

IAIS Consultations

Print view of your comments for "Consultation on Higher Loss Absorbency (HLA) requirements for G-SIIs" - Date: 21.08.2015, Time: 17:42

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Jurisdiction	International
Role	Other
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Treat my comments as confidential	No

Q-Nr.	Reference	Question
Question 1	Section 2.1	Executive Summary Overview <p>Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issues that should be considered, then please outline them and how they may impact the conclusions reached.</p> <p>Although Section 2.1 on the whole is quite clear and succinct, the following are key topics where improved clarity would be helpful. Paragraph 11 includes the statement that the HLA will not exceed 20% on average for G-SIIs. While there is some material supporting the rationale for this amount later in the document, Section 2.1 does not provide a context for this key aspect of the HLA. In particular, how was this amount determined? Paragraph 12 speaks to the need to balance three key policy objectives, one of which is “risk sensitivity”. This term can have many meanings for various readers but it is not defined in the document. Is it a reference to the ability to capture accurately the risks of a G-SII, some of which are complex and very material but which are not well captured by simple approaches? Is it a reference to formula stability under different scenarios in a way that is to address concerns about pro-cyclicality? Is it a reference to aligning risk management with risks assumed? There is little discussion in the consultation document of the meaning or intent of this term. Even HLA Principle 2 – G-SII Risks states only that “the HLA should reflect the drivers of the assessment of G-SII status” and that “these drivers are indicative of the risks... [of] the HLA”. We believe, given its importance, that further elaboration of this term would be of benefit. Given that the insurers in question are the world’s largest, many outside observers will expect the consultation to address the best ways to provide an additional buffer reflective of each G-SII’s specific risks, as opposed to the drivers that have made it classified as a G-SII. If this is not the goal of the HLA, then its true purpose should be stated clearly in Section 2.1. For example, a statement that the HLA is “to reflect the drivers of the G-SII status, not necessarily the specific risks undertaken by each G-SII” would be useful. Lastly, Section 2.1 fails to mention whether it is intended that there be a connection in overall design between the BCR and the HLA. If the HLA is to be built on top of the uplifted BCR (as seems to be intended), there is no articulation of the manner in which the design of each is to be complementary or the incentives for risk management they promote (directly or indirectly) for G-SIIs. We believe it would be appropriate for the final HLA design document to include a reference to the fundamental design decisions included in the combined BCR/HLA package, including the decision regarding the foundational financial statements being used.</p>
Question 2	Section 2.2	Key HLA consultation points <p>Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issues that should be considered, then please outline them and how they may impact the conclusions reached.</p>

The following are several areas in which Section 2.2 should be clarified. 1. Paragraph 14 states that the HLA-required capital formulae will be factor-based. This is stated as a “given” without elaboration or support. This is one of the most fundamental design choices in the HLA. If the choice of such a simple approach is intended to reflect the choices made in the BCR design, it should be so described. An advantage of using the approach described in paragraph 14 is, of course, simplicity and comparability of results for G-SIIs across the globe. The proposed design enables the size of the HLA to vary, reflecting only very broad measures of the size and significance of G-SII risks. 2. A significant weakness of the proposed approach (perhaps to be rectified by the ICS regime currently being developed) is that the exposure/factor technique is not as effective in measuring specific risk exposures as the shock techniques currently used in modern insurance standard approach capital regimes (e.g., Solvency II, Canadian MCCSR, NAIC C-3 RBC testing, etc.). This weakness is relevant for insurers in their traditional business, as well as their NT businesses where the exposure/factor approach is a poor proxy for the variability of these risks across insurers and also over economic conditions. These issues are magnified for G-SIIs for which it would be even more important that such risk sensitivity be better recognized. 3. Paragraph 14 raises three HLA design issues which have merit and should be considered. Further comments on all three are provided later in this response document. However, at this early stage in the consultation process, it is not sufficiently clear why bullet two (choice of HLA formula) is being advanced as a design issue. Would it not also be appropriate to simply accept the HLA from each of traditional, NI and NT (i.e., an “absolute” calculation), rather than go through elaborate attempts to re-scale them collectively to 15/20% (i.e., a “relativistic” calculation)? We welcome the invitation to discuss the trade-offs between risk sensitivity, robustness and simplicity. But, as mentioned earlier in our comments, without clarity of definition of these terms and concepts (such as risk sensitivity and/or the ability to capture each G-SII’s risks accurately, and formula sensitivity), commenters will have many different types of responses. “Risk sensitivity” is mentioned in paragraph 15, while (perhaps) the more general term “sensitivity” is mentioned in paragraph 16. The latter seems to request input on formulaic sensitivity rather than “risk sensitivity”. Was this the intent?

Question 3 Section 3.1 Context Overview

Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

Question 4 Section 3.2 The purposes of HLA at July 2013

Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

Although the text is clear, paragraph 28 and the statement of desired outcomes of HLA capacity gives rise to the following comments. 1. The quoted paragraph from the G-SII Policy Measures speaks of “desired outcomes”. The need to avoid certain undesirable outcomes should also be mentioned. One such outcome to be avoided is that, as a result of the imposition of HLA requirements, insurers will a) re-structure their affairs to avoid being identified as a G-SII and/or b) maintain their size below G-SII status (for example, by restricting their growth) to avoid the additional capital requirements. 2. The second and third bullets are laudable, but the broad HLA design presented (i.e., the exposure/factor approach) is unlikely to achieve these goals for the specific risks of a G-SII except at a very broad and high level.

Question 5 Section 3.3 IAIS position on systemic risk

Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

The assessments and conclusions made in this section are appropriate. We do have the following comments on it. 1. The “time dimension” reference in paragraph 30 refers to “runs”. More commonly, the time dimension is worthy of note, especially for life insurers, due to the length of their insurance guarantees. The length of these guarantees creates a large amplification (present value) effect on the measurement of required capital, which in turn can increase the non-liquidity systemic aspects of a G-SII’s risks. 2. We especially agree with the third bullet, which states that traditional insurance neither generates nor amplifies systemic risk. 3. Not explicitly mentioned in paragraph 30 is that certain NT activities involve non-diversifiable risks for which increasing scale has no benefits for the

pooling of risks and only increases the concentration of risk in this category.

Question 6 **Section 3.4** **Relatively small size reported of BCR NT insurance and BCR NI required capital amounts**
Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

It is important to distinguish between the field testing finding (as stated in paragraph 32) and a possible misunderstanding by readers that NT risks for each G-SII are necessarily “low”. This would be unfortunate, as the exposure/factor approach to assessing certain NT risks (e.g., variable annuity product guarantees and mortgage insurance) may be very broad-based and inadequate to capture the nature and variability of a G-SII’s specific risk.

Question 7 **Section 3.5** **HLA Relationship with ICS**
Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

We agree that when the ICS is completed the HLA will need revision, particularly with respect to the factors used.

Question 8 **Section 3.6** **Principles for development of HLA**
Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

No comment, other than was previously provided above with respect to HLA Principle 2.

Question 9 **Section 3.7** **HLA time frame**
Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

Based on relatively recent experience of certain jurisdictions that have redesigned their approach to regulatory capital, the overall timeframe for the various IAIS initiatives listed appears to be quite ambitious. Each initiative is important and should be assembled with a view to the cohesiveness of the overall governance, resolution and capital requirement framework. It is hoped that the experiences of these jurisdictions will prove useful in the development of the ICS. Since the ICS will apply to all IAIGs, it may be pragmatic to suggest that given the finite amount of insurance industry expertise (e.g., regulatory, insurer, consulting and actuarial), the current work on the HLA should be streamlined to enable comprehensive attention to be given to the more important (and more risk sensitive) work on the ICS.

Question 10 **Section 4.1** **BCR Calibration**
Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

See our comments on Section 4.3 below.

Question 11 **Section 4.2** **Components of total BCR + HLA**
Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

Question 12 **Section 4.3** **Uplifting the BCR**
Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

Uplifting the BCR is designed to achieve a result that is similar to the PCR on a broad basis. Using this broad methodology is likely to produce false results (either positive or negative) relative to the true risks of the G-SIIs. Since the uplift is a temporary adjustment, no uplift should be required once the ICS replaces the BCR. We think it particularly important to clarify the specific risks the HLA is meant to reflect, where it needs to be held and how it may or may not interact with the separate ICS discussions.

Question 13 Section 4.4 Transition period for Uplifts

Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

If the uplift is adopted, we don't see the value in a transition period. Should there be a concern about a false indication the result can easily be adjusted by a regulator to reflect the true situation.

Question 14 Section 5.1 Overall Approach (Possible HLA required capital formulas)

Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

With respect to paragraph 56, please note our comments on paragraph 14 that contain much of the same text. Paragraph 59 discusses the need to trade-off risk sensitivity and complexity. Although we agree that this is needed, the paragraph fails to adequately distinguish the type of risk sensitivity being referred to. This lack of clarity makes it difficult to comment on the trade-offs with complexity. For example, consider variable annuity guarantee risks. These risks include complex-to-value financial options that can increase in value exponentially with market conditions as they move "into the money". An exposure/factor approach for these risks is inadequate in valuing these options. Specifically, such an approach will not identify those insurers with the largest "in the money" position unless this is captured in the exposure measure. In addition, the "in the money" position will vary daily with the market values of the underlying assets. This creates a very volatile risk exposure which should consequently result in a similarly volatile (risk sensitive) capital requirement. While such a requirement may not be indicative of a short term liquidity need for cash, it does represent a current estimate of future capital needs over a possible 10 or 20+ year horizon.

Question 15 Section 5.2 Bucketing

Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

Assuming that the conceptual clarity indicated earlier is resolved, along with the consistent integration of the HLA method with the BCR and ICS methods, we concur with the concepts presented in Section 5.2. The IAA's normal preference would be to advocate for more buckets or even a variable approach to increasing amounts of risk in order to avoid cliff effects as G-SII status is reached. Nevertheless, as there are a limited number of G-SIIs, comparability to the treatment of G-SIBs is important to the IAIS (i.e., the largest G-SII is in bottom bucket for G-SIBs) and since the BCR/HLA is a stop-gap measure, we can support the simpler IAIS proposal for a 2 bucket (one populated) approach for this purpose. This support is contingent on a subsequent review of the HLA design once the ICS for all IAIG's is developed with a goal of eliminating the bucket approach in favor of one that eliminates the possibility of cliff effects. We do note that having only one bucket for G-SII's can create, on one hand, an incentive not to be a G-SII and on the other hand, fail to require appropriately larger HLA amounts for larger G-SIIs. However, given that the largest G-SII is likely no larger than the smallest G-SIB bucket, we understand that a one populated bucket approach may be appropriate to avoid cross-sector capital arbitrage.

Question 16 Section 5.3 Proposed HLA Insurance formulas

Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

The options presented in this section (especially paragraphs 69 and 70) seem more complex than is required. We agree that it may be appropriate to distinguish in the HLA requirement between traditional insurance risks and NT risks. Therefore we suggest that this be accomplished by simply requiring a different HLA percentage for each type of business (e.g., 10% for traditional and 25% for NT – these percentages are only meant as directional indicators. Without more clarity on the purpose and location of the HLA we cannot make any specific recommendation). We do not advocate trying to achieve a G-SII average result across all G-SIIs of 20% as seemed to be suggested in various worksheets in the consultation document. In advocating this view we put forth the following points to more appropriately link the charges with the underlying risks: 1. G-SII difficulties (like many insurers), may stem from operational risks such as senior management dominance. This can occur regardless of the traditional/NT split in the G-SII. 2. NT activities tend to result in greater inter-connectedness and systemic risk than do traditional insurance activities. For this reason the HLA percentage should be much greater for NT than for traditional insurance. 3. If the treatment of NT risks in the BCR was felt to be less representative of the true risk, then this also would be a reason for selecting a much higher NT HLA percentage than for traditional insurance. 4. As mentioned elsewhere in our response, the consultation document fails to document why the same (or different) HLA % was chosen relative to the banks. We believe that the basis for this decision should be provided.

Question 17 Section 5.4 Calibration of HLA

Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

As noted in our response to question 16, we support having separate HLA percentages for traditional and NT business. We also believe that they should be calculated on an “absolute” rather than “relativistic” approach as suggested in the consultation document.

Question 18 Section 5.5 HLA Non-Insurance required capital formulas

Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

We have no comment on the assessments and conclusions in this section, except that a simpler alternative might be to use the BCBS requirements for banking activities.

Question 19 Section 5.6 Outcomes for a range of Combined HLA required capital formulas

Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

As noted in our response to question 16, the numerical approach detailed in this section seems overly complex. We recommend that a simpler technique be used to distinguish a separate HLA percentage for traditional and NT activities. The worksheet in Table 5.2 appears to force a combined G-SII average HLA % across all activities of 15% (total HLA capital of 20 in the example provided across all values of gamma). It is not clear why forcing such an aggregate average value across G-SIIs with varying amounts of NT and NI business is appropriate or in keeping with the overall simple design of the BCR/HLA combination. We favor a simple absolute value calculation using (possibly) separate percentages for the traditional and NT business within a G-SII.

Question 20 Section 5.7 Coverage ratios using various calibration reference points

Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

Our responses to this section are contained in the responses to the specific questions asked after paragraph 92 (see below).

Question 21 Section 5.7 - Question 1
The IAIS is currently considering putting G-SIIs into one or two populated buckets when determining the HLA required capital. How many buckets should the IAIS consider selecting to manage the tension between risk sensitivity, complexity and volatility when calibrating the HLA required capital? Please provide a rationale for your response and suggest how this may be done if you consider it should be done.

See our response to question 15 (bucketing) and question 32 (risk sensitivity, volatility, complexity).

Question 22 **Section 5.7 - Question 2** Should the IAIS consider selecting the size of gamma to manage the tension between risk sensitivity, complexity and volatility when calibrating the HLA required capital? Please provide a rationale for your response and suggest how this may be done if you consider it should be done.

The consultation document appears to suggest the selection of a single gamma that all G-SIIs (regardless of NT %) would apply to determine their HLA amount. We do not understand the beneficial effect of this complex calculation and suggest that our approach (see response to question 16 or 19) is more direct, risk sensitive, simple to calculate and more transparent. However, if the gamma approach is adopted, we believe a gamma set close to 1.0 would be more reflective of the actual risk exposure. Also see our response to question 32 (risk sensitivity, volatility, complexity).

Question 23 **Section 5.7 - Question 3** Should the IAIS consider selecting the calibration levels of the factors to manage the tension between risk sensitivity, complexity and volatility when calibrating the HLA required capital? Please provide a rationale for your response and suggest how this may be done if you consider it should be done.

We have no comments on calibration levels directly, although we note that it will be important to field test the impact of the BCR/HLA requirements on G-SIIs by jurisdiction (i.e., to determine if jurisdictional specificities result in consistent G-SII coverage bias in their jurisdiction). Also see our response to question 32 (risk sensitivity, volatility, complexity).

Question 24 **Section 5.7 - Question 4** Should the IAIS consider introducing ceilings and/or floors on results for G-SIIs to manage the tension between risk sensitivity, complexity and volatility when calibrating the HLA required capital? Please provide a rationale for your response and suggest how this may be done if you consider it should be done.

The IAA believes the simpler and more direct approach included in our response to question 22 would reduce this concern. Also see our response to question 32 (risk sensitivity, volatility, complexity).

Question 25 **Section 5.7 - Question 5** Should the IAIS consider using a combination of the above approaches to manage the tension between risk sensitivity, complexity and volatility when calibrating the HLA required capital? Please provide a rationale for your response and suggest how this may be done if you consider it should be done.

The IAA believes the simpler and more direct approach included in our response to question 22 would lessen this concern. Also see our response to question 32 (risk sensitivity, volatility, complexity).

Question 26 **Section 5.7 - Question 6** Should the IAIS consider using other approaches to manage the tension between risk sensitivity, complexity and volatility when calibrating the HLA required capital? Please provide a rationale for your response and suggest how this may be done if you consider it should be done.

Question 27 **Section 6.1** **BCR and HLA capital resources**
Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

Question 28 **Section 7.1** **HLA interaction with G-SII designation process**
Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

Question 29 **Section 7.2** **Field Testing 2015**
Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

Question 30 **Section 7.3** **HLA reporting process**
Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

Question 31 **Section 7.4** **BCR and HLA review process**
Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.

Question 32 **General** Are there any further comments you would like to make regarding this Consultation which have not been included in your responses under specific sections above?

The IAA is pleased to provide its comments on this consultation document based on our international actuarial expertise, which includes actuaries with significant regulatory backgrounds. We support the IAIS consultation with key stakeholders on HLA design issues. The design choices to be made include consideration of the tradeoffs among risk sensitivity, volatility and complexity. Balancing these objectives is important, as the choices made will influence G-SII (and those companies close to G-SII size) behavior. The IAA recognizes that the HLA/BCR combination is being designed on a high priority basis for a limited number of G-SIIs at the same time as banks are undergoing their G-SIB requirements. A need for comparability of similar risk exposures across the banking and insurance sectors with respect to overall design and timing is desirable to mitigate systemic risk and avoid cross-sectoral arbitrage. We also appreciate that the HLA/BCR requirements are intended to be broad in nature as more specific requirements are being designed as part of the ICS and that the implementation gap between the 2 sets of requirements may only be a year or two. Consequently, the IAA's views on the consultation document are summarized as follows:

Risk sensitivity The IAA observes that the consultation appears to focus on some aspects of risk sensitivity but not others that we view as being at least as important. For example, the proposals seem to focus on capturing traditional versus NT risk from a broad (high level) relativistic perspective. We would prefer:

1. A greater focus on (and discussion of) the ability of the HLA (in combination with the BCR) to accurately value the insurer's risks,
2. Consideration of the merits of modern shock-based techniques, and
3. The HLA be determined on an absolute basis (not relativistic as described in the document), with (possibly) separate factors for traditional and NT business within a G-SII.

Volatility The IAA observes that capital requirements such as the proposed HLA/BCR can be subject to several types of volatility such as:

1. Volatility of results for a G-SII over time due to changes in economic conditions and business mix that may or may not reflect the underlying business model and risk exposures. In general, while financial markets prefer to see stable financial results/strength from publicly traded companies, including G-SIIs, they also want to see the underlying extent of possible exposure to market risks.
2. Volatility of results between G-SIIs. Such volatility (or lack of comparability) would require enhanced disclosure of the reasons for such differences so that appropriate comparisons can be made.
3. False positive volatility of factor based methods when the factors do not reflect the actual risks due to a changed environment or business model.
4. Volatility due to an insurer/group moving in/out of G-SII status on several occasions over a period of years.
5. Volatility of risks over a long time

horizon, which results in short- to medium-term liquidity needs. For example, market-based valuation requirements may result in significant volatility in valuation and capital requirements, even though the underlying liability risk cash flows are of a long term nature. This type of volatility may not reflect the underlying business risks and may send inappropriate pro-cyclical (and possibly systemic) messages unless addressed in the design of the standards. The IAA is uncertain which of these types of volatility are of greater concern to the IAIS. We observe that if the HLA/BCR favors broad based risk measures (which we believe is the direction being proposed), it will likely achieve lower reported volatility on both of the first two bullet points above. However, the IAA believes that the IAIS should focus primarily on issues of risk sensitivity versus complexity. While the volatilities that result from the choice of method need to be recognized and communicated, we believe that, in general, concern over volatility of insurer results should not drive the HLA design. We do note that the IAIS will need to consider G-SII status volatility and develop some transitional rules to avoid rapidly swinging capital requirements that result in G-SIIs bouncing in/out of G-SII status repeatedly. Complexity The IAA observes that increased complexity of capital requirements has value when it encourages improved risk management at a reasonable cost. In contrast, overly simplistic requirements can fail to be responsive to the G-SIIs risks and therefore may do little to incentivize improved risk management practices. Based on this, we offer the following observations, 1. As noted above, we believe the HLA/BCR requirements are very broad based and are likely too simplistic for G-SIIs. This may, however, be an appropriate stop-gap decision for the IAIS if these requirements are for relatively few companies and are to be in effect for a short period of time while more extensive risk sensitive requirements (ICS) are being developed. 2. We believe the proposal for a relativistic approach to the combination of traditional and NT business is overly complex. It will not incentivize proper risk management as well as the use of a simpler absolute calculation with (possibly) separate HLA percentages for these 2 businesses within a G-SII. 3. With respect to bucketing, the IAA's normal preference would be to advocate for more buckets or even a variable approach to increasing amounts of risk in order to avoid cliff effects as G-SII status is reached. Nevertheless, as there are a limited number of G-SIIs, comparability to the treatment G-SIBs is important (i.e., the largest G-SII is in the bottom bucket for G-SIBs) and since the BCR/HLA is a stop-gap measure, we can support the simpler IAIS proposal for a 2 bucket (one populated) approach for this purpose. We do recognize that the use of multiple buckets may create complexity, as the rules for defining the buckets can themselves be complex and result in complex administration. IAA support for the IAIS 2 bucket proposal is contingent on a subsequent review of the HLA design once the ICS for all IAIG's is developed. Location of HLA Capital Expectations as to where in the G-SII the HLA needs to be held are not addressed in the consultation document. Absent an explicit risk purpose for the HLA, it is difficult to make a specific recommendation. If the HLA is held at the highest corporate level, it may have the flexibility to be used anywhere in the organization. However, if its distribution is subject to local regulatory restrictions and approvals, then when a systemic crisis arises it may be unavailable for the specific sub-entity that needs the capital. If the HLA includes more risk specific details/requirements, then the capital could perhaps be held at the level of the enterprise creating the systemic risk exposure. The IAA hopes that these comments are of assistance to the IAIS in its design of HLA requirements. We are available for further consultation if needed and we look forward to being of assistance in the design of the ICS as our expertise will likely be o
