# Response to IAIS consultation on the review of the IIM assessment methodology

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Insurance Europe welcomes the opportunity to provide feedback on the Individual Insurer Monitoring (IIM) assessment methodology.

## Key views on the IIM assessment methodology

- While recognising the IAIS's mandate to continually evolve and improve the IIM assessment methodology, the European insurance industry considers that the most important consideration should be to stabilise, or preferably streamline, the IIM data collection. Further additions to the templates and indicators are not considered to bring material benefits to the primary objective of the Global Monitoring Exercise (GME), ie to detect key risks and trends and the potential build-up of systemic risk, but instead create additional burdens for participating insurers. Insurance Europe does not support the IAIS decision to introduce five new ancillary liquidity indicators. The use of multiple indicators and time horizons is considered to be unnecessary given the low level of macroprudential liquidity risk in the insurance sector.
- Insurance Europe does not support the development of further ancillary indicators for reinsurance or credit risks. The need to develop such indicators does not appear to be substantiated by empirical evidence of macroprudential risks in the insurance sector.
- Insurance Europe does not support the removal of the financial guarantees indicator. The classification and weighting of systemically important activities in the scoring should depend not on insurance companies' current business model and activities but on the assessment of systemic relevance and systemic risks.
- The IAIS should foresee more time for participants to complete the IIM data request. Ideally, the timeline should be provided well in advance, along with the data template and technical specifications.

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## IIM scoring indicators

*Which (underlying) data rows would be necessary to monitor the different types of level 3 assets? If possible, also provide the technical specifications for these rows.*

N/A

*Which (underlying) data rows would be necessary to monitor illiquid/difficult to value assets held at historical cost or valued using other non-fair value methods? If possible, also provide the technical specifications for these rows*

N/A

*Which other refinements could be made to the level 3 assets indicator?*

- Collecting more granular data on Level 3 assets will not address the shortcomings of the current Level 3 asset indicator for the purpose of assessing asset liquidation risk under the IIM methodology.
- Level 3 assets need to be considered in the context of insurers asset/liability management (ALM), specifically the duration of the liabilities that the Level 3 assets are held to match.

*Which (underlying) data rows would be necessary to better capture (1) cross-border reinsurance exposures (ceded and assumed) and (2) the concentration risk of cross-border reinsurance in certain insurers or jurisdictions? If possible, also provide the technical specifications for these rows*

- The use of reinsurance is an effective risk mitigation technique and therefore primary insurers should not be disincentivised from purchasing reinsurance for fear of increasing their score in the interconnectedness indicator. Reinsurance enables insurers to strengthen their own solvency and expand their capacity to absorb different types of business and customer risk, both catastrophic and non-catastrophic. In addition, reinsurance helps insurers reduce the volatility of their earnings, accompanied by positive effects on capital costs, which insurers can pass on to policyholders, for example in the form of lower prices. Reinsurance has also driven the advances in catastrophe risk modelling capabilities, which are now so critical to adapting to climate-related physical risk.
- Reinsurance is fundamentally a cross-border business, and this feature is a specific characteristic of the reinsurance business model, not a risk *per se*. Professionally managed and well-capitalised reinsurance companies that are subject to solvency requirements should be able to operate in open markets worldwide to allow for an effective diversification of risks.
- Global reinsurers' business models are based on the widest possible distribution of risks (economies of scale) and the utilisation of diversification effects (economies of scope). They benefit from these economies by writing a large number of diversified risks in as many markets as possible. In contrast, any penalisation in the treatment of cross-border reinsurance compared to domestic reinsurance would run counter to the principle of diversification of risks and could lead to a concentration of risk in the domestic market. It is therefore crucial for firms with adequate expertise, appropriate risk-management tools and capital commensurate with the risks they assume to enjoy unrestricted worldwide access to markets, freedom of contract and complete fungibility of capital.
- Insurance Europe does not see any additional benefit in collecting more granular data and would advise against introducing further requirements, however should the IAIS nevertheless be determined to increase the granularity of data this could be achieved as follows:
    - including in the IIM template after row 27.1.C: Question 3 of the Qualitative Component (with an additional column for ceded premiums) or rows R17 to R20.1 of the reinsurance component of the SWM data collection (adjusted to also work for direct insurers' ceded premiums); and,
    - including in the IIM template after row 27.1.C: Question 13 of the Qualitative Component.

- Those new rows would make it possible to monitor the flows of ceded premiums (ie, "premium origin" and "premium destination") as well as the distribution of reinsurers assuming those flows in a proportionate manner.

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| *Which potential reinsurance ancillary indicator could be developed? If possible, also provide the data rows and technical specifications* |

- Insurance Europe does not consider it necessary or proportionate to invest more time and resources in defining another ancillary indicator and would strongly argue against developing a new ancillary indicator on reinsurance for the reasons already stated above.

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| *Which other refinements could be made to better capture reinsurance exposures under the intra-financial assets and liabilities indicators? If possible, also provide the technical specifications for these rows* |

N/A

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| *Which (underlying) data rows would be necessary to monitor the different types of derivatives? If possible, also provide the technical specifications for these rows* |

N/A

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| *Which other variables could be looked at to monitor derivatives exposures and their potential 'outward' risk, in addition to gross notional amounts?* |

N/A

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| *What is your assessment of the difference in systemic risk between the risk from OTC derivatives that are centrally cleared vs derivatives that are bilaterally settled?* |

N/A

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| *Should the hedging leverage in derivatives and repo exposures be monitored? If yes, how?* |

N/A

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| *Which (underlying) data rows would be necessary to monitor the potential outward risk of short-term funding? If possible, also provide the technical specifications for these rows* |

N/A

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| *Which other refinements could be made to the short-term funding indicator?* |

- Currently, row 43.4.d in the IIM template seeks the value of collateral, where the right to resell, re-use or re-hypothecate collateral is explicitly prohibited in the contract. The focus on contractual conditions rather than actual practice in this respect is too restrictive and may provide misleading results. The measure of securities lending should therefore be refined in the technical specifications for the IIM to exclude all securities finance transactions where collateral is held and not reinvested (whether this is due to contractual conditions or insurers' own risk-management appetite and practice).

*Do you have any feedback on the removal of financial guarantees as an indicator?*

- The weight for "financial guarantees", which was 9.4%, is now considered to be 0%. The IAIS justifies this with changes in business models and certain insurers' activities, which led to the fact that the financial guarantees indicator became immaterial from year-end 2016 to year-end 2021.
- However, Insurance Europe considers that the classification and weighting of systemically important activities in the scoring should not depend on the current business model and activities of insurance companies but on the assessment of systemic relevance and material systemic risks.
- If "financial guarantees" are seen as a systemically important activity, they should not be omitted from the IIM simply because the insurers deliberately avoid them.
- The negative consequence of removing "financial guarantees" indicator is that the weights of the other categories have been adjusted accordingly. This shifts the weight from a category that is underrepresented to one that is overrepresented. Consequently, the overall score will probably increase although the systemic relevance may have remained unchanged.
- What would the IAIS do if insurers cease to use derivatives or any other systemically important activities? Would they also set this category to zero and adjust the rest of the weights? That would suggest an increase in systemic risk when the opposite is the case.
- This highlights one of the problems in the current methodology, where the removal of an indicator increases the relative weight of other indicators, which can skew the results despite there being no other changes in the factors measured.

*Do you have any other feedback on any of the indicators?*

- The indicators are based on the data provided in the IIM template. The valuation basis of the various data cells is based on accounting standards. Insurance Europe questions whether this provides a good comparison basis and whether an economic valuation/fair-value basis would not be a better standard for comparison. This would allow for true comparability between indicators. Within a submission, amortised cost and fair-value data would be added to complete the rows as required.

*What is your view of the overall granularity of the IIM data template (Annex 1)?*

- On the granularity of the section on liquidity (2.10 row 33), one could question the details requested as there is no clear empirical evidence of the relevance of the split other than for the bucketing needed for the liquidity metrics.
- Technical specifications are, in many cases, unclear or not precise enough and participating insurers have to make their own interpretations. As an example, it is unclear whether securitisations should be included in rows 65.1 and 65.2.

## Indicator weighting

*Do you have any feedback on the updated indicator weighting?*

- See reply above to the question on the removal of the financial guarantees indicator.

## Insurer Pool selection criteria

*Do you have any feedback on the Insurer Pool selection criteria?*

N/A

## Reporting to participating insurers and the public

*Do you have any feedback on the Participating Insurer Reports?*

- The reports are factual and to the point. However, the IAIS could add the conclusion they would draw in comparison with the previous period and in comparison with the average benchmark.

In addition, Insurance Europe would like to highlight the following aspects of the data collection process:

- **Stability/streamlining of the data collection is paramount**
  - New data fields and qualitative components have been added every year with little notice before the changes were implemented. Many of the new data fields are not available from the financial statement and must be produced specifically for the IIM. Insurance Europe urges the IAIS to keep the IIM stable for the next three-year cycle.
  - Only a relatively small number of data fields (c.15%) are used for Participating Insurer Reports/indicators. The qualitative component is seen as providing low added value because answers are not comparable between participating insurers and there is a perception that the information collected does not inform the ultimate goal of the GME process, which is to detect the possible build-up of systemic risk in the global insurance sector. The continuing deletions and additions of data fields and qualitative components suggests that the majority of the information collected is not necessary.
- **The need to expand the data collected on reinsurance business is questionable**. The combination of the IIM quantitative template, the IIM qualitative questionnaire and the reinsurance component of the Sector Wide Monitoring (SWM) provides a lot of information on reinsurance exposures and cross-border reinsurance activities. It should also be remembered that reinsurance business is cross-border by nature; this is not a risk but the core of the reinsurance business model. Insurance Europe strongly recommends that the IAIS does not to develop new ancillary indicators before the lessons of the implementation of the liquidity indicators over the three-year cycle are learnt. The development of the liquidity ancillary indicators proved to be an onerous process and priority for all stakeholders should be given to get accustomed to them. Furthermore, on substance, Insurance Europe does not see the macroprudential value added of a reinsurance ancillary indicator for the reasons stated above.
- **More time should be given to participants to complete the IIM** and the timeline should be provided well in advance, along with the data template and technical specifications. The staff involved in the preparation of the IIM data collection are the same people involved in the year-end and quarterly closings and filings. The IIM timing overlaps with this work and creates a lot of stress on internal processes at a time when companies are revamping their systems and processes to apply the new IFRS accounting rules. Providing more time to populate the IIM and the timeline far in advance would allow the teams to fit this exercise into their planning more efficiently, ie, when a cycle ends and before a new cycle (a point in time different for each company, hence the longer period that should be provided to answer the survey).

*Do you have any feedback on the Global Insurance Market Report (GIMAR)?*

- As noted during the IAIS call on 10 January 2023, Insurance Europe considers the IAIS's decision to develop five liquidity metrics is unnecessary and should be streamlined.
- The IIM section of the 2022 GIMAR indicates that the IAIS performed trend analysis on data from the insurer pool. This indicates that the aggregate systemic risk score has been increasing over the past five years. However, it is not entirely clear from the report whether this is due to increases in the size of the pool, the insurers within it or insurers pivoting away from traditional activities towards those that are perceived to have the potential to give rise to systemic risk.

- The IIM section of the 2022 GIMAR report also provides a comparison of insurers’ systemic footprint with that of banks, using the scoring methodology based on indicators that are common to both global systemically important banks and the IAIS IIM methodology. This notes that insurer scores trended upwards (+14%) whereas bank scores trended slightly downwards (-3%). However, comparing the methodology scores between banks and insurers is not a good basis for assessing their comparative systemic footprint, given that the methodology is overly influenced by size. All banks undertake potentially systemic activities, and it follows that large banks will pose greater risk than smaller banks. The same is not true for insurers, where it is not the size of an insurer but particular activities that may be a source of potential systemic risk, and it will be the size of those potentially relevant activities in the context of the global financial system, rather than the insurance pool, that will be relevant.