7.16 Currency risk

Q128 Section 7.16 Is the approach to Currency risk (eg level of the stresses, correlation factor, treatment of currency pegs, partial exemption for investments in foreign subsidiaries) appropriate for ICS Version 2.0? Please explain.

Organisation	Jurisdiction	Confidential	Answer	Answer Comments
European Insurance and Occupational Pensions Authority (EIOPA)	EIOPA	No	No	The methodology seems to be generally appropriate, although EIOPA would prefer a simpler approach. For instance, this could be a single shock factor for all currencies. In this respect, CEIOPS' Advice on the calibration of the market risk module found that a stress between 20% and 30% would be recommended for diversified currency portfolios. In addition, EIOPA would like to question the 10% liabilities offset and has concerns that this is too broad and not prudent.
Insurance Europe	Europe	No	No	The currency risk exposure for an IAIG is largely a result of the currency translation risk ie the contribution arising from foreign-currency denominated subsidiaries. Insurance Europe believes that the currency risk charge should be redesigned to remove the charges for currency translation risk. Currency translation risk does not impact on policyholder protection, nor does it detract from financial stability, the stated main objectives of the ICS. Indeed, requiring capital to be held against this risk could incentivise risk management practices that would be detrimental to policyholder interest as well as being contrary to ICS Principle 6 (the promotion of sound risk management). This is partially recognised by the IAIS through the 10% proxy exemption for investments in foreign subsidiaries. Additionally, requiring capital for translation risk will reduce comparability across IAIGs, as the capital requirements will depend on each Group's reporting currency ie. two IAIGs with exactly the same business and balance sheet could have different ICS requirements,

				depending on their reporting currency. Insurance Europe further notes that some of the current calibrations for currency risk far exceed the calibrations based on historical data. In the currency risk design, IAIS should allow for recognition of the loss absorbing capacity of technical provisions as it does for other risks.
Allianz	Germany	No	No	Compared to historical data some of the shock sizes are very high and far exceeding historically calibrated 1-in-200-year event levels (for example, BRL: 60%, JPY: 40% vs. an average of historically calibrated 1 in 200y event of 22%. The Solvency II Standard Formula is calibrated at 25%).
German Insurance Association	Germany	No	No	Compared to historical data some of the shock sizes are very high and by far exceeding historically calibrated 1 in 200 year events (for example, BRL: 60%, JPY: 40% vs. an average of historically calibrated 1 in 200y event of 22%. SII SF is calibrated at 25%).
Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)	Germany - BAFIN	No	No	The methodology seems to be generally appropriate, although we would prefer a simpler approach. For instance, this could be a single shock factor for all currencies. In this respect, EIOPS' Advice on the calibration of the market risk module found that a stress between 20% and 30% would be recommended for diversified currency portfolios. In addition, we question the 10% liabilities offset and has concerns that this is too broad and potentially not prudent.
Global Federation of Insurance Associations	Global	No	No	GFIA takes the view that the current approach is not appropriate in determining the currency risk charge. Currency risk must separately consider: (1) Currency mismatch: e.g. where a liability is supported by an asset denominated in a different currency. (2) Currency translation: e.g. due to aggregation and translation of assets and liabilities from foreign currencies to the domestic currency. The IAIS should exempt the portion of the currency risk charge relating to currency translation risk, which forms the majority of the currency risk captured in the Standard Method. Currency translation risk does not materially impact upon an IAIG's ability to meet

				policyholder obligations and is therefore unnecessary to meet ICS Principle 2 (the main objective of the ICS is policyholder protection). In addition, if modelled accurately, the risk diversifies very significantly even from a shareholder perspective, as the currency exposures will reduce when a subsidiary sustains losses and increase when a subsidiary makes gains. Requiring capital to be held against this risk could incentivise behaviour that would be detrimental to policyholder interests, such as inappropriate risk management practices. In particular, it could encourage all the surplus capital resources to be held in the reporting currency, rather than maintaining a buffer in the currency of individual business units. As well as contradicting ICS Principle 6 (promoting sound risk management), the current approach reduces comparability across IAIGs, as the capital requirement will depend on each IAIG's reporting currency, contrary to ICS Principle 1 (capital required to be held "irrespective of the location of its headquarters"). GFIA notes that this is partially recognised by the IAIS introducing a 10% proxy exemption for investments in foreign subsidiaries. Requiring capital for translation risk will reduce comparability across IAIGs, as the capital requirement will depend on each Group's reporting currency; i.e. two IAIGs with exactly the same business and balance sheet would have different ICS requirements, depending on their reporting currency. GFIA proposes that the currency risk charge should be redesigned to remove the charges for currency translation risk.
International Actuarial Association	International	No	No	The consultation paper mentions the use of a 10% proxy for the level of capital required to support the liabilities in a particular currency, but mentions that addressing the concerns raised by the use of this proxy would « significantly increase the complexity of this module ». The non-life risk factors in Table 25 of the Technical Specifications, and Premium and Claims Reserve factors in that table are typically in the 20% to 30% range (or higher) with only a few factors as low as 10% (the lowest factor shown). It may be that the 10% factor was based on a focus on life insurance, where leverage factors for the ratio of equity to liabilities are typically materially lower than for non-life. The Insurance Regulation Committee

				of the IAA supports the suggestion that the proxy could vary by type of business – perhaps a 10% proxy for life liabilities, but a higher proxy for non-life liabilities.
Dai-ichi Life Holdings, Inc.	Japan	No	No	
General Insurance Association of Japan	Japan	No	Yes	
Financial Supervisory Service (FSS) & Financial Services Commission (FSC)	Korea (Republic of)	No	Yes	
Aegon NV	The Netherlands	No	Yes	
Legal & General	UK	No	No	The fact that net insurance liabilities are only deducted from currency exposures in one direction, and then only deducted at 10%, appears arbitrary and appears likely to give rise to uneconomic and unrepresentative capital figures for many IAIGs. Other than this we are broadly comfortable with the design and calibration of currency risk capital.
Association of British Insurers	United Kingdom	No	No	The ABI believes that the current approach is not appropriate in determining the currency risk charge. Currency risk must separately consider: (1) Currency mismatch: e.g. where a liability is supported by an asset denominated in a different currency. (2) Currency translation: e.g. due to aggregation and translation of assets and liabilities from foreign currencies to the domestic currency. The IAIS should exempt the portion of the currency risk charge relating to currency translation risk, which forms the majority of the currency risk captured in the Standard Method. Currency translation risk does not materially impact upon an IAIG's ability to meet

				policyholder obligations and is therefore unnecessary to meet ICS Principle 2 (the main objective of the ICS is policyholder protection). In addition, if modelled accurately, the risk diversifies very significantly even from a shareholder perspective, as the currency exposures will reduce when a subsidiary sustains losses and increase when a subsidiary makes gains. Requiring capital to be held against this risk could incentivise behaviour that would be detrimental to policyholder interests, such as inappropriate risk management practices. In particular, it could encourage all the surplus capital resources to be held in the reporting currency, rather than maintaining a buffer in the currency of individual business units. Solvency II creates similar incentives, and IAIS should consider the European experience. It should be noted that EIOPA has recently put forward a proposal to allow groups to nominate an alternative "reporting currency" for the purposes of the Solvency II standard formula currency risk sub-module calculation, which may ease the capital burden for some groups. As well as contradicting ICS Principle 6 (promoting sound risk management), the current approach reduces comparability across IAIGs, as the capital requirement will depend on each IAIG's reporting currency, contrary to ICS Principle 1 (capital required to be held "irrespective of the location of its headquarters"). The ABI notes that this is partially recognised by the IAIS introducing a 10% proxy exemption for investments in foreign subsidiaries. Requiring capital for translation risk will reduce comparability across IAIGs, as the capital requirement will depend on each Group's reporting currency; i.e. two IAIGs with exactly the same business and balance sheet would have different ICS requirements, depending on their reporting currency. The ABI proposes that the currency risk charge should be redesigned to remove the charges for currency translation risk.
National Association of Mutual Insurance Companies	United States	No	No	The ICS is not yet fit for purpose. Significant additional work is needed to achieve an appropriate global capital standard and it may be completely unachievable. Currency risk and all other risks and their factors should be determined by the local jurisdictional supervisor. NAMIC disagrees with the mandate of a standard method, the 99.5% VaR

				calibration level and the IAIS dictating the factors to be used in the formula. Jurisdictional flexibility is the appropriate way to capture these risks with mutual recognition and shared understanding of the jurisdictional approach at supervisory colleges.
RAA	United States and many other jurisdicitons	No	No	We believe that the current approach is not appropriate in determining the currency risk charge. Currency risk must separately consider: - Currency mismatch, where a liability is supported by an asset denominated in a different currency. - Currency translation, due to aggregation and translation of assets and liabilities from foreign currencies to the domestic currency. The IAIS should exempt the portion of the currency risk charge relating to currency translation risk, which forms the majority of the currency risk captured in the Standard Method. Currency translation risk does not materially impact upon an IAIG's ability to meet policyholder obligations and is therefore unnecessary to meet ICS Principle 2 (the main objective of the ICS is policyholder protection). In addition, if modelled accurately, the risk diversifies very significantly even from a shareholder perspective, as the currency exposures will reduce when a subsidiary sustains losses and increase when a subsidiary makes gains. Requiring capital for translation risk will reduce comparability across IAIGs, as the capital requirement will depend on each Group's reporting currency; i.e. two IAIGs with exactly the same business and balance sheet would have different ICS requirements, depending on their reporting currency.
American Academy of Actuaries	United States of America	No	No	The consultation paper mentions the use of a 10 percent proxy for the level of capital required to support the liabilities in a particular currency, but mentions that addressing the concerns raised by the use of this proxy would "significantly increase the complexity of this module". The non-life risk factors in Table 25 of the Technical Specifications, and Premium and Claims Reserve factors in that table are typically in the 20 percent to 30 percent range (or higher) with only a few factors as low as 10 percent (the lowest factor shown). We can only speculate that the 10 percent factor was based on a focus on life insurance, where leverage factors for the ratio of equity to liabilities are typically materially lower than for non-life. This leads us to the suggestion that the proxy should vary by type of business—perhaps a 10 percent proxy for life liabilities, but a higher proxy for non-life liabilities.

Prudential Financial, Inc.	United States of America	No	Yes	
Property Casualty Insurers Association of America (PCI)	USA	No	No	PCI´s yes or no response was simply required in order to open the text box and file comments. We believe this question to be best addressed by field test volunteers who have the ability to do so with the benefit of actual data for support and context. The absence of a response by PCI should not be taken one way or the other with respect to the subject of the question.
National Association of Insurance Commissioners (NAIC)	USA, NAIC	No	Yes	Yes.

End of Section 7.16