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Orlando, FL

IAIS Stakeholder Meeting on the Insurance Capital Standard

Principles for the Monitoring Period

Appendix: Outstanding ICS Issues

Institute of International Finance

Background

The IIF and its members have been actively engaged in dialogue with the IAIS and its members throughout the multi-year process of developing the insurance capital standard (ICS). As the IAIS prepares to release in November the ICS Version 2.0 for the Monitoring Period, we would like to offer some high-level principles that could provide some additional clarity and structure to the further development of the ICS and the activities of the IAIS and its members during the Monitoring Period.

We encourage the IAIS to consider more fully the timing of the Monitoring Period and publish for comment in June a comprehensive and formal Monitoring Period Framework that incorporates these principles.

In the Appendix, we have highlighted some of the key issues for the further development of the ICS. The Appendix is not intended to be exhaustive and the relative importance of a particular issue will vary from company to company. Our summary is based on 2018 field testing and will be updated to reflect 2019 field testing, as well as the continued resolution of various issues.

We appreciate the various channels provided by the IAIS to contribute to the discussion of the ICS and the Monitoring Period, including through the Stakeholder Meetings.

Principle 1: The IAIS should use the Monitoring Period to identify, assess the impact of, and address comprehensively the full range of issues related to the design and calibration of the ICS, including those that are identified in the Appendix.

- The Monitoring Period Framework should include specific policies, procedures and processes for the consideration, evaluation of stakeholder input on, and resolution of ICS design and calibration issues.

- We encourage continued and increased transparency around the resolution of issues during the Monitoring Period. The IAIS should explain in sufficient detail its reasons for rejecting stakeholder recommendations, particularly where those recommendations have been advanced by a wide range of stakeholders. We would encourage the IAIS to share its calibration methodology and related data with stakeholders at the start of the Monitoring Period.

- We understand and appreciate that the IAIS is committed to robust oversight of the Monitoring Period. This could be achieved through the creation of an Executive Committee-level ICS Monitoring Period Governance Committee reporting regularly to the IAIS ExCo and, consistent with the protection of confidential and proprietary information, to stakeholders.

Principle 2: The Monitoring Period Framework should protect the confidentiality of ICS calculations, related data and supporting information.

- Consistent with its practices for the G-SII data calls and field testing, the IAIS, group-wide supervisors (GWS), and any parties acting as agent or on behalf of the IAIS or a GWS, should hold in strict confidence the reporting by IAIGs of ICS calculations, related data and supporting information during the Monitoring Period.

- During the Monitoring Period, the GWS should seek the consent of the IAIG prior to reporting to, or discussing with, the supervisory college the IAIG's ICS calculations.

- The IAIS and GWS should state publicly that IAIGs are only permitted to report their ICS results to their supervisors and are prohibited from sharing them with external parties – e.g. rating agencies, underwriters or lenders.

Principle 3: The Monitoring Period Framework should facilitate supervisory and stakeholder outreach and education, provide for a feedback loop from supervisors, and include a process for ensuring that ICS results do not trigger supervisory action or have an adverse market impact on insurers.

- The Monitoring Period provides the IAIS with an opportunity to receive feedback on the design and calibration of the ICS from GWS and supervisors and an opportunity to enhance supervisors' understanding of the ICS.

- The Monitoring Period also provides the IAIS with an opportunity to further explain the status of the ICS to external stakeholders, including the Financial Stability Board. In its stakeholder communications, the IAIS should continue to emphasize that the ICS remains in development during the Monitoring Period and is not yet mature as a regulatory capital standard.

- During the Monitoring Period, the GWS should not use the ICS as a basis for supervisory action or request or expect an IAIG to use the ICS for purposes of calculating internal or regulatory capital or for risk measurement or management.

- Internal models are integral elements of group supervision frameworks and form the basis of solvency assessments in many jurisdictions. The ICS should reflect this fact and the Monitoring Period Framework should reaffirm that an IAIG's GWS has the sole discretion to permit the IAIG to use one or more internal models for purposes of ICS calculations during the Monitoring Period. The IAIS should reflect the results of internal models in its consideration of ICS design and calibration.

Principle 4: The IAIS should conduct formal and robust market impact and cost/benefit analyses of ICS Version 2.0 for the Monitoring Period.

- The IAIS should conduct a market impact analysis of ICS Version 2.0 for the Monitoring Period, updated annually to reflect refinements to the design and calibration of the ICS.
- The market impact analysis should include an assessment of the ICS against existing group capital standards and alternative group capital standards in development.
- The market impact analysis should contain both quantitative and qualitative elements, should be sufficiently granular, and should consider the impacts of the ICS on insurance sub-sectors and on specific insurance products and investments through a broad range of economic conditions.
- The process of conducting the market impact analysis should be transparent to stakeholders and the aggregate or high-level results should be discussed at regular stakeholder meetings and in ongoing discussions with the Financial Stability Board.
- The IAIS should encourage GWS to discuss the results of the market impact analysis with local supervisors and IAIGs, to conduct market impact analyses in their individual jurisdictions, and to report aggregated or high-level jurisdictional findings to the IAIS.
- We encourage the IAIS to perform a robust cost/benefit analysis of the ICS prior to the adoption of an ICS for implementation at the jurisdictional level, taking into consideration IAIS and jurisdictional market impact analyses.

Principle 5: The IAIS should consult on a comprehensive set of standards for the conduct of comparability assessments early in the Monitoring Period.

- Early in the Monitoring Period, the IAIS should consult on a comprehensive set of standards for the conduct of comparability assessments of jurisdictional alternatives to the ICS that produce supervisory outcomes that are comparable in practice to the outcomes produced by application of the ICS and lead to a level playing field among IAIGs.

- There is a need for clarity on how comparability assessments would be conducted and on how different jurisdictional approaches would align with the ICS.

- The evaluation of the ICS against existing and alternative group capital standards conducted as part of the market impact analysis could help to inform the development of comparability assessment standards.

Appendix: Summary of key issues in the current ICS 2.0* (based on 2018 Field Testing)

	Issues Identified	IIF Recommendations
The Three-bucket Approach	The cash flow matching criteria for the Middle bucket are too strict.	The current criteria should be rationalized and alternatives should be tested and explored.
	The gross spreads (before application of the risk charge) for the Middle bucket are not reflective of actual spreads earned by IAIGs and, therefore, do not incentivize appropriate ALM.	The gross spreads used for the Middle Bucket should be consistent with the spreads earned by the IAIG.
	The current approach does not reflect jurisdictional and internal ratings for assets that serve an important social role.	We recommend the recognition of jurisdictional and internal ratings.
	The current approach does not recognize spread on equity investments.	We suggest recognition of spread on equity investments for long-term liabilities.
	Alternatives to the three bucket approach have not yet been recognized.	Alternatives that are consistent with an IAIG's ALM should be recognized.
	The current approach does not recognize the equity risk premium (ERP) in the spreads and the projection of cash flows/growth rate.	We recommend that a conservative ERP be recognized when equities back long term liabilities, both in the discounting and growth rate.
	The change in the LTFR methodology results in all developed markets being grouped together (e.g. EU, Japan, Korea and US) and inconsistent LTFRs for economies within this group.	We suggest adjusting the LTFR methodology so that each jurisdiction calibrates jurisdiction-specific LTFR based on economy-specific data.
	The current ICS 2.0 fails to recognize a spread term structure.	We suggest that the application of a term structure to spread adjustment would be more appropriate for long-term business.
	For some emerging markets with a LOT of 10 years, the volatility of the liabilities is largely driven by the yield at a single point (10-year yield). Artificial volatility is created for a very long period of 50 years.	We suggest shortening the grading period for currencies with short LOT.

* Please note that this is not the exhaustive list of all issues identified across the different ICS elements. It is a summary of some of the key issues that we request the IAIS consider during the Monitoring Period. The relative importance and priority of these issues varies among different firms. We understand that these issues will evolve over time and some of the items are already being tested in the 2019 field testing. Accordingly, we will continue to update this list and engage actively with the IAIS to provide industry inputs.

Appendix: Summary of key issues in the current ICS 2.0 (based on 2018 Field Testing)

	Issues identified	IIF recommendations
MOCE	The objective and impact of MOCE is unclear. The inclusion of MOCE in the current ICS 2.0 could result in double counting.	Further analysis is warranted and alternatives should be explored and tested.
Capital Resources	The current treatment of surplus notes and senior debt is inappropriate.	Surplus notes and senior debt should be Tier 1 capital instruments for both mutual and stock companies
	The proposed capital composition implies that Tier 1 capital resources will be limited to 10% of the ICS capital requirement, which is too restrictive. The proposal to restrict the recognition of Tier 2 non-paid-up capital to mutual IAIGs and the 10% limit on Tier 2 non-paid-up capital resources are too restrictive.	Tier 1 limited capital resources should be limited to 20% of unlimited capital resources. Tier 2 non-paid-up capital should be included in qualifying ICS capital resources for both mutual and stock companies. The 10% limit on Tier 2 non-paid-up capital resources should be increased to 50%, consistent with outstanding regulatory approaches to insurance capital standards in key jurisdictions.
	The tracing exercise is problematic in practice.	Discretion should be given to jurisdictional supervisors to set the minimum maturity, taking into account the requirements or constraints under local supervisory regimes.
The Standard Method	A range of issues have been raised as part of the Field Testing exercise in relation to the specification and calibration of capital requirements under the standard formula.	These issues need to be addressed in order to secure an economically sound approach and to avoid unintended effects such as double counting and excessive requirements, which could have negative impacts on economic growth.
	It is important to recognize that IAIGs are likely to be large and diversified by their nature, and that differing business models may be difficult to fully capture within a single approach.	We suggest allowing the use of internal models and alternative methods that reflect appropriate ALM and risk management.

Appendix: Summary of key issues in the current ICS 2.0 (based on 2018 Field Testing)

	Issues identified	IIF recommendations
Interest rate risk	The current approach to aggregate the interest rate risk charges for each currency using a correlation matrix is inappropriate.	Interest rate correlations should be based on observed market data and the interest rate charge should be revised to reflect interest rate risk models that incorporate market correlations.
Non-default spread risk	The introduction of a risk charge for non-default spread risk is problematic. Volatility in credit spreads should not impact an insurer's capital, if the insurer adheres to prudent ALM and liquidity management.	The rationale for the non-default spread risk should be clarified. The IAIS should use the ComFrame criteria to incentivize prudent ALM, including the management of potential exposure to spread volatility.
Currency risk	Currency translation risk does not impact of a group's ability to meet policyholder liabilities. Requiring capital for translation risk will reduce comparability across IAIGs, as the capital requirement will depend on each Group's reporting currency.	The IAIS should exempt the portion of the currency risk charge relating to currency translation.
Credit risk	There is an excessive commercial mortgage loan (CML) credit risk charge. Current risk factors are based on BCBS bank data.	The IAIS should continue to work with the industry to compile data to devise factors based on insurance experience and superior loan performance.
	While credit ratings from rating agencies are acknowledged, the assessments developed by supervisory organizations are not recognized.	The IAIS should also recognize credit risk assessments of jurisdictional organizations.
Equity volatility risk	Implied volatility shocks are assumed to be permanent and do not reflect strong mean reversion characteristics exhibited by implied vol in practice.	The rationale for including equity volatility risk should be clarified and any implied vol shock should be based on observable experience.

Appendix: Summary of key issues in the current ICS 2.0 (based on 2018 Field Testing)

	Issues identified	IIF recommendations
Equity risk	Long term holdings of strategic equity positions can be a good match for long term life liabilities.	We recommend more granularity in the "Other Equity" category, at least for strategic equity holdings. The risk charges for these equities should not be higher than for assets consolidated on the balance sheet.
Operational risk	Current framework does not recognize different market stages.	Premium growth should vary with different market stages.
Lapse risk	Current elements of policy lapse stresses are onerous and/or insufficiently granular, including lapse shock of retail policies, lapse risk stresses for a wide range of policyholder options, and the application of homogeneous risk groups within the lapse stress.	The lapse shocks should be revised downwards to reflect more realistic assumptions. Appropriate consideration should be given to the calibration of non-standard policyholder options (e.g. utilization rates for VAs).
Calibration	The calibration of risk charges continues to be excessive.	Data and analysis on historical volatilities should be improved and reflected in the calibration.
Diversification	The ICS reflects inadequate diversification effects; in particular, there is no geographical diversification for equity, lapse, mortality, morbidity, and operational risks.	A more granular approach to geographical diversification and diversification across and within risk types should be adopted.
Tax treatment	Simplistic constraints are applied to the amount of DTA includible in current Available Capital and the approach to tax-effecting Required Capital.	Economic assessments of expected monetization over a future horizon should be allowed.
	The valuation of deferred taxes is problematic.	The valuation of deferred taxes should build on the same principles as the valuation of other assets.
	The current approach does not reflect existing approaches and information regarding tax.	The ICS tax treatment should build as far as possible on existing approaches and information and should not require new and different approaches.

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