C-ROSS Phase II and its Impact on the Insurance Industry

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1.1 The Goals of C-ROSS Phase II

- In September 2017, CIRC issued the "Construction Plan for C-ROSS Phase II, and stated the main goals and tasks of C-ROSS Phase II.

- Focus on highlighting the requirements for keeping the bottom line of risks in the environment of preventing financial risks
- Further improve the scientificity, effectiveness, pertinence and adaptability of the solvency supervision of the insurance industry
- Revise and improve the controversial content in Phase I

- Three Quantitative Impact Studies(QIS) have been carried out in the insurance industry so far.

- **The first QIS : from January to February 2020**
- **The second QIS : from July to August 2020**
- **The third QIS : from July to August 2021**

The Overall Trends of C-ROSS Phase II

- There are some trends in C-ROSS Phase II.

1. Capital requirements for risks(insurance, market, credit etc.) will be tightened
2. Growth of capital requirement for large insurers may be higher than smaller insurers (adjustment of layered risk factors, excessive growth factor)
3. The trend of unified supervisory standards for banking industry and insurance industry appears (e.g. change of credit guarantee insurance)

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2.0 Overall Introduction of C-ROSS Framework

C-ROSS is based on a 3-pillar regulatory framework.

Quantitative Capital Requirement

Capitalized Risks
- Insurance Risk
- Credit Risk
- Market Risk

Supervisory Tools
- Quantitative capital requirement
- Actual capital assessment
- Capital stratification
- Stress test
- Regulatory measurement

Regulatory Discipline
- Comprehensive Solvency Ratio
- Core Solvency Ratio

Qualitative Supervisory Requirement

Uncapitalized Risks
- Operation Risk
- Strategy Risk
- Reputation Risk
- Liquidity Risk

Supervisory Tools
- Integrated Risk Rating （IRR）
- Solvency Aligned Risk Management Requirements and Assessment（SARMRA）
- Liquidity Risks
- Analysis and Examination (A&E)
- Regulatory Measurement

Regulatory Discipline
- IRR Ratings
- Control Risk Scores

Market Discipline Mechanism

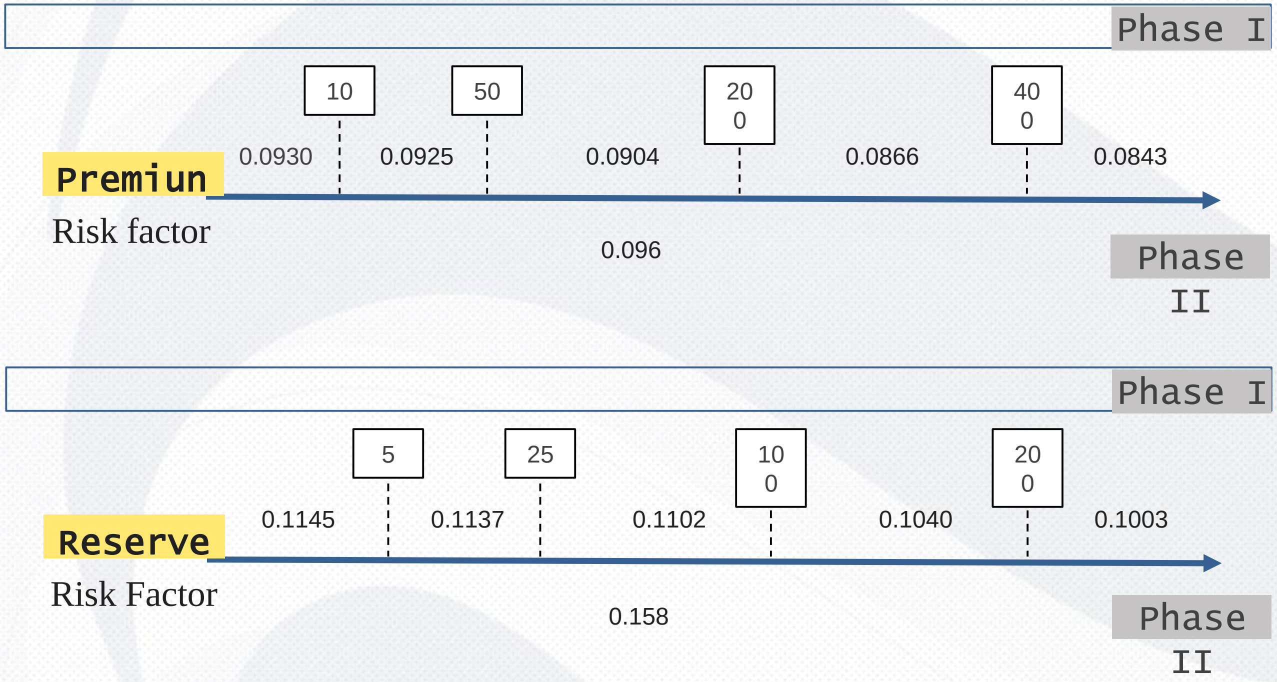
Unregulated Risks

Supervisory Tools
- Company Information Disclosure
- Regulator Information Disclosure
- Credit Rating

Market Discipline
- … …
- … …

2.1 Cancellation of Layered Risk Factors

Take motor insurance for an example.



2.2 Addition of Motor Excessive Growth Factor

When the growth rate of motor business of a P&C insurer is faster than the industry, an excessive growth factor will be applied.

$$MC = EX \times RF,\ RF = RF_0 \times (1 + K),\ K = K_1 + K_2 + \ldots$$

Excessive Growth Factor

For an insurer with motor GWP<RMB 2b:

$K_4 = 0$

For an insurer with market share>20%:

$$K_4 = \begin{cases} 0.00 & (-\infty, 0\%] \\ 0.15 & (0\%, 2\%] \\ 0.25 & (2\%, +\infty) \end{cases}$$

For others:

$$K_4 = \begin{cases} 0.00 & (-\infty, 10\%] \\ 0.15 & (10\%, 20\%] \\ 0.25 & (20\%, +\infty) \end{cases}$$

Regulatory consistency between banking industry and insurance industry and avoidance of regulatory arbitrage:

Current C-ROSS

MC Minimum capital = EX exposure × RF Risk factor

- Minimum capital measuring distinguishes premium risk between reserve risk.
- Premium risk exposure is net retained premium during the past 12 months; Reserve risk exposure is the amount of net loss reserves.
- $\mathrm{RF} = \text{Basic risk factor} (\mathrm{RF}_0) \times \text{Characteristic factor}(1+k)$

Commercial bank capital management regulation

- $\textit{Capital Adequacy Ratio} = \dfrac{\textit{General Capital} - \textit{Corresponding Capital Deductions}}{\textit{Risk-weighted Assets}}$
- Risk-weighted assets of credit risk = (Book value of the assets - Impairment reserve) × Risk weight

MC of Credit Risk = (Book value of the assets - Impairment reserve) × (Risk weight × Required capital adequacy ratio)

2.3 Financing Credit Guarantee Insurance (continued)

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Future Framework: minimum capital measurement for financing credit guarantee insurance

MC Minimum capital

=

EX exposure

×

RF risk factor

Loan balance for type i reinsured loan (within the agreed insurance amount or liability limit)

−

Reserves

New Measuring method

Risk weight × Required capital adequacy ratio

summation

$$MC = \sum_{i=1}^{n} EX_i \times RF_i$$

Summation of minimum capital of various types of* financing credit guarantee insurance *directly

Main changes in the risk framework of agricultural insurance:

Cancellation of catastrophe risk module

- Catastrophe risk would be incorporated into premium risk due to the obscure boundary between catastrophe and non-catastrophe risks for agricultural risk.

Introduction of the characteristic factor for policy-based agricultural insurance business

- Start-up of policy-based agricultural insurance business.
- The greater weight of policy-based business, the greater the capital discount factor.

Major changes in catastrophe risk framework:

Refinement of the catastrophe risk of overseas business

- Territory partitions includes Asia Pacific, North America, Europe, and the rest.
- The catastrophe risk exposure of overseas business is measured on the basis of premiums.

Improvement and optimization of catastrophe risk for domestic business

- Cancellation of agricultural catastrophe risk module.
- Increasingly reasonable handling of catastrophe excess of loss reinsurance.

Major changes in morbidity rates:

- CI Morbidity Rates Table (2020)
- Addition of trending factor

Major changes in market risk:

- Increase of risk factors
- Interest rate risk factor is applied to all bonds
- Addition of Asset Concentration Risk Factor
- The risk factors for foreign reinsurers decrease

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- Confronting the changes in C-ROSS Phase II, it is recommended that insurers should make some preparations for it.

Prepare for the increase of capital requirement

Better utilize capital tools including reinsurance

Sketch business structure adjustment in advance

THANKS

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September 2019