insurance europe

Position Paper

Comments on the IAIS consultation on the draft definition and high-level principles for comparable outcomes to the ICS

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Introduction

Insurance Europe welcomes the opportunity to provide comments on the IAIS draft definition and high-level principles for comparable outcomes to the ICS. The ICS project is of particular relevance to and impact for the European industry, given that a significant number of the IAIGs that are in the scope of ComFrame/ICS are European groups.

Insurance Europe recognises that the IAIS is conducting the ICS with the aim of *creating a common language for supervisory discussions,* with the *ultimate goal of a single ICS that includes a common methodology by which one ICS achieves comparable (ie substantially the same) outcomes across jurisdictions*[1] and that its objective is *to enhance global convergence among group capital standards*[2]. **Insurance Europe emphasises its support for the ICS project on the condition that it leads to a high-quality and robust global insurance standard, which promotes a sound, global regulatory level playing field.** It is vital that the comparability assessment exercise is sufficiently robust to ensure the same level of policyholder protection, and therefore does not undermine the key objective of a global standard for prudential supervision.

As is the case with any jurisdictional prudential standard, the ICS can have a direct impact on insurers' global competitiveness. Yet, the ICS can only be considered global if all major jurisdictions commit to implementing it consistently, and this is another reason why a robust and quantitative comparison between the ICS and AM is needed. Therefore, **the European industry believes that the ICS should be considered for implementation in Europe only if all major jurisdictions commit to this.** This is the only way to guarantee a global level playing field for the European industry

While the ICS itself does not fall within the scope of the current consultation, Insurance Europe would like to take this opportunity to highlight that there are still a number of important improvements and changes to the ICS framework that are needed for it to become eligible for consideration in Europe. In particular, **internal models are a key risk management and capital measurement tool and should be a permanent and integral part of the ICS framework.** Such internal models — intended solely for a more accurate calculation of the capital requirements based on the same measurement framework and at the same confidence level as

[1] As noted by IAIS in ICS Level 1 document
[2] As noted by IAIS in Explanatory Note on the ICS and Comparability Assessment

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the standard method and subject to a number of appropriate company and supervisor validation and approval requirements — will enhance the ICS.

With respect to the IAIS high-level principles under consultation, Insurance Europe appreciates that these are derived from the Abu Dhabi agreement on ICS 2.0, and notes that they are a good starting point for assessing comparability between the ICS and the AM. However, there are some key areas in which the definition and principles need to be adjusted to enhance clarity. For example, there is some good language in the ICS principles agreed a few years ago by the IAIS which should be made use of in the ICS-AM comparability assessment. More broadly, there is clearly a need to expand these principles into more specific criteria that would allow for a proper assessment of comparability. Further detailing of these high-level comparability principles by the IAIS will definitely support enhanced understanding and comparability between the ICS and the AM. This is another reason why it is so important to have very clear comparability criteria that expand these principles. Insurance Europe looks forward to contributing to this process.

Comments on definition of comparable outcomes

Definition of comparable outcomes (Q1):
Comparable outcomes to the ICS means that the Aggregation Method (AM) would produce similar, but not necessarily identical, results over time that trigger supervisory action on group capital adequacy grounds.

Insurance Europe appreciates that the ICS framework could not be deemed truly international unless key jurisdictions such as the US were committed to it. From this perspective, it understands the IAIS agreement to consider the AM that was proposed by the US and assess it for comparability with the ICS.

Ultimately, in order to be able to claim that the ICS and the AM provide together comprehensive comparable outcomes. Therefore, the assessment of comparability between the ICS and the AM needs to be done in a very thorough and consistent manner. The reference to both results and supervisory action is positive. However, additional specifications are needed to the current proposals, to ensure that a level playing field can be achieved through comparability of both quantitative results and the supervisory ladder of intervention at the group level.

Specifically, Insurance Europe notes that:

- The IAIS should clarify what is meant by "results". There are two elements that need considerations:
    1. In light of ICS Principle 10[3], and prior to identifying what results refers to, **it is key to clarify that "target criteria for regulatory capital requirements", which produce the "results", are the same.** Specifically, the ICS 2.0 target criteria is a 99.5% Value at Risk (VaR), over a one-year time horizon, of adverse changes in the IAIG's qualifying capital resources.
    2. **Capital adequacy (as referred to in ICS principle 5[4]) should be one of the elements that defines what "results" means**.

[3]ICS Principle 10: The capital requirement in the ICS is based on appropriate target criteria which underlie the calibration. The level at which regulatory capital requirements are set reflects the level of solvency protection deemed appropriate by the IAIS.

[4]ICS Principle 5: The ICS aims at comparability of outcomes across jurisdictions and therefore provides increased mutual understanding and greater confidence in cross-border analysis of IAIGs among group-wide and host supervisors. Applying a common means to measure capital adequacy on a group-wide consolidated basis can contribute to a level playing field and reduce the possibility of capital arbitrage.

- The IAIS should insert a clear reference to the AM ensuring the same level of policyholder protection as the ICS, in light of ICS Principle 2[5]. Therefore, the following change should me made: "similar, but not necessarily identical, results" should be replaced with "the same level of policyholder protection".
- The IAIS should clarify what it means by "the triggering of supervisory action". Insurance Europe believes that it should be clearly stated that the ladder of supervisory intervention should be similar for the ICS and the AM. This means that similar supervisory actions should be taken, and these should be triggered at the equivalent solvency control levels[6] for both the ICS and the AM. The future consultation package on assessment criteria should spell out specific group-level supervisory actions that will be benchmarked in the assessment.

Comparability can only be confirmed if it can be confirmed that the similar results would be obtained under a full range of economic and other conditions both "normal" and "stressed". At a minimum a set of scenarios should be defined for which outcomes will be compared eg high/low interest rates, high/low spreads, pure life vs pure non-life vs mixed entities, different size groups, different asset mixes, mature low growth/ high growth company, etc.

In addition, it is important that the AM and ICS remain comparable over time and would therefore benefit from continuous follow-up monitoring to ensure the same level of policyholder protection.

In light of the above, the definition should be amended to read as follows:

> *"Comparable outcomes to the ICS means that the Aggregation Method (AM) would produce ~~similar, but not necessarily identical, results~~ the same targeted level of policyholder protection and triggers similar supervisory actions over time – and at the same point in time under stressed conditions – by the group supervisor, including any enforceable action when the PCR is no longer complied with, ~~that trigger supervisory action~~ on group capital adequacy grounds."*
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> *"Comparable outcomes to the ICS means that the Aggregation Method (AM) would produce the same targeted level of policyholder protection and triggers similar supervisory actions over time – and at the same point in time under stressed conditions – by the group supervisor, including any enforceable action when the PCR is no longer complied with, on group capital adequacy grounds*."

Comments on high-level principles

High-level principle 1 (Q2):
AM and ICS results are significantly correlated in that they change similarly in response to changing economic and financial market conditions over the business cycle, not short-term market fluctuations, although the quantum of change may differ.

High-level principle 1 requires material changes, as the current wording can be interpreted in an opposite way to comparability. For example:

- Allowing the "quantum of change" between the ICS and the AM to differ can lead to cases where the change in one method (be it ICS or AM) would lead to supervisory actions (eg supervisory intervention, limitations on dividend distributions) and the other would not. Clearly such a scenario, which is contrary

[5] ICS Principle 2: The main objectives of the ICS are protection of policyholders and to contribute to financial stability. The ICS is being developed in the context of the IAIS Mission, which is to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders and to contribute to global financial stability.

[6] See Insurance Core Principle (ICP) 17.4 which defines a PCR as a solvency control level above which the supervisor does not intervene on capital adequacy grounds. As the ICS is designed as a minimum standard, national supervisory authorities may elect to take a more prudent approach and set a PCR that is higher than the ICS PCR (as stated in the ICS Level 1 Document).

to what is envisaged in the definition of comparable outcomes, could not be considered a global, comparable, consistent approach to prudential supervision.

- Using terminology such as short-term market fluctuations is misleading. As noted above, it can be short-term market fluctuations that lead to supervisory actions in some cases. Also, non-life business is usually short(er)-term so one should not exclude this business from the comparability assessment.
- Using the "business cycle" as a reference comparison timeframe is also misleading, not least due to 1) the various perspectives of research on this term and 2) the global context. Clearly, an objective comparability cannot be assessed on the basis of such a vague term.

Against the above, Insurance Europe proposes to:

- Remove references to business cycle and short-term time horizons. Instead, assess responsiveness to changing conditions on the basis of reporting dates.
- Remove the reference to the quantum of change.

In light of the above, high-level principle 1 should be amended to read as follows:

"AM and ICS results are significantly correlated in that they change similarly in response to changing economic and financial market conditions ~~over the business cycle, not short-term market fluctuations, although the quantum of change may differ~~ at the reporting dates."

"AM and ICS results are significantly correlated in that they change similarly in response to changing economic and financial market conditions at the reporting dates."

High-level principle 2 (Q3):
Individual elements of a group solvency approach, ie valuation, capital resources and capital requirement, will be analysed; however, the decision on comparable outcomes will consider the elements in totality.

The following will be assessed in undertaking the analysis of the individual elements:

- The AM captures the same underlying risks as the ICS, even if this is achieved differently within the quantitative calculation of the group capital requirement. The overall AM capital requirement and ICS capital requirement provide a similar level of solvency protection.
- The overall quality and eligibility of capital resources allowed in the AM is similar to the ICS and is assessed considering the same five key principles identified for ICS capital resources: loss-absorbing capacity, level of subordination, availability to absorb losses, permanence and absence of encumbrances and mandatory servicing costs.

Insurance Europe supports the commitment in principle 2 to analyse all the aspects that are at the core of the ICS development, and should thus be also at the core of the comparability between the AM and the ICS, namely valuation, capital resources and capital requirements. It appreciates that ultimately the decision on comparability will be made by considering these areas in their totality.

As High-level principle 1 above raises the issue of responsiveness to changing conditions, such an analysis should be done at the level of the three core items (valuation, capital requirements and resources). It is important to assess how each component reacts to changes in economic conditions and what the key drivers of such changes are.

With respect to the further specifications being made by the IAIS:

- On capital requirements:
    - As noted under Q1, it is key to clarify that the "target criteria for regulatory capital requirements" are the same. Specifically, the ICS 2.0 target criteria is a 99.5% Value at Risk (VaR), over a one-year time horizon, of adverse changes in the IAIG's qualifying capital resources.

- Regarding the reference to the "*similar level of solvency protection*" – the IAIS should ensure consistency with High-level principle 3 below, which notes the AM cannot be less prudent than the ICS. Having the same target criteria for regulatory capital requirements is key. Insurance Europe would also thus suggest replacing this reference with a reference to "same level of policyholder protection".

- On capital resources:
    - Comparability of capital resources between the ICS and the AM is key. In fact, the ICS already contains extensive analysis of the principles and capital items that meet them, and the ICS already includes local practices, so there is no reason to have a different/separate approach in the AM. Instead, any discussion on local practices should take place in the ICS, and replicated in the AM.

In light of the above, principle 2 should be amended to read as follows:

"Individual elements of a group solvency approach, ie valuation, capital resources and capital requirement, will be analysed individually and their responsiveness to changing conditions will be assessed at the level of each one of the three core items; however, the decision on comparable outcomes will also consider the elements in totality.

The following will be assessed in undertaking the analysis of the individual elements:

- *The AM captures the same underlying risks as the ICS, even if this is achieved differently within the quantitative calculation of the group capital requirement. The overall AM capital requirement and ICS capital requirement provide a similar level of solvency protection.*
- *The overall quality and eligibility of capital resources allowed in the AM is similar to the ICS and is assessed considering the same five key principles identified for ICS capital resources: loss-absorbing capacity, level of subordination, availability to absorb losses, permanence and absence of encumbrances and mandatory servicing costs.*
- *The AM provides data that enables quantitative comparison with the ICS."*

"Individual elements of a group solvency approach, ie valuation, capital resources and capital requirement, will be analysed individually and their responsiveness to changing conditions will be assessed at the level of each one of the three core items; however, the decision on comparable outcomes will also consider the elements in totality.

The following will be assessed in undertaking the analysis of the individual elements:

- *The AM captures the same underlying risks as the ICS, even if this is achieved differently within the quantitative calculation of the group capital requirement. The overall AM capital requirement and ICS capital requirement provide the same level of policyholder protection.*
- *The overall quality and eligibility of capital resources allowed in the AM is similar to the ICS and is assessed considering the same five key principles identified for ICS capital resources: loss-absorbing capacity, level of subordination, availability to absorb losses, permanence and absence of encumbrances and mandatory servicing costs.*
- *The AM provides data that enables quantitative comparison with the ICS"*

High-level principle 3 (Q4):
The AM could be more but not less prudent than the ICS, which is being developed as a minimum standard.

Insurance Europe appreciates the intention of this principle to emphasise the fact that the ICS is intended to ultimately become a PCR (which is a solvency control level according to ICP 17).

However, the IAIS needs to explain very clearly what it means by level of prudence in the ICS and/or the AM. In Insurance Europe's view, a robust global standard should target the same level of policyholder protection. In fact, there are a few elements in the ICS principles which, combined, can be used as an assessment basis for level of prudence, namely valuation, capital requirements and resources[7]. As noted above, Principle 10 of the ICS seems to cover this aspect by referring to appropriate target criteria which underlie the calibration.

In fact, Insurance Europe believes that the discussion over the level of prudence in the capital requirements is equally relevant for the inclusion of Internal Models in the ICS. Internal Models are a key risk management and capital measurement tool and should be a permanent and integral part of the ICS framework. Internal models allow to analyse risk in more detail so that the output of the model more closely reflects complex risk profiles. Such internal models — intended solely for a more accurate calculation of the capital requirements at the same confidence level as the standard method and subject to a number of appropriate requirements — will enhance the ICS.

High-level principle 4 (Q5):
The AM and ICS use the same scope of the group, consistent with that set out in ComFrame.

Insurance Europe supports principle 4.

High-level principle 5 (Q6):
A representative sample of Volunteer Groups, covering a diversity of business models, provide both ICS and AM data under various economic and financial market conditions over the business cycle.

Insurance Europe agrees that, in order to test comparability, a representative and relevant amount of data is necessary. Such data should indeed cover a diversity of business models and business lines, geographical footprints, various financial and market conditions, including both normal and stress market situations. This should be achieved by back-testing the comparability assessment against past data including those under a number of stressed market conditions. The primary focus of the comparability assessment should be on the supervisory actions triggered in response to stressed situations.

As noted under Q2, the reference to "business cycle" should be removed.

In addition to the above, it is important that the comparability assessment (just like any other implementation assessment framework) becomes a permanent part of the framework. Specifically, the comparability assessment at inception should be followed by a monitoring exercise on an ongoing basis, in cases where either the ICS or the AM would suffer changes. The AM cannot avoid being affected by the changes made to local regimes, the relevance of which should be assessed to meet the comparability objective.

Looking ahead, it is very important that the IAIS already considers and presents to stakeholders the process by which the comparability assessment would be done, and a conclusion would be reached.

In light of the above, principle 5 should be amended to read as follows:

> *"A representative sample of Volunteer Groups, covering a diversity of business models <u>and geographical footprints</u>, provide both ICS and AM data under various economic and financial market conditions over ~~the business cycle~~ <u>time including a number of observed stressed situations</u>."*
>
> *"A representative sample of Volunteer Groups, covering a diversity of business models and geographical footprints, provide both ICS and AM data under various economic and financial market conditions over time including a number of observed stressed situations."*

[7] See notes of ICS Principle 1

High-level principle 6 (Q7):
The AM and ICS are similarly transparent, in terms of facilitating understanding and comparability, within and across jurisdictions, of the group solvency position through public disclosure and reporting to group-wide supervisors.

Insurance Europe agrees that the AM and ICS should be similarly transparent and notes that this is already well defined under ComFrame[8], so the ICS would apply in conjunction with the ICPs and in particular ICP 9 (supervisory reporting) and ICP 20 (public reporting).

[8] In particular ICP 9 (supervisory reporting) and ICP 20 (public reporting)