RISK BASED CAPITAL (RBC)
Sri Lanka’s experience

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Overview of the Insurance Industry – Sri Lanka

- The Regulator – IBSL
- Insurance Companies – 21

(Long-term: 3, Non-Life: 6, Composite: 12)

- Insurance Brokers – 54
- Insurance Agents – 37,000 approx.
- Growth of GWP – 11.03% (2012)
- Growth of Total Assets – 15.50% (2012)

	2008	2009	2010	2011	2012
Total Premium Income (US$ millions)	447	443	510	604	670
GDP (US$ millions)	34000	37000	43000	50000	58000
Penetration (Total Premium as % of GDP)	1.32	1.19	1.18	1.2	1.15
Total Assets of the Industry (US$ Million)	1200	1392	1685	2010	2322

What is Risk Based Capital (RBC) framework?

Definition of Society of Actuaries:

"Risk Based Capital represents an amount of Capital based on an assessment of risks that a company should hold to protect customers against adverse developments."

- Amount of capital required based on the risks faced by the insurer, to protect customers.

- Risk relates to classes of businesses underwritten and the assets held by insurers.

- Greater the risk greater the amount of capital required.

Why RBC?

- RBC is an approach towards efficient and prudent management of capital for an insurance company.
- It would identify potential risks, assesses mitigating factors and encourages proper management of all risks.
- Provides Incentives for insurers to strengthen appropriate risk management systems.
- Allow for greater transparency and prudential supervisory oversight.
- Flexible and principles-based Framework.

Why RBC? (contd.)

- Scarce supervisory resources could be targeted at insurers perceived as more risky.
- Allow regulator to intervene at an early stage with introduction of appropriate trigger points.
- Supervisor can benchmark institutions and assess overall industry.
- Market participants will be focused on managing risks rather than managing rules.

Benefits of adopting RBC Framework

- More efficient use of capital and informed decision making.
- Significant increase in risk awareness amongst the insurance companies.
- Risk sensitive approach will enhance the efficiency of capital and risk allocation.
- Highlights riskier and capital-intensive products and provides opportunities for portfolio optimization, keener pricing and enhanced product profitability.
- Operational efficiencies from better risk management will reduce costs for more capital efficient companies.
- Will upgrade risk management processes and controls and capital management skills which in turn should enhance investor confidence.

Sri Lanka's move towards Risk-Based regime

- In 2007, before the global financial crisis fully materialized, Industry leaders in Sri Lanka promoted the introduction of Risk Based Capital.
- At the same time, the Insurance Board also was examining the prospects of strengthening prudential supervision of the insurance sector.
- This partnership between the industry and the Regulator has resulted in seamless progress in the transition from Rules-Based to Risk-based regime.
- The RBC Project was initiated in Sri Lanka in 2009 with the assistance of the World Bank and First Initiative.
- The Project included an analysis of the Sri Lankan insurance market, a qualitative report and a quantitative report, culminating in a RBC Framework .

Steps of Development of RBC Framework

- Deloitte Touch Tohmatsu Ltd, India was appointed as Consultant to provide technical assistance to develop the RBC Rule.

- Three main reports were produced by the consultants:

a) **Market Assessment Report**

b) **Qualitative Report** – identified and defined appropriate risk factors

c) **Quantitative Report (Draft RBC Framework)** – Quantified the capital charges for various risk categories defined in Qualitative Report and proposed valuation methodology of assets and liabilities of insurers.
This report was issued to industry for comments.

Steps of Development of RBC Framework (contd.)

- A Joint Working Committee was formed with representatives from industry and the Regulator to address all areas of concern.

- Draft RBC Framework with Generic Templates were submitted to industry to commence the Road Test from 3rd Quarter 2012.

- Questionnaires were developed on Long Term and General insurance businesses to obtain responses from insurers for clear understanding of concepts and principals used by them for the Road Test.

Current Status of RBC

- RBC Final Framework has now been prepared based on analysis of quarterly Road Test results (past 4 quarters), feedback received from the industry and the input from the Regulator as well as the consultants.

- Key areas Covered in this document:
  - a) Summary of significant revisions
  - b) The RBC Framework
  - c) Determination of Risk Capital Charges
  - d) Implementation
  - e) Industry Discussion and Feedback

Way Forward

- Seminar to be held on 24th October 2013 to issue RBC Final Framework to the industry and train representatives of insurance companies to provide them a better understanding.
- RBC Final Framework will be converted to RBC Final Rule (legal form).
- During the next two years there will be a parallel run with both current (Solvency Margin Rule) and new regimes running simultaneously, in order to further calibrate the Risk based Capital Rule.
- During this period insurers could apply for early adoption of RBC methodology. But they will not be allowed to revert to existing Solvency Margin Rules once they switched to RBC.
- From the beginning of 2016, RBC methodology will be effective for all insurers.

Conclusion

- Risk Based Capital Framework, once finalized will be the way forward for a sustainable industry because there are changes in the financial landscape, this framework is flexible enough to allow for re-calibration whenever needed in the future.

- Each country will have its own unique model regarding capital adequacy and there will be no ‘one size fits all’ model. But we all can share our experiences and either improve what we have or assist another to improve on theirs.

Thank you