PRESS RELEASE

CMF amends methodology for calculating asset sufficiency and technical reserves for life insurance companies

- *The amendments are intended to safeguard the solvency of these entities and bring the regulatory framework in line with the best international practices.*
- *With the application of the new discount rate vector, it is expected that companies will have room to increase the amounts of future pensions subscribed after the regulation comes into force.*

August 28, 2020 – After the conclusion of a public consultation process, the Financial Market Commission (CMF) has published regulatory amendments to the methodology for calculating asset adequacy and the constitution of technical reserves of life insurance companies.

The amendments, which aim to improve the regulation of entities that sell life annuities in line with the best international practices, affect General Rule No. 209 and General Rule No. 318. First, they introduce improvements to the methodology for calculating sufficiency in the Asset Adequacy Test (TSA, for its Spanish acronym). The aim is to better reflect projections of asset and liability flows, as well as the relevant discount rate and, ultimately, the reinvestment risk faced by insurance companies holding annuity policy obligations.

The amendments modify the method of calculating the discount rate vector (VTD, for its Spanish acronym) currently used to carry out the asset sufficiency analysis. It also adjusts the methodology to the best international practices in this area, which are applied in insurance markets serving as a reference for Chile. It also increases the maximum amount of equity, proportional to the technical reserves of each company's annuities, that insurers can include in the TSA.

In addition, the proposal intends to make an adjustment in the treatment of asset flows that are incorporated into the TSA. Accordingly, the treatment of Real Estate is modified regarding its valuation, as well as the adjustments for credit risk and prepayments applied to some of the assets incorporated in the test.

Technical Reserves

The regulations also involve a change in the way technical reserves are constituted for both annuities and disability and survivors' insurance (SIS, for its Spanish acronym). They replace the current methodology for VDT calculation exclusively for new sales of annuity policies in a manner consistent with the one addressed in the TSA. This is done to achieve consistency between the rules for calculating reserves, those of the TSA itself, and International Financial Reporting Standards.

According to calculations based on impact estimates, it is expected that by applying the new vector the constitution of technical reserves for new life annuity policies will decrease by around 10 percent (data as of June 2020). This gives insurance companies leeway to increase the amounts of future pensions taken out once the regulation comes into force. As the amendment applies only to the sale of new annuity policies, there would be no impact on the technical reserves and solvency indicators of companies currently holding a stock of annuity policies.

The amendments proposed by the CMF are in line with the bill that the Ministry of Finance recently submitted to the Senate. Said bill seeks to adjust aspects of the current regulatory framework that could generate rigidities in the current scenario, as well as strengthen the capital base of insurance companies in the medium term.

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