INTERNATIONAL ASSOCIATION OF
INSURANCE SUPERVISORS

Public

Resolution of Main Issues from the Comments on:
Basic Capital Requirements (BCR) for
Global Systemically Important Insurers (G-SIIs)

Consultation Period: 9 July to 8 August 2014

29 October 2014

Introduction

On 9 July 2014, the IAIS issued a public consultation document on its proposal for Basic Capital Requirements (BCR) for Global Systemically Important Insurers (G-SIIs). The consultation closed on 8 August 2014 and the feedback received was published on the IAIS website.

Responses were received from a total of 53 respondents from 17 jurisdictions. 21 of these respondents were from the USA, including NAIC and 8 industry associations. There were 18 respondents from Europe including 6 supervisors and 6 industry associations. Other respondents were from Bermuda, Canada, China, Hong Kong, Japan.

This document highlights the major issues raised by respondents and provides IAIS' comments in response to these issues.

Topic	Feedback Received	Response
Calibration		
Alpha scalar	Clarifications on the determination of the alpha scalar were sought. Some respondents expressed difficulty in commenting on the calibration level given that the alpha scalar may be further revised.	The alpha scalar, as indicated in the consultation document, was proposed to be 100% and feedback was sought on this basis. The scalar will be retained at 100% subject to review and refinement during the period of confidential reporting. The alpha scalar will be reexamined during HLA development, given that it is the combination of BCR and HLA that will form a consolidated capital requirement for G-SIIs. Overall calibration level will be further monitored during the period of confidential reporting, and refined if necessary.
Impact on G-SIIs	Feedback was received that it should not be necessary for BCR and HLA, when considered together, to result in a higher	It is expected that BCR+HLA will be an increase in capital requirements over existing jurisdictional requirements for at least some G-SIIs. The IAIS agrees that this may not always be the case where the G-SII faces jurisdictional capital

Topic	Feedback Received	Response
	capital requirement for G-SIIs in all cases than otherwise required given that jurisdictional requirements vary and may, in some cases, already require more capital than necessary to cover the systemic risk.	requirements that exceed the combined BCR+HLA requirements.
Treatment of minority interests	Questions were received on the treatment of minority interests.	The IAIS has determined that Capital instruments issued by a fully consolidated regulated financial subsidiary of the G-SII to third-party investors (minority interests) may be recognized as either core or additional capital if the instrument meets or exceeds all of the criteria for classification as core or additional capital respectively.
Treatment of capital in banking entities	Comments were received against the proposal to deduct investments in Core Capital-like capital resources of non-insurance financial institutions subject to risk-based capital requirements (banks subject to Basel capital requirements) from BCR capital resources.	The IAIS has removed this deduction from capital resources, in order to be consistent with the approach taken to include capital requirements for banking subsidiaries in the BCR.

Segmentation		
Treatment of participating products	A number of respondents were of the view that insufficient credit had been given to risk absorbing features in Participating products. Feedback was also received that discretionary payments in such products should be recognised when discounting.	The IAIS recognises that some participating contracts have a risk profile lower than that of non-participating business. This could be considered in a lower factor. However, a number of products with different risk profiles were included in the participating products segment. The IAIS will assess whether improvements can be made to the granularity of the definition of participating products during the confidential reporting period from 2015 to 2018, in order to better evaluate the relative risk profiles
Discretionary payments in participating contracts	Feedback was received that discretionary payments should be recognised in participating contracts when discounting	A Current Estimate of cash flows will include the value of cash flows as a result of the exercise of discretions consistent with the assumed policyholder behaviour and other valuation assumptions.
Trade Credit and Surety	Several respondents disagreed with the treatment of trade credit insurance and surety business as non-traditional.	Short term trade credit was defined in the July 2013 G-SII policy measures paper as traditional insurance. The BCR will be amended to make this clearer. The treatment of this segment will be reviewed using information from confidential reporting.
Treatment of CAT Risks	Feedback was received on the inadequate treatment of natural catastrophe risks in the proposed BCR.	The IAIS agrees that CAT risk is an important and relevant risk. As a simple and straightforward approach, the factor for Property is defined as a percentage of net premium which partly captures some CAT risk. A multiple of net premium will be applied to the same factor for Non-Proportional and CAT property business to account for differences in the magnitude of risk relative to premium for such business, thus better capturing the CAT risk in Non-Proportional and CAT property business. A more sophisticated approach to CAT risk will be considered in the ICS.

Mortgage insurance	The factor for mortgage insurance was expressed as a percentage of 'Face Value'. However, paragraph 36 of Annex F referred to Risk-in-Force as an exposure measure. Respondents sought clarification on this with some respondents expressing the view that Risk-in-Force was more appropriate than Face Value.	The IAIS agrees with the feedback and will amend the factor for mortgage insurance exposure to be Risk-in-Force rather than Face Value. Given that the former is a lower measure of risk exposure than the latter, the factor has been adjusted accordingly to 4% which produced a minor increase in the BCR calculation.
Other Non-Traditional (NT)	Other NT factor is lower than Other Non-Life factor	Amongst G-SIIs, 'Other NT' is mostly comprised of life NT and very little non-life NT. The treatment of NT will be further refined as part of HLA development in 2015.
Policyholder loans	Feedback was received that policyholder loans should be treated less punitively given that they are generally secured by accrued policy benefits.	The IAIS has noted the feedback and has amended the BCR Proposal to classify policyholder loans as 'investment grade credit'' instead of as 'non-investment grade'.
Use of internal ratings	Comments were received encouraging the recognition of internal ratings of assets that are not rated by an external recognised rating agency.	For the purposes of BCR, assets not rated by recognised rating agencies will be considered to be non-investment grade. It has not been possible to provide flexibility for internal ratings to be used in a standardised and globally comparable approach.
Non-investment assets	Comments were received regarding the treatment of non-investment assets which receive no asset charge but are counted towards capital resources of the G-SIIs under the BCR.	Supervisory experience indicates that a significant proportion of non-investment assets consist of own-use real estate. The proposal has been modified to apply the same asset charge on own-use real estate as for real estate for investment purposes. The treatment of other non-investment assets will be explored further during the period of confidential reporting and refinement from 2015 onwards.

Non-Insurance		
Treatment of assets under management	Some were concerned that assets under management would be effectively risk charged twice. Feedback was received against the imposition of a capital charge of up to 25 basis points on third party assets under management. Some respondents argued that such a requirement would generate an unlevel playing field, while others sought clarity on how the capital charge would be determined.	Third party assets under management are excluded from the asset factors for insurance operations and are to be treated separately. There will be no 'double counting'. Should a global capital standard for such activities be established by IOSCO and FSB, that standard will be incorporated into the BCR. In the interim, the IAIS has determined that it would be appropriate to apply the existing Basel II operational risk charge requirement for third party asset management activities to such activities conducted by a G-SII. This application of a charge that is already applied to some asset managers globally will increase comparability across G-SIIs who currently face different jurisdictional requirements for such activities.
Banking activities	Some respondents expressed support for the use of the leverage ratio for banking activities in the BCR. Several respondents sought further guidance on how the leverage ratio would be applied to regulated and unregulated banking activities	The Basel III Leverage Ratio framework will be applied to calculate a risk charge on all assets captured in the exposure measure that are related to regulated and unregulated banking activities. Subject to any future changes in the Basel III Leverage Ratio calibration, a risk charge of 3% of on balance sheet assets (related to regulated and unregulated banking activities) will be applied, plus a corresponding charge for related off balance sheets assets.
Materiality threshold for NI activities	Several respondents suggested defining a materiality threshold for all non-insurance activities.	No proposals were received on how such a materiality threshold could be effectively defined. However, this issue will be monitored during the period of confidential reporting.

Treatment of non-financial activities	Questions were raised as to which non-financial activities will be subject to capital requirements and what those requirements, if any, would be. Some respondents suggested excluding such activities altogether.	None of the current G-SIIs have reported material non-financial activities in 2014 field testing. However, group-wide supervisors may determine that a non-financial activity is to be included in both capital resources and required capital for BCR if it is deemed to be material. The risk charges to be applied to such activities will be determined after further data analysis in 2015 field testing. The possibility of using a more risk sensitive treatment of non-financial activities will be revisited during ICS development.
Valuation		
Balance Sheet	A significant number of comments against use of common market adjusted balance sheet were received.	The IAIS has determined that the market adjusted balance sheet is an appropriate and comparable approach for the BCR. Further investigation will be undertaken during development of the ICS to determine an appropriate and comparable approach in that context.
Contract Boundaries	Concerns continued to be expressed over the application of contract boundaries to renewable contracts.	The IAIS' proposed approach for contract boundaries in the BCR is a prudent approach that is consistent with current accounting and many regulatory approaches. Expected profits from such renewals cannot be recognised as current qualifying capital resources given that they may not be readily available as capital resources during periods of stress.
Yield Curves	A range of concerns were expressed on the IAIS-specified yield curves, in particular their treatment of long term business and potential volatility. Some respondents requested for more transparency on how the yield curves were derived and will be revised.	The IAIS-specified yield curves are being developed in an evolutionary process that needs to be adjusted over time. The starting point with respect to valuation of assets and liabilities across jurisdictions was not comparable. The IAIS has been testing different methodologies during field testing and this will continue during the period of confidential reporting. It is expected that further enhancements will reduce concerns about volatility during that period.

Corporate Spread	A number of respondents disagreed with the use of only 40% of the actual corporate bond spread for the adjustment of yield curves.	Although 40% may appear low relative to the illiquidity premium estimated by some researchers, the same adjustment is applied to all products under the BCR (including, for example, products that could be surrendered at any time without penalty). On balance, the IAIS has determined that the outcome is reasonable and does not deviate significantly from adjustments proposed by some members of the industry. The IAIS has been testing different methodologies during field testing and this will continue during the period of confidential reporting. It is expected that further enhancements will reduce concerns about volatility during that period.
Capital Resources		
Capital instruments	Feedback was received from a wide range of industry participants that surplus notes, senior debt and deferred tax assets should be counted as core capital.	Core capital is required to be available for the group on a going concern basis. Some capital instruments (including senior debt) do not meet that test and hence are not included in the definition of core capital.
Margin Over Current Estimate (MOCE)	A significant number of respondents were against the reintroduction of some margins into the technical provisions, although several respondents also agreed that not all MOCE should be in core capital resources.	IAIS intends to further review the treatment of margins, but given the nature and complexity of the exercise, it will be done as part of ICS development rather than BCR (as was stated in the consultation document).
Fungibility of capital	Several respondents queried whether or how fungibility of capital would be considered in the BCR.	The IAIS agrees that fungibility of capital is a important consideration for assessing a G-SII. However, fungibility of capital is not easily captured in a simple and straightforward quantitative requirement. It will instead be part of a qualitative capital adequacy assessment in ComFrame, of which ICS will be a

		part.
Tiering	Comments were received against the tiering of capital, particularly given the differences between the characteristics of insurance and banking business.	Core capital refers to capital that can absorb losses on a going concern basis while additional capital is to protect policyholders in wind-up. The IAIS is cognisant of the difference in risks between insurers and banks; nonetheless, differentiation between core and additional capital is necessary given that insurers are not immune to failure.
Qualifying Reinsurance	A number of respondents were against the possibility of extending the definition of non-qualifying reinsurance as outlined in the consultation document.	Field Testing results indicate that very few existing reinsurance contracts are disqualified based on the current definition of non-qualifying insurance, i.e. the lack of a legally binding contract. As stated in the consultation document, the question on how reinsurance with unauthorised reinsurers should be treated is being explored as part of ICS development in order to avoid loopholes in the framework.
Other issues		
Consistent Implementation	Several respondents raised concerns over the consistency of implementation of the BCR by different jurisdictions.	Consistency of implementation of the BCR is central to its aim of enhancing comparability. This will be discussed and coordinated within IAIS by the relevant IAIS members who will be responsible for implementation.
Confidential Reporting	A significant number of respondents expressed support to have a period of confidential reporting. However, several were concerned about how confidentiality of the information will be ensured particularly given the transmission of such data to the IAIS.	Strict confidentiality protocols will be established and adhered to in order to protect the transmission of BCR-related data to the IAIS during the period of confidential reporting. Such protocols have, in fact, been already demonstrated and effectively utilised during 2014 field testing. The period of confidential reporting will make use of the field testing infrastructure and processes set up in 2014. Further guidance on the proposed approach to confidential reporting will be

		made available to G-SIIs in October 2014.
Resistance against publishing each G-SII's BCR after 2019	Concerns were expressed regarding the proposal to require G-SIIs to publish specific components of the BCR calculation after the period of confidential reporting is over.	After 2019, publication of both BCR and HLA will be expected. This issue will be dealt with in detail during development of the HLA.