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INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

Summary of Feedback from Consultation on BCR for G-SIIs, 16 Dec 2013 – 3 Feb 2014

Contents

- Objective of BCR
- Principles/Approach in Development
- Interaction with Other Capital Requirements
- Timeframe
- Factor-Based Approach
- Segmentation
- Diversification & Risk Mitigation
- Accounting & Valuation Approach
- Off-Balance Sheet Items
- Discount Curves
- Insurance Liabilities
- NTNI
- Capital Resources

Objective of BCR

- Concerns about lack of clarity of BCR objective (more covered under Q1 later)
- General discomfort with focus on “going-concern” as a goal
  - Some believe it should focus on gone-concern only
- Large no. of respondents believe BCR should be a minimum (MCR)
  - Given BCR’s simplicity, using it as a target capital level is inappropriate / could negatively influence risk management decisions

Principles/Approach in Development

- Widespread support for the recognition that banking leverage ratio is inappropriate for insurance business
- Many respondents expressed concern that BCR appears overly geared towards simplicity and preferred for a greater emphasis on risk sensitivity
- Many also expressed concern that BCR should not be volatile or encourage pro-cyclical behaviour
- Several respondents suggested BCR should leverage on the work already done for factors in Solvency II, US NAIC RBC Formulas and the Canadian regulatory framework
- Several said that “Resilience to stress” needs to be defined clearer

Interaction with Other Capital Requirements

- Many respondents expressed concern that BCR should not increase or conflict with existing group capital requirements on insurers
- Many also shared that the intended interaction between BCR and other standards/policy measures (HLA; ICS; ICP 17) lacked clarity

Timeframe

- While nearly all agreed the timeframe was tight, several respondents explicitly requested IAIS to reconsider the timeframe for BCR.
  - Several suggested implementing a phase-in period for BCR to allow for further calibration
  - 2 respondents urged IAIS to seek FSB agreement to deliver framework by Nov 2014 and calibrate during 2015

- Several believed that field testing should focus on BCR only in the interest of resources and time

Factor-Based Approach

- General support of the factor-based approach
- A few voiced disagreement with a factor-based approach
  - Does not adequately reflect each company's risk profile thus producing 'false comparability'
  - Alternative suggestions: stochastic models; scenario-based assessments; discussion of local capital requirements and internal models at Supervisory Colleges

- Many believe more than 10 factors will be needed and that it is premature to specify or restrict the number of factors at this stage

- Concern that the use of pre-calibrated factors from Solvency I and Basel III would not be appropriate especially beyond NTNI risks
  - Solv I calibrated at a fairly low standard (below 99.5% or below BBB, i.e. meeting requirements achieves only junk bond status) and was subsequently modified for Solv II
  - Basel III is calibrated for the banking business model and hence should not be applied to anything other than banking risks

Segmentation

- Preference for more granular segmentation of business lines
  - Simplest proposal of having only broad “life” and “non-life” segments generally considered insufficient

- General support for separation of Non-Proportional reinsurance

- Some suggested for Catastrophe risk to be distinguished

Diversification & Risk Mitigation

- Consistent call for recognition of diversification, reinsurance, hedging, ALM and risk-mitigating / loss absorbing features in products
  - Several requested for greater clarity on how diversification will be implicitly factored in during calibration
  - Some suggested that recognising diversification explicitly would not be complex / would be simpler than doing so implicitly
    - Variance / co-variance approach with pre-defined correlations between risks

Accounting & Valuation Approach

- General agreement for use of consolidated group-level approach, widely-used accounting methods and fair values for invested assets

- Concerns that market-based approach does not recognise / is not appropriate for long-term nature of business
  - Forces insurers to recognise short-term losses in long-duration assets that are held to maturity to match long-duration liabilities
  - Introduces short-term volatility without any benefit in identifying or understanding entity's risks
  - Effect would be to discourage long-term business
  - Adjustments would need to be made to reduce pro-cyclicality

Off-Balance Sheet Items

- General agreement that off-balance-sheet items should be excluded if immaterial
  - Most off-balance-sheet items would not be material. Material items should be part of consolidated balance sheet.
  - Off-balance-sheet items should be treated symmetrically (i.e. if off-balance-sheet liabilities are taken into account, then similarly off-balance-sheet assets should be considered)
- Some expressed that the term “off-balance-sheet exposures” requires further definition
- A few said that criteria for immateriality needs to be made clearer

Discount curves

- General sentiment that it is impractical for IAIS to specify yield curves
- Suggestion to construct yield curve for major currencies based on the assets (or referenced asset portfolio) backing the liabilities
- Suggestion for IAIS to define principles or guidance for determining discount rates / yield curves, e.g.
  - Allow for both top-down and bottom-up approaches for defining discount rate
  - Calculating discount rates based on reliable and relevant observable market data of financial instruements with same cash flow characteristics
  - Request firms to submit their own curves and submit explanation/ justification on how it was derived

Insurance Liabilities

- General support of use of current estimates
  - One respondent was unclear whether ‘current estimates’ includes unearned reserves

- Several respondents opined that it is more appropriate/practical for non-life technical provisions to be undiscounted
  - Many jurisdictions require the use of undiscounted estimates

- There was some disagreement with the statement that internal models increase complexity and make supervision more difficult

NTNI

- Some expressed that “NTNI” needs to be better and more clearly defined

- General agreement that NI should be addressed using respective sectoral rules

- Concern over double-charging for NTNI activities that are also risk charged under other factors

- A few respondents disagreed with use of Risk Weighted Assets for NTNI, unless it already applies to non-insurance entities subject to Basel rules, due to differences between banking and insurance environments

Capital Resources

- Many expressed that BCR should not have tiering of capital

- Several also believe qualification of capital resources should be principles-based rather than rules-based

- There was some concern that supervisory discretion on transferability/ fungibility of capital reduces comparability and should be minimised