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New Regulation on Capital Adequacy Requirements of Insurance and Pension Companies

Overview

On 23 August 2015, the Treasury issued the Regulation on Measurement and Assessment of Capital Adequacy of Insurance, Reinsurance and Pension Companies (the **Regulation**), which sets out rules for insurance, reinsurance and pension companies to maintain a minimum level of equity against their liabilities and potential risks (**minimum required solvency margin**). The Regulation replaces the previous regulation dated 19 January 2008, which had the same title, (the **Former Regulation**) and introduces a variety of novelties on the calculation of the minimum required solvency margin, reporting obligations of the companies and measures to be taken by the Treasury.

Calculation of the Minimum Required Solvency Margin

Similar to the Former Regulation, the Regulation provides for two methods in calculating solvency margins of the companies, whereas the higher amount calculated based on the first method or second method, constitutes the minimum required solvency margin that must be met by the relevant company.

<u>First Method:</u> While the Regulation largely retains principles under the first calculation method for life and non-life insurance branches, the calculation methods with respect to pension products have slightly changed. Accordingly, the Regulation extinguishes the sliding-scale calculation method under the Former Regulation, where the minimum required solvency margin was calculated at different ratios depending on the accumulated savings amount in the pension account and provides that the minimum required solvency margin for pension products would be 0.5% of the accumulated savings in the pension account (regardless of the amount of the savings).

<u>Second Method:</u> The Regulation does not change the existing principle of the calculation methods under the second method. Accordingly, the minimum required solvency margin is equal to the sum of the results of the company's (i) asset risk, (ii) reinsurance risk, (iii) excessive premium increase risk, (iv) outstanding claims provision risk, (v) underwriting risk, and (vi) exchange rate risk. However, the Regulation changes certain coefficients by which the relevant risk type is multiplied, and sets out new principles on the implementation of these coefficients in terms of proportional reinsurance and exchange rate risk.

Reporting obligations of companies

Under the Regulation, companies must prepare capital adequacy statements twice a year, ie at the end of June and December, and submit such statements to the Treasury within two months of the relevant period. The Treasury is authorised to make changes on the terms and submission periods of capital adequacy statement preparation.

Administrative measures

The Regulation describes different stages for companies as per their solvency margins as follows:

<u>Self-evaluation Stage:</u> If the solvency margin ratio is between 100% and 115%, the company will be deemed to be at "self-evaluation stage". At this stage, the company must evaluate its risk level within 45 days after

the submission date of the capital adequacy statement and submit to the Treasury a report explaining the reasons for the deficiency and the projections for the upcoming terms.

Precaution Stage: If the solvency margin ratio is between 70% and 99.99%, the company must submit to the Treasury a plan, within 30 days after the submission date of the capital adequacy statements, to close the deficit via capital contribution or reduction of risks or any other means approved by the Treasury. Within one year following the submission of the Plan to the Treasury, the company must either close the capital deficit or make an advance payment in lieu of capital contribution.

Immediate Precaution Stage: If the solvency margin ratio is between 33% and 69.99%, the company must submit to the Treasury, within 20 days after the submission date of the capital adequacy statements, a plan to close the deficit via capital contribution or reduction of risks or any other means approved by the Treasury. Thereafter, the company must increase its solvency margin ratio to (i) 70% within six months, and (ii) 100% within one year.

Intervention Stage: If the solvency margin ratio drops below 33%, the Treasury may apply the administrative steps set out under the Insurance Law No. 5684 and Law on Private Pension Savings and Investment No. 4632.

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