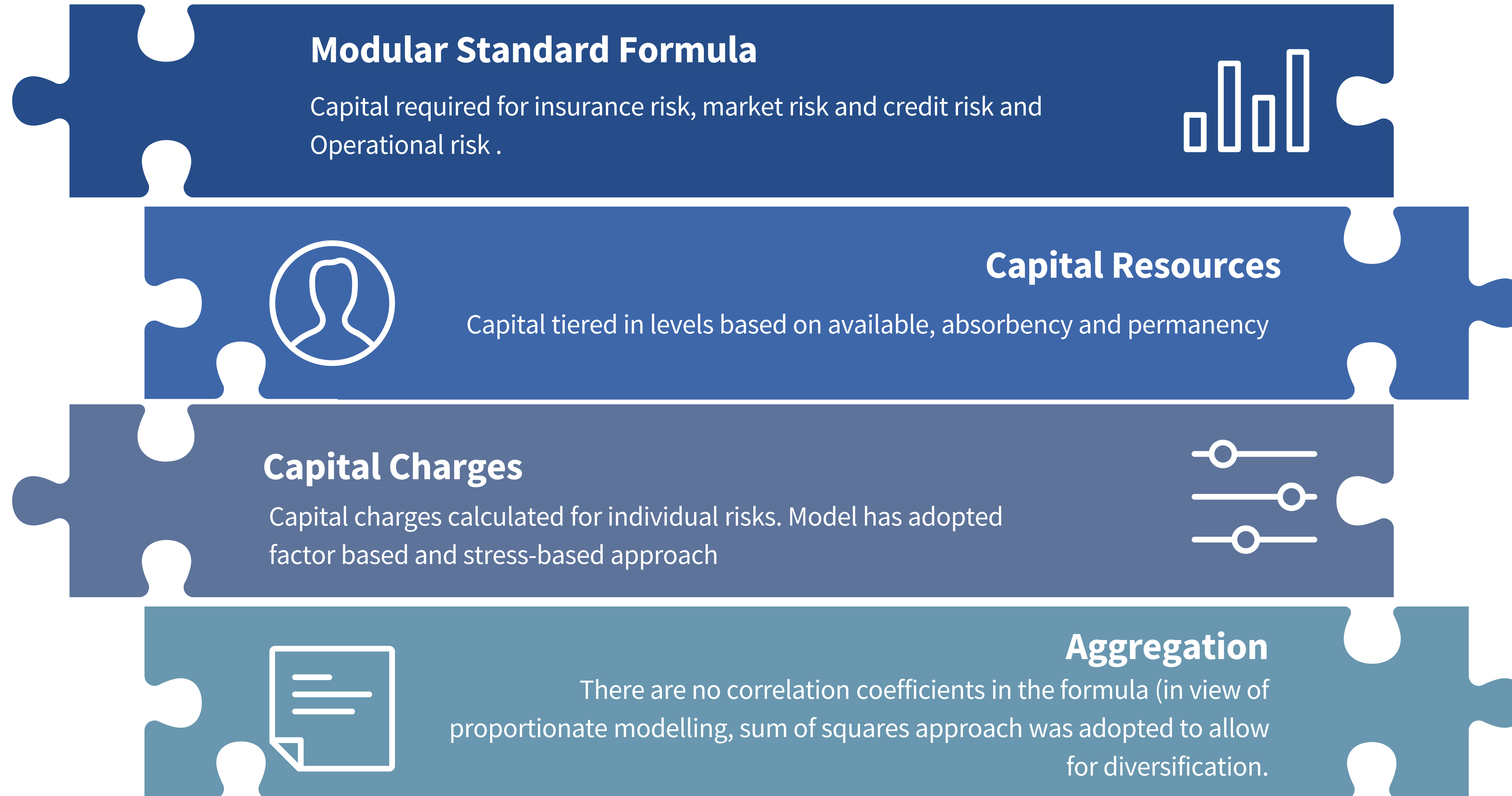
The need to incorporate risk management into insurance business practices - Establishing a common risk aware culture within the organization (Enterprise Risk Management)

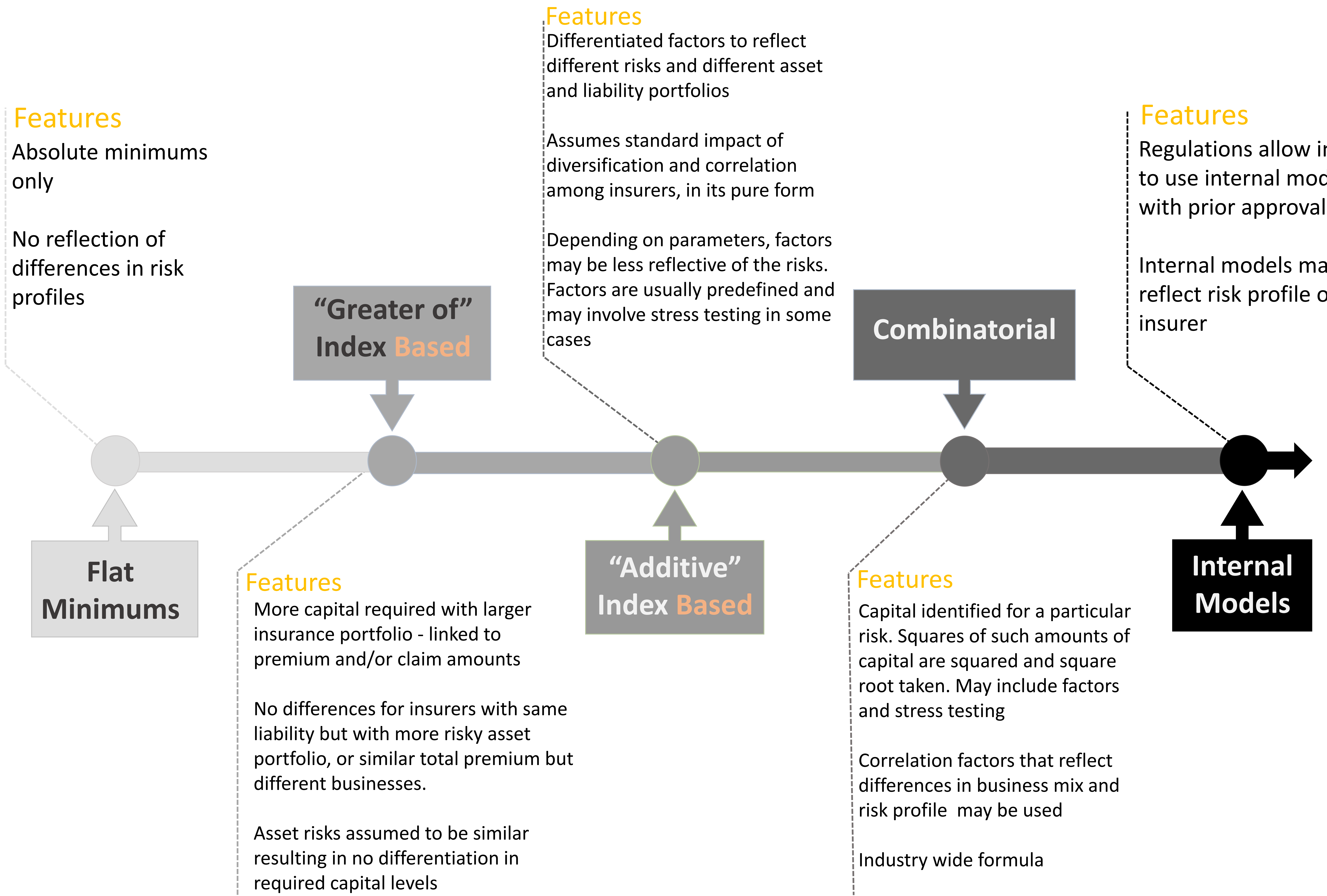


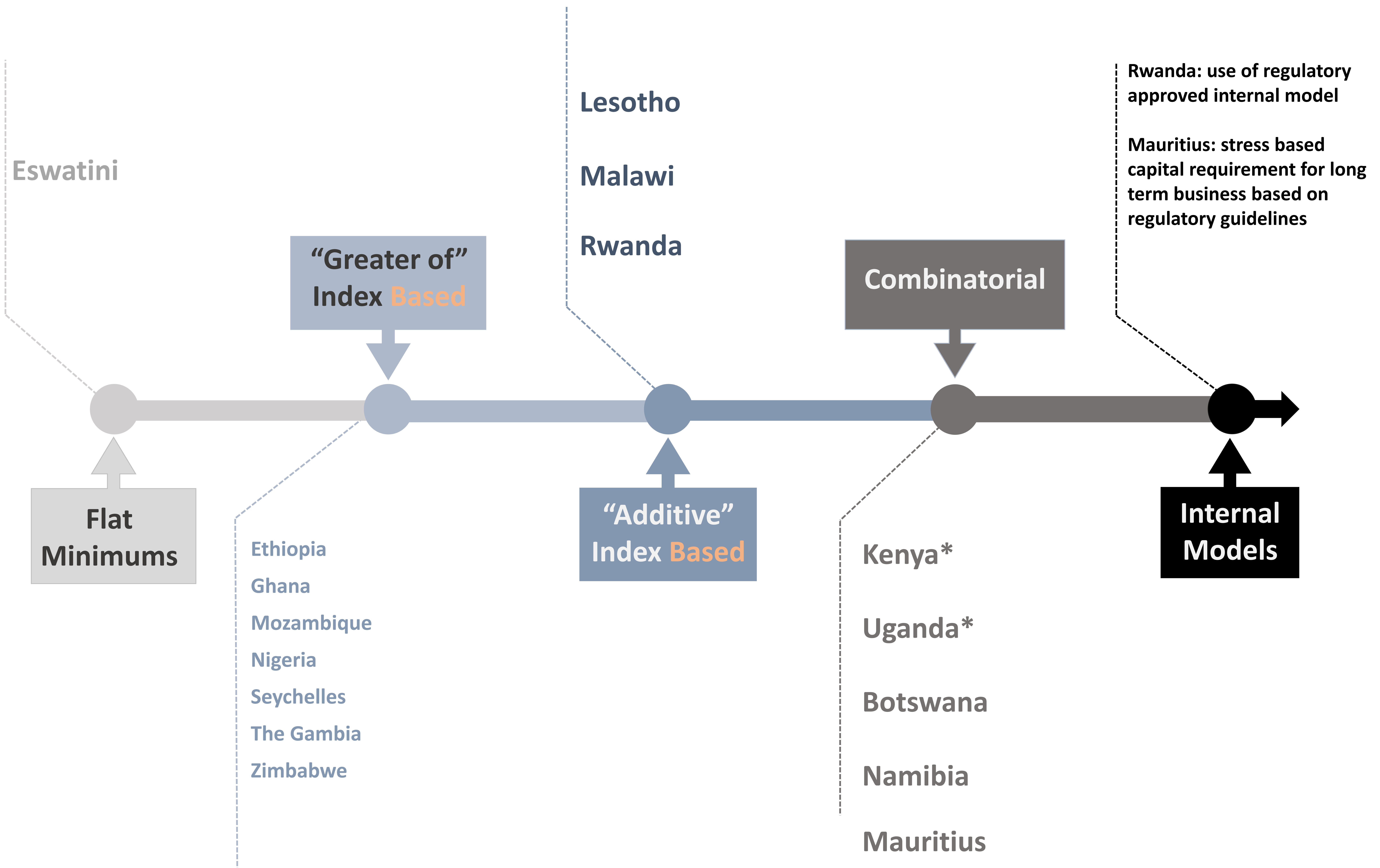
Harmonization to international standards - framework developed is appropriate, fit for purpose and proportional to the insurance market

THE MODEL

SIMPLIFIED SOLVENCY II




Features
Absolute minimums only
No reflection of differences in risk profiles
"Greater of" Index Based
Features
Differentiated factors to reflect different risks and different asset and liability portfolios
Assumes standard impact of diversification and correlation among insurers, in its pure form
Depending on parameters, factors may be less reflective of the risks. Factors are usually predefined and may involve stress testing in some cases
Combinatorial
Features
Regulations allow insurers to use internal models, with prior approval
Internal models may fully reflect risk profile of the insurer
Flat Minimums
Features
More capital required with larger insurance portfolio - linked to premium and/or claim amounts
No differences for insurers with same liability but with more risky asset portfolio, or similar total premium but different businesses.
Asset risks assumed to be similar resulting in no differentiation in required capital levels
"Additive" Index Based
Features
Capital identified for a particular risk. Squares of such amounts of capital are squared and square root taken. May include factors and stress testing
Correlation factors that reflect differences in business mix and risk profile may be used
Industry wide formula
Internal Models


Eswatini
"Greater of" Index Based
Lesotho
Malawi
Rwanda
Combinatorial
Rwanda: use of regulatory approved internal model
Mauritius: stress based capital requirement for long term business based on regulatory guidelines
Flat Minimums
Ethiopia
Ghana
Mozambique
Nigeria
Seychelles
The Gambia
Zimbabwe
"Additive" Index Based
Kenya*
Uganda*
Botswana
Namibia
Mauritius
Internal Models

WHY THE SIMPLIFIED APPROACH

STATE OF INSURANCE LAW

Most of insurance regulators in East Africa, continue to strengthen their regulatory and supervisory framework in line with international standards and as such has embarked on a process to implement a risk-based capital framework as well as to strengthen its risk-based supervision and other supervisory processes

International Association of Insurance Supervisors (IAIS) has published its consultation document on Risk-based Global Insurance Capital Standard Version 2.0.

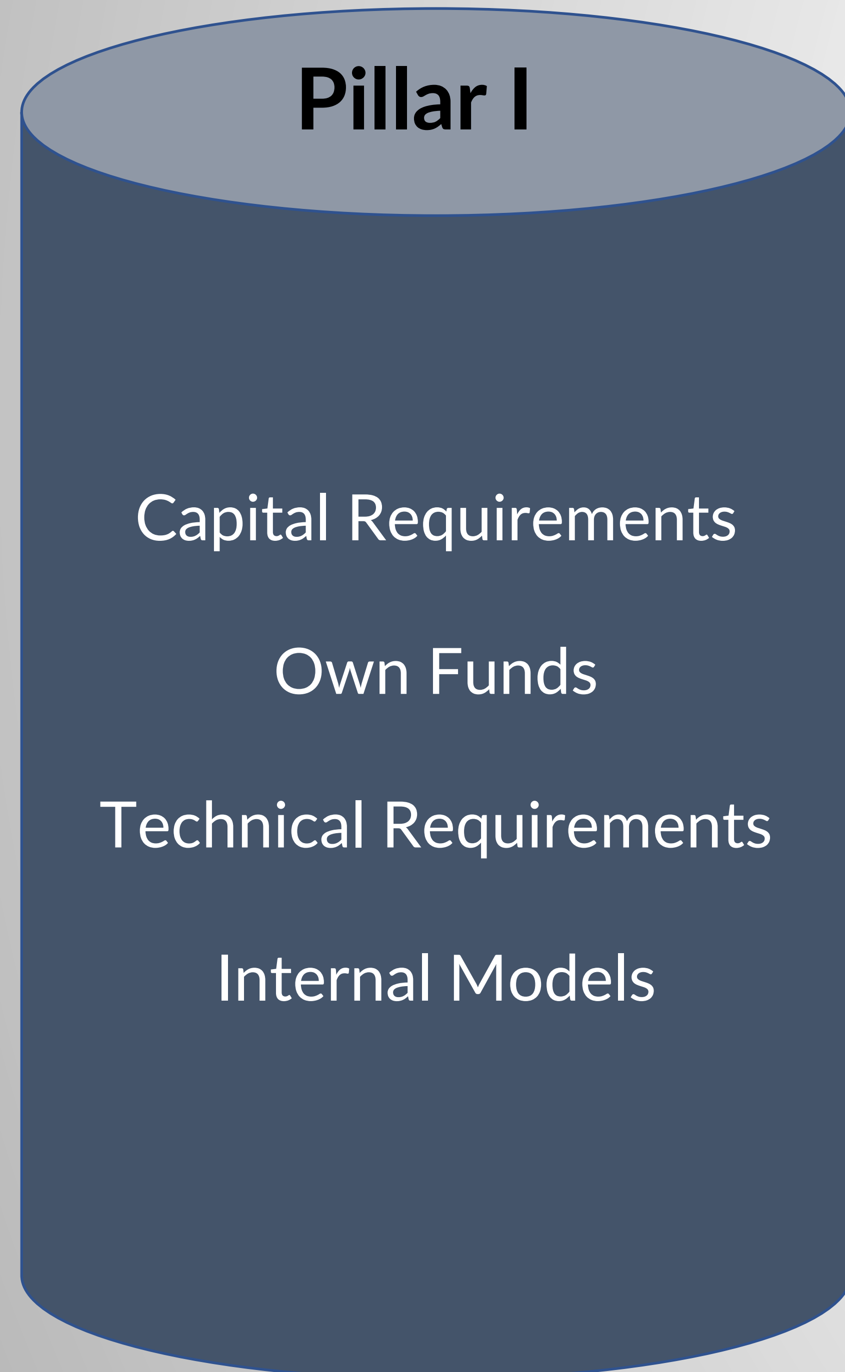
Consequently, care must be taken to ensure that the framework developed for the region is appropriate, fit for purpose and proportional to the regional and domestic insurance market. Hence, the principle of proportionality is being considered in the design of the risk-based capital standard for the region

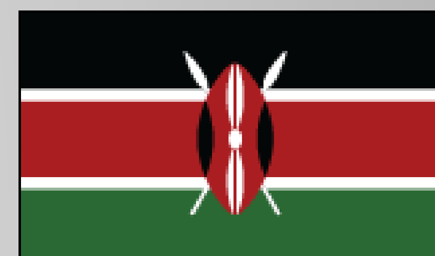
SIMPLIFIED SOLVENCY II" APPROACH

Contoso

SAFARI - SIMPLIFIED SOLVENCY II

Implementation Framework for SAFARI * - Simplified Solvency II (SSII) Approach to Insurance Supervision in East Africa





*Solvency Assessment For Africa Reinsurers and Insurers

** Enhanced CARAMELS to include additional Risks (C Capital Adequacy; A – Asset Quality (Credit Risk), Concentration Risk; R – Reinsurance; A – Actuarial (insurance Risks); M – Management soundness; E – Earnings and profitability; L – Liquidity; R – Reputational Risk; B – Business Strategy and Operational Risks; S – Systemic Risk and Sensitivity to Market Risks

Decision Usefulness of IFRS 17 for Solvency and Capital Adequacy Assessments

The objective of general purpose financial statements to provide useful financial information for economic decision-making is somewhat different than for solvency and capital adequacy purposes.

In assessing decision usefulness of a valuation approach for solvency purposes, the guidance of ICP 14 applies. ICP 14.4 calls for the valuation of policyholder liabilities to be an economic valuation

economic valuation to be "a valuation such that the resulting assessment of an insurer's financial position is not obscured by hidden or inherent conservatism more optimism in the valuation."

With the adoption of IFRS 17, IFRS standards will be compatible with the objectives and standards of ICP 14.

ICP 17 Capital Adequacy

The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention

ICP 17.1

- The supervisor requires that a **total balance sheet approach** is used in the assessment of solvency to recognise the interdependence between assets, liabilities, regulatory capital requirements and capital resources and to require that risks are appropriately recognised.

ICP 17.3

- The criteria used by the supervisor to establish **solvency control levels** should be transparent.

ICP 17.8

- The supervisor sets appropriate target criteria for the calculation of regulatory capital requirements - standardised approach or internal model

ICP 17.8.1

- The level at which regulatory capital requirements are set will reflect the risk tolerance of the supervisor.

Application ICP 17 to IFRS 17

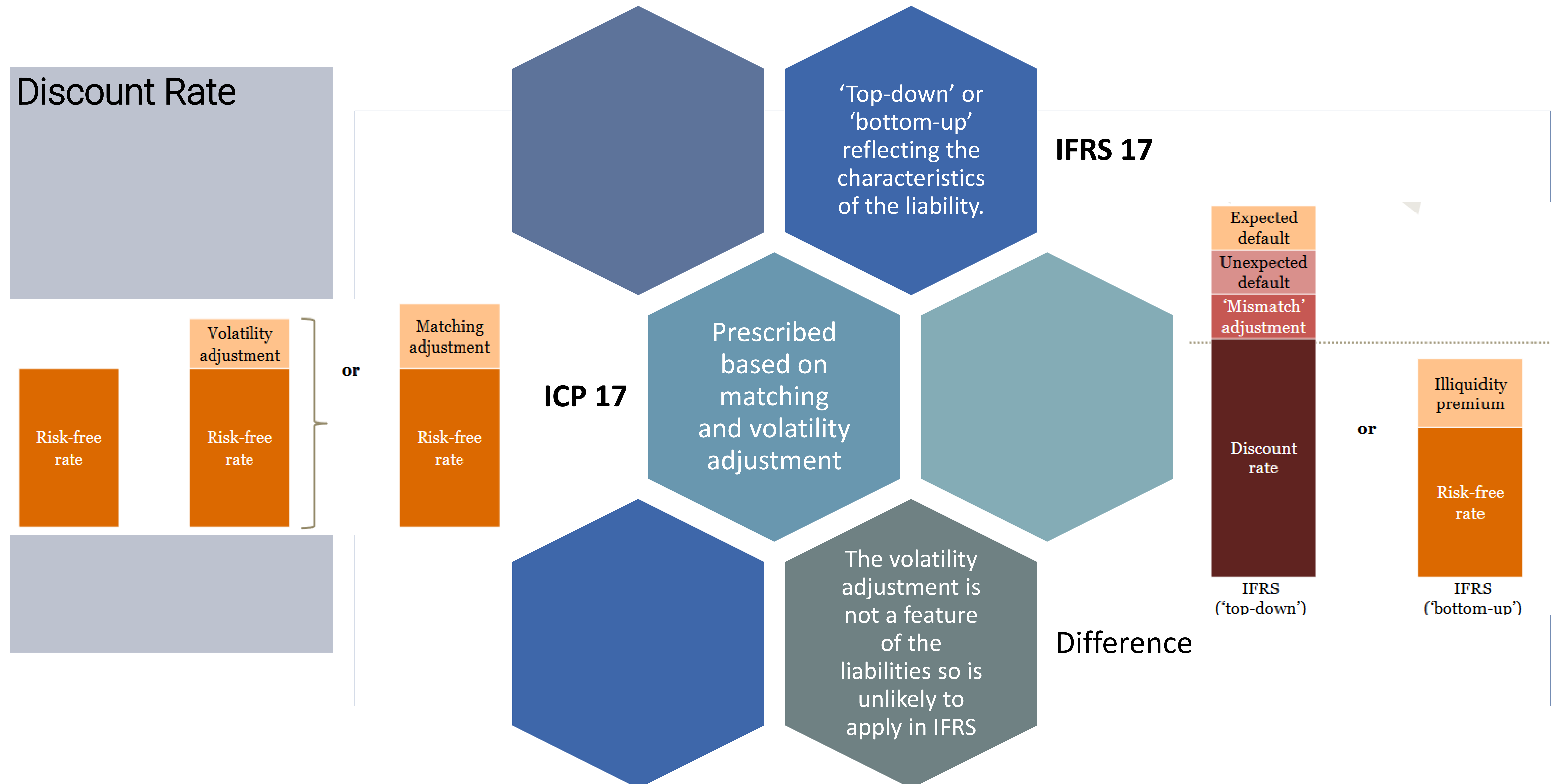
Application of the principles of ICP 17 to establish capital adequacy requirements using a total balance sheet approach can be accommodated using IFRS 17 accounting standards through judicious use of prudential filters, careful design and calibration of required capital and/or solvency control levels, allowing internal models under certain conditions, appropriate transition arrangements

Technical Considerations - ICP 17 & IFRS 17

Margins for risk

- IFRS 17 the confidence level of the risk adjustment is to reflect the risk tolerance of the entity.
- ICP 17 are to be calibrated based on the supervisor's risk tolerance.
- Risk adjustment under IFRS 17 is only in respect of non-financial risk

Technical Considerations - ICP 17 & IFRS 17

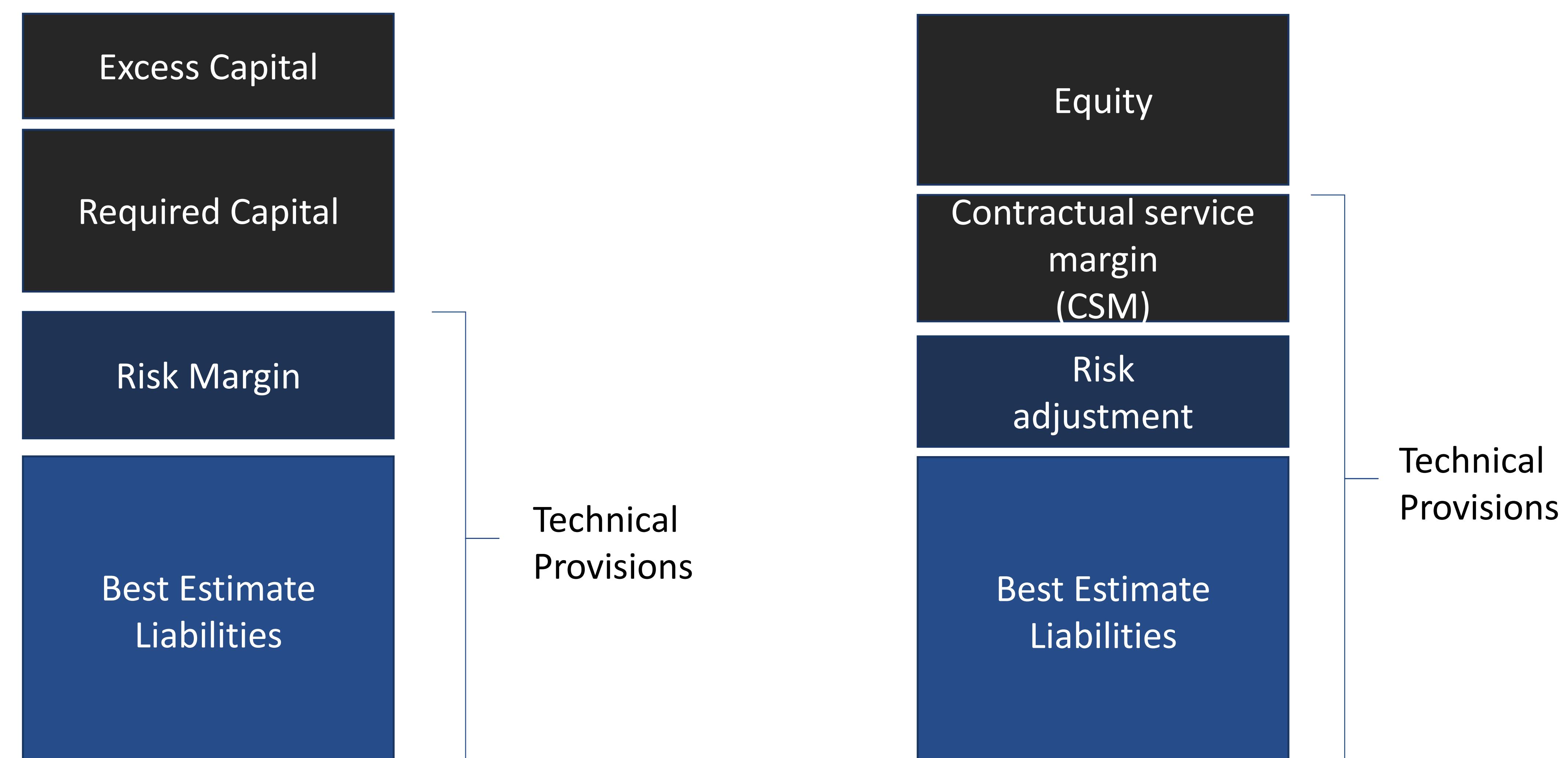


IFRS 17 do not take the expected return on the backing assets into account unless the asset cash flows affect the liability cash flows. There is no margin for reinvestment risk

Technical Considerations - ICP 17 & IFRS 17

CSM

Regulators and supervisors should consider the extent to which the CSM could be included in capital resources.



The CSM is a mechanism that affects the measurement and reporting of an insurer's profit over time

LESSONS LEARNT

ITS CHALLENGING BUT POSSIBLE