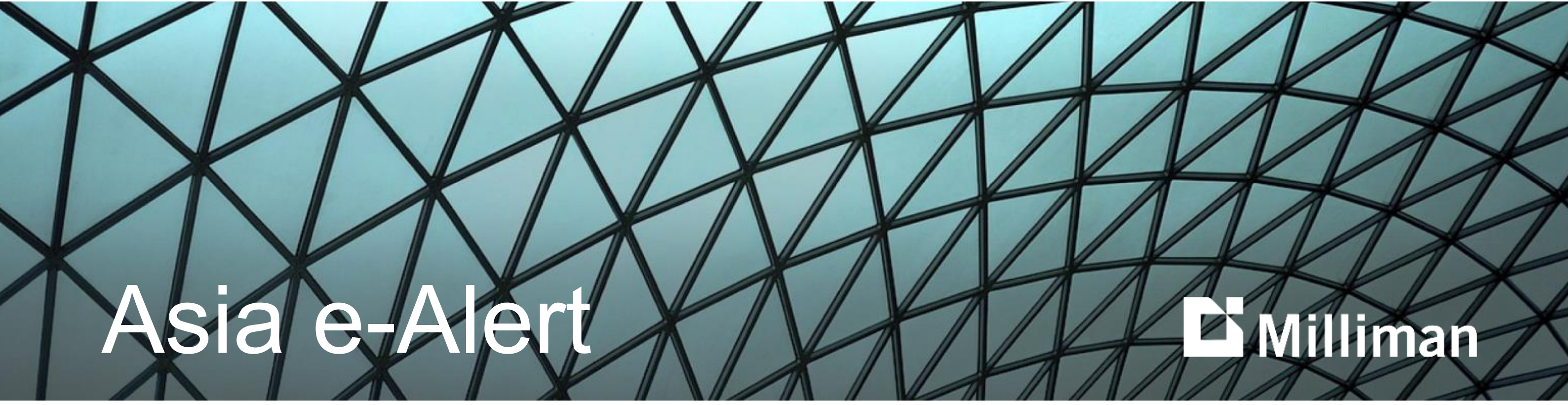

Key regulatory changes in Thailand: RBC2 quantitative requirements, ERM guidelines and ORSA reporting requirements

Introduction

2019 will be a year of considerable regulatory changes pertaining to risk management in Thailand. The new risk-based capital framework (RBC2) will replace the current one (RBC1), and insurance companies will be required to implement Enterprise Risk Management (ERM) and Own Risk and Solvency Assessment (ORSA).

In addition, impact studies for IFRS9 and IFRS17 are expected to take place prior to the complete transition to the 99.5% confidence level (which is expected in 2022 according to a public hearing earlier this year).

While at the time of writing this e-Alert, the RBC2 and ORSA requirements are still being finalised, we summarise the new capital and reporting requirements from these anticipated regulatory changes.

Key points of focus:

- 95% confidence level of RBC2
- Proposed ERM framework and ORSA reporting requirements
- Risk management process and governance
- Continuity and stress testing analysis

RBC2 quantitative requirements

The change from RBC1 to the 95% confidence level of RBC2 is likely to increase the market risk capital requirement while lightening the capital requirements for insurance and credit risks[1]. At the overall industry level, the impact on the total capital requirement is not expected to be material.

RBC2 qualitative requirements: ERM and ORSA

The implementation of ERM and ORSA frameworks is expected to start in 2019.

Companies will be required to establish a risk governance framework that ensures effective ERM and appropriate segregation of duties.

An ORSA must be conducted at least once a year or whenever a significant change arises. This is to assess the adequacy of the company's risk management, taking into consideration the current as well as future viability of the business operation.

TIER CLASSIFICATION

The OIC has recommended classifying insurers into two tiers. Regulatory requirements and supervisory efforts will vary across the two tiers depending on the company's size, interconnectedness, complexity and business type. Tier 2 is further divided into two groups (Tier 2A and Tier 2B) to account for the specificities of the Thai insurance market.

All ERM and ORSA requirements are compulsory for Tier 1 companies, while some are optional for Tier 2A and Tier 2B.

Tier 1 refers to insurers with total asset value of Thai baht (THB) 90 billion or more and reinsurance companies. Tier 2A refers to companies that fall into one of the following subcategories:

- Companies with total asset value less than THB 90 billion but no less than THB 10 billion baht; or
- Companies with total asset value less than THB 10 billion that are subsidiaries of an offshore group of companies.

Tier 2B refers to companies that fall in neither Tier 1 nor Tier 2A.

[1] More details are available from the previous e-Alerts: Transition to Thailand Risk-Based Capital 2 Framework: QIS 2 results And Draft Risk-Based Capital 2 Framework for Thailand

As at Q2 2018, approximately half of life insurance companies in Thailand belong to Tier 1.

In the sections below, we summarise and discuss the key topics and requirements under the ERM and ORSA frameworks.

RISK MANAGEMENT FRAMEWORK AND PROCESS

The risk management framework is required to cover the key risks faced by the insurer across its activities and processes, with a feedback loop embedded within the ERM framework. A feedback loop is the process of assessing the effect of changes in risk leading to changes in risk management policy, tolerance limits and risk mitigating actions. The framework must incorporate a set of key risk indicators that allow the company to actively monitor the key risks underlying the business.

The risk governance framework adopted by the insurer should clearly separate risk taking activities from risk oversight and risk monitoring activities. A risk culture must be defined and developed within the organisation, where risk management is seen as part of the job of every employee.

The risk management system is required to include the following processes:

- Identification of risks and sources of risks that have a financial and non-financial impact on the company and a review of these risks at least annually or when risk factors have changed
- Defining methodology for risk assessment and risk prioritisation
- Responding to risk in accordance with the policies
- Controlling risks and monitoring evaluation
- Reporting on risk management and risk status

The risk management system should be aligned with the insurer's risk culture and embedded into the various business areas, supported by a suitable internal control system.

RISK MANAGEMENT POLICY

The risk management policy must be based on the business plan of the company and cover the time horizon that is consistent with the business plan. It must capture, at minimum, the following:

- The company's policy for managing the risks that the company currently faces
- Link between the risk management system, the corporate governance, and the corporate culture
- Relationship between pricing, product development, underwriting, and investment
- Risk reporting guidelines and the responsibilities of those involved in the risk management process
- Stress testing frequency and content
- Risk tolerance for each risk that is consistent with the company's risk appetite[2]
- Linkage between risk tolerance, regulatory capital, economic capital (if applicable), and risk monitoring process

The risk management policy is to be approved by the Board of Directors and must be reviewed at least annually or whenever changes in business strategies or other significant changes arise. The head of the risk management department is responsible for quarterly risk reporting to the company's Risk Management Committee (RMC), and the Office of Insurance Commission (OIC) reserves the right to review and audit the results at any time.

The key written policies must cover:

- Risk management
- Product design and development
- Pricing
- Underwriting
- Investment
- Claims management
- Reinsurance

Tier 1 and Tier 2A insurers must also maintain the following written policies:

- Outsourcing
- Capital management
- Asset-liability management

RISK GOVERNANCE STRUCTURE

An insurer is required to appoint a Board of Directors, senior management and RMC as responsible persons for its risk management framework.

The Board is responsible for reviewing and approving the risk management framework, policy, risk appetite, and the ORSA reports. The Board must also define the insurer's business strategy and ensure the company has sufficient capital to run its current and future business.

Senior management responsibilities include, but are not limited to, ensuring personnel are appropriately educated on roles and responsibilities defined by the risk management framework and

[2] Tier 2 companies are required to set risk tolerance limit for insurance risk, market risk, and credit risk. For Tier 2B market risk need not include asset-liability management risk.

policy, ensuring day-to-day operations are in line with the business strategy, risk management framework and policy, and ensuring the completeness and accuracy of the ORSA.

The RMC is required to be approved by the Board and to meet and report to the Board quarterly. The size of the committee should be commensurate with the size, type and complexity of business operations. The regulator has prescribed that the committee should have at least five members, at least one of whom is a Board member.

The RMC is responsible for setting the scope of the risk management framework and policy, ensuring the compliance of business operations to the framework. The committee is also responsible for overseeing the risk related activities of the company monitoring their management and recommending any improvements, including establishment of risk mitigation plans in stressed circumstances.

Subsidiaries of companies with offshore head or regional offices can have the offshore RMC perform the prescribed responsibilities subject to the OIC being satisfied that the regulations are being complied with.

In addition to the roles above, companies are required to establish risk management, compliance, actuarial and internal audit functions.

The risk management function's responsibilities include, but are not limited to, identifying, assessing and reporting key current and future risks including any changes in the company's risk profile, conducting regular stress testing and production of the company's ORSA for internal and regulatory submission.

Companies need to appoint a head of risk management, with the appropriate knowledge and expertise to fulfill the roles and responsibilities, in addition to presenting quarterly risk management results to the RMC and the management.

Amongst other responsibilities, the compliance function is responsible for promoting and sustaining an ethical corporate culture and ensuring key legal and regulatory requirements are met, taking corrective actions where required.

The actuarial function is responsible for evaluating and advising the company in areas that are vital to the solvency and profitability of the business, including solvency valuation (including insurance liabilities), asset liability management, product development and capital adequacy assessment. The function is also responsible for researching, developing, and validating internal models for actuarial and financial forecasts and for the ORSA purposes.

The internal control function must be free from undue influence by other functions and the Board. Its responsibilities include establishing a risk-based audit plan aligned with the insurer's risk culture. It is also responsible for evaluating the adequacy of the policy, processes, documentation, internal controls and management information, as well as being required to coordinate with external auditors and share key findings with other functions while assessing their effectiveness.

The aggregation and outsourcing of key functions is allowed, subject to the OIC's approval, but the internal audit function must be independent.

Companies are required to have a reliable information system that is appropriate for the size, profile, and the complexity of the business. The system must enable effective risk monitoring and control, ensuring effective and correct use of data. Risk management measures related to data and information system must also be put in place.

RISK AND CAPITAL MANAGEMENT

An insurer is required to ensure that the calculation of regulatory capital requirements is sufficient and aligns with the risk profile of the company. Where the insurer considers and foresees that the regulatory capital requirement does not reflect the risk profile of the company, economic capital needs to be calculated. However, if an insurer considers the calculation of regulatory capital requirement to be adequate, reasons for not performing economic capital calculations need to be clearly documented.

As part of capital management, insurers are also required to:

- estimate available funds[3] that can be considered to meet capital requirements set out in the RBC framework;
- establish an internal Capital Adequacy Ratio (CAR) level which must exceed the capital adequacy ratio required by regulation;
- develop capital planning process consistent with its business plan time horizon[4]; and
- develop a capital contingency plan[5] that covers its strategic business direction and the changing business environment together with thresholds to act as triggers for corrective actions.

Stress and scenario testing is considered a key link between the company's risk appetite, business plan and capital management. This needs to be performed at least annually, covering major risks under the ERM and ORSA frameworks, including quantitative and qualitative risks. The testing should include stresses for macroeconomic, financial crisis, pandemic, catastrophe, reverse stress testing and other self-selected scenarios.

A management action plan in response to the business continuity analysis and plan must be established. Management

[3] Tier 1 companies must ensure economic capital requirement are also covered

[4] Optional for Tier 2B companies

[5] Not required for Tier 2B companies

actions should consider economic capital, regulatory capital requirements and financial resources.

If under stress and scenario testing, the CAR falls below defined thresholds, the company is required to report details of the relevant stress being tested, together with a management action plan.

In the event that the OIC foresees any risks that may affect the revenue, capital, reputation, or financial viability of the business, it may require additional stress tests on an ad hoc basis.

RISK APPETITE AND TOLERANCE

Insurers should develop a risk appetite framework, approved by the Board, with consideration to its risk exposures (those it is willing to accept and unwilling to accept), business plan and stress test results. A risk tolerance statement setting out overall quantitative and qualitative risk tolerance levels and defined limits should be established. An insurer's risk appetite needs to take into account its tolerance towards identified risks and any proposed activity that would breach the Board-approved risk appetite will be subject to further review and Board approval.

RISK REPORTING

A risk register must be put in place. Key risks and indicators must be reported to the management and the risk committee on a regular basis and at least quarterly.

Risks must be monitored in such a way that risks are maintained within risk appetite. The effectiveness of the risk control must be reported to the Board and to management on a regular basis.

Companies must establish a system for reporting risk management information and risk status by type of risk and the documentation thereof must be made available for OIC's inspection at all times. The risk reporting requirements include

- Summary of risk status - the results of the risk management process that has been reviewed by the RMC and presented to the Board at least quarterly
- Summary of the results of the annual internal audit that has been reviewed by the Audit Committee or the Board
- Minutes of the Board meetings covering the reporting of the risk management results at least annually or when an event that may have a significant impact on the financial status of the company occurs

ORSA

The ORSA is required to be produced annually and approved by the Board. Within the ORSA, both the current and projected future solvency positions should be analysed using a time horizon and date that is in line with the business plan.

The key purpose of the ORSA is to provide timely information to management and for decision making purposes and the regulator has provided guidance on sections of the ORSA reporting. These include, but are not limited to, ERM and ORSA frameworks and processes, risk management policy, link between risk, strategy and capital, capital requirements and capital management, stress testing and risk appetite.

Companies are also required to assess the accuracy of the ORSA and ERM frameworks, and, for this purpose, the ORSA report should cover:

- Comparison of actual experience to projection from prior year
- Comment on the appropriateness of the current projection assumptions compared to past actual experience
- Comment on management actions taken in previous periods
- Summary outcome of internal or external independent review of ORSA
- Analysis of changes made on the ORSA during the year and analysis of the impact of changes
- Limitations and reliances

Following approval from the Board, the ORSA report is required to be submitted to the OIC.

Conclusion

Focused investment to develop ERM and ORSA processes will help build a risk management framework that creates measurable value while making ERM much more effective at responding to a rapidly changing risk environment. There is increasing recognition of the value that can be added by strong risk management frameworks, integrated into strategy and business planning, which provide insights into decision making. A strong risk management function enables a company to take strategic and operational risks more consciously and consider the risk/reward trade-off during early stages of initiatives to ensure sustainable value growth and protection for its shareholders and policyholders.

In order to meet the proposed regulatory requirements, together with the required subject matter and technical expertise, strong senior management and Board sponsorship would be essential to ensure the development of independent control functions and embedding a risk culture across the organisation.

For insurers in Thailand, the next 12 months will be a crucial time in ensuring readiness to avoid being caught off guard.

If you would like to discuss any aspects of this e-Alert or would like to discuss this further, please contact any one of our consultants below.

CONTACT

Shoaib Hussain (Consulting Actuary)
shoaib.hussain@milliman.com

Michael Daly (Principal & Consulting Actuary)
michael.daly@milliman.com

Clement Bonnet (Principal & Consulting Actuary)
clement.bonnet@milliman.com

Suthida Supantamart (Actuarial Associate)
suthida.supantamart@milliman.com