CENTRAL BANK OF TRINIDAD & TOBAGO

Financial Institutions Supervision Department

Comments on the Proposed Amendments to the Insurance (Capital Adequacy) Regulations, 2020 and the Quantitative Impact Study

June 2022

#	Issue	Location	Exact Query &/ Comment Received	CBTT's Response
1	Risk adjustment	Regulation 2	The logic for using 70% of the entity determined risk adjustment is not specified.	For the purposes of this QIS, CBTT is desirous of assessing the impact of using 70% of the Risk Adjustment (RA) in applying the total balance approach. Taking 70% of the RA is consistent with the current approach where the Net Tier 1 Capital Ratio is based on a 70% factor, that is, the ratio between the minimum Net Tier 1 Ratio (105%) and Regulatory Capital Ratio (150%).
2	Risk adjustment	Regulation 2	It would be good to state why CBTT considers 70% as appropriate. I know that Canada also uses 70%.	
3	Risk adjustment	Regulation 2	What is the basis for the 70% amount used in the definition of net tier 1 ratio in the marked-up capital adequacy insurance regulation? Given that the capital framework is not an own risk solvency framework (like ORSA in the US or Solvency II in Europe), it seems that the full RA should be available as capital for the company should it be needed. In other words, not including all of the RA seems to exclude some capital that could be used to pay policyholder benefits in the case of a liquidation event.	

4	Risk adjustment	Regulation 6.1	If this is supposed to be the IFRS 17 Risk Adjustment, it should clearly say so. I am almost sure I saw where OSFI makes it clear that it's not just that both returns and statements need to comply with IFRS but they also the numbers should not differ. I couldn't find it - their instructions to the forms only state that they should be calculated using IFRS.	The definition of the risk adjustment has been amended to state: "risk adjustment" means an amount of risk adjustment determined under regulation 6(1) and the amount reported in the insurer's financial statements and financial returns. Note that financial statements and financial returns are to be prepared in accordance with the financial reporting standards as set out in Sections 144 and 145 of the Act.
5	Risk adjustment	Regulation 6.1	Under section 6.1, it states that “The risk adjustment in relation to a specific block of business,…”. However, risk adjustment is held at the company level and is not necessarily related to a specific block of business.	Regulation 6(2) has been reorganised to state: "The risk adjustment used in determining the Regulatory Capital Ratio and the Net Tier 1 Ratio is equal to the net risk adjustment (that is the risk adjustment net of all reinsurance) reported in the financial statements in respect of all insurance contracts. Otherwise, the risk adjustment in relation to a specific block of business, refers to the risk adjustment for non-financial risks reported in the financial statements that is associated to the block of business. The risk adjustment excludes all provisions for credit risk and counterparty default, as these are financial risks."

6	Risk adjustment	Regulation 18 (1)	Ignoring RA?	The descriptions has been amended as follows: 18. (1) The interest margin pricing risk charge shall be the sum of the best estimate liabilities net of reinsurance (that is excluding risk adjustment, contractual service margins and time value of money and the financial risks related to the future cash flows) multiplied by the appropriate risk factor for the type of policy in accordance with Schedule 12. (2) The reasonable flexibility of the crediting features with respect to universal life policies shall be tested in pricing the policy or elsewhere, and shall demonstrate that the insurer may recoup at least half of any unexpected losses due to disintermediation risk.

7	Risk adjustment	Schedule 9 (Regulation 15)	Ignoring RA?	1. Subject to paragraphs 2 and 3 of this Schedule, the asset liability mismatch risk charge shall be ten per cent of the absolute change in the best estimate liabilities net of reinsurance (that is excluding risk adjustment, contractual service margins and time value of money and the financial risks related to the future cash flows) resulting from a one per cent parallel shift in the discount rate. 2. Where the insurer has implemented an asset liability management policy in place and has the ability to stress test the assets supporting the liability segment, a one per cent parallel shift in the yield curve shall be determined and the asset liability mismatch risk charge shall be the lesser of − (a) the absolute change in the best estimate liabilities net of reinsurance (that is excluding risk adjustment, contractual service margins and time value of money and the financial risks related to the future cash flows) minus the absolute change in the assets, when a one per cent parallel shift is applied; and (b) the charge calculated under paragraph 1 of this Schedule. 3. The asset liability mismatch risk charge does not apply to the portion of the assets backing and the best estimate liabilities net of reinsurance (that is excluding risk adjustment, contractual service margins and time value of money and the financial risks related to the future cash flows) of the investment linked insurance business if - (a) the assets are genuinely identifiable and valued at market value; (b) transfers into and out of the portfolio of assets occur at market value; and (c) there is full pass through of investment returns due on the policies and credited returns are not based on the insurer's discretion.

8	Risk adjustment	QIS Forms	Companies are not asked to disclose the confidence level for the Risk Adjustment. Is there an expectation that will need to be disclosed prior to the implementation date?	For the QIS, insurers will not be required to disclose the confidence level used for the RA. Please however feel free to disclose it.
9	Contractual Service Margin (CSM)	Regulation 7.1	Can you have a negative CSM? If CSM goes negative, it is a loss component that you write off.	CSM reported as assets is related to reinsurance contracts held, which can have a positive or negative CSM in accordance with paragraph 65 of IFRS 17. Further, if a loss is recognised on a group of underlying contracts, paragraph 66A of IFRS 17 allows an insurer to adjust the CSM of an existing reinsurance contract held to reflect any offsetting gain.
10	Adjusted Retained Earnings	Regulation 7.1	Will the “Adjusted Retained Earnings” be shown on the Balance Sheet in place of (or in addition to) the Retained Earnings?	No, the Balance Sheet in the financial returns will capture the figures as it would in the Financial Statements. The Adjusted Retained Earnings is just for capital adequacy purposes and will be determined per Tab 40.012 in the Returns. For the QIS, the Reconciliation of Changes tabs can also be used to illustrate the expected change in the retained earnings due to adoption of IFRS 17/IFRS9.
11	Report reference used	Schedule 18 (Regulation 7(3))	Currently, the policy groups are in the schedules to the actuarial valuation report, not the "financial returns".	Reference changed to the Appointed Actuary's Report.

12	Statement/ description for negative reserves is inaccurate	20220427_Policy Rationale	Pg 4 infers that negative reserves imply profitable business. This is not true – it only suggests that future premiums exceed future benefits. This could reflect high up-front costs (high commissions) or premiums that increase while benefits are level (or conversely, where premiums are level and benefits decline, such as mortgage insurance). Suggest to clarify or omit.	Noted. The wording in the policy rationale document has been amended to now state: "IFRS 17 requires a significant change in how profits are recognized. Under the current CPPM regulation, negative reserves are permitted. This means that a large portion of ~~the~~ future unearned profits are recognized at issuance of a policy. Under IFRS 17, future unearned profits must be deferred and are only recognised as the insurer provides insurance services. The CSM is the component of the liability that represents the unearned profit to be recognized in the future. " The following amendment in red has also been made to paragraph 3 on page 4 "The treatment as a component of available capital under the amended capital adequacy regulation ~~is equivalent to~~ parallels the current treatment of negative reserves at issue and run off of those negative reserves albeit at a different rate."
13	Negative Reserves	Schedule 19 (Regulation 7(3))	Is there a definition of define negative reserves? My current understanding is that under IFRS 17 there will no longer be negative reserves, due to the contractual service margin (CSM) which will take any negative reserve amount and hold it as a liability that is released as service is rendered.	Please refer to Schedule 19 for the definition of Negative Reserves.

14	Cash Surrender Value Deficiencies (CSVD)	Schedule 18 (Regulation 7(3))	The calculation of cash surrender value deficiencies seems like it will be more difficult now if the CSM is included, as the CSM amortization may have a different pattern/process based on the IFRS 17 cohort rather than at a policy level. If the CSM is excluded from this comparison, it leads to other questions regarding the total liability on the policy. As an example, if the best estimate liability (BEL) and risk adjustment (RA) are less than the cash value, than an extra amount of capital will be required even when the insurer is already holding a total liability (including the CSM) that may be greater than the cash value. It seems plausible that intermediate periods may find situations where the CSM has amortized off in part and the cash value has grown larger than the total liability for remaining coverage (LRC). This seems better done via the lapse risk charge than the current cash surrender value deficiency approach.	The CSV deficiency is now being calculated using fulfilment cash flows which exclude the CSM. Please note that one of our main objectives was to minimize changes to the current capital adequacy framework. The recommendation to use a lapse risk charge approach instead of the current cash surrender value deficiency approach is therefore noted.
15	IFRS 17 wording	20220427_Marked up Insurance (Capital Adequacy)	Pg. 27 now uses "received premiums" rather than "earned premiums". This is a shift from an earned basis (previous) to a cash basis. Could you please provide clarification of the reason for this change?	Earned premiums will no longer be an item reported in the IFRS 17 financial statements whereas paid premiums are used in the determination of insurance contract liabilities.
16	IFRS 17 wording	20220427_Marked up Insurance (Capital Adequacy)	Pg. 28 – same as previous point	
17	IFRS 17 wording	QIS Forms-Tab 40.032	Tab 40.032: Heading for Column B says "Annual Net Premiums", changed from "Annual Written Premium". Please clarify the reason for this change or ensure consistency wording.	

18	IFRS 17 wording	20220427_Marked up Insurance (Capital Adequacy)	Pg. 30, 34 – It's not clear what "time value of guarantees" represents. This is not a phrase in the IFRS 17 Standard. The closest reference is "time value of money and the effect of financial risk". Suggest harmonizing with the IFRS 17 Standard.	Reference changed to "time value of money and the financial risks related to the future cash flows"
19	Timing	General	It states that the QIS is due in mid-June 2022. It also states that companies will get 2 months from the release of the QIS letter. I assume that companies will be given at least the 2 months to complete this QIS.	Yes, companies will be given 2 months to complete the QIS
20	Timing	General	Regarding the QIS, you gave an indication that there would be a two month time frame given. Based on the draft template attached, we believe that a two month time frames should be adequate for us from the time the final template is issued. That is, if the template QIS is finalized by mid-June (next week) with the same requirements/scope, we should be able to complete it by mid-August. If it is not finalized until end of June, then it will be end of August, assuming the same scope.	
21	Profoma Forms-Reporting date	Initial Letter to Industry – FINAL DRAFT	QIS will be issued by mid-June 2022; this will include proforma IFRS 17 / IFRS 9, based on December 31, 2021. Can you confirm if this is the balance sheet only at this point?	The Proforma statements include both the Balance Sheet and the Statement of Income based on December 31, 2021.
22	Timing and Proforma Forms Reporting date	General	The QIS comes at a time that is critical for companies to be focusing on getting results of the standard and I wonder if companies will be able to fulfil the request. Also, although the transition balance of 12/31/2021 is needed for the 2022 comparative, I do not believe the standard requires 2021 income statement and that may not be available especially if companies are unable to do the full retrospective approach and opt to do fair value for transition.	Your comment is noted. Insurers are expected to use their best efforts to complete the template and are encouraged to do so. Information is needed for the possible recalibration of the risk factors and the regulatory capital ratios, at a minimum, and to finalise the adjustments being consulted upon.

23	Level of detail	General	In general, noted that the QIS template income statement and balance sheet is very similar to that of the OSFI QIS 3 template. This level of detail may be difficult for some companies to populate, including preparing an income statement for 2021 when the assumed transition date is 12/31/2021.	
24	RBC framework changes	General	Regarding the amendments to the RBC- we don't have comments. Our observation so far is that the main change to the structure is the allowance of the CSM as available capital. Are there any other key changes that we should be aware of?	That is one of the main changes. Other changes are highlighted in the tracked changes version of the Regulations, which will be posted on our website.
25	Number of QISs	Questionnaire	The questions in questionnaire 1 are centered around timing and challenges. Is there an anticipation that an additional QIS will be required if companies are behind on their implementation?	At this time, another QIS in the **currently proposed format** is not planned.
26	Clarification issue	Discount rate tabs	Discount Rate Tabs – Two tabs are listed – one for the top-down approach while one for the bottom-up approach. Can you confirm that one or both be completed, as appropriate?	Insurers should complete the bottom-up and top-down discount rate tabs applicable to them.
27	General	20220427_Marked up Insurance (Capital Adequacy)	The updates are written seemingly with the general measurement model (GMM) and variable fee approach (VFA) in mind. For the premium allocation approach the RA and CSM are not explicit. Are there adjustments needed to the regulations, the adjusted retained earnings, or the net tier 1 capital for this? Schedules 14 and 15 show us the risk charge factors on the LRC and the LIC for PAA. However, the factors are based on the class of insurance business and group life and health is not listed.	For this QIS, no further adjustments are needed to the adjusted retained earnings or net tier 1 capital in this regard. Note under Schedule 1 of the IA 2018, group life business is classified as long-term insurance business and group health may be classified as either Accident and Sickness (Long-Term Insurance) or Personal Accident-Short Term Business. The capital charges will therefore be applied accordingly.