Position Paper

Insurance Europe response to the IAIS consultation on a proposed updated G-SII assessment methodology

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Introductory comments

Insurance Europe welcomes the chance to respond to the consultation and recognises that the revised methodology is improved. Although a number of industry comments have been taken into account, the consultation presents a set of apparently unrelated changes in the methodology, which makes it difficult to fully understand the overarching rationale behind the update. Estimating the ultimate effect of these changes on the methodology is further obscured by the fact that the methodology is tightly interlinked with other parts of the G-SII framework, such as the bucketing approach in the Higher Loss Absorbency (HLA) and the parallel consultation on the definition of non-traditional non-insurance (NTNI) activities.

The consultation reiterates the objective of the assessment methodology, (i.e. to identify any insurers whose distress or disorderly failure, because of size, complexity and interconnectedness, would cause significant disruption to the global financial system and economic activity). However, both the current and proposed methodologies do not adequately distinguish:

- between institution-specific risks and sector-wide or even financial system-wide risks; and
- between insurers being exposed to systemic risk and insurers creating systemic risk (i.e. where the failure of the insurer causes disruption to the financial system).

The International Association of Insurance Supervisors' (IAIS) move toward absolute reference values for certain indicators appears like a positive development if it means that the systemic risk potential of insurers is rightfully assessed in relation to the financial system, as opposed to a sample of approximately 50 other insurers.

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The impact of this change remains unpredictable at this stage, because it is unclear how the threshold for dividing the sample of insurers into candidates and non-candidates is set. Insurance Europe would ask for more transparency in this respect and would also point out that:

- A number of details relating to the determination of absolute reference values are left open and therefore it is not clear how absolute reference values will lead to a potential G-SII designation and how the thresholds are set. Insurance Europe believes that an absolute threshold (set for example in the context of all participants in the financial system) for the level of activity that would lead a company to be considered systemic must be introduced. Activity below this level should be excluded from the assessment score as it would not be a relevant contributor towards systemic risk.
- The quantitative assessment will remain relative in nature if an absolute threshold is not introduced and in this case the purpose of assessing the contribution of the insurance industry to global systemic risk would be defeated because only a measure of contribution relative to other insurers would be provided.
- Based on the IAIS' comments during the stakeholder meeting of 20 January 2016, Insurance Europe understands that the IAIS intends to implement absolute reference values in its quantitative assessment and that it acknowledges the implicit indicator weight change and implicit impact on other indicators.
- Indeed, Insurance Europe notes that the use of absolute reference values for some indicators only would implicitly and artificially change the weights of the other indicators (typically by increasing them). Therefore, in Insurance Europe's view, it would be preferable to change the entire assessment into an absolute one or to limit the potential variation of indicators and categories for which relative values are still used.
- A way to address the implicit weight changes of absolute indicators and their impact on other indicators could be to re-balance the weights within their categories, so as to not affect the entire assessment approach.
- Under these conditions, Insurance Europe believes that additional indicators should be amended. A list is proposed in the answer to question 2.
- The use of absolute reference values for reinsurance may provide a better indication as to the level of use of reinsurance relative to the reinsurance market as a whole, rather than to a subset thereof. Nonetheless, the underlying assumption that reinsurance contributes to systemic interconnectedness or the use of exposure measures which do not take into account the risk mitigating benefits inherent in the use of reinsurance is not appropriate.

Insurance Europe welcomes the inclusion of an exchange with prospective G-SII in Phase IV of the methodology. This exchange should consist of a dialogue and, if the prospective G-SII is able to allay concerns raised by the IAIS, this should be taken into account in the designation process.

Insurance Europe remains concerned that not enough recognition is given to the fact that most activities of insurance undertakings do not give rise to systemic risk. Therefore, there remains a non-negligible likelihood of wrongful designation of firms as G-SIIs when they are not systemically risky. This is all the more concerning given the continued absence of a clear indication of how an insurer can exit the list of G-SIIs. From a legal process standpoint, Insurance Europe also remains concerned by the lack of remedies or means to challenge the G-SII designation.

Finally, while Insurance Europe understands that the focus of the IAIS in this consultation is on the G-SII designation methodology, it also notes that, regardless of the final changes and improvements, the quantitative assessment must rest on unambiguous instructions and definitions. The data collection informing the 2016 G-SII designations will be the fourth such exercise but the data collection instructions and related definitions remain an area of the annual G-SII designation process which is still in need of significant improvements, such as:

- **Reinsurance.** The scope of third party reinsurance is not fully defined yet. For instance, it is not clear whether firms are expected to report business volume originated through fronting under the reinsurance indicator or not. In economic terms, business originated through fronting (e.g. originated in jurisdictions where the insurer has no subsidiaries or branches by involving a third party), is equivalent to business originated directly, as the fronting party and the reinsurance contract between the parties act as a pass-through. The risk kept by the fronting party is negligible, if it exists at all. This would be a strong argument against reporting fronting under third party reinsurance. In case the IAIS takes the view that business volume originated through fronting is relevant and akin to third party reinsurance, then the instructions have to state that fronting must be reported and under what conditions.

- **Life insurance.** The NTNI consultation paper suggests assessing surrender values under normal economic conditions and stressed market conditions. However, the IAIS fails to define the stressed market conditions to establish a robust comparison among the sample firms. This is of particular relevance in regard of the applicability of stays on surrenders, their ultimate duration, and hence the pay-out pattern. While the ability of authorities to suspend surrenders is codified in various markets, it is situational and fraught with rational and behavioural considerations.

Answers to consultation questions

***Question 1**: Is the use of absolute reference values appropriate for the indicators for reinsurance, financial guarantees, and derivatives trading (CDS sold)?*

Insurance Europe welcomes the use of absolute reference values for certain indicators if the systemic risk potential of insurers will end up rightfully being assessed in relation to the financial system or the relevant market, as opposed to a sample of approximately 50 other insurers. On the assumption that the IAIS intends to implement absolute reference values in its quantitative assessment approach, Insurance Europe believes that additional indicators should be amended, particularly when insurers are one of the many participants in the financial system (See answer to Question 2).

Insurance Europe would highlight that the use of absolute reference values needs to be combined with an absolute threshold (set for example in the context of all participants in the financial system) for the level of activity that would lead a company to be considered systemic. Activity below this level should be excluded from the assessment score as it would not be a relevant contributor towards systemic risk. The quantitative assessment will remain relative in nature if an absolute threshold is not introduced and in this case the purpose of assessing the contribution of the insurance industry to global systemic risk would be defeated because only a measure of contribution relative to other insurers would be provided. In addition, more transparency regarding the threshold for dividing the sample of insurers into candidates and non-candidates is needed.

Insurance Europe notes that the use of absolute reference values for some indicators only would implicitly and artificially change the weights of the other indicators (typically by increasing them). Therefore, in Insurance Europe’s view, it would be preferable to change the entire assessment into an absolute one or to limit the potential variation of indicators and categories for which relative values are still used. A way to address the implicit weight changes of absolute indicators and their impact on other indicators could be to re-balance the weights within their categories, so as to not affect the entire assessment approach.

Insurance Europe would point out that the magnitude of an insurer’s activity in relation to the absolute reference value (i.e. the denominator representing the total respective market) for the same activity, should be the main indicator for determining whether this involvement would give rise for systemic concerns.

A combination of financial or insurance sector-wide denominators with either a change in the total score to be allocated or a change in the way the total score is apportioned (e.g. a concentration rather than a market share approach) would ensure that absolute reference values truly have an impact on the quantitative assessment. For example, the total score per indicator could reflect a year-on-year evolution of the business volume or assumed riskiness in the sample.

***Question 2:** Should the IAIS consider measuring other indicators by absolute reference values? If yes, identify the indicator, explain the absolute reference value that can be used and explain why the use of the absolute reference value would improve the Proposed Methodology in the future.*

On the assumption that the IAIS intends to implement absolute reference values in its quantitative assessment approach, Insurance Europe believes that additional indicators should be amended, particularly when insurers are one of the many participants in the financial system. Relative measures are not suitable, as they do not determine the potential risk to the global financial system. This change would help the IAIS determine whether the insurance sector's specific activity is sufficiently significant to be considered an appropriate indicator of systemic risk. In Insurance Europe's view, absolute reference values should be applied to the following indicators:

- **Size** (total assets)
- **Interconnectedness** (derivatives)
- **NTNI**
  - Short term funding - indicators for securities lending and repo.
  - Securities lending – reference values from the International Securities Lending Association (ISLA) market report which sets out the value of aggregate global securities lent.
  - Repos - reference values could be based on activity reported to the European Repo Council for its Repo Market Survey.

***Question 3:** What information or data could be used as an absolute reference value for the financial guarantees indicator?*

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***Question 4:** Is structured finance bonds insured an appropriate denominator or should the denominator reflect the notional value of bonds guaranteed by the broader financial sector via non insurance products?*

A clear definition of structured finance bonds is required, in case that the absolute reference value takes only structured finance bonds into consideration. Moreover, the concept of bonds guaranteed via non-insurance products should be explained.

***Question 5:** Are BIS statistics on the overall global CDS market an appropriate absolute reference value for the derivatives trading (CDS sold) indicator? If so, how should this absolute reference value be used by the IAIS? What other information or data could be used as an absolute reference value for the derivatives trading (CDS sold) indicator?*

The BIS statistics provide the only public and quantified data on traded derivatives. However, the BIS data should be tested against information submitted by the Global-Systemically Important Banks (G-SIBs) on Credit Default Swaps (CDS) to ensure their reliability. It would also make sense to build a ratio between the CDS sold by the sample insurer and the overall global CDS market.

***Question 6:** Are total global reinsurance premiums written an appropriate absolute reference value for the reinsurance indicator? If so, how should this absolute reference value be used by the IAIS? What other information or data could be used as an absolute reference value for the reinsurance indicator?*

Insurance Europe would point out that no case has yet been made for considering reinsurance as giving rise to systemic risk. Therefore, reinsurance should not be included in the list of indicators. Instead, reinsurance should be incentivised as a stabilising factor to the financial system.

Paragraph 22 suggests that alternative capital sources will constitute an increasing portion of the global reinsurance market; then this will reduce any extent to which reinsurers could possibly give rise to systemic risk and the methodology should take this into account. At the same time, in this scenario, the IAIS should be able to assess such alternative capital sources for systemic riskiness.

The use of absolute reference values for reinsurance may provide a better indication as to the level of use of reinsurance relative to the reinsurance market as a whole rather than to a subset thereof. Nonetheless, the underlying assumption that reinsurance contributes to systemic interconnectedness or the use of exposure measures which do not take into account the risk mitigating benefits inherent in the use of reinsurance is not appropriate.

The choice of absolute value for the indicator should recognise that the current reinsurance market is not characterised by an individual reinsurer being a source of global systemic risk. Therefore, the absolute value of the indicator should reflect a share of the total insurance market that is significantly higher than any single reinsurer currently achieves.

With due consideration for all of the above: The IAIS proposes to rely on gross written premia for the indicator. Insurance Europe notes however that a combination of both gross written premia and technical provisions would better capture both current and run-off business.

Question 7: *To what extent are large exposures an appropriate indicator of an insurer's interconnectedness with the financial system? What is the appropriate way to measure or understand the interconnections between an insurer's large exposures and the financial system?*

Insurance Europe disagrees with considering the large exposures indicator during Phase III analysis. Investing large exposures and maintaining interconnections with the financial system is a natural consequence of insurers acting as institutional investors. Insurance Europe believes that large exposures management is a micro prudential issue, as large exposures do not create linkages that result in the transmission of risk to the system. Consequently, the large exposures indicator cannot provide relevant information for the purpose of systemic risk assessment.

Question 8: *To what extent, if any, are intra-group commitments an appropriate measure of a potential G-SII's systemic relevance?*

Though intra-group commitments or transactions may certainly affect the financial condition of an insurer, there is no reason to consider this risk systemically relevant. The G-SII framework is meant to avoid dislocation in the global financial system and to prevent adverse economic consequences across a range of countries due to a failure of individual institutions. It is not supposed to eliminate the risk of failure itself. In addition, similar to large exposures or risk concentrations, intra-group commitments are subject to regular reporting requirements which enable supervisory authorities to intervene in a timely manner, if necessary.

Question 9: *To what extent is the derivatives trading (excluding hedging and replication) in economic terms indicator an appropriate indicator of NTNI activities? What is the appropriate way to measure or understand the systemic importance of speculative derivatives trading?*

Insurance Europe disagrees with the suggestion that insurers use derivatives for speculative purposes. In most jurisdictions, insurers are prohibited from speculative derivatives trading, and these are instead used for hedging and risk management purposes. The fact that data reported on CDS was not meaningful is therefore not surprising.
Insurance Europe understands that the IAIS may be concerned by the use of derivatives by insurers, however such concerns are only justified only for derivatives that are uncollateralised and have potential for counterparty risk. In fact, given the recent G-20 derivatives reform, such cases should be isolated.

The G-20 derivatives reform, which was launched in 2009 and triggered a set of measures aimed at increasing the transparency of the derivatives market and addressing systemic risk. There measures included: compulsory central clearing (where possible), compulsory reporting of derivatives and compulsory margining of derivative exposures. Two types of margin were defined: a) the variation margin – aimed at covering daily changes in the market value of a derivative position and b) the initial margin – aimed at covering any changes in the value of variation margin collateral in cases where a default would occur and this collateral would need to be sold. The entire framework for haircuts on collateral and initial margins was very conservatively calibrated with the stated objective of them being sufficient to offset any loss caused by the default of a counterparty with a high degree of confidence. In addition to the important safeguards already embedded in the regulation of the derivatives market, in Europe the prudential framework for insurers (i.e. Solvency II) includes extra capital requirements meant to cover derivatives counterparty risk. Against this background, Insurance Europe believes that in jurisdictions that have implemented the G-20 derivatives reform systemic and counterparty risk concerns have already been addressed by regulation and there if therefore no reason to automatically assume that derivatives are appropriate indicators of NTNI activities.

The analysis should also consider structures where the risk isn't materially offset (e.g. offsetting long and short positions within a fund).

Question 10: *The weightings in Phase II of the Proposed Methodology emphasize the insurer's NTNI activities (45%) and its interconnectedness (40%). Are there any developments or trends in the global insurance market that warrant further refinements to the 2013 Methodology, potentially including changes to the category weightings? Please explain your answer.*

Insurance Europe believes that systemic risk in the insurance sector can only originate in the extent and the potential impact of certain NTNI activities. Although the assessment methodology is attributing the highest weight to NTNI, the other categories - most notably interconnectedness - still have significant impact on the outcome of the quantitative assessment. In Insurance Europe's view, interconnectedness indicators, as used in the current methodology, do not provide meaningful results in terms of systemic risk, whereas size and global activity actually improve the risk-absorbing capacities of insurers. Insurance Europe understands that the concept of interconnectedness is very much linked to the Financial Stability Board's (FSB) definition of systemic risk. However, the proposed measurement of interconnectedness does not appropriately reflect the potential transmission of risk from the insurance industry to the system.

Question 11: *Will the responsiveness of the derivatives indicator in the interconnectedness category be improved by using other data such as an appropriate net fair value figure (either positive or negative)? If so, what are more appropriate data and what is the appropriate way to use such data to measure or understand the interconnectedness caused by derivatives transactions? Should the IAIS measure interconnectedness with respect to derivatives transactions in the same manner as the BCBS? Please explain your answer.*

Irrespective of the technical implications of raising meaningful data on derivatives, the more important question is what economic purpose derivatives serve. Insurance Europe understands that derivatives traded for profit (speculative) reasons are addressed in the NTNI category as far as CDS sold are concerned, whereas other profiles will be assessed in Phase III of the evaluation.

The derivatives addressed in the interconnectedness category are part of a hedging strategy determined to secure market positions or policyholder options. The use of derivatives for hedging purposes is part of the asset-liability-management of insurers intended to mitigate risks rather than amplify them. Therefore, these transactions should not be considered systemically risky at all and the IAIS approach should appropriately reflect the outcomes of the G-20 derivatives reform that was aimed precisely at addressing systemic risk concern in the derivatives market.

The derivatives indicator should be improved to focus on potentially systemic activity that has not already been addressed by regulation triggered by the G-20 derivatives reform. A first stage would be to distinguish between derivatives used for replicating, hedging and trading and pure speculations. Vanilla derivatives used to better match liabilities should be stripped out. Risk mitigation from collateralisation and clearing should also be fully acknowledged.

Gross notional value of derivatives held is considered an indicator of interconnectedness. In Insurance Europe's view, the IAIS should focus on the net fair value of the derivative activity it considers as NTNI and exclude derivatives used for what are deemed traditional purposes from the assessment methodology.

Where there are specific positions where gross notional materially misrepresents the risk, these should be netted down. Example: equity futures, where a fund can have a long and a short position with the exchange where the risk is fully offsettable. When using gross notional values the positions would be added together to show a big risk, rather than netted off, as they are offsettable at all times.

Some other considerations:

- When insurers buy options, they will be exposed to counterparties and not the other way around.
- Use of collaterals is a mitigating factor to the exposure that a counterparty may have to insurers.
- The derivatives indicator should be improved to focus on potentially systemic activity only. The current approach will disincentivise the use of derivatives to ensure assets held by insurers better match their liabilities. In addition, it makes no account of the type of derivative assets so that a one week FX hedge to fix a dividend cash flow is treated the same as a Collateralised Debt Obligation (CDO).

Question 12: *How can the reliability and responsiveness of any indicator, including those mentioned above, be further improved, modified or revised for the Proposed Methodology?*

Insurance Europe would challenge the relevance or the way in which some of the indicators are used in assessing systemic risk:

- The short term funding indicator should be improved to focus on potentially systemic activity related to securities lending rather than measuring all securities lending. The IAIS methodology document recognises that there are types of short term funding arrangements that are "vanilla" and carried out within traditional businesses without creating risks. For example, "if the cash collateral from the repurchase agreement or securities lending transaction is reinvested in liquid, high credit quality assets, and if the security lent or put out on a repo is liquid, then the activity is traditional. However, if the reinvestment is in long-term, or low credit quality or illiquid securities then the risks are sufficient for the activities to be deemed NTNI. Moreover, if low credit quality or illiquid assets are used for securities lending or in repurchase agreements, then the risks are sufficient to be deemed NTNI." It is therefore important that for securities lending within the short term funding indicators that the data collected focuses on securities lending used for maturity transformation and collateral hypothecation, and excludes "vanilla" securities lending which the IAIS's accepts is not NTNI. If for some reason this distinction cannot be operated, the IAIS should at least introduce a threshold recognising that, below a level of activity, short term funding and securities financing transactions are legitimate and unproblematic operations of insurers in the context of liquidity management.

- Regarding liability liquidity, there needs to be a distinction between the theoretical possibility of surrender and actual expected behaviour as the policyholders will have other associated benefits which are valuable (e.g. insurance cover, guarantees). The reliability of the indicator could be improved by taking a net view of asset and liability liquidity, which tie into asset-liability management, a critical component of proper insurance risk management. For instance, when the investments are clearly allocated to the policyholder, the liquidity constraint should be defined as the net position between the surrender value and the liquid assets available to pay the surrender value, and not as the full surrender value.

- In the appendix, where the rationale for choice of indicators is described, with respect to minimum guarantees on variable insurance products the consultation paper states the following: "variable insurance products (including variable annuities and unit linked products with capital protection) most often include some type of guaranteed levels of payment to policyholders: attempting to pay guaranteed amounts could accelerate asset sales by an insurer and exacerbate already distressed market conditions". Insurance Europe disagrees with this statement: guarantees on variable annuities and unit-linked products are generally not provided on surrender and payments on account of guarantees will usually be foreseen. Therefore, the presence of guarantees doesn't create any risk of acceleration of asset sales in distressed market conditions.

- The level 3 asset indicator should be removed as it does not take into account the asset-liability management or insurers' long-term investment role. For example, level 3 assets may be backing non-liquid liabilities and therefore in such circumstances there can be no fire sale concerns. Therefore, if the indicator were to be retained, where level 3 assets are held to back non-liquid liabilities they should be excluded.

- Intra-financial assets expose insurers to systemic risk but do not create systemic risk. The IAIS argument that there may be a fire sale of these assets seems therefore exaggerated in the context of creating systemic risk. This indicator should be removed.

Question 13: *What criteria, other than those listed above, should the IAIS consider when determining whether to include an insurer in the Phase I data collection?*

In general, Insurance Europe is unconvinced that there is any link between many of the criteria specified and global systemic risk. To reiterate the IAIS's own views: *"there is little conceptual reason for life and non-life insurance activities to either trigger or amplify systemic risk."* The criteria seem to relate simply to amounts of assets and premiums, even though large-scale "traditional" insurance activities will not give rise to systemic risk. Large insurers with no or only limited exposure to systemically risky activities will therefore be investigated, whereas theoretically if a smaller insurer would engage in a large number of such activities, it would avoid scrutiny. More information about the process which has led to the selection of figures and ratios would be needed.

Question 14: *What are the strengths and weaknesses of consistency and relative annual stability as a guiding principle for establishing the quantitative threshold in Phase II? For purposes of establishing the quantitative threshold, what other principle(s), if any, should the IAIS consider?*

The threshold which will separate the sample into a group of candidates and a group not envisaged for G-SII-designation is the most important junction of Phase II. Insurance Europe strongly believes that this junction should be subject to a maximum degree of transparency. Undertakings need to know and be able to understand why and based on which analysis the IAIS settled on the threshold.

It is crucial that this analysis is focused on systemic risk considerations instead of simply dividing the sample into groups in order to comply with the process. Consistency means that a threshold calibrated along these lines should not rule out the possibility that no individual insurer would eventually qualify for G-SII-designation. Moreover, it is important that the process to establish the threshold remains flexible to be aligned to future developments, if necessary.

Therefore, Insurance Europe understands the principle of relative stability to mean that once the IAIS has agreed on a threshold, it will be applied for the assessment process of the corresponding year, (i.e. there won't be retrospective changes).

Question 15: *For purposes of establishing the quantitative threshold in Phase II, what other approaches, if any, should the IAIS consider? What are the strengths and weaknesses of the alternative approaches, as listed above, to determining the quantitative threshold?*

To ensure consistency on a cross sectoral basis, comparison to G-SIFIs and G-SIBs in particular would seem the most appropriate basis for determining the quantitative threshold. Banking is inherently systemic, but the threshold for G-SIBs has been set so that only the most systemic banks are designated. Therefore, it would be appropriate that the threshold for insurers is set at a comparable level to the G-SIB threshold.

Question 16: *While the majority of the Proposed Methodology will be based on quantitative outputs, what specific qualitative aspects of a potential G-SII should be considered in Phase III that are not captured in Phases I and II?*

Insurance Europe welcomes the fact that the IAIS proposes to consider insurers' exposure to large counterparties only qualitatively as this does not indicate the impact of the insurer's failure on the system. The same principle needs to be applied to other indicators and a distinction between insurers' exposure to systemic risk and the system's exposure to insurers needs to be made.

The qualitative assessment should take account of regulatory frameworks applicable in the jurisdictions of the G-SII-candidates, as well as of other potential mitigating factors. In the process of comparing and ranking insurance companies, financial strength and risk management practices need to be incentivised. In the context of a major financial crisis, it is of crucial importance whether a counterparty fails and is therefore not able to fulfil its obligations. This could happen either to a company which has not implemented effective risk management practices or to one that is not financially strong.

Phase III should also assess the quantitative data to ensure that it is representative. For example, it should consider the ancillary factors set out in the parallel consultation on NTNI to determine whether any of the quantitative outputs for each indicator should be disregarded.

Question 17: *What constraints should be imposed on the use of non-quantitative analysis of the potential systemic importance of insurers in the Proposed Methodology? To what extent, if at all, can qualitative analysis enhance the IAIS's understanding of the systemic importance of a potential G-SII?*

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Question 18: *What other indicators, if any, could be considered by the IAIS to inform the supervisory judgment aspects of the Proposed Methodology?*

Whether the group falls within the definition of a financial conglomerate (in some jurisdictions the distinction between a financial conglomerate and an insurance group is reflected in the applicable supervisory set-up; e.g. the Financial Conglomerate Directive vs. the Insurance Group Directive) could be an appropriate indicator to include within the interconnectedness category to provide a focus on any potential complexity and interconnectedness that may be present where a group has material business in other sectors, such as banking.

Question 19: *How can the additional information collected in the supplementary reinsurance-specific questions as part of the data collection be relevant to better assess the potential effects of a reinsurer's failure on other reinsurers or primary insurers? Should the IAIS set a threshold amount of third-party reinsurance activities that must be exceeded by an insurer in order to be required to complete the supplementary reinsurance-specific questions in Phase 1? If so, what should be the level of the threshold?*

Insurance Europe does not understand the purpose of the Reinsurance Supplemental Assessment. The IAIS has looked at reinsurance in detail and concluded that "*traditional reinsurance is unlikely to cause, or amplify,* *systemic risk.*"[1] It is then unclear why there should be a need for an additional analysis of an undertaking's reinsurance activities in Phase III, particularly since there is already a reinsurance indicator in Phase II. If such an assessment is to be carried out, it only makes sense instead of rather than in addition to the Phase II reinsurance assessment.

The assessment of the potential effects of a reinsurer's failure on other reinsurers or primary insurers should take full account of the IAIS's own work on extreme stress scenarios, the conclusion of which was: "The results are similar for both primary insurers and reinsurers. The impact on equity capital (which in this context serves as a proxy for solvency) of severe financial market crises far outweighs the adverse effect of large catastrophic loss events. Adding the default of one large reinsurer would make a comparatively small contribution to the total losses absorbed by primary insurers."

In addition, the IAIS report "Reinsurance and Financial Stability" dated 19 July 2012 concluded that "*as far as traditional reinsurance activities are concerned, the potential for adverse and potentially systemic intra-industry impacts is small and will likely be contained within the insurance sector*". It should also be noted that the IAIS affirms in its 2015 Global Insurance Market Report that "the global reinsurance market has proven able to withstand the impact of large catastrophes and economic events; recent examples include the terrorist attack on the World Trade Centre on September 11, as well as the hurricanes Katrina, Rita and Wilma in 2005". The Reinsurance Supplemental Assessment is unlikely to provide any new insights.

Notwithstanding the very important role they play in supporting the activity of primary insurers by pooling tail risk globally, the interconnections between reinsurers and the rest of the financial system are unlikely to prove problematic from a systemic perspective. In fact, only around 5% of global primary insurance premiums are ceded to reinsurers. This risk is partially passed on through insurance-linked securities (ILS) to capital markets and other reinsurers. But total ILS issuance is equivalent to around 0.1% of global insurance premiums. Retrocession (which consists of reinsurers buying reinsurance) is considered the main channel of direct interaction between reinsurers. Retrocession is mainly used for peak risk exposures and amounts to 13% of global reinsurance premiums and a mere 0.6% of global insurance premiums. Risks are retroceded only once and this process rarely occurs between top reinsurers but more often involves second or third tier reinsurers[2]. Consequently, there is no network-like inter-insurance market similar to the interbank market[3] and the systemic risk potential is correspondingly much lower. It has been shown (in particular by the French regulator[4]) that even an extreme scenario in which all reinsurers in a market fail, would only adversely impact a small number of insurers, without leading to the materialisation of counterparty risk. As the IAIS already noted, "the (re)insurance sector has built in circuit breaks" and "connections between reinsurers are weak and most likely immaterial".

Finally, any assessment methodology should be open, transparent and applied consistently by supervisors across jurisdictions. Clarity is especially needed with respect to the Phase III assessments as well as in the case of the Reinsurance Supplemental Assessment, where it is a component of Phase III.

Question 20: *Are gross written premiums, technical provisions or exposures an appropriate way to measure and/or understand the interconnections between an insurer's third-party reinsurance activities and other primary insurers and reinsurers?*

Insurance Europe believes that gross written premiums provide a rough indication of the interconnections between an insurer's third-party reinsurance activities and other primary insurers and reinsurers with regard

[1] IAIS (2012) – *Reinsurance and Financial Stability*

[2] Source of all figures in this paragraph available upon request (SwissRe, MunichRe Economic Research)

[3] Fig. 21, p. 28 in http://iaisweb.org/index.cfm?event=openFile&nodeId=34379

[4] Frey, Tavolaro, Viol (2013) – « Analyse du risque de contrepartie de la réassurance pour les assureurs français », Autorité de Contrôle Prudentiel – Débats économiques et financiers, 4/2013

to current business, whereas in run-off technical provisions are a better indicator. However, the level of interconnections has limited value in terms of systemic risk. Measured by absolute reference values, only around 5% of global written insurance premiums are ceded to reinsurers.

Question 21: *How could the information collected be used to evaluate the extent to which an insurer's third-party reinsurance activities disperse or concentrate risk in the global insurance market?*

As noted, the reinsurance market is considerably smaller than the primary insurance market and this is reflected in the smaller number of reinsurance players. While simple measures, such as gross written premiums provide an indication of interconnectedness, these measures cannot be used to evaluate risk concentration. Identification and assessment of risk concentrations is one of the key uses of internal models which by design measure risk exposures at appropriately granular levels. Where internal models are supervisory approved, this provides a further layer of comfort that risk concentrations are adequately captured. Overly high levels or simplistic exposure measures will not appropriately capture risk profile and concentration risks.

Question 22: *Are an insurer's third-party reinsurance activities interconnected with financial markets and, if so, how? What additional data measures could be useful to understand the extent to which an insurer's third-party reinsurance activities are interconnected with other parts of the financial markets (e.g. banks or asset managers)?*

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Question 23: *What other data points would be relevant for the IAIS to consider in the Proposed Methodology when evaluating the extent to which the potential geographic risks (i.e. the risk that a reinsurer or insurer may be overly concentrated in one area) of the global reinsurance market are dispersed or concentrated among certain reinsurers or insurers?*

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Question 24: *What types and forms of information exchange with prospective GSIIs should the IAIS consider?*

There should be a frank and in-depth conversation between the IAIS, the relevant authority and a prospective G-SII. The IAIS should explain exactly how the assessment has been carried out and why the insurer has been designated a prospective G-SII, so that the insurer has all the relevant information, in order to be able to provide the IAIS with any additional information or arguments. During this dialogue, the prospective G-SII should have a chance to allay the IAIS' concerns, and this should then be considered in the designation process. More precisely, the following should occur:

- The insurer should be asked for qualitative information surrounding the data request for the assessment methodology, so that it can highlight where it potentially considers that the data does not adequately represent the risk that the IAIS methodology is intended to address.
- The group supervisor should consider representations made by insurers through the data collection exercise and take account of the Systemic Risk Management Plan (where an insurer has been required to prepare one) in its assessment. The group supervisor should issue a written preliminary response setting out where it agrees or disagrees with representations made, and whether and if so how it will amend the data included within the quantitative assessment leading to the overall score under the assessment process.
- It would be helpful if this were followed up with a meeting between the group supervisor and the insurer, before a final determination by the group supervisor is reached. This determination should be confirmed in writing.

Question 25: *Is it reasonable for Phase 2 of the Methodology to be the basis for applying HLA to G-SIIs? Please indicate any alternative methods that the IAIS should consider for this allocation process. What constraints, if any, should be applied to Phase III's effect on the allocation of HLA?*

It is important the HLA is based on appropriate data. Where Phase III assessment considers that the data is not indicative of potential risk, for example after considering the ancillary factors, then the data should be disregarded from the assessment and should not contribute to the G-SIIs overall score, as this could otherwise influence the bucket that the insurer is allocated to for the purposes of HLA.

The allocation for HLA purposes should be determined and communicated to the potential G-SIIs as soon as possible. Therefore, it is reasonable to base the initial allocation on the initial G-SII assessment of Phase II. However, any fundamental changes of assessment due to discoveries in Phase III or even Phase IV must be considered in the HLA bucket allocation. The IAIS clearly states that the assessment process is not final before Phase V and the HLA allocation cannot be based on a preliminary result.

Question 26: *What factors, such as stability in the G-SII list, should the IAIS consider when determining the appropriate presumption period for G-SII status?*

In Insurance Europe's view, a relevant factor would be whether a change in an insurer's overall score in the designation process was due to temporary factors, or whether is indicative of a more permanent view. Where it is a temporary factor, this should not necessarily lead to an insurer entering or exiting the list, but where the change is indicative of a more permanent view, there should be no reason to delay the insurer's entry or exit from the list of G-SIIs. This should be discussed with the insurer as part of the information exchange.

Insurance Europe does not agree with the two-year minimum presumption of G-SII status. It is not reasonable and proportionate for an insurer to remain on the G-SII list and subject to policy measures if it has taken satisfactory steps to reduce its systemic relevance. The stability of the G-SII list is not a value in itself that needs to be protected. The first G-SII designation should also be instantly effective without granting transitional periods.

Question 27: *How and, if so, to what extent should conceptual aspects of the Proposed Methodology, including, the data instructions, the data template, and the detailed formulas used for the calculation of indicator scores be made publicly available? If made publicly available, who should disseminate this information? What factors should the IAIS consider in this respect?*

There should be as much public disclosure as possible around the methodology, including the detailed formulas used for the calculation of indicator scores. The IAIS should disseminate this information via their website.

Question 28: *How and, if so, to what extent should the resulting score be communicated to the prospective G-SII?*

The resulting score should be communicated to the prospective G-SII within Phase IV of the methodology, where the IAIS, the relevant authority and the prospective G-SII will have an in-depth conversation about the assessment and resulting score, allowing the prospective G-SII to provide additional information and arguments to inform the G-SII designation.

It will be essential that the resulting score and the breakdown of how it has been calculated between the differing factors is clearly communicated to prospective G-SIIs to enable them to understand the nature of their designation and the actions they may need to take to address perceived systemic activity if they want to exit the list of G-SIIs.

Question 29: *How and, if so, to what extent should the data used for the calculation of the scores and the resulting scores be made transparent to the public? If made publicly available, who should disseminate this information? What factors should the IAIS consider in this respect?*

The data used for the calculation of the scores and the resulting scores should not be made publicly available.