Insurance Europe submission
19 October 2016

Public Consultation on

Risk-based Global Insurance Capital Standard Version 1.0

Questions for Stakeholders

(this document follows the template provided by the IAIS)

3 Scope of group: perimeter of ICS calculation

Q1 Section 3 Should the IAIS further define the concept of an insurance-led financial conglomerate to give greater certainty to supervisors and IAIGs as to how the head of an IAIG will be identified in a complex conglomerate structure? If "yes", is the proposed definition a helpful start and if so what further specification is suggested?

☒ Yes ☐ No

Insurance Europe supports the initiative to define the concept of an insurance-led financial conglomerate and it proposes the following elements for the definition:

1) An insurance-led financial conglomerate means a financial conglomerate that the most important financial sector of which is insurance.

2) In order to determine the most important financial sector the following steps are needed:

2.1 For each financial sector one should calculate the average of:

- the ratio of the balance sheet total of that financial sector to the balance sheet total of the financial sector entities in the group and;
- the ratio of the solvency requirements of the same financial sector to the total solvency requirements of the financial sector entities in the group.

2.2 The most important financial sector in a financial conglomerate is the sector with the highest average.

2.3 For the purposes of calculating the average, the banking sector and the investment services sector shall be considered together.

Q2 Section 3 Are there any instances of groups likely to be identified as IAIGs where it is likely supervisory judgement will need to be exercised in determining the level at which the group consolidated balance sheet should be prepared for ICS purposes? If "yes", what is the nature of the uncertainty in identifying the Head of the IAIG?

☐ Yes ☐ No

No comments.

Q2.1 Section 3 If "yes" to Q2, is this uncertainty related to the insurance group or financial conglomerate forming part of a wider group? If "yes", please describe concerns with identifying the correct Head of the IAIG.

☐ Yes ☒ No

No comments

Q3 Section 3 Given the description of entities to be included in the consolidation for ICS purposes, are there uncertainties as to material entities that should be included within the perimeter of the ICS calculation? If "yes", for which types of entities are supervisors and IAIGs most likely to benefit from greater specification of the scope of the group?

☐ Yes ☐ No

No comments

Q4 Section 3 Are there any further comments on this section on the scope of group that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

The IAIS should use the data of the 2016 FT exercise to assess the scope of groups and to ensure that the envisaged approach is applied consistently across jurisdictions.

While the IAIS offers possibilities for exemption of related entities within the ICS, Insurance Europe believes that differences in scope of consolidation between GAAP and ICS can potentially create confusion, unnecessary additional work, and can pose problems for reconciliations. In many instances this will also imply manual adjustments. Insurance Europe believes that the alignment of consolidation approaches will enhance the transparency and understandability of public data, limit the additional review work of the second and third line as well as of external auditors.

4 Valuation

4.1 Market-adjusted valuation (MAV) approach

4.1.1 MAV general approach

Q5 Section 4.1.1 Do the adjustments to GAAP specified in the 2016 Field Testing Technical Specifications for the construction of the MAV balance sheet succeed in providing a largely comparable picture of the financial situation of IAIGs and a consistent basis for the calculation of the ICS? Please explain.

☐ Yes ☒ No

It is key that, if the ICS targets all IAIGs, then it should be ensured that that same risks are measured in the same way, independent of the jurisdiction where a specific IAIG is based. In this context, it is key to ensure that the valuation basis is as comparable and convergent as possible, and will generate the same outcomes for required and available capital. The IAIS should therefore ensure that all necessary adjustments are made to statutory accounts in order to achieve a consistent and comparable MAV across all IAIGs.

In addition, when considering the adjustments on the liabilities side, all the assets that are used by an insurer to cover those liabilities should be recognised (eg bonds/loans, equity).

Q6 Section 4.1.1 Are there any other material areas of divergence across existing GAAPs (or statutory accounts) that should be subject to adjustments when constructing the MAV balance sheet? If "yes", please explain.

☐ Yes ☐ No

No comments

4.1.3 Contract boundaries

Q7 Section 4.1.3 Should MAV include a more economic approach to contract boundaries (eg renewal rate and stability of premiums) rather than focusing on contractual or legal aspects? If "yes", why would this provide a better assessment of the solvency position of IAIGs?

☐ Yes ☐ No

No comments

Q8 Section 4.1.3 If an economic approach were adopted, would that make the determination of the contract boundaries more complicated? Please explain.

☐ Yes ☐ No

No comments

Q9 Section 4.1.3 If an economic approach were adopted, the calibration of some ICS risk charges would need to be revised to capture the different exposure to risks (eg Lapse risk). What areas of the ICS capital requirement would be affected and how? Please explain in terms of the defined risks in the ICS capital requirement.

No comments

Q10 Section 4.1.3 To ensure the overall consistency of the framework, the definition of MOCE would need to be reviewed following the adoption of an economic approach to contract boundaries. Would a change to an economic approach to contract boundaries impact the specification of MOCE? Please explain.

☐ Yes ☐ No

No comments

Q11 Section 4.1.3 If material amounts of future business were included in the valuation of insurance liabilities through the consideration of future expected renewals, would the resulting capital resources (future profits) continue to meet the criteria for inclusion in Tier 1 (eg regarding the criterion on availability)? Please explain.

☐ Yes ☐ No

No comments

Q12 Section 4.1.3 Would other components of the ICS, be affected by such change? If "yes", please specify those components and provide an explanation.

☐ Yes ☐ No

The alignment should be done between the current estimate contract boundaries and the volumes of premiums that should be taken into account in the calculation of the ICS to ensure that ICS is calculated and based on the real risk covered by IAIGs.

4.1.4 Discounting

4.1.4.3 IAIS' response to stakeholder comments and Field Testing results

Q13 Section 4.1.4.3 Is the current 3-segment approach to the definition of IAIS base yield curves a sound basis to determine the base yield curve? Please explain.

☒ Yes ☐ No

Insurance Europe supports the three segment approach proposed by the IAIS.

Q14 Section 4.1.4.3 The base yield curves are based on either swaps or government bonds, depending on the liquidity of the underlying markets. Are any of the IAIS' choices of either swaps or government bonds as a basis for determining individual currency yield curves as set out in Table 4 inappropriate? If "yes", for which currencies is the choice inappropriate? Please explain your answer.

☐ Yes ☐ No

No comments

Q15 Section 4.1.4.3 For each currency, the extrapolation period begins at the point where the market for the instruments used no longer fulfils the criteria for being considered deep, liquid and transparent. Is the starting point of Segment 2 inappropriate for any currency? If "yes", for which currencies is the starting point inappropriate? Please explain.

☐ Yes ☐ No

No comments

Q16 Section 4.1.4.3 Currently, the IAIS has adopted the simplification that Segment 3 should start at maturity 60 for all currencies. Should the IAIS continue with this simplification? If "yes", are there any necessary amendments to that approach? If "no", should the IAIS seek to adopt a different approach to determining the start of Segment 3 based on one of the following options?

☐ Yes ☒ No

No comments

Q16.1 Section 4.1.4.3 Should the IAIS harmonise the length of Segment 2 at a set number of years? If "yes", what should be the length of Segment 2?

☐ Yes ☐ No

No comments

Q16.2 Section 4.1.4.3 Should the IAIS consider determining a minimum convergence point as well as a consistent convergence time and take a maximum of the last point of Segment 1 plus the consistent convergence time and the minimum convergence point? If "yes", what should be the consistent convergence time and minimum convergence point?

☐ Yes ☐ No

No comments

Q17 Section 4.1.4.3 The proposed LTFR is based on a macroeconomic approach using OECD information. Is this methodology appropriate? Please explain.

☐ Yes ☒ No

Insurance Europe does not support the current approach, and notes that the OECD data is not replicable. A better alternative would be to derive the LTFR based on long-term interest rates and inflation.

Q17.1 Section 4.1.4.3 If "no" to Q17, should the IAIS develop an alternative methodology to derive the LTFR? Please provide an outline of such an alternative methodology.

☒ Yes ☐ No

Insurance Europe believes that the IAIS should develop an alternative methodology to derive the LTFR, by which the LTFR should be defined as the sum of:

- long-term expected real interest rates; and
- expected inflation.

In order to derive the long-term expected interest rates, the IAIS should consider an approach based on historical averages. LTFR should be stable and robust, representing a very long term equilibrium of short term nominal rates

Q18 Section 4.1.4.3 The discounting approach is based on a stable macro-economic long-term anchor while the methodology to derive it may show drifts or even steps over time. Should the IAIS also address the issue of frequency of assessment and ways to update the LTFR? If "yes", please provide details of how the IAIS should address the issue of frequency of assessment and ways to update the LTFR.

☒ Yes ☐ No

The issue of frequency of assessment and ways to update the LTFR is a key element of the valuation framework and should be given appropriate consideration. Insurance Europe proposes the following:

- The UFR should be based on **long-term expectations** and thereby provide a stable anchor for the calculation of discount yields.
- The LTFR should be defined as a stable long-term parameter and the LTFR should not in itself become a source of volatility. The IAIS should aim to avoid both volatility and uncertainty

regarding the prudential valuation of technical provisions and capital requirements. The IAIS should therefore aim to recalibrate the UFR at sufficiently relevant intervals, that allow insurers an appropriate projection of expectations. Insurance Europe supports a **recalibration of the LTFR every 10 years**.

- **Changes to the LTFR, once triggered by the methodology, should be spread in a predictable way over a number of years**. An annual limit for the change in the LTFR should be defined. Insurance Europe supports an annual limit of 10 basis points.

Q19 Section 4.1.4.3 Do you have any other proposals for refinement of the methodology to derive the base yield curves? If "yes", please provide a detailed rationale for your suggestions.

☐ Yes ☐ No

No comments

4.1.4.4 Policy issues regarding the design of the adjustment

Q20 Section 4.1.4.4 Which approach to portfolio selection, as a basis for the calculation of the credit spread adjustment, is more appropriate for the MAV approach, taking into account the need to ensure a balance between complexity, comparability and basis risk? Please explain.

Insurance Europe supports a consistent valuation basis to be part of the ICS. This should ensure that the long-term nature of the business and asset/liability management are appropriately reflected and artificial volatility in available capital is avoided. The ICS should rely on an economic approach in which:

- Assets are valued at market value.
- Liabilities are valued based on current estimates and projected cash-flows are discounted using a discount rate that reflects the nature of the business and how assets match liabilities.

Insurers' investments are a consequence of the nature and profile of their liabilities, therefore it makes perfect sense, from an economic perspective, that the valuation approach for liabilities reflects the assets that cover the liabilities. Such reflection would in fact act as a good risk management incentive and it can be implemented with a bucketing approach, by creating buckets of liabilities and matching them with the corresponding assets, as a starting point for the valuation.

When calculating the credit spread adjustment for the discounting of the liabilities, the IAIS should consider not only fixed income assets, but also equity assets – in line with industry practice. The ability to adopt and maintain a long-term view in the management of assets is provided by the duration of the liabilities at large, including free surplus. Insurers are not exposed to forced sales on a one-year basis and the short-term volatility of assets is" hedged" by the duration of the holdings, be it on a line by line basis (bonds held to maturity) or through the percentage of target asset allocation (common stocks). Such asset management strategies permit enhanced diversification of the asset portfolio improving key indicators such as profitability, liquidity and solvency. They also lead to a countercyclical investment behaviour whereby insurers not only avoid forced sales but actively manage their assets on the underlying risk factors of the assets. Therefore, from a holistic balance sheet approach and in line with asset/liability management, equity holdings should be reflected in the calculation of the spread intended for the adjustment to the risk free curve.

Insurance Europe supports the IAIS objective of avoiding excessive balance sheet volatility caused by short-term market fluctuations. Asset/liability management practices are different across insurers and they should have an impact on the valuation of the liabilities. More specifically, for those assets and liabilities subject to the same ALM approach, a similar valuation is needed to ensure consistency.

As a general comment on valuation, Insurance Europe highlights that, in order to reflect the differences in ALM between insurers, there should be flexibility to choose a discounting method that reflects the link between assets and liabilities and the way in which assets and liabilities are managed. From this perspective, it makes sense that the IAIS proposes alternatives that are, together, able to cover and reflect differences in ALM across companies. Given the valuation solutions currently proposed by the IAIS, Insurance Europe would like to share the following comments:

- Insurance Europe supports, as a valuation alternative, a discounting approach based on spreads calculated on actual asset returns. This approach needs to also have as option to take into account the appropriate hypothecation of assets to liability buckets at firm level for the purpose of liability valuation. In such a case the liquidity of the liabilities is the most appropriate criteria to allocate liabilities to different valuation buckets and differences in characteristics of liabilities should justify the identification of more than one bucket. Where liabilities are illiquid and cannot be surrendered or withdrawn, as a minimum there should at least be one bucket with a 100% application ratio. For other liabilities, Insurance Europe would expect the liquidity of hypothecated assets should already reflect the liquidity necessary to meet liabilities - and therefore would already be reflected in the adjustment to the discount rate. As a consequence, a 100% application ratio should also be used.
- Some companies may take asset/liability management strategies that would not justify a bucketing approach for liabilities, but would still be expected to earn spread over time. Insurance Europe supports, as a valuation alternative, an approach based on a representative portfolio, taking into account the liabilities and the asset earned rate at currency/jurisdiction level. This approach is in line with liability-driven investment strategies and Insurance Europe supports a discounting approach based on spreads calculated by firms on actual asset returns in the representative portfolio.
- In addition, an option based on a "weighted average of multiple reference portfolios linked to the assets held by the firm" should be available for more tailored asset portfolios based on the group's assets composition.

As highlighted above, it is important that any approach recognizing the link between assets and liabilities is not limited to bonds and loans, but also includes other assets, such as equity, mortgage loans and property.

As a general comment, Insurance Europe believes that the IAIS should continue the to test the proposed valuation alternatives, and also consider, in its analysis, the potential impact of a range of financial and economic environments.

Q21 Section 4.1.4.4 Is it appropriate to have entity-specific elements in the valuation of insurance liabilities?

☒ Yes ☐ No

No comments

Q21.1 Section 4.1.4.4 If "yes" to Q21, to what extent is this appropriate?

It is fully appropriate to reflect both asset/liability management and a company's specific situation in the valuation framework. In fact, the framework should incentivise asset liability management and reward insurers that have managed to optimise the link between assets and liabilities. It should be recognised that insurers may decide to optimise either based on a total balance sheet approach including own funds, or based on a hypothecation of assets to specific liability buckets.

Q21.2 Section 4.1.4.4 If "yes" to Q21, how can that be aligned with the market-based nature of the framework (evident in the approach used to value assets) and the need to protect all policyholders in an equal manner, independently of the individual choices made by each IAIG, as discussed above?

Insurance Europe does not agree with the IAIS observation that firm-specific adjustments are "not consistent with a MAV methodology". As long as the assets are measured at market value, a reflection of the assets' characteristics on the liabilities side of the balance sheet remains market consistent.

Comparability between IAIGs is ensured by the simple fact that the same methodology is applied for assets and liabilities to all of them.

Regarding the potentially higher risk embedded in higher yield assets, this should be reflected on the capital requirements side so that comparability between IAIGs will be ensured as long as the same methodology for capital requirements is applied.

Q22 Section 4.1.4.4 Is it important for the valuation framework, together with the capital requirement framework, to not provide incentives for low quality investments undermining policyholder protection? Please explain.

☒ Yes ☐ No

The following two key principles are key for answering this question:

1) A prudential framework (including its approach to valuation and capital requirements) should not be designed to create incentives/disincentives for investments. It should rather be focused on reflecting the business model and the actual risks faced by the undertaking.
2) Under a risk-based framework, undertakings should not be subjected to investment limits, but instead should be allowed to invest in the widest range of assets that they consider appropriate, as long as they are able to cover the relevant capital requirements. Equally important, these capital requirements should be calibrated to reflect the actual risks that undertakings are exposed to when investing.
3) A risk-based framework should be able to recognise that diversification of the investment portfolio is beneficial and can enhance investment performance to the benefit of policyholders.
4) It should be noted that incentives for good risk management can and should also be of qualitative rather than quantitative nature. For example, risk management policies and the application of the prudent person principle are a safeguard to ensure that the investments are not detrimental to the interests of the policyholders.

Q22.1 Section 4.1.4.4 If "yes" to Q22, is the capping of the contribution to the Adjustment to that of a comparable BBB asset an effective way of achieving that objective? Please explain.

☐ Yes ☐ No

No comments

Q22.2 Section 4.1.4.4 If "no" to Q22.1, what other approaches could the IAIS explore to achieve that objective?

No comments

Q23 Section 4.1.4.4 Should insurance liabilities be segregated into buckets for the purpose of applying the credit spread adjustment?

☐ Yes ☐ No

No comments

Q23.1 Section 4.1.4.4 If "yes" to Q23, which criteria are appropriate to allocate liabilities to the different buckets?

Q23.2 Section 4.1.4.4 If "yes" to Q23, what is an appropriate number of buckets?

See answer to Q20

Q23.3 Section 4.1.4.4 If "yes" to Q23, what should be the application ratios associated with each bucket?

See answer to Q20

Q23.4 Section 4.1.4.4 If" no" to Q23, as an alternative to a criterion for predictability of insurance liabilities, could partial risk transfer to policyholders (eg market value adjusted products) be a criterion for determining the credit spread adjustment?

No comments

Q24 Section 4.1.4.4 Does the ability of IAIGs to earn credit spreads above the risk-free interest rates in a risk-free manner depend on the IAIGs' ability to match liability cash-flows with asset cash-flows? Please explain.

☐ Yes ☐ No

No comments

Q25 Section 4.1.4.4 What level of granularity is more appropriate for the calculation of the credit spread adjustment? Please justify your answer.

☒ A single spread adjustment calculated and then applied to the different buckets (if more than one) using different application ratios.

☒ The IAIG identifies different classes or combinations of assets backing specific classes of liabilities associated with each bucket, calculating different credit spread adjustments for each bucket on the basis of the groups of assets identified.

Please refer to answer to Q20.

Q26 Section 4.1.4.4 In the absence of requirements concerning asset-liability matching and ring-fencing, should supervisors require the proposed allocation be demonstrated and maintained throughout the lifetime of the corresponding insurance liabilities? Please explain and if "yes", how could this be achieved?

☐ Yes ☐ No

No comments

Q27 Section 4.1.4.4 Is the proposed approach for calculating the adjustments for default reasonable? If "no", please explain how it could be improved.

☐ Yes ☐ No

No comments

Q28 Section 4.1.4.4 Should the IAIS consider introducing an adjustment to the LTFR? If "yes", what would be the technical rationale for an adjustment to the LTFR and which methodologies should the IAIS explore?

☐ Yes ☐ No

No comments

Q29 Section 4.1.4.4 Is there a way to avoid or mitigate the issue of "inverted risk profile" (as described in Section 4.1.4.4)? If "yes", please explain.

☐ Yes ☐ No

No comments

Q30 Section 4.1.4.4 Is the move to an adjustment defined as an absolute change (in bps) to the base yield curve appropriate, rather than a proportional movement? Please explain.

☐ Yes ☐ No

No comments

4.1.4.5 Options for adjustments to base yield curves – 2016 Field Testing

Q31 Section 4.1.4.5 Which of the proposed options strikes a better balance between the different policy issues under consideration by the IAIS? Please explain.

Reference methods should ensure a common basis for the valuation of liabilities and for ICS calculation.

Insurance Europe believes that the "asset earned rate" approach should be included as an option, rather than as a reference method. As indicated in the response to Q 20, Insurance Europe supports the option(s) that a) best reflect the link between assets and liabilities, including by bucketing liabilities and assets and b) minimise artificial volatility in capital resources.

Q31.1 Section 4.1.4.5 Could the chosen option be modified to make it even more appropriate? If "yes", please provide details of the suggested modifications to the chosen option.

☐ Yes ☐ No

No comments

4.1.5 General comments

Q32 Section 4.1.5 Are there any further comments on MAV that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

Insurance Europe believes that the IAIS should take the necessary time and invest the necessary efforts to ensure that:

- The valuation approach(es) appropriately reflect insurers' business model, and in particular the link between assets and liabilities. An "asset earned rate" valuation method, reflecting the link between assets and liabilities specific to every company, would often be the most appropriate valuation method, able to best address balance sheet volatility. In fact, the AOCI adjustment for GAAP plus allows for a full recognition of illiquidity premium of assets backing liabilities, so a similar principle should be envisaged in the MAV approach.
- The valuation approaches should be based on consistent principles and lead to substantially the same outcomes. Once the valuation approaches are finalised, a company should be given the choice of which approach to choose and a supervisor should be agnostic to the choice.

4.2 GAAP with adjustments

4.2.5 2016 Field Testing

Q33 Section 4.2.5 The AOCI adjustment is proposed to only apply to unrealised gains and losses related to debt securities backing long-term liabilities where it is more likely than not that the unrealised gains and losses would not be realised. Is this an appropriate way to segregate non-economic volatility from the fair value measurement of investments in debt securities? If "no", what alternative would you propose, and why?

☐ Yes ☐ No

No comments

Q34 Section 4.2.5 Are there any refinements that should be made to identify assets backing long-term liabilities for purposes of the AOCI adjustment? For example, would a bucketing approach similar to that proposed for assets under MAV discounting option 3 (based on liquidity characteristics of the liabilities) be an appropriate way to identify assets backing long-term liabilities? Please explain.

☐ Yes ☐ No

No comments

Q35 Section 4.2.5 Is the "more likely than not" criterion to exclude certain unrealised gain/losses an appropriate element of the AOCI adjustment calculation? Please explain.

☐ Yes ☐ No

No comments

Q35.1 Section 4.2.5 Is this an appropriate way to segregate assets where unrealised gain/loss is more likely than not to be realised? If "no" what alternative would you propose and why?

☐ Yes ☐ No

No comments

Q36 Section 4.2.5 Are there specific asset classes that should be included in the "more likely than not" category? If "yes", please explain.

☐ Yes ☐ No

No comments

Q37 Section 4.2.5 Is a default risk adjustment appropriate? Please explain.

☐ Yes ☐ No

No comments

Q38 Section 4.2.5 A possible method for calculating the default risk adjustment is to reference the credit rating at purchase (or previous write down) as compared to the current rating. The change in rating can be used to determine the portion of the credit spread related to default risk. Is this an appropriate method to estimate the unrealised loss related to default risk? Please explain. If "no", please suggest an alternative method that could be used to calculate the default risk spread.

☐ Yes ☐ No

No comments

Q39 Section 4.2.5 It has been suggested by some Volunteer IAIGs that the default risk spread could be highly volatile in certain periods of stress. Are there methods to evaluate this volatility over historically relevant periods, and is appropriate data available to do so? Please explain.

☐ Yes ☐ No

No comments

Q40 Section 4.2.5 Do the GAAP Plus principles and guidelines constitute a sufficient basis for the specification of an ICS Valuation Approach that fulfils the ICS Principles as defined by the IAIS? Please explain.

☐ Yes ☐ No

No comments

Q41 Section 4.2.5 Are there any internal inconsistencies in the GAAP Plus jurisdictional examples as outlined in the 2016 Field Testing Technical Specifications, or any area which is not aligned with the stated GAAP Plus principles and guidelines? If "yes", please explain what you would propose to amend in the examples.

☐x Yes ☐ No

The starkest differences arise between the US GAAP and European Solvency II bases, which are each considered to be GAAP+ but clearly reflect different bases of presentation with one being a historic accounting financial statement basis and the other being a market consistent regulatory basis.

Q42 Section 4.2.5 Under GAAP Plus there are differences between jurisdictions in the approach to valuing assets. Should all assets be valued under the same approach (whether that be fair value or a mix of cost and fair value) for all jurisdictions? Please explain.

☐ Yes ☐ No

No comments

Q43 Section 4.2.5 Under GAAP Plus there are differences between jurisdictions in the approach to valuing liabilities. Should all liabilities be valued under the same approach whether that be closer to book value or market value for all jurisdictions? Please explain.

☐ Yes ☐ No

No comments

Q44 Section 4.2.5 Are there any refinements that could be made to lead to a more comparable valuation outcome for insurance liabilities between jurisdictions? Please explain.

☐ Yes ☐ No

No comments

Q45 Section 4.2.5 A method for aggregating financial data for U.S. Statutory only filers has been developed for GAAP Plus (see section 7.3.2 of the 2016 Field Testing Technical Specifications). Does this method capture all material elements such that the resulting aggregated financial statements would be materially equivalent to U.S. GAAP consolidated statements? If "no", please provide details of other elements or adjustments that could address any material differences.

☐ Yes ☐ No

No comments

Q46 Section 4.2.5 Is there a way to evaluate the impacts of these proposed accounting standards on the ICS, and more specifically on GAAP Plus, in the absence of current data and prior to the implementation of the rules? Please explain.

☐ Yes ☐ No

No comments

4.2.6 General comments

Q47 Section 4.2.6 Are there any further comments on GAAP Plus that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

Insurance Europe believes that the IAIS should take the necessary time and invest the necessary efforts to ensure that:

- The valuation approach(es) appropriately reflect insurers' business model, and in particular the link between assets and liabilities. An "asset earned rate" valuation method, reflecting the link between assets and liabilities specific to every company, would often be the most appropriate valuation method, able to best address balance sheet volatility. In fact, the AOCI adjustment for GAAP plus allows for a full recognition of illiquidity premium of assets backing liabilities, so a similar principle should be envisaged in the MAV approach.
- The valuation approaches should be based on consistent principles and lead to substantially the same outcomes. Once the valuation approaches are finalised, a company should be given the choice of which approach to choose and a supervisor should be agnostic to the choice.

4.3 Margin Over Current Estimate (MOCE)

4.3.5 Open issues for consultation

Q48 Section 4.3.5 With respect to the CC MOCE calculations (both prudence and cost of capital approaches), are there any particular issues with the way that GAAP Plus liabilities are calculated that would necessitate a difference in the calculation of a CC MOCE under GAAP Plus from the CC MOCE under MAV? If "yes", please explain.

☐ Yes ☐ No

No comments

4.3.5.1 Cost of capital approach

Q49 Section 4.3.5.1 *Margin observed in actual market transactions* - Based on your experience or any data analysis, are you able to observe or estimate the value of market transactions of insurance liabilities in comparison with the current estimate as defined in the MAV? If "yes", what value do you observe or estimate related to the current estimates (to be differentiated by type of liabilities, if appropriate). Please provide evidence or references to support the response.

☐ Yes ☐ No

No comments

Q50 Section 4.3.5.1 *Cost of capital parameter* - Should the hurdle cost of capital parameter be:

☐ Fixed? If "yes", how should it be determined? Click here to enter text.

☒ Linked to another economic variable in order, in particular, to reflect different economic environments? If "yes", which economic variable should be used (eg interest rate curve, spread level…)? Click here to enter text.

☐ Determined with reference to a minimum (hurdle) level that could be different from the average observed level? If "yes", please explain why and how this should be reflected. Click here to enter text.

☐ Based on a broad equity market or on insurance-specific measures? If "yes", please explain.

The cost of capital rate should be a function of interest rates, to capture the sensitivity of the overall balance sheet to market interest rates.

Q51 Section 4.3.5.1 *Projection of capital requirement* - Are the risks to be included in the projected capital requirement appropriate? If "no", please explain which risks should be excluded/added and why.

☐ Yes ☐ No

No comments

Q52 Section 4.3.5.1 *Projection of capital requirement* - Is the calculation of the global projected capital requirement appropriate? If "no", please suggest amendment(s) with supporting rationale.

☐ Yes ☐ No

No comments

Q53 Section 4.3.5.1 *Projection of capital requirement* - Is the approach to project the future capital requirements as part of the standard method appropriate considering the trade-off between accuracy/risk sensitivity and simplicity (eg outgoing cash flows excluding maturity benefit for Mortality risk or sums a risk)? If "no", please suggest and justify any proposed amendment.

☐ Yes ☐ No

No comments

Q54 Section 4.3.5.1 *Projection of capital requirement* - Is an IAIG's ICS capital requirement (99.5% one-year VaR) the appropriate amount of capital on which to base the CoC MOCE? If "no", please provide an alternative suggestion with rationale.

☐ Yes ☐ No

No comments

Q55 Section 4.3.5.1 *Projection of capital requirement* - Should the projected future capital requirements reflect minimal, average, or optimal diversification benefits (considering a willing buyer which is likely to achieve a conceivable synergy from the transaction)? If "yes", how can the diversification benefit be reflected in the CoC MOCE calculation?

☒ Yes ☐ No

Any diversification benefits recognised in the determination of capital requirements should also be recognised in the MOCE.

Q56 Section 4.3.5.1 *Discount factor* - If Market risks and most of the Credit risk are excluded from the projection of the future capital requirements as per the 2016 Field Testing Technical Specifications, does this imply that such MOCE only allows a recapitalisation where no Market risk and only limited Credit risk could be supported (ie with not enough resources to take on market risks)? If "no", please explain.

☐ Yes ☐ No

No comments

Q57 Section 4.3.5.1 *Discount factor* - If no Market risk and only limited Credit risk could be supported by the level of recapitalisation allowed by the level of MOCE, then should the future return from invested assets free of Market risk and Credit risk be the risk free rate? If "no", please explain.

☐ Yes ☐ No

No comments

Q58 Section 4.3.5.1 *Discount factor* - Assuming that the answers to the two questions above are "yes" then is it consistent to discount the projected future capital requirement by the risk free rate? If "no", please provide an alternative suggestion with rationale.

☐ Yes ☐ No

No comments

Q59 Section 4.3.5.1 *Discount factor* - Should the discount factor be linked in some way to the hurdle rate (cost of capital parameter)? If "yes", please provide an alternative suggestion to discounting at risk free rate and the rationale.

☐ Yes ☐ No

No comments

Q60 Section 4.3.5.1 *Interaction with capital resources and capital requirement* - Should the CoC MOCE be part of the valuation of insurance liabilities and not included in capital resources? If "no", please explain.

☐ Yes ☒ No

Insurance Europe does not believe that the introduction of MOCE is necessary. In fact, a transfer MOCE would only be necessary if there is a need for transfer, so from this perspective MOCE could be seen as a reference point for the supervisor with the understanding that interventions should occur before the breaching of the MOCE, in order to allow for a transfer of portfolio.

In addition, any risk associated to uncertainty of cash flows is already reflected in the capital requirements so, if a MOCE was calculated, it should not be treated as a liability.

Q61 Section 4.3.5.1 *Interaction with capital resources and capital requirement* - Is holding the CoC MOCE, in addition to a 99.5% VaR calibrated capital requirement, a condition to ensure that the IAIG remains prudentially viable with a 99.5% probability (by providing the cost to serve a level of capital meeting the supervisory capital requirement)? If "no", please explain.

☐ Yes ☐ No

No comments

Q62 Section 4.3.5.1 *Interaction with capital resources and capital requirement* - If CoC MOCE is targeted to a level of prudential viability, is the current definition of capital resources appropriate? If "no", please explain, including details of what level of prudential viability should be maintained, and whether other forms of capital resources should be considered for that purpose.

☐ Yes ☐ No

No comments

Q63 Section 4.3.5.1 *Interaction with capital resources and capital requirement* - Is there any double counting between the CoC MOCE and the capital requirement? Please explain.

☒ Yes ☐ No

No comments

4.3.5.2 P-MOCE approach

Q64 Section 4.3.5.2 Should the P-MOCE be loss absorbing? Please explain and if "yes", elaborate on the circumstance(s) in which this loss absorption may occur.

☐ Yes ☐ No

No comments

Q65 Section 4.3.5.2 Should the P-MOCE be stressed along with other balance sheet items in the calculation of the ICS capital requirement? Please explain.

☐ Yes ☐ No

No comments

4.3.6 General comments

Q66 Section 4.3.6 Are there any further comments on MOCE that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

Please refer to our answer to question 60.

4.4 Reinsurance recognition

Q67 Section 4.4 Should all reinsurance contracts be identified using a consistent definition across all jurisdictions? If "yes", please propose a definition.

Yes ☐ No

No comments

Q68 Section 4.4 Considering proportionality and the desire for pragmatism, would it be appropriate to limit a consistent approach across jurisdictions to only certain types of reinsurance contracts? If "yes", what kind of contracts? Please explain.

☐ Yes ☐ No

No comments

4.4.1 General comments

Q69 Section 4.4.1 Are there any further comments on reinsurance recognition that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

Please refer to our answer to question 67.

5 Capital resources

5.3 Open issues for consultation

5.3.1 Principal loss absorbency mechanism

Q70 Section 5.3.1 Should Tier 1 Limited financial instruments be required to have a principal loss absorbency mechanism?

☒ Yes ☐ No

Q70.1 Section 5.3.1 If "no" to Q70, should the principal be considered to provide loss absorbency on a going concern basis? Please explain how the instrument demonstrates loss absorbency on a going concern basis.

☐ Yes ☐ No

No comments

5.3.2 Financial instruments issued by consolidated subsidiaries of the IAIG and held by third parties

Q71 Section 5.3.2 Is there an objective methodology that the IAIS could use to determine the amount of financial instruments issued by consolidated subsidiaries of the IAIG and held by third parties that is not available to the group for the protection of policyholders of the IAIG? Please explain.

☒ Yes ☐ No

One possible way to ensure that financial instruments issued by a consolidated subsidiary are used only for the protection of its own policyholders could be to limit the subsidiary's consolidated capital at IAIG level. Such a limit should be at least equal to the subsidiary's capital requirement.

However, if the issuing entity is an intermediate holding company that is not an insurance subsidiary and so does not have a capital requirement, a more subjective measure would be required. This could be along the lines of demonstrating the assets of the entity being available to support losses elsewhere in the group.

5.3.3 Treatment of items deducted from Tier 1 (DTAs, computer software intangibles, net defined benefit pension plan surplus asset)

Q72 Section 5.3.3 Is there an objective methodology that the IAIS could use to determine the amount that should be added back to Tier 2 for those items deducted from Tier 1? Please explain.

☒ Yes ☐ No

In principle, there should be no limit to the recognition of the three items as mentioned and the quality of capital resources should be approached from both a quantitative and a qualitative perspective.

The software intangible assets should only be recognised if a transfer of the corresponding amounts is possible or when it can be demonstrated that these items are critical for the operations of the insurer. The operational costs related to the IT systems, including possible software costs, are included in the best estimate so, for symmetry reasons, it makes sense to include these in Tier 1.

Similarly, in the case of the DTA, if a recoverability analysis can be demonstrated (also based on accounting standards) the amounts should not be restricted. For example, if DTAs could be recovered on a going concern basis, the amount of recoverable could be added to Tier 1. In the case where an IAIG relies too much on DTA to cover capital requirements, the supervisor should discuss the quality of capital in the context of the supervisory review process and ask for sensitivity analysis within the ORSA.

The pension surpluses should also not be restricted if it can be demonstrated that these amounts are actually available without consequences.

5.3.4 Structural vs contractual subordination (treatment of senior debt)

Q73 Section 5.3.4 Is structural subordination sufficient to guarantee that policyholders will be paid first in a winding up? Please explain.

☐ Yes ☐ No

No comments

Q74 Section 5.3.4 Does structural subordination produce the same outcomes as legal or contractual subordination? Please explain.

☐ Yes ☐ No

No comments

5.3.5 Mutual IAIGs

Q75 Section 5.3.5 Is a requirement for supervisory approval prior to the redemption of a financial instrument at contractual maturity sufficient for that instrument to be considered perpetual? Please explain.

☐ Yes ☐ No

No comments

Q76 Section 5.3.5 Is a requirement for supervisory approval of distributions prior to contractual maturity (eg interest payments, dividends) sufficient for the distributions to be considered non-cumulative? Please explain.

☐ Yes ☐ No

No comments

Q77 Section 5.3.5 Do existing financial instruments issued by mutual IAIGs (for example, but not limited to surplus notes, Kikin and other forms of subordinated financial instruments) absorb losses on a going concern basis? Please identify which instrument and explain.

☐ Yes ☐ No

No comments

Q78 Section 5.3.5 Should the Tier 1 criteria (unlimited or limited) be changed in some way to better classify the financial instruments of mutual IAIGs? Please explain.

☐ Yes ☐ No

No comments

Q79 Section 5.3.5 What would prevent mutual IAIGs from issuing other financial instruments that meet the qualifying criteria for Tier 1 capital resources as set out in the 2016 Field Testing Technical Specifications? Please explain.

No comments

5.3.6 Non-paid-up capital

Q80 Section 5.3.6 Should non-paid-up items be included in ICS qualifying capital resources? Please explain.

☒ Yes ☐ No

Insurance Europe believes that non-paid up items should be part of tier 2, subject to appropriate qualifying criteria. Non-paid up capital items, when subject to reasonable safeguards, constitute a reliable form of capital, recognised in existing regulatory capital regimes. Prohibiting or significantly restricting their use as qualifying capital resources would be unnecessarily restrictive, reducing insurers' capital flexibility without enhancing policyholder protection or financial stability.

If the IAIS is minded to restrict the use of non-paid up capital items, it should, before taking action, conduct a detailed and transparent review of the use of non-paid up capital in the insurance sector, to ensure that any regulatory action is based on evidence and fully justified in the light of IAIS and ICS objectives.

There should not be a closed list of non-paid up elements. Instead, the quality and diversity of capital instruments should be part of the internal scrutiny included in risk management / capital management / ORSA exercises. This section will be part of the ongoing dialogue between supervisors and insurers as part of the supervisory review process.

Non-paid up tier 1 elements should be classified as tier 2 until they are paid up.

Q80.1 Section 5.3.6 If "yes" to Q80, do the qualifying criteria set out in the 2016 Technical Specifications capture all the requirements that should be applied to the assessment of non-paid up items? Please explain.

☐ Yes ☐ No

No comments

Q81 Section 5.3.6 If non-paid-up capital items are permitted, is the capital composition limit proposed in 2016 Technical Specifications appropriate? If "no", how should the limit be set?

☐ Yes ☒ No

A limitation to 10% of the ICS capital requirement is not appropriate. No justification has been presented as to why this is the right level of restriction and there is no evidence that a higher limit would pose unacceptable risks to policyholders.

Non-paid-up items will include letters of credit, which have proved a reliable source of capital. As an unconditional obligation on a bank to pay (and therefore not contingent) they are fully and immediately available and able to absorb losses.

Insurance Europe believes that a separate capital composition limit should not be set for non-paid-up items. The limit on Tier 2 capital resources is sufficient.

Insurance Europe also questions whether the use of non-paid-up capital by field testing participants will be on a sufficient scale for field testing to reach useful conclusions on the appropriateness of this capital composition limit.

5.3.7 Capital composition limits

Q82 Section 5.3.7 What theoretical basis could the IAIS use to determine appropriate capital composition limits?

No comments

5.3.8 Prior supervisory approval for redemption of financial instruments

Q83 Section 5.3.8 When should prior supervisory approval of the redemption of a financial instrument issued by an IAIG be required?

☒ At its effective maturity date.

☒ At its contractual maturity date.

Otherwise. Please explain.

It should be required for both unless there is a lock in, i.e. cannot redeem where there is non-compliance with capital requirements.

Q83.1 Section 5.3.8 Should any other factors (eg lock-in and amortisation) be taken into consideration? Please explain.

☒ Yes ☐ No

The local supervisor could require a delay of the redemption.

Q84 Section 5.3.8 Does a lock-in feature provide the same safeguard as supervisory approval prior to redemption of a financial instrument? Please explain.

☐ Yes ☐ No

No comments

Q84.1 Section 5.3.8 If "yes" to Q84, should the ICS qualifying criteria be amended to remove the requirement for prior supervisory approval where a financial instrument possesses a lock-in feature? Please explain.

☐ Yes ☐ No

No comments

5.3.9 Treatment of Accumulated Other Comprehensive Income (AOCI)

Q85 Section 5.3.9 Do any of the above AOCI elements provide loss absorbing capacity on a going concern basis? Please provide an explanation as to how the element(s) absorbs losses.

☒ Yes ☐ No

When assessing the loss absorbing capacity of these items the IAIS should also consider the losses itself and the DTAs related to these items. The treatment should be symmetrical. If these items are considered to be of a lower loss absorbency this feature should also factor in the calculation of the capital requirement. For instance, unrealised losses of an Asset for Sale (AFS) instrument should not lead to a capital requirement if the unrealised result is not accepted as part of the capital resources.

Q86 Section 5.3.9 Are there any additional elements that are included in AOCI under specific jurisdictional GAAPs that could be considered to be loss absorbing on a going concern basis, and therefore should be included in capital resources? Please explain.

☐ Yes ☐ No

No comments

5.3.10 Treatment of insurance liability/reinsurance adjustment offset

Q87 Section 5.3.10 Is the definition of insurance liability/reinsurance adjustment offset as described appropriate? Please explain.

☐ Yes ☒ No

Insurance Europe does not support this calculation, as it is comparing a prudential balance sheet with a financial balance sheet, which is not meaningful as the two are developed with different purposes. The difference only indicates the level of prudence in various (and not comparable) GAAP balance sheets. The difference does not imply that any of the capital under the MAV balance sheet is of an inferior quality. Moreover, the ICS requirements already capture the risk associated in the total net assets when stresses are applied to the total balance sheet.

Q88 Section 5.3.10 Are there any valuation adjustment amounts that should be included or excluded? Please explain.

☐ Yes ☐ No

No comments

Q89 Section 5.3.10 Would the inclusion of insurance liability/reinsurance adjustment offset generate significant volatility in capital resources? If "yes", how should the volatility be addressed?

☒ Yes ☐ No

The IAIS should recognise that increased volatility will be inherent in any economic balance sheet and there is no reason to link it to the difference with an accounting balance sheet. The volatility should be addressed by an appropriate valuation basis for assets and liabilities.

5.4 General comments

Q90 Section 5.4 Are there any further comments on capital resources that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

As a more general comment, the IAIS should consider transitional arrangements to allow companies to adapt to new requirements without major distortions in their capital and risk management. The period over which transitional measures would apply should extend substantially beyond the planned introduction of ICS and should be a subject of future consultation.

6 ICS capital requirement: the standard method

6.3 Risk Mitigation

6.3.4 Open issues for consultation

6.3.4.1 Allowance for the effect of risk mitigation techniques in the ICS capital requirement only on the basis of assets and liabilities existing at the reference date of the ICS calculation

Q91 Section 6.3.4.1 Is the principle of allowing for the effect of risk mitigation techniques in the ICS capital requirement only on the basis of assets and liabilities existing at the reference date of the ICS calculation appropriate? Please explain.

☐ Yes ☒ No

Future Risk Mitigation Techniques (RMT) should be allowed, in particular to avoid cut-off effects and to take into account future management actions.

For example, if the IAIG has a recurrent annual financial hedging program or a renewal option in the contract or a longstanding relationship, the rollover of the hedging should be recognised.

The criteria for the RMT eligibility should be detailed.

The presence of risk-mitigation techniques should be recognised on the basis of the same time horizon, ie 1 year, and should not be limited to only exposures as at ICS calculation date.

Q92 Section 6.3.4.1 Should dynamic hedging arrangements be included in the scope of recognised risk mitigation techniques for ICS Version 2.0? Please explain.

☒ Yes ☐ No

Yes, dynamic hedging should be allowed for, if volatility risk is included in the framework as well.

See also comment to Q91.

Q92.1 Section 6.3.4.1 If "yes" to Q92, please comment on dynamic hedging programs that should be recognised in the ICS.

No comments

Q92.2 Section 6.3.4.1 If "yes" to Q92, please comment on how the principle of allowing for the effect of risk mitigation techniques in the ICS capital requirement only on the basis of assets and liabilities existing at the reference date of the ICS calculation could be amended in a manner appropriate to the ICS and the way it is currently constructed (ie the use of instantaneous shocks for market risk).

No comments

Q92.3 Section 6.3.4.1 If "yes" to Q92, please comment on what criteria should be met to allow the effect of dynamic hedging arrangements to be recognised in the ICS capital requirement.

See comment to Q91.

6.3.4.2 General treatment for risk-mitigation techniques that are in force for less than the next 12 months

Q93 Section 6.3.4.2 Is the general treatment given for risk-mitigation techniques that are in force for less than the next 12 months appropriate for the ICS standard method? Please explain. If "no", please provide details of a practical alternative that would be appropriate for the ICS standard method.

☐ Yes ☒ No

It is not appropriate to consider only a partial credit for derivatives that expire in less than one year. As the shock is defined as being instantaneous, the full benefit of the hedge held by the IAIG should be recognised, independent of when the hedge reaches maturity.

6.3.4.3 Criteria for recognising the renewal of Non-life risk mitigation arrangements

Q94 Section 6.3.4.3 Are the criteria for recognising the renewal of Non-life risk mitigation arrangements appropriate for the ICS standard method? Please explain. If "no", please detail which criteria should be amended, including rationale and suggested amended wording.

☐ Yes ☐ No

No comments

6.3.4.4 Renewal of risk mitigation arrangements for risks other than non-life (eg Currency risk) arising out of assets and liabilities existing at the reference date of the ICS calculation

Q95 Section 6.3.4.4 With regard to risks arising from the balance sheet as at the reference date, should renewal of risk mitigation arrangements other than those relating to non-life insurance risks also be recognised? Please explain.

☒ Yes ☐ No

See comment to Q91.

Q95.1 Section 6.3.4.4 If "yes" to Q95, please provide specific suggestions for criteria that can be applied to the recognition of such renewals.

No comments

Q95.2 Section 6.3.4.4 If "yes" to Q95, please provide specific examples of risk mitigation arrangements that would qualify as such, including details of the risks addressed and the materiality of these arrangements.

No comments

Q95.3 Section 6.3.4.4 If "yes" to Q95, please provide suggestions on how the issues such as future availability, future cost and uncertainty of the decision should be addressed.

No comments

6.3.4.5 Basis risk

Q96 Section 6.3.4.5 Should a materiality threshold for basis risk arising from any risk mitigation techniques be defined? If "yes", please provide a detailed suggestion of a definition that would be appropriate for the ICS and your rationale.

☐ Yes ☒ No

An explicit materiality threshold should be avoided and the assessment of basis risk should be left to every IAIG to calculate.

Q97 Section 6.3.4.5 Are you aware of organisations that account for basis risk arising from risk mitigation techniques? If "yes", please provide details on how this is done in practice.

☐ Yes ☐ No

No comments

6.3.5 General comments

Q98 Section 6.3.5 Are there any further comments on risk mitigation that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

Insurance Europe strongly supports the inclusion of internal models and IAIG-specific adjustments to the standard method in the ICS development.

Internal models and IAIG -specific adjustments to the standard method should be explicitly tested in the upcoming field testing exercises as alternatives to allow the IAIS to develop conclusions on internal models based on concrete proof.

Proposing only a standard method that captures all risks across firms is not adequate and not sufficient, particularly given the bespoke nature of insurers' risks. The necessity of internal models and/or IAIG-specific adjustments, in addition to the standard formula-type methods to identify and to capture all potential risk classes by risk type or region will avoid an arbitrary allocation of risks to certain classes with consequences for the calibration and aggregation of those risks and/or an overly complex standard method which does not reflect the risk profiles of many of the groups to which it is applied.

For a significant part of the European market, internal models are a key tool from a risk management perspective. They are integral to their business and are not only used to generate a solvency number. The use for internal models allows for an alignment of internal steering view with regulatory view and appropriate determination of risk, including adequate reflection of risk mitigation instruments and quantification of diversification benefits.

6.4 Look-through

6.4.1 General comments

Q99 Section 6.4.1 Are there any comments on look-through that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

Insurance Europe supports option 1, which proposes that the look-through approach applies to the extent possible on the basis of the underlying current exposures at a point in time inherent in the indirect investment or insurance arrangement. This option should also be allowed for partial look-through when full look-through is not possible. However, when no look-through is possible, this option proposed that the full investment should be considered as an asset belonging to the asset class with the highest risk charge.

6.5 Management actions

6.5.2 2016 Field Testing

Q100 Section 6.5.2 Is this extension of the definition of management actions to include limited premium increases for health business appropriate? Please explain.

☐ Yes ☐ No

No comments

6.5.3 Open issues for consultation

6.5.3.1 Further extension of management actions

Q101 Section 6.5.3.1 Are there examples of other instances for which an extension of management actions to allow for the recognition of premium adjustments may be appropriate? Please explain.

☒ Yes ☐ No

The benefit of management actions should be allowed for where the IAIG has the ability to amend the premium. In this context, the definition of management actions should be extended to allow for the appropriate premium increases for business on (re)insurance contracts, not only on health business, where the features of those contracts allow for such premium increases. Where the premium increases are economically justified in line with the nature of the contract they should not be subject to a cap.

6.5.3.2 Cap on management actions

Q102 Section 6.5.3.2 Is the method to determine the effect of management actions in a stress scenario inconsistent with the recognition of future premium increases in stress scenarios? If "yes", please suggest a solution.

☐ Yes ☐ No

No comments

6.5.4 General comments

Q103 Section 6.5.4 Are there any further comments on management actions that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☐ Yes ☐ No

No comments

6.6 Mortality and Longevity risk

6.6.2 2016 Field Testing

Q104 Section 6.6.2 Should the trend component be explicitly considered within Mortality risk? Please explain.

☐ Yes ☒ No

To maintain simplicity, the trend should not be explicitly considered within mortality risk. A unique factor should be keep for the mortality risk.

Q105 Section 6.6.2 Are the stress levels for Mortality risk appropriate? Please explain. If "no", please provide supporting evidence and rationale for a different stress level.

☐ Yes ☐ No

No comments

Q106 Section 6.6.2 Should the trend component be explicitly considered within Longevity risk? Please explain.

☐ Yes ☒ No

The trend should not be explicitly considered within longevity risk as it is not observable over one year and therefore not consistent with the one-year approach of the ICS. A unique factor should be kept for mortality risk. In particular, the application of the formula described in §347 could be implemented differently across companies as the order between a) and b) is important.

Q107 Section 6.6.2 Are the stress levels for Longevity risk appropriate? Please explain. If "no", please provide supporting evidence and rationale for a different stress level.

☐ Yes ☒ No

The current stress overstates the actual longevity risk, especially in the case of markets that have significant experience in managing this risk. In addition, the addition between the stresses on longevity level and trend implicitly assumes a 1 correlation between the two, which is not proven.

6.6.3 Open issues for consultation

Q108 Section 6.6.3 Is there evidence to support the use of stresses for Mortality and Longevity risk that vary by geographical region? Please explain and provide supporting evidence.

☐ Yes ☐ No

No comments

Q109 Section 6.6.3 Is there a specific methodology and reference data that the IAIS should use to determine appropriate mortality and longevity stress levels by geographic region? Please explain.

☐ Yes ☐ No

No comments

6.6.4 General comments

Q110 Section 6.6.4 Are there any further comments on Mortality and Longevity risk that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

The level at which the shock is applied should not be the policy level, but rather a larger group such as: product level; group of policies level; portfolio level.

In fact, as a consequence of the nature of Mortality/Longevity risks, factors such as pollution, new diseases, and breakthrough in medicine that could modify the risk profile of a liability will most often apply to larger groups of policies.

6.7 Morbidity/Disability risk

6.7.2 2016 Field Testing

6.7.2.1 Option 1 - Health risk

Q111 Section 6.7.2.1 Is the proposed segmentation for health business appropriate? Please explain.

☐ Yes ☐ No

No comments

Q112 Section 6.7.2.1 Are the stress levels for the health segments appropriate? Please explain. If "no", please provide supporting evidence and rationale for a different stress level.

☐ Yes ☐ No

No comments

Q113 Section 6.7.2.1 Is the shock for Health lapse risk appropriate? Please explain.

☐ Yes ☐ No

No comments

6.7.2.2 Option 2 - Morbidity/Disability risk

Q114 Section 6.7.2.2 Are the two product segments as defined appropriate? Please explain.

☐ Yes ☐ No

No comments

Q115 Section 6.7.2.2 Are the stress levels appropriate? Please explain. If "no", please provide supporting evidence and rationale for a different stress level.

☐ Yes ☐ No

No comments

6.7.3 Open issues for consultation

6.7.3.1 Calibration of stresses and geographic differentiation

Q116 Section 6.7.3.1 Is there evidence that the volatility of health claims (Option 1) varies by geographical region, thereby justifying a more refined granularity? Please explain.

☐ Yes ☐ No

Q117 Section 6.7.3.1 Is there a specific methodology and reference data that the IAIS should use to determine appropriate Health stress levels by geographic region? Please explain.

☐ Yes ☐ No

No comments

Q118 Section 6.7.3.1 Is there evidence to support the use of stresses for Morbidity/Disability risk (Option 2) that vary by geographical region? Please explain and provide supporting evidence.

☐ Yes ☐ No

No comments

Q119 Section 6.7.3.1 Is there a specific methodology and reference data that the IAIS should use to determine appropriate Morbidity/Disability stress levels by geographic region? Please explain.

☐ Yes ☐ No

No comments

6.7.3.2 Single approach to Morbidity/Disability for ICS Version 1.0

Q120 Section 6.7.3.2 Is Option 1 (Health risk) or Option 2 (Morbidity/Disability risk) the most appropriate to adopt within ICS Version 1.0? Please explain.

No comments

Q121 Section 6.7.3.2 Should any revisions or modifications be made to the approach selected in Q120 to make it more appropriate for ICS Version 1.0? Please explain.

☐ Yes ☐ No

No comments

6.7.4 General comments

Q122 Section 6.7.4 Are there any further comments on Health or Morbidity/Disability risk that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

The calibration of the non-life underwriting risk section should be based on an appropriate dataset and not merely on the data gathered by the field tests. In recent years the IAIS has gathered data by means of a "data collection" but that was very limited and not related to the objective of calibration of for example non-life underwriting risk. Also the correlation suggested with other risk types should be revisited, in order to reflect the typical characteristics of the various lines of business.

6.8 Lapse risk

6.8.2 2016 Field Testing

Q123 Section 6.8.2 Is the stress level for the level and trend component appropriate? Please explain. If "no", please provide supporting evidence and rationale for a different stress level.

☐ Yes ☒ No

The level of calibration (40%) expected for the lapse risk module in the ICS doesn't reflect the reality of the covered risk, and the IAIS should further investigate historical data on lapse risk across jurisdictions.

Q124 Section 6.8.2 Is the stress level for Mass Lapse risk appropriate? Please explain. If "no", please provide supporting evidence and rationale for a different stress level.

☐ Yes ☐ No

No comments

Q125 Section 6.8.2 Is the treatment of dynamic lapses appropriate? Please explain. If "no", please suggest an alternative treatment.

☐ Yes ☒ No

The treatment should be more precisely specified as the scope of application is unclear. As a part of dynamic lapses comes from market stresses, the treatment may introduce unintended double counting.

Q126 Section 6.8.2 Is the approach of taking the maximum of the level and trend components and the mass lapse component appropriate? Please explain.

☐ Yes ☐ No

No comments

6.8.3 Open issues for consultation

6.8.3.1 Calibration of stresses and geographic differentiation

Q127 Section 6.8.3.1 Is there evidence to support the use of stresses for Lapse risk that vary by geographical region? Please explain and provide supporting evidence.

☐ Yes ☐ No

No comments

Q128 Section 6.8.3.1 Is there a specific methodology and reference data that the IAIS should use to determine appropriate lapse stress levels by geographic region? Please explain.

☐ Yes ☐ No

No comments

6.8.3.2 Treatment of surrender strain for determining mass lapse component

Q129 Section 6.8.3.2 Should the mass lapse stress be applied to all surrenderable policies, regardless of surrender strain? Please explain.

☒ Yes ☐ No

While reputation risk can be a highly likely trigger for mass surrenders, it is not linked to product features.

Q130 Section 6.8.3.2 Should the mass lapse stress be applied only to surrenderable policies with positive surrender strain? Please explain.

☐ Yes ☐ No

No comments

6.8.4 General comments

Q131 Section 6.8.4 Are there any further comments on Lapse risk that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

The shock should apply at the level of group homogeneous risks, rather than at policy level, as the forecast deviation applies to the entire population, rather than to a subgroup.

6.9 Expense risk

6.9.2 2016 Field Testing

Q132 Section 6.9.2 Is the stress level for Expense risk appropriate? Please explain. If "no", please provide supporting evidence and rationale for a different stress level.

☐ Yes ☐ No

No comments

6.9.3 Open issues for consultation

6.9.3.1 Calibration of stresses and geographic differentiation

Q133 Section 6.9.3.1 Is there evidence to support the use of stresses for Expense risk that vary by geographical region? Please explain and provide supporting evidence.

☐ Yes ☐ No

No comments

Q134 Section 6.9.3.1 Is there a specific methodology and reference data that the IAIS should use to determine appropriate expense stress levels by geographic region? Please explain.

☐ Yes ☐ No

No comments

Q135 Section 6.9.3.1 Is there evidence that the volatility of expense inflation experience for insurance companies varies from that of general inflation? Please explain.

☐ Yes ☐ No

No comments

6.9.3.2 Aggregation of unit expense and expense inflation

Q136 Section 6.9.3.2 Should the IAIS assume 100% correlation between unit expense and expense inflation? Please explain. If "no", how could correlation be built into the assumptions?

☐ Yes ☐ No

No comments

Q137 Section 6.9.3.2 Are there data sources available that could be used to calibrate the correlation between unit expense and expense inflation? If "yes", please provide information on the source.

☐ Yes ☐ No

No comments

6.9.3.3 Compounding effect of inflation expense

Q138 Section 6.9.3.3 Should the IAIS consider introducing a cap to moderate the compounding effect of expense inflation? If "yes", what would be a reasonable level for the cap? Please provide rationale for the proposed level of the cap.

☐ Yes ☐ No

No comments

6.9.4 General comments

Q139 Section 6.9.4 Are there any further comments on Expense risk that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☐ Yes ☐ No

No comments

6.10 Premium and Claims Reserve Risks

6.10.4 Open issues for consultation

6.10.4.1 Use of jurisdictional reporting segments

Q140 Section 6.10.4.1 Non-life exposures should be reported based on the location of risks to ensure consistency across IAIGs. Regarding the reporting segment, which of the following should be used:

☐ A more compact standardised segmentation? If "yes", please explain the rationale. Click here to enter text.

☐ A more detailed reporting segmentation based on existing jurisdictional reporting segments? If "yes", please explain how consistent treatment across segments could be ensured.

No comments

Q141 Section 6.10.4.1 Should projected net earned premiums be used as the exposure base for Premium risk? If "no", please specify what other measure should be used and why.

☒ Yes ☐ No

The IAIS should envisage to align the volume of premiums used for the ICS calculation and the volume of premiums taken into account in the current estimate.

The suggested measure seems reasonable for reserve risk. As to premium risk, the proposed approach does not reflect the differentiation between proportional and non-proportional reinsurance business. Insurance Europe believes that flexible adjustment factors should be allowed for all non-proportional reinsurance (or other forms of reinsurance), including for contracts combining several segments, to reflect more adequately the reality of the risk transfer.

Q142 Section 6.10.4.1 Should net current claims estimates be used as the exposure base for Claims Reserve risk? If "no", please specify what other measure should be used and why.

☒ Yes ☐ No

The IAIS should envisage to align the volume of premiums used for the ICS calculation and the volume of premiums taken into account in the current estimate.

Flexible adjustment factors should be allowed for all non-proportional reinsurance (or other forms of reinsurance), including for contracts combining several segments, to reflect more adequately the reality of the risk transfer.

6.10.4.2 Diversification within Non-Life risks

Q143 Section 6.10.4.2 For the purposes of the ICS standard method, is the approach taken in 2015 and 2016 Field Testing adequate to account for diversification effects in Premium and Claims Reserve risks? If "no", please provide a more appropriate alternative suggestion including rationale, keeping in mind the need to apply a consistent methodology across all jurisdictions, and to balance practicality and materiality with risk sensitivity in a standard method.

☐ Yes ☐ No

No comments

Q144 Section 6.10.4.2 Are the correlation factors appropriate for the ICS standard method? If "no", please provide rationale and alternative suggestions supported by evidence.

☐ Yes ☐ No

No comments

Q145 Section 6.10.4.2 Is the 50% correlation factor between categories appropriate for the ICS standard method? If "no", please provide rationale and alternative suggestions supported by evidence.

☐ Yes ☒ No

Further work to compare and supply specific suggestions with evidence is needed to validate the correlation factor selections. This should be considered at the same time as the granularity of reporting segments.

Q146 Section 6.10.4.2 Is the 25% correlation factor between regions appropriate for the ICS standard method? If "no", please provide rationale and alternative suggestions supported by evidence.

☐ Yes ☒ No

Further work to compare and supply specific suggestions with evidence is needed to validate the correlation factor selections. This should be considered at the same time as the granularity of reporting segments.

6.10.4.3 Calibration Approach

Q147 Section 6.10.4.3 Is there a methodology that the IAIS could use for the calibration of Premium and Claims Reserve risk factors that can be easily and consistently applied across jurisdictional lines of business using the supplementary data requested in 2016 Field Testing? If "yes", please provide specific details, technical references and rationale. Please indicate if some methods are more appropriate for particular segments or particular types of data.

☐ Yes ☐ No

No comments

Q148 Section 6.10.4.3 In the absence of adequate data, is there a way that the IAIS could determine appropriate Premium and Claims Reserve risk factors for lines of business. If "yes", please explain.

☐ Yes ☐ No

No comments

Q149 Section 6.10.4.3 Is there a methodology that the IAIS could use to determine the appropriate number of buckets and factors, taking into consideration the context of the ICS standard method and the aim to achieve comparable results across comparable risks? Please explain.

☐ Yes ☐ No

No comments

6.10.4.4 Adjustments Needed When Calibrating Data

Q150 Section 6.10.4.4 Are there practical methods for determining these adjustments in the context of the ICS standard method (considering, in particular, the trade-off between materiality of the impact and complexity of the method)? If "yes", please provide details. If necessary, please differentiate by risk and reporting segments.

☐ Yes ☐ No

No comments

6.10.5 General comments

Q151 Section 6.10.5 Are there any further comments on Premium and Claims Reserve risks that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☐ Yes ☐ No

No comments

6.11 Catastrophe Risk

6.11.2 2016 Field Testing

6.11.2.2 Latent liability scenario

Q152 Section 6.11.2.2 Is the new specification of "latent liability risk" appropriate? Please explain.

☒ Yes ☐ No

In principle, Insurance Europe supports the new specification. The nature of the loss seems appropriate. However, deriving a net loss on the basis of a gross/net premium ratio does not give a reasonable estimate of the benefit of reinsurance, as reinsurance is likely to be non-proportional, and so will respond in adverse scenarios better than is suggested by the proportion of premiums. Furthermore, using all premiums will include some claims-made policies, to which the latent scenario would not apply.

Q153 Section 6.11.2.2 Should the mass tort scenario be used to represent latent liability risk in the ICS? Please explain.

☒ Yes ☐ No

No comments

Q154 Section 6.11.2.2 Are any other scenarios/refinements needed for the latent liability scenario? If "yes", please specify and provide rationale.

☒ Yes ☐ No

No comments

6.11.3 Open issues for consultation

6.11.3.1 List of perils

Q155 Section 6.11.3.1 In addition to the perils covered in 2016 Field Testing (listed above), are there other material Catastrophe perils to which IAIGs may be materially exposed for which a scenario should be defined in the ICS standard method? If "yes", please provide a list, including a definition of the peril and any other specific details to support the suggestion(s).

☐ Yes ☐ No

No comments

Q156 Section 6.11.3.1 Are there scenarios used in 2015 and 2016 Field Testing (listed above) which, for materiality or other reasons, should not be included in the Catastrophe risk component? If "yes", please provide a list, including the rationale.

☐ Yes ☐ No

No comments

6.11.3.2 Use of natural catastrophe models as part of the standard method

Q157 Section 6.11.3.2 Should the IAIS allow the use of catastrophe models for ICS Version 1.0? Please explain.

☒ Yes ☐ No

No comments

Q158 Section 6.11.3.2 If the IAIS allows the use of catastrophe models in ICS Version 1.0, should there be requirements to ensure that the use of catastrophe models results in a fair and comparable assessment of the natural catastrophe risk? If "yes", please comment on requirements that should be included.

☒ Yes ☐ No

Insurance Europe strongly supports the use of natural catastrophe risk models to capture this risk type and believe it is the only practical way to adequately quantify such risk exposures. Notwithstanding some limitations of those models, some consistency could be sought through requiring firms to provide version and basis of model run details with the submission numbers.

Q159 Section 6.11.3.2 Is there information about catastrophe models and their use by the IAIG that should be reported to the group-wide supervisor? If "yes", please provide specific examples.

☐ Yes ☐ No

No comments

Q160 Section 6.11.3.2 Are there additional conditions or restrictions about catastrophe models or their use by IAIGs that should form part of ICS Version 1.0? Please explain.

☐ Yes ☐ No

No comments

Q161 Section 6.11.3.2 If an IAIG were unable to meet the requirements that were set out in the specifications of the ICS, are there measures that the group supervisor should take in order to correct the weaknesses? If "yes", please provide details of suggested measures and the rationale.

☐ Yes ☐ No

No comments

6.11.3.3 Man-made catastrophe scenario

Q162 Section 6.11.3.3 Is the man-made catastrophe scenario (as defined in the 2016 Technical Specifications) appropriate for the ICS standard method? If "no", please provide specific suggestions supported by reference or evidence to amend the scenario(s).

☐ Yes ☐ No

No comments

6.11.3.4 Calculation of the recoverable amount to be used for the calculation of the contingent Credit risk

Q163 Section 6.11.3.4 Is the approach to calculate the contingent Credit risk associated with reinsurance recovery appropriate for the purposes of ICS Version 1.0? Please explain. If "no", please provide details of an alternative approach that would be more appropriate for the ICS standard method.

☐ Yes ☐ No

No comments

6.11.4 General comments

Q164 Section 6.11.4 Are there any further comments on Catastrophe risk that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☐ Yes ☐ No

No comments

6.12 Market risk

6.12.1 Interest Rate risk

6.12.1.4 Open issues for consultation

Q165 Section 6.12.1.4 Are there any calibration methodologies for stressed yield curves that work in both the current negative and low interest rate environment in developed countries and where base yield curves are as they have been in the past with higher rates observed at all maturities? If "yes", please provide details.

☐ Yes ☐ No

No comments

Q166 Section 6.12.1.4 Is the IAIS approach to calibrate Interest Rate risk stresses using six years of historical data appropriate? If "no", please comment on the appropriate length of data to calibrate Interest Rate risk stresses to a target level of VaR 99.5% over a one-year time horizon. If a shorter time series is preferred, please comment on how to deal with changing market conditions and the frequency of recalibrating the ICS Interest Rate risk stresses.

☐ Yes ☒ No

The observation period used is too short. Data from only six years are insufficient to calibrate the true 99.5% quantile because there are severe problems with autocorrelation and heteroscedasticity in the data. This means that data patterns in such a short observation period are most likely distorted by periodic fluctuations in the level and volatility of interest rate changes. To avoid interest rate risk being both miscalibrated and fast changing over time, a longer observation period has to be applied.

Equally important, there is a fundamental problem with the IAIS approach to calibrate interest rate risk stresses directly using historical data. By this approach it is blindly supposed that volatility observed before the onset of the low interest phase is the same as volatility in a low/negative interest rate environment. This is not a plausible assumption.

As a consequence of the methodology used, based on such a short time period for calibration, the interest rate stresses are too high and pro-cyclical, meaning that a recent rapid fall in interest rates would increase the measured standard deviation. For example, the downwards stress 10-year yield for EUR is lower than JPY, despite the base yield being approximately1% higher, and this is due to the fact that the calibration uses the recent falls in EUR interest rates.

The above concerns could be addressed by lengthening the time period used to calibrate the stress (ie to cover multiple economic cycles) and introducing mechanisms to reduce the stress in falling or low interest rate environments (eg adjust the size of the stress to reflect current interest rate levels). The IAIS therefore needs to aim for more realistic results by applying an appropriate interest rate model and calibrating its parameters on the basis of the data (estimate the model).

Q167 Section 6.12.1.4 Should the ICS only assess the principal observed driver in yield curve evolutions (upward and downward movements), or should twists (flattening or steepening) be included in the risk assessment? Specifically, which of the following should be used? Please explain your answer.

☒ Only upward and downward movements Changing interest rates constitute a single risk. This risk may be modelled in a more simple and robust way with only one risk factor or in a more sophisticated way with two risk factors (1st and 2nd principal component if PCA is applied) within the same scenario. However, in both cases, there should be only one downward scenario (resp. one combined downward and flattening scenario). The use of two uncorrelated scenarios both calibrated at the 99.5% VaR level would lead to double-counting.

☐ Upward, downward and flattening Click here to enter text.

☐ Upward, downward and steepening Click here to enter text.

☐ Upward, downward, steepening and flattening Click here to enter text.

Q168 Section 6.12.1.4 Is the methodology used by the IAIS to determine Interest Rate risk post-diversification appropriate? If "no", please suggest an alternative methodology.

☐ Yes ☐ No

No comments

Q169 Section 6.12.1.4 Should the IAIS recognise diversification of Interest Rate risk between currencies? Please explain and provide details of how this could be done.

☐ Yes ☐ No

No comments

Q170 Section 6.12.1.4 Which of the alternative methods for GAAP Plus (1 or 2) is a better measure of Interest Rate risk? Please explain. If neither are considered suitable, please suggest an alternative method or refinements to the current method.

No comments

Q171 Section 6.12.1.4 Method 2 is based on the assumption that certain assets backing liabilities are intended to be held to maturity, and consequently are only exposed to reinvestment risk. Should the IAIS consider developing criteria to identify such assets? If "yes" please explain and provide suggestions for such criteria.

☐ Yes ☐ No

No comments

Q171.1 Alternatively, should method 2 make allowance for the fact that some of these assets may in fact not be held to maturity? If "yes", please explain and suggest how this may be done.

☐ Yes ☐ No

No comments

6.12.1.5 General comments

Q172 Section 6.12.1.5 Are there any further comments on Interest Rate risk that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

The IAIS should improve its approach to calibrating the stress by, for example, lengthening the period based on which historical data is extracted for the calibration and introducing mechanisms to reduce the stress in falling or low interest rate environments.

There is a fundamental problem with the IAIS approach to calibrate interest rate risk stresses directly using historical data. By using this approach, it is blindly supposed that volatility observed before the onset of the low interest phase is the same as volatility in a negative interest rate environment. This is not a plausible assumption. (see answer to Q 166)

6.12.2 Equity risk

6.12.2.1 Background

Q173 6.12.2.1 Is the four-bucket approach to the segmentation of equities appropriate? Please explain. If "no", please provide an alternative suggestion and rationale.

☐ Yes ☐ No

No comments

6.12.2.3 Open issues for consultation

Q174 Section 6.12.2.3 Should an equity volatility stress be included in the ICS standard method? Please explain.

☐ Yes ☒ No

Insurance Europe does not support an equity volatility stress. The stress on equity prices should already reflect the impact of volatility.

In addition, the current multiplicative approach between the two stresses is very procyclical, as a low stress will arise when volatility is low and an unreasonably high stress will emerge when volatility is high.

Q175 Section 6.12.2.3 Is the design of the equity volatility stress in 2016 Field Testing appropriate? If "no", please provide specific suggestions, as well as supporting rationale and evidence.

☐ Yes ☒ No

The volatility stress should be removed.

Q176 Section 6.12.2.3 Is the multiplicative approach suitable for the ICS standard method? Please explain. If "no", please highlight the key design and data considerations for developing an alternative approach (eg additive volatility stress).

☐ Yes ☐ No

No comments

Q177 Section 6.12.2.3 Is the treatment of long-term equity investments appropriate? Please explain. If "no", how should they be treated differently and what criteria should be used to define long-term equity investments? Please highlight key design features and provide supporting evidence (including data).

☐ Yes ☒ No

Long-term equity investments should have a more tailored capital treatment, reflecting the cases where insurers have the ability to hold these assets for a long term.

An insurer's ability to adopt and maintain a long-term view in the management of assets is a direct consequence of the long duration of liabilities. Insurers managing their assets with a long term view are not exposed to forced sales on a one-year basis and the short-term volatility of assets is" hedged" by the duration of the holdings, including in the case of common stocks. Such asset management strategies allow for an enhanced diversification of the asset portfolio improving key indicators such as profitability, liquidity and solvency. They also lead to a countercyclical investment behaviour whereby insurers have the ability to buy when everyone else is selling. Therefore, the calibration of capital requirements should reflect the true level of risks for insurers with long term holdings. Typically, the volatility of common stocks is much lower if assessed in a long-term perspective. Such an approach would in fact lead to a much lower calibration of equity held long-term.

Q178 Section 6.12.2.3 Is there evidence that supports the application of a correlation matrix for determining the Equity risk charge? If "yes", please provide evidence supporting suggested correlations.

☐ Yes ☐ No

No comments

Q179 Section 6.12.2.3 Should the Equity risk charge include a countercyclical measure to reduce pro-cyclical behaviour? Please explain. If "yes", how should such a measure be designed and calibrated? Please highlight key data considerations where relevant.

☒ Yes ☐ No

A symmetric adjustment taking into account the market volatility under the equity cycle should be introduced as a countercyclical measure to reduce pro-cyclical behaviour during stressed periods. This adjustment should be based on a function of the current level of an appropriate equity index and a weighted average level of that index.

Q180 Section 6.12.2.3 Are the current approaches in the ICS appropriate for products with path dependent valuations? Please explain.

☐ Yes ☐ No

No comments

Q181 Section 6.12.2.3 Does the ICS capture all of the material risks for these types of contracts? Please explain.

☐ Yes ☐ No

No comments

Q182 Section 6.12.2.3 Are there alternative approaches that would capture path dependent Equity and Interest Rate risk? Please explain.

☐ Yes ☐ No

No comments

6.12.2.4 General comments

Q183 Section 6.12.2.4 Are there any further comments on Equity risk that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

The IAIS should investigate a more tailored capital treatment for infrastructure assets and strategic investments.

6.12.3 Real Estate risk

6.12.3.2 2016 Field Testing

Q184 Section 6.12.3.2 Is the approach adopted for Real Estate risk in 2016 Field Testing appropriate for the ICS standard method under MAV? Please explain. If "no", please provide specific proposals to amend the approach as well as supporting rationale and evidence.

☐ Yes ☒ No

The proposed shock level of 30% is extremely conservative and does not reflect the often very low market volatility of this asset class. The IAIS should consider a more tailored geographical approach, with different stresses for different areas. Such an approach would be in line with the comparability objective.

Q185 Section 6.12.3.2 Is the approach adopted for Real Estate risk in 2016 Field Testing appropriate for the ICS standard method under GAAP Plus? Please explain. If "no", please provide specific proposals to amend the approach as well as supporting rationale and evidence.

☐ Yes ☐ No

No comments

6.12.3.3 General comments

Q186 Section 6.12.3.3 Are there any further comments on Real Estate risk that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

The IAIS should consider a geographical differentiation of the stress levels.

6.12.4 Currency risk

6.12.4.2 2016 Field Testing

Q187 Section 6.12.4.2 Is the methodology used to determine the level of the Currency risks stresses appropriate? Please explain.

☐ Yes ☒ No

The 2015 FT conclusions indicated that currency risk was overstated for the IAIGs with significant currency exposure. In the 2016 FT the IAIS should avoid this over statement and reflect the real exposure in the expected calibration of this module. The historical volatility between individual currencies should be taken into account to define the level of shocks. The appropriate correlation should also be defined based on historical data where available.

In addition, the IAIS should further investigate whether a capital charge is indeed the right policy measure to address currency risk that is generated by currency translations from contributions by subsidiaries.

The majority of the currency risk captured in the standard method arises from currency translation risk (i.e. subsidiary contributions). Insurance Europe considers that the capital required to be held for this exposure even after taking into account the exemption is still far too high. This is because currency translation risk does not materially impact an IAIGs ability to meet policyholder obligations and consequently Insurance Europe would question whether capital is the right regulatory tool to address it. Indeed, requiring capital to be held against this risk could incentivise behaviour that would be detrimental to policyholder interests. In addition, if modelled accurately the risk diversifies very significantly even from a shareholder perspective, as the currency exposure will reduce when a subsidiary sustains losses and increase when a subsidiary makes gains.

Q188 Section 6.12.4.2 Is the assumption of a single correlation factor of 50% for all currencies appropriate in a time of stress? Please explain. If "no", what methodology could the IAIS use to determine an appropriate correlation matrix for Currency risk?

☐ Yes ☐ No

No comments

Q189 Section 6.12.4.2 Is the treatment of currency pegs appropriate? Please explain.

☐ Yes ☐ No

No comments

Q190 Section 6.12.4.2 Should the IAIS allow for a partial exemption for investments in foreign subsidiaries? Please explain.

☐ Yes ☐ No

No comments

Q191 Section 6.12.4.2 Is the exemption for investments in foreign subsidiaries appropriate? Please explain.

☐ Yes ☐ No

No comments

Q192 Section 6.12.4.2 Is there a better proxy of the subsidiary's contribution to the ICS? Please explain.

☐ Yes ☐ No

No comments

Q193 Section 6.12.4.2 Are there any further comments on the approach described for 2016 Field Testing? Please explain.

☐ Yes ☐ No

No comments

Q194 Section 6.12.4.2 Is the treatment of currency exposures with a maturity of less than one year appropriate? Please explain.

☐ Yes ☐ No

No comments

6.12.4.3 General comments

Q195 Section 6.12.4.3 Are there any further comments on Currency risk that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

The level of shocks too high, while the application of shocks to currency couples is too complex. Less granular buckets should be considered.

6.12.5 Asset Concentration risk

6.12.5.2 2016 Field Testing

Q196 Section 6.12.5.2 Is the approach adopted for Asset Concentration risk in 2016 Field Testing appropriate for the ICS standard method? Please explain. If "no", please provide specific proposals to amend the approach as well as supporting rationale and evidence.

☐ Yes ☒ No

The diversification benefit should be recognized for all exposures.

6.12.5.3 General comments

Q197 Section 6.12.5.3 Are there any further comments on Asset Concentration risk that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☐ Yes ☐ No

No comments

6.13 Credit risk

6.13.3 Open issues for consultation

6.13.3.1 Reliance on the use of external credit ratings

Q198 Section 6.13.3.1 Do you support the approach used for 2016 Field Testing with respect to allowing the use of external credit ratings for ICS Credit risk purposes? Why or why not?

☒ Yes ☐ No

The use of external credit ratings should be allowed, and alternatives should be envisaged when these are not available.

It should be recognised that in practice it would neither be feasible nor desirable to refrain from any reference to external ratings. Any limitations in this area should take into account the nature, scale and complexity of insurers' business and investments.

Q199 Section 6.13.3.1 Does any alternative to the use of ratings issued by credit rating agencies exist in the regulatory framework of your jurisdiction (eg supervisory-owned processes)? Please provide details.

☐ Yes ☒ No

Solvency II allows, as an alternative to external credit ratings, the recognition of credit risk assessment via internal approaches. Solvency II also gives due consideration to the difficulties that insurers might face in developing their own risk assessment models: *"In order to avoid overreliance on external credit assessment institutions when they use external credit rating assessment in the calculation of technical provisions and the Solvency Capital Requirement, insurance and reinsurance undertakings shall assess the appropriateness of these external credit assessments as part of their risk management by using additional assessments wherever practically possible in order to avoid any automatic dependence on external assessments."*

Q200 Section 6.13.3.1 Should the IAIS allow the use of ratings and/or designations that are not issued by credit rating agencies, for example, ratings and/or designations that are issued by a supervisory-owned process (eg, the NAIC Securities Valuation Office)? Please explain.

☐ Yes ☐ No

No comments

Q200.1 Section 6.13.3.1 If "yes" to Q200, should the IAIS consider modifying the criteria for the recognition of rating providers, taking account of the specific features of the supervisory-owned process? Please explain.

☐ Yes ☐ No

No comments

Q200.2 Section 6.13.3.1 If "yes" to Q200, are the criteria for credit rating agencies appropriate for alternatives to the use of credit rating agencies? Please explain.

☐ Yes ☐ No

No comments

Q201 Section 6.13.3.1 Are there any additional factors the IAIS should consider when deciding on whether to allow in the ICS the use of credit assessments (eg ratings or designations) from sources other than credit rating agencies? If "yes", please explain and provide details.

☐ Yes ☐ No

No comments

6.13.3.2 Granularity of commercial and residential mortgage factors

Q202 Section 6.13.3.2 Is the approach adopted for 2016 Field Testing for commercial and residential mortgage Credit risk charges appropriate for the ICS standard method? Please explain. If "no", please provide specific proposals for how it should be changed as well as supporting rationale and evidence.

☐ Yes ☒ No

The residential mortgage shocks are too high and fail to reflect a number of key elements specific to jurisdictions where IAIGs operate, including:

- Very limited default experience of these assets, often linked to regulatory caps on loan-to-value ratios.
- The presence of government support through government guarantees.

This is a very good example of how a more tailored approach could be taken for assets, to increase the risk-sensitivity of the framework. Comparability would be maintained, as long as all IAIGs would be charged the same capital for the same risk.

6.13.3.3 Treatment of reinsurance exposures

Q203 Section 6.13.3.3 Should the IAIS continue to explore a different approach for Credit risk from reinsurance exposures, and in particular, for collateralised reinsurance? Why or why not? If "yes", please provide specific proposals, rationale and evidence to support the proposals.

☐ Yes ☐ No

No comments

6.13.4 General comments

Q204 Section 6.13.4 Are there any further comments on Credit risk that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

Management actions should be considered for credit risk, especially for life insurers and with-profits / unit-linked contracts where insurers share losses.

Local authorities' ability to collect taxes should be out of the scope of credit risk scope, similar to sovereign entities.

6.14 Operational Risk

6.14.3 Open issues for consultation

Q205 Section 6.14.3 Should the IAIS use exposures that are reported before the impact of ceded reinsurance for determining the Operational risk charge? Please explain.

☐ Yes ☐ No

Unit-linked business indicators (current estimate or premiums) should not be considered for operational risk calculation.

Q206 Section 6.14.3 Are the proposed Operational risk exposures appropriate for the ICS standard method? Please explain.

☒ Yes ☐ No

Unit-linked business indicators (current estimate or premiums) should not be considered for operational risk calculation.

Q207 Section 6.14.3 Are the proposed Operational risk factors appropriate for the ICS standard method, both in terms of size and relativity? Please explain.

☐ Yes ☐ No

No comments

6.14.4 General comments

Q208 Section 6.14.4 Are there any further comments on Operational risk that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

A cap should be considered on operational risk charges as a proportion of the other risk modules, as the overall calibration of the shocks are too high.

In fact, premiums are often not a good proxy for the level of operational risk, especially in the case of annuity / investment-related / whole-life products. Premiums not directly related to insurance risks should be excluded from the operational risk premium charge calculation, but still be captured under the current estimate charge. For example, annuity premiums, investment-related premiums, premiums on whole of life contracts. For these products, premiums are a poor proxy for the level of operational risk. For example, under the current operational risk calibration, single premiums (e.g. on single premium annuities) will attract a capital charge of 4%-8%, which is well in excess of a 1-in-200 level. In subsequent time periods, the charge on business will fall to 0.4% of that premium. It is not appropriate for the operational risk capital charge in the first year of single premium products to be 10-20 times that of existing business.

6.15 Aggregation/Diversification

6.15.3 Open issues for consultation

6.15.3.1 Structure of the aggregation calculation

Q209 Section 6.15.3.1 Is the structure of the correlation matrices used for 2016 Field Testing appropriate? If "no", please provide specific alternative suggestions and evidence on why this approach would be more appropriate.

☐ Yes ☐ No

No comments.

6.15.3.2 Calibration of correlation parameters

Q210 Section 6.15.3.2 Should the calibration of the correlation parameters for the ICS standard method include a material degree of judgement since relevant and available data are limited? Please explain. If "no", please provide rationale, specific suggestions and evidence or references to support an alternative approach.

☐ Yes ☐ No

No comments.

Q211 Section 6.15.3.2 How could the IAIS combine data and judgement in the calibration of correlation parameters for aggregation and diversification?

No comments.

Q212 Section 6.15.3.2 Are there available data that would be relevant for the calibration of the correlation parameters of the ICS standard method? Please explain.

☐ Yes ☐ No

No comments

Q213 Section 6.15.3.2 Are the correlation factors being used between ICS risks appropriate for the ICS standard method? Please explain. If "no", please provide rationale and alternative suggestions supported by evidence.

☐ Yes ☐ No

No comments

Q214 Section 6.15.3.2 Are the correlation factors being used for Life risks appropriate for the ICS standard method? If "no", please provide rationale and alternative suggestions supported by evidence.

☐ Yes ☐ No

No comments

Q215 Section 6.15.3.2 Are the correlation factors being used for Market risks appropriate for the ICS standard method? If "no", please provide rationale and alternative suggestions supported by evidence.

☐ Yes ☐ No

No comments

6.15.4 General comments

Q216 Section 6.15.4 Are there any further comments on Aggregation and Diversification that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☒ Yes ☐ No

An appropriate recognition of aggregation and diversification in the ICS standard method is very challenging and can in fact only by addressed by an internal model approach, that would be able to reflect the specificities of an insurer's business. For example:

- The correlation between the market risk and like risk will differ between an insurer that writes business mainly exposed to longevity risk and an insurer mainly exposed to lapse risk.
- Non-linear interactions and tail dependencies between risks are also not recognised, which can lead to an undue loss of diversification.
- The low correlation between operational risk and other risks is not recognised in the standard method.

7 Holistic approach to tax within the ICS

7.2 Open issues for consultation

7.2.1 Valuation

Q217 Section 7.2.1 What would be an appropriate level of granularity that would strike a balance between accuracy and operational feasibility/complexity?

No comments

Q218 Section 7.2.1 Would an approach that utilises an effective tax rate at the country level be appropriate? Please explain.

☐ Yes ☐ No

No comments

Q219 Section 7.2.1 Please provide any commentary on what would be considered an appropriate method to derive a global effective tax rate. Please support any proposed method with a short list of pros and cons.

No comments

Q220 Section 7.2.1 If post valuation adjustment DTAs would be included as a component of capital, a method to determine realisability or a partial deduction would also likely be an element of the calculation. Do you have any suggestions for an appropriate method to determine realisability of DTAs given a top-down approach? Would you prefer a partial deduction method? Please provide a rationale for your answer.

No comments

Q221 Section 7.2.1 Should the IAIS pursue a more bottom up approach to determining deferred taxes post valuation adjustment? If "yes", please provide any commentary to support this view.

☐ Yes ☐ No

No comments

Q222 Section 7.2.1 Please provide any other options that should be considered by the IAIS with respect to reflecting the impact of revaluation under GAAP Plus and MAV on deferred taxes.

No comments

Q223 Section 7.2.1 Should DTAs and DTLs be adjusted in both the MAV and GAAP Plus approaches to take into account the effect of discounting to ensure they are valued consistently with other material balance sheet items? Please explain.

☐ Yes ☐ No

No comments

Q224 Section 7.2.1 If the answer to the above question is "yes", should a restriction be applied to the discounting of only one type of DTA or DTL, eg long-dated item? Please explain.

☐ Yes ☐ No

No comments

Q225 Section 7.2.1 Should an approximation of the discounting effect on a post-stress DTA be taken into account in any tax adjustment to the ICS capital requirement? Please explain.

☐ Yes ☐ No

No comments

7.2.2 Margin over current estimate

Q226 Section 7.2.2 Should MOCE be tax effected? If "yes", what effective tax rate should be applied, and why? Please answer for both prudence and cost of capital MOCE.

☐ Yes ☐ No

No comments

Q227 Section 7.2.2 Should deferred tax assumptions be incorporated into the cost of capital MOCE calculation? If "yes", please specify.

☐ Yes ☐ No

No comments

7.2.3 Capital resources

Q228 Section 7.2.3 Please provide any specific recommendations for an appropriate realisability methodology.

No comments

Q229 Section 7.2.3 Please provide any input or feedback on the consideration to limit the DTA in capital resources either through a partial deduction and/or an overall limit.

No comments

7.2.4 ICS capital requirement

Q230 Section 7.2.4 Is there an appropriate methodology for evaluating the realisability of DTAs under stress which would lead to an appropriate treatment of deferred tax in the ICS capital requirement? If "yes", please explain.

☒ Yes ☐ No

IAIGs should have the possibility to apply their own methodology to assess and justify the recovery of DTAs under their own scenarios based on their own business plans.

Q231 Section 7.2.4 Which of the following approach should the IAIS consider for including the impact of taxes in the calculation of the ICS capital requirement? Please explain, including providing a list of pros and cons.

☐ Should the tax impact be included in the individual ICS risk charge calculations pre-diversification? Click here to enter text.

☐ Should the IAIS ignore the tax impact on the ICS capital requirement, and instead reflect that impact in the calibration of the ICS capital requirement through the calibration of individual ICS risk charge calculations pre-diversification? (Please provide any suggestions as to how the individual ICS risk charges could be recalibrated to reflect this.) Click here to enter text.

☐ Should the ICS capital requirement be calculated in a similar fashion to the current Field Testing approach, where each ICS risk charge is calculated on a pre-tax basis and the tax impact computed on a consolidated post-diversification basis using a global effective tax rate? Click here to enter text.

☐ Should any other approach be used? (Please provide details)

No comments

Q232 Section 7.2.4 Should tax strategies/management actions and diversification impacts be reflected/allocated to tax jurisdictions if the deferred tax impact is calculated using a bottom-up approach? If "yes", how should this be reflected/allocated?

☐ Yes ☐ No

No comments

Q233 Section 7.2.4 Should the IAIS address the substantiation of the realisability of DTAs? If "yes", please explain, taking into account issues related to a stress DTA (including defining future tax profits, reflecting the shock on future profits and avoiding double counting).

☐ Yes ☐ No

No comments

Q234 Section 7.2.4 Should groups be able to assume they can obtain value for the tax effects of the stress loss by selling tax losses to unregulated group companies which have taxable profits? If "yes", how would they assess whether these group companies would still be profitable in stress?

☐ Yes ☐ No

No comments

7.3 General comments

Q235 Section 7.3 Are there any further comments on the approach to tax within the ICS that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.

☐ Yes ☐ No

No comments