Position paper

Insurance Europe response to the IAIS consultation on a risk-based global Insurance Capital Standard

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Insurance Europe, the European insurance and reinsurance federation, welcomes the opportunity to respond to the IAIS consultation on the risk-based global insurance capital standard.

General remarks on the ICS:

- Developing multi-national risk-based solvency systems requires significant time, effort and engagement from both regulators and industry to design and test measures that are able to 1) capture the true risk profile of the insurance business and 2) minimise unintended consequences.
- The currently envisaged IAIS timeline for the ICS is very ambitious. With the recent European experience of developing Solvency II in mind, Insurance Europe believes that it would be more realistic for the IAIS to give itself enough time to design and test measures that are fit-for-purpose, take into account the wide variation in product design, risks and risk mitigation across the global insurance industry and that do not result in unintended consequences.
- Insurance Europe believes that the ICS project should aim at achievable incremental progress.
- Insurance Europe is confident that sophisticated regimes, such as Solvency II, will represent an acceptable implementation of the ICS framework.
- Insurance Europe therefore believes that the ICS project should be defined as a set of stepping stones. While the ultimate target for the ICS should indeed be comparability of outcomes (such as available and required capital), at this stage the IAIS should focus on:
  - Defining fundamental principles for the ICS construction.
  - Considering how the ICS would interact with existing and future solvency regimes.
- Before progressing to the subsequent stepping stones, the IAIS should take the time to consider the impact of proposals that have already been implemented, and take stock of any developments in capital regimes around the world.
- At this stage it's not clear what is meant by a "minimum standard" and what kind of "minimum standard" would deliver on the comparability objective.

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- Looking ahead, Insurance Europe believes that:
  - Local regimes that are consistent with the ICS framework should be recognised as a suitable implementation of it, subject to sufficient supervisory control as part of the framework to ensure a level playing field.
  - If a number of local implementations are in line with the ICS framework, IAIGs should be given the option to choose which of the "equivalent" local implementation to apply for their business.
- Care needs to be taken to avoid forcing insurers to manage their capital and risks based on multiple and differing measures (for which supervisors will have the responsibility of oversight)
- As highlighted in the past, Insurance Europe believes that a better understanding of how likely it is for IAIS member countries to actually adopt and implement the ICS framework globally is needed. For example, does the IAIS plan to seek global commitment and, more specifically, G-20 commitment to support implementation?

Insurance Europe supports the following elements to be part of the ICS development:

- A consolidated group-wide balance sheet should be the basis for measuring capital adequacy.
- Available Capital should be determined as the excess of assets over liabilities, plus subordinated liabilities, based on a solvency rather than accounting balance sheet.
  - Quality of capital resources (ie tiering) must be based on their ability to absorb risk, and not on arbitrary definitions.
- A target level of solvency should be used to ensure consistency of calibrations.
- A consistent valuation basis should be part of the ICS, ensuring that the long-term nature and ALM are taken into account and therefore avoids "artificial" volatility in available capital. The ICS should rely on an economic approach in which the matching between assets and liabilities is key. Insurance Europe believes that:
  - Assets should be valued at market value.
  - Insurance liabilities should be valued based on current estimates, ie projection of best estimate cash flows, not conservative estimates.
    - Projected cash flows should be discounted using a discount rate that reflects the nature of the business and how matching links assets and liabilities.
- Required capital should reflect the risk of change in value of the available capital to target level of solvency.
  - The standard method for deriving capital requirements should be based mainly on a scenario approach.
  - The requirements should be calibrated at a certain confidence level over one year and the minimum confidence level should be explicitly defined as part of the ICS framework.
  - Internal models (partial and full), which are subject to consistent and transparent supervisory approval, must be allowed to determine solvency since they represent the most accurate reflection of the company's idiosyncratic risks and exposure.
  - The loss-absorbing capacity of technical provisions and tax should be appropriately recognised.
- Reinsurance and other risk mitigation (eg profit sharing, hedging), ALM and diversification should be taken into account in determining the overall required and available capital.
- Transitional measures should be part of the framework.
- Stress tests should be limited to the strict necessary.

Comments on the consultation paper:

Question 1. Are these principles appropriate as the foundation for a global consolidated insurance capital standard? Are any enhancements or modifications needed to the ICS Principles?

Insurance Europe believes that some fundamental assumptions should be added to the principles, namely:

- Going concern: the ICS should assume that insurers are in business at the reference date and continue to be so in subsequent periods (contrary to a winding-up assumption).
- Economic value: valuation should reflect the link between assets and liabilities, as a key feature of the insurance business model. Insurance Europe supports market values for assets and current estimates for liabilities.

Regarding **ICS Principle 1**: Insurance Europe welcomes the consolidated group-wide balance sheet being the basis for measuring capital adequacy.

Regarding **ICS Principle 2**: Insurance Europe believes that contribution to financial stability should not be an objective *per se*, but rather the ICS should avoid any unintended consequences on financial stability by appropriately measuring insurance risks and avoiding incentives for pro-cyclical behaviour through artificially volatile measurement of risks.

Regarding **ICS Principle 3**: While Principle 3 creates a link between the ICS and the HLA, Insurance Europe believes that such a link is premature. Before such a link is created, Insurance Europe would need clarification from the IAIS on various fundamental issues concerning the HLA, which have not been addressed so far, including:

- Its precise purpose.
- The nature of the risks it is supposed to address, including the definition of the "NTNI" activities.
- Its interlinkage with existing solvency frameworks and with the rest of the G-SIIs policy measures.

As indicated in the past, Insurance Europe believes that the BCR is not sufficiently risk-sensitive and gives insufficient recognition to risk mitigation and diversification.

Regarding **ICS Principle 5**: Insurance Europe believes that this principle creates a mix between the initial objectives of the ComFrame project (ie mutual understanding and greater confidence) and the emerging objectives of the ICS, which is part of ComFrame but whose objective (ie comparable outcomes) goes beyond ComFrame.

Regarding **ICS Principle 6**: Insurance Europe supports this principle and believes that it should trigger work from the IAIS on defining how the ICS would interact with existing solvency regimes, given that companies optimise their balance sheets and risk-management based on existing local solvency rules.

Regarding **ICS Principle 8**: Insurance Europe believes the ICS should aim to appropriately capture the real risks that insurers are exposed to. While a balance between risk-sensitivity and simplicity is welcome, risk-sensitivity should not be sacrificed for the sake of simplicity. For example:

- If the risks are complex, sometimes a more complex technique should be used, rather than the other way around.
- The nature, scale and complexity of risks should be taken into consideration when using simplifications or alternative approaches.

Question 2. What does comparability mean for the ICS from your perspective?

Comparability for the ICS should mean comparability of outcomes across jurisdictions. Practically, this means that similar risk profiles should result in similar capital requirements, independent of jurisdiction. As noted in its general remarks, Insurance Europe believes that the ICS project should be defined as a set of stepping stones that would require incremental progress and comparability of outcomes could be defined as a ultimate goal of the ICS development.

Insurance Europe would, however, like to note that comparability should be counterbalanced by another fundamental objective, which is for the ICS to capture the true risk profiles of IAIGs. For example, calculating a comparable capital requirement for companies A and B through a standard model approach would not be relevant if the risk profiles of companies A and B differ dramatically. Depending on how far the companies' risk profiles differ from that of a "standard" undertaking, their capital requirements will reflect their profiles to a greater or lesser extent. Insurance Europe, therefore, believes that any approach that does not allow for the use of internal models cannot deliver comparability.

Comments on paragraph 17

At this stage it is not clear what is meant by a "minimum standard" and what kind of "minimum standard" would deliver on the comparability objective.

Looking ahead, Insurance Europe believes that once a minimum standard has been achieved and if a number of local implementations meet the minimum standard, IAIGs should be given the option to choose which of the "equivalent" local implementation to apply for their business. In addition, care needs to be taken to avoid forcing insurers to manage their capital and risks based on multiple and differing measures.

Comments on paragraph 25

It is not clear what the definition of "premium" is in this measure. Under several accounting standards some insurance contracts are not considered to be insurance contracts, but are classified as "investment contracts". For these contracts the deposit accounting is used, therefore not recognising premiums.

Comments on paragraph 32

As mentioned before, Insurance Europe believes it is premature to determine that the ICS will replace the BCR as the basis for the HLA. While the BCR has severe limitations in terms of its risk sensitivity, it's not clear that the scope of BCR and ICS needs to be the same.

Question 3. Should the IAIS consider integrating the measurement of some or all risks across different sectors?

Risks that are captured by solvency regimes of other financial sectors (such as the Basel accords for credit institutions) should be respected and integrated. Developing separate standards for these sectors under ICS will create opportunities for regulatory arbitrage and result in non-level playing field between insurance groups and other financial groups. Sectorial requirements should, therefore, be used.

Comments on paragraph 36

Insurance Europe regards the application of a total balance sheet approach as a sound basis for the ICS. This approach reflects the interactions between assets and liabilities, which is considered appropriate, as changes of circumstances usually affect both sides of the balance sheet simultaneously. Consistent with a total balance sheet approach, the starting point in defining available capital should be the "excess of the value of assets over the value of liabilities, plus subordinated liabilities".

Comments on paragraph 42

Insurance Europe supports the use of a market-adjusted valuation (MAV) approach.

Comments on paragraph 46

Insurance Europe supports the use of current estimates for valuing liabilities. It is important that the projected cash flows are discounted using a discount rate that reflects the (long-term) nature of insurance business and reflects the interaction between assets and liabilities, which is at the centre of the insurance business model.

This is referenced in Annex 4 of the consultation (paragraph 21, page 140), and Insurance Europe would argue that the ICS should be designed not to "reduce", but to "avoid" artificial volatility to ensure the sustainability of the long-term business model.

Comments on paragraph 53

The approach presented here is very much in line with the IFRS 4 phase II approach. This will, however, not achieve comparability for supervisory purposes since the residual component will vary depending on the GAAP approach to valuing liabilities. The residual component should be included in the capital resources and not remain as a separate component on the balance sheet.

Question 4. Should the IAIS attempt to develop a consistent and comparableMOCE? Why or why not?

Insurance Europe believes that the development of a comparable and consistent MOCE is a very challenging task and a MOCE is not needed for the purpose of the ICS. In addition, it would be very difficult for a GAAP-MOCE to achieve the comparability and consistency objectives.

The MOCE concept was also part of the BCR consultation and Insurance Europe noted that a MOCE conceived as part of liabilities would in effect translate into an additional provision for the same risks that the capital requirements are intended to cover. If a MOCE was envisaged as part of available capital, its calculation is not really needed as its identification as a distinctive element would serve no clear purpose.

Should a MOCE be developed, Insurance Europe supports a transfer value/cost of capital approach. The cost of capital would vary across jurisdictions and would be linked to relevant interest rates and macroeconomic parameters in a particular jurisdiction.

Question 5. If the IAIS were to develop a consistent and comparable MOCE should it fulfil one of the possible purposes listed in paragraph 49 above? If yes, please explain. If no, what should be the purpose of the MOCE? Please explain.

Any MOCE, if considered, should have a technical rationale and should not be developed only for the sake of adding a margin of prudence. Insurance Europe would not support a MOCE that is a margin for prudence as this translates into additional provision for the same risks that the capital requirements are intended to cover.

A margin for prudence to derecognise future profits is inconsistent with a current estimate approach for liabilities. Derecognising future profits would be a double counting of lapse risk which is already reflected in the standard method and would also reduce comparability – as more profitable products will be penalised more.

The rationale and basis for a MOCE, if any, should be consistent with the principles for development of the qualifying capital and ICS requirements. For example, if the ICS is expected to be based on the principle of transfer of assets and liabilities to a third party in a stress scenario, MOCE could be considered based on whether the third party would require a premium/margin to take over the assets and liabilities. However, if the ICS is based on the principle of run-off of assets and liabilities, a MOCE is less relevant as it will only act as a margin that is released over the life of the policies.

Should the IAIS pursue with the development of a MOCE, Insurance Europe would support a transfer value/cost of capital approach. The cost of capital would be specific to every jurisdiction and closely linked to the interest rate and macroeconomic environment.

Question 6. If the IAIS were to develop a consistent and comparable MOCE, what principles should underlie its development?

It is difficult to answer the question without understanding the ins and outs of the ICS. The potential benefits of the currently considered MOCE should be further assessed against the additional complexity that it adds. Should this option be however considered, the MOCE together with the current estimate of the insurance liabilities should be equal to the value another insurer would be willing to pay to take over the obligations.

Additional principles for the development of a MOCE could be:

- The components of MOCE should only relate to risks that are embedded in the insurance obligation that cannot be hedged.
- The MOCE should refer to a third party which is also an IAIG.
- The third party would ensure the assets covering the insurance liabilities are such that all risks embedded in the insurance liabilities are hedged to their fullest extent.
- The cost of capital approach should be allowed as a good proxy for the MOCE. As indicated in the response to question 4, the cost of capital would vary across jurisdictions and would be linked to relevant interest rates and macroeconomic parameters in a particular jurisdiction.

Question 7. Depending on your answers to the above three questions, what calculation methodology should be applied for the MOCE?

Insurance Europe believes that a cost of capital approach should be considered.

Comments on paragraph 55

As the IAIS is considering further approaches and refinements, the final ICS will need to be evaluated in the context of all final decisions. Decisions or changes on any of these issues could have multiple effects on other issues and on the overall performance of the ICS.

Question 8. Should the IAIS develop an alternative definition of contract boundaries? If so, please provide such a definition with rationale for that alternative definition.

No comments.

Question 9. If such alternative definition is adopted what would be the impact on the definitions of ICS capital requirement and qualifying capital resources?

No comments.

Question 10. Are there any other aspects of the market-adjusted approach that would benefit from further enhancement or greater specificity or other changes in any way?

A clear approach would be needed for all balance sheet items, including reinsurance assets, property, receivables, property for own use, other assets, financial liabilities, employee benefits, other liabilities.

Question 11. What refinements, if any, should be made to the market-adjusted approach as currently formulated in regards to the treatment of long-term business?

This depends on various factors, such as decisions regarding the ICS yield curve to be used and the valuation approach to discretionary benefits. The market-adjusted approach should acknowledge the relationship between assets backing insurance liabilities (as referred to in Annex 4, paragraph 21). For example, products that are structured in such a manner that no interest rate risk exists should also be treated as such, ie the ICS approach should not lead to artificial mismatches.

Question 12. What enhancements could be made to the IAIS prescribed yield curve used to discount insurance liabilities? In particular, what enhancement could be made to further consider procyclicality with reference to ICS Principle 7?

The proposed valuation approach for liabilities avoids complexity, but will not correctly reflect the long-term nature of insurers' business and makes the link between the valuation of assets and the valuation of liabilities very poor. While assets are measured at fair value, the valuation of liabilities risks creating significant balance sheet volatility for (at least) the following reasons:

- The spread adjustments do not reflect the actual portfolios of companies.
- The adjustment for corporate bonds is fixed at the 10-year maturity and applied to all the points of the discount rate curve.

This approach for measuring liabilities can potentially lead to a significant exaggeration of the volatility of the balance sheet, and therefore capital resources, especially during periods of financial stress.

Insurance Europe believes that an adjustment of only 40% of the actual corporate bond spread insufficiently reflects the illiquidity of many products and also creates significant balance sheet volatility, which can potentially lead to pro-cyclical actions during periods of financial markets stress.

In addition, an approach based on 10-year spreads creates basis risk between assets and liabilities, as the value of assets reflects changes in spreads at different points on the curve, while the value of liabilities would not. The focus on the 10-year spread unfortunately reflects no link between an insurer's liabilities and the actual spread the insurer earns on the actual bond portfolio.

Question 13. Is the methodology for determining the IAIS yield curve under the market-adjusted approach appropriate for and consistent with the business models of insurers that write long-term business? If not, how should it be adjusted? Please explain.

The valuation approach for long-term liabilities has to recognise the real credit risk faced by an insurer that, as a result of long-term liabilities, holds investment assets matching those liabilities long-term and is not exposed to forced sales.

The valuation of long-term liabilities needs a mechanism that prevents changes in the value of assets, caused by spread movements, from flowing through to companies' balance sheets where companies have fully or partially mitigated the impact of these movements.

Comments on paragraph 62

The IAIS should consider using a broader approach to collecting data. Only looking at a set of IAIGs could give a biased view.

Comments on paragraph 66

It should be avoided that IAIGs have to report and prepare multiple balance sheets: accounting, market-adjusted, GAAP-adjusted and a balance sheet for local supervisory reporting. The cost-benefit analysis should be clearly sought here.

Question 14. Would your IAIG/jurisdiction be likely to consider the use of a GAAP with adjustments valuation approach, and why?

The European insurance industry supports the market-adjusted valuation approach.

Question 15. For the purpose of determining ICS qualifying capital resources, what adjustments, if any, should be made and to which local jurisdictional GAAP financial statements?

Insurance Europe supports a market-adjusted valuation approach for both assets and liabilities (with liabilities measured as current estimate), which would ensure comparability in the determination of available capital and required capital.

Question 16. For the purpose of determining the ICS capital requirement, what adjustments, if any should be made to which local jurisdictional GAAP financial statements?
No comments.

Question 17. Please describe how the above adjustments should or could be calculated, using GAAP or readily available information, so that the results could be most comparable to the market-adjusted valuation approach, after application of the ICS. Please also comment on the likely or potential variations of the results of the adjustments using the GAAP with adjustments approach compared to the market-adjusted valuation approach.
No comments.

Question 18. Are there other key principles not included above that should be considered when assessing the quality of financial instruments for regulatory capital purposes? If so, please suggest other principles and the rationale for including them.
No comments.

Comments on paragraphs 76-77
The definition of capital resources must be based on economic principles. Rather than prescribing a list of capital instruments, the definition of capital resources should correspond to the valuation principles for assets and liabilities and should be calculated as the residual of those values plus subordinated debts.

Comments on paragraph 84
Deductions should already be considered in the market-adjusted balance sheet. No additional deductions should be envisaged.

Comments on paragraph 86
The IAIS states "[…] should be approved by supervisors […]" Our understanding is that this should be the supervisor in the jurisdiction where the head office of the parent is located since the assessment relates to group available capital.

Question 19. Should qualifying capital resources be classified in more than one or more than two tiers of capital? How many? And, if different from above, what key criteria should be used to determine tiering?
The starting point for the determination of capital resources should be the excess of assets over liabilities plus subordinated liabilities. This amount can then be sub-divided into tiers if necessary based on the quality of the components. For this purpose, two tiers should be sufficient. Sub-limits should be avoided as much as possible. The classification should be aligned as much as possible with the current approaches as many capital instruments are already issued to the capital markets, and they should be based on ability to absorb risk. Any new definitions would need grandfathering features.

A more detailed assessment will have to be made when proposals for the exact dimensions of these limits have been published.

Question 20. If qualifying capital resources are classified in two or more categories of capital, should the ICS capital adequacy be expressed using only one, two or more ratios? Why?
Insurance Europe supports the use of only one ratio. If the IAIS introduces limits on the relative proportions of tier 1 and tier 2, multiple ratios are not necessary.

Question 21. Should any amount of non-paid-up items be included in qualifying capital resources? Why? If yes, how should these be classified and should there be limits? Should there be an additional limit on non-paid-up elements that give rise to paid-up Tier 2 elements as opposed to those that give rise to paid-up Tier 1 elements? Please give reasons for your answer.
Uncalled up capital is a generic term covering different forms of assets. It is inappropriate to impose a blanket restriction on their use, without having regard to the proven strength of particular forms of such assets.

Insurance Europe believes that non-paid up items should be part of tier 2, subject to appropriate qualifying criteria. Non-paid up capital items, when subject to reasonable safeguards, constitute a reliable form of capital, recognised in existing regulatory capital regimes. Prohibiting or significantly restricting their use as qualifying capital resources would be unnecessarily restrictive, reducing insurers' capital flexibility without enhancing policyholder protection or financial stability.

If the IAIS is minded to restrict the use of non-paid up capital items, it should, before taking action, conduct a detailed and transparent review of the use of non-paid up capital in the insurance sector, to ensure that any regulatory action is based on evidence and fully justified in the light of IAIS and ICS objectives.

There should not be a closed list of non-paid up elements. Instead, the quality and diversity of capital instruments should be part of the internal scrutiny included in risk management / capital management / ORSA exercises. This section will be part of the ongoing dialogue between supervisors and insurers as part of the supervisory review process.

Non-paid up tier 1 elements should be classified as tier 2 until they are paid up.

Question 22. If non-paid-up capital items were permitted, should the capital composition limit for non-paid-up Tier 2 items be based on a percentage of Tier 1 capital resources, on ICS capital requirement or determined on another basis?
Non-paid up capital items included in tier 2 should not be subject to a separate capital composition limit, but should be treated in the same way as other tier 2 items. Non-paid up items will enable an IAIG to meet liabilities to policyholders in the event of a winding-up, so additional restrictions on their use, on top of the qualifying criteria, are unnecessary.

Comments on paragraph 88
The list of capital resources elements suggests that the starting point for capital resources is an accounting balance sheet as opposed to the balance sheet that is used for solvency purposes (eg market-adjusted valuation balance sheet). For example, "accumulated other comprehensive income" is included as a Tier 1. This is a very distinct accounting term which you would not expect to find in a market-adjusted valuation balance sheet. We would suggest that the IAIS start from the excess of assets over liabilities plus subordinated liabilities for all paid up capital items.

Question 23. Should the residual amount of GAAP insurance liabilities in excess of current estimate plus consistent MOCE (as referred to in paragraphs 53 and 89) continue to be considered as part of Tier 1 capital resources? If so, should it be all in Tier 1 for which there is no limit, or at least partially recognised in Tier 1 for which there is a limit? If it is not all recognised in Tier 1, should it be recognised in Tier 2, and if so, which part of Tier 2? Should any part of the residual amount of GAAP insurance liabilities not be recognised at all in qualifying capital resources, and therefore effectively be deducted from qualifying capital resources?
The entire amount should be considered in tier 1 capital resources, since it meets all the envisaged tier 1 criteria. Any alternative approach will undermine comparability due to differences between accounting regimes.

Question 24. Should reserves that are set up under regulatory requirements to cover specific types of risks, and that can be unappropriated under supervisory approval, be considered unrestricted and therefore be included in Tier 1 capital?
Insurance Europe believes that if capital requirements are meant to account for all material risks, then the purpose of such reserves is not clear.

Question 25. Should Tier 1 instruments for which there is a limit be required to include a principal loss absorbency mechanism that absorbs losses on a going- concern basis by means of the principal amount in addition to actions with respect to distributions (e.g. coupon cancellation)? If so, how would such a mechanism operate in practice and at what point should such a mechanism be triggered?
Triggering of such mechanisms should be compatible with local regimes and practice.

The features for classifying as tier 1 unrestricted or tier 1 limited should be aligned with relevant characteristics used by investors in order to achieve a level playing field when issuing capital instruments to the capital markets.

Comments on paragraph 93
Not-paid up tier 1 instruments should also qualify for tier 2 eligibility when the holder of that instrument can be compelled to pay the outstanding amounts when needed.

In Insurance Europe's view the amounts put forward under (g) should not be deducted from tier 1. This deduction is also not in line with paragraph 88.

It is unclear how the IAIS has motivated the decision for 50% under (h).

Question 26. Should any value with respect to DTA, computer software intangibles and defined benefit pension plan assets be included in Tier 2 capital resources? Why?
These assets should be considered as part of tier 2. This is consistent with a going concern assumption.

Computer software intangibles and defined benefit pension plan assets should be included as part of the tier 1 capital. There is no reason for disqualifying them from the capital resources.

Question 27. Is it appropriate to include in Tier 2 add-backs from items that are deducted from Tier 1 capital resources (i.e. DTAs, computer software intangibles, defined benefit pension plan assets)? What methodology could the IAIS use to determine an objective realisable value in a stress scenario for these items or should the IAIS adopt a more arbitrary approach such as permitting a percentage of the amount deducted from Tier 1 capital resources to be included in Tier 2 capital resources? If Tier 2 add-backs are included, how would the ICS capital requirement work in relation to the amounts added back?
Deferred tax assets should be subject to the same criteria for recognition as is used for accounting purposes (for example IAS12) where they are only recognised if there is a possibility for recovery.

In case of own fund items that cannot be fully categorised into one tier, the limited part should be categorised into the lower tier. This is the only way to ensure that all the IAIG's capital resources are recognized to cover the ICS.

Intangible assets (not recognised due to a business combination) can only be recognised if there is a market on which they can be sold (see, for example, IAS38). If the criteria are not met then the asset is not recognised. The asset is furthermore assessed for impairments regularly.

Therefore we would suggest adding them back entirely, and valued as per the above rules.

Comments on paragraph 94
The criteria for capital instruments should be aligned as much as possible with those in other regimes that are currently in place. A subordinated capital instruments should not have to satisfy multiple different set of criteria. This will make it very difficult to issue a capital instrument if that instrument has to satisfy different criteria.

The criterion (d)(i) is not necessary and should be removed.

Question 28. What objective methodology could the IAIS use to determine the amount of a non-controlling interest that is not available to the group for the protection of policyholders of the IAIG?
As non-controlling interests (minority shares) are already deemed to not qualify as part of the qualifying capital there is no need for an additional limit.

The only additional criterion that could exist for a non-controlling interest to be included is an agreement that the non-controlling interest also shares in losses even when the non-controlling value becomes negative (from the perspective of the non-controlling interest). The holder of the instrument is, therefore, also liable for additional losses over the issuing price.

Question 29. Should other items be deducted or should some of the above items not be deducted? Please provide details and explain your answer.
Components presented under (b), (c) and (d) should remain as part of tier 1 qualifying capital.

Question 30. Instead of treating the above elements as deductions to Tier 1 capital resources, should some or all of these elements be included in the ICS capital requirement? Please provide details and explain your answer.
Insurance Europe believes that risks that are reflected in capital requirements should not also be captured through deductions to capital resources.

Question 31. Instead of treating the above elements as deductions to Tier 2 qualifying capital resources, should some or all of these elements be included in the ICS capital requirement? Please provide details and explain your answer.
If some items are considered not to be eligible as capital, they should be deducted from available capital. They should not be added to capital requirements, as this could distort solvency ratios.

Question 32. Should the ICS contain capital composition limits? Why?
In principle, qualifying capital should not have any other limits. It is normal practice, however, to have some limits in place based on the first category.

Question 33. If it were to contain limits, what would be an appropriate limit for Tier 1 capital instruments that satisfy the criteria set out in Section 6.3.3 (i.e. Tier 1 capital resources for which there is a limit)? How should this be expressed? If it were expressed as a percentage of Tier 1 capital resources, net of regulatory adjustments and deductions, what would an appropriate limit be?
Any limits should aim for compatibility with local regimes to minimise implementation challenges and not distort the competitive level playing field domestically/regionally.

Question 34. If the ICS were to include a capital composition limit on Tier 2 capital resources, how should it be determined? If it were set as a percentage of the ICS capital requirement, what should the limit be? Please include reasons for your answer.
No comments.

Question 35. If GAAP with adjustments were used as an alternative valuation approach for the ICS, are the definitions of capital resources detailed above appropriate? Please describe key differences and any complications that might emerge under a GAAP with adjustments approach to valuation.
No comments.

Question 36. Should the IAIS consider transitional arrangements for financial instruments that do not meet the ICS qualifying criteria? If so, what transitional arrangements would be appropriate?
Yes, a transitional regime is necessary to avoid disruptions. Multiple jurisdictions are already transforming their current solvency regimes with transitional provisions for financial instruments issued before the application of new regimes.

When the ICS is implemented, existing transitional provisions should be carried forward in addition to new transitional measures to allow for a smooth transfer of solvency regimes without disruptions in the financial markets.

Question 37. Should the ICS capital requirement be developed so that it can be implemented as a PCR? If not, why not?
PCR-like measures, where they exist in local solvency regimes, are a key driver of risk and capital management. The development of an ICS that would take the form of a PCR would put insurers in the position of having two potentially different measures for steering capital management, which is simply unworkable and unmanageable in practice.

Question 38. Should the IAIS promulgate a less risk-sensitive backstop capital measure? Should this backstop measure be used for monitoring the risk- sensitive ICS capital model, or should the backstop serve the role as a capital floor to the ICS?
Insurance Europe does not support the introduction of backstop capital measures or other risk-insensitive floors as part of the ICS.

Model and assumption risks are best managed through suitable governance. The use of a less risk-sensitive capital calculation cannot be used to monitor a risk sensitive ICS uniformly as the relation between the two measures would vary depending on the risk profile of insurers and also depending on which risk materialises. Reliance on such a flawed measure can create a false sense of security/panic and can lead to the risk that model and assumptions governance are not given the due attention. Further, the use of a risk insensitive measure as a floor will create complications for risk and capital management, as well as risk of sub-optimal decisions, especially in stress scenarios.

Question 39. What other risks should be included in the ICS capital requirement? Should any of the risks identified be excluded from the ICS capital requirement? Please provide reasons.
The risks mentioned are the main risk types. In principle, no other risk should (at this stage) be included.

Question 40. Are these specified risks and their definitions appropriate for the ICS capital requirement? If not, why not?
Given that the ICS will apply to IAIGs who, by definition, are the largest and most complex groups, it is nearly impossible to derive a standard method that captures all risks appropriately. The allowance of full and partial internal models is absolutely essential to avoid an overly complex standard method which does not reflect the risk profiles of many of the groups to which it is applied.

Care is needed in defining catastrophe risk, as companies often include non-natural (ie man-made) catastrophe within their premium risk for modelling purposes.

Premium credit risk is relatively immaterial for a non-life insurer and so consideration should be given as to whether this can be ignored for non-life entities.

Question 41. Is it appropriate to not quantify risks other than those identified in Table 2 in the ICS capital requirement? If not appropriate, what risks in addition to those in Table 2 should be quantified in the ICS capital requirement, and how could they be quantified?
Please refer to the comments on question 40.

Relying on capital requirements is not always the best way to mitigate the risks. For example, a capital requirement for liquidity risk will introduce a circular treatment. Risk mitigation and contingency planning is more effective in this sense.

Comments on paragraph 115
Insurance Europe supports the consolidated group approach.

Comments on paragraph 119
ComFrame should address this risk as part of risk management strategies and/or contingency planning.

Question 42. Which risk measure – VaR, Tail-VaR or another – is most appropriate for ICS capital requirement purposes? Why?
Insurance Europe favours the use of VaR. Conceptually, VaR is easier to explain and communicate within the company. VaR is also easier to calculate and implementation of a scenario-based approach within a VaR method is straightforward. In addition, there are significant precedents to the use of VaR in both companies' existing risk management processes and supervisory frameworks.

Tail VaR requires information on the tail of the distribution, which may not be available for some companies and often requires additional assumptions based on expert judgement that needs to be validated by the supervisor. Tail VaR is also not compatible with the use of scenarios within the standard approach. In order to perform a Tail VaR analysis, one would require scenarios to describe every position in the tail. This is not practical and could significantly increase the burden on companies, with potentially limited additional value.

While Insurance Europe would support VaR for the standard method, the possibility to use different risk measures eg Tail VaR in internal models should not be precluded, provided that these are calibrated to comparable confidence level.

Question 43. What are some of the practical solutions which may be used to address known issues with respect to modelling tails and diversification benefits, e.g. in the internal risk measures used by IAIGs, particularly in ORSA?
The recognition of both diversification and risk-mitigation effects is essential and strongly supported. The pooling and management of risk is at the heart of the insurance business model and must be recognised in the ICS.

The most accurate approach for capturing these effects is through an approved internal model. For a standard method Insurance Europe suggests the recognition of diversification effects by the use of covariance matrices or copulas.

Question 44. Is the prescription of a one-year time horizon appropriate? If not, what are the alternatives and why?
The one-year time horizon is appropriate. It is the most commonly used approach and can be explained most easily.

Question 45. Should the ICS capital requirement include an assumption that the IAIG will carry on existing business for the one-year time period as a going concern? Should the ICS capital requirement only apply to risks at the existing measurement date? Why?
One of the most important assumptions is the going concern.

If this is not applied, multiple valuations in the market-adjusted balance sheet will have to differ. Using a winding-up scenario (ie gone concern) would have a huge impact on the assumptions in the valuation of the current estimate, which would mean that a different value would have to be calculated.

A winding-up scenario would cause all sorts of differences, including: management actions will have no impact, deferred tax assets would not exist, cost assumptions in valuations would be different. The corresponding values and requirements would not be considered by management because they would apply the going concern assumption in their risk management and internal steering. Relying too much on winding-up can even cause counter-productive decisions by management (and more incentives for short-term planning).

Question 46. In what ways are the proposed initial field testing target criteria appropriate or inappropriate for the development of the ICS?
As noted in our response to question 42, Tail VaR is not suited to a standard formula approach and therefore should not be field tested. Where the standard formula approach allows for use of internal model, ie cat risk, volunteers of the field testing exercise may use Tail VaR if they use it as part of an internal model.

Question 47. Describe the costs and benefits of conducting field testing on either one or both target criteria.
The IAIS should be cautious about creating field testing requirements that are too burdensome for companies, so it should narrow down the scope of testing to "most likely to be implemented" solutions. Insurance Europe believes that an appropriate ICS that works as intended can only be achieved if appropriate and enough field testing exercises are proposed.

We would like to reiterate that we would strongly favour the VaR approach as part of a standard formula, while Tail VaR should only be tested for specific risks (eg cat risk) as part of an internal model approach.

Question 48. In order to field test a Tail-VaR measure, how should the IAIS specify the Tail-VaR measure for a given confidence level?
No comments.

Question 49. Do the proposed principles adequately address the concept of risk mitigation? If not, which principles should be changed and why? What additional principles should the IAIS consider and why? What unintended consequences do the proposed principles create?
The recognition of both diversification and risk-mitigation effects is essential and strongly supported.

Insurance Europe supports the IAIS' acknowledgment of risk mitigation and welcomes an approach that recognises it, since it would promote sound risk management, thereby advancing the objective of policyholder protection.

However, the way that risk mitigation is allowed for in the ICS must not produce bias in favour of one type of insurer over another. For example, at present the non-life premium and reserve risks are quantified in the standard method using factors that do not take into account the potential impact of any non-proportional outwards reinsurance that the insurer might have (which is a key risk mitigation tool that should be reflected in the ICS). At the same time, life insurance risks are quantified by stress scenarios that allow reinsurance to be reflected. This disparity seems to bias the ICS against non-life insurers which would be in breach of the ICS consistency/comparability principles.

Dynamic hedging strategies and rolling reinsurance arrangements should be taken into consideration if these are embedded in risk management strategies or policies. In Insurance Europe's view, this should be possible whenever the capital requirements are based on a time horizon of one-year (not only for non-life insurance as presented under (135)).

Question 50. Existing risk mitigation arrangements with respect to non-life business could be in force for a shorter period than the time horizon for the calculation of the ICS. If that is the case:
a) Which criteria should be considered in order for the renewal of risk mitigation arrangements to be recognised in the ICS calculation?
b) In particular, which criteria should be met for a full recognition of the renewal of risk mitigation, and which criteria should lead to partial recognition of the renewal of risk mitigation?
No comments.

Question 51. Should credit for participating/profit sharing and adjustable products be calculated in a last step adjustment as an overall adjustment to the capital requirement, or along the intermediate calculation steps in the determination of individual risk charges? Why?
In principle, the two approaches should lead to similar outcomes, so it should be left to the insurer to choose which method to apply. Both approaches have their advantages and disadvantages.

An important question to be answered is whether the provision for discretionary profit sharing can exceed the amount recognised on the market-adjusted balance sheet. Several profit sharing features for example will react to the scenario which is considered.

Question 52. How can an overall adjustment for discretionary credits be calibrated in a manner that takes account of the reaction of policyholders to extreme scenarios into account? How can it be made comparable to calculations based on scenario projections?
The profit sharing features are at the discretion of the insurer. Decision on whether to change the terms of adjustable products is also at the discretion of the insurer. The extent to which these features can be taken into consideration depends on a) the internal governance of the insurer and b) the expectations in the market. The governance should be such that an insurer will actually apply the reduction (almost as a pre-defined management action). The reaction should almost be automatic based on the events specified. The policyholders should be aware that the changes or adjustments can happen based on events that can occur. There is no vested right to either the profit sharing or a continuing of current terms of the product.

The reaction of policyholders to these events should already be taken into consideration when the management action is defined and also in the assessment of the willingness of management to take these actions. This assessment should be made for each calculation, as circumstances can change over time. The subsequent reactions of policyholders should not be included in the ICS, but rather in the ComFrame considerations.

Question 53. What are some other criteria or considerations in determining qualifying participating/profit sharing and adjustable products?
Please refer to comments on question 52.

Question 54. What are some of the considerations for determining the aggregation of the credit for participating/profit sharing and adjustable products? What are some of the limitations with respect to cross-subsidisation of different products, the application of the credit generally or its ability to be used across the IAIG?
Please refer to comments on question 52.

Question 55. As a starting point for determining the value of the credit, does the approach described above represent any challenges? What other options or methodologies should be considered and why?
Please refer to comments on question 52.

Comments on paragraph 152
It is very questionable to draw conclusions and extrapolate based on one event as mentioned in this paragraph. The financial crisis and the following years have shown that in many cases unrealised losses were reversed in the years after the start of the crisis.

The financial crisis has also seen that certain onerous developments in one portfolio in one jurisdiction were different from a similar portfolio in other jurisdictions. For example, the behaviour of RMBS in the United States was different from their behaviour in continental Europe.

Question 56. How should dependencies and inter-relationships between risks during stressful situations be addressed by the ICS capital requirement?
The aggregation using a defined dependency structure (eg a variance-covariance matrix or copulas) should be used.

Question 57. Are there any aspects of diversification of an IAIG's activities that are not identified in this section and that the IAIS needs to consider?
Geographical diversification is a key form of diversification for international groups. There is a concern that the geographical granularity in many of the risk categories will not be sufficient to adequately reflect this diversification benefit.

For non-life premium and reserve risk a factor based approach has been proposed. These factors should vary with volume as, all other things being equal, a larger portfolio of insurance risks should result in a proportionately lower volatility – this is one of the principles of insurance. This should be reflected in the risk factors by allowing them to vary with volume, or by adding some volume-based adjustments.

Comments on paragraph 160
Insurance Europe supports the approach of determining risk charges for most categories with a stress scenario approach rather than a factor-based approach. The stress scenario approach accounts for the individual set-up of the group and is therefore preferred.

Comments on paragraph 163
If firms do not use an internal model, but a standard method, this should be scenario based rather than factor based.

Question 58. What major approaches for measuring risk are not included in Sections 8.2 to 8.5? In what circumstances would these alternative approaches be appropriate?
No alternative approach is needed.

Question 59. Should a look-through approach be applied on the basis of Option 1 or Option 2?
Option 1 should be applied as it captures in essence the actual underlying exposure. To account for the issues mentioned under option 2 one could consider hedge funds or equity funds as a distinct asset class with the appropriate calibration.

Question 60. Is the proposed grouping above appropriate? How can the grouping be refined?
The shocks should be applied on the level of the homogenous risk group, eg a group of policies that would be considered to behave consistently when confronted with the predefined stresses.

In principle, the scenarios should be applied consistently within a single jurisdiction, regardless of the homogenous risk group, as it will be difficult to have two scenarios simultaneously (especially if the scenarios are contradicting each other, eg an improvement and deterioration of mortality tables within one jurisdiction).

Question 61. Is it appropriate and practical to use a stress approach to calculate the mortality and longevity risks for some products/portfolios within the ICS? If yes, which products/portfolios? If not, why not (see also Question 62)?
It would be more appropriate to use a stress approach than a factor-based approach, however, only the use of internal models will provide a truly risk-sensitive measure.

Question 62. Is it appropriate and practical to use a factor approach to calculate the mortality and longevity risks for some products/portfolios within the ICS? If yes, which products/portfolios? If not, why not?
Please refer to comments on question 61.

Question 63. Where risk mitigation tools are used, which ones are more practically measured separately from the liabilities and which ones are more practically measured in combination with the liabilities?
The use of reinsurance arrangements and hedges of life risks should be included in the total balance sheet approach, eg when applying the proposed stresses the total impact on the own funds will be presented as capital requirement.

While it is possible to measure the impact of these risk mitigation instruments separately, this may not bring added value. In principle, these instruments will either have a corresponding asset value or will be used as input in other risk modules (for example counterparty/credit risk).

Question 64. How should participating policies be allowed for in the mortality and longevity risk charge calculations?
Participating features should be allowed in the calculation of the stresses. One should however consider the ability of the insurer to lower any participating features and the consequences of this action. Effectiveness, legal enforceability and willingness of management should be considered.

Question 65. Which sub-risk components (see paragraph 194) should be included within the mortality and longevity risks calculation?
There is limited or no benefit in stressing volatility or trend of mortality rates.

Question 66. For each risk component that should be included, which approach may be most appropriate for its measure and why?
No comments.

Question 67. Should the IAIS explore other groupings or should it not further explore one or both of the geographic or stress bucket groupings in favour of determining a specific level of stress for each jurisdiction as these implement the ICS at the then specified target criterion?
Yes. When considering the grouping of risks, both similar stresses and geographical diversification should be studied, in particular where the aggregation approach described in paragraph 362 were to be used.

The economic/political classification included in paragraph 204 is not relevant for most risks. A more in-depth analysis for each risk should be carried out in order to reflect risks in an economic manner. The geographic grouping should differentiate at least between continents.

The question illustrates why standard formula is not the best way to achieve a risk sensitive method that will deliver comparability of outcomes.

Question 68. Are there jurisdictions where an IAIG does business for which it may not be clear in which geographic grouping it should be included? If yes, which jurisdictions and in which geographic group should they be included?
No comments.

Question 69. How could stress buckets/groupings be used and how should these is defined?
No comments.

Question 70. If GAAP with adjustments were used as an alternative valuation approach for the ICS, detail those adjustments, if any would be required to produce comparable mortality/longevity risk charge to those produced using the Market-Adjusted Valuation approach under the mortality/longevity risk charge described in this section.
No comments.

Question 71. With respect to the list examples of major types of morbidity/disability in paragraph 211, the expectation is that the "Other" category should be small. Are there material omissions in the preceding list of examples?
No comments.

Question 72. Are there any material or benefit payment approaches (or implications of them) that that should be included but are not mentioned above?
Life insurance contracts may include acceleration of benefits in case of some contingencies. For such contracts, it should be ensured that capital requirements are not double-counted.

Question 73. Regarding the over/under payment risk, is this likely to be significant?
More generally, are there good reasons for excluding consideration of the over/under payment risk in the design of risk charges for morbidity/disability risk?
No comments.

Question 74. Should a distinction be made between "similar to life" and "not similar to life" products? Or should a stress scenario as designed above be applied consistently across all the portfolio of policies of IAIGs?
No comments.

Question 75. With regard to the stress scenario, is the example provided above fit for purpose? If not, why? If "no," what should be refined, e.g. the differentiation of the stress factors by type of biometric risk; by geographical area; by point in time in the future (please indicate in order of priority)?
No comments.

Question 76. Is the combination structure presented above (simultaneous occurrence of stresses) appropriate? If not, why and what is the alternative?
No comments.

Question 77. If GAAP with adjustments were used as an alternative valuation approach for the ICS, detail those adjustments, if any that would be required to produce comparable morbidity/disability risk charge to those produced using the market-adjusted valuation approach under the morbidity/disability risk charge described in this section.
No comments.

Question 78. Does the proposed scope of the capture the key risks relating to lapses? If not, please provide comments on any other key risks that should be considered.
Insurance Europe agrees that lapse risk "is likely to apply only to life business" (paragraph 219). This risk component should therefore apply to life business only and not to non-life business.

Question 79. Is the proposed grouping by geographical region appropriate for lapse risk? If not, what should be the appropriate geographical grouping?
Please refer to comments on question 67.

Question 80. Should the mass lapse risk charge depend on the type of products? If yes, how should the mass lapse risk charge be considered by product?
No comments.

Question 81. Is the above methodology appropriate? If not, please provide comments on how the methodology can be refined.
No comments.

Question 82. Is lapse risk also relevant for Non-life business, and if so, to what extent would the methodology described for measuring lapse risk for life business be appropriate for non-life business?
As noted above, Insurance Europe does not consider that lapse risk is relevant to non-life business. Non-life policies are typically for a period of one year or less. In the event of their cancellation prior to term, they are subject to short-period premiums reflecting the risk taken on and the administrative costs incurred. No non-life insurer has ever got into financial trouble through a mass lapse event and it is difficult to envisage circumstances in which this could happen.

Question 83. If GAAP with adjustments were used as an alternative valuation approach for the ICS, detail those adjustments, if any that would be required to produce comparable lapse risk charge to those produced using the market- adjusted valuation approach under the lapse risk charge described in this section.
No comments.

Question 84. Is the above methodology appropriate? If not, please provide comments on how the methodology can be refined.
No comments.

Comments on paragraph 238
It is not clear what the IAIS intends to do when it says: "upward shock to unit expense assumptions may be further refined by increasing the shock in the next 12 months". If a one-year VaR method id used, why would a shock after 12 months be applied?

Question 85. If GAAP with adjustments were used as an alternative valuation approach for the ICS, detail those adjustments, if any that would be required to produce comparable expense risk charge to those produced using the market- adjusted valuation approach under the expense risk charge described in this section.
No comments.

Question 86. Will there be any issues with separating non-life business in the way outlined above? Why or why not?
Insurance Europe agrees with the approach of separating premium risk for non-life business from morbidity/disability risk and do not believe there would be a challenge in doing this.

Question 87. Will there be any difficulties in separating premium and catastrophe risk? If yes, how else can these two risks be treated? If no, where should the threshold between premium risk and catastrophe events be set? Why is this appropriate?

Separating premium and catastrophe (CAT) risk could in practice prove challenging. If catastrophe is defined as natural catastrophe and man-made catastrophe, then many firms use a combination of approaches. This may involve modelling natural catastrophe (and some man-made such as US terrorism) using commercial software such as RMS and then model other catastrophes through the inclusion of deterministic scenarios in the underwriting risk distributions (which are validated against RDS). Separation of the CAT element of the premium for man-made catastrophes therefore might be difficult.

It is important to ensure that there is no double counting between premium risk and CAT risk. Including premium from CAT-exposed lines within premium risk calculation, and then adding on another CAT risk charge represents a double counting of risk and should be avoided.

Insurance Europe believes that premium and CAT risks should be separated. There should be a diversification benefit applied to them. The threshold should be set to where premium writings are CAT-exposed, meaning the parameters of CAT exposed lines of business should be adjusted to exclude the CAT exposure. This could also be done by adding more geographical zones to better distinguish where premium writing are most likely exposed to specific CAT losses.

Insurance Europe agrees with the approach of separating premium risk for non-life business from morbidity/disability risk and does not believe there would be a challenge in doing this.

Question 88. Is it appropriate to use a factor-based approach to calculate premium risk? If not, what other alternative approaches in Section 8 could be used? How would it/they work? If yes, which type of factors should be included in the ICS capital requirement, set factors or shocks to loss ratios? Is it necessary to address idiosyncratic risks?

No comments.

Question 89. Which exposure amount – premium charged or unearned premium – would be most appropriate to use for most classes of business and why? Which classes of business should not use this as an exposure measure? If possible, provide alternatives including reasons for those alternatives.

No comments.

Question 90. How should the risk charge for premium risk capture these additional risks? Why is this appropriate?

No comments.

Question 91. What segmentation of business lines would be appropriate for premium risk? What specific issues with respect to reinsurance should be addressed?

No comments.

Question 92. Is the proposed grouping by geographical region appropriate for premium risk? If not, what should be the appropriate geographical grouping?

No.

When considering the grouping of risks, both similar stresses and geographical diversification should be studied, in particular where the aggregation approach described in paragraph 362 were to be used.

The economic/political classification included in paragraph 204 is not relevant for premium risk. A more in-depth analysis for each risk should be carried out in order to reflect risks in an economical manner. The geographic grouping needs to be much more granular and should differentiate at least between continents. It is essential that this risk category takes proper account of geographical diversification.

Question 93. If GAAP with adjustments were used as an alternative valuation approach for the ICS, detail those adjustments, if any that would be required to produce a comparable premium risk charge to those produced using the market- adjusted valuation approach under the premium risk charge described in this section.
No comments.

Question 94. Will there be any issues with separating non-life business in the way outlined above? Why or why not?
No comments.

Question 95. Is it appropriate to use a factor-based approach to calculate claim reserve/revision risk? If not, what other alternative approaches in Section 8 could be used? How would it/they work?
No comments.

Question 96. Is it appropriate to apply the factor to current estimates? If not, what exposure would be more appropriate? Why?
No comments.

Question 97. What segmentation of business lines would be appropriate for claims reserve/revision risk? Should the segmentation be the same for premium risk? Why or why not?
No comments.

Question 98. Is the proposed grouping by geographical region appropriate for claim/revision risk? If not, what should be the appropriate geographical grouping?
No.

When considering the grouping of risks, both similar stresses and geographical diversification should be studied, in particular where the aggregation approach described in paragraph 362 were to be used.

The economic/political classification included in paragraph 204 is not relevant for claim/revision risks. A more in-depth analysis for each risk should be carried out in order to reflect risks in an economical manner. The geographic grouping should differentiate at least between continents.

Question 99. If GAAP with adjustments were used as an alternative valuation produce a comparable claim/revision risk charge to those produced using the market-adjusted valuation approach under the claim/revision risk charge described in this section.
No comments.

Question 100. Which of the two approaches described above would be most appropriate in the context of the ICS capital requirement?
No comments.

Question 101. Is the approach above appropriate? If not, please explain what other approach should be adopted and why.
This section on catastrophe risk does not comment on geographical segmentation. Insurance Europe would like to stress that incorporation of a catastrophe risk segment in a regulatory capital requirement must make adequate provision for geographical diversification.

Question 102. Which perils should be included in the ICS standard method? Is the list above appropriate? Should it include additional perils or exclude some of the listed perils? Please provide comments with reasons. Please provide comments about possible criteria for perils to be included in the list of perils.
No comments.

Question 103. How should the IAIS define material in this context? Should materiality be defined in terms of likely impact on the ICS, or in relation to a more objective measure such as premium or other exposure threshold?
No comments.

Question 104. For the purpose of field testing, the IAIS is considering collecting data for various confidence levels from full empirical distributions, in order to consider the shape of the distribution and the most appropriate aggregation method. Is that likely to be a challenge for IAIGs? Please explain.
This data may be difficult to collect, as not all IAIGs will be modelling this and it is challenging especially in the case of life insurers.

Question 105. Are the defined scenario method and the use of partial models appropriate for the purpose of the ICS standard method? If yes, please explain why. If not, please provide alternative methods and explain why they would be more appropriate.
No comments.

Question 106. In case of a defined scenario by the IAIS:
a) What elements should be part of the description of the scenario defined by the IAIS? Please provide an example.
b) Which calculation method by the IAIG of the impact of a defined scenario should be allowed by the IAIS for the ICS standard method? Please explain why this is appropriate.
No comments.

Question 107. In the case of a bespoke defined scenario by the IAIG, should the scenario be approved by the IAIS before its application by the IAIG?
No comments.

Question 108. Should the use of partial models be allowed for the calculation of catastrophe risk for the ICS standard method? Why or why not.
It is absolutely essential that the use of partial and full internal models will be allowed for. It needs to be ensured that IAIGs can model their individual risk profiles properly while pursuing the aim of comparability.

Question 109. In the case where the use of partial models is allowed by the IAIS:
a) Should IAIGs be required to seek prior approval of the partial models?
Yes, from their home supervisor. Details on the approval process should be developed soon.

b) What criteria should be applied by the IAIS (either as generic conditions, or as part of the prior approval) to allow the use of internal models?
No comments.

c) What information about the partial model and its use by the IAIG should be provided to the supervisor with each ICS calculation?
No comments.

Question 110. If GAAP with adjustments were used as an alternative valuation approach for the ICS, detail those adjustments, if any that would be required to produce a comparable catastrophe risk charge to those produced using the market-adjusted valuation approach under the catastrophe risk charge described in this section.
No comments.

Question 111. Are the approaches outlined above appropriate for the calculation of the interest rate risk charge? Should any other approaches be considered, and if so, what are they and why?
While Insurance Europe understands that the ICS is at an early stage of development and the various technical proposals will be refined during this process, it would like to highlight that it's important to have a consistent measurement approach for assets and liabilities, for both available and required capital. As indicated in the comments on question 13, the valuation of (long-term) liabilities needs a mechanism that prevents changes in the value of assets, caused by spread movements, from flowing through to companies' balance sheets where companies have fully or partially mitigated the impact of these movements by matching assets and liabilities.

In the case of capital requirements, the same principle should be replicated and it should be recognised that insurers' asset/liability matching significantly diminishes or even eliminates insurers' exposure to risk of losses on forced sales. This can have an impact on the actual risk exposure emerging from both equity and debt-like assets. For example, in the case of bonds, default risk is another aspect of credit risk which, in many cases, is the most or the only relevant risk.

Question 112. What should be the form of the prescribed interest rate shocks, and in particular how should the shocks relate to the existing term structure? Are there any other scenarios besides upwards and downwards shocks at all terms that should be included in the set of prescribed scenarios?
For a standard method, it is difficult to envisage stresses other than rates "up" and "down" that can be applied. IAIGs have different exposures to interest rate shocks and these could be captured in different ways. This complexity would be difficult to reflect through prescribed stresses to a standard method and these limitations emphasise the benefits of internal models.

Question 113. Under the second approach, should the IAIS consider different shock magnitudes for each duration bucket, or even a flat or inverted yield curve scenario?
IAIGs may be exposed to different "twists" of the yield curve, eg some portfolios may be impacted by steepening of yield curves. It is difficult to capture all possibilities in a standard method. It is preferable that a standard method restricts itself to a rate "up" and "down" stress.

Question 114. Should the IAIS consider an immediate shock or a shock over a period of time, or both?
When a market adjusted valuation is used, an immediate stress will capture the risk appropriately. A shock over a period of time may not add much value.

Question 115. Should the IAIS consider inclusion of interest rate volatility shocks in addition to the term structure shocks?
No comments.

Question 116. If GAAP with adjustments were used as an alternative valuation approach for the ICS, detail those adjustments, if any, that would be required to produce a comparable interest rate risk charge to those produced using the market adjusted valuation approach under the interest rate risk charge described in this section. Please pay particular attention to interest rate-sensitive liabilities.
No comments.

Question 117. Is it appropriate for the equity risk to include a stress on volatilities? For IAIGs, is the impact of a stress on volatilities likely to be material when compared to the impact of a stress on equity prices?
No comments.

Question 118. Would implementation of a volatility stress result in a significantly increased implementation complexity? In particular, would such a stress result in the necessity to set up IT tools not required otherwise, or a significantly increased time calculation when computing the effects of stress scenarios? Please provide any quantitative or qualitative detail if possible.
No comments.

Question 119. Is segmentation based on 5 buckets appropriate? Should the number of buckets be increased, or reduced? Why?
The IAIS should provide a clear list of which jurisdictions are considered to be "developed" markets.

Question 120. Are the proposed buckets fit for purpose? If not, what could be an alternative?
No comments.

Question 121. Is it appropriate to apply all stresses simultaneously across all equity classes or would it be more appropriate to use a correlation matrix?
No comments.

Question 122. With regard to hybrid debt and preference shares, amongst the 3 proposed alternatives, which is more appropriate? Why? Is there any other alternative that should also be considered?
No comments.

Question 123. Assuming that a volatility stress is included in the ICS framework, is it sensible to use the same relative stress across all types of equity?
No comments.

Question 124. Would the proposed design in this example lead to an adequate quantification of the equity risk? If not, why?
No comments.

Question 125. Does the proposed design in this example involve workable and proportionate calculations? If not, why?
No comments.

Question 126. What improvements to that design would be needed, in order to improve either accuracy or feasibility?
No comments.

Question 127. If GAAP with adjustments were used as an alternative valuation approach for the ICS, detail those adjustments, if any that would be required to produce a comparable equity risk charge to those produced using the market- adjusted valuation approach under the equity risk charge described in this section. Please pay particular attention to equity market-sensitive liabilities like variable annuities and index annuities.
No comments.

Question 128. Is it appropriate to use a stress approach to calculate the real estate risk within the example standard method for the ICS capital requirement? Why or why not?
No comments.

Question 129. Which components should be included within the real estate risk charge, if a stress approach is taken?
No comments.

Question 130. Is it appropriate to include property held for own use in the real estate risk within the real estate risk charge?
No comments.

Question 131. Is it worthwhile to have different stresses applied depending on specific items or usage characteristics? If yes, under a stress of real estate market price approach, should the granularity of the stress be limited to only broad characteristics, such as commercial vs residential, to cover the real estate risk within the example standard method for the ICS capital requirement? What would be the optimal granularity for the example standard method for the ICS capital requirement?
Property risk should recognise geographical diversification.

Question 132. Would the benefits of the increased risk sensitivity of a layered approach based on splitting a rental yield in a real estate spread on top of a financial component outweigh the costs of increased complexity? Why or why not?
No comments.

Question 133. Should lease payments and other contractually specified cash flows associated with a property be unbundled from its market value? Is it appropriate to use an equity-type stress for the residual amount?
No comments.

Question 134. Is the proposed stress or scenario approach appropriate? If not, please describe a more appropriate approach and explain why it is more appropriate.
No comments.

Question 135. Is the identification of the reference currency for the purpose of assessing the currency risk appropriate? If not, please explain why, suggest an alternative approach and explain why this will be more appropriate.
It is important to recognise that currency risk is not simply currency exchange rate volatility, but a consequence of a situation where liabilities are in a different currency from the assets held to cover those liabilities – hence the importance of asset/liability matching.

Insurance Europe supports the identification of the reference currency as either the currency in which the financial statements are produced or the currency of the jurisdiction in which the IAIG is located or domiciled.

However, it is important that the stress approach does not discourage undertakings from holding certain surplus assets in foreign currencies, which is often good currency risk management practice. An approach that stresses the net asset value of each foreign currency as compared to the reference currency would create the wrong risk management incentives because IAIGs would be encouraged to have the currency to cover the liabilities in that currency, but no provisions for unexpected losses.

A group may have a subsidiary in another jurisdiction, transacting business in a foreign currency (ie a currency other than the reference currency). A change in exchange rates cannot affect the solvency position of the subsidiary, since its assets and liabilities are priced in the same currency and their values move in the same direction. However, it would affect the group surplus capital position when translated into a reference currency and the IAIS proposal could treat this as a solvency issue. It is therefore possible for the currency risk segment to create a group solvency deficit, even in cases where every group subsidiary actually has a solvency surplus. Furthermore, the capital charge under this segment could be directly linked to the size of the surpluses in foreign currency at subsidiary level, with larger surpluses producing bigger capital charges – a counter-intuitive result.

Question 136. Is the proposal to adopt option b) for the standard method appropriate? If not, please describe a more appropriate proposal and explain why it is more appropriate.
Please refer to comments on question 135.

Question 137. Is proposal to adopt option a) for the standard method appropriate?
If not, please described a more appropriate approach and explain why it is more appropriate.
Please refer to comments on question 135.

Question 138. How should the currency risk charge be applied to net capital investments in foreign subsidiaries?
Net capital investments in foreign currencies do not necessarily give rise to an economic risk. This actually diversifies the total surplus capital held by an IAIG across multiple currencies and can be useful in stress scenarios.

If a capital requirement is however considered necessary in this area, it should only consider net assets in foreign subsidiaries in excess of capital requirements arising for that subsidiary.

Question 139. How should the issue of asset concentration be addressed for the purpose of the ICS capital requirement? Please provide detailed considerations and rationale.
No comments.

Question 140. Should the large exposure limit be based on qualifying capital resources, or should the limit be based on other measures such as assets?
Exposure limits should only be based on assets and not available capital. Available capital will be volatile and exposures cannot be managed if the limits are volatile.

Question 141. Should the ICS credit risk factors vary by maturity?
No comments.

Question 142. Are there any other major asset classes that this list has omitted?
Should some of the classes in this list be further segmented or merged? Why?
No comments.

Question 143. Are there are any proposed alternatives for assessing credit quality that do not rely on rating agencies or on internal models?
While Insurance Europe expects that some IAIGs have the expertise and resources to assess credit quality based on internal models, it believes that, where this is not the case, calibrations based on the solvency ratio of the IAIG may be used as an alternative to external/internal ratings.

Question 144. Are the Basel II standardised credit risk weights an appropriate basis for the ICS credit risk charges? If yes, what modifications should be made to the factors? If no, what other basis is appropriate?
The use of a factor-based approach for credit risk is not recommended for the purpose of ICS. A stress testing approach that considers the ability of liabilities to absorb losses should be used (to be consistent with other risks). It should be noted that defaults will not necessarily have the same impact on insurance balance sheets as they have on banking balance sheets as liabilities may have the ability to absorb losses.

Further consideration is needed regarding overlap with spread risk.

Question 145. Are there any proposed risk segmentations of residential and commercial mortgages that are possible to apply internationally to differentiate the credit risk charge?
No comments.

Question 146. Should a different approach be used for reinsurance exposures than is used for other credit risk exposures?
No comments.

Question 147. If GAAP with adjustments were used as an alternative valuation approach for the ICS, detail those adjustments, if any that would be required to produce a comparable credit risk charge to those produced using the market- adjusted valuation approach under the credit risk charge described in this section.
No comments.

Question 148. Which of the options presented above should be pursued? Why should this method be pursued? How can the drawbacks to that method be addressed within the standard method?
No comments.

Question 149. Are there any alternative methods to capture operational risk that should be explored other than the three methods described in paragraph 345 above? If so, please provide details and rationale.
Internal models should be considered.

Question 150. What risk charges as outlined in this Consultation Document should be included when determining the exposure measure for the IAIG that is used in the operational risk charge? Why is this appropriate?
No comments.

Question 151. Should the operational risk charge include an additional component for growth? Why or why not?
No comments.

Question 152. What are the views on the granularity and exposure measures proposed above for option (b)?
No comments.

Question 153. Is the use of a variance-covariance matrix approach appropriate for the example standard method for the ICS capital requirement? If not, please explain what other approach would be more appropriate and why.
No comments.

Question 154. Which approach (i.e. single or multiple steps) should the IAIS adopt for the example standard method for the ICS capital requirement and why? If a multiple steps approach is recommended, please describe and explain why this will be appropriate.
No comments.

Comments on paragraphs 363-365
Insurance Europe welcomes the consideration of inclusion of chapter 10 "Other methods of calculating the ICS capital requirement".

Insurance Europe believes that a better understanding of how likely it is for IAIS member countries to actually adopt and implement the ICS framework globally is needed. For example, does the IAIS plan to seek global commitment and, more specifically, G20 commitment to support implementation?

Multinational groups should be allowed to use the local implementation of the ICS to build up their consolidated group capital requirement.

Question 155. How can it be assured that different implementations of the ICS are sufficiently comparable? What is the role of the example standard method in this context?
If the ICS describes a certain confidence level and level of policyholder protection, any other system should explain why it has the opinion that it will provide a similar protection as envisaged in the ICS. Rather than specifying more prudence, the key feature should be better reflection of the risk profile of IAIGs and jurisdictions.

As already indicated, it is very important that appropriate measurement of risk is prioritised against comparability.

Question 156. What other methods besides those in this section may be able to be implemented whilst still meeting the ICS Principles and ICPs?
The Solvency II regime as described by the Directive of the European Union 2009/138/EC and Regulation 2015/35.

Comments on paragraph 366
Prudence should be replaced by "better reflection of the actual risk profile".

Question 157. Should any variation to the standard method be allowed? If so, should IAIG-specific variations to the standard method be allowed? If yes, for which risks should IAIG specific parameters be allowed?
Adjusted parameters should be allowed if such parameters better reflect the risk profile of an IAIG. The standard parameters will be based on a global perspective which is not always a proper reflection. This will be especially the case in the stress defined for the underwriting risk. In the various jurisdictions the underlying legislation differs, trends are different, economic and societal circumstances are different, etc.

The adjusted parameters could be defined by either the competent supervisor or the insurer. The first case would ensure comparability within a jurisdiction.

Question 158. If variations from the standard method are allowed, what disclosure should be made of the variations? Should there be a standardised disclosure no matter what variations are allowed so that stakeholders can assess the impact of the variations?
A full disclosure of the differences with arguments should be made, enabling users of the information to understand the differences. A disclosure of the impact should not be disclosed as it is not consistent with the reflection of the risk profile. A qualitative disclosure should be sufficient.

Question 159. Should the IAIS permit the use of partial internal models for calculating elements of the ICS capital requirement? If so, for which elements of the ICS capital requirement should partial models be allowed? What are the advantages and disadvantages?
Yes, but full internal models should also be permitted (see comments on question 160).

Question 160. Should the IAIS permit the use of a full internal model for calculating the ICS capital requirement? What are the advantages and disadvantages?
Yes, full internal models should be allowed. Internal models represent the most accurate calculation of the company's idiosyncratic risks and exposures, as it is virtually impossible to construct a standard formula that measures the risks to which IAIGs are exposed in an accurate way.

Internal models are a key tool from a risk management perspective. They are integral to the business and are not used to only generate a solvency number. The allowance for internal models allows for an alignment of internal steering view with regulatory view and appropriate determination of risk, including adequate reflection of risk mitigation instruments and quantification of diversification benefits. Internal models also enable companies to allocate capital to portfolios based on contribution to risk.

The IAIS' position on internal models is set out in paragraph 17.12.4 of Insurance Core Principles, Guidance and Assessment Methodology, namely: *"The IAIS supports the use of internal models where appropriate as they can be a more realistic, risk-responsive method of calculating capital requirements…"* This IAIS document goes on to say: "Effective use of internal models by an insurer for regulatory capital purposes should lead to a better alignment of risk and capital management by providing incentives for insurers to adopt better risk management procedures which can: produce regulatory capital requirements that are more risk sensitive and better reflect the supervisor's target criteria; and assist the integration of the internal model fully into the insurer's strategic, operational and governance processes, systems and controls. Insurance Europe supports these views.

Question 161. In what ways would the inclusion of internal models impact the ability of the ICS to be comparable across jurisdictions?
The use of internal models would improve the comparability across jurisdictions. While product features may vary by region/country, the outputs of an approved internal model where the calibration target and scope of risks are prescribed are directly comparable.

Internal models can indeed produce comparable outcomes, if they are subject to supervisory approval, granted on the basis of agreed criteria.

Question 162. What additional safeguards and supervisory standards will the IAIS need to develop to support and complement the use of internal models (partial or full)? Please explain.
Internal models should be subject to a consistent and transparent approval process.

Internal models should be subject to a "use" test to ensure that they are an integral part of an IAIG risk and capital management.

Insurance Europe does not support the development of benchmarks, which would undermine the benefits of internal models from a risk sensitivity perspective.

Question 163. Should the development of internal models for the ICS be assessed against the standard method? What role should the example standard method play in this context?
No comments.

Question 164. Please give details and explain any experience with model approval processes.
The model approval process is usually based on a combination of desk research (reading the model documentation), workshops/meetings with the company and formal on-site inspections. The process of internal model approval provides supervisors with a much deeper understanding of the risks to which a group is exposed. In particular, a dialogue with the supervisor can considerably shorten the time needed to understand and assess an internal model.

Question 165. Should the use of external models be allowed? Should it be restricted to certain risks? If yes, which risks should be better assessed using external models?
External models should be allowed.

Question 166. Should the criteria for the use of external models be the same as for internal models? Please provide the reasons.
External models should undergo the same requirements as internal ones: the undertaking needs to have full understanding of the model and own its calibration.

Question 167. In order to achieve comparability across IAIGs, what criteria should be applied to the use of internal models and why?
No comments.

Question 168. What are the risks that are more likely to be reliably modelled, and which are the risks that are less likely to be reliably modelled?
No comments.

Question 169. In order to allow for the use of internal models, what are the criteria to be set in order to provide a framework consistent with the ICS principles?
No comments.

Comments on paragraph 19, Annex 4
Insurance Europe believes that the asset-liability management techniques are of fundamental importance to the long-term insurance business model, and as such strongly urges the IAIS to take the view proposed in point b) of this paragraph.

Comment on paragraph 21, Annex 4
Insurance Europe supports this view and believes this is a necessary refinement to the ICS.