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Response to IAIS consultation on Insurance Capital Standard as a Prescribed Capital Requirement

Our reference:	ECO-IAR-23-127	Date:	21/09/2023
Related documents:	Insurance Capital Standard as a Prescribed Capital Requirement		
Contact person:	Maryvonne Maetz Policy Advisor, International Affairs	E-mail:	international@insuranceeurope.eu
Pages:	18	Transparency Register ID	33213703459-54

General comments

Insurance Europe welcomes the opportunity to provide comments to the International Association of Insurance Supervisors (IAIS) on the Insurance Capital Standard (ICS) as a Prescribed Capital Requirement (PCR). The ICS project is of particular relevance to, and has an impact on, the European industry (EU member states, Switzerland and the UK) given that 28 out of 52 internationally active insurance groups (IAIGs) worldwide (ie, the majority) are European and that European (re)insurers are active globally.

Insurance Europe supports the initial objective of the ICS project to create a **high-quality and robust global insurance standard that promotes a sound and level global regulatory playing field.** It recognises that the IAIS is developing the ICS with the aim of "creating a common language for supervisory discussions" with the "ultimate goal of a single ICS that includes a common methodology by which one ICS achieves comparable — ie, similar but not identical — outcomes across jurisdictions" and that its objective is "to enhance global convergence among group capital standards".

However, given the diversity of views at the IAIS on how to deliver this outcome, the objective of the ICS has evolved over time to now only provide what the IAIS calls a "minimum standard" to be achieved through various methodologies, using the ICS as a reference or the Aggregation Method (AM) as an outcome equivalent. In that sense, the achievability of the initial objective is significantly put into question by the evolution of the nature of the ICS project.

Internal models

Insurance Europe particularly **appreciates the inclusion of internal and partial internal models** in the candidate ICS. For an effective, efficient, and robust capital standard, the inclusion of internal models should remain, provided that they are calibrated to a consistent (ie, the same or materially similar) confidence level, and they should be an inherent component of the core ICS standard rather than merely an implemented version of it.

Insurance Europe aisbl
Rue du Champ de Mars 23, B-1050 Brussels
Tel: +32 2 894 30 00
E-mail : info@insuranceeurope.eu
www.insuranceeurope.eu

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In Europe, internal models are a proven risk-management framework and tool which are inherently embedded in the solvency regimes. They are subject to extensive governance and validation requirements and approval by European supervisors. The proposals in the consultation to introduce similar requirements as part of the inclusion of internal models in the ICS are welcomed.

Internal models form a coherent whole and have proven to be an efficient mechanism to better capture the risk profiles of a company and should be recognised as such. Insurance Europe strongly opposes the inclusion of output floors as well as requirements for double reporting using the standard formula for internal model users. These would undermine the economic risk signals provided by internal models and are not needed as long as there is a robust supervisory validation process.

Technical specifications of the candidate ICS standard model

The ICS project has transitioned through several phases over the years, including the ICS, ICS 2.0 for field testing and now the candidate ICS. In addition, there has been extensive data collection and quantitative testing through the field-testing exercises and the monitoring period. The consequence of all these developments is that the technical specifications for the ICS have become overly detailed and prescriptive.

While there remain a number of important questions relating to the jurisdictional implementation of the ICS, Insurance Europe is not aware of any jurisdiction that will implement the ICS to the letter, using the technical specifications designed and calibrated by the IAIS. The ICS therefore is more of a theoretical example than a specific operational framework, like all other Insurance Core Principles. As such, the level of detail and granularity of the technical specifications seem to contradict the "example" approach. Implementational alignments at that level of detail, if that is what the IAIS is indeed aiming for, are actually an impediment to broader scale convergence (see 'Jurisdictional implementation of the ICS' below).

One aspect of the technical specifications that remains an outstanding concern is the margin over current estimates (MOCE). Putting aside Insurance Europe's long-held view that the MOCE should have been based on a cost of capital approach, the MOCE calibrations in the consultation create an unjustified and excessive prudential buffer. This underestimates the available capital, reducing risk-taking capacity for insurers and adversely impacting customer choice, products or prices. **The proposed calibrations of the MOCE should therefore be materially reduced.**

Jurisdictional implementation of the ICS

Insurance Europe supports **Solvency II, Solvency UK and the Swiss Solvency Test (SST) as the implementations of the ICS in the EU, the UK and Switzerland** respectively. These frameworks are based on a total balance-sheet/consolidated approach, are underpinned by economic valuation principles and convergent own fund criteria and are similarly risk-based in terms of target calibration. As such, they should be considered as an implementation of the ICS, without any further changes and with no double reporting requirements.

What implementation of the ICS will mean in practice and how this will be assessed is currently unclear. The IAIS in its consultation indicates that implementation of the ICS will vary significantly between IAIGs and supervisors and across regions due to different local circumstances but it is unclear, given the current prescriptiveness of the ICS, how such flexibility over implementation will be incorporated in the final standard.

From Insurance Europe's point of view, the goal of the ICS is to create **a common methodology that leads to comparable outcomes across jurisdictions**. To be considered a success, the ICS needs to be truly global and can only be considered global if all major jurisdictions commit to implementing it consistently.

Insurance Europe also **remains concerned that the AM approach is fundamentally different from the candidate ICS and risks undermining the objectives on which the ICS project was based** ("common language", "single ICS that includes a common methodology", etc). These objectives were the basis of industry support for the ICS project. Concerns also remain about the **lack of transparency regarding the development and comparability assessment of the AM.** Currently, the proposed AM approach remains unspecified and the process that the IAIS will use to assess its comparability with the ICS is as yet publicly undocumented. This is

contrary to the ICS, which has extensive, multi-level technical specifications and has been subject to field testing and monitoring. For the ICS to be "fit for implementation as a Prescribed Capital Requirement", it is vital that the comparability assessment exercise is sufficiently robust and quantitatively substantiated and transparent to ensure the same level of policyholder protection and not to undermine the key objective of a global standard for prudential supervision implemented across *all* major jurisdictions.

There should be no double reporting requirements.

When the ICS becomes a PCR, it is understood that it will only exist through the means of its legally enforceable transposition into local frameworks. Therefore, it should be the solvency requirements from the recognised frameworks that are used for the purpose of the global colleges of supervision or any other purposes (including the global monitoring exercise).

Consultation questions

Q1. *Do you have comments regarding the general guiding principles of the ICS?*

N/A

Q2 *Do you have comments regarding the perimeter of the ICS calculation?*

N/A

Q3 *Do you have comments on the introduction of a term structure of credit spreads for discounting?*

Insurance Europe takes note of the introduction of a term structure of credit spreads for discounting.
The benefits would be a more accurate reflection of the spread structure in the discounting. However, further assessment of this change to the methodology is needed to assess whether the benefits justify the additional complexity of such an approach. Nevertheless, to mitigate any potential complexities stemming from this approach, the ICS could indicate both a term and a level structure, as the latter is widely used by other solvency regimes and can be a reasonable alternative to the term structure.

Q4 *Do you have comments on the revised eligibility criteria for the Middle Bucket?*

Insurance Europe welcomes the efforts made by the IAIS in revising the eligibility criteria with the aim of reducing their restrictiveness for certain products. Insurance Europe believes that the following refinements would further improve the Middle Bucket criteria:

- Removal of criterion to manage the portfolio of assets and liabilities separately.
- Reconsideration of the requirements on surrender options and lapse risk.

Q5 *Do you have comments on the introduction of a modulation factor?*

Insurance Europe recognises that the inclusion of a mechanism to mitigate against durational overshooting can be merited from a prudential perspective.

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Q6 Do you have other comments regarding the Market-Adjusted Valuation?

Insurance Europe recognises the efforts that have been made to develop the MAV approach to better recognise the long-term nature of the insurance business model.

However, the result of these efforts is a relatively complex and prescriptive set of draft technical specifications. When finalising the standard, the IAIS should consider whether this level of granularity remains necessary and justified.

Discount curves — Insurance Europe would like to reemphasise the importance of recognising the long-term nature of the insurance sector and its capacity to avoid forced sales, making it less vulnerable to short-term market fluctuations. Insurance Europe broadly welcomes the changes the IAIS has made to integrate this characteristic in the design of the discount curves to avoid introducing any unintended volatility.
Insurance Europe supports a methodology to derive the discount rate that does not introduce artificial volatility. While the MAV approach proposed by the IAIS is potentially more complex than methods used by other prudential frameworks, it appears that the proposed approach to the derivation of the discount curve has the potential for effective implementation.

On L2-62: The methodology to derive the LTFR implies a relationship between risk-free rates, inflation and the central bank's inflation target. However, Insurancee Europe currently sees a situation in which the inflation targets and the observed inflation differ significantly. Should this situation prevail, the methodology as described in L2-62 could lead to results that are counterintuitive. In this case, the methodology should be reviewed.

MOCE — Despite Insurance Europe's long-held view that the MOCE should have been based on a cost of capital approach, the MOCE calibrations in the consultation lead to a level that is too high. In this regard, Insurance Europe declares its support for a lower calibration of the percentiles that would result in a significant reduction in the size of the MOCE for both life and non-life business. An appropriately calibrated MOCE would enhance insurers' capacity to take on risks and invest in the economy, while remaining sufficiently prudent.

In addition, as noted by the IAIS, "The MOCE covers the inherent uncertainty in the cash flows related to insurance obligations. As such, MOCE considers all uncertainties attached to these obligations." However, these uncertainties are already covered by the PCR which is calculated to a 99.5% VaR so the risk to policyholders from these uncertainties is already assessed elsewhere in the framework.

Management actions — Insurance Europe also considers that there should be an appropriate recognition, in L2-40 and L2-140, of the value of premium increase management actions for life reinsurance business in line with their economic value. Premium increases for reinsurance have the same economic impact as a reduction in discretionary benefits, since premiums and claims are paid simultaneously on a reinsurance treaty and the reinsurance premium increase has the same impact on net cashflow as a reduction in benefits paid. Under the treaty, reinsurance claim payments will be met on the basis that reinsurance premiums are paid. There are no such restrictions in terms of the reflection of management actions for life reinsurance business in similar but more stringent capital frameworks such as Solvency II.

Q7 Do you have comments on the changes regarding eligibility criteria for Tier 1 Limited and Tier 2 financial instruments? Please explain your response based on actual terms and conditions of instruments commonly issued by insurers.

The extensive and detailed ICS requirements in the area of capital resources can potentially lead to diverging impacts per jurisdiction — immediately after implementation as well as over time — keeping in mind that local rules around such instruments can differ significantly. For the established solvency standards in Europe, ie,

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Solvency II, Solvency UK and SST specifically, the local valuation and eligibility rules for determination of available capital resources should apply and be used as an implementation of the ICS to preserve the coherence of these existing frameworks.

Insurance Europe has the following specific remarks regarding capital resources:

- In comparison to ICS 2.0, the candidate ICS criteria for Tier 1 Limited instruments relaxed the general prohibition of all event calls other than tax and regulatory calls during the first five years (articles L2-112.e and L2-114.e). Insurance Europe welcomes this relaxation.
- However, the candidate ICS only allows such other event calls subject to prior "economic" (lower cost) replacement. In the case of event calls, the requirement for the cost of replacement instruments to be lower than those of the instrument to be called is not prudentially justifiable. The occurrence of an event that gives rise to an event call means that the instrument has become inefficient for rating, accounting or other purposes. Replacing the now inefficient instrument with a new, efficient instrument may make perfect economic sense even if the replacement instrument is more costly than the now inefficient instrument.
- The terms and conditions of the new (but efficient) instrument will likely have to differ from those of the old (but inefficient) instrument, and to the extent that efficiency requires terms that increase the economic risks borne by investors, the replacement instrument will be more costly than the old (but inefficient) instrument, all else being equal. Nonetheless, an issuer may want to make use of its call right to pay a higher spread (accept higher costs) in return for increasing the efficiency of the instrument. Yet the new Tier 1 Limited criteria (Candidate ICS) would prohibit the replacement.
- The concept of "economic replacement" is prudentially more meaningful in the context of ordinary calls, where the instrument to be called is typically fully efficient and thus more comparable with the potential replacement instrument. In the case of event calls, the candidate ICS does not require tax and regulatory calls to be "economic" (lower cost replacement). All other customary event calls including accounting, rating and clean-up calls should also be exempt from the requirement of economic replacement.
- Insurance Europe also points to the logical and prudential inconsistency of limiting event calls on the one hand, but allowing repurchases at any time (L2-112) on the other hand. Event calls have the benefit of a contractually defined call (redemption) price (typically at par). Event calls define a maximum redemption price. Limiting an issuer's ability to make use of event calls "forces" issuers to make a (more costly) repurchase instead.
- The recognition of Tier 2 non-paid-up capital resources should not depend on an IAIGs legal form or ownership as various insurers have access to non-paid-up capital that is external to the group, such as letters of credit. Tier 2 non-paid-up capital resources should form part of the Tier 2 capital resources and should be subject to the normal capital composition limits.
- The current 10% limit for Tier 2 non-paid-up capital resources is overly restrictive and can clash with jurisdictional solvency frameworks, ie, could create an unlevel playing field locally if IAIGs are subject to more restrictive limits than non-IAIGs and solo entities.

Specifically, regarding capital composition limits the following is noted:

- There should be no distinction in capital composition limits for mutuals and non-mutuals, in order to avoid an unlevel-playing field.
- The Tier 1 limited capital composition limit of 10% of the ICS capital requirement is too onerous and clashes with jurisdictional solvency frameworks, ie, it creates an unlevel playing field locally if IAIGs are subject to more restrictive limits than non-IAIGs and solo entities.

Finally, the determination of capital resources should not amount to an assessment of the features of the assets/liabilities that are included in computing the excess of assets over liabilities, or the underlying items in the undertaking's financial statements. As a result, Insurance Europe believes that L1-60b should be deleted.

Q8 Do you have comments on the introduction of a limit on non-controlling interests, such as the one specified in section 6.4.4?

N/A

Q9 Do you have other comments regarding capital resources?

Articles L2-116 and L2-117 allow holding companies to issue senior debt instruments to third parties. To the extent that proceeds are downstreamed as equity (capital resources) to insurance subsidiaries, they are considered as "structurally subordinated", which allows the senior bond proceeds to qualify as eligible Tier 2 own funds for the purposes of the ICS capital requirement.

While the practice of downstreaming senior bond proceeds in the form of equity contributes to the subsidiary's solo own funds, it does not benefit the group, as the group internal equity contribution cancels out on a group basis and the externally raised funding (senior bond) cannot absorb losses for the purposes of the group.

This is especially critical if the holding company issuing senior debt instruments is not an insurance company and would not be considered within the scope of the ICS. In this case, no double-counting would occur and the consolidation would not remove the subordinated debt from the balance sheet. Even if the ICS and the Aggregation Method developed by the US avoid double-counting by consolidating balance sheets, a holding company outside the calculation scope would not be affected and would enable the scenario described above.

Furthermore, structural subordination rests on the idea that the equity downstreamed to the subsidiary (and financed externally via the issuance of a senior bond) is effectively "locked" at the subsidiary level thanks to stringent regulatory oversight at the subsidiary (solo) level. In practice, solo regulation that is stringent enough to enforce structural subordination may well have to ignore the needs and interest of the wider group to which the relevant subsidiary (and the issuer of the senior bond) belongs. In other words, the subsidiaries' equity may not be available on a group-wide basis (no or insufficient transferability/fungibility). As a result, allowing senior debt as group own funds based on structural subordination is in conflict with allowing the same group to benefit from group diversification when calculating ICS capital resources. Insurance Europe proposes to disallow senior debt in group own funds, or, where an insurance group makes use of senior debt in its ICS group own funds calculation, to prohibit this group from benefitting from group diversification benefits.

According to article L2-128, the conversion of a Tier 1 Limited instrument into a Tier 1 unlimited instrument would be a possible PLAM. However, this form of conversion is considered very problematic, as it may accelerate a solvency crisis, since the issuance of shares in the middle of a crisis without a positive impact on the ICS ratio will put a lot of downward pressure on the share price. Note that the market will anticipate that, in addition to the share issuance resulting from PLAM, a major capital increase is likely to be necessary to address the solvency crisis, which exacerbates the pressure on the share price, posing a significant challenge to recapitalisation. Insurance Europe suggests that this form of a PLAM should be ruled out."

Q10 Do you have comments regarding the ICS risks and calculation methods?

It is essential that internal models (IM) are fully accepted if calibrated to a consistent (ie, the same or a materially similar) confidence level. The IAIS should therefore not prescribe additional requirements, such as capital floors, standard method benchmarking and reporting or internal capital targets that surpass the standard method's requisites.

The ICS should not include output floors for IM. They need to comply with extensive design and calibration standards to substantiate the calibration to the set confidence level. As a result, any deviation, eg, through an output floor, would be inappropriate and go against sound supervisory practices.

Similarly, deviations from the standard model results are to be expected for IM users because IMs are made to capture the idiosyncratic nature of each individual IAIG's business model. Double reporting (ie, of the IM numbers and standard model numbers) would only create cost and confusion. It could undermine the purpose of IM and their thorough and costly approval processes as well as undermining the sound and effective supervision of IMs.

Q11 Do you have comments regarding the grouping of policies for life insurance risks?

The suggested considerations for grouping life insurance risks are reasonable.

Q12 Do you have comments regarding the calculation of the Life risk charges?

Insurance Europe takes note of the calibration of the stress factors for mortality and longevity.
With regards to mortality risk, however, Insurance Europe considers applying flat mortality shocks to all geographies and age groups simultaneously to be unrealistic. More appropriate would be an approach that allows for diversification across geographies and across age groups.

In addition, offsetting effects should be considered because it would be more appropriate if the shocks were also applied to policies where an increase in mortality rates would lead to an increase in the NAV.
Furthermore, capital charges for mortality and longevity should not be cumulative as it is highly unlikely that both shocks would materialise together. Therefore, Insurance Europe suggests adopting the maximum of mortality and longevity capital charges.

Regarding **morbidity/disability risk** — the additional granularity within the ICS approach can result in complexity.

Regarding **lapse risk** — Insurance Europe believes that the current mass lapse stress factors are unnecessarily high. High surrenders at a certain moment or over a short period are very unlikely, particularly for life insurers, because policyholders usually buy life insurance products not only for investment purposes but also for protection against old-age poverty or to protect family members in the event of their own death.

Q13 Do you have comments regarding the calculation of the Non-life risk charges?

Insurance Europe generally supports the methodology to calculate the non-life risk charges. Insurance Europe would advise the IAIS to consider some regional diversification benefits within the area of EEA and Switzerland (such as northern Europe, eastern Europe, etc.). It also suggests the recalibration of the premium risk factors for general liability and non-proportional casualty and MAT and reserve risk factors for legal expenses as these seem to be excessively calibrated. The excessive calibrations highlight the challenge of accurately reflecting the underlying risks, especially in the context of risks that are considered as more complex. This further emphasizes the need to incorporate internal models into the final ICS, as they offer a more accurate and precise depiction of an insurance company's risk profile.

Q14 Do you have comments regarding the calculation of the Catastrophe risk charges?

N/A

Q15 Do you have comments regarding the list of market risks considered in the ICS, the general principles to calculate them and the way to aggregate them?

The list of market risks is considered comprehensive and the general calculation principles and approach to aggregating them are reasonable.

Q16 Do you have comments regarding the Interest Rate risk?

N/A

Q17 Do you have comments regarding the Non-Default Spread risk?

Insurance Europe fully supports the application of the Non-Default Spread Risk (NDSR) stresses to both assets and liabilities. This is a correct approach to determining the risk of fixed income investments for an insurance company with long-term and stable balance sheets.

Q18 Do you have comments on the differentiated treatment for investments in infrastructure equity?

N/A

Q19 Do you have comments on the inclusion of the Equity risk counter-cyclical measure (NAD)?

Care should be taken when including measures such as the counter-cyclical measure that basis risk inherent in some designs does not create, rather than mitigate, additional solvency volatility for insurers.

Q20 Do you have comments on the proposed design of the Equity risk counter-cyclical measure?

Insurance Europe does not have additional comments on the design of NAD but would advise that its application is made optional based on the undertaking's own professional judgement.

Q21 Do you have comments on whether the Equity risk counter-cyclical measure should allow for more granular calibrations to reflect geographical market specificities?

N/A

Q22 Do you have other comments regarding Equity risk?

Insurance Europe would encourage the IAIS to consider the inclusion of another category of long-term investment in equity, such as long-term equity and/or strategic equity, with suitable risk charges that represent the actual risks of such investments. This investment class is well recognised in other prudential frameworks (eg, Solvency II) and it is in line with insurers' ALM strategy.

Q23 Do you have comments regarding Real Estate risk?

Insurance Europe suggests a further reduction in the Real Estate charge, currently equal to a 25% decrease of real estate prices, to better align with the long-term nature and historically low market volatility of this asset class as evidenced by market data.

Q24 Do you have comments regarding Currency risk?

In the ICS, currency risk is assessed against the reporting currency of an IAIG. While this approach represents a shareholder protection perspective, a more appropriate approach to reflect a policyholder perspective would be to assess currency risk against a currency basket that is representative of the currencies in which claims arise. Nevertheless, the ICS should be formulated in a way that leaves implementing jurisdictions the flexibility to also choose such an approach to currency risk.

Q25 Do you have comments regarding Asset concentration risk?

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Insurance Europe would also advise considering a simple factor approach for exceeding of an exposure threshold which would result in a very similar impact while reducing the complexity greatly.

Insurance Europe would also like to highlight that the approach to asset concentration risk considers the contribution of individual counterparties to credit and equity risk charges, which is in contrast to the calculation of credit and equity risk modules that operate on a more aggregated level. Thus, a certain level of assumptions and loops within the process are required.

Q26 Do you have comments on the differentiated treatment for investments in infrastructure debt?

Insurance Europe supports the differentiated treatment of investments in infrastructure debt within credit risk.

Q27 Do you have other comments regarding Credit risk?

Insurance Europe suggests the IAIS reconsider its decision to treat internal ratings as non-rated, according to point (b) of L2-330, providing the internal rating process is well governed. This will serve to reduce reliance on external rating agencies, support the development of robust internal risk management processes and promote investment in emerging economies and others where ECAI ratings are not available. The treatment of internal ratings in combination with the very conservative stresses for non-rated credit exposures does not reflect the economic reality and leads to an unjustifiably high credit risk charge.

According to Article L1-131, the calculation of the credit risk charge takes management actions into account, which from Insurance Europe's understanding includes loss-absorbing effects from policyholder participation according to L2-40.

Article L2-304 prescribes that collateral does not offset the reinsurance exposure but rather only allows the redistribution of the exposure to the credit rating of the collateral rather than the reinsurer. It would be more economically accurate to allow the collateral to reduce the reinsurance exposure and hence the credit risk charge, which is also how it is treated under Solvency II. This would be more reflective of the reinsurance credit risk than the redistribution approach, which seems excessively punitive.

Q28 Do you have comments regarding Operational risk?

Insurance Europe notes that the IAIS has decided to reflect operational risk in the ICS by imposing factor-based capital charges. As recognised in IAIS ICP 17.7.4, however, operational risk is less readily quantifiable than other risks and is subject to data and valuation challenges. In view of this, ICP 17.7.4 also provides for supervisory tools other than imposing capital charges to control operational risk. This should be reflected in the ICS in order to ensure consistency between IAIGs and non-IAIG insurance undertakings.

While always arbitrary to some extent, Insurance Europe believes that compared to other frameworks and under the premise that this is the way a jurisdiction chooses to supervise operational risk, the overall approach to the calculation of operational risk is reasonable. However, Insurance Europe would advise that the IAIS:

- Considers the gross earned premiums as a premium and growth exposure instead of gross written premiums. Generally, gross earned premiums are a better proxy indicator for operational risk exposure as earned premium patterns are linked to the insurer's core business activities as well as the underlying overall risk of products.
- Liability is not a good representation of operational risk for products where the policyholder bears the investment risk. Insurance Europe would suggest using the expenses of these products as a proxy.

Q29 Do you have comments regarding the aggregation / diversification of ICS risk charges?

Insurance Europe takes note of the approach for aggregating ICS risks, and the way that their diversification is allowed in the ICS standard method.

However, the prescribed, top-down aggregation matrices are rather coarse and might be a bad reflection of the dependencies within an IAIG's risk profile. In order to reflect dependencies more appropriately, it is important that aggregation/diversification may be calculated in the ICS using supervisor-approved internal models.

Q30 Do you have comments regarding the optionality given to group-wide supervisors to require a calculation based on the Basel III approach for calculating risk charges for non-insurance non-banks financial entities?

N/A

Q31 Do you have comments regarding the optionality given to group-wide supervisors to require an additional risk charge for non-insurance, non-bank financial entities without a sectoral capital requirement where an operational risk charge would not capture all material risks?

N/A

Q32 Do you have other comments regarding non-insurance risk charges?

N/A

Q33 Do you have comments regarding the use of a simplified utilisation approach for tax?

Insurance Europe welcomes the introduction of a simplified utilisation approach for tax, but the application of the group effective tax rate (G-ETR) on MOCE might result in less accurate results than the application of an average weighted tax rate of insurance entities. This is more similar to Solvency II, where an entity-specific tax rate is applied to the Risk Margin. The G-ETR under the ICS includes both insurance and non-insurance entities

Q34 Do you have comments regarding the option given to the supervisor to require a more complex approach for tax?

Insurance Europe strongly advises against introducing additional complexities that would not meet the purpose of a minimum standard and would not be proportionate to the scope of the ICS. Insurance Europe suggests that any alternative approach to tax other than the simplified one, should follow local regulatory standards.

Q35 Do you have other comments regarding tax?

According to L1-149, the calculation of Deferred Tax Assets is based on the GAAP balance sheet. While L2-348 implies that the MOCE results in a DTA, it is unclear whether the DTA resulting from the risk margin on the GAAP balance sheet (eg, IFRS) is removed. If not, this would exaggerate the DTA value. It should be made clear that the Deferred Tax Assets and Liabilities are based on valuation and income differences between the ICS and the underlying tax balance sheets. Insurance Europe suggests clarifying that article L1-149 refers to the tax balance sheet as the starting point of the DTA calculation.

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Q36 Do you have comments regarding Other Methods for the calculation of the ICS capital requirement?

Insurance Europe is strongly supportive of the recognition of IM in the ICS, provided they achieve the same level of protection with a target criterion of 99.5% VaR over a one-year time horizon and there are no additional requirements to hold capital beyond this level.

IM are necessary to the management of groups whose risk profile are inappropriately reflected by the standard method and, as a result, are necessary to the proper functioning of the ICS. IM bring benefits to the resilience of individual insurance groups and to the resilience of the sector as a whole, such as:

- **Supporting a holistic understanding of risks**: IM play a crucial role in understanding risks holistically, particularly for large multinational (re)insurers operating in complex risk landscapes. These models effectively capture, in the most practical way, the diversification of benefits and risk concentrations within diverse global portfolios and their aggregation structure accurately represents the dependence between individual risk scenarios.
- **Better capturing the individual risk profile of a group:** IM analyse undertakings' risks in detail and their output is an adequate reflection of the company's risk profile.
- **Incentivising good risk management:** (Re)insurance groups thoroughly and carefully select the methods and parameters for their internal model calibration, ensuring accurate internal risk steering. The calibration process involves individual risk assessment and transparent procedures and it results in a unified risk measurement framework that is strongly anchored in the risk culture of the (re)insurer. Moreover, IM calibration improves the group's risk understanding and expertise, and contributes to the development of validation tools that can later be integrated into the regular risk management processes.
- **Supporting financial stability:** IM support financial stability in numerous ways. In particular, IM enhance the society's knowledge of risk by encouraging the development of specialised models, such as natcat modelling, and their refinement. Not only do they offer a more sophisticated approach to capturing risk and their interdependencies, but they can also incorporate new developments with greater ease, timeliness and flexibility. By ensuring that capital requirements reflect risks, internal models enable (re)insurers to continue to play an important stabilising role for the financial industry and the economy. In the case of a macroeconomic development, the use of IM will bring diversity in the evolution of the impact on the insurance market, treating risks in a more bespoke way and limiting the risk of all companies undertaking similar action at the same time.
  Further advantages of an individual risk measure are the reduction of herd mentality and the possibility to consider new developments quickly and flexibly.
  Indeed, IM contribute to solving the "problem of risk model homogeneity"[1] associated with "systemic fragility to the errors in [prescribed standard] models"[2].
- **Enhancing supervisory scrutiny and risk dialogue:** The process of developing and submitting IM for approval involves a substantial level of interaction between undertakings and supervisors resulting in benefits for both sides. This comprehensive dialogue has facilitated a more structured discussion between them, and it has also fostered a culture of improved internal controls, better governance oversight and enhanced documentation within companies. The requirements for model validation necessitate ongoing discussions, which are well-structured and organised, and the testing of assumptions, further strengthening the understanding between undertakings and regulatory bodies.

While Insurance Europe appreciates the inclusion of IM in the ICS, it is also important to stress that the ICS should not include output floors, as mentioned above (see Q10), and IM should be explicitly allowed as an alternative to the Standard Method and not on top of it.

[1] T. Heinrich, J. Sabuc, J. D. Farmer, *A simulation of the insurance industry: the problem of risk model homogeneity*, Journal of Economic Interaction and Coordination, 2020.
[2] Ditto

Insurance Europe also regrets that the candidate ICS does not recognise the possibility to use Group Specific Parameters (GSP) or Undertaking Specific Parameters (USP). Such features are already being accepted and recognised in other advanced frameworks, such as Solvency II, as they are proven to be appropriate tools to allow for better reflection of the risk profile of a group and/or undertaking, under clear conditions.

Overall, Insurance Europe considers features such as GSP, USP and internal models to be a clear sign of the level of maturity of a prudential framework and the capacity for insurers to rely on them should not be compromised by the ICS.

In light of the above, the IAIS is advised to remove references to reporting of standard method results when an internal model is used and, subsequently, to any output/capital floor or benchmarking.

Q37 Do you have comments regarding SOCCA processes?

N/A

Q38 Do you have comments on the overall requirements (section 9.4.1)?

Insurance Europe welcomes the recognition of IM in the ICS, although further improvements should be made to the Candidate ICS to properly capture the benefits of IM (see questions below for more detail).

Q39 Do you have comments on the general provisions on the use of an internal model to determine regulatory capital requirements (section 9.4.2)?

Insurance Europe is generally supportive of the use of IM to determine regulatory capital requirements, as set out in 9.4.2. However, further improvements could be made to the candidate ICS.

- Standard Method (SM) benchmarking
  - Insurance Europe strongly disagrees with the view that the standard method should be a benchmark for internal models (L2-371), as the only benchmark should be the risk profile of the group and not the SM which has already been deemed inappropriate. In this respect, the supervisory process should focus on ensuring that the IM is in line with the risk profile of the group, not about comparing it with the standard method. SM benchmarking is not justified and will not yield meaningful insights, while carrying additional unnecessary costs.
  - Similarly, the approval of an IM is currently based on the SM risk categories (L2-372). It is clear that IM must also cover all risks of the SM if they are material for the IAIG. However, it should be clear from the article that this is the intention rather than a standardisation of IM according to the SM. The freedom of modelling should be ensured by the ICS.

- Internal capital target
  - In addition, Insurance Europe disagrees with L2-363: IM should aim to have an internal capital target at the same VaR level as the standard method (99.5% VaR over a one-year horizon), not achieve a capital target greater than that. Indeed, this would inappropriately override ICS principle 10 and the general principle of L1-151 that provides that the target capital is the same level of protection under IM and the SM. Therefore, Insurance Europe suggests the removal of this requirement.

- Conditional approval
  - The introduction of a conditional approval (L2-374), especially with the option to define capital floors (see also below) based on the ICS, is seen as critical. Insurance Europe does not see the need for or benefit from adding this as a possible outcome of the approval process.

- Capital floors
  - Insurance Europe strongly opposes the imposition of capital floors to IM capital requirements as a pre-condition for their approval (L2-375). In particular, capital floors based on the ICS do not appropriately reflect the risk profile of the undertaking and would go against the purpose of IM. While capital add-ons could be temporarily justified, it is not the case for capital floors. In this respect, capital floors and similar measures based on the standard method should be ruled out.
  - Moreover, any model that is approved should not be changed by the GWS since the approval already implies that the IM yields at least the same risk protection as the standard method while reflecting the IAIG's risk profile more appropriately.

- Reporting and disclosure
  - The disclosure of the difference between IM and SM should be limited to their respective underlying assumptions — there is no policyholder protection interest in performing an undefined comparison.
  - Finally, Insurance Europe disagrees that the SM output should be required as part of the IM reporting as provided by L2-381. Running two parallel systems under IM and SM would be extremely burdensome and costly, without bringing any added value.

Q40 Do you have comments on the criteria for internal model approval (section 9.4.3)?

L2-408: An annual revision of model parameters would necessarily lead to a re-parametrisation of all model components for comparison. Such a re-parametrisation of all model components is a highly resource-intensive task with potentially little value. Insurance Europe suggest a lower frequency if the IAIG is compliant with all validation criteria and without any known model malfunction.

L1-163: IAIGs that use a different confidence level, risk measure or time horizon are required to ensure that policyholders and beneficiaries are provided with an equivalent or higher level of protection in comparison to the standard approach. It should be made clear that this is meant with respect to the confidence level by adding "[…] equivalent or higher level of protection than VaR 99.5% over the one-year time horizon." at the end of the paragraph. This is the confidence level applicable in Solvency II and Solvency UK while the TVaR 99% confidence level applicable in SST is deemed equivalent or more conservative in some situations.

L2-426: A full Back-Testing is highly dependent on appropriate data on realisations. There may not be this kind of appropriate data for each model component. Therefore, Insurance Europe thinks an addendum of "[…] where appropriate data is reasonably available." should be included. It may also not be feasible to maintain benchmark or alternative models on each component parallel to the model-in-use. Benchmark-testing is desirable but not a necessary step in model validation.

Q41 Do you have comments on the additional considerations (section 9.4.4)?

Insurance Europe would like to note that the additional considerations are generally reasonable but, nevertheless, it would suggest including criteria for the approximations of cumulative effects under L2-441 as, from a purely technological standpoint, it may not be feasible to maintain the functionality in multiple model versions.

Q42 Do you have comments on the general provisions on the use of partial internal models (PIM) (section 9.4.5)?

N/A

Q43 Do you have other comments regarding the use of internal models?

N/A

Q44 Do you have additional comments on the ICS?

See general comments above.

Q45 Do you anticipate any impacts from the implementation of the ICS on the new business strategy of IAIGs? If so, please explain the potential impacts.

It is difficult to assess the exact impact of the implementation of the ICS on the business strategy of IAIGs. However, if Solvency II, Solvency UK or SST, as expected, are the implementation of ICS, Insurance Europe does not expect significant changes to the business models of European IAIGs.

Nonetheless, in the event that the ICS imposes a duplication of requirements and creates an additional layer of supervision, material costs would be incurred in terms of IT infrastructure, resources and capital, which could have significant wider implications including on product pricing and product availability.

In order to reduce the imminent impact of introducing the ICS, local transitional measures should not affect the process of assessing the compatibility of local solvency regulations with the ICS. In particular, Insurance Europe suggests that any transitional measure that is already in effect in the local regulatory framework should not be considered when reviewing whether the framework is accepted as an implementation of the ICS.

Q46 Do you anticipate any impacts from the implementation of the ICS on the pricing of products of IAIGs and/or across the insurance industry? If so, please explain the potential impacts.

See response to question 45.

Q47 Do you anticipate any impacts from the implementation of the ICS on the range of product features available in the market (for example investment guarantees? If so, please explain the potential impacts.

See response to question 45.

Q48

Do you anticipate any impacts from the implementation of the ICS on the duration of products written (eg offering products with shorter-term guarantees)? If so, please describe the products that might be affected and the potential impacts.

See response to question 45.

Q49 Do you anticipate the implementation of the ICS resulting in an IAIG's withdrawal from writing specific types of products? If so, please describe the products that might be affected and the potential impacts.

See response to question 45.

Q50 Do you anticipate the implementation of the ICS requiring changes to risk appetite of IAIGs? If so, please explain the potential impacts.

See response to question 45.

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Q51 Do you anticipate any circumstances in which the implementation of the ICS might create or help resolve protection gaps (eg due to changes in product availability)? If so, please explain the potential impacts.

Insurance Europe does not expect a direct correlation between the ICS implementation and closing protection gaps on the basis that Solvency II "as is" will be the implementation in the EU. Indeed, Insurance Europe only foresees a limited impact on product availability, which is therefore unlikely to reduce the protection gap. However, should the ICS negatively impact pricing and product availability, this might actually lead to an increase in the protection gap.

Q52 Do you anticipate that any reduction in product availability from IAIGs could be filled by other market participants? If so, please explain the potential impacts.

Insurance Europe does not expect the ICS to lead to any compensation for a reduction in product availability by other market participants. Indeed, existing regulations already aim to ensure a level playing field and the ICS should not distort existing competition and level playing fields.

Q53 Do you anticipate any opportunities for an increase in the range of products available in the insurance market as a result of the implementation of the ICS? If so, please explain the potential opportunities.

See response to question 45.

Q54 Do you anticipate any impacts from the implementation of the ICS on the long-term strategy of IAIGs? If so, please explain the potential impacts.

See response to question 45. Insurance Europe believes that this will depend on the concrete implementation of the ICS.

Q55 Do you anticipate that the implementation of the ICS could lead to a change in the risk sensitivity of the solvency position of IAIGs? If so, please explain the potential impacts.

See response to question 45.

Q56 Do you anticipate that the implementation of the ICS could lead to a change in the profitability of an IAIG's business units or insurance entities focusing on a specific product type or market segment? If so, please describe the products or market segments potentially affected.

See response to question 45.

Q57 Do you anticipate any circumstances in which IAIGs will need to raise additional capital (beyond those currently anticipated) as a result of the implementation of the ICS? If so, please explain the potential impacts.

See response to question 45.

Q58 Do you have any concerns over the ability of IAIGs to raise capital or issue debt in the future as a result of the implementation of the ICS? If so, please explain the potential impacts.

See response to question 45.

Q59 Do you anticipate any circumstances in which IAIGs might change their risk management strategy as a result of the implementation of the ICS? If so, please explain the potential impacts.

See response to question 45.

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Q60 Do you anticipate any circumstances in which IAIGs might change their approach to risk mitigation as a result of the implementation of the ICS? If so, please explain the potential impacts.

See response to question 45

Q61 Do you anticipate circumstances in which IAIGs would re-structure their business as a direct result of the implementation of the ICS? If so, please explain the potential impacts.

See response to question 45

Q62 Do you anticipate any other changes to the operating model of IAIGs as a result of the implementation of the ICS? If so, please explain the potential impacts.

See response to question 45

Q63 Do you anticipate any changes to risk management practices across the insurance industry as a result of the implementation of the ICS? If so, please explain the potential impacts

See response to question 45

Q64 Do you anticipate any benefits to the business model of IAIGs as a result of the implementation of the ICS? If so, please explain the potential benefits.

In addition to the obvious advantage of having a globally accepted standard, if implemented in all jurisdictions to the same standard which enables consistent comparisons across IAIGs from various jurisdictions, Insurance Europe does not anticipate any other significant benefits arising from the implementation of the ICS.

However, considering that no jurisdictions appear to have committed to implement the ICS as per the technical specifications defined by the IAIS, and the development of the comparability with the Aggregation Method developed by the US, this question might not be entirely relevant.

See response to question 45 for more details.

Q65 Do you anticipate any impacts to the competitiveness of IAIGs relative to non-IAIGs with the implementation of the ICS?

See response to question 45. Insurance Europe believes that the ICS project should neither harm the competitiveness of IAIGs nor significantly disadvantage them when compared to non-IAIGs.

Q66 Do you anticipate any changes to the investment strategy of IAIGs which could lead to greater pro-cyclical behaviour, as a result of the implementation of the ICS? If so, please explain the potential impacts.

See response to question 45

Q67 Do you anticipate any changes to the investment strategy by other market participants which could lead to greater pro-cyclical behaviour, as a result of the implementation of the ICS? If so, please explain the potential impacts.

See response to question 45

Q68 Do you anticipate any impacts from the implementation of the ICS on asset concentration risk, either within IAIGs or across insurance markets? If so, please explain the potential impacts.

See response to question 45

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Q69 Do you anticipate the implementation of the ICS altering the investment strategy or investment decisions of IAIGs in response to stressed market conditions? If so, please explain the potential impacts.

See response to question 45. Moreover, Insurance Europe believes that insurers, due to their long-term nature, have the capacity to hold assets until maturity, making them resilient to short-term fluctuations and their ALM strategy is therefore not highly impacted during stressed market conditions.

Q70. Do you anticipate the implementation of the ICS resulting in a change in the market demand for specific asset classes (eg AAA / BBB rated corporate or government bonds, equities) driven by IAIGs? If so, please explain the potential impacts.

See response to question 45.

Q71 Are there any other areas of the financial markets (eg derivatives or stock lending) that might be impacted – directly or indirectly – by the implementation of the ICS? If so, please explain the potential impacts..

See response to question 45.

Q72. Do you have any concerns over the availability of longer-term assets in the market to meet any increase in demand from IAIGs as a result of the implementation of the ICS? If so, please explain the potential impacts.

See response to question 45.

Q73 Do you anticipate any increased risk to the broader financial markets (eg from re-allocations into or out of specific asset classes in response to shocks in financial markets) as a result of the implementation of the ICS? If so, please explain the potential impacts..

See response to question 45.

Q74 Do you anticipate any specific benefits to the insurance market or broader financial markets as a result of the implementation of the ICS? If so, please explain the potential benefits.

As per the response to question 45, Insurance Europe considers that the success of the ICS project will depend on its concrete implementation, as well as on the outcome of the ICS/AM comparability assessment. To reap the full benefits of the ICS, it will be important that the ICS becomes a truly global standard, implemented by most jurisdictions.

Q75 To the extent that it can be predicted, do you anticipate the insurance industry having to devote resources, including training, to implement the requirements of the ICS? If so, please explain the potential impacts..

See response to question 45.

Q76 To the extent that it can be predicted, do you anticipate impediments to implementing the requirements of the ICS? If so, please explain the potential impacts.

Insurance Europe considers that the ICS should be fully implemented through Solvency II, Solvency UK and the SST (“as is”). As a result, Insurance Europe does not foresee direct impediments linked to the implementation of the ICS, assuming that Solvency II will be considered compliant with the ICS.

Q77 Could any costs of implementing the ICS be absorbed by or shared with other implementation projects running concurrently (eg IFRS 17)? If so, please explain how this might be achieved.

Insurance Europe does not believe that these costs can be shared, given that the European industry has already fully implemented standards such as IFRS 17.

Q78 Do you anticipate any other impacts from the implementation of the ICS, not covered above? If so, please explain the potential impacts.

See response to question 45.

Insurance Europe is the European insurance and reinsurance federation. Through its 37 member bodies — the national insurance associations — it represents all types and sizes of insurance and reinsurance undertakings. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers pay out over €1 000bn annually — or €2.8bn a day — in claims, directly employ more than 920 000 people and invest over €10.6trn in the economy.