AIA Group Comments on the ICS

Garth Jones, Group CFO

IAIS Stakeholders Meeting, November 1, 2017, Kuala Lumpur

Good afternoon. My name is Garth Jones, Group CFO of AIA Group. I appreciate the opportunity to express our views to the regulators and stakeholders gathered at this meeting. AIA is a purely Asian life insurer operating in 18 markets in Asia ex-Japan. With a market cap of around USD 90 billion AIA is the second largest pure life insurer globally. We focus on the protection and savings needs of our customers through traditional and unit linked products without secondary guarantees. We are clearly an IAIG and just as clearly not a G-SII.

My comments today cover three specific aspects of the ICS, namely the application of equivalence, use of internal credit models and holding company senior debt

Firstly equivalence; As Group CFO, one of my most important responsibilities is to look after the current and ongoing future solvency of the Group across all our entities. Our local business units are subject to the solvency requirements in the various jurisdictions in which we operate. At the same time, we are also subject to the group-wide solvency requirements of Hong Kong, our home jurisdiction. Driven in part by a desire to be ICP compliant, many of these jurisdictions have recently changed or are in the process of changing their solvency regimes. We seek to maintain sufficient capital in our local business units to remain above regulatory minimums with a high degree of confidence. Additional capital is maintained at the corporate centre for unforeseen contingencies.

We are concerned about the potential for overlapping, additional requirements as a result of the ICS. Local players in most of the Asian markets in which we operate are generally not subject to the ICS. A standard that apples to IAIG's only will therefore put IAIG's operating in that market at a disadvantage compared to local players. While we recognize that the ICS is intended as a group wide standard rather than a solo entity one, the Group is the sum of the solo entities. We seriously question the need for another standard at a Group level when the local standard is ICP compliant, other than to deal with systemic or cross-border risks inherent in that Group, or jurisdictions where the local standard in considered inadequate.

Capital held at the business unit or operating company level is fungible in normal operations, however in reality both liabilities and capital are not readily fungible in a crisis. This is understandable since each jurisdiction has a primary responsibility to the policyholders in that jurisdiction. Furthermore, in many jurisdictions there are policyholder protection structures in place which would potentially incur greater liabilities should the entire assets and liabilities of a Group be pooled together in a crisis. In the absence of a clear agreed process and authority level across all of a Group's assets and liabilities between regulators that defines in advance how the local and Group supervisors will operate in such circumstances, it is difficult to see how an ICS has any validity in a crisis situation; put simply there is a clear disconnect between the theory and the practice which provides an unfounded level of confidence. Fundamentally capital issues need primarily to be dealt with jurisdiction by jurisdiction rather than at a Group level.

We therefore favour an outcomes-based approach to the ICS that gives deference to local regimes where those regimes meet established standards, such as ICP compliance. Such an approach recognises that the regulator with principle responsibility for local policyholders is the local regulator, not the Group supervisor.

Together with the development for the standard formula, we believe that criteria for equivalence should be developed to allow a "level playing field" for Group supervision and allow IAGs to effectively compete in jurisdictions where the local regime is considered adequate as defined by the IAIS in its ICPs. The standard formula would be reserved for regimes where ICP compliance cannot be demonstrated. This is not without precedent. The concept of equivalence is enshrined in Solvency 2, with Bermuda and Switzerland already recognized as fully equivalent to Solvency 2. Furthermore US subsidiaries of EU companies can apply US RBC requirements in place of Solvency 2. The EU and the US have concluded a covered agreement regarding reinsurance. The Hong Kong Insurance Authority and the China Insurance Regulatory Commission have concluded an "Equivalence Assessment Framework Agreement on Solvency Regulatory Regime" in May of this year. **Equivalence makes sense and should be an integral component of the ICS as well.**

As with Solvency 2, individual entities that operate in jurisdictions where an equivalent basis applies can then simply be included in the group consolidation using an aggregation approach. This approach means that capital requirements for such solo entities would not be further diversified beyond the solo entity level. We have no issue with this, because it better reflects the non-fungibility of capital at the local entity level in a crisis. Additional capital can later be required by the Group supervisor to deal with the particular minimums.

In a perfect world there would be a single valuation approach globally and a single capital standard that applies at the both solo entity and the group basis. However, in practice insurance laws, insurance markets, capital markets and regulatory approaches vary widely. It will be a long time, if ever, before we reach regulatory Nirvana. In the meantime, practical solutions that work need to be developed. The most technically correct solution is not necessarily the most appropriate one especially when considering the first global insurance capital standard.

Insurance companies are already burdened by the impacts of new or modified local regulatory capital requirements, as well as the huge amount of work associated with IFRS17. An equivalence based solution on the lines suggested will limit the additional work to those areas where it is considered essential for the Group supervisor to provide additional policyholder security due to the inadequacy of the local regulatory capital regime, as determined by the IAIS criteria.

The second and related area I want to cover today is the use of internal credit models, and the current intended requirement of the ICS to base credit risk charges exclusively on external ratings.

In many of our jurisdictions it is not common for investments to be rated, and in many countries the international credit ratings including those of Governments unsurprisingly are focused on international issues, normally in US dollars, Euros, Sterling or Yen. We contend that such an approach may be appropriate for the relevant developed economies, however it is not suitable for developing markets, or markets that are almost exclusively the domain of local investors.

We strongly believe that internal credit ratings should be allowed if they are acceptable to the local supervisor, and that these may then incorporate to a greater or lesser degree the ratings of local ratings agencies. It may be possible for the local supervisor to rely on the Group supervisor to review the company's internal credit rating system. **This is fundamental to the business model in much of the less developed world and essential if the insurance industry is to play its rightful role in the formation of capital and development of capital markets and contribute to economic growth.**

A further very important point I wish to make on this subject is that in our view it is very clear that the use of internal ratings is distinct from and therefore should not be tied to an internal model approval process. In this regard, Bermuda can serve as an example. In Bermuda, approval of the use of internal ratings is a separate and more focused process than approval of a complete internal capital model.

The final area I wish to cover today is the role of holding company senior debt and recognition of the corporate structure of many insurance groups and other groups with insurance interests. Like many companies in North America, AIA raises debt at the non-licenced holding company level to fund our operations. Typically, the proceeds are contributed to the licenced operating companies and become equity capital at that level. We feel strongly that this form of **structurally subordinated** debt should be treated as capital both within the licenced entity and for Group solvency purposes. The alternative of having to raise **contractually subordinated** debt is more expensive and the additional cost involved will ultimately be borne by policyholders, with no real benefit from a prudential or security point of view.

Thank you for your attention and I'd be happy to answer any questions you might have.