GCR Global Credit Rating Co.
Local Expertise • Global Presence

First Floor, Block A,
Wierda Court,
107 Johan Avenue,
Sandton, 2146
Tel No. : +2711 784-1771
Website:www.globalratings.net

Press release: April, 2012

NEW SOLVENCY REQUIREMENTS ALREADY BEING ENFORCED

The Financial Services Board's planned Solvency Assessment & Management (SAM) initiative, to ensure all insurers have sufficient capital to mitigate against a number of risks, is planned for implementation in 2014. Leading up to the implementation of SAM, however, a new statutory capital requirement is also being enforced from the start of 2012.

According to Marc Chadwick at Global Credit Ratings (GCR), the interim statutory solvency requirements, which adopt a more risk-based approach relative to existing regulatory calculations, allow insurers to phase-in the planned SAM capitalisation framework progressively.

Chadwick noted that the updated legislation reflects an increased degree of technicality, and is more in line with modern international requirements. "The total risk exposure which a business must assess is primarily a function of the source and magnitude of each segmented risk. There are a few categories for risk quantification including underwriting risk (based on the line of business); market risk (riskiness of investment assets); credit risk (riskiness of counterparties); and operational risk (risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events). "

Insurers that do not meet the requirements would need to provide additional capital to bring the coverage factor up to a required level, failing which the FSB may place restrictions on the particular insurer's business mix and volumes. "The more risk-specific analysis of an insurer, via the new statutory capital calculations, allows for an insurer to remain compliant with statutory capital requirements by reducing its risk exposure in areas of business that are more capital intensive."

Chadwick says the new SAM framework is a scientific, risk-based approach to managing capital that will assist in the rating process by providing a risk-consistent method to compare and benchmark insurers. In this regard, the capital adequacy ratio serves as a reference point for judging the relative strength of capital. Qualitative and quantitative enhancements are applied as warranted to derive a more complete picture of an insurer's capital position, which then feeds into the broader rating criteria. "The structure and underlying objective of the new compliance requirements will drive an enterprise-wide risk management culture, with risk quantification and assessment being one of the biggest factors for the management of insurance companies to consider."

"The bulk of insurers' core activities will now have to factor in these requirements (governed by Solvency II's Pillar I), which are augmented by strengthened governance and risk management practices (Pillar II considerations)."

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“As a result, it will be critical for insurers always to have a close eye on the risk they are carrying and ensure that they are managing that risk, whilst also considering how it affects other core aspects of operations such as growth and profitability. In so doing, the industry will see the application of capital requirements commensurate with companies’ risk profiles,” concludes Chadwick.