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G-SII Update

Ian Carey – Prudential Group Risk Capital Management
Jeff Davies – Ernst & Young LLP



07 November 2014

Agenda

No.	Item
1	G-SII Background & Designation
2	G-SII Scope & Requirements
3	Implications for capital requirements
4	Wider considerations

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2



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1. G-SII Background & Designation

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Introduction

*"The global financial crisis underscored the **interconnected nature** of financial firms and the **widespread financial and economic costs** of their severe distress or failure as well as with public sector interventions for those that were distressed or expected to fail. The crisis also underscored the **need for public authorities** to act promptly and proactively to **identify** financial firms that are systemically important and to **take measures** to lessen the impact and reduce the moral hazard associated with public sector interventions and the distress or failure of such financial firms."*

G20 Leaders asked the Financial Stability Board (FSB) to develop a **policy framework to address the systemic and moral hazard risks** associated with systemically important financial institutions (SIFIs)

On 18 July 2013, the International Association of Insurance Supervisors (IAIS) published a methodology for identifying **global systemically important insurers (G-SIIs)**, and a set of policy measures that will apply to them

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4

Do Insurers Pose Systemic Danger?



“...Based on information analysed to date, for most lines of business there is **little evidence of traditional insurance either generating or amplifying systemic risk within the financial system or in the real economy**. Of course, empirical assessments about the systemic importance of insurers and insurance groups may change over time. A benign record in the past does not ensure the absence of a systemic risk potential in the future. **The potential for systemic risk in insurance may become relevant** where insurers significantly deviate from the traditional insurance business model and **particularly where they engage in non-traditional insurance or non-insurance (NTNI) activities or as a result of interconnectedness...**”

9 October 2013

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5

G-SII background



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(1) FSB: Financial Stability Board; (2) TBTF: Too big to fail; (3) SIFIs: Systemically Important Financial Institutions; (4) G-SIBs: Global systemically important banks; (5) NBNIs: Non-bank non-insurance; (6) G-SIFIs: Global systemically important financial institutions

6

G-SII Designation

- The IAIS collected year-end 2011 data from organisations in October 2012
- The FSB designated nine insurers (shown below) as G-SIIs on 18th July 2013. The IAIS simultaneously announced updated policy measures that will apply to G-SIIs
- The list of G-SIIs was updated in November 2014. It was decided to identify for 2014 the nine G-SIIs identified in 2013 and to postpone a decision on the G-SII status of reinsurers, pending further development of the methodology



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7

Initial IAIS assessment methodology of G-SII designation – 5 indicator categories and 21 measures

Indicator Category	Size	Global Activity	Inter-connectedness	NTNI ⁽¹⁾	Substitutability
Measurement	<ul style="list-style-type: none"> • Total Assets • Total Revenues 	<ul style="list-style-type: none"> • Revenues derived outside of home country • Number of countries 	<ul style="list-style-type: none"> • Intra-financial assets • Intra-financial liabilities • Reinsurance • Derivatives • Large exposures • Turnover • Level 3 assets 	<ul style="list-style-type: none"> • Non-policy holder liabilities and non-insurance revenues from financial activities • Derivatives trading • Short term funding • Derivatives • Financial guarantees • Minimum guarantee on variable insurance products • Intra-group commitments • Derivative trading (excluding hedging and replication) in economic terms • Extent of liquidity of insurance liabilities 	<ul style="list-style-type: none"> • Premiums for specific business lines

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⁽¹⁾ NTNI: Non-Traditional Non-Insurance activities

8



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2. G-SII Scope & Requirements

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G-SII scope



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STABILITY
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G-SII Scope

"Set policy measures to address the systemic and moral hazard risks associated with G-SIIs"



International Association
of Insurance Supervisors



G-SII Policy Framework

- 1 Recovery and resolution planning requirements for Effective Resolution
- 2 Enhanced group-wide supervision
- 3 Higher loss absorbency requirements (HLA) for NTNI activities

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10

Key G-SII requirements



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11

G-SII deliverables – Systemic Risk Management Plan (SRMP)

Description

- SRMP describes how the G-SII will manage, mitigate and possibly reduce its systemic risk
- Where feasible and appropriate, the SRMP may include effective separation of systemically important NTNI activities from traditional insurance business and/or restrictions or prohibitions of specified systemically important activities or any other measures

Requirements

- Identify NTNI activities & interconnectedness activities in scope
- Assessment of activities' materiality
- Assess existing risk mitigation structures
- Demonstrate robust risk management process for systemic risks

Work

- Review and summarise risk management framework in respect of systemically risky activities

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12

Overview of Recovery Plan (RCP) requirements

RCP – Main Objective



“...The recovery plan serves as a guide to the recovery of a distressed firm...”



“...Recovery plans should set out options to restore financial strength and viability when the firm comes under severe stress...”

RCP – Key Elements

1	Recovery options	► Actions to restore the company to a stable and sustainable condition
2	Intervention Conditions	► Criteria (triggers and/or early warning signs) that determine when a company may/would be likely to implement aspects of the RCP
3	Stress Scenarios	► Scenarios to assess the robustness of the RCPs, evaluate recovery options and calibrate triggers
4	Governance framework	► Processes, oversight and approvals around the preparation, assessment, review and update of the RCP and execution of options

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13

G-SII deliverables – RCP

Description	Requirements	Work
<ul style="list-style-type: none"> Demonstrate to the Group-Wide Supervisor (GWS) a set of material credible recovery options which can be executed in a timely manner which will enable the Group to survive extreme financial stress 	<ul style="list-style-type: none"> Determine point of non-viability Identify recovery triggers & analyse scenarios Identify recovery options Agree governance for recovery options Determine link to Resolution Plan 	<ul style="list-style-type: none"> Build on existing reverse stress testing work Review of existing triggers Generate further details on implementation for suitable recovery options Identify the point of non-viability

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14

G-SII deliverables – Liquidity Risk Management Plan (LRMP)

Description

- Regular gap analysis of liquidity risks and the adequacy of available liquidity resources, under normal and stressed conditions
- Should consider adjustments for the expected behaviour of market participants and customers during stressed conditions

Requirements

- Framework for managing liquidity
- A policy for managing liquidity risk
- The ability to meet liquidity needs even under stress
- Access to liquidity facilities
- Use of derivatives
- Management of short-term sources of credit

Work

- Build on existing liquidity stress testing work

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15

Overview of Resolution Plan (RSP) requirements

RSP – Overview



“...aim of making the resolution of any firm feasible **without severe disruption** and **without exposing taxpayers to loss...**”

“...the **responsibility** for developing and maintaining, and where necessary, executing the resolution strategies set out in resolution plan lies with the **authorities....**”

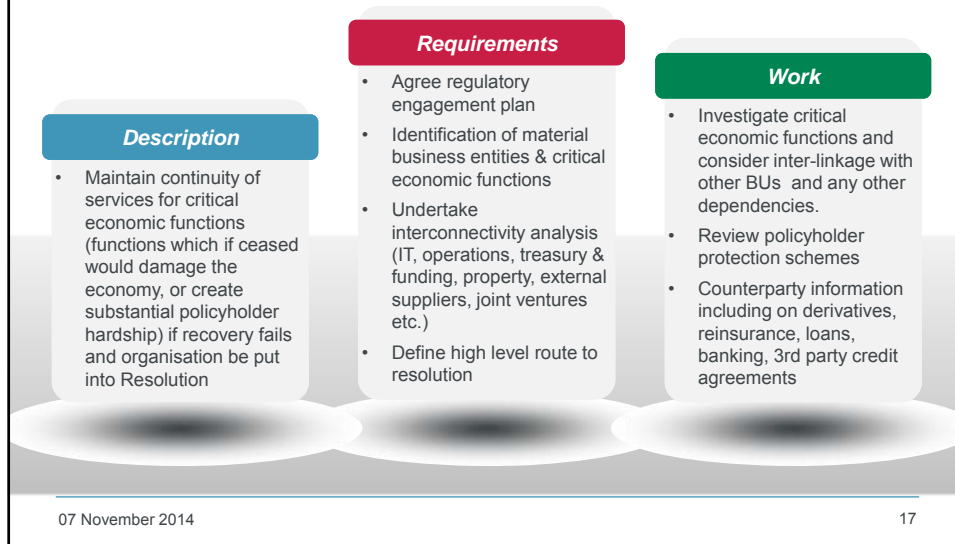
RSP – Key deliverables to the PRA to support its drafting of the RSP include:

1	Overview of Group	<ul style="list-style-type: none"> ▶ Details on the Material Entities and Critical Economic Functions ▶ Includes interconnections/interactions within the Group
2	Impact of resolution on material contracts	<ul style="list-style-type: none"> ▶ Financial contracts such as debt issued, loans, reinsurance, guarantees and derivatives. ▶ Non-financial contracts such as outsourcing, service level agreements and with suppliers.
3	Policyholder compensation scheme	<ul style="list-style-type: none"> ▶ Covered of Group's business by policyholder compensation schemes (e.g., FSCS) ▶ Speed and granularity of policyholder valuations

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16

G-SII deliverables – Respond to GWS Resolution Plan data request



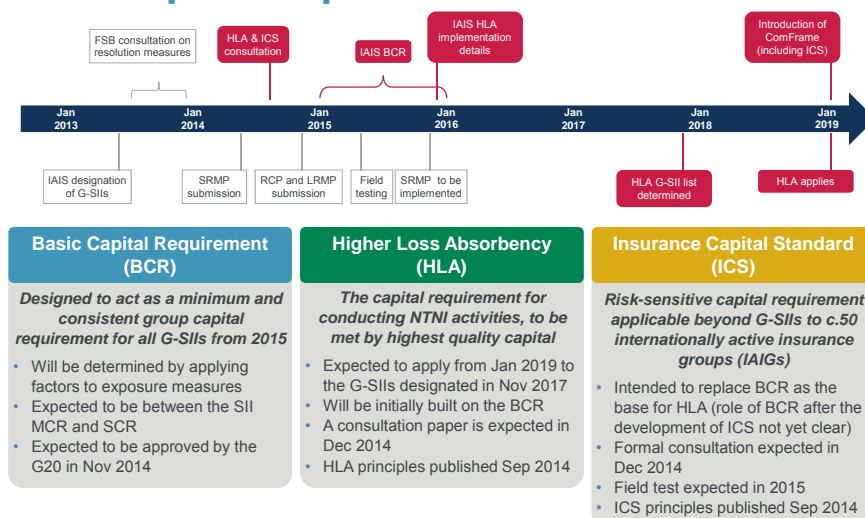
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3. Implications for capital requirements

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Expertise
Thought leadership
Progress
Community
Sessional Meetings
Education
Working parties
Volunteering
Research
Shaping the future
Networking
Professional support
Enterprise and risk
Learned society
Opportunity
International profile
Journals
Support

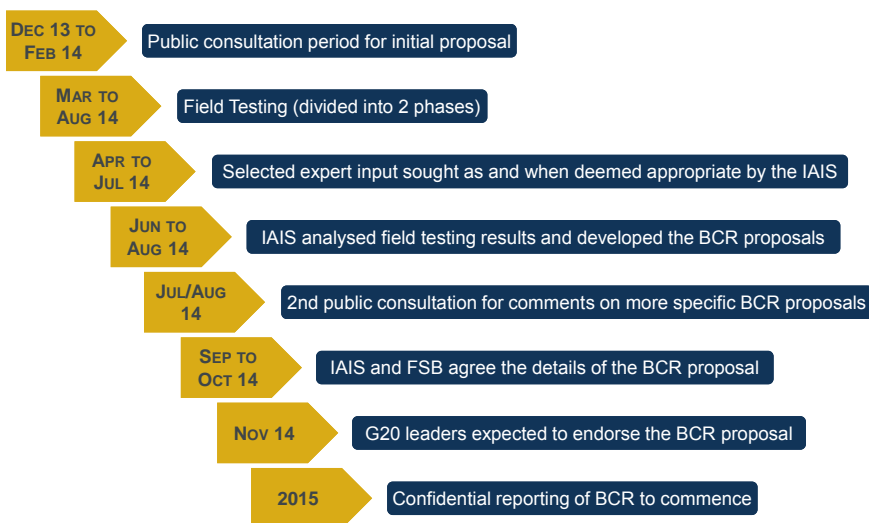
G-SII capital requirements



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19

BCR Proposal – Background & Timeline



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20

IAIS approach to calculate the BCR - Overview

Minimum Capital Requirements

- G-SIIs (up to 2019) → BCR + HLA (once HLA is determined)
- G-SIIs (from 2019) → ICS + HLA
- IAIGs (from 2019) → ICS

Valuation Basis

- Investment Assets → Fair value
- Technical Provisions → Best estimate basis with the yield curves being prescribed by the IAIS
- Contract boundaries → not based on economic criteria

Tiering Criteria

- Tiering criteria for available capital → based on Comframe proposals

Required Capital

- Calculation → Consolidated group-wide basis
- Approach → 'Factor-based' approach (15 factors applying to defined segments within the main categories of insurance activity)
- Main categories of insurance activity
 - Traditional Life (TL) insurance → Traditional Non-Life (TNL) insurance
 - Non-Traditional (NT) insurance → Assets (A) → Non-Insurance (NI)
- Non-insurance activities
 - Basel III Leverage Ratio requirements on banking components
 - No regulatory capital requirements (at the moment) on other non-insurance financial and material non-financial activities

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21

IAIS approach to calculate the BCR – Issues for G-SIIs

Areas Under Review

- BCR calibration factors
- Capital charge for material non-financial activities
- Technical guidance for residual asset risk
- Granularity of reporting of participating business
- Assessment of resilience of BCR under stress
- Impact of asset stresses relative to Basel framework (to avoid regulatory arbitrage)

Concerns

- What will be the level of the total G-SII capital requirements (i.e. BCR + HLA) given lack of clarity on HLA
- To which activities HLA will apply
- Adoption of BCR into local laws and regulations

Other Technical Issues Raised

- Participating Contracts → Loss absorbency of liabilities has not been considered
- Variable annuities → Proposed exposure measure (notional value of guarantee) is a measure of volume and not risk
- Non-material banking type exposures → Proportionality to be applied for calculation of capital
- Ongoing yield curves → Lack of clarity on how IAIS expects to mitigate volatility and procyclicality concerns

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22

IAIS approach to calculate the BCR – Field testing results

Overview of field testing exercise

- Field testing exercise commenced on 21 March 2014
- Thirty-four volunteer insurance groups participated in the exercise. All nine G-SIIs participated in the exercise
- Volunteers covered a wide range of products and geographical markets
- Data collected was used to inform the BCR design, special factors and calibration level

Overview of field testing results

	G-SIIs	All volunteers
Proposed BCR as % of Prescribed Capital Requirement (PCR)	75%	67%
Total Qualifying Capital Resources as % of proposed BCR	380%	427%
Core Qualifying Capital Resources as % of proposed BCR	332%	384%
Solvency ratio (Qualifying Capital Resources/PCR)	200%-400%+	N/A

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23



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4. Wider considerations

Expertise
Mentorship
Thought leadership
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Networking
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Enterprise and risk
Learned society
Opportunity
International profile
Journals
Support

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How are G-SIIs progressing?

Documentation Progress – Feedback from Regulators

RSP

- Feedback from regulators expected soon once plans are finalised

RCP

- Need for clear links between RCP and RSP to minimise misunderstanding

LRMP / SRMP

- Generally well received by regulators
- No significant improvement needs

Impact of being designated

PROS

- ✓ Improved understanding of the firm by regulators
- ✓ Continued improvement in relationship with regulators
- ✓ Increased documentation can improve understanding of the firm (e.g. RCP)

CONS

- ✗ Increased costs
- ✗ Increased documentation requirements if documentation is not already in place (e.g. LRMP)

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25

Looking ahead

Next G-SII designation

- Updated G-SII list published on 6 November 2014
- All nine existing G-SIIs are on the list, with no new insurers added
- A decision on the G-SII status of reinsurers was postponed, pending further development of the methodology

G-SII Requirements

RSP

- Regulators are considering how to expand the scope – i.e., could:
 - Expand **breadth** by including more of the Group's entities in scope
 - Expand **depth** by going into further detail on the entities currently in scope – e.g. consider more scenarios in the analysis of the path to resolution

RCP

- Further simulations and war gaming
- Possibly increased focus on board training

LRMP

- Improvement in liquidity monitoring and reporting
- Possible further iterations of liquidity policies

SRMP

- Re-designated G-SIIs will need to discuss any new drivers of designation
- Any newly designated G-SII will be given the drivers behind its designation to be discussed in the SRMP

Overarching considerations

- Conflicts with preparation for SII likely to limit feasibility of meaningful expansion of scope – especially for RSP
- Companies will look to start some embedding processes into BAU – risk management and reporting
- Some plans will need tweaking in response to regulators' feedback, regulatory publications, lessons learned, etc.

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26

Recovery and Resolution Planning not just for G-SIIs

The FSB opened the door to RRP having a wider scope than just the G-SIIs



“...Jurisdictions should put in place an ongoing process for recovery and resolution planning, covering at a minimum domestically incorporated firms that could be systemically significant or critical if they fail....”

The PRA introduced Fundamental Rule 8 (FR8) that requires RRP to be undertaken by all PRA-regulated companies (including insurers)



“...FR8 — A firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services....”

Market reaction

- An increasing number of domestic requests are being received both in the UK and wider afield
- Some insurers have (partially) developed plans before receiving requests from regulators
- ...getting on the front foot has given senior management and regulators much comfort

Note, SRMP and LRMP are currently anticipated to be requirements only for G-SIIs

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27

Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenters.

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28