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GLOBAL INSURANCE CAPITAL STANDARD

No competitive disadvantage

The ICS must not result in EU insurers operating at a disadvantage in global markets

2019 represents a milestone for the global insurance capital standard (ICS) project, as the second version, ICS 2.0, is due to be finalised by the IAIS and start a five-year monitoring period. This involves significant work and costs for the European companies involved, which at the same time are having to provide substantial data and input into the major review of the EU's Solvency II framework that is running until 2020 (see p6).

The European insurance industry has two key strategic priorities for the ICS:

- to ensure that the reviewed — and improved — version of Solvency II becomes the European implementation of the ICS, and thus that EU insurers avoid the unacceptable situation of having to run their business under two parallel prudential regimes; and,
- to avoid the ICS leading to further competitive disadvantage for EU insurers globally, especially given that Solvency II is the most conservative regime in the world.

The first of the two priorities will remain for a while, since the ICS is still in development and Solvency II is under review. Broadly speaking, it is key for the European industry that the ICS takes a risk-based approach, is based on an appropriate market-adjusted valuation for the balance sheet and allows the use of both the standard formula and internal models for measuring capital requirements. None of these technical elements have yet been finalised in the ICS.

Testing so far has revealed flaws in the various options tested and confirmed that the IAIS is still some way from finding a framework that captures the risks well enough to both provide consumer protection and avoid unintended consequences. It has also revealed how difficult it is for IAIS members to agree, so final decisions for ICS 2.0 are expected to be taken very late. This leads us to expect that more discussion will be needed during the monitoring phase.

The second priority — avoiding competitive disadvantage — is more complicated, as it relates to the question of just how global the global ICS will be.

How global is global?

Ever since the ICS project began five years ago, the European insurance industry has stressed that the ICS can only be of value as a truly global standard if it receives support from a global community of regulators. The industry has since expressed concerns that political support appears to be lacking in a number of key jurisdictions. On several occasions, the question of just how global the ICS will be has been raised, but without a clear resolution, not least because:

- Supervisors cannot answer the question: the IAIS is a group of supervisors developing standards for the consideration of regulators, so they can only take responsibility for development, not for implementation.
- Regulators cannot answer the question: jurisdictional regulators (with rare and isolated exceptions) have indicated that they cannot confirm whether ICS will be implemented — as it is not yet finalised.

A few months before the finalisation of ICS 2.0 and the launch of the monitoring period, it is not just the technical details that lack agreement and clarity from the IAIS, but also more high-level issues that are key for the European industry. Although most of these issues were agreed by IAIS members when they met in Kuala Lumpur in November 2017, details of how those agreements will be implemented are still lacking.

Going to college

A very clear example relates to the existence and role during the monitoring period of supervisory colleges, which are formed to monitor insurers active in multiple jurisdictions. The Kuala Lumpur agreement foresees that ICS 2.0 will be used for discussion in the colleges. Today, it is clear that all European internationally active insurance groups (IAIGs) have a college, however this is not the case for all non-European ones. ComFrame, the common framework for supervising international groups of which the ICS forms part, which is also due for finalisation in November 2019, does include a requirement for colleges to be set up. So, the question is whether ComFrame is enough to ensure that all IAIGs are treated the same way when it comes to this element of the Kuala Lumpur agreement.

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A reassurance from the IAIS that all IAIGs will have a college would help ensure comparable application of ICS 2.0-related provisions to all IAIGs in the monitoring period. The existence of colleges for all is key, and it is likewise essential that the ICS-related information that is discussed in the colleges is the same for everyone and that supervisory discretion is avoided, as it could lead to different applications of the provisions.

Comparability question

The most frequently asked, and least frequently answered, question relates to comparability. The Kuala Lumpur Agreement notes that the goal of the ICS is comparable — ie, substantially the same — outcomes. This is important because, although the Kuala Lumpur agreement foresees a reference methodology based on a single market-adjusted valuation, it also allows testing of a different "aggregation" measure during the monitoring period. This aggregation measure would be assessed against the reference to determine whether it leads to substantially the same outcomes.

It appears unlikely that this will be clarified soon, not least because the IAIS is prioritising the technical discussion and the governance of the monitoring period. The European insurance industry has been calling for transparency in the IAIS discussions on this matter and for stakeholder consultation.

Ultimately, it is vital that the ICS, which was intended to increase understanding and convergence, does not have the opposite effect of creating, or increasing existing, competitive disadvantages for specific jurisdictions and/or entities.