Own Assets with Guardrails (OAG) Version 1.0
Key Observations from the 2017 ICS Field Testing

November 1, 2017

2017 ICS Field Testing Stakeholder Meeting in Kuala Lumpur

Background and aims of today's discussion

Background	■ The 2017 ICS Field Testing exercise and results are essential for the continued evolution of the OAG approach from v1.0 to v2.0 to promote an economically meaningful and globally applicable valuation approach
	■ Field Testing is a mechanism to:
	– Understand the behavior and sensitivities of OAG, in relation to other approaches
	– Identify areas of technical refinement
	– Evaluate operational and process-related aspects of performing the underlying calculations
	■ OAG v1.0 reflects specific technical requirements which were applied as placeholders for potential refinement. Further assessment of these placeholders is necessary in OAG v2.0 to ensure the OAG's key principles, sensitivities, and guardrails are tested properly. For example:
	– The prescribed reinvestment rate assumption was too low – i.e. 10 bps long-term forward rate
	– Equity sales cash flows were not recognized (limited to equity dividends only) in the determination of the average lifetime spread
Aim of today's meeting	■ Convey high level observations and findings from the 2017 ICS Field Testing (theoretical, quantitative, and process related)
	■ Potential areas for further refinement
	■ Open discussion and Q&A with stakeholder participants

Key issues of the OAG and findings from the 2017 Field Test

Findings based on discussions among OAG working group members

Ease of Use / Scope

- Firms applied OAG in a proportionate manner – i.e. tending to apply it to longer term business whilst applying the alternative method for short term business

- Benefit of OAG was more limited for some Par / Adjustable segments where OAG yield curve refinements were partially offset by rebasing

- Required data generally available for matched segments and/or where there is already detailed segmentation of asset and liability cash flows but there were some data challenges when this was not the case. Data requirements are expected to become less onerous as OAG becomes more established and/or as a result of technical refinements applied to simplify calculations.

- OAG templates met objective of standardizing calculations and promoting comparability – further refinements required to improve ease of use

Appropriateness of Results

- Relative to other methods, OAG provided a more consistent measurement of the impact of market movements on assets and liabilities – better at avoiding artificial volatility in stress scenarios

- Guardrails provide constraints on range of practice, but in places were too constraining e.g. lack of recognition of equity asset sales cash flows

Key technical issues for further refinement

OAG v1.0 reflects specific technical requirements which were intended as placeholders for the 2017 FT and further refinement in OAG v2.0

#	Technical Requirements	Issues	Potential Refinements
1	Long-term forward rate (LTFR) placeholder of 10 bps	The currently placeholder of 10 bps is not representative of long-term historical spreads that have been observed in practice	Develop LTFR based on an analysis of observed long-term historical spreads by geography
2	Recognition of equity cash flows are restricted to dividends only	The exclusion of equity sales cash flows creates an artificial ALM mismatch in respect of long term liability cash flows backed by equity assets	Reflect equity sales proceeds, subject to guardrails in respect of timing and amount of future equity sales proceeds, to better reflect asset/liability matching within OAG calculation
3	Adjusted spread on reinvestment assets calculated based on average adjusted spread on current held (own) assets up to year 10, with linear grading to the LTFR at year 60 thereafter	• 10 year reinvestment cut-off assumption is not directly related to availability of reinvestment assets by geography • Linear grading is simplistic and inconsistent with other grading calculations in ICS	• Consider reinvestment cut-off based on availability of reinvestment assets by geography e.g. consideration of deep and liquid markets • Consider alternative grading mechanisms e.g. Smith-Wilson method
4	Average lifetime spread calculated as weighted average of spread on own assets and reinvestment spread	Adjusted lifetime spread calculated using ratio of asset to liabilities cash flows at time t may be volatile when asset and liability cash flows are not exactly matched on an annual basis	• Refinement to item 2 will improve this calculation. • Modify annual cash flow matching calculation to reduce sensitivity on average lifetime spread
5	The use of internal ratings is currently not permitted	Assets such as mortgages and unrated bonds are not properly taken into account in the OAG calculation	Allow for the use of internal ratings in the OAG calculation subject to guardrails as appropriate
6	Introduce refinements which produce materially the same results but ensure that the OAG calculation remains proportionate	Some volunteers have cited proportionality concerns with the OAG calculations for example with respect to participating business	Introduce refinements to address proportionality concerns and circularity of calculations for participating business

Open discussion and Q&A

- What are your observations and experience with the OAG?

- Do you support the proposed refinements for OAG v2.0?

- Do you have any suggestions on how to improve the OAG approach?