Position Paper

Insurance Europe response to the IAIS consultation on activities-based approach (ABA) to systemic risk

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General comments

- Insurance Europe appreciates the opportunity to engage with the IAIS at this early stage of the development of the activities-based approach (ABA).
- Insurance Europe has always argued that traditional insurance is not systemically risky and that systemic risk from individual insurers can only originate from a very limited number of activities undertaken on a large scale in the wrong conditions.
- The IAIS' work is at a very early stage and many more aspects need to be clarified (e.g. the scope of implementation of the ABA and of its measures, the impact on the different types of IAIGs according to their characteristics, the timing, the evolution of the overall methodology and the way it will integrate the ABA). Nonetheless, Insurance Europe believes that a proportionate and properly-designed ABA could address "domino" as well as "tsunami" views of risk, given the focus on risk management and preventative actions, thereby fulfilling many of the objectives of the current EBA approach. Where the current EBA is focused on the "domino" effect, the ABA has the potential to consider counterparty risk through the lens of the nature of the underlying activities, thereby making a separate entity-based methodology redundant. Insurance Europe is advocating that a holistic ABA should guide the subsequent definition of appropriate policy measures where necessary, with a particular focus on risk management and preventative actions. This being said, further research is needed in order to better understand the probability and the magnitude of potential "tsunami"-effects.
- Insurance Europe reiterates that the EBA is simply not appropriate for assessing systemic risk in insurance because this risk should always be determined holistically rather than through the use of the current G-SII Assessment indicators that are biased towards measuring the size of an insurance group.
- In Insurance Europe's view, an assessment of systemic risk should go beyond merely identifying whether activities giving rise to potential vulnerabilities exist, but also consider whether the risk stemming from these activities can actually be transmitted to the wider global financial system and how it is mitigated in practice. A link to the global financial system through transmission channels should be clearly identified and the level of diversification within the insurance group should be adequately considered (i.e. ABA should be built by also taking into account a group perspective, not only an activity-based perspective).

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- Insurance Europe would also emphasise that <u>the materiality of the potential systemic risk transmitted to the financial system should be an essential consideration under an ABA</u>. In the assessment of materiality, additional factors which may act as mitigants of systemic risk (such as nature of interconnectedness and counterparty exposure and size of the exposure) should be duly considered, to ensure the accuracy of any assessment of an activity's systemic risk potential.

1. *Do you agree with the IAIS' definition of an ABA? If not, please provide an alternative definition and explain how it improves on the IAIS' one.*

- Insurance Europe notes that the proposed definition is still vague at this preliminary stage of the process as it refers to a number of indefinite terms which need more clarifications. In Insurance Europe's view, the ABA should go beyond merely identifying whether activities giving rise to potential vulnerabilities exist, but also consider whether the risk stemming from these activities can actually be transmitted to the wider global financial system. A link to the global financial system through transmission channels should be clearly identified. Therefore, the reference to transmission channels in paragraph 16 is welcomed.
- Insurance Europe considers that the IAIS' approach of interpreting 'activity' based on its risk exposure, rather than its legal form, is appropriate. However, just because an insurer undertakes a certain activity does not necessarily mean that systemic risk is created, given that asset and liability management (ALM) plays a fundamental role in insurance, as paragraph 94 rightly recognises.
- Insurance Europe would suggest that an ABA should also take into account the materiality of the potential systemic risk transmitted to the global financial system. This is mentioned in the proportionality considerations in paragraphs 112-114, but should be reflected in the definition. In relation to non-insurance activities, to the extent that these are covered by banking or securities regulation they should be treated consistently on a cross-sectoral basis.
- Insurance Europe does not agree with the distinction drawn between ABA and EBA in terms of the "tsunami" and "domino" analogies. The correlation of macro-prudential risk exposures can bring about both "tsunami" and "domino" views through interactions between companies and common behaviour. Given that the activities may be the same in either analogy, a holistic approach should be taken. Therefore, an activity-based assessment should address *both* the "tsunami" and "domino" analogies for systemic risk transmission.

2. Does the proposed definition allow the assessment of the most significant potential sources of systemic risk?

In Insurance Europe's view, it is appropriate to interpret an "activity" based on the risk exposure rather than on its legal form. This approach allows for the assessment of a broader range of activities, and has the added benefit of not rendering the approach irrelevant when activities change in nature. However, the more relevant question in the context of the proposed definition will be around the concrete *levels* of risk exposure that are deemed systemically relevant.

When defining "activities", an appropriate granularity must be achieved so that focus can be placed on those specific activities that cause or amplify systemic risk. More granularity is needed on the following aspects:

- In order to specifically define activities that (through collective actions) can have a considerable impact on financial stability, one should first have a clear idea about the magnitude of an event (on a global scale) that can be deemed as systemically relevant, i.e. some type of threshold (minimum magnitude) that includes a global systemic event is needed.
- After that, one should look at activities/practices/product features that have a substantial accumulative impact, being able to quantify a minimum contribution that qualifies these as potentially risky.

3. *What are your views on the comparison between ABA and EBA?*

As noted in the response to question 1, while Insurance Europe agrees that the ABA needs to address the "tsunami view", this approach can also be used to assess and ensure mitigation of entity-based risk as well; therefore, a binary distinction between the two views for the purpose of the ABA should not necessarily be drawn.

Existing micro-prudential policy is designed to ensure the prudent management of risk in insurers and to protect policyholders; therefore, existing policy has a relevant focus on mitigating the impact of firm failure and is relevant to the "domino" view. Consequently, the ABA should seek to address both views of systemic risk.

4. *Do you agree with the IAIS' conceptual approach? Please explain any suggested changes.*

Insurance Europe suggests that the conceptual approach to developing ABA policy measures needs to be more of an iterative process rather than the step-by-step approach set out in Section IV. The outcome of this process must be a decision on whether the right activities were identified at Step 1.

- **Step 1:** This first step is a decisive part of the process, and needs to be rigorous so as not to undermine the conceptual approach. The initial identification will inevitably be based on regulators' judgment and experience, which means that the nature of the exposure to be identified needs to be very clear; in this context, Insurance Europe would suggest that the description of activities which can "potentially threaten global financial stability in an ABA context" is ambiguous and the phrase "in an ABA context" should be removed. It is essential that the IAIS recognises that assets and liabilities need to be viewed holistically, as part of an ALM policy.

- **Step 2:** Rather than an "evaluation" of the existing IAIS policy measures (paragraph 28), this step is an identification of such policy measures, which is followed by the actual evaluation at Step 3. Insurance Europe agrees that it is appropriate to consider at Step 2 the extent to which other international, regional and national standard-setters have already introduced policy measures that may address the relevant risk exposure. The advanced regime in place in Europe, for example, already provides for a number of such measures which should find due consideration in the development of the ABA.

- **Step 3:** It is appropriate that the IAIS should consider whether there are mitigating policy measures in place that would appropriately address the potential systemic risk before imposing new/additional policy measures.

- **Step 4** should only apply where the residual systemic risk identified in Step 3 is material. As noted before, the risk must be material in terms of the global financial system as a whole. Therefore, the reference to proportionality in paragraph 32 is welcomed but Insurance Europe believes that materiality should also feature in Step 4. A systemic risk framework should ensure that policy measures are appropriately tailored and proportionate to address the risks posed by potentially systemic activities to the global financial system, while also taking into account risk management practices that insurers use in practice, not just those that are mandated.

5. *Do you agree with defining activities broadly in terms of risk exposures (e.g. liquidity risk) rather than more narrowly in terms of their legal form (e.g. securities lending)?*

As noted before, it is appropriate to interpret an "activity" based on the risk exposure rather than on its legal form. Just because an insurer undertakes a certain activity does not necessarily mean that systemic risk is created. This approach allows for the assessment of a broader range of activities, and has the added benefit of not rendering the approach irrelevant when activities change.

Nevertheless, Insurance Europe would point out that by reducing the number of criteria used in this consultation, there is a risk that some activities may be identified as systemic when in fact a due consideration of other factors relevant to determine whether such activities may have a material impact (such as nature of interconnectedness and counterparty exposure and size of the exposure) would show that they are not.

6. *Do you agree with the two main risk exposures identified for the purposes of an ABA (i.e. liquidity risk and macroeconomic risk exposures)? If not, how could this be improved?*

In principle, Insurance Europe agrees with the two risk exposures identified as potentially systemic for the purposes of the ABA. Nevertheless, Insurance Europe would emphasise that the materiality of the potential systemic risk transmitted to the global financial system should be an essential consideration under the ABA. In the assessment of materiality, additional factors which may act as mitigants of systemic risk (such as nature of interconnectedness and counterparty exposure and size of the exposure) should be duly considered, to ensure the accuracy of any assessment of an activity's systemic risk potential.

Within the scope of macroeconomic risk, Insurance Europe notes that it is the existence of products with guarantees that provide substantial sources of stability for the financial system because products with such guarantees generally lead to stable and long-term investment horizons.

7. *How should counterparty exposure be treated under the ABA?*

Insurance Europe considers that a more thorough analysis is needed to determine how counterparty exposure should be treated within an ABA. Insurance Europe agrees with the IAIS that counterparty exposure is not a direct source of systemic risk. In addition, risk management practices around counterparty exposures can be an important mitigant for any residual risk and reduce any potential transmission of systemic risk.

- As noted before, where the current EBA is focused on the "domino" effect, the ABA has the potential to consider counterparty risk through the lens of the nature of the underlying activities, thereby making a separate entity-based methodology redundant. In the assessment of materiality, the nature of counterparty exposure is one of the factors that should be duly considered, to ensure the accuracy of any assessment of an activity's systemic risk potential.
- However, Insurance Europe would also like to highlight that poorly-designed regulation on counterparty exposure has the potential of triggering significant risk transfer away from the insurance sector. The IAIS should always consider how its measures potentially discourage the use of insurance, restricting the role of insurance as a risk absorber and mitigant.

8. *How should substitutability be treated under the ABA?*

Insurance Europe considers that the IAIS should analyse more thoroughly whether substitutability is relevant within an ABA.

9. *Should any other activity or risk exposure be considered potentially systemically risky under this framework?*

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10. *Do you agree with the assessment of liquidity risk in the context of an ABA? If not, please explain why and how this could be improved.*

Insurance Europe agrees with the conclusion of the IAIS' assessment of liquidity risk (i.e. that insurers' liquidity risk is generally well-contained). Insurance Europe would again emphasise that the materiality of the potential systemic risk transmitted to the global financial system should be an essential consideration under the ABA, including when it comes to liquidity risk. In the assessment of materiality, additional factors which may act as mitigants of systemic risk (such as nature of interconnectedness and counterparty exposure and size of the exposure) should be duly considered, to ensure the accuracy of any assessment of an activity's systemic risk potential. Insurance Europe would welcome objective criteria in further IAIS work on liquidity risk in order to reduce the part of expert judgement in the supervisors' assessment. In addition, the assessment of liquidity risk

should be sufficiently granular; for example, when considering liquidity risk arising from collateral calls on derivatives exposures, it should be taken into account that, where insurers are hedging against equity markets falling, the insurer would be a receiver of collateral.

Paragraph 43: needs to include factors that may indicate the plausibility of surrenders of policies at short notice leading to a threat to global financial stability. While the paragraph mentions potential vulnerabilities of insurers due to selling assets at a discount, it does not link this to how potential systemic risk to the global financial system could occur.

Paragraph 44:

- The assessment of liquidity risk must consider the materiality of the potential systemic risk transmitted to the global financial system. Therefore, this paragraph as well as the "examples in practice" provided should take this into account and clarify that the concern of the IAIS is not just any impact, but those that are material.
- With respect to the risk of mass surrender by policyholders*,* the potential for supervisory and/or management actions should be considered, as such actions can be used to control liquidity risk. More specifically, in many cases insurers have the contractual ability to delay surrenders and/or resolution authorities have the power to apply temporary stays. In fact, it is no coincidence that in markets where products have flexible surrender options supervisors have the power to intervene. Where such powers exist, there is evidence that they have been used and Insurance Europe is not aware of any evidence that such supervisor powers cannot be relied upon when needed.
- The decision to surrender is not straightforward for policyholders and this can create a significant disincentive to surrender. Policyholders are in fact faced with uncertainty as they will need to weigh up whether they are ready to lose valuable benefits/guarantees that are only payable at specified contractual events, to be faced with tax implications either direct (e.g. taxable income deductible) or indirect (e.g. inheritance tax planning) that they had not planned for, to incur additional costs in securing alternative provisions, to require advice which may be difficult to find and costly, etc. In addition, the existence of guarantees will create an extra disincentive for policyholders to surrender and guarantees should in fact be considered when assessing liquidity risk.
- Any public concern about the viability of a particular business model or widely held asset class seems extremely unlikely in the context of a threat to global financial stability. The IAIS should consider that insurers may look to sell "liquid assets" in first instance and will then hold substantial liquid assets that could be used where there are deep and liquid markets.

Paragraph 45 references counterparty exposure; please refer to earlier comments provided in response to questions 1 and 7.

Table 1 presents factors affecting the extent of liquidity risk from securities lending. Insurance Europe would point out that, in the absence of leverage or maturity transformation, changes in value and liquidity of collateral and mark to market changes in value of the underlying instrument are not sources of potential systemic risk on their own.

11. *Do you agree with the transmission channel, i.e. the reasons and conditions for this risk to be potentially systemic, and how it is described in this section?*

The paper seems to indicate that the possible transmission of risk arises through:

- Impact on market prices through the liquidation of assets, with consequential losses to other parts of the global financial system also holding those assets, (therefore counterparty/sector exposures will be relevant);
- Loss given default in that the liquidity strain leads to the failure of the insurer with consequential impacts to its counterparties;
- The cancelling of financial contracts that other financial counterparties may rely on for funding.

While the above may represent potential transmission channels for risk, they need to be considered in the context of how the activities of insurers could give rise to/be subject to fragility that could plausibly be a cause of material systemic risk to the global financial system.

Insurance Europe therefore agrees that the ABA should go beyond merely identifying whether activities giving rise to potential vulnerabilities exist, but also consider whether the risk stemming from these activities can actually be transmitted to the wider global financial system. A link to the financial system through transmission channels should be clearly identified. The distinction between the underlying risk and the transmission channel could be drawn more clearly.

In order to be systemic, Insurance Europe also believes that the risk must be sufficiently material to create the possibility of near-simultaneous failures of multiple financial institutions. As stated before, the materiality of the potential systemic risk transmitted to the financial system should be an essential consideration under the ABA. In the assessment of materiality, additional factors which may act as mitigants of systemic risk should be duly considered, to ensure the accuracy of any assessment of an activity's systemic risk potential.

12. *Are there additional examples of significant exposure to liquidity risk that should be considered?*

Insurance Europe believes that the first example of liquidity risk is not accurate enough. The example takes into account only negative disincentives to surrender, such as tax and penalties. It should also include positive disincentives such as loss of advantages (fiscal precedence, guarantees, etc.).

An additional example of significant exposure to liquidity risk is that caused by regulation. The corporate bond market was a fairly liquid market for a traditional asset class but, following the imposition of additional liquidity requirements on market-makers, it has suffered from a decline in liquidity, with turnover falling.

13. *Do you agree with the IAIS' assessment of macroeconomic risk in the context of an ABA? If not, please explain why and what changes you think should be made.*

The IAIS' assessment of macroeconomic risk is opaque. In the context of Step 1 of the IAIS' contextual approach, an opaque concept of macroeconomic risk makes the identification of potentially systemically risky activities difficult, as the boundaries of this risk are unclear.

The assessment of macroeconomic risk must also consider the materiality of the potential systemic risk transmitted to the global financial system.

Insurance Europe notes that it is the existence of products with guarantees that provides substantial sources of stability for the global financial system, because products with such guarantees generally lead to stable and long-term investment horizons. In the event of a guarantee, which is usually linked to the fact that the customer needs to hold their policy for a certain period to get the benefit of the guarantee, the client is inclined to take a long-term perspective on their investment. Therefore, it is unclear why such products are singled out negatively in the light of potential systemic risk even if the IAIS itself recognises that such guarantees are not inherently systemically relevant. A more nuanced approach is needed in the analysis, and to a certain extent this is already visible but needs further analysis to avoid introducing any counter-productive and damaging policy measures. Insurance Europe would welcome objective criteria in further IAIS work on macroeconomic risk in order to reduce the part of expert judgement in the supervisors' assessment.

Insurance Europe disagrees with the following sentence in paragraph 50: "The aggregate risk of the global financial system will increase where such risk is retained by the firms". Aggregate risk will only increase if the risk to policyholders is not taken into account. Without these guarantees, the policyholders would be the ones that bear the risk and they are much less well-placed to do so than insurers.

With respect to the use of derivatives by insurers mentioned in paragraph 105: Insurance Europe is encouraged by the IAIS' recognition that derivatives used for hedging purposes should not be considered as a source of risk.

In most cases, insurers use derivatives exactly for such purposes and this is part of the ALM of insurers intended to mitigate risks rather than amplify them.

With respect to the use of derivatives outside of a hedging or replicating programs, the IAIS states in paragraph 105 that this could create systemic concerns. Insurance Europe would point out that, given the recent G-20 derivatives reform, the use of uncollateralised derivatives should be the exception. And in addition to the important safeguards already embedded in the regulation of the derivatives market, the prudential framework for insurers in Europe for example entails extra capital requirements intended 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 is therefore no reason to automatically assume that derivatives are appropriate indicators of potential systemic importance.

14. *Do you agree with the transmission channel, i.e. the reasons and conditions for this risk to be potentially systemic, and how it is described in this section?*

As stated before, the distinction between the activity and the transmission channel could be drawn more clearly. There must be a clearly articulated link between the risk and the global financial system for the risk to be potentially systemic.

The paper seems to focus on factors that relate to situations where the capital position of the insurer may be weakened:

- Activities that could result in heightened risk to the viability of an insurer and therefore its loss given default impacting counterparties.
- Correlated actions of insurers, amplifying market price movements impacting other market participants and/or withdrawing funding from the financial sector while it is under stress.
- Exposures that are highly correlated with each other and with the market.
- Leverage – use of derivatives to gain exposure without upfront cost of purchasing assets, use of borrowing & exposures through writing of derivatives contracts that are not used to hedge risks or do not closely match the underlying exposure.

The IAIS should therefore recognise that, due to the long-term nature of insurance liabilities, the factors that may lead to heightened risk are likely to involve significant leverage and/or maturity and liquidity transformation. It should also be recognised that poorly-designed prudential regulation has the potential to create incentives for herding and/or procyclical behaviour.

Insurance Europe agree that the risks stemming from liquidity and the macroeconomic risk exposures are related, as the sale of assets and variations to collateral requirements may stem from macro-economic incentives. Insurance Europe also agrees that the potential extent of macroeconomic risk depends on the way in which the risk is managed and on the insurers' ALM.

15. *What are your views on the inclusion of the negative impact of reduced funding of other financial sectors?*

The ABA framework should not aim to protect all financial sectors from a loss of funding from insurers as this is not a systemic risk. The negative impact of reduced funding of other financial sectors is only relevant to the assessment if it contributes to systemic risk. The consultation paper does not include a definition of systemic risk, but the G-SII framework is focussed on significant disruption to the global financial system and economic activity, and the BIS' definition of systemic risk requires that a disruption is caused by an impairment of all or part of the global financial system, and has the potential to have serious negative consequences for the real economy. Otherwise, reduced funding by insurers of other financial sectors is not a systemic risk, but simply a rational response to an asset that is no longer performing, with the funding easily replaceable by other sources.

Ultimately, counterparty exposure of other financial sector participants to insurers is a matter that should be reflected in their risk management and prudential oversight/regulation (in the same manner that insurers

manage counterparty risk emanating from other participants within the global financial system. As with other risks, the IAIS should undertake some analysis to determine the plausibility of such risk in relation to both its potential occurrence and the materiality of its impact.

Finally, Insurance Europe would point out that it is neither the role of insurers to fund other financial sectors nor the role of the IAIS to ensure bank financing.

16. *Are there additional examples of significant macroeconomic exposure that should be considered?*

Consideration should also be given to incentives that may be created by prudential regulation. Please refer to the responses provided to Qs 14 and 24.

17. *What are your views on the IAIS' consideration of operational risk in the development of ABA policy measures?*

The IAIS points out in paragraph 57 that "operational difficulties and business transition issues at insurers generally have not caused serious market disruptions in the past and have not raised financial stability issues". Insurance Europe agrees and therefore believes that operational risk should not be considered under any systemic risk assessment.

Paragraph 57 does suggest cyber risk as an operational risk that could have systemic implications, as cyber risk is a risk for all types of financial institutions. However, Insurance Europe suggests that more work should be done to show how, in practice, this risk would be transmitted throughout the global financial system. It is also unclear whether insurers are originators or transmitters of cyber risk, which has important implications for how the risk should be addressed. Cyber risk should be approached on a cross-sectoral basis rather than sector silos. If this risk is included within the ABA framework, it should be evident how any proposed policy measures would lead to its reduction.

With respect to the asset management example, it is unclear why there would be systemic implications in an insurance context.

18. *What are your views on the IAIS' consideration of other common or procyclical behaviours that do not directly stem from either liquidity risk or macroeconomic exposure?*

While the IAIS may have concerns relating to the areas mentioned in this section, this does not mean these should be included within the ABA framework. Step 1 of the proposed conceptual approach requires an identification of the activities that may give rise to systemic risk, *and* of the transmission channels that then spread that risk to the financial sector. The ABA must also consider the materiality of the potential systemic risk transmitted to the global financial system. It is not sufficient that there exists potential for the transfer of systemic risk, but that risk must be material in terms of the global financial system as a whole.

As noted before, Insurance Europe sees herding and procyclicality as factors relevant to macroeconomic exposures and therefore does not consider that they should be separated. (The plausibility of the "examples given" of mispricing risk, search for yield in low interest rate environment, dynamic hedging, would become apparent through micro-prudential stress-testing in terms of individual firm vulnerability; whether this could be of a magnitude that could become a threat to global financial stability would need to be evaluated. These would also seem to be macroeconomic exposures and therefore should not be separated.)

19. *Do you agree with the description of how the existing policy measures could mitigate systemic risk?*

Insurance Europe agrees that the IAIS should consider how existing policy measures could mitigate systemic risk, but would point out that consideration should also be given to how existing policy measures may actually give rise to systemic risk, by causing common or procyclical behaviour.

Insurance Europe agrees in principle that the current tools set out in Table 3 are all relevant approaches in mitigating the build-up of potential systemic risk that are relevant to an ABA and are either incorporated within the ICPs, or could be incorporated in a proportionate manner.

20. *Are there other mitigating policy measures in the wider IAIS policy framework that should be taken into account? If so, what are these and how do they mitigate the risk?*

In addition to the policy measures listed in Table 3, enhanced supervision and recovery and resolution planning might be considered. Enhanced supervision of firms, where proportionate, is probably implicit in supervisory oversight, but recovery and resolution planning may also serve a useful purpose in addressing sector wide risks as an extension to the ORSA and stress testing. However, overreliance on such plans may also distort the management's judgement in a case of emergency. They may be useful to raise a general awareness for a crisis scenario and establish certain organisational mechanisms in terms of, for instance, competences and communication channels. As such, they must remain proportionate and not burdened with the ambition to anticipate any imaginable scenario in vast detail.

The FSB's policy measures for OTC derivatives and securities lending should also be taken into account, as indicated later in the paper in paragraph 93.

21. *Do you agree with the IAIS' description of the gap analysis? If not, please explain how it could be improved?*

Insurance Europe welcomes the intention in paragraph 93 to include policy measures contained in other relevant international standards within the gap analysis. It is crucial to the analysis that these measures are taken into account, as transmission channels often lie outside the insurance sector. Stress testing will be the most appropriate method to quantify residual risk.

However, a gap analysis inherently presumes that it is not possible for current regulatory measures to be excessive. More practically, the gap analysis should not be limited solely to IAIS-developed policy measures but rather should be conducted in a more principle-based manner that includes existing local measures.

22. *Do you have any suggestions on how to measure (residual) liquidity risk in a proportionate manner?*

The IAIS June 2016 paper on systemic risk from insurance product features notes that, for liquidity liability, there is a complex interaction between contract features, the state of the insurer, the market environment, individual characteristics and other dynamics that will determine the extent to which counterparties have an incentive to surrender. Therefore, care must be exercised in order to determine plausible, rather than pure theoretical examples of potential risk.

In considering what may be plausible scenarios, it should be noted that insurers tend to be large holders of liquid assets, and therefore scenarios involving the forced sale of assets for which there isn't a liquid market are extremely unlikely. It will also be important to reflect on insurers' ALM practices, as where illiquid assets are held for illiquid liabilities there can be no risk of forced sale. As the IAIS notes, LRMPs as part of the enterprise risk framework can help focus on the tools available to manage liquidity risk. In this respect, the plans should demonstrate that there are sufficient liquid assets to back liabilities.

Insurance Europe highlights that recovery and resolution plans and liquidity management plans should be applied subject to the proportionality principle.

23. *How can the (residual) macroeconomic risk be appropriately measured, taking into account the extent that this risk is managed through ALM?*

The IAIS has identified ERM, ORSA, investment, ALM, and capturing material risks within capital adequacy requirements, as existing policy measures that address macro-prudential risk. These measures would ensure that, in a risk-sensitive prudential regime, potential negative externalities are internalised. Therefore, the stressed PCR, aggregate credit counterparty exposures and market exposures could be used as metrics to measure potential residual macro-prudential risk and determine materiality in the context of those exposures.

24. *Are there any other important considerations that are not included?*

The IAIS needs to also take into account the extent to which existing policy measures give rise to systemic risk. For example, investment requirements may lead to situations in which all insurers invest only in certain types of assets, thereby increasing the potential for systemic risk if there is disruption in that asset market.

Stress testing of capital against plausible scenarios would provide a metric to assess macro-prudential risk. However, Insurance Europe would emphasise that the scenarios need to be plausible.

25. *Do you have any comments on the potential policy measures considered?*

Specific policy measures can be an effective way of addressing risks identified after an appropriate assessment which includes a consideration of materiality and the existence of transmission channels. These policy measures should be appropriately designed and proportionate to address the risks posed by potentially systemic activities to the global financial system as a whole, taking into account risk management practices that insurers already apply. While Insurance Europe supports an exploration of alternative policy measures under ABA, it would not be favourable to any policy measures which could have the consequence of unnecessarily limiting the availability of insurance products to consumers at reasonable prices.

Liquidity Risk

- As the IAIS notes, LRMPs as part of the enterprise risk framework can help focus on the tools available to manage liquidity risk. In this respect, the plans should demonstrate that there are sufficient liquid assets to back liabilities. Stress testing would provide a basis in the future to determine the materiality of any correlated liquidity risk in the sector.
- Insurance Europe highlights that recovery and resolution plans and liquidity management plans should be applied subject to the proportionality principle.
- Supervisors may have powers to intervene to prevent mass surrenders at individual company level and aggregate level.

Macroeconomic exposure

- Given that the discussion on policy measures in relation to macroeconomic exposure is not very clear with respect to the actual risk targeted, more analysis needs to be done to clarify what the specific concerns of the IAIS are. Furthermore, the analysis around guarantees does not recognise that it is exactly products with such guarantees, in a variety of forms, that provide important financial stability through more stable investment strategies compared to when such guarantees would be non-existent.
- It is important to recognise the relationship between assets and liabilities in a holistic manner, and stress testing, applied in a proportionate and targeted manner, is an appropriate way of assessing this relationship.
- Insurance Europe agrees that qualitative measures to focus on macroeconomic risk exposures from non-insurance activities would be a proportionate way to ensure that any potential risk has appropriate management and supervisory focus. The SRMP currently serves this purpose for G-SIIs and potentially a similar approach could be applied through the ICPs/ComFrame to a wider population of firms where this would be proportionate to address potential systemic risk; this would be broader in scope than a derivatives-use plan considered in the paper.
- In order to determine whether the sector could pose a risk - through correlated macroeconomic exposures - to the global financial system, Insurance Europe agrees that some form of assessment of common exposures at a market-wide level would be required. This may be best coordinated through liaison with jurisdictional central banks to ensure that a market-wide exercise can be undertaken.

- Insurance Europe agrees also that recovery planning has a useful role as it helps management consider actions that they may usefully take if scenarios tested were to materialise. This can be achieved through an extension/complement to the ORSA. To serve this goal, recovery planning should focus on organizational aspects rather than anticipating a myriad of crisis scenarios. Insurance Europe also highlights that recovery and resolution plans and liquidity management plans should be applied subject to the proportionality principle.

Operational risk – the existing guidance in the ICPs is sufficient.

Regarding the examples of common behaviour not stemming from liquidity and macroprudential exposures – as noted in the answer to question 18 – Insurance Europe believes that these can be characterised as macroprudential exposures, and therefore stress testing would allow assessment of such risks.

26. *How should the IAIS determine the scope of any proposed policy measures? Should the scope vary based on the policy measure in question or should the scope be the same for all policy measures?*

The ABA should be implemented in a manner that is proportionate to the level of systemic risk that is presented by the activities undertaken, in line with the IAIS' overarching concept of proportionality. The scope will necessarily depend on the nature of the measures. If they are matters of sound risk management practice then they should be applicable to all.

27. *How could costs and benefits be measured by the IAIS?*

Additional policy measures can only be justified if they serve a genuine purpose (i.e. they address real systemic risk in the global financial system). Therefore, the IAIS need to qualify the plausibility of potential systemic risk from the insurance industry (from the different channels it has set out), to determine whether this risk could in fact be material in the context of the global financial system. The cost analysis must also include the opportunity costs of forgone economic activity as a result of the regulation. This cannot and must not be ignored or overlooked, as it is in most cases the largest incurred cost block.

28. *How could a materiality threshold be set?*

Paragraph 114 rightly recognises the need for a proportionate application of policy measures. Insurance Europe believes that policy measures must only be applied where there is a meaningful contribution to the insurance sector's risk, and that risk posed by the insurance sector has the potential to have a material impact on the wider global financial system.

29. *Are there other aspects the IAIS should consider in assessing the implications of ABA work?*

Yes, as noted in the answer to question 3, the focus of ABA should not be seen as limited to the "tsunami risk", as with many of the examples in the paper, because the ABA approach can also address "domino risk" given the focus on risk management and preventative actions.

30. *What impact, if any, do you think the ABA should have on the revision of the G-SII Assessment Methodology?*

The consultation document acknowledges that ABA policy measures can address not only "tsunami" effects, but also "domino" effects through the incorporation of counterparty exposure. As noted before, Insurance Europe also believes that a proportionate and properly-designed ABA could address "domino" as well as "tsunami" views of risk, given the focus on risk management and preventative actions, thereby fulfilling many of the objectives of the current EBA approach.

The ABA also demonstrates that HLA is not a necessary or appropriate policy tool for insurance, given that - where all material risks are already being captured in capital adequacy requirements - potential negative externalities are being internalised (with other measures ensuring risk is assessed, monitored and managed in a preventative manner). In Insurance Europe's perspective, important elements of G-SII framework could be covered by the assessment of materiality and proportionality and the determining of the scope of policy measures.

If the G-SII framework is retained, significant improvements are needed. For example, it is unreasonable to evaluate a firm's systemic risk footprint on a basis that is relative to other insurers. Another significant inadequacy in the G-SII Assessment Methodology is that it focuses undue attention on the life insurance business model, particularly long-term guarantees. Insurance Europe believes that some of the proposed ABA policy measures may help to give greater weight to how different product features operate together and incorporate how insurers manage the risk transferred to the insurer by those features. In general, Insurance Europe encourages holistic assessments of risk, rather than the use of the current G-SII Assessment indicators that are biased towards measuring the size of an insurance group.

31. *Do you have any other comments on the approach taken?*

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