GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

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GFIA response to the IAIS public consultation on risk-based global insurance capital standard (ICS)

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 GFIA appreciates the opportunity to comment on the IAIS consultation document on the ICS.

The GFIA hopes that the IAIS finds this submission helpful in highlighting the many points of commonality in the insurance industry's thinking around the world. At the same time, many jurisdictions are starting from very diverging positions in this process, and the GFIA recognises that reaching consensus on some areas, most notably valuation, remains a significant challenge. This is a result of the differences across jurisdictions in terms of both markets and capital regimes.

The GFIA believes that its thoughts on how these differences can be accommodated within an ICS framework will prove useful for its successful development. The GFIA would welcome further opportunities to engage with the IAIS in the development of this important proposal.

General comments

The regional and national associations that comprise the membership of the GFIA represents a very broad spread of insurance companies across the globe, from large composite insurers to specialised micro-businesses, covering life insurance, property and casualty business and reinsurance, publicly quoted companies, private companies and mutuals. Understandably, there is a very wide spectrum of views on the principle and the detail of an ICS.

However, the GFIA's member associations have in common a deep understanding and respect for the regulatory regimes of the jurisdictions they serve in, and an understanding of the reasons why they have developed as they have. The development of local regimes has evolved in response to policyholders' and policymakers' experience of past events, historic risk appetite, the nature of local markets and products, and familiarity with established ways of achieving social aims. However desirable it may be, to be accepted, an international standard must take into account the limits of what is reasonable in local jurisdictions.

The GFIA therefore urges the IAIS to embrace a programme of incremental change, working with the grain of regulation as developed in local jurisdictions, and can make use of their proven effectiveness and reputation for fit for purpose regulation of insurance. Only once this has been achieved will the conditions be present in which the lead might be taken at the international level. And even then, events and disruptions will be perceived differently in different jurisdictions, and there will need to be a constant process of iteration between national, regional and international levels to ensure acceptance of progress in insurance regulation.

Global Federation of Insurance Associations (GFIA)
Secretariat: rue Montoyer 51, 1000 Brussels, Belgium
Tel: +32 2 894 30 81 E-mail: mihai@GFIAinsurance.org
www.GFIAinsurance.org

Within this context, the GFIA would like to highlight the two areas of the ICS proposals that are of the greatest shared importance to insurers globally:

- How the ICS will relate to existing capital regimes
- The type of measure the ICS would be

Finally, the GFIA hopes that the IAIS will re-consider its concerns around timelines.

How the ICS will relate to existing capital regimes

Local considerations in developing a global measure

At the IAIS Observer Hearing in October 2014, the GFIA highlighted the challenges of developing a global capital standard that would accommodate the specificities of local products and markets.

To give but a few examples, mortality improvement rates and volatility in mortality experience have varied globally and are heavily influenced by local conditions. Catastrophe risks, by their very nature, are localised. The risk measurement approach in health insurance depends on the level of healthcare expenses and the structure of healthcare providers. Markets for products such as health insurance, pensions and income protection are also shaped by the national governments' social and welfare policies.

It is important that the ICS framework reflects such local characteristics, and does not result in unintended consequences of either over-capitalising or reducing policyholder protection in other jurisdictions, or undermining local business practices. The GFIA believes that ensuring the continual availability of products across various markets should also be an important part of the ICS' considerations.

In addition to market specificities, capital regimes also vary. Supervisory frameworks differ in their objectives, including the desired level of policyholder protection (and/or financial stability) and are, in some cases, supplemented by policyholder protection or guarantee schemes. There is also divergence in key areas such as the valuation of assets and liabilities and the measurement of capital.

These differences mean that the final ICS framework must be sophisticated enough to deal with a range of products and markets around the world. It also needs to consider the degree of disruptive and costly change it could create.

A way for overcoming local differences

As outlined above, differences in local markets and regimes present a challenge in developing a global capital standard. Nevertheless, the GFIA believes that the development of an ICS is possible provided local regimes that are consistent with the ICS framework on an outcomes-based analysis are recognised as a suitable implementation of the ICS framework.

This approach has the additional advantage of allowing for compatibility and comparability between local supervisory regimes and the ICS, and ensures a level playing field within jurisdictions.

The type of measure the ICS would be

ICS as a minimum level and a framework for supervisory college review

The GFIA recognises the importance of effective supervision, including monitoring of internationally active insurance groups' solvency positions. The GFIA would, therefore, welcome efforts to make international supervision and the functioning of colleges more effective. At the same time, the GFIA notes that local supervisors remain responsible for prudential supervision, including any necessary intervention actions for insurers operating in their jurisdictions.

With this in mind, the GFIA envisages the ICS as a group-level framework, in the sense that it should facilitate discussions within colleges, rather than be a trigger for intervention. As an international tool, the ICS should enhance communication and mutual understanding among supervisors in a college. If group level monitoring presents issues, the supervisory college would be the appropriate forum for addressing them. Consequently, the ICS would help to develop a common understanding of risk and help Colleges make recommendations, and would not act as an additional system on top of local supervisory powers.

This monitoring, however, is very different from the issue of legal authority of one jurisdiction over another, and the ICS should not seek to include the "authority" of one supervisor to intervene in other jurisdictions. The GFIA believes this is consistent with the IAIS's vision for the ICS to be a global capital measure that does not affect existing arrangements or capital standards (paragraph 6).

To summarise, the GFIA believes that an ICS designed as a framework that delivers comparability of outcomes would play an important role in improving international supervisory understanding and co-operation, and facilitate discussions within colleges.

Concerns with ICS as a Prescribed Capital Requirement (PCR)

Setting the ICS as a PCR, with its breach triggering supervisory intervention (as suggested in paragraph 105), would likely create tensions with local regimes, produce unnecessary regulatory action due to volatility in the current proposal, and make capital and risk management difficult.

In particular, if the ICS imposes capital requirements that are materially different or in conflict with each Internationally Active Insurance Groups (IAIG)'s local regulatory regime, IAIGs, and/or their subsidiaries, could be placed at a competitive disadvantage compared to other insurers, and comparability within jurisdictions would be undermined.

For these reasons, the GFIA is not in favour of a PCR approach, and would prefer an ICS that serves as a framework to initiate supervisory college discussions.

Timelines for development and implementation

The timeline for developing the ICS remains overly ambitious. Experience from the GFIA's members involved in developing new local and regional capital regimes suggests that many years are needed to address technical issues, ensure unintended consequences are understood and carry out sufficient testing. 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 – and can be actually implemented - in all jurisdictions, despite varying governmental, legal and corporate structures, and function under both normal and crisis conditions.

Achieving an ICS which actually works as intended across the globe should take precedence over hitting an aggressive 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.
2. **Timing for implementation**, ensuring that the ICS will not have unintended consequences. In this respect, the GFIA welcomes the proposal for transitional measures.

Question 1 - Principles

In addition to the proposed ICS Principles, which are discussed below, the GFIA would suggest the introduction of the following objectives:

- The ICS should facilitate supervisory coordination and cooperation in the consolidation supervision of IAIGs (consistent with the primary objective of ComFrame).
- The ICS should not impede the development and growth of vibrant, innovative and competitive insurance markets.
- The ICS should not create competitive distortions within jurisdictions.

The GFIA would also like to specifically highlight that the ICS principles should consider the need for development of insurance markets in emerging economies as an important social need. The impact on the development needs and priorities of these markets should be evaluated throughout the course of the ICS's development.

Principle 2 – The main objective of the ICS are protection of policyholders and to contribute to financial stability

The GFIA believes that the primary goal of the ICS should be policyholder protection. It is not clear how the ICS might contribute to financial stability over and above solid local regimes, the measures specifically designed to address the perceived systemic risk posed by G-SIIs and the FSB's proposals for critical functions analysis. The GFIA is concerned that diluting the purpose of the ICS away from policyholder protection could set the required capital at an excessive level for some jurisdictions and impair policyholders' interests in the medium to longer term. In addition, given the trade-offs the additional complexity would involve, the GFIA suggests that, if there are any perceived concerns relating to IAIGs, these are best addressed through adequate group supervision.

Principle 3 – ICS is the foundation for HLA for G-SIIs

Members of the GFIA believe that it is too early to adopt Principle 3 because this would depend on the final nature of the HLA. Also, the BCR and the ICS are being developed with significantly different purposes and timelines, and transition from one to the other may not, therefore, be appropriate or effective.

Principle 5 – The ICS aims at comparability of outcomes across jurisdictions and therefore provides increased mutual understanding and greater confidence to cross-border analysis among group-wide and host supervisors

The GFIA supports the ICS's aim to achieve comparability on an outcomes basis. This is discussed in more detail in our response to Question 2.

Principle 7 – The ICS promotes prudentially sound behaviour while minimising pro-cyclical behaviour by supervisors and IAIGs

The GFIA agrees that avoidance of pro-cyclicality and artificial volatility must be a key aim of the ICS. Care needs to be taken to ensure that insurers' long-term business models, and in particular their ability to offer long-term products to customers, are not undermined by exaggerated exposure to short-term market volatility.

For life insurers in particular, the long-term nature of the business, as well as the link between assets and liabilities, requires a valuation approach for liabilities that takes 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.

Principle 8 – The ICS strikes an appropriate balance between risk sensitivity and simplicity

While GFIA understands the need for a balance between risk-sensitivity and simplicity, the GFIA believes that the key aim of the ICS should be that it 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 reinsurance, 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.

Principle 9 – The ICS is transparent, particularly with regard to the disclosure of final results

The GFIA agrees that ICS requirements should be reported in a transparent way. The nature and extent of disclosure requirements must, however, take into account the costs and benefits of providing the information and the protection needed for confidential information included in individual group reporting. The ICS disclosure should only be on an aggregate basis and should only commence once the ICS framework is fully tested and finalised, much like the confidential reporting included in the adopted BCR.

In addition, the principle should reflect that a transparent IAIS process for developing the ICS is as important as the clarity of reporting.

Question 2 - Comparability

The GFIA supports the comparability of outcomes in terms of policyholder protection as one of the ICS's objectives. The GFIA thinks that drawing inferences based on insurers' raw regulatory numbers and ratios alone should be done with caution even within home jurisdictions – and would be even more prone to perverse outcomes at the college level given the market and regime differences discussed earlier. On the other hand, an ICS which delivers comparability of outcomes could play an important role in enhancing discussions within colleges, which should be the key decision-making forum for most IAIGs.

In particular, the GFIA would welcome an approach whereby local regimes that are consistent with the ICS framework on an outcomes-based analysis are recognised as a suitable implementation of the ICS framework. The GFIA would like to specifically highlight that an option to use internal models, if these are part of local jurisdictional approaches, would contribute to the comparability of outcomes, by ensuring that all IAIGs' actual risk profiles are accurately captured.

Such an ICS delivering comparability of outcomes would form a useful basis for college discussions and would enhance mutual understanding. A college could reasonably take confidence from the knowledge that all supervisors present were working on capital requirements based on the same principles, with a common appreciation of risk and the value of risk mitigation actions. This might lead to improved trust between supervisors and, therefore, in due course to increased supervisory co-operation. The GFIA would welcome such enhanced supervisory co-operation, whose importance was underscored by the recent financial crisis.

Technical considerations

Internal models

Internal models (partial or full) should be allowed to determine solvency if these fit with local jurisdictional methods. The option to use internal models is very important for the ICS to avoid becoming hugely complex, while ensuring the ICS reflects the real risks across all the companies applying the ICS, enhancing the comparability of outcomes. 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. Better reflection of all firms' risk profiles will also contribute to the comparability of outcomes.

The use of internal models could be subject to governance mechanisms and supervisory approval, as proposed in the consultation document.

Margin Over Current Estimate (MOCE)

It is not clear whether MOCE is defined as a margin to recognize transfer value or a margin for prudence. We are concerned that inclusion of margins for prudence would duplicate the allowance for uncertainty that will be included within the ICS capital requirements. We note that the development of a comparable and consistent MOCE is a very challenging task and the inclusion of MOCE is not a pre-condition for the development of the ICS, but rather a driver for further complication.

Tiering of capital resources

Some members of the GFIA oppose the proposed tiering system of capital resources. The view of these members is that creating multiple tiers introduces unnecessary complexity for an international capital standard. Each jurisdiction may have rational reasons for incorporating different capital constructs. Insistence on a particular approach internationally for a segment of the industry could create competitive distortions locally. Subordination to policyholder liabilities should be the key determinant of whether a capital instrument should be recognised for ICS purposes.

Other members of the GFIA support for the QCR/ICS capital requirement ratio would depend on how the numerator and the denominator are defined.

Members who support the tiering of capital resources into two categories believe that the starting point for the determination of capital resources should be the excess of assets over liabilities plus subordinated liabilities. For this purpose, two tiers should be sufficient, and sub-limits should be avoided as much as possible. The classification should be based on ability to absorb risk.