insurance europe

Position Paper

Response to IAIS consultation on draft supervisory material related to the holistic framework for systemic risk

Our reference:	ECO-IAR-19-084		
Referring to:	IAIS consultation on draft supervisory material related to the holistic framework for systemic risk		
Pages:	7	Transparency Register ID no.:	33213703459-54

Q1 General comments on the Revisions related to the Holistic Framework for Systemic Risk in the Insurance Sector

- Insurance Europe has always argued that conventional insurance is not systemically risky, and that systemic risk can only originate from a very limited number of activities undertaken on a large scale in the wrong conditions. A greater focus on potentially systemic activities of the insurance sector as a whole is therefore warranted.
- As with all IAIS work, it is important to ensure that comparable outcomes are achieved in every jurisdiction, so as to ensure a global level playing field.
- A strict and consistent application of the principle of proportionality is crucial. Proportionality should not be limited to requiring all insurers or all IAIGs to apply a measure with different expectations of granularity. Proportionality also means questioning whether an insurer shall be subject to a certain measure at all. In general, Insurance Europe has always argued that conventional insurance and reinsurance are not systemically risky. The example of conventional reinsurance is particularly relevant: the IAIS itself has stated that reinsurance was not systemic and does not carry out a risk of contagion. Supervisors should demonstrate the proportionality principle in the application of the measures.
- The data collection amendments in the ICPs go very far in terms of significantly increasing the burden both for insurers and supervisors.

Q7 Comment on Guidance ICP 10.0.2

Insurance Europe welcomes the explicit statement that the interests of policyholders and the public interest of financial stability are not independent of each other and that measures primarily aimed at policyholder protection also contribute to financial stability. At the same time however, the industry suggests a wording that takes the strong interconnection between these objectives fully into account. Sophisticated regulatory frameworks, for example Solvency II, quite effectively address financial stability threats as well. Therefore, the application of preventive and corrective measures already available to ensure compliance with laws and regulations also serve financial stability as a rule. Only in rare and exceptional circumstances might a conflict of objectives occur. Accordingly, the last sentence of 10.0.2 should be worded as follows:

> "By mitigating certain risks, preventive and corrective measures that are primarily intended to protect policyholders ~~may also~~ regularly contribute to financial stability as well, by decreasing the probability and magnitude of any negative systemic impact".

Q8 Comment on Guidance ICP 10.2.2

Insurance Europe aisbl
Rue Montoyer 51, B-1000 Brussels
Tel: +32 2 894 30 00 • Fax: +32 2 894 30 01
E-mail : info@insuranceeurope.eu
www.insuranceeurope.eu

The proposed drafting is potentially very broad in scope. Insurance Europe suggests making it clear that measures should be proportionate to the financial stability threat originating from the insurance industry. Because of the limited systemic risk posed by the insurance industry, it should be clarified that urgent measures solely dedicated to preserve financial stability should be applied with maximum restraint.

Q9 Comment on Guidance ICP 10.2.6

The first sub bullet point of the second bullet point has been amended to provide an example indicating that supervisors should have the power to impose hard or soft counterparty limits on individual counterparties, sectors or asset classes. The industry believes this example should be deleted as it would be inappropriate for supervisors to set such limits, rather insures should manage counterparty exposures in line with their risk appetite as indicated in ICP16.6.

In our view, such thresholds can be destabilising themselves. Interventions via hard threshold values could lead to a sustained disruption of the necessary balance between profitability, liquidity and security at the portfolio level of the individual insurer. Besides, assets are managed in line with the liability side. Hence, any exposure limit or concentration threshold would have to encompass asset-liability aspects. At financial market level, selling pressure or forced sales would have negative side-effects and are potentially destabilising. Setting thresholds could lead to herd behaviour and procyclical actions, rather than mitigating them. Even soft thresholds require insurers to take them into account in their investment strategy, reporting obligations and regulatory interactions. Therefore, any form of thresholds should be avoided.

Systemic Risk Management Plans (SRMPs) may offer a useful way for insurers to take corrective action on systemic risk before supervisory measures are necessary, but these need to be justified by clearly quantified and articulated evidence of systemic risk in advance with a clear commitment to proportionality.

Considering that ICP 24 addresses supervisory intervention and measures, it will be important to consider process and timeline to ensure SRMPs are meaningfully taken into account. According to ICP 24.3.4 the supervisor has to require the insurer to take action necessary to mitigate any particular vulnerability that has the potential to affect financial stability. In addition, ICP 24.4.3 clarifies that the supervisor should have supervisory requirements targeted at those insurers that have been identified as systemically important to mitigate systemic risk. A systemic risk report should therefore be used as an option for insurers to initially suggest mitigating measures to the supervisor, with more interventionist supervisory actions considered only once an insurer's report and proposed mitigating actions have been considered. , More reports and information requirements would produce significant administrative burdens and necessitate additional IT investments at the expense of insurers and, ultimately, policyholders. Any request for systemic risk reports should therefore be convincingly justified and subject to the proportionality principle. In practice this is likely to mean that supervisors bear in mind the cost and practicality of requiring a systemic risk report from an insurer with limited resources.

Q10 Comment on Guidance ICP 10.2.7

It is highlighted that a maximum interest rate could be a sensible instrument to avoid underpricing or under-reserving in excessively competitive market situations.

Regarding an additional reserving requirement, Insurance Europe highlights the proposal should be carefully analysed and put forward within the right context, in order to have a proper understanding of the purpose and expected benefits of such an intervention power. In some jurisdictions, reserving already considers the time value of financial guarantees on the basis of the actual interest rate environment. If such a measure is introduced, the design is crucial and needs comprehensive analyses and the implementation of adequate safeguards in order to avoid double counting of the same risk.

While supervisory or management actions regarding a temporarily freeze of the redemption values on insurance liabilities or payments of advances on contracts could be considered when faced with the manifestation of the tail risk mass surrender, at the same time however, this strong tool has to be handled with great care, especially when it comes to disclosure, in order to avoid undesirable side effects.

Further criteria for the design of an assessment are required.

Q16 Comment on Standard ICP 16.2

Insurance Europe welcomes the use of stress testing as a useful tool in identifying where a real risk arises in the broader context of the whole risk management framework for an insurer.

Q18 Comment on Guidance ICP 16.2.23

Macroeconomic exposure can accumulate at the liability and at the asset side. Insurance Europe would refrain from giving examples.

Q19 Comment on Guidance ICP 16.2.24

Insurance Europe welcomes the discussion of stress testing in other ICPs, but since ICP 16.2 refers specifically to insurers' own Enterprise Risk Management (ERM) frameworks, it is inappropriate to reference supervisory intervention in relation to the frequency, scope and type of stress testing here. A sound ERM framework is based on the premise that insurers develop internal management and controls. This could be undermined by stress tests imposed by supervisors directly within a firm's ERM framework. ERM frameworks could be informed by macroprudential stress testing, but this would be well beyond the scope of ICP 16.2. We therefore suggest ICP 16.2.24 is deleted.

Q20 Comment on ComFrame Standard CF16.2.b

The relationship between CF 16.2.b and CF 16.12.b is not clear as both require macroeconomic stress tests. Insurance Europe suggest merging both ComFrame elements.

Q22 Comment on Standard ICP 16.6

The requirement to integrate credit risk appetite under an investment policy is too prescriptive. Insurers should have the flexibility to document their risk appetites in the manner that best fits their ERM framework, for example through including (credit) counterparty risk appetite alongside capital and liquidity risk appetite within an ERM policy.

Q32 Comment on Guidance ICP 16.8.1

The expectations are too far-reaching for the moderate liquidity risk level of conventional insurance. Insurers' business models differ fundamentally from banks' business models. Insurers' investments are long term in character because they are backed mainly by long term liabilities. Therefore, it makes no sense to expect comprehensive analyses (like ability to monetise assets in each situation, characteristics of insurance contracts that may affect policyholder behaviour around lapse, withdrawal or renewal; contingent sources of liquidity). Further it is not clear why the analysis needs to be provided to the supervisor and how this duty relates to the liquidity risk management report (compare also comment on Question 36). In addition, policyholder behavior in a mass lapse event is not solely linked to contractual features. The whole ecosystem, including the retirement system, possible inheritance planning, avaibility of other financial products, etc. can provide disincentive or not to surrender. Insurance Europe would recommend deleting the guideline.

Q36 Comment on Standard ICP 16.9

Insurance Europe welcomes the use of stress testing as a useful tool in identifying where a real risk arises in the broader context of the whole risk management framework for an insurer.

In relation to the second bullet point, the reference to 'unecumbered high quality liquid assets' should be amended to 'unecumbered liquid assets'. The quality of those assets should be determined by insurers' liquidity risk appetite and the time horizon which could - for example - permit lower-quality unencumbered liquid assets subject to appropriate haircuts and stresses and depending on the time horizons considered. This bullet point should also have "in appropriate locations" added to the end of the sentence so that it is consistent with CF16.9.b.

The requirement of a more detailed liquidity management process is viewed very critically. This applies in particular to the requirements of a contingency funding plan and liquidity stress tests. The IAIS has not demonstrated why liquidity risk is assigned such a role within the holistic framework. An investigation of EIOPA concerning leading causes of insurers' failures and near misses, which comprises a sample of 180 affected insurance undertakings in 31 European countries from 1999 to 2016, also confirms that insurers' liquidity risk is of very limited systemic relevance (EIOPA 2018, Failure and near misses). Herein, EIOPA concludes that the financial crisis 2008 put a substantial amount of insurance undertakings and groups under severe financial distress and several insurers were affected. But this was attributable mainly to asset price losses, the interconnectedness with banks or, in general, evidence of weak governance. Liquidity shortfalls played a very limited role in the sector. In contrast, Central Banks had to massively provide liquidity to the banking sector via LTROs.

Given the fact that liquidity risks played a very limited role in the European insurance industry as a whole during one of the largest financial crises in modern financial history it appears reasonable to assume that existing liquidity risk management processes should generally be sufficient to address what is generally characterized as a moderate level of liquidity risk. EIOPA conluded that "there is no evidence yet of material liquidity risk at macro level that would justify the development and implementation of binding liquidity requirements for insurers" (compare p 68, EIOPA 2018, Other potential macroprudential tools and measures to enhance the current framework). Besides, there could be potential side effects, e.g. opportunity costs would arise in case certain minimum requirements would be set, insurers could be compelled to invest in lower yielding liquid assets to comply with a coverage ratio instead of investing in less liquid, higher yielding assets etc.)

Finally, it is unclear how contingency funding plans work and to what extent they impinge on pre-emptive recovery planning.

Q37 Comment on Guidance ICP 16.9.1

Insurance Europe does not believe it is appropriate to discredit activities such as repo, securities lending, derivatives or some insurance products in the way the IAIS proposes to do. Liquidity management should be considered at the company level, or at minimum within the legal boundaries to allow for cross-funding and not through a silo approach per activity, as long as an appropriate framework/governance is in place to manage risks inherent to such activity.

Q41 Comment on Guidance ICP 16.9.5

HQLA is a banking concept which is mainly used to measure if a bank has sufficient high-quality liquid assets (HQLA) to survive a significant stress scenario lasting for 30 days. Insurance Europe does not believe this is relevant to the insurance business.

Cash flow patterns in case of stress over 30 days in the banking sector justify such considerations, whereas insurance stresses are in their vast majority unwinding beyond this time horizon, and do not call for similar or identical consideration regarding assets' liquidity. Due to the longer horizon, cash flows generated by assets (e.g. coupons, redemptions, dividends, rents) are also important to face liquidity engagements in stressed situations. HQLA relies on a pure asset liquidation basis in a very short-term time horizon and is obviously not consistent with insurance time horizons.

In addition, such strict bucket approaches should be avoided. It would conflict with principle and risk-based frameworks such as SII where investments and ALM are not pre-judged.

Q49 Comment on ComFrame Standard CF16.9.b

The standard to maintain an adequate level of unencumbered liquid assets should be applied in a proportionate manner and should depend on the risk profile of each IAIG (compare also comment on Q32 and Q36). This requirement also exceeds the prudent person principle and gives too much power to supervisors on the asset mix of IAIGs.

The reference to 'unecumbered high quality liquid assets' should be amended to 'unecumbered liquid assets'. The quality of those assets should be determined by insurers' liquidity risk appetite and the time horizon which could - for example - permit lower-quality unencumbered liquid assets subject to appropriate haircuts and stresses and depending on the time horizons considered.

Q58 Comment on ComFrame Standard CF16.9.c

The standard to maintain a contingency funding plan should be applied in a proportionate manner and should depend on the risk profile of each IAIG (compare also comment on Q32 and Q36).

Q69 Comment on ComFrame Standard CF16.12.b

The relationship between CF 16.2.b and CF 16.12.b is not clear as both require macroeconomic stress tests. Insurance Europe suggest merging both ComFrame elements.

Q71 General Comment on revisions to ICP 20

Insurance Europe would caution that, with respect to liquidity risk, public disclosure could also have negative and procyclical effects. Disclosing an increasing liquidity risk could unduly lessen the confidence in an insurer and could thereby amplify the risk. If enforced, reporting on liquidity should be limited to supervisory reporting (ICP9) to avoid such procyclical effects.

In contrast with banks, there is no standardised liquidity risk measure for insurers. In addition, insurance products and asset liability management approaches will vary from firm to firm, making it difficult to compare liquidity risk measures between insurers.

Q74 Comment on Standard ICP 20.11

While Insurance Europe does not object to public reporting of qualitative information on liquidity risk, the inclusion of quantitative measures in supervisory standards is too prescriptive and should be removed. Prescribed metrics should be avoided for liquidity since these can give a distorted view. Most existing liquidity metrics that work in assessing bank balance sheets, would not be appropriate to apply to insurers. In the development of any liquidity metrics, the unique nature of life insurers and their ability to invest in illiquid assets that match illiquid liabilities should be taken into account. Accounting standards, such as IFRS should be deferred to in respect of quantitative reporting.

Q77 General Comment on revised ICP 24

Insurance Europe has always argued that conventional insurance is not systemically risky, and that systemic risk can only originate from a very limited number of activities undertaken on a large scale in the wrong conditions. A greater focus on potentially systemic activities of the insurance sector as a whole is therefore warranted. However, the size of individual insurers is still considered a source of systemic risk. An individual insurer's size should not be a focus in its potential contribution to systemic risk since conventional insurance business contributes very little to systemic risk; rather the focus should be on the size or scale of actual systemic activity.

There is still a lack of articulation around the nature of systemic risk in the insurance sector. For any activity to be deemed potentially systemically risky there needs to be a clear transmission channel into wider financial markets, with the quantification of the nature, scale and materiality of activities/exposures in the context of the size of the market as a whole. Insurance Europe believes that guarantees, derivatives etc. should not be viewed in isolation as sources of systemic risk, but should instead be viewed in the context of the overall Asset Liability Management and Risk Management frameworks of the insurer, with techniques such as stress testing used to identify their contribution to systemic risk. It is therefore not necessarily helpful to individually identify these items.

In terms of global collaboration and cross-sectoral consistency, it is not clear how this will work in practice. In particular, there were several issues raised with the draft indicators proposed in the previous Holistic Framework consultation in terms of identifying and mitigating systemic risk and it is therefore impossible to express a view on monitoring without seeing a more concrete framework for monitoring, application of supervisory powers and disclosure.

Throughout the standards in ICP 24 reference is made to 'The supervisor' which creates the potential that supervisors of different parts of an insurance group may seek to assess systemic importance separately for the parts they supervise, rather than focusing on the group as a whole. We therefore recommend that reference to 'The supervisor' is replaced with 'The supervisor, or for an insurance group the group supervisor'.

Q78 Comment on Guidance ICP 24.0.2

From our perspective it is important that additional data collection from insurers should be minimised and already available data should be taken into account (e.g. Solvency II data). Double queries should be avoided (also with regard to different institutions such as NSA, ECB).

Q81 Comment on Guidance ICP 24.0.4

Insurance Europe is unconvinced by the argument that systemic risk stems from a lack of substitutability; we see this predominantly as a competition issue. An insurer's size is also a poor indicator of systemic risk, rather the focus should be on an identified systemic activity, the size of this specific activity and then a transmission channel into wider financial markets.

Q84 Comment on Standard ICP 24.1

The commitment to cost-benefit analysis as well as proportionate data requests based on the nature, scale and complexity of the insurer is welcome. The supervisory definition of proportionate is likely to differ between jurisdictions and so the IAIS should elaborate on what it means by proportionate and then attempt to ensure consistent outcomes.

Q85 Comment on Guidance ICP 24.1.1

Insurance Europe agrees that data collection should examine costs and benefits and data requests should be proportionate. It should be reminded that the amount of data collected by the IAIS has significantly increased over the past few years even though it was explained that such data collection should be streamlined. Data collected should be strictly limited to those relevant to construct market indicators.

Q86 Comment on Guidance ICP 24.1.2

Asset-liability management is at the heart of insurers' investment management and risk management, so it is unlikely liquidity mismatch will be a material or systemic issue for most internationally active groups. Life insurers in particular invest in long-term illiquid assets in order to match them with long-term illiquid liabilities. Measuring the overall "degree of liquidity" of the assets is likely to prove meaningless and this should only be considered relative to liability liquidity, i.e. liquidity mismatch.

Insurance Europe would also point out that the current approach lacks empirical evidence regarding the dynamic of surrender in the insurance business. The ECB recently published historical data observed during liquidity crisis and the dynamic of cash outflows in the banking industry. The IAIS should perform a similar analysis for the insurance industry to construct a more sensible approach to liquidity matters. Regulators should collect more evidence and share information on historic or present examples of insurers presenting liquidity issues. It would be good practice to build up evidence where this has been the case and share this more widely with industry and between regulators.

Q95 Comment on Guidance ICP 24.2.4

A pragmatic approach should be taken when compiling relative rankings and identifying outliers. Benchmarking across industry should not result in everyone being moved to the most onerous position since the most conservative approach is not always the right one.

Q100 Comment on Guidance ICP 24.2.9

Insurance Europe is unconvinced by the argument that systemic risk stems from a lack of substitutability; we see this predominantly as a competition issue.

Q106 Comment on Guidance ICP 24.3.2

The overwhelming majority of insurers buy derivatives in order to hedge risks as part of prudent risk management rather than as speculative trades. Central clearing requirements introduced since the financial crisis have also mandated collateral to be posted against most derivatives, ensuring financial protection in the event of counterparty default. Taking both these facts into account, degree of engagement in derivatives is a poor indicator of systemic risk. The focus should instead be on identifying speculative derivatives or derivatives sold by groups of insurers to hedge the risks of other financial institutions, although it is not clear that any insurers are engaging in such activity.

Q107 Comment on Guidance ICP 24.3.3

A more horizontal view of systemic risk across all financial market activity is needed. The guidance under ICP 24.3 lacks contextualisation of the materiality of potential systemic risk, we therefore suggest that ICP 24.3.3 is amended as follows – 'As part of its assessment, the supervisor should consider recent developments, such as changes in economic conditions or technological change that may affect the insurance sector's risk exposures. Additionally, the supervisor should cooperate and coordinate with other financial sector supervisors (such as banking, securities and pension supervisors, central banks and government ministries) to gain additional perspectives on the nature, scale and materiality of activities/exposures in the context of the size of the market as a whole in considering whether it has the potential to be systemic, and the potential change in the risk exposures of insurers stemming from evolutions of other markets'.

Q111 Comment on Guidance ICP 24.4.2

Insurance Europe agrees that many "macroprudential tools are, in effect, microprudential instruments developed or applied with a macroprudential perspective in mind". This perspective and, more widely, the relationship between micro and macroprudential rules should be considered at every step of policymaking. It is essential that microprudential regulation does not unintentionally exacerbate macroprudential concerns and so it is crucial that these IAIS workstreams are not siloed.

In addition, we suggest that the strong interconnection between the two objectives "policyholder protection" and "financial stability" is made clearer with a change of wording in the last sentence of 24.4.2:

> "By mitigating certain risk exposures, measures that are primarily intended to protect policyholders ~~may also~~ regularly contribute to financial stability by decreasing the probability and magnitude of any negative systemic impact."

Q112 Comment on Guidance ICP 24.4.3

The final sentence where an insurer or insurers are "determined to be systemically important" suggests this is a permanent determination that cannot be rescinded. The insurer or insurers should be given the opportunity to address the activity or aspect of their business deemed to be systemically relevant and so any extension of requirements should be potentially temporary. This would be more consistent with ICP 10.2.6 which details that insurers should "prepare a report describing actions it intends to undertake to address specific activities the supervisor has identified".

The emphasis within the paragraph is on targeting measures at insurers or groups of insurers, whereas we consider the focus should be on the activities of insurers or groups of insurers that may individually or collectively have the potential to cause material levels of systemic risk. The IAIS needs to revisit the drafting of the paragraph in this context.

The final sentence in particular should be amended as follows – '…the supervisor should extend certain requirements as necessary to insurers and/or a group of insurers that it has determined to be systemically important based on its assessment of the materiality of the potential systemic risk that the nature, scale and complexity of the activities could plausibly give rise to.'

Q114 Comment on Guidance ICP 24.4.5

While Insurance Europe appreciates the removal of the ICS as a metric for assessing systemic risk, it is concerned that ICP 24.4.5 introduces the concept that supervisors may develop requirements that are time varying in nature depending on the economic environment. Insurance Europe believes that supervisors should exercise extreme caution in considering such measures as they potentially risk creating incentives for procyclical behaviour..