EIOPA-IRSG-15-04

IRSG response to IAIS public consultation on Risk-based Global Insurance Capital Standard

Executive Summary

The IRSG supports the development of the global capital standard with the purpose to ensure increased resilience of the global financial system.

The IRSG would recommend IAIS to consider developing the global capital standard by taking a step-by-step approach where the IAIS is first fostering more alignment in existing solvency regimes before making the leap to a full global standard. The lessons learned as they unfold from various regional developments that currently take place in Europe (implementation of Solvency II in 2016 and subsequent years) as well as other jurisdictions, should be accounted for in the efforts towards convergence. A regulatory solvency framework such as the ICS is never benign. It has real impacts on companies, products, consumers, markets, and economies. The IAIS should absolutely prevent the development of duplicative standards and avoid local market competition is not distorted significantly. Decision making in insurance companies is already complex given existing regulatory, IFRS, rating agencies, tax and internal frameworks. All these various 'lenses on the business' give different views as to what is 'right'. Adding another regulatory system in the form of an ICS only further complicates management decision making, resulting in an increased cost of compromise. Policyholders will have to pay for this cost, without getting more protection in return.

Therefore it is very important that the IAIS confirms early in the development process that local regimes that are consistent (or above) the ICS minimum standard would be acknowledged as being a suitable implementation of the ICS framework.

Answers

Q1.1 (section 2.1): Are these principles appropriate as the foundation for a global consolidated insurance capital standard?

The IRSG generally support the principles and believe they provide a good foundation for the ICS. The principles will need to be reviewed/ revisited to ensure their appropriateness when the final details of the ICS have been settled.

Comments to ICS principle 3

- The **ICS should ensure a minimum standard of consumer protection.**

Comments to ICS principle 5

- The **comparability should be of quantifications of available and required capital** irrespective of the country the group is headquartered in.
- The ICS framework should be **designed such that political consensus can be achieved for legal implementation in each jurisdiction**. A unilateral implementation of the ICS in Europe only would not provide any benefit.

Comments to ICS principle 6

A "one size fits all" rules-based capital standard that generates the right risk management incentives for all IAIGs is not a viable objective. An alternative would be more extensive use of principles considering whether there are areas where different approaches would be allowed subject to prior supervisory approval (e.g. use of (partial) internal models, company specific parameters, company specific stresses).

Q1.2: Are any enhancements or modifications needed to the ICS Principles?

Any long-term ICS framework should satisfy the following substantive conditions:

- The underlying balance sheet should – eventually – be constructed following **bottom-up principles rather than building on adjustments to existing accounting regimes**. Adjustments to existing accounting regimes in order to arrive at market-adjusted values for assets and insurance liabilities are unlikely to yield comparable results due to conceptual

differences, which cannot easily be bridged by high-level adjustments.

- **Approved internal models should qualify for the calculation of the ICS capital requirement.** Internal models can adequately cover the spectrum of risk profiles of very diverse insurance groups. A standardized approach alone is unlikely to be flexible enough and could result in inaccurate capital requirements as compared to companies' true risk profiles.

Q2 (section 2.1): What does comparability mean for the ICS from your perspective?

The most important objective should be that the ICS is a reasonably accurate measure of available capital and risks, however the long term ICS framework should also ensure comparability of quantification of available and required capital. This should be reflected within the ICS principles.

Q3 (section 4): Should the IAIS consider integrating the measurement of some or all risks across different sectors?

IRSG support that the consolidated group-wide balance sheet should be the basis for measuring capital adequacy.

The IRSG do not agree with the integrated approach rather it should be based on a sensible sectorial approach that can cope with holding company debt allocated in a reasonable way. This is an important matter that should be further considered and co-ordinated with the banking regulators as appropriate.

If at all possible the situation already experience in EU should be avoided, where a financial conglomerate led by a mixed financial holding company (MFHC) need to apply solvency rules for various formations of part of the whole group, but all including that MFHC, according to conglomerate rules, banking group rules and insurance group rules, respectively.

Given the ICS is a group standard, various "group issues" will likely be very important and probably difficult. Examples are how to calculate the capital base in different kinds of groups and whether there a rules about capital fungibility between legal units of the IAIG. A lot of time will likely be needed to specify such rules and test them, and time should be allowed for that in the development of the ICS.

Q4 (section 5.1.1): Should the IAIS attempt to develop a consistent and comparable MOCE? Why or why not?

The IAIS should not develop a MOCE as part of the ICS framework. It will be a very challenging task to develop a comparable and consistent margin over current estimate (MOCE). Bearing in mind that the ICS is a minimum standard, the MOCE should be part of core capital. It can then be left up to local regimes if they include a MOCE in liability calculations.

Q5 (section 5.1.1): If the IAIS were to develop a consistent and comparable MOCE should it fulfil one of the possible purposes listed in paragraph 49 above? If yes, please explain. If no, what should be the purpose of the MOCE? Please explain.

As indicated in Question 4, the MOCE should be left as part of capital in the ICS. However, if the concept is to be defined then its purpose should be as a margin to recognise transfer value.

It should not be a margin for prudence in case liabilities are higher than expected, as this is the purpose of solvency capital and would create double counting and/or severely complicate calibration of the framework. Furthermore there should be no indication of the need to "derecognise future profit" as this interferes with the definition of capital as being equal to value of assets less value of liabilities. The future profits are simply recognition of the net value created, and available to absorb risk, because insurance companies gather and invest premiums which are in excess of the future claims to be paid out. The impact and risk of lapses/surrenders is reflected in the capital charge for surrender and any further de-recognition would be double counting.

As a part of capital, the MOCE calculation is not really needed, as its identification as a distinctive element would serve no clear purpose.

Q6 (section 5.1.1): If the IAIS were to develop a consistent and comparable MOCE, what principles should underlie its development?

The MOCE together with the Current Estimate of the insurance liabilities should ensure that this is equal to the value another insurer would be willing to pay to take over the obligations. Assumptions underlying both parts should be based on logical economic principles.

Q12 (section 5.1.3): What enhancements could be made to the IAIS prescribed yield curve used to discount insurance liabilities? In particular, what enhancement could be made to further consider procyclicality with reference to ICS Principle 7?

The IAIS may wish to consider the pro / cons of introducing a ultimate forward rate concept for the discounting rate curve and a spread risk component. That could help addressing volatility and pro-cyclicality.

Q14 (section 5.2): Would your IAIG/jurisdiction be likely to consider the use of a GAAP with adjustments valuation approach, and why?

Given the current lack of global accounting standards, the IRSG support the market-adjusted valuation approach as the most pragmatic approach to achieving a standard that the major insurance markets potentially can agree on.

In terms of what an ICS should look like from a more technical perspective, the recognition of the long term nature of insurance is paramount. Insurance companies provide policyholders with products that give them comfort/security around their long term financial future. Any regulatory standard for the insurance sector therefore should properly reflect the long term and highly illiquid nature of insurance business. Effectively, this means adopting a valuation basis that avoids showing artificial balance sheet volatility and avoids setting artificially short contract boundaries. The latter is especially damaging as it effectively reduces long-term liabilities to short-term liabilities, which obstructs long term investment into the general economy and earning the expected yield for the policyholders. It actually increases the insurance industry’s exposure to low interest rate environments.

While convergence of valuation principles should be targeted by the IAIS to the greatest extent possible, if supervisors and politics are satisfied with more than one approach to valuation, the actual choice of the calculation method should be left to the insurer, based on the following arguments:

- If under a global common standard several calculation methods are seen as equivalent, then each insurer must have the right to choose the method it likes, as otherwise a global level playing field would not be granted.
- This idea forms the basis of the current equivalence discussions under Solvency II: in order to secure a local level playing field,

certain countries are deemed to have a supervisory system that is equivalent to Solvency II.

- Not leaving the choice to the insurer would be misinterpreted by public stakeholders as it pretends full global comparability of diverging systems where there is no such comparability. Solvency figures and the financial strength of companies would thus be misinterpreted.

Q18 (section 6.2.1): Are there other key principles not included above that should be considered when assessing the quality of financial instruments for regulatory capital purposes? If so, please suggest other principles and the rationale for including them.

The quantifying capital resources (available Capital) should be determined as the excess of assets over liabilities plus subordinated liabilities. The tiering and quality of capital resources should be based on ability to absorb risk.

Q170: Comments on Section 1 – Introduction

See Executive Summary.

Q171: Comments on Section 2 – Insurance Capital Standard

The IRSG generally support many of the principles as a good foundation for the ICS. The principles will need to be reviewed/ revisited to ensure their appropriateness when the final details of the ICS have been settled.

A "one size fits all" rules-based capital standard that in itself generates the right risk management incentives for all IAIGs is not a viable objective. An alternative would be more extensive use of principles considering whether there are areas where different approaches would be allowed subject to supervisory approval e.g. use of (partial) internal models, company specific parameters, company specific stresses.

Q174: Comments on Section 3 – Scope of application

Once Solvency II is introduced in Europe, EU should be considered as one jurisdiction in line with, for example, the treatment of America as one jurisdiction.

An IAIG need not be dominated by insurance so are needs to be taken in defining the criteria for IAIG who fall under the Comframe requirements. It is unclear whether "total assets" is meant to be purely insurance assets. This should be clarified to avoid that a banking-dominated financial group with a miniscule insurance operation in three markets would be considered an IAIG. There appear to be a lot of discretion with the supervisor, which makes the rules less clear. The definition could be made clearer.

Q176: Comments on Section 5 – Valuation

The IRSG believes that the valuation principles and framework should be finalised as soon as possible given they provide the basis for determining exposure measures for the ICS as well as the qualifying capital resources against which the capital requirement is measured. In our view, it should be made clear, that all companies will be required to apply a consistent valuation approach for assets and liabilities. It should also not be left ambiguous as to whether jurisdictions will be allowed to apply significantly different valuations.

The IAIS should not develop a MOCE as part of the ICS framework. It will be a very challenging task to develop a comparable and consistent margin over current estimate (MOCE). Bearing in mind that the ICS is a minimum standard, the MOCE should be part of core capital. It can then be left up to local regimes if they include a MOCE in liability calculations.