

Solvency Assessment and Management 2012 Update



MARCH 2012

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1. Introduction

The Solvency Assessment and Management (SAM) framework is currently being developed to establish a risk-based supervisory regime for the prudential regulation of both long-term and short-term insurers¹ in South Africa. Since the Financial Services Board (FSB) and the industry embarked on the project during 2009, there has been significant progress in the development and implementation of the framework, and accordingly the FSB would like to thank the industry and all other stakeholders for their participation in the project.

However, as with any project of this magnitude, it is difficult to accurately estimate the duration of the various inter-linking processes in advance, given the extent of the issues that need to be addressed and the large number of stakeholders involved in the process. Therefore, there have been several revisions of the various timelines that were originally envisaged in the SAM Roadmap as published in November 2010.

The purpose of the SAM 2012 Update is to highlight the various revisions to these timelines, as well as changes to some of the structures and processes currently in place. This document should be read in conjunction with the SAM Roadmap, as many of the timelines in the original Roadmap have become out-dated and should be replaced by the equivalent information in this Update. The annexure to this document compares the details of the original SAM Roadmap and IMAP Guide to those that are revised in this SAM 2012 Update.

The principal change is that the final date for full implementation of the SAM framework has been changed from 1 January 2014 to 1 January 2015. This means that all insurers are required to fully implement the SAM framework by 1 January 2015, while the SAM framework and the existing regime should run in parallel during 2014.

Although the final implementation date has been revised, insurers should not interpret this as an opportunity to relax their implementation efforts. The 2015 implementation deadline remains onerous, as there is still a lot of effort required in relation to the development and implementation of the framework. The FSB expects insurers to be in a position where they are able to calculate and report on the regulatory requirements under the SAM framework from the start of the parallel run in January 2014.

¹ Throughout the report any reference to insurers will be to both insurers and reinsurers unless specifically stated otherwise.

2. Governance

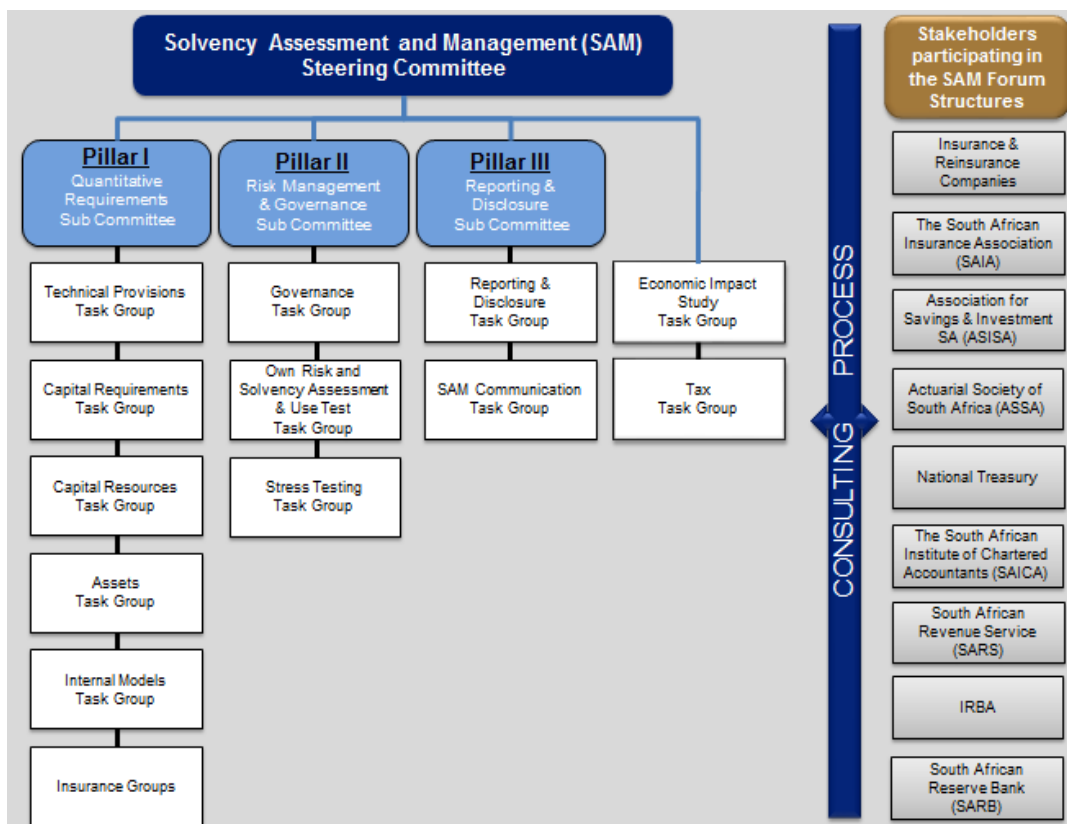
The SAM governance structure was initially set up to provide the FSB with recommendations to best achieve the aims of developing the new SAM regulatory regime. There have been several changes to the governance structure which should better assist in achieving these aims.

Firstly, under Pillar II the *Internal Control and Risk Management Task Group* and the *Corporate Governance Task Group* have been combined into a single task group, namely the *Governance Task Group*. These two task groups were combined as there were several overlapping areas between the original task groups.

Secondly, the *Economic Impact Sub Committee* has been removed. It was felt that both the Economic Impact Study Task Group and the Tax Task group could report directly into the *SAM Steering Committee*. The change was brought about to avoid duplication of discussions leading to a more efficient structure.

Finally, the South African Reserve Bank now also participates in the SAM structures and they are represented at the *SAM Steering Committee*.

Figure 1: Revised SAM Governance Structure



3. Timelines

The roll-out of the SAM regime is a consultative process with industry, and SAM is based on Solvency II, which is subject to uncertainties that accompany international negotiations and policymaking. Furthermore, the timelines related to the parliamentary process are uncertain. It is therefore not possible to ascertain the duration of the various processes upfront, and consequently the setting of final deadlines was originally envisioned as an adaptive process.

- *The Road to Parliament*

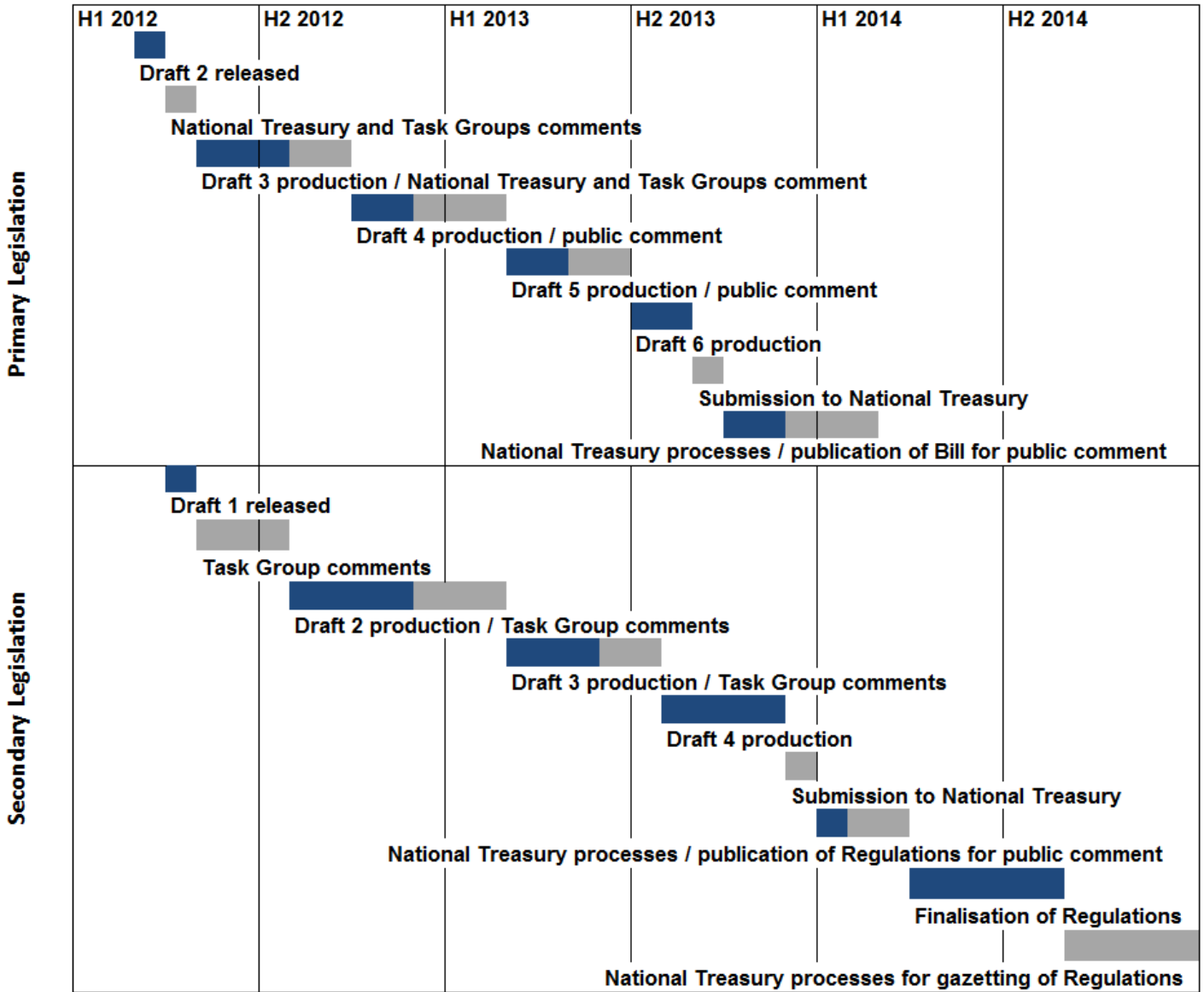
The broad policy approach to be adopted by the FSB, in consultation with the National Treasury, is given substance through initial proposals for primary and secondary legislation as a result of the outputs from the various SAM task groups. These initial proposals follow a 'Road to Parliament', in the course of which a number of drafts of the proposed legislation are produced through an iterative consultation process by the SAM task groups and National Treasury. Only in the final stages once the proposed legal text is nearing completion, will the general public be invited to comment.

Revised milestones in the Road to Parliament are illustrated in figure 2 below. It is anticipated that the final draft of the primary legislation will be released for public comment by the end of 2013, as opposed to the beginning of 2013 as had been originally envisaged. Following the completion of the consultative process in relation to the proposed legislation, the draft Bill will be finalised and submitted to Cabinet. A further opportunity for public consultation is thus anticipated during the second half of 2014 through the Parliamentary process, before the legislation is promulgated.

Similarly, the final draft of the secondary legislation will be available for public comment by the beginning of 2014.

Figure 2 overleaf shows the various changes to the Road to Parliament.

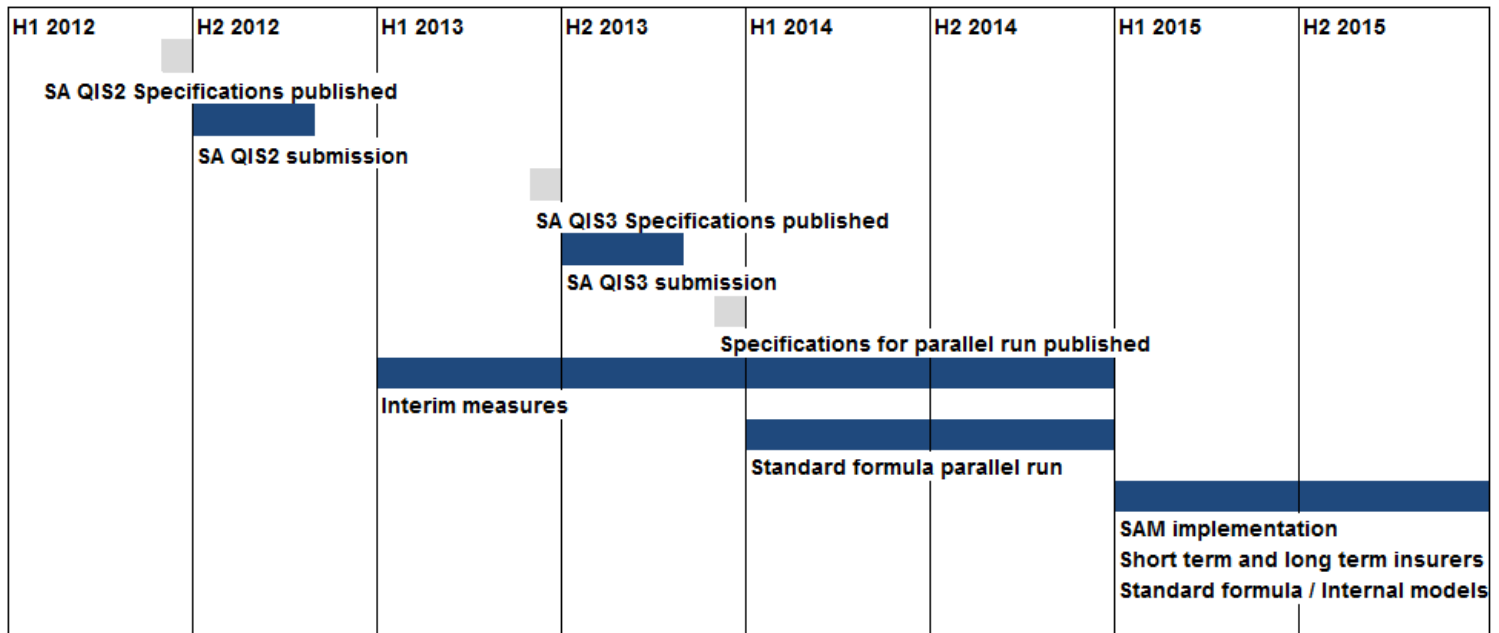
Figure 2: Revised SAM Road to Parliament Timeline



- **SAM Roll-out**

Due to the revision of the legislative deadlines, the SAM project deadlines in general needed to be revised. The final SAM implementation date for insurers has changed from 1 January 2014 to 1 January 2015. Figure 3 below illustrates the various changes to the SAM roll-out timeline.

Figure 3: Revised SAM High Level Roll-out Timeline



SAM roll-out
 Insurer activity

From the above it can be seen that there will be a parallel run during 2014 for insurers. Insurers will be expected to submit statutory returns on the current basis as well as on the SA QIS 3 basis (with possible further refinements to the basis) using standard formulae during this period. The SA QIS exercises are discussed in more detail in the next section.

During the parallel run in 2014, the primary legislation will follow parliamentary processes towards the final promulgation.

- **Interim Measures**

Interim measures regarding the *prescribed requirements for the calculation of the values of the assets, liabilities and capital adequacy requirements of short-term insurers* (Board Notice 169 of 2011) have been issued by the FSB. Further interim measures regarding insurance groups, governance, risk management and internal controls for long-term and short-term insurers are expected to take effect from 1 January 2013. It should be noted that this timeline will be subject to the timing of the key stages involved in the promulgation of the Insurance Laws Amendment Bill.

4. Quantitative Impact Studies (QIS)

Throughout the development of the SAM framework and legislation, quantitative impact studies will be conducted by the FSB to help inform the debates underlying the development. Given the revision in the timelines, it is now envisaged that there will be 3 quantitative impact studies in total.

- *SA QIS 1*

The first quantitative impact study - SA QIS 1 - was conducted during 2011 with a tremendous participation rate covering over 90% of the South African insurance industry by premium volume. The FSB released a report on the results and findings of SA QIS 1 during December 2011, entitled *Report on the results of the 1st South African Impact Study* and this document is available on the FSB website.
- *SA QIS 2*

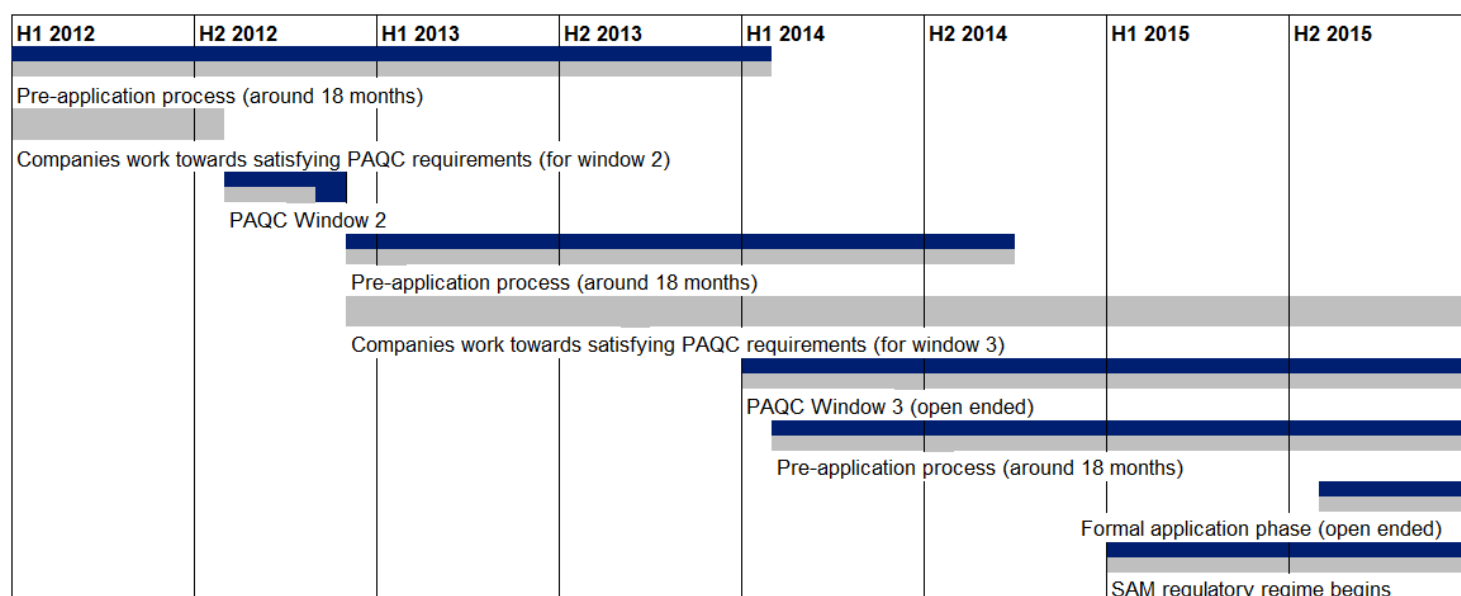
SA QIS 2 will be conducted during 2012, with the FSB releasing the technical specification for SA QIS 2 by the end of May 2012. Insurers who elect to participate in the exercise will be required to submit their QIS returns to the FSB in September 2012. It is anticipated that participation in SA QIS 2 will be greater than that of SA QIS 1, given that most SA QIS 1 participants are expected to participate in SA QIS 2 as well. A report on the results and findings of SA QIS 2 will be released at the end of 2012.
- *SA QIS 3*

SA QIS 3 will be conducted during 2013, and insurer participation in the exercise will be **compulsory**. The FSB will issue the technical specification by the end of May 2013, and all participants will be required to submit their SA QIS 3 returns in September 2013. A report on the results and findings of SA QIS 3 will be issued at the end of 2013.

5. Internal Model Approval Process (IMAP)

Due to the final SAM implementation date being revised to 1 January 2015, the timeline for the approval of internal models has also been revised. The second window where insurers have the opportunity to submit their Pre-Application Qualifying Criteria (PAQC) to the FSB will be open from 1 August 2012 to 31 October 2012. Once all PAQCs have been received, the FSB will communicate decisions back to the insurers by 30 November 2012. The open-ended PAQC window 3 will start 1 January 2014. The key changes to the IMAP dates have been illustrated in figure 4 below.

Figure 4: Revised Internal Model Approval Process Timeline



FSB Activity
 Insurer Activity

6. Pillar II Readiness

Whereas there has been a lot of activity from both the FSB and the industry in the implementation efforts relating to Pillar I through SA QIS 1 and the IMAP process, not much work has been done yet by the FSB on ascertaining the development work being done by insurers to prepare themselves for Pillar II of the SAM framework. The FSB regards Pillar II as a fundamental part of the SAM framework and as such will be conducting a compulsory Pillar II readiness exercise during the course of 2012.

The exact detail of the exercise is still being developed, but it is envisaged that the exercise will consist of a survey, followed up by targeted interviews at the insurers to understand what developments are taking place at the insurers and how they are preparing themselves for Pillar II. The results of the survey and the interviews will be treated as confidential, but a report on the general findings of the Pillar II Readiness exercise will be released by the FSB towards the end of 2012.

7. Transitional Equivalence Arrangements

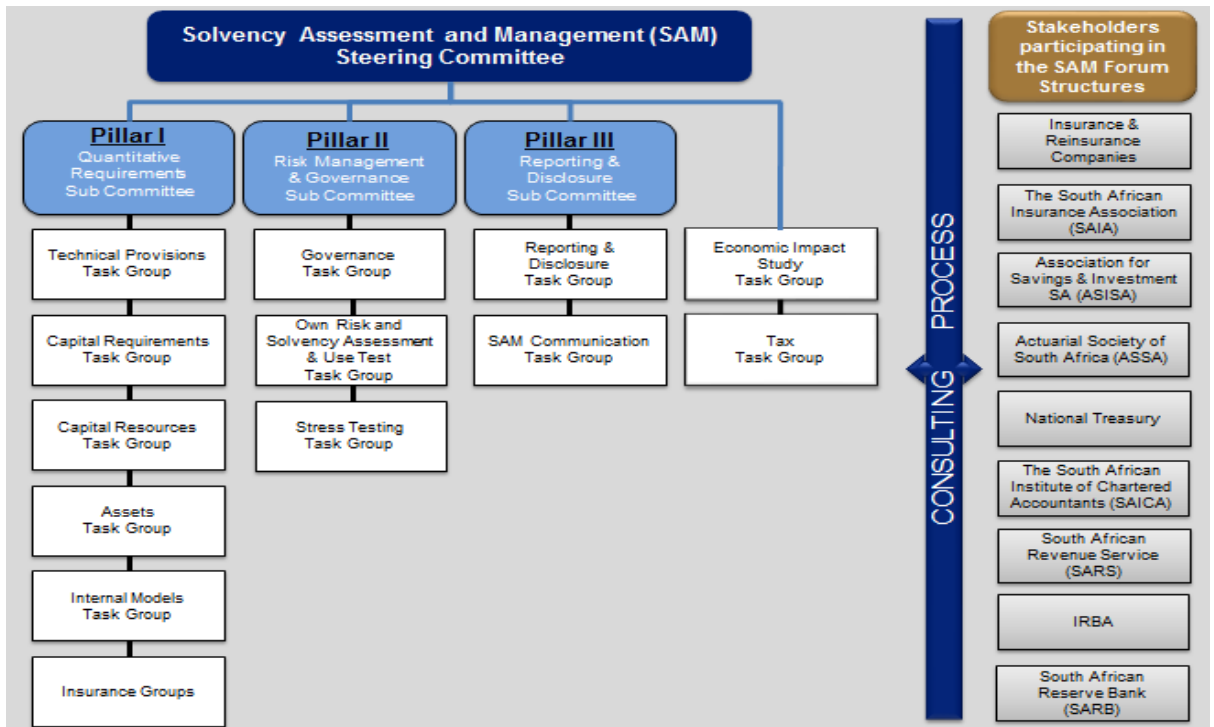
When discussing the objectives of the SAM framework, the SAM roadmap stated that an overarching principle is that the recommendations arising from the SAM project should meet the requirements of a 3rd country equivalence assessment, as established by the European Union.

The Solvency II regime is still being developed, and the requirements for 3rd country equivalence are not yet finalised. In addition, the European Commission may not be able to make decisions on whether all of the respective 3rd countries would be equivalent before the implementation of Solvency II in 2014, due to the limited time available. However, the European Commission is considering transitional arrangements whereby countries may be deemed equivalent for a set period of time from Solvency II implementation.

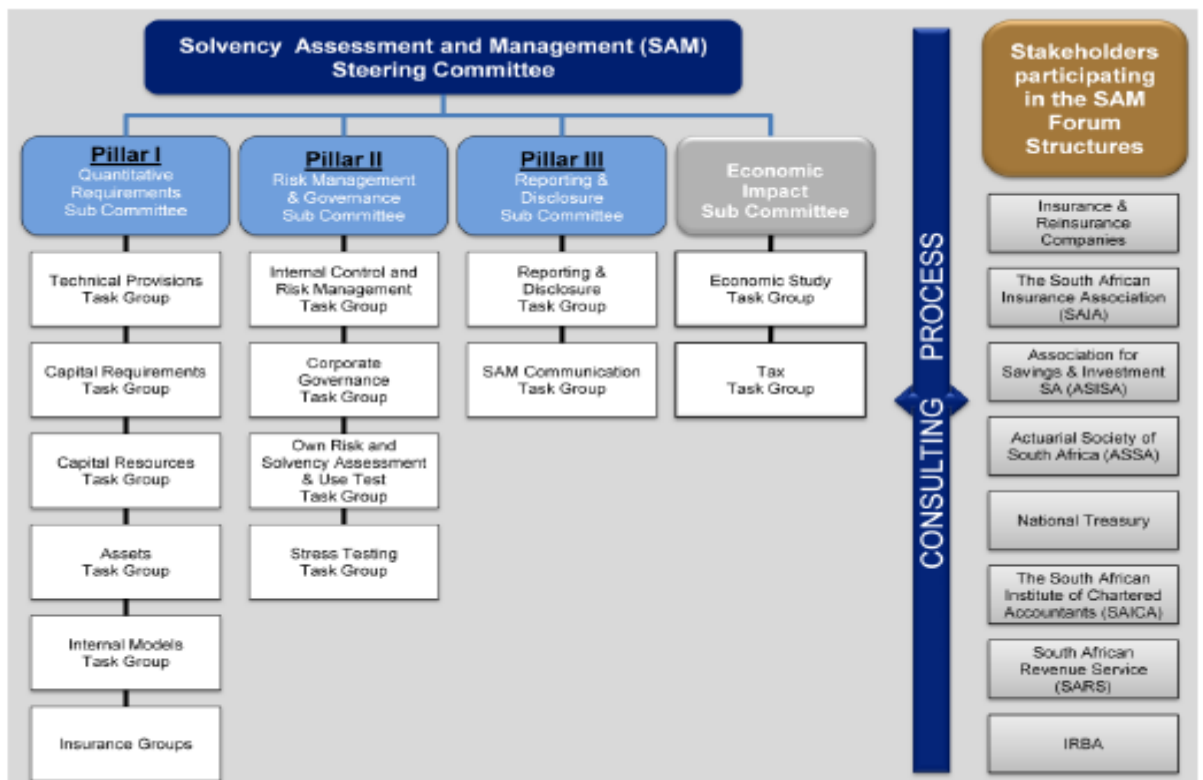
The European Commission has identified South Africa as one of seven countries where they have asked EIOPA to carry out a technical analysis on the regulatory regime for insurers. This technical analysis will assist the European Commission in making a decision on whether South Africa should qualify for the transitional arrangements. The FSB is currently working with EIOPA on this analysis, and it is expected that the European Commission will make a decision on which countries qualify for the transitional arrangements in 2013.

Annexure: Comparisons with original timelines

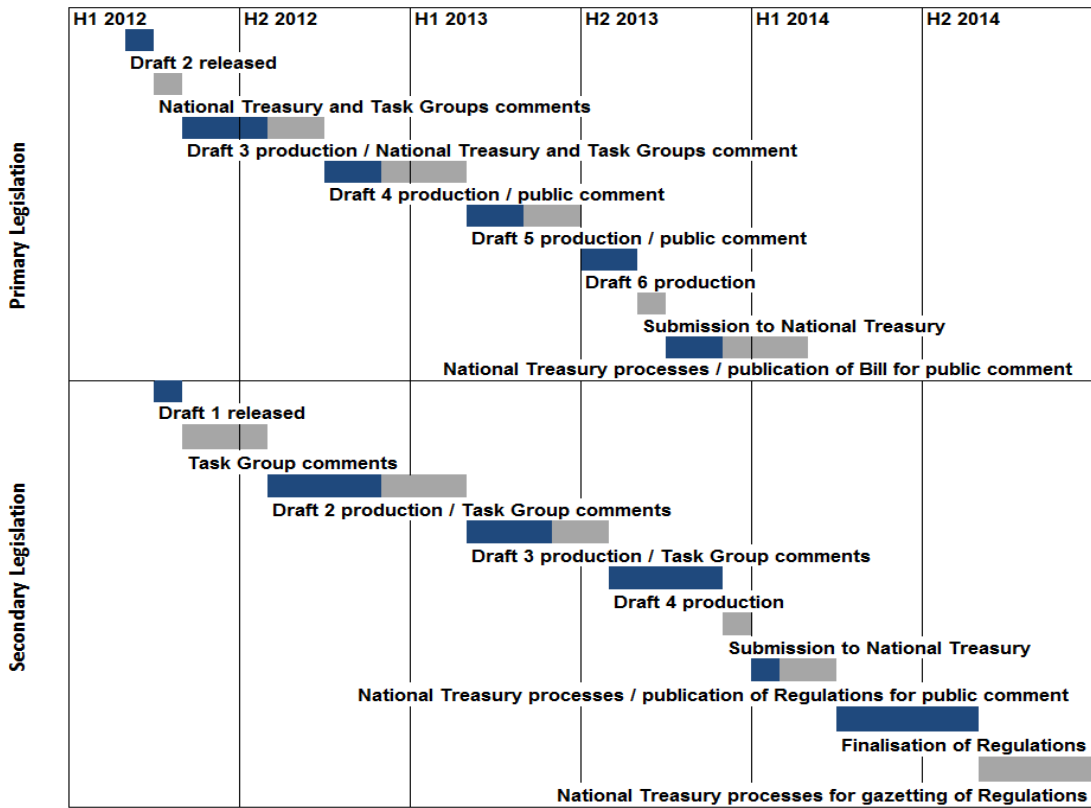
Revised SAM Governance Structure



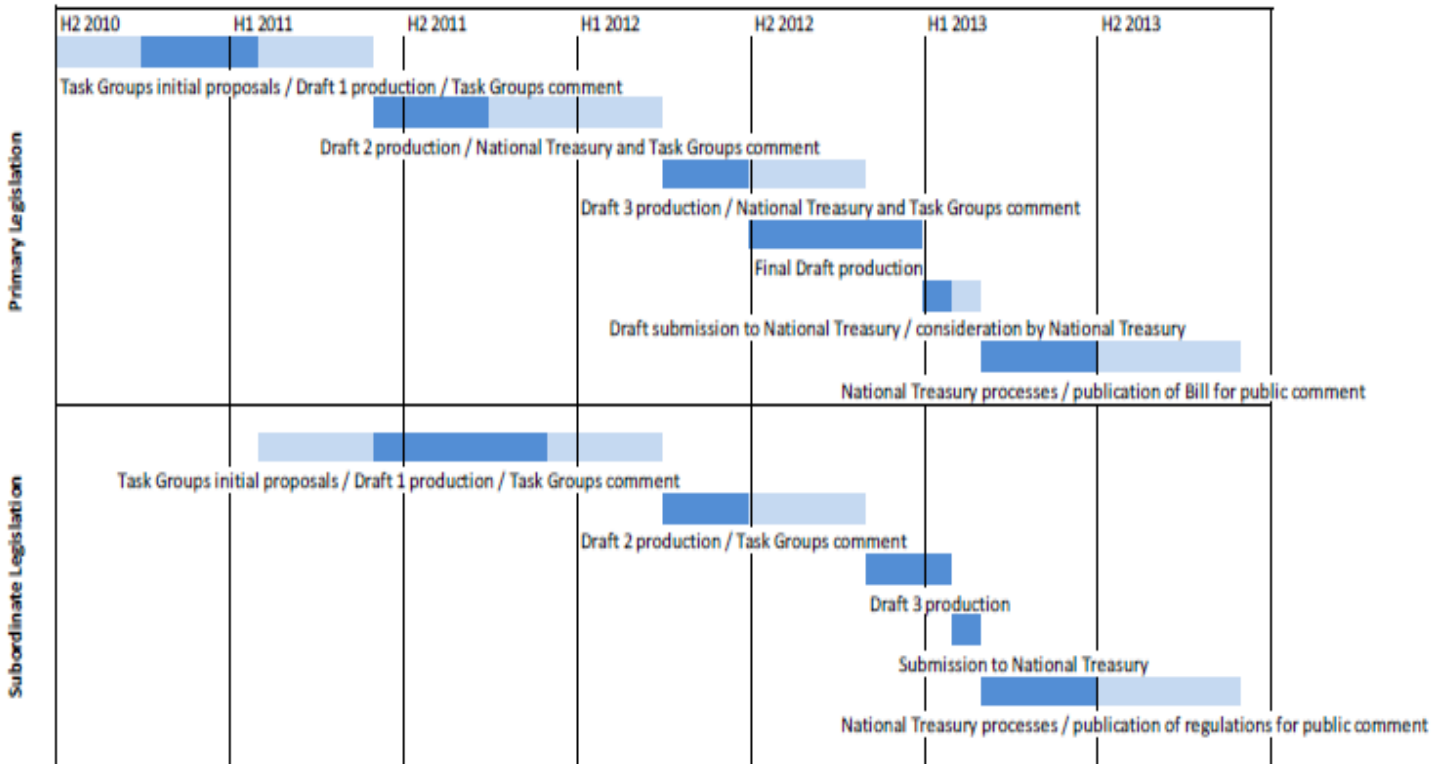
SAM Governance Structure according to the original SAM Roadmap



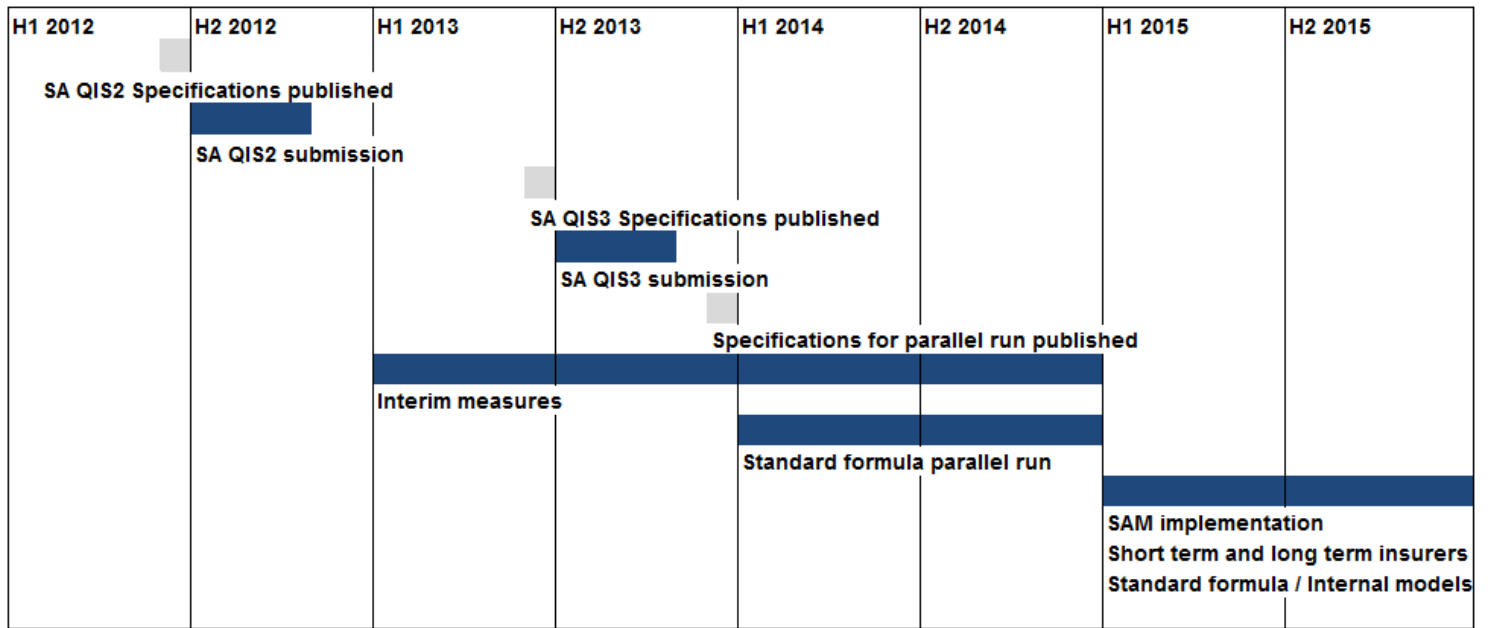
Revised SAM Road to Parliament



Road to Parliament according to the original SAM Roadmap

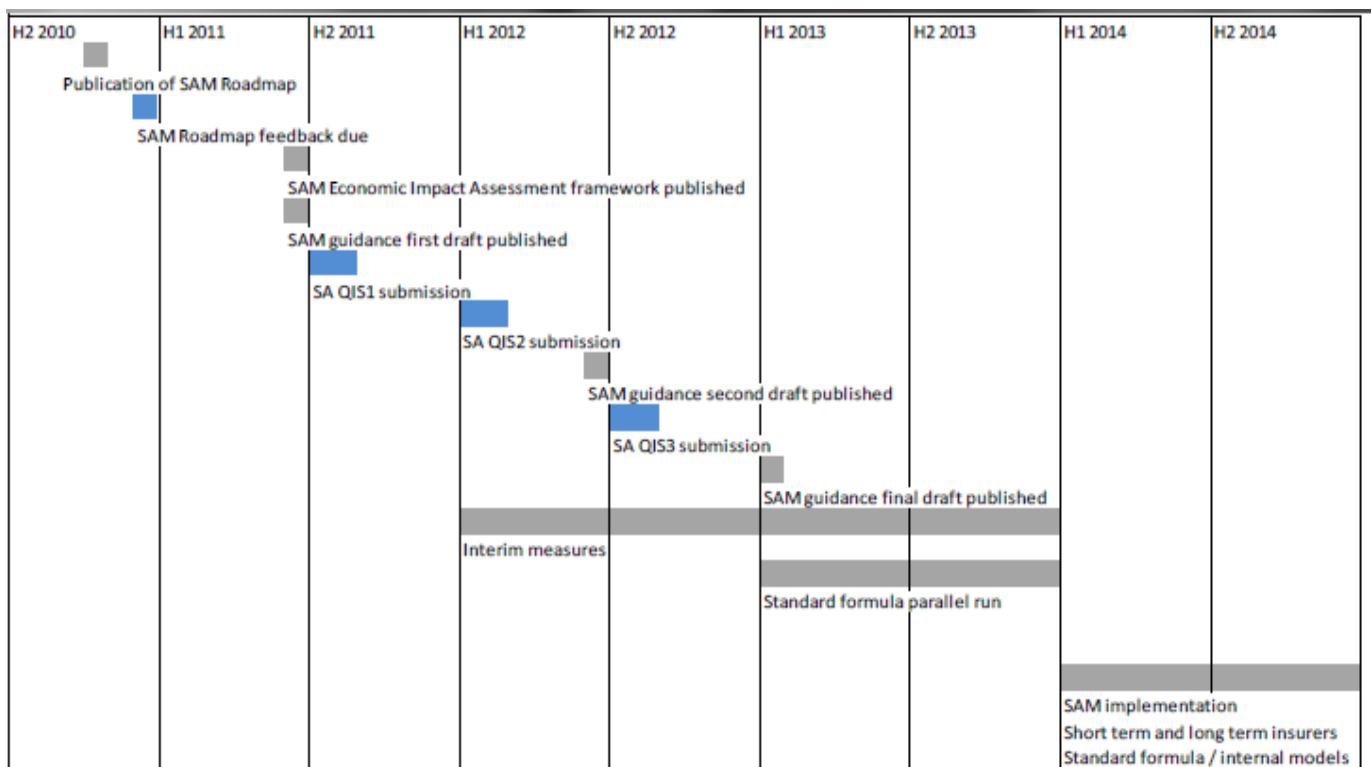


Revised SAM High Level Roll-out Timeline



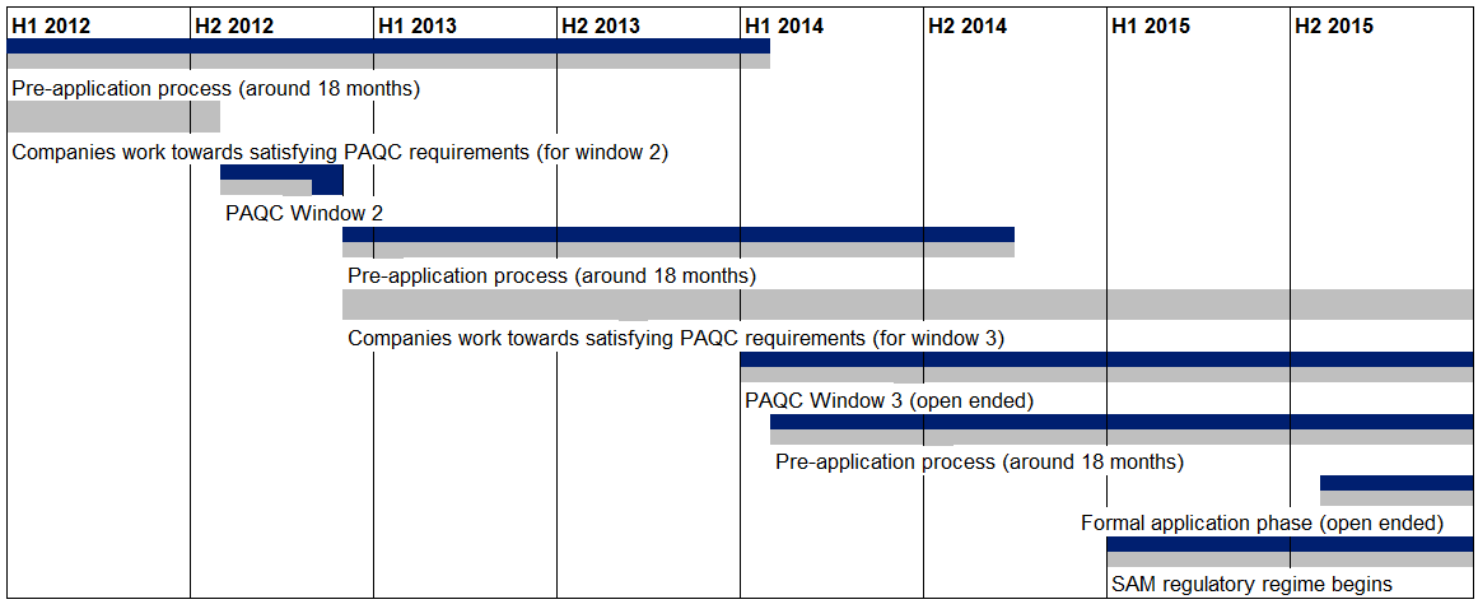
SAM roll-out
 Insurer activity

SAM High Level Roll-out Timeline according to the original SAM Roadmap



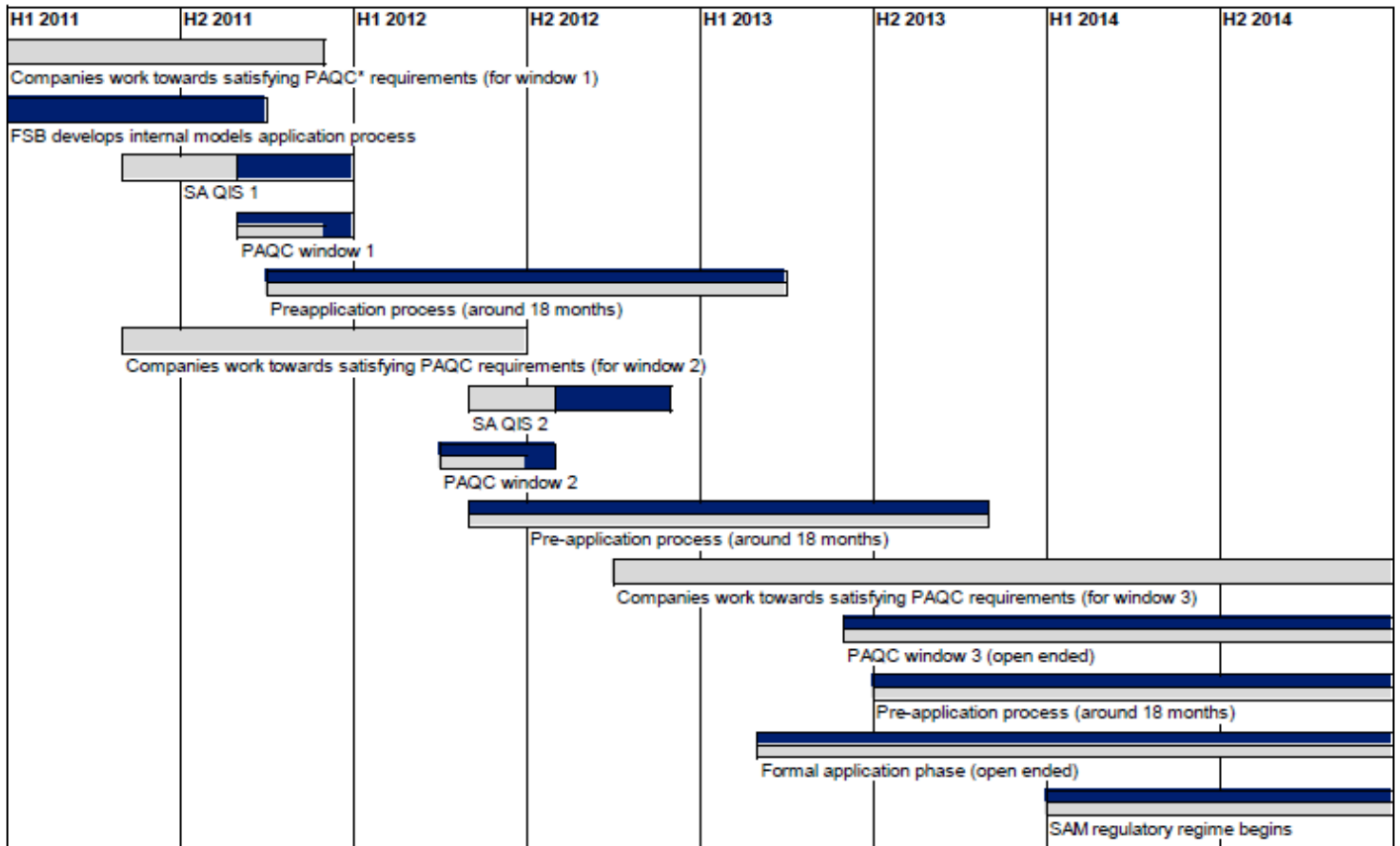
SAM roll-out
 Insurer activity

Revised Internal Model Application Process Timeline



■ FSB Activity
■ Insurer Activity

Internal Model Application Process Timeline according to the IMAP Guide



■ FSB Activity
■ Insurer Activity

* PAQC stands for pre-application qualifying criteria