GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

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GFIA position paper for IAIS hearing on 20 October

The Global Federation of Insurance Associations (GFIA) through its 38 member associations represents insurers that account for around 87% or more than $4.0 trillion in total insurance premiums worldwide. The global insurance industry is also a major investor in the world's economy, with nearly $26.8 trillion of assets under management in 2012.

The GFIA appreciates the chance to provide input into the process of the ICS development. The previous informal consultation and the ten principles put forward by the IAIS provide valuable insight into current IAIS thinking of the design of the ICS, and constitute a useful basis on which to exchange views. The GFIA would welcome the opportunity to engage similarly in future exercises.

While members of the GFIA generally agree on a number of concepts and key attributes that the ICS should include if it is developed, there are also a number of areas where opinions diverge, as a direct consequence of existing approaches in local capital regimes. Such areas therefore need further discussion.

To reflect this, the current position paper is split into 2 sections: The first highlights areas of agreement among the GFIA members and the second, areas where further discussion is needed.

Section 1: Areas of agreement among members of the GFIA

Challenges in how the ICS will relate to existing regimes

The challenges emerge from the reality of currently having in place different solvency regimes across the world. While they were all developed to fit with the specificities of local products and markets, the regimes often differ in many important areas such as valuation of assets and liabilities or measurement of capital to cover risks underlying the business.

Whatever the final ICS framework will look like, it will need to be sophisticated enough to cope with the range of specific needs across the global industry, and flexible enough to avoid forcing unnecessary changes to local products and markets solely due to a desire for a global framework.

Currently it remains unclear what the IAIS' expectations are with respect to how the ICS will interact with local capital regimes. To avoid unnecessary costs and having potentially conflicting requirements, local regimes which are consistent with the ICS framework should be recognised as a suitable implementation of the ICS framework.

Avoidance of pro-cyclicality and artificial volatility

Members of the GFIA agree that avoidance of pro-cyclicality and artificial volatility must be a key aim of the ICS framework, as stated in the ICS Principles 2 and 7.

When moving to a valuation approach involving market values, some GFIA members have noted that from their experience, there appears to be a tendency to ignore or under-estimate the very large importance that the asset and liability management of long-term liabilities can have in reducing or even eliminating insurers' exposures to short-term market volatility. If the IAIS develops global standards which exaggerate the true exposure to market volatility these standards will result in an exaggeration of the volatility of insurers' available capital and a significant overestimation of the required capital for asset risks. These two results, especially their combined impact, can seriously damage insurers' long-term business model, in particular their ability to offer long-term products to customers and the price at which they do so. In addition, it can

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impact their very important role in the wider economy as providers of long-term investment and as stabilisers during periods of financial market stress.

Group-wide approach

Members of the GFIA are largely supportive of an appropriately designed group-wide approach to solvency assessment. However, the framework must separate proposals for assessing group level solvency from the issue of possible authority for a group supervisor in one jurisdiction to intervene in another jurisdiction.

GFIA members recognise that groups should be able to assess and monitor their own solvency at the group level as well as entity and national levels. Although exceptions will exist, generally excess capital (above that needed to cover local entity requirements) which is spread across a group should be considered as fungible for group solvency purposes. Capital efficiency is a key focus for insurance groups. Groups with a diversified set of businesses and risks will benefit from this diversification in order to cope with a greater range of events. Groups can and do move capital around their group, for example, to fund investment opportunities and dividend payments as well to address local problems if they arise. However, this movement does not imply that entities in the group can or should be forced to bail-out other entities in the group.

GFIA also recognises that, as a result of the financial crisis, there is a strong desire to put in place global measures that allow for the monitoring of the solvency position of internationally active groups. This monitoring, however, is very different from the issue of legal authority of one jurisdiction over another. The ICS and ComFrame should limit their focus to the role of group supervisor and group level solvency reporting for the purpose of measurement and monitoring, and should not seek to include the issues of powers of group supervisor and "authority" to intervene in other jurisdictions. If group level monitoring presents issues, the supervisory college is the appropriate forum for addressing them.

Reflection of local market specificities

While developing the ICS framework with an overarching aim of comparability, as indicated in IAIS Principle 1 and Principle 5, the GFIA believes that the IAIS needs to appropriately reflect on the following considerations:

- A globally comparable standard must not ignore local issues, which could result in an unintended consequence of either over-capitalising or reducing policyholder protection in other jurisdictions. For example, mortality improvement rates and volatility in mortality experience have varied globally and are heavily influenced by local conditions. Further, health insurance businesses vary quite substantially globally and, for example, any risk measurement approach depends on the level of healthcare expenses and the structure of healthcare providers. Catastrophe risks, by their very nature, are jurisdictional. Property/Casualty insurance coverages vary based upon the requirements of local law. Thus, it is important that the ICS framework does not prevent a proper reflection of such local characteristics.
- Ensuring continuity of availability of products across various markets should also be an aim of the ICS to ensure that the ICS does not have unintended consequences of products becoming unsustainable.

Risk-sensitivity and simplicity

While members of the GFIA understand the need for a balance between risk-sensitivity and simplicity as indicated by the IAIS in Principle 8, they believe that the key aim should be that the ICS works well in practice and appropriately reflects the risks to which insurers are exposed.

Members of the GFIA believe that explicit and appropriate recognition of diversification and risk-mitigation (including re-insurance, profit sharing and hedging) are key to achieving the envisaged risk-sensitivity feature of the ICS framework. Diversification and risk mitigation are fundamental aspects of the insurance business and are also closely linked to ICS Principle 6 on promoting sound risk management by IAIGs and G-SIIs.

Importance of internal models

Internal Models (partial or full) should be allowed to determine solvency. The option to use internal models is very important to ensure the ICS avoids becoming hugely complex while still ensuring that solvency requirements will be aligned to the real risks across all the companies applying the ICS. Internal models provide insurance companies and supervisors with better insights into the firm's idiosyncratic risks and therefore promote sound risk management, in line with ICS Principle 6.

Timelines for development and implementation

The time-line for developing the ICS is overly ambitious. Experience from GFIA members involved in developing new local and regional capital regimes is that it has taken many years to address the technical issues, ensure unintended consequences are understood and that sufficient testing has taken place. While a global regime can in certain ways gain from these past experiences, it is a project of significantly greater complication and scope. It is important, for example, that the IAIS designs a framework that can work in all jurisdictions with varying government, legal and corporate structures, and under both normal and crisis conditions.

Achieving an ICS which actually works as intended across the globe should take precedence over hitting an optimistic target timeline. A realistic ICS timeline should take into account two important perspectives:

1. **Timing for development,** which remains ambitious as existing solvency regimes exhibit significant differences in key areas such as valuation, and
2. **Timing for implementation**, ensuring that the ICS will not have sudden unintended consequences. Transitional measures should therefore be part of the ICS framework.

Transparency

Members of the GFIA agree that ICS requirements should be reported in a transparent way, in line with IAIS Principle 9. However, the nature and extent of disclosure requirements must take into account the costs and benefits of providing the information.

In addition, a transparent process for developing the ICS should be as important as the clarity of reporting, and emphasised in IAIS Principle 9.

Replacement of the BCR with the ICS

Members of the GFIA believe that it is too early to adopt Principle 3 because whether or not it is appropriate to replace the BCR with the ICS will depend on the final nature and calibration of the BCR (which itself is likely to be refined over the testing period) and of the HLA (which has not yet even been designed and calibrated). In addition, the BCR and the ICS are being developed with significantly different purposes and timelines; therefore, transition from one to the other may not be appropriate or effective. The discussions about the BCR and ICS should be kept separated at this stage and Principle 3 should be reconsidered later.

Section 2: Areas where further discussion is needed between members of the GFIA

Valuation and capital requirements are key areas where further discussion among members of the GFIA is needed and fundamental to achieving a workable ICS. Both existing and developing capital regimes take significantly different approaches in these two areas.

Valuation

The issue of valuation methodology is acknowledged by members of the GFIA as a complex one which requires significant further discussion. As illustrated by the ongoing work of the IASB and FASB, the development of a convergent global valuation approach is extremely challenging.

For life insurers in particular the long-term nature of the business, as well as the link between assets and liabilities leads to a valuation approach for liabilities that must take into account economic links between those liabilities and the assets that back them. The business model differs in the non-life sector. However, members of the GFIA strongly agree that any valuation approach must appropriately reflect key elements of the insurance business.

While some members of the GFIA believe that the valuation approach should be consistent between long and short-duration contracts (for instance life and non-life), other members believe any valuation approach must recognize the differences between the business models for short duration and long duration contracts.

Capital requirements

There are currently different approaches for determining the required buffers for uncertainty and risks within capital regimes. Key considerations include:

- scenario vs factor based approach
- specific calibration level vs outcomes-based approach
- one year assessment vs run-off assessment
- reflecting uncertainty as part of both technical provisions and capital vs reflecting uncertainty only as part of capital requirements
- some markets have policyholder protection schemes intended as part of overall customer protection framework, some consider policyholder protection as completely separate and in some cases there is no additional protection and therefore the company solvency is the only protection

Each solvency regime has been designed and developed over time for the local market. The range of approaches and combinations mean that direct comparisons of solvency ratios cannot be made. However, that does not mean that overall levels of protection for policyholders are not similar.

The discussion on capital requirements, linked to the IAIS Principle 10, is therefore closely linked to the discussion on valuation and available capital. In both areas further discussion is needed among members of the GFIA.

About the GFIA

Through its 38 member associations, the Global Federation of Insurance Associations (GFIA) represents the interests of insurers and reinsurers in 58 countries. These companies account for around 87% of total insurance premiums worldwide. The GFIA is incorporated in Switzerland and its secretariat is based in Brussels.