



IAIS

INTERNATIONAL ASSOCIATION OF
INSURANCE SUPERVISORS

Global Insurance Capital Standards: the new regulatory frontier

Presidents' Forum – International Actuarial Association

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Background

- Crucial stage of development of insurance regulation
- Unique opportunity to develop a credible and coherent **global** insurance regime
- IAIS' work doesn't stop with G-SII...
- IAIS is undertaking an ambitious programme of work for internationally active insurance groups (IAIGs)
- By 2020
 - Enhanced standards of global insurance supervision and cooperation
 - Greater policyholder protection
 - More confidence in the safety and soundness of insurers and reinsurers
 - Meaningful global approach to insurance resolution
 - Greater supervisory cooperation and coordination in standards
 - Quantitative Capital Standards for IAIGs

IAIS role as international standard setter

- Promote **effective and globally consistent supervision** of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders; and to
- Contribute to **global financial stability**.

IAIS policy initiatives

- The Common Framework for the Supervision of IAIGs – **ComFrame**
- A **global quantitative insurance capital standard (ICS)** for IAIGs
- **Straightforward basic capital requirement (BCR)** to act as a basis on which loss absorbency requirement for G-SIIs can be based
- **Higher loss absorbency (HLA)** proposed with the intention that G-SIIs are appropriately capitalised
- **Recovery and Resolutions Plans (RRP)** to ensure that in the event of a failure a systemic (re)insurer can be adequately resolved
- **Crisis Management Group (CMG)** to deliver co-ordination in a crisis event

Architecture of IAIS international supervisory requirements

Type of entity	Legal Entity	Group	Internationally Active Insurance Group (IAIG)	Global Systemically Important Insurer (G-SII)
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Supervisory requirements and actions

First tier ICPs	ICPs that apply only to legal entities	ICPs that apply to legal entities and groups		
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Second tier ComFrame	ComFrame		
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Third tier G-SII package	G-SII package		
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Focus of current projects



ComFrame an Overview

Module 1

Identification of IAIGs

Process of identifying IAIGs

Scope of supervision

Identification of GWS

Module 2

IAIG's legal and management structures

Governance

ERM

ERM Policies

Capital adequacy assessment

Module 3

Group-wide supervisory process

Supervisory colleges, cooperation and coordination

Crisis management and resolution measures among supervisors

- ComFrame development began in July 2010
- Three consultations - each year from 2011 to 2013
- Development nearly complete – June 2014
- Further development and refinements through field testing

Basic Capital Requirement

- *BCR required capital =*

$$\alpha \left[\sum_{i=1}^4 a_i TL_i + \sum_{i=1}^4 b_i TNL_i + \sum_{i=1}^4 c_i NT_i + \sum_{i=1}^3 d_i A_i \right] + \sum_{i=1}^n NI_i$$

- α is the scalar to adjust the overall BCR level and potentially target a specified confidence level
- a_i , b_i , c_i and d_i represent the factors applied to the exposures
- TL_i , TNL_i , NT_i , and A_i represent the exposure
- NI reflects the charges provided by sectoral rules for non-insurance activities – for example, Basel Accord requirements, established by the Basel Committee on Banking Supervision (BCBS)

- BCR development began in July 2013
- Two consultations - December 2013 and July 2014
- Development nearly complete – September 2014
- FSB and G20 – September and November 2014

BCR detailed formula – July 2014

BCR segment	Exposure measure	Factor	Factor value
Traditional Life			
Protection life	Net Amount At Risk	a ₁	0.056%
Participating products	Current Estimate	a ₂	0.6%
Annuities	Current Estimate	a ₃	1.2%
Other life	Current Estimate	a ₄	0.6%
Traditional Non-life			
Property	Premium	b ₁	6.25%
Motor	Current Estimate	b ₂	6.25%
Casualty	Current Estimate	b ₃	11.25%
Other non-life	Current Estimate	b ₄	7.5%
Non-Traditional			
Variable annuities	Notional Value	c ₁	1.2%
Mortgage insurance	Face Amount	c ₂	1.11%
GICS & Synthetic GICS	Notional Value	c ₃	1.11%
Other non-traditional	Current Estimate	c ₄	1.29%
Assets			
Credit - investment grade	Fair Value	d ₁	0.69%
Credit - non investment grade	Fair Value	d ₂	1.8%
Equity	Fair Value	d ₃	8.4%

Insurance Capital Standard (ICS)

- The ICS is being developed in the context of the IAIS Mission, which is to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and **protection of policyholders** and to contribute to **financial stability**
- The ICS aims at **comparability of outcomes across jurisdictions** and therefore provides increased mutual understanding and greater confidence in cross-border analysis of IAIGs among group-wide and host supervisors
- The ICS aims to promote prudentially sound behaviour while minimising inappropriate procyclical behaviour by supervisors and IAIGs

How is the IAIS approaching the development of the ICS? (1)

- Developing global insurance capital standards is a complex matter.... especially if time is at premium
- Our goal is to develop a truly global insurance capital standard for the largest internationally active insurers (IAIGs). We are striving to create something **unique** that works for different firms, markets and supervisors
- ...and let me clarify... this does not mean lifting altogether any of the existing regulatory frameworks into the ICS (e.g. RBC, SST, S2 or APRA's)

How is the IAIS approaching the development of the ICS? (2)

- On one hand, we are trying to combine experience from supervisors and stakeholders (industry observers, actuarial profession, trade bodies, etc.) to inform the development of the initiatives through the Capital Development Working Group (CDWG) and Observers' hearings
- On the other, we are using the field testing process
 - to assess the impact of different options on firms, markets and supervisors and
 - propose refinements to address issues identified during field testing
- Many actuaries work for IAIS members and our capital development & field testing working groups include senior experienced actuaries, economists, statisticians, supervisors, policymakers who work together as a multi-disciplinary team
- Many of the team have had experience in developing solvency and capital frameworks in their own jurisdictions
- We usually spend a full week at meetings most months, with numerous conference calls and other activities between the meetings
- The ongoing activities that would have been undertaken by the IAIS Solvency and Actuarial Issues Subcommittee have been subsumed into the capital development & field testing working groups (most of the members of that Subcommittee are now actively participating with the new working groups)

How can the global actuarial community contribute to shaping this framework?

- Development of relevant ISAPs (like ISAP7)
- Development of relevant technical input to IAIS
- Follow IAIS activities
- Respond to IAIS consultations
- Informal discussions between IAA & IAIS working groups
- Research on ICS related issues
- Participate in Observer sessions (esp October 2014 in Amsterdam)
- Participate in Stakeholder sessions (from 2015)
- Arrange some IAA activities on ICS related themes (eg building on the May seminar in Basel)

More specifically, how can the IAA assists during the development of these initiatives? (1)

- **Valuation of insurance liabilities - Current estimate – ISAP 7**
 - Segmentation
 - Cash flow projections
 - Contract boundaries
 - Data quality, assumptions settings and possible methodologies
 - Valuation of options and guarantees
 - Policyholders' behaviour
 - Valuation of future benefits (discretionary vs. non discretionary)
 - Management Actions
 - Discounting and volatility in the current estimate
 - Margins – should there be a margin? If so, what should be the purpose?

More specifically, how can the IAA assist during the development of these initiatives? (2)

- **Design and methodology for the ICS**
 - Risk coverage – what risks should be included?
 - How to quantify risks? What is the most appropriate approach for a specific risk? Factor-based, single stress, scenarios, etc.
 - Risk sensitivity vs simplicity – the granularity dilemma
 - Risk mitigation, diversification effects and ALM
- **Calibration of the ICS and target criteria**
 - What is the most appropriate risk measure? CTE/TVaR vs VaR
 - What is the most appropriate confidence level?
 - What is the most appropriate time horizon?

Group-wide actuarial function

- ICS will be a consolidated group-wide capital standard
- Most IAIGs prepare consolidated financial statements
- IAIS sees a role for **group-wide** actuarial function as part of the IAIG's checks and balances
- The IAIG's **group-wide** actuarial function should aggregate and review actuarial information at the group level.
- The form and implementation of a **group-wide** actuarial function may vary
- Should be designed to have an overview of the actuarial activities, function and risks of the insurance entities within the **IAIG as a whole**
- IAIG's **group-wide** actuarial function cooperates with actuarial functions at the insurance entity level
- The group-wide actuarial function should focus on **group-wide** reporting and disclosure as well as **group-wide** internal management reporting
- **ANOTHER ROLE FOR IAA STANDARDS!**

Group-wide actuarial function

- Many believe ComFrame introduces this requirement
- It does not – it is already in the ICPs
- ICPs and their standards apply on a solo and group-wide basis unless otherwise stated
- **ICP Standard 8.5**
- **"The supervisor requires that there is an effective actuarial function capable of evaluating and providing advice to the insurer regarding, at a minimum, technical provisions, premium and pricing activities, and compliance with related statutory and regulatory requirements."**
- ComFrame elaborates on this requirement at the group-wide level in the context of IAIGs

What sort of things would group-wide actuarial function do?

Advice to the governing body and senior management on:

- the IAIG's solvency position, including a calculation of regulatory capital requirements and technical provisions (when ICS is incorporated in ComFrame this gives actuaries a direct role in providing advice on ICS)
- investment policies
- valuation of assets
- actuarial policies and controls
- distribution of dividends or other benefits
- product development and design, including the terms and conditions of insurance contracts
- actuarial-related risk modelling in a group Own Risk and Solvency Assessment (ORSA) and use of internal models

Group-wide actuarial policy

The IAIG's **group-wide** actuarial policy sets out procedures for:

- coordinating the calculation of technical provisions at the **group-wide level**
- coordinating the calculation of reinsurance recoverable assets at the **group-wide level**
- assessing the appropriateness, **at the group-wide level**, of the methodologies and underlying models used as well as the assumptions made in the calculation of those technical provisions
- Some minimal guidance but left to industry and actuarial profession to develop and evolve
- This fits neatly with the need to develop a comparable valuation approach for IAIGs

An IAA Standard on development of a group-wide actuarial policy would be really helpful.

Group-wide actuarial opinion, report, advice or review

- Used all possible terms to describe document – different legal frameworks require different terms
- Focus on content which is at least the following subjects:
 - a prospective analysis of the financial situation of the IAIG which goes beyond the current balance sheet of the IAIG
 - the reliability and sufficiency of the technical provisions
 - the adequacy of reinsurance credit for technical provisions
 - consideration of non-insurance entities and non-regulated entities.
- May use the underlying actuarial reports submitted locally by the individual insurance entities as input to annual **group-wide** actuarial opinion
- Some further guidance given as to what could be in the group-wide actuarial opinion but again left to industry and actuarial profession to develop and evolve

An IAA Standard on development of a group-wide actuarial opinion would be really helpful.

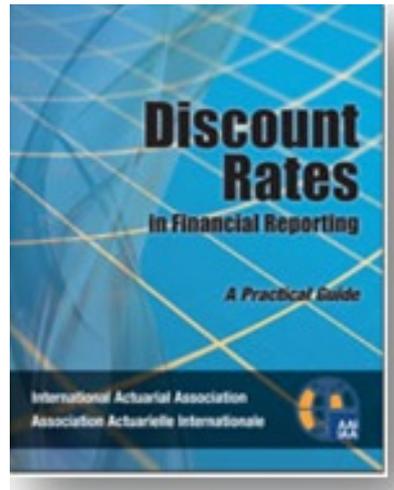
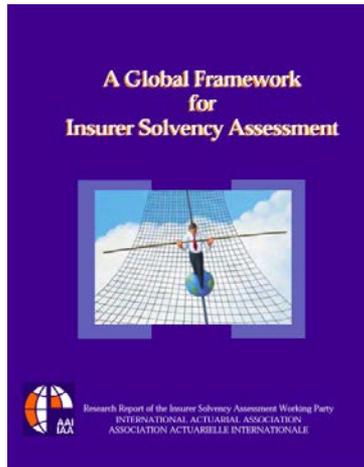
Qualitative Field Testing

- To be launched in October 2014
- Will include questions about group-wide actuarial aspects just outlined
- Through consultations we know that the proposals are not popular with the industry
- We believe actuarial advice provided directly to the Governing Body of an IAIG is an essential source of professional advice for the governance of IAIGs
- Actuarial profession could assist with this debate and about the place of actuaries in providing advice on a **group-wide** basis
- We know in some jurisdictions this would be an expansion of the role of actuaries but we believe the costs are justified by the benefits
- Field testing will provide some data on existing gaps in practices compared to ComFrame and therefore quantify costs
- We believe there are benefits to actuarial advice at the highest level in IAIGs
- If the actuarial profession believes there are such benefits then it should be part of that debate

IAIS global capital standards - summary

Standard	Deadline	Apply G-SII	Apply IAIG
BCR	2014	Yes	No
HLA	2015	Yes	No
ICS	2016	Yes	Yes

IAA publications & papers – helping to build the ICS?



Measurement of Liabilities
for Insurance Contracts:
Current Estimates and Risk Margins



Note on the use of Internal Models
for Risk and Capital Management
Purposes by Insurers

November 2010



Stress Testing and Scenario Analysis

July 2013

Process and Timetable

Expected timing	Key milestone
November 2014	G20 Leaders expected to endorse the BCR proposal
December 2014	Initial consultation documents on HLA and ICS released
From 2015	Confidential reporting of BCR to group-wide supervisors with access by the IAIS for the purpose of reviewing and refining the BCR (to be provided in conjunction with the IAIS field testing process)
February 2015	Deadline for responses to the HLA and ICS consultation documents
March to September 2015	Field testing of HLA and ComFrame, including ICS
November 2015	HLA proposal to be finalised & endorsed by G-20
March to September 2016	Further field testing of ComFrame, including ICS
December 2016	ICS to be agreed, subject to further refinement via field testing
2017 and 2018	Further refinement of ComFrame, including ICS, via field testing
Late 2018	ComFrame, including ICS, to be adopted by IAIS
From 2019	Implementation of ComFrame, including ICS, to commence

Conclusions

- Unique opportunity to contribute to shaping the **global** insurance regime
- We would welcome your technical support during the development of the ICS through:
 - Ongoing engagement with the IAIS followed-up with ad-hoc requests
 - Responses to consultation
 - Informal discussions between IAA & IAIS working groups
 - Research on ICS related issues
 - IAA participation in Observer sessions (esp October 2014 in Amsterdam)
 - Participation in Stakeholder sessions (from 2015)
 - Arrangement of some IAA activities on ICS related themes (eg building on the May seminar in Basel)



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Thank you

