Ayubowan

Vanakkam

Good Morning

Distinguished participants

Ladies & Gentlemen

I shall start my speech with a brief introduction of current status of the insurance industry in Sri Lanka. It is widely accepted that a well developed insurance sector helps the public in general in managing their risks better and contributes to the development of the economy. It is also instrumental in enhancing the overall efficiency of the financial system in any country by reducing transaction costs, creating liquidity, and facilitating economies of scale in investment.

The insurance sector in any economy **must** operate on a financial sound basis and contribute to economic growth and efficiently allocate resources. It should also contribute to mobilize long-term savings in order to benefit and protect policyholders as well as promote economic development.

Despite the challenging global economy and the adverse weather conditions such as droughts and floods that prevailed in Sri Lanka during 2012, the insurance industry was able to continue an upward growth trajectory recording a Gross Written Premium of approximately US Dollars 700 million. The industry has seen double digit growth in the past 3 years reflective of the improvement in macroeconomic conditions since the advent of peace in Sri Lanka after a 30 year war. During the past 5 years, the average growth of total assets of the insurance sector has been 17%, and in 2012, it grew by 15.5% which is almost double the value in 2008 (total assets in 2012 – Rs.301 billion).

However, despite the phenomenal Gross Written Premium and asset growth, insurance penetration in Sri Lanka remains low at 1.15% compared with 4.1% in India, 3% in China and 8.1% in USA. However, when taken in the context of a healthy double digit growth rate and with only 12% of the population with insurance cover, the low level of penetration in Sri Lanka highlights the vast potential that exists in this country of 20 million population.

With the ongoing exploitation of this potential by the industry, the need to ensure stability of the industry on a sustainable basis becomes greater.

What is this Risk Based Capital Framework? Why do we need it?

As we all know, a sound regulatory and supervisory system is necessary for maintaining a fair, safe, stable and efficient insurance market, which will lead to growth and sustainability of the industry. Risk Based Capital is an approach towards efficient and prudent management of capital for an insurance company. According to the definition of Society of Actuaries, "Risk Based Capital represents an amount of capital based on an assessment of risks that a company should hold to protect customers against adverse developments". At present Risk Based Capital has been adopted in several countries including USA, Japan, Singapore, Taiwan, Malaysia, South Korea and Thailand. Several other countries including Sri Lanka are either in the process of adoption or considering adopting Risk Based Capital.

Implementation of Risk Based Capital is intended to increase transparency and prudential supervisory oversight whilst establishing appropriate risk management systems. Put simply, under the Risk Based Capital regime the market participants will be focused on managing risks rather than managing rules.

The Insurance Board, after examining various models across the globe, initiated the RBC Project in Sri Lanka, with the assistance of the World Bank and FIRST Initiative. The Project which commenced in 2009 included an analysis of the Sri Lankan insurance market, a qualitative report and a quantitative report, culminating in a RBC Framework for Sri Lanka.

It is important to mention here the important role that the insurance industry in Sri Lanka has played in establishing the Risk Based Capital regime in this country. From inception, the industry has championed the effort to move from a rules-based regime to a risk-based regime. Way back in 2007, before the global financial crisis fully materialized, industry leaders in Sri Lanka promoted the introduction of Risk Based Capital. During that time, the Insurance Board also was examining the prospects of strengthening prudential supervision of the insurance sector. This partnership between the industry and the regulator has resulted in seamless progress in this transition from rules-based to risk-based regimes. The insurance industry, and in particular the Insurance Association of Sri Lanka, have been fully committed and proactively involved in the critical input to this entire process and have been instrumental in shaping the framework that we have today.

The Risk Based Capital framework in Sri Lanka is currently being assessed through an industry test run and the analysis by the Consultant Actuary of the IBSL will provide a better understanding of how the final rule for Risk Based Capital should be fine tuned by the end of this year. Then during the next two years, there will be a parallel run with both current and new regimes running simultaneously, in order to further calibrate the Risk Based Capital rule. It is our expectation, that at the beginning of 2016, Risk Based Capital will be the industry norm.

This framework, once finalized will be the way forward for a sustainable industry, because when there are changes in the financial landscape, this framework is flexible enough to allow for re-calibration whenever needed in the future.

We are in mid 2013 and I think this is the right time to carefully look at the pros and cons of RBC. I am sure that will be discussed during the next two days at this Seminar. The more efficient use of capital and informed decision making Risk Based Capital introduces, as well as the significant increase in risk awareness amongst the insurance companies will be major benefits of Risk Based Capital.

Furthermore, a risk sensitive approach to business will enhance the efficiency of capital and risk allocation. Risk Based Capital will also highlight riskier and capital-intensive products and will provide opportunities for portfolio optimization, keener pricing and enhanced product profitability.

It is expected that operational efficiencies from better risk management will reduce costs for more capital efficient companies in terms of raising new capital or deploying existing capital.

We also believe that the Risk Based Capital will upgrade not only risk management processes and controls, but also capital management skills. This in turn should result in improved market perception and enhance investor confidence.

However, one of the key challenges associated with the implementation of the Risk Based Capital framework in Sri Lanka is the expanded role of actuaries and the current dearth of such professionals in the country. Not only will actuaries play an important role in assisting insurers adopt the framework but also in full implementation of Risk Based Capital into the future.

The exact impact in terms of additional capital required will depend on the risks associated with the existing business of each individual insurer and the risk management practices already in place. Although certain opinions were expressed in the media that smaller companies will struggle to adopt Risk Based Capital we are pleased to note that some of them have already begun preparing themselves for increase in Capital, segregation, listing and adoption of Risk Based Capital.

Conclusion

On our part, Insurance Board of Sri Lanka will need to overcome supervisory challenges of the introduction of new processes and tools related to Risk Based Capital as well as familiarization of the RBC model through hands-on practical training in order to build up supervisory capacity.

The Board as the regulator is also expected to assist the industry in building required capabilities, in addition to enhancing its regulatory oversight. This seminar is an affirmation of the Regulator's sincerity of purpose in assisting the industry in capacity building. At this point, I wish to thank Mr. Sivam Subramaniam who readily accepted our request to hold a seminar on this highly technical subject. We know this was not in his program schedule. We really appreciate his kind gesture.

Each country will have its own unique model regarding capital adequacy and there will be no “one-size-fits-all” model that is expected as an outcome of this seminar. But if we all can share our experiences and either improve what we have, or assist another to improve on theirs, then we could consider this seminar a success.

I see some Experts on this subject are here, to share their expertise and experiences. With their interaction and sharing experiencing across the region and the globe, I am certain that the next two days will prove fruitful to all the delegates and the sessions will generate stimulating, interactive and lively discussions.

I shall conclude by wishing all of you the very best! After the seminar, please don’t forget to experience and enjoy the beauty of Sri Lanka.