Position Paper

Response to IAIS consultation on the holistic framework for systemic risk in the insurance sector

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General comments

- Insurance Europe has always argued that traditional insurance is not systemically risky, and that systemic risk can only originate from a very limited number of activities undertaken on a large scale in the wrong conditions.
- Insurance Europe notes that the IAIS proposes a new framework intending to combine three different approaches:
  - an entity-based approach
  - an activity-based approach (e.g. an aggregated data collection reflecting the insurance sector's risk per activity with a focus on liquidity risk)
  - a cross-sectorial approach based on the comparison of common indicators.
- Insurance Europe sees the need for a clearly defined mechanism with respect to the scope of application of policy measures: before requiring the application of a supervisory power of intervention, a national supervisor should coordinate with the insurer, achieve a mutual understanding of the situation that might give rise to systemic risk and discuss alternatives. The insurer should also be given the right to appeal against certain measures. Otherwise, the new approach would tend to blur traditional references in IAIS norms and may result in subjectivity, an unclear scope of application and in regulatory uncertainty for many insurers.
- In considering the scope of the application of policy measures, the IAIS should distinguish between:
  - those measures that are reflective of good practice, which should be approached in a proportionate manner given the nature of insurers' business and very low likelihood of potential contribution towards systemic risk (for example, managing counterparty exposures as part of ERM); and
  - those measures with more limited scope, such as resolution, which should only be applied where it can be demonstrated that there are material risks to the global financial system.
- Insurance Europe would emphasise that extending some of the measures that currently only apply to G-SIIs to a broader portion of the insurance sector means that the idea of proportionality and the consideration of cost and benefit aspects become crucial, given the extremely low systemicity of the insurance sector. The challenge is to define a concrete threshold to identify systemically risky

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activities that could lead to collective actions and therefore amplify shocks to the rest of the financial system. The threshold must be adequately calibrated to meet the materiality criterion.

- A globally-consistent, proportionate application of policy measures linked to systemic risk is crucial, and Insurance Europe supports the IAIS' efforts in this sense. Based on the strong application of the proportionality principle, Insurance Europe believes that undertakings whose activities are not shown to pose systemic risk concerns should not be subject to undue regulatory burdens (this could be achieved, for example, through a waiver).
- The current set of IAIGs includes groups of varying size, that run a wide range of activities; therefore, these insurers' systemic potential is not identical. Insurance Europe also believes that the holistic framework should pay particular attention to preserving a level playing field between different insurance groups and jurisdictions.
- The IAIS puts forth a wide range of liquidity-oriented measures. Several measures appear to be non-essential, burdensome and without evidence of their potential effect on systemic risk. In Europe, the liquidity management requirements that are currently part of Solvency II are generally sufficient, given the limited liquidity risk in insurers' traditional business models, the high complexity of operationalisation of liquidity-oriented measures and the potential side effects, as EIOPA recognises in its recent report on other potential macroprudential tools and measures (section 3.3).
- More generally, Insurance Europe understands the need for data to support an adequate and relevant supervisory process. But Insurance Europe would point out that insurers already have to face very burdensome data collection exercises. Therefore, the IAIS should ensure that its data collection exercise is proportionate and appropriately justified.
- The holistic framework for systemic risk needs to be compatible with other existing requirements, such as national provisions, stress tests, European initiatives on macroprudential and the ICS.
- In particular, Insurance Europe believes that the IAIS should clarify that the ICS should not be used as a basis for supervisory intervention under the holistic framework until it is formally implemented as a group-wide PCR in jurisdictions.

2. Sources of systemic risk from the insurance sector

2.2 Exposures potentially leading to systemic impact

Question 1: Is the list of key exposures that may lead to a systemic impact and its description appropriate? Please elaborate

A globally-consistent, proportionate application of policy measures is also desirable, and Insurance Europe supports the IAIS' efforts in this sense.

However, Insurance Europe believes that there is still insufficient clarity on how systemic risk is generated by insurers and transmitted to the financial system or even how the definition of "systemic risk" can be operationalised for the insurance sector. In order to have a coherent framework, specificity and definition are needed around the scope of activities and risks that are potentially subject to systemic risk regulation. The IAIS should propose clear criteria for a risk manifestation to be considered "systemic" for the insurance industry. The challenge is not only to distinguish micro from macro risk, but also to assess which systemic (macro) risk is related to insurance. These elements should be better articulated before the holistic framework can provide a basis for the assessment and mitigation of systemic risk in the insurance sector.

Extending some measures that currently only apply to G-SIIs, to a broader portion of the insurance sector means that the idea of proportionality and the consideration of cost and benefits aspects become crucial. The challenge is to define a concrete threshold to identify systemically risky activities that could lead to collective actions and therefore amplify shocks to the rest of the financial system. The threshold must be adequately calibrated to meet the materiality criterion. Furthermore – supposing there is a residual gap – policy measures must be proportionate. That includes a strong focus on how existing policy measures and risk management practices reduce or even close the gap (e.g. Solvency II).

The objectives of supervision are an adequate protection of policyholders and beneficiaries and the stability of financial system. Therefore, the holistic approach should focus on the stability of the global financial system. Lack of substitutability should be excluded from the sources of risks. The operation of an insurer in a specific market should not be considered as an activity of potential systemic risk to the financial system. Including these criteria might disincentivise product offerings in highly concentrated markets and lead to a restricted product range in terms of marine, aviation, export credit, catastrophe, mortgage and financial guarantee insurance.

In paragraph 39, the IAIS states that reinsurance contracts could be a source of counterparty exposure. Insurance Europe would point out that IAIS concluded in its 2012 report "Reinsurance and financial stability" that traditional and finite reinsurance is unlikely to create systemic risk.

Even though cyber risks can surely cause significant damages, Insurance Europe does not see how this risk could be adequately quantified and it would also be difficult to quantify climate risk exposure. As emerging risks, there is currently no evidence that these can be considered systemic. In the new holistic framework, the scope regarding these risks should be confined to extensive monitoring.

2.3 Transmission channels of systemic risk

Question 3: Is the description of the transmission channels of systemic risk appropriate? Please elaborate.

Insurance Europe notes that IAIS describes scenarios leading to transmission to the entire financial system. But the description is purely qualitative, and Insurance Europe would have expected the IAIS to assess whether these scenarios are in fact economically plausible and how the activities of insurers could give rise to/be subject to fragility that could plausibly be a cause of material systemic risk to the global financial system.

In order to be systemic, Insurance Europe believes that the risk must be sufficiently material to create the possibility of near-simultaneous failures of multiple financial institutions.

2.3.4 Brief summary of the transmission mechanism for systemic risk in insurance

Question 5: Are there any further considerations on Section 2? Please elaborate.

The inclusion of the "Other" category in Figure 1 on page 5 is a concern, as this would include: under-reserving risk (which is already micro-regulated), cyber risk (not yet assessed, see Paragraph 45), climate risk (not yet assessed, see Paragraph 48) and other items not yet identified.

3 Supervisory policy measures

3.1 Introduction to supervisory policy measures

Question 6: Do you agree with the proposed scope of application and of the practical application of the proportionality principle as described above? Please elaborate.

Considering the summary of policy measures in table 2 (page 41), it is clear that the IAIS pursues the generalisation of policy measures designed for the G-SII, to make them "applicable to the supervision of all insurers within a jurisdiction, including International Active Insurance Groups (IAIGs)." Insurance Europe would emphasise that extending some of the measures that currently only apply to G-SIIs to a broader portion of the insurance sector means that the idea of proportionality and the consideration of cost and benefits aspects become crucial, given the extremely low systemicity of the insurance sector.

At this stage, it remains very unclear which measures would apply to which insurers and under what circumstances. Insurance Europe would like to know what "applicable" means. Insurance Europe emphasises that the ICPs can achieve their aims only if they are implemented consistently across jurisdictions and believes that guidelines on this issue would be helpful.

In considering the scope of the application of policy measures, the IAIS should distinguish between:

- those measures that are reflective of good practice, which should be approached in a proportionate manner given the nature of insurers' business and very low likelihood of potential contribution towards systemic risk (for example, managing counterparty exposures as part of ERM); and
- those measures with more limited scope, such as resolution, which should only be applied where it can be demonstrated that there are material risks to the global financial system.

Question 7: Do you have any other comments on the introductory description of the supervisory policy measures as described in section 3.1? Please elaborate.

The consultation paper does not specify which measures are to be used and when. The connection between risk exposure and policy measures is quite vaguely defined. This is critical, since transmission channels to the broader economy vary depending on the underlying activity. As a result, policy measures should address the underlying activity, so as to be most effective and to avoid unintended consequences.

The consultation paper makes frequent use of the term "macroprudential monitoring/surveillance". The IAIS has not appropriately explained the objective of macroprudential monitoring/surveillance and how it is to be achieved. This needs to be done before any further details can be developed. The IAIS should explain how and if "macroeconomic risks" differ from systemic risks. In general, insurers are not amplifiers of macroeconomic cycles, so do not warrant specific monitoring.

3.2 Macroprudential surveillance by supervisors

Question 9: Do you agree with the above proposal to amend the Standards and Guidance on macroprudential surveillance? Please elaborate.

The proposal to amend the Standards and Guidance on macroprudential surveillance is based on data collection. Macroprudential surveillance should not result in the creation of a data warehouse of insurers' data. Insurance Europe recommends that IAIS should ensure that its data collection exercise is proportionate and appropriately justified.

In addition, Insurance Europe considers that the proposed enhancements to ICP 24 in Paragraph 77 should place the emphasis on insurers understanding their liquidity risk and evidencing this through their ORSA. As a first resort, supervisors should look to gain comfort in this way, rather than from a prescription that they should undertake their own granular independent assessment.

Question 10: Do you agree with the above proposal to amend the Standards and Guidance on macroprudential surveillance? Please elaborate.

The IAIS has chosen a stress-testing approach for assessing systemic risk. This approach can bring benefits to the supervision of systemic risk, as it could assess the vulnerabilities of the insurance sector and raise awareness of the potential threats to financial stability.

However, the intended scope of stress testing (proposed in the enhancements to ICP 24, as set out in Paragraph 79) is insufficiently clear. The IAIS should provide more clarity in this respect.
In order for stress-testing to bring benefits, Insurance Europe emphasises that:

- A realistic view of the vulnerability of the insurance sector can only be achieved if the technical specifications underlying the exercise are consistent with economic reality and allow for management actions. In particular, it should be recognised that any exercise which is based on instantaneous shocks is a simplification of reality. Due consideration should therefore be given to the fact that insurers will be able to mitigate the impact of the shocks through necessary management actions over weeks and months.
- To properly assess the potential systemic impact of the adverse economic events, the extreme scenarios being tested must remain plausible, economically justifiable and should be internally consistent. The IAIS proposes a variety of stress testing, involving as many as nine different frameworks (three types of stress test for three types of risks). Even for a large insurer, this seems excessive. Insurance Europe does not support any form of prescribed individual company stress testing.
- If the ICS were to be implemented, the calculation of the post-stress capital requirements would rely on a "stress upon a stress" exercise. The capital requirements would be the reflection of higher level of risks than in the initial capital standard. This would create an unnecessarily pessimistic view of the health of the insurance industry and result in confusion.
- Stressing should not be used for enforcing capital add-ons for insurers.
- Operationally speaking, early engagement with industry and appropriate timelines should be foreseen to ensure a smooth execution of the process.

Insurance Europe believes that IAIS amendments should include guidelines on the issues raised above.

Question 11: What should be the role of supervisory stress testing? Please elaborate.

Insurance Europe strongly opposes supervisor-prescribed microprudential stress testing on individual companies that can have the practical effect of creating an additional binding standard, perhaps indirectly through forced public disclosure. Insurance Europe also opposes capital stress-testing approaches that involve calculating a post-stress solvency ratio, leading to an implicit requirement to hold capital to survive a stress on a stress.

Stress testing is most relevant for capital and liquidity but much less meaningful for counterparty exposure. While Insurance Europe supports counterparty reporting requirements and internal exposure limits, designing and executing counterparty stress testing would be extremely difficult.

Finally, regarding liquidity risk analysis, because of the importance of entity-specific factors it is not necessarily clear whether meaningful liquidity analysis can be performed at an industry level.

Question 12: Is the development of an Application Paper on macroprudential surveillance deemed useful? Please elaborate.

Following the previous answer, the amendments to the Standards and Guidance on macroprudential surveillance should be strengthened and give guarantees to the industry on: data collection and stress- testing design and use. An Application paper could be useful for this purpose.

Question 14: Are the proposals on macroprudential surveillance as described in section 3.2 appropriate? Please elaborate.

The proposals on macroprudential surveillance could be appropriate under the condition that they are accurately defined and adequately targeted, which they are not at this stage of the IAIS' work.

The consultation paper notes in Paragraph 80 that the ICS will provide a global risk sensitive measure that could be used to contribute to monitoring and assessment within the holistic framework. While this may be desirable in the long run, it should be noted that as part of the Kuala Lumpur agreement the IAIS has committed to not using the ICS as a basis to trigger supervisory action during the monitoring period. Therefore, Insurance Europe believes that the IAIS should clarify that the ICS should not be used as a basis for supervisory intervention under the holistic framework until it is formally implemented as a group-wide PCR.

Question 15: What are the expected costs and benefits of the proposals on macroprudential surveillance as discussed in section 3.2?

The expected costs will originate in the implementation of data collection and stress-testing exercises. Recent experience in Europe has highlighted that stress-testing required the development of new calculation and reporting tools, as the design of the exercise did not allow for the re-use of regular closing tools.

3.3 On-going supervisory policy measures on insurers

3.3.1 Policy measures for liquidity risk

Question 16: Do you agree with the above proposal to amend the Standards and Guidance on ERM? Please elaborate.

Insurance Europe generally agrees with the principle of the proposed enhancements to ICP 16 as set out in Paragraph 90, apart from the bullet indicating that guidance should include "the report to the supervisor". The IAIS should clarify that the ORSA should be the first tool the supervisor uses to assess how an insurer manages its liquidity risk within its ERM framework. If the ORSA is satisfactory, a separate report would be duplicative in this respect and unnecessary. Insurance Europe also has concerns over the prescriptiveness of the proposed Application Paper on Liquidity Planning. This should be principles-based and not prescriptive, given that its purpose is to provide guidance on how the standards can be applied, rather than setting standards. Finally, the safeguards that will address any liquidity shortfall should encompass the management actions of the insurers.

Question 17: Do you agree with the above proposal to apply the more detailed requirements on liquidity planning and management to IAIGs, and other insurers as necessary? Please elaborate.

More detailed requirements on liquidity planning, management and reporting need to be carefully analysed, taking into account the benefits and costs induced to the industry and the financial system. Liquidity planning should be aligned with an insurer's business and form part of its enterprise risk management. If the IAIS considers that further guidance is required to strengthen liquidity reporting, Insurance Europe considers this would be more appropriately addressed in the first instance through the ORSA requirements in ICP16. If the ORSA is satisfactory, Insurance Europe does not believe that separate public reporting will add value.

Question 18: Do you agree with the above proposal to amend the Standards and Guidance on disclosure? Please elaborate.

While transparency can at times be seen as a tool to promote best practice, in this instance, Insurance Europe believes that such measure may increase systemic risk, since they could lead to unpredictable policyholder behaviour. The proposed public disclosures on liquidity risk seem counterproductive and should not be further considered by the IAIS.

Question 19: Taking into account the objective of the public disclosure requirement, should the disclosure of quantitative information receive a higher weight in the supervisory material compared to the qualitative? Please elaborate.

Paragraph 19 states that the disclosure of results to the group-wide supervisor and to insurers in the Insurer Pool is required; it also proposes that firms disclose a Public Report. The footnote to this adds that the IAIS is looking for disclosure of Phase II outcomes and Phase III analysis and outcomes; however, it also states that the IAIS will review this during 2019. It is therefore unclear what public disclosures are proposed to be made prior to 2020.

Just as unclear is paragraph 93, which introduces a requirement for disclosing liquidity risk and cites IAIS' work on a liquidity metric, without providing any further detail.

More generally, the IAIS puts forth a wide range of liquidity-oriented measures. While liquidity risk is not one of the main risks insurers face, Insurance Europe accepts that this type of risk can be relevant for certain activities and that supervisors may want to monitor these. In Europe, Solvency II already requires insurers to assess their liquidity risk; any additional monitoring should be based on data that is already available and metrics currently used within companies, to avoid additional cost and strain on implementation capacity.

Question 20: Are the proposals in 3.3.1 on liquidity risk appropriate? Please elaborate.

Insurance Europe believes that the ORSA should be the first source of information used by supervisors to assess insurers' liquidity risk management; any additional guidance should be principles-based and focused on outcomes. If the ORSA is satisfactory, separate reporting to (or information requests from) supervisors should not be required, as the IAIS proposes in the consultation paper. Specifically:

- Paragraph 77 (enhancements to ICP 24) sets out information that supervisors should collect and analyse in assessing liquidity risk;
- Paragraph 90 (enhancements to ICP 16 and development of an Application Paper) is generally quite prescriptive and includes a "report to the supervisor";
- Paragraph 94 (enhancements to ICP 20) requires public disclosures; and
- Paragraph 105 (enhancements to ICPs 15 and 16) requires a breakdown of counterparty exposures, where total exposure would appear more appropriate.

3.3.2 Policy measures for macroeconomic exposure

Question 22: Are the proposals in 3.3.2 on macroeconomic exposure appropriate? Please elaborate.

Paragraph 96 notes that, as a standardised metric, the ICS could be useful in assessing macroeconomic exposure by providing comparable information to supervisors. However, it is unclear how the IAIS is proposing to use an ICS that is still under development to measure macroeconomic exposures, or in which ways it will aid in analysing the impact of macroeconomic shocks on the total balance sheet. The IAIS has previously committed to not applying the ICS as a PCR during the monitoring period, and companies will not be managing to it. During the monitoring period, the ICS will continue to be calculated on an approximate, unaudited basis. Therefore, the ICS is unlikely to produce meaningful and actionable information during this time. Another concern with using the ICS is the blurring between micro- and macroprudential regulation. The ICS is a micro-metric, and so the IAIS needs to articulate how this will help identify emerging macro-risks. Similarly, paragraph 47 discusses the risk of under-reserving (also mentioned in EIOPA's 2018 paper on additional macroprudential tools), but this risk is already covered by existing microprudential regulation.

3.3.3 Policy measures for counterparty exposure

Question 23: Do you agree with the above proposal to amend the Standards and Guidance on counterparty exposure? Please elaborate.

The details set out in the second bullet point of Paragraph 105 regarding proposed enhancements to ICPs 15 and 16 are too prescriptive. The enhancements should be more principles-based and proportionate and focus on total counterparty exposure. In particular, the requirement under the final bullet point requiring insurers "to also encompass all reasonably foreseeable and relevant material counterparty exposures" is excessively prescriptive.

3.5 Powers of intervention for supervisors

Question 30: Do you agree with the above proposal to amend the Standard on powers of intervention based on macroprudential surveillance? Please elaborate.

Insurance Europe considers that care needs to be taken when applying supervisory powers of intervention to groups of insurers on a market-wide basis. While this may make sense for the banking sector, given its homogeneous business, application of broad market-based powers of intervention in the insurance sector could result in unforeseen consequences. Unlike banks, individual insurers have very different products, business mixes and liabilities, which may respond differently to a market-wide macroprudential intervention. Any powers of intervention introduced to the ICPs should have a clearly articulated purpose in terms of the nature and level of potential systemic risk to the global financial system their use would be intended to mitigate. In addition, the use of such powers of intervention should be subject to adequate safeguards. The supervisor should demonstrate that their use is only considered where: (1) there is potential material, systemic risk to the global financial system; and (2) the necessary reduction or mitigation of this risk cannot be achieved through existing supervisory approaches and tools. As such, any powers of intervention should be viewed as powers of last resort for use in exceptional circumstances.

Question 31: Do you agree with the above proposal to amend the Standards and Guidance on preventive and corrective measures? Please elaborate.

Insurance Europe considers that some of the additional measures set out under the third bullet point of Paragraph 129 regarding proposed enhancements to ICP 10 seem to be more appropriate as crisis management/resolution measures, rather than measures aimed at mitigating/managing systemic risk.

Question 32: Are the proposals in section 3.5 on powers of intervention appropriate? Please elaborate.

Insurance Europe believes that an understanding of an insurer's business should be a prerequisite to the use of intervention powers.

As set out in the answer to Question 30, Insurance Europe believes that intervention powers should be used as a last resort when: (1) there is potential material, systemic risk to the global financial system; and (2) the necessary reduction or mitigation of this risk cannot be achieved through existing supervisory approaches and tools.

3.6 Brief summary of the supervisory policy measures

Question 34: Are there any further considerations on Section 3? Please elaborate.

Clarity is required over when and to whom intervention powers may apply, and how this links to the global monitoring exercise. For example, Insurance Europe would ask the IAIS to clarify whether there would be a materiality threshold for potential systemic activity/exposure below which such intervention powers would not be considered appropriate.

4 Global monitoring exercise by the IAIS

Question 35: Do you agree with the approach to the global monitoring exercise as described above? Please elaborate.

The IAIS has still not clearly articulated how the data collection process will work – for example, it is not clear what kind of data will be collected, with what level of granularity, and how exactly the data will be used (i.e. at a firm level or on a more general market basis).

With respect to the "global monitoring of individual insurer's systemic importance", Insurance Europe generally welcomes the changes made to the indicators. However, the data used should more explicitly measure the degree to which individual insurers are pursuing systemically risky activities. Supervisory intervention powers should apply only when individual insurers engage in systemically risky activity to the extent that they can initiate a "domino effect". This is only the case when the activity is concentrated in a single/few insurers and the insurer(s) are engaging in this activity on a very large scale. Such situations are rare.

4.1 Global monitoring of individual insurer’s systemic importance

Question 36: Should the IAIS consider changing the identification process and criteria for the selection of insurers for inclusion in the data assessment? Please elaborate.

Many existing measures applicable to G-SIIs are being rolled out more widely to IAIGs and other groups and firms, as set out in Table 2 on page 41. The implications of a firms’ score within the systemic risk assessment is not clear.

If the IAIS intends to use a score-based method (as currently used for G-SIIs), then it needs to address concerns that the data indicators are still not linked clearly enough to the causes/transmission channels and put too much weight on size and global activity, which penalises large firms. If the intention is to intervene on an activity basis when certain activities are identified, it is not clear how this aligns with the indicators and designations.

4.1.1 Proposed changes to the indicators and weighting

Question 38: Are the proposed changes to the Intra-financial assets (IFA) and Intra-financial liabilities (IFL) indicators appropriate? Please explain.

With reference to paragraph 150 of the consultation document, Insurance Europe would suggest working on the basis of absolute values reflective of the global financial markets (as it was the case in the 2016 G-SII methodology for specific indicators only), in conjunction with materiality thresholds that identify only those activities/exposures that might lead to systemic risk.

Question 39: Are the proposed changes to the Derivatives indicator appropriate? Please explain.

It is not clear why derivatives are effectively double-counted through inclusion under intrafinancial assets (IFA) and intrafinancial liabilities (IFL), and in a separate category in Table 3 on pages 45-46. The separate derivatives category under the counterparty exposure indicators should be removed to avoid duplication, given that OTC derivatives will be centrally cleared and reflected in the other indicators. The framework also seems confused when mapping the areas where derivatives are marked as causing exposure on to the indicators. Situations where these risks could arise should be considered more widely.

Question 40: Are the proposed changes to the Level 3 assets indicator appropriate? Please explain.

Level 3 assets need to be considered in the context of insurers' ALM and liquidity management, specifically the duration of the liabilities that Level 3 assets are held to match. Measuring the absolute value of Level 3 assets alone is a meaningless indicator of asset liquidation risk. For example, where Level 3 assets are held to match illiquid liabilities, there is no liquidity risk (i.e. they cannot be subject to the risk of fire sale).

Insurance Europe therefore suggests that the indicator should be deleted if a meaningful way to consider Level 3 assets in the context of ALM and liquidity management is not found. Alternatively, the indicator could be supplemented with ancillary information so that a meaningful assessment can be made.

The IAIS should also be mindful of insurers' natural role as long-term investors and not disincentivise them (through inappropriate measures) from investing in Level 3 assets such as infrastructure, which are important to the global economy, and a good match for long term illiquid liabilities.

Question 42: Are the proposed changes to the Short-term funding (STF) and Liability Liquidity (LL) indicator appropriate? Please explain.

Insurance Europe agrees that the potential risk from securities lending transactions stems from collateral reinvestment. But the proposal to exclude only securities finance transactions where collateral reuse is contractually explicitly prohibited is too restrictive and would lead to inappropriate inclusion of securities finance transactions where there is no collateral reuse and no potential systemic risk. Insurance Europe suggests that this measure is further refined to exclude all SFTs where collateral is held and not reinvested.

The changes in Table 3 on pages 45-46 propose considering potential future exposures in case markets move against derivative positions. However, this is heavily dependent on which direction the movement goes – if the position is such that other sources of liquidity would increase when a firm needs to post collateral, that is unlikely to be a problem. Conversely, if the position is such that collateral is needed when other liquidity sources are diminishing, that would be more problematic. Paragraph 37 also mentions that not hedging could increase risk; however, this is not referenced later on when the indicators are considered.

Question 44: Are the suggested changes to the indicators appropriate in improving the consistency with the banking methodology? Please elaborate.

Insurance Europe does not consider the suggested changes to be appropriate. The aim of any indicators should be to identify the potential for real systemic risk. The measurement of potential systemic risk should seek to identify the relevance of the level of potential systemic activity/exposure to the global financial system. Building a framework that seeks consistency between the insurance and banking methodologies should not be the goal, as this may introduce artificial biases in measures. For example, Paragraph 143 notes that systemic risk can differ significantly across sectors, and this can lead to different choices for specific

weightings between indicators. Insurance Europe disagrees with the statement in Paragraph 146 that "it is not desirable to significantly change the underlying weighting scheme between the categories". Insurance Europe believes that the weighting scheme should be removed from the methodology and replaced with absolute values combined with a threshold for the level of activity/exposure that would lead it to be considered a material systemic risk.
In principle, a cross-sectoral approach is the only appropriate way to measure and mitigate systemic risk and therefore a financial sector-wide monitoring would be more appropriate compared to a monitoring focusing on the insurance sector only.

4.1.2 Considering relative, absolute and cross sectoral aspects

Question 47: Do you agree with the move towards a more absolute approach to the assessment of systemic risk stemming from the failure or distress of individual insurers? Please elaborate.

Insurance Europe welcomes the IAIS' proposal to move to a more absolute approach as the predominant systemic risk assessment methodology but believes that further work is needed to ensure that the indicators are designed and calibrated to measure potential systemic risk that is material to the global financial system. Specifically:

- To be credible, any assessment of potential systemic risk needs to be based on absolute measures (that compare the size of the activity/exposure to the market size for such activities) to determine whether they are material to the global financial system. Therefore, a materiality threshold should be developed at an indicator/category level, to determine whether the potential systemic risk each indicator/category is designed to assess is likely to be material.
- Insurance Europe would suggest working on the basis of absolute values reflective of the global financial markets (as it was the case in the 2016 G-SII methodology for specific indicators only), in conjunction with materiality thresholds that identify only those activities/exposures that might lead to systemic risk.
- The use of weightings between indicators will also distort results, given that the weightings are designed to add up to 100%. This means that reducing weightings in one area will necessitate increases elsewhere
- Freezing the denominator at outset, as set out in Paragraph 150, is inappropriate as it will result in changes in markets not being reflected, which could distort results over time.
- Deducting banking data from the denominators, as set out in Paragraph 153, is inappropriate as it will mean that potential systemic risk to the global financial system is not being assessed with reference to the whole global financial system, but a subset of it. This will distort results.

Question 48: Are there other considerations on the cross-sectoral analysis? Please elaborate.

Insurance Europe does not believe that comparing scores between the different methodologies used by banks and insurers (as noted in Paragraph 153) would be an appropriate approach. Nevertheless, the relative size of insurers' activities/exposures to the global financial system, in comparison to the banking sector's activities/exposures where the same activity is undertaken, may provide a useful (albeit crude) guide to arriving at a threshold above which that activity/exposure may be regarded as potentially systemic.

Notably missing from this cross-sectoral section is any mention of asset managers.

4.1.3 Setting criteria for the consideration of increased systemic importance

Question 50: Do you agree with the move away from setting a (fixed) threshold that results in a binary *classification of insurers as either systemic or not? Please elaborate.*

Insurance Europe agrees that there should not be a threshold that determines whether an insurer is deemed to be a G-SII or not. Insurance Europe considers that the previous methodology had conceptual flaws which led to G-SIIs being designated largely due to their size, with few relevant measures of actual potential risk. However, it is unclear from the consultation paper how the IAIS will determine whether an insurer is demonstrating a significant level/trend of increasing systemic impact, or how this links with the use of intervention powers discussed in the consultation. In moving away from a threshold, it is still important that where the IAIS/national authorities determine that an insurer is demonstrating a significant level and/or trend of increasing potential systemic impact in case of distress or failure, that they can quantify objectively the level of risk to the global financial system. Insurance Europe therefore considers that, instead of a threshold applied to the sum of all the indicators, each indicator should have an objective threshold based on absolute measures that could pose a material threat to the global financial system. In addition, Insurance Europe would ask the IAIS to clarify the meaning of the final sentence of Paragraph 155, which notes that the threshold "would not solely be used to identify a specific status". This implies that the IAIS may continue to designate insurers as G-SIIs.

4.1.4 Supporting analysis and ancillary indicators

Question 52: Do you support the development of a quantitative metric to measure liquidity risk? Do you have suggestions for the development of such a metric?

The consultation document mentions that the IAIS "intends to develop" liquidity risk metrics, while giving little information on the specifics of such metric metrics, thereby making it difficult to discuss the proposal. Nevertheless, Insurance Europe believes that using a tool initially developed for banking supervision to compute a liquidity ratio such as the one presented in Annex 2 of the consultation document, would not capture the specificities of insurance business. The liquidity ratio requires banks to hold an amount of highly liquid assets that are equal to or greater than their net cash flow over a 30- day stress period. A 30-day horizon represents nearly an instantaneous lapse time. It can be useful for banking system assessment as shocks in bank can be instantaneous. In an insurance context, investment, cash management and ALM rely on longer time horizons and instantaneous shocks do not materialise immediately on insurers' balance sheets.

Question 53: Are there any other ancillary indicators that the IAIS should consider?

The need for other ancillary indicators in part depends on the adequacy of the indicators included within the global monitoring. Insurance Europe considers that the current measure on Level 3 assets is inappropriate in an insurance context, as it does not consider the liquidity of an insurer's assets in the context of the liquidity of its liabilities i.e. where illiquid assets are held against illiquid liabilities there is no liquidity risk. If this deficiency in the indicators is not corrected, then an ancillary indicator/assessment should be introduced to ensure Level 3 assets are viewed in the context of the liquidity of insurers' liabilities. Similarly, for securities lending transactions where collateral is held and not reinvested, the proposed changes to the indicators to exclude transactions where there are contractual provisions to prohibit collateral reinvestment (while a welcome step in the right direction) will still not recognise all securities transactions where there is no collateral reinvestment. Ideally, this should be corrected; if this is not done then an ancillary indicator should be introduced to ensure that such transactions are properly assessed.

4.2 Sector-wide global monitoring

Question 56: Do you agree that the sector-wide monitoring should have an annual assessment including a possibility for specific, more detailed assessments when needed? Please elaborate.

Sector-wide monitoring should be assessed every three years and there should also be a possibility for specific and more detailed assessments when needed and duly justified. Insurers being long-term investors, the risk profile of the insurance sector does not change drastically over a year, except in crisis periods. Besides, a framework built on data collection and stress-testing could be very burdensome for insurers if implemented every year.

Question 57: Do you have additional suggestions on how to identify levels and trends for the sector- wide assessment of systemic risk? Please elaborate.

The "sector-wide global monitoring" is the foundation of a domestic systemic risk framework. Insurance Europe would point out that a domestic systemic risk only rarely leads to a global systemic risk. This would tend to be the case when the same risk materializes in several jurisdictions. Therefore, the IAIS should monitor aggregated data only, rather than focus on individual jurisdictions.

Stress testing may indicate how a given stress may impact different insurers' business models, and whether there are any potential systemic vulnerabilities.

Question 58: Do you agree that the additional sector-wide data collection should be based on a representative sample of insurers from relevant jurisdictions, using aggregate data from legal entities? Please elaborate.

While the aggregation of data under a macroprudential framework may make sense for the banking sector given the homogeneous nature of this business, insurers have very different products, business mixes and liabilities. Given these differences, Insurance Europe questions what data could be collected and aggregated that would be useful in identifying potential systemic risk. To be meaningful, data would need to be considered in the context of widely differing individual business models. Any aggregation of information risks inaccuracy and misunderstanding due to potential inconsistencies. More generally, the approach would need to allow for overall ALM and risk management.

Multiple data collections should be avoided. Available data, like the OECD Global Insurance Statistic (GIS) should be considered before collecting further data. If additional sector-wide data collection were to be done, the IAIS must ensure that it is proportionate and appropriately justified.

Question 59: Do you have alternative suggestions on how to identify appropriate samples for the additional sector-wide data collection of systemic risk?

As noted in the answer to Question 58, Insurance Europe does not consider that aggregate data will be useful. As suggested in the answer to Question 57, stress testing would be more likely to indicate how a given stress may impact different insurers' business models.

Question 60: Do you agree that the IAIS seeks to extend the use of other IAIS data collections for the purpose of sector-wide monitoring, where relevant? Please elaborate.

At this stage, the IAIS is collecting a large amount of data, especially from G-SIIs. Insurance Europe would welcome an assessment of how this data is being used before additional data collection is planned.

5 Implementation assessment by the IAIS

Question 64: Do you agree with the proposed implementation assessment as described in section 5? Please elaborate.

Insurance Europe agrees the IAIS should ensure that the measures are consistently implemented. Improvements in the measures should be discussed as part of the annual global monitoring.

Question 66: Is the table above from the 2016 G-SII methodology still appropriate? Please elaborate.

Only focusing on economic penalties and delay in access is not a good overall proxy for liquidity risk in insurance. There are many factors that may provide disincentives for policyholders to surrender policies, including opportunity costs that cannot be adequately assessed through a simple metric. The absence of a “first mover advantage” is also an important factor, for example where surrender values can be adjusted to match market values.

Insurance Europe does not consider the 2016 G-SII methodology to be appropriate and proposes that the table is removed, as it does not provide a good overall proxy for liquidity risk in insurance. Insurance Europe anticipates that the proposed development of metrics to assess insurers’ liquidity risk (discussed in Paragraphs 160 to 162) will provide more insight.