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The much-heralded new risk-based capital (RBC) framework is being implemented in Thailand from September 2011. The Office of the Insurance Commission (OIC) carried out a second round of test calculations earlier this year to assess the solvency position of all insurance companies as at 31 December 2010. The test results that were published recently by the OIC provide a good indication of the capital position of the industry under the new RBC rules.

Introduction

The new RBC framework being introduced in Thailand with effect from September 2011 requires insurance companies to calculate the Total Capital Required and the Total Capital Available under the prescribed RBC rules. The Capital Adequacy Ratio (CAR) is then determined as the Total Capital Available divided by the Total Capital Required.

Under the new framework, assets are mainly valued at market value with adjustments. Liabilities are calculated using a gross premium valuation (GPV) approach, with best-estimate liabilities plus provisions for adverse deviations (PADs) set at a 75% confidence level. The discount rates used to value liabilities are based on zero-coupon Thai government bond yields, subject to a maximum rate determined by reference to a weighted average of current yields at the valuation date and historical yields over a period of seven quarters prior to the valuation date.

The four components of Total Capital Required are market risk charge, credit risk charge, concentration risk charge and insurance risk charge. Within the market risk charge, the interest-rate risk charge is determined by carrying out prescribed stress tests on the level of discount rates. For other components of the market risk charge, and for credit and concentration risk charges, a set of prescribed risk factors is applied. For the insurance risk charge, a GPV approach with a more stringent confidence level of 95% is used.

All insurance companies in Thailand will need to hold solvency capital at a level not lower than a prescribed minimum CAR in order to avoid potential regulatory intervention This prescribed minimum CAR is based on a sliding scale, with an initial statutory minimum CAR of 125%, increasing to 140% from 1 January 2013.

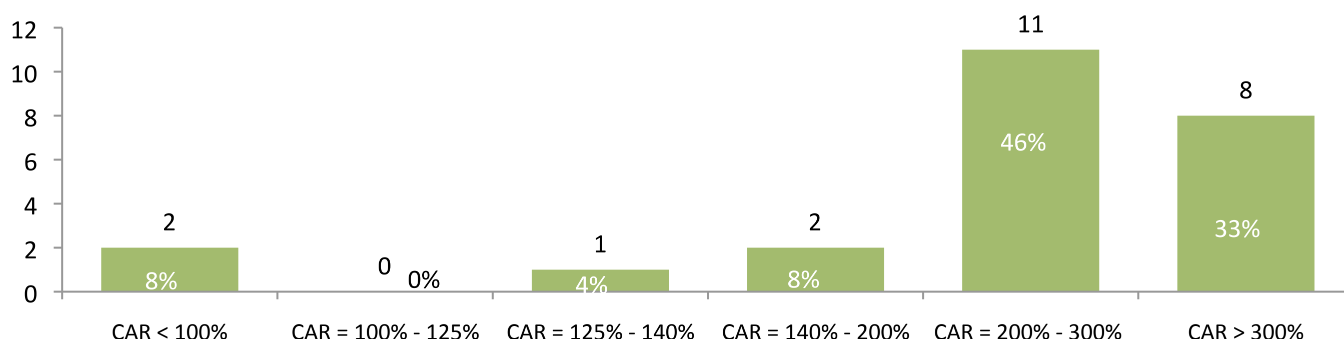
In 2010, the OIC required insurance companies to submit test calculations (Parallel Test 1) as at 31 December 2009, based on draft RBC rules. Following subsequent analysis of the Parallel Test 1 results and industry discussions, some changes were made to the proposed calculation basis. Earlier this year, insurance companies were requested to submit updated test results showing their solvency position as at 31 December 2010 on the revised calculation basis (Parallel Test 2). These results were published by the OIC in late August 2011.

Some of the key results from the Parallel Test 2 exercise for life insurance companies are shown below:

Parallel Test 2 Results

i) Distribution of CAR by company

Number of life insurance companies and proportion of total in each CAR range



Source: OIC, 23 August 2011

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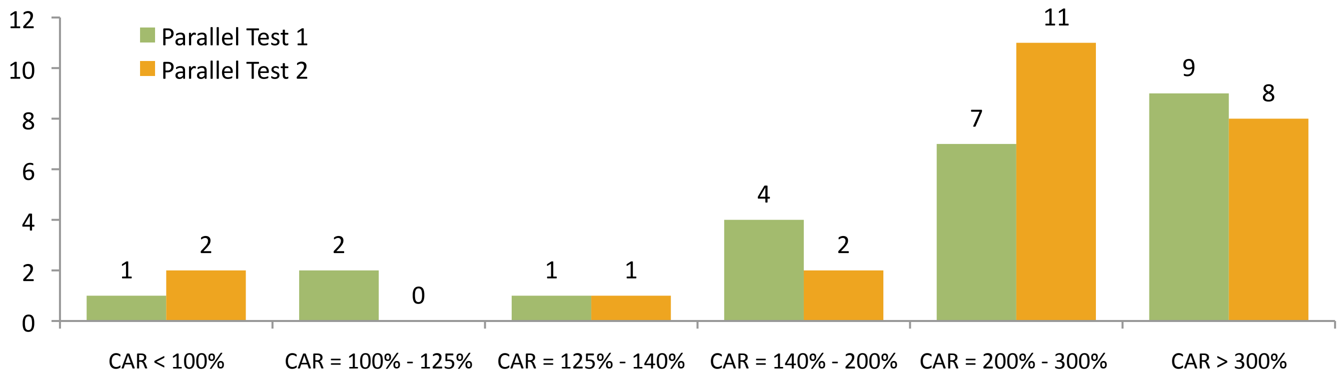
ii) Parallel Test 2 versus Parallel Test 1

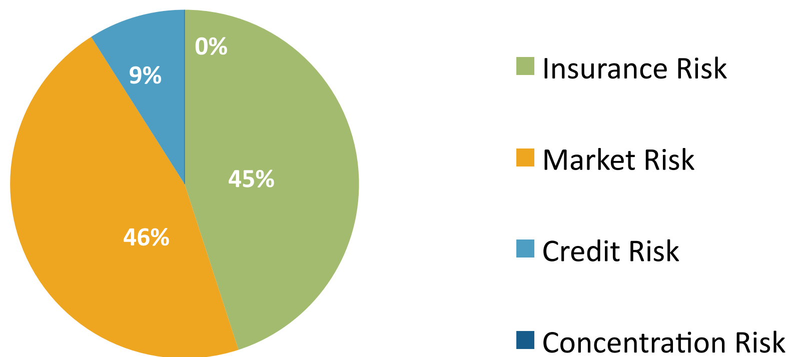
Number of life insurance companies and proportion of total in each CAR range



Source: OIC, 23 August 2011

- The above comparison of the distribution of CAR levels between the two parallel tests shows that under Parallel Test 2 more companies have moved into the 200%-300% CAR range and slightly less are in the 140%-200% and greater-than-300% CAR ranges. One additional company moved into the below-100% CAR range in Parallel Test 2.
- For most life insurance companies in Thailand, the RBC requirements under Parallel Test II are less stringent than under Parallel Test 1, with lower prescribed risk charges, particularly for interest-rate risk and credit risk.

iii) Split of Total Capital Required by risk type for life insurers under Parallel Test 2



Source: OIC, 23 August 2011

- Across the life insurance industry, market risk and insurance risk changes accounted for the highest proportion (91%) of Total Capital Required. Credit risk was seen to have a less significant impact on RBC solvency capital across the industry, and concentration risk was not material.

Conclusions

- After much discussion, deliberation, testing and revisions of calculation bases and assumptions, insurance companies in Thailand are poised to move to the new RBC approach for determining statutory solvency capital. The recently published Parallel Test 2 results suggest that most life insurers have sufficient capital to comfortably meet the minimum regulatory solvency requirements. However, a small number of life insurers may require capital injections in the short term to strengthen their solvency position.
- Looking more widely, the move to a new RBC framework represents a positive step in terms of creating a closer association between the amount of capital an insurer holds and the underlying risks of the business. As expected, the main risks impacting capital for life insurers are market risk and insurance risk. Credit risk and concentration risk are far less significant.
- The focus for most insurers up to now has been largely on building the internal capabilities to be able to determine snapshot RBC calculations to ensure compliance with regulatory reporting requirements. It will be interesting to witness the extent to which companies extend this initial RBC work into other areas such as product pricing, business projections and embedded value reporting in order to embrace the full benefits of an RBC framework.

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