



IAIS

INTERNATIONAL ASSOCIATION OF
INSURANCE SUPERVISORS

CAA Meeting 2015

Are Insurers Systemically Important: IAIS view and international initiatives

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Agenda

- ▶ Context and timetable
- ▶ Systemic risk
- ▶ Current positions
 - BCR
 - HLA
 - ICS

Context and timetable

IAIS mission

▶ 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

▶ Contribute to global financial stability

IAIS website

IAIS activities

- ▶ Standard setting
 - The global standard setter for insurance
 - ▶ Support implementation of IAIS standards
 - ▶ Support supervisory co-operation
 - ▶ Represent IAIS Members
-
- ▶ The IAIS represents insurance regulators and supervisors of more than
 - 200 jurisdictions in nearly 140 countries
 - Constituting 97% of the world's insurance premiums

IAIS three layer approach to standard setting

Architecture of IAIS international supervisory requirements

Type of entity	Legal Entity	Group	Internationally Active Insurance Group (IAIG)	Global Systemically Important Insurer (G-SII)
Supervisory requirements and actions				
First tier ICPs	ICPs that apply only to legal entities	ICPs that apply to legal entities and groups		
Second tier ComFrame			ComFrame	
Third tier G-SII package				G-SII package

Perspective

*‘IAIS considers a sound **capital and supervisory framework** for the insurance sector essential for supporting financial stability and protecting policyholders’*

July 2013

- ▶ Capital is an important aspect of solvency
- ▶ Solvency is an important part of the full supervisory framework

‘... in the absence of a global capital standard...’

July 2013

IAIS global capital standards

- ▶ Basic Capital Requirement (BCR)
- ▶ Higher Loss Absorbency (HLA)
- ▶ Insurance Capital Standards (ICS)

	Adopt	Confid Report Annual Review	Apply	Apply to
BCR	2014 FSB G20	2015 ->	2019 ->	G-SII
HLA	2015 FSB (G20)	2016 ->	2019 ->	G-SII
ICS 1.0	2017	2017 ->	n/a	IAIG (G-SII)
ComFrame incl ICS 2.0	2019	n/a	2020 ->	IAIG (G-SII)

Systemic risk

Systemic risk

- ▶ The risk of disruption of financial services that is
 - Caused by impairment of all or parts of the financial system and
 - Has the potential for serious negative consequences for the real economy

FSB and IMF (2009)

- ▶ External to institutions
 - So may be imposed on an insurer
 - Systemic risk events impact multiple insurers
- ▶ Macroprudential in nature
 - Different perspective to microprudential, institution focused, regulation and supervision

Globally systemically important

- ▶ G-SIFI (per FSB):
 - Institutions of such size, market importance, and global interconnectedness that their distress or failure would cause significant dislocation in the global financial system and adverse economic consequences across a range of countries.
- ▶ G-SIB: Global Systemically Important Bank
- ▶ G-SII: Global Systemically Important Insurer
- ▶ Key is being designated globally systemically important, not the specific path

Summary of IAIS position

- ▶ Systemic risk is present in insurance
- ▶ Currently 9 designated G-SIIs (by FSB)

	G-SII Business		
	Traditional	Non-Traditional	Non-Insurance
Is Susceptible	YES	YES	YES
May Amplify	YES	YES	YES
May Generate		YES	YES

Current position - BCR

BCR scope

'As a foundation for HLA requirements for G-SIIs, the IAIS will as a first step develop straightforward, backstop capital requirements to apply to all group activities, including non-insurance subsidiaries, to be finalised by the end of 2014.'

IAIS and Financial Stability Board (FSB)
BCR Consultation Document, IAIS website

- ▶ 'BASIC' replaces 'Backstop'
 - No 'front-stop' to support (the front-stop will be ICS)
 - Different role to Basel III 'backstop' for banking

BCR formulas

- ▶ BCR status given by

$$\text{BCR Ratio} = \frac{\text{Qualifying Capital Resources (for BCR)}}{\text{Required Capital (for BCR)}}$$

- ▶ 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 (alpha) is the scalar to adjust the overall BCR level
- a_i , b_i , c_i and d_i are factors applied to the exposures
- TL_i , TNL_i , NT_i , and A_i represent the exposures
- NI reflects charges provided by sectoral rules for non-insurance activities – for example, Basel Accord requirements.

BCR factors and exposures

BCR segment	Exposure measure	Factor	Factor value
Traditional Life			
Protection life	Net Amount At Risk	a1	0.06%
Participating products	Net Current Estimate	a2	0.6%
Annuities	Net Current Estimate	a3	1.2%
Other life	Net Current Estimate	a4	0.6%
Traditional Non-life			
Property	Premium Measure	b1	6.3%
Motor	Net Current Estimate	b2	6.3%
Casualty	Net Current Estimate	b3	11.3%
Other non-life	Net Current Estimate	b4	7.5%
Non-Traditional			
Variable annuities	Notional Value	c1	1.2%
Mortgage insurance	Risk in Force	c2	4.0%
GICS & Synthetic GICS	Notional Value	c3	1.1%
Other non-traditional	Net Current Estimate	c4	1.3%
Assets			
Credit - investment grade	Fair Value	d1	0.7%
Credit - non investment grade	Fair Value	d2	1.8%
Equity, real estate & non-credit investment assets	Fair Value	d3	8.4%

BCR features

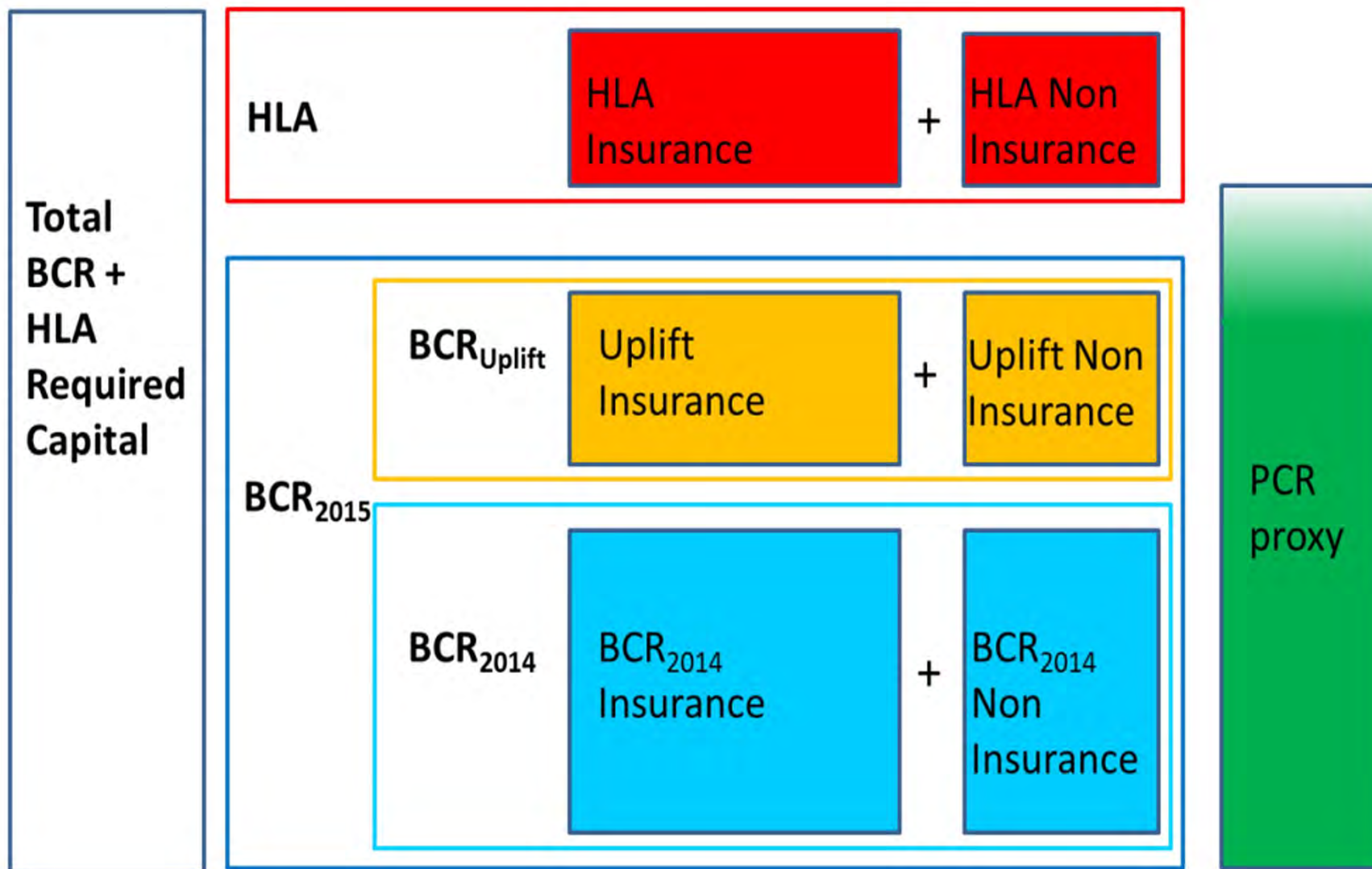
- ▶ Current Estimates are the primary proxy measure for risk exposures for insurance liabilities
 - Achieves comparability in principle
- ▶ Asset valuations are based on generally accepted accounting principles (in each relevant jurisdiction), with adjustments to enhance comparability
- ▶ Quality of capital resources: 'Core' or 'Additional'
 - Not more than 50% of capital resources supporting BCR may be additional capital
- ▶ Level of calibration set in 2014 with alpha = 100%
 - On average, over G-SII 75% of (proxy) Group PCR

Current position - HLA

Key design considerations

- ▶ Balance three key policy objectives, risk sensitivity, robustness and simplicity
- ▶ Disincentives built into the HLA formulas to encourage G-SIIs to reduce potential systemic activities
- ▶ Separate Insurance and NI business aspects so that existing global regulatory requirements in non-insurance sectors may be reflected
- ▶ The HLA is initially built on the foundation of the BCR. When the ICS is developed, the HLA will then be reviewed as the ICS will replace the BCR as the foundation for HLA.

Total BCR + HLA required capital

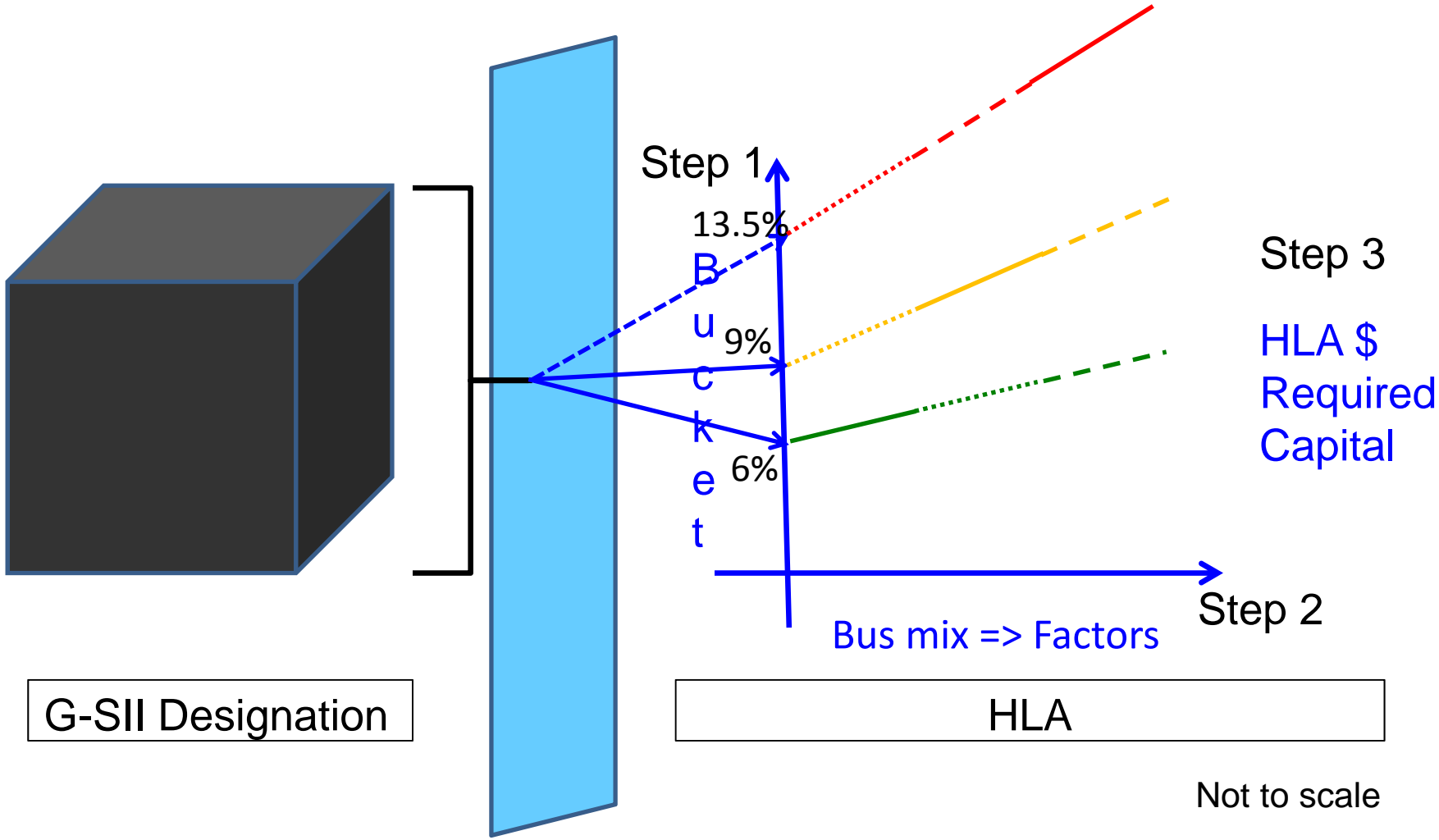


BCR Uplift

- ▶ Based on 2014 and 2015 field testing data, the average BCR_{2014} required capital, expressed as a percentage of PCR, in aggregate for all G-SIIs, was 75%.
 - To scale the value of the aggregate BCR_{2015} required capital up to 100% a 33% uplift of the BCR_{2014} is needed.

- ▶ The Uplift is achieved by;
 - Increasing the BCR_{2014} scalar α (alpha) from 1.00 to 1.33
 - Applying a 33% uplift to all NI components of BCR_{2014} except Regulated banking (based on BCR_{2015} - greater of 3% leverage ratio and 8% of risk weighted assets)

HLA process picture



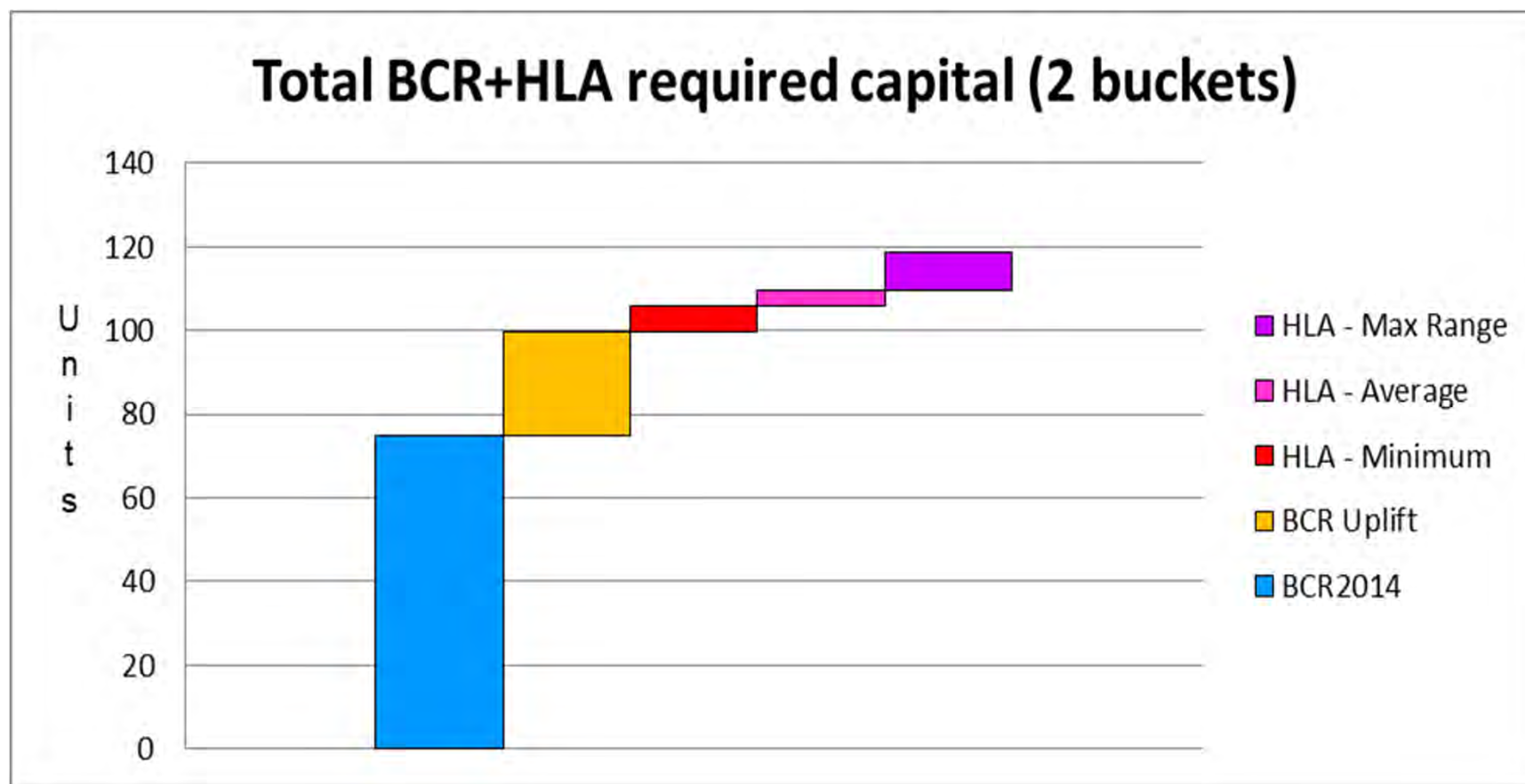
Required capital formula factors

BCR required capital exposure	HLA Factors		
	Low Bucket	Mid Bucket	High Bucket
Traditional Life insurance	6%	9%	13.5%
Traditional Non-Life insurance			
Assets			
Non-Traditional insurance	12%	18%	27%
Non-Insurance – Assets Under Management			
Non-Insurance – Other			
Non-Insurance – Regulated Banking	8.5%	12.5%	18.75%
Non-Insurance – Unregulated Banking	12.5%	18.75%	25%

Overall calibration outcomes

- ▶ On average, over the set of G-SIIs designated in the past years, the HLA required capital amount with the two populated buckets and HLA factors generated an average of approximately 10% of the BCR_{2015} amount
- ▶ In combination, the $BCR_{2015} + HLA$ increase the overall required capital compared to the BCR_{2014} is 45% on average.

Range of hypothetical outcomes



- ▶ HLA results reflect the full range of possible values based on the HLA Factors. They do not report results for any actual G-SII

Calibration considerations

- ▶ The overall calibration level and HLA design strike an appropriate balance between competing elements:
 - **Minimum level** -The need to ensure an appropriate minimum level of HLA for G-SIIs
 - **Relativity (1)** - The need for an appropriate relativity between traditional insurance business, non-traditional insurance business and non-insurance business
 - **Relativity (2)** - The need for an appropriate relativity between traditional insurance business and regulated banking business
 - **Ordering between G-SIIs** - Not producing an outcome that is significantly different with respect to what has been produced by the G-SIIs designation methodology
 - **Maximum level** - Not producing a calibration level for individual G-SIIs that is significantly higher than a G-SIB allocated to the lowest bucket (12.5%)

Advantages of HLA design

- ▶ Advantages of 4 factors per bucket
 - Further incentive to reduce NT and NI activities (as measured by BCR required capital exposures)
 - Need to reflect existing or future cross-sectoral requirements:
 - Direct linkage with HLA charges for G-SIBs for regulated banking activities
 - Higher charges for unregulated banking activities
 - Anticipated linkages with other cross-sectoral requirements
 - Robust design if G-SIBs change their business mix over time

Advantages of using buckets

- ▶ Advantages of 3 buckets
 - Incorporates focus on systemic footprint (85% based on NTNI and Interconnectedness)
 - Clear incentives to reduce systemic footprint (as measured by G-SII assessment methodology)
 - Recognises two populated buckets for G-SIIs
 - Clear incentives not to increase systemic footprint (due to third higher unpopulated bucket)

BCR+HLA Ratio

- ▶ BCR+HLA status given by

BCR+HLA Ratio =

$$\frac{\text{Qualifying Capital Resources (for BCR+HLA)}}{\text{Required Capital (for BCR+HLA)}}$$

- ▶ Required capital - Factor-based
 - Exposures based on BCR required capital amounts
 - HLA factors reflect the assessed systemic risk of each G-SII
 - Buckets reflect assessment of systemic risk from G-SII designation process
- ▶ Qualifying capital resources
 - HLA: Of the highest quality (BCR Core capital)
 - BCR+HLA = Core Capital + min(50% BCR, Additional Capital)

Average impacts on current G-SIIs

	G-SII	All Volunteer
BCR_{2014} / BCR_{2015}	75%	n/a
$HLA / BCR_{2015} (*)$	10%	n/a
$BCR_{2015} / PCR (**)$	100%	90%
$(BCR_{2015} + HLA) / PCR (**)$	110%	100%
BCR+HLA Ratio (**)	260%	305%

Notes

- Results averaged over 2014 and 2015 field testing
- Results rounded to 1% (*) or 5% (**)
- Non-G-SII Volunteers assumed in lowest HLA bucket only for illustrative purposes

Review process

- ▶ Annual review of BCR and HLA, including considering impact of possible changes in
 - Definitions of NT and NI activities
 - G-SII designation methodology
- ▶ Review of role of BCR and the design and calibration of HLA once ICS developed
 - Intend ICS to replace BCR as foundation for HLA
- ▶ Supported by
 - Annual field testing and confidential reporting through to (at least) 2019
 - Interaction with field testing Volunteers and key stakeholders

Current position - ICS

ICS development context

- ▶ The ICS is being developed in the context of the IAIS Mission:
 - Maintain fair, safe and stable insurance markets
 - For the benefit and protection of policyholders
 - Contribute to financial stability

- ▶ The ICS aims at comparability of outcomes across jurisdictions
 - Increased mutual understanding
 - Greater confidence in cross-border analysis of IAIGs among group-wide and host supervisors

ICS key points

- ▶ To be a group-wide, risk-based, consolidated insurance capital standard applicable to all IAIGs
 - And so all G-SIIs
- ▶ ICS will be a measure of capital adequacy part of ComFrame for IAIGs
 - Is not intended as a legal entity requirement
 - Will constitute the minimum standard to be achieved
 - Expected supervisors represented in the IAIS will propose for adoption in their respective jurisdictions
- ▶ Supervisors will be free to
 - Adopt additional arrangements that set higher standards or higher levels of minimum capital.
 - Put in place supplementary measures of capital adequacy for the IAIGs in their jurisdiction

ICS process

- ▶ Supported by IAIS field testing
 - Approximately 35 Volunteers, represent IAIGs
 - Includes all G-SIIs
 - Provides process for confidential reporting of BCR and HLA
- ▶ Currently 'work in progress'
 - Next round of field testing - 2016
- ▶ Staged
 - Version 1.0 (Confidential reporting) - mid 2017
 - Version 2.0 (adoption as part of ComFrame) – 2019
 - Ultimate version - subsequently
- ▶ ICS Principles approved by IAIS in October 2014

Some references

- ▶ IAIS website: www.iaisweb.org
- ▶ ICPs:
 - 17 - Capital Adequacy
- ▶ BCR:
 - Basic Capital Requirements for Global Systemically Important Insurers, IAIS, October 2014
- ▶ HLA:
 - Higher Loss Absorbency Requirement for Global Systemically Important Insurers, IAIS, October 2015
- ▶ ICS:
 - Past and future Consultation Documents re ICS



Thank you ...

Global Capital Standards:
Status in 2015

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