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Insurance Global Capital Standards

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25 April 2014

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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



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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, targeted to non-traditional, non-insurance activities
- **Recovery and Resolutions Plans** (RRP) to ensure that in the event of a failure a systemic reinsurer can be adequately resolved
- **Crisis Management Group** (CMG) to deliver co-ordination in a crisis event

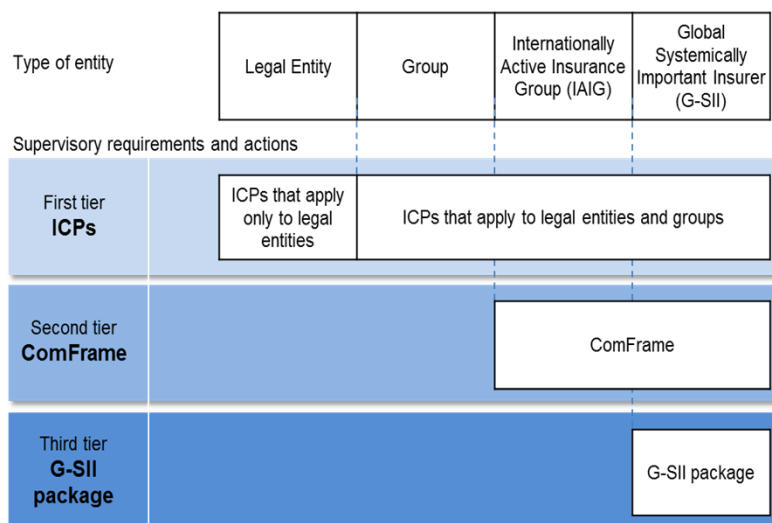


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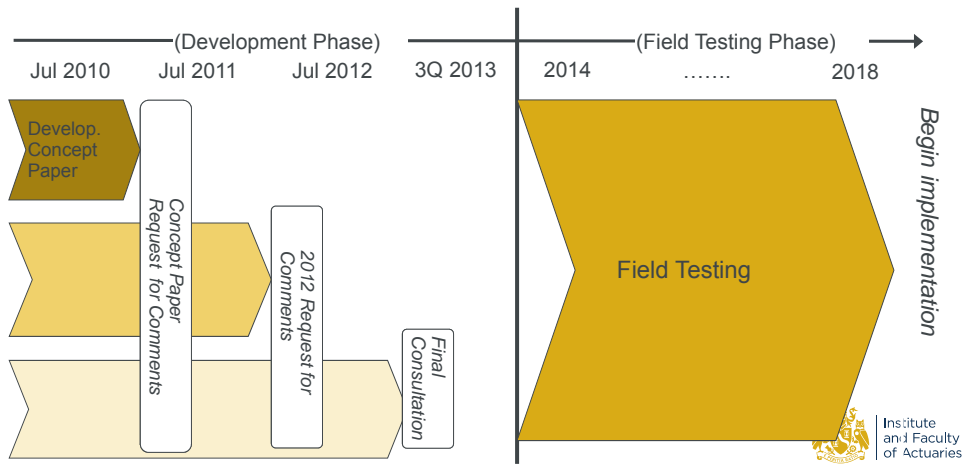
What does the PRA want to achieve from this work?

- Comparability
- Avoid undue complexity
- Emphasise co-operation and information sharing
- Ensure that global standards enhance the ability of national supervisors to make judgments and proactively identify and mitigate risks
- Global standards should be sympathetic to the characteristics of local markets and should not create an uneven playing field

Architecture of IAIS international supervisory requirements

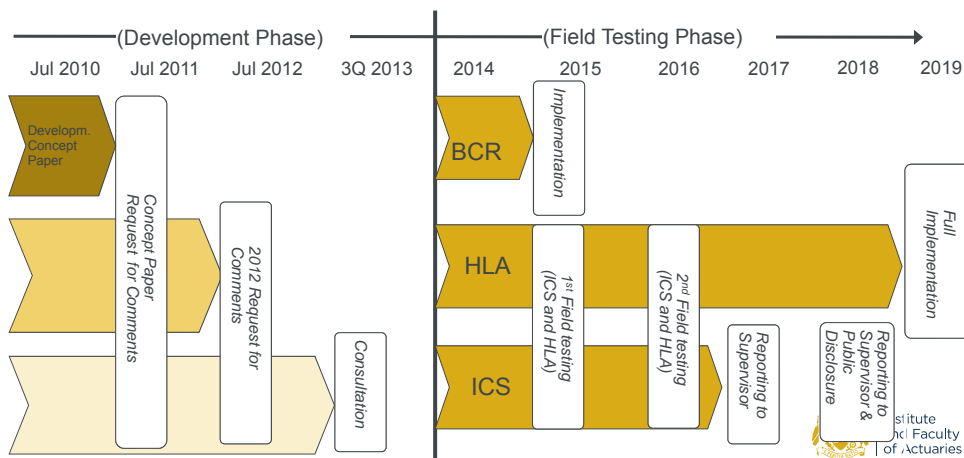


IAIS plans before FSB recommendations (June 2013)



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IAIS plans after FSB recommendations (October 2013)



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What is ComFrame? What does it include?

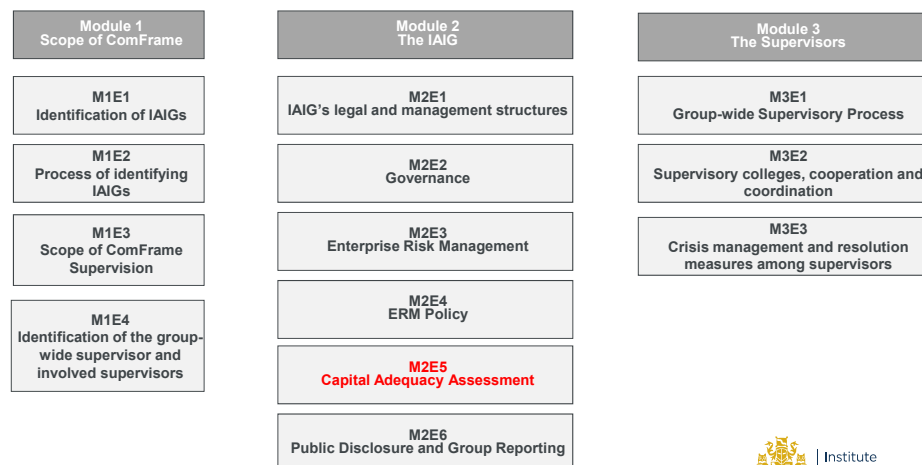
- It is the Common Framework for the Supervision of Internationally Active Insurance Groups (IAIGs)
- It is primarily intended to **enhance cooperation and coordination among supervisors**
- To achieve these objectives **comparability** of IAIG regulation and supervisory processes is needed
- ComFrame sets out a comprehensive range of **qualitative and quantitative requirements specific to IAIGs**
- ComFrame also includes **requirement for supervisors**



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An overview of ComFrame



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Risk-based global insurance capital standard (ICS)

- **Global Insurance Capital Standard (ICS)** to be developed by the end of 2016
- **ICS will be included in ComFrame** replacing the content of Module 2 Element 5 “Capital Adequacy Assessment”
- **Field testing of ICS** started in 2014 with the Balance Sheet – different valuation approaches (also to be used as an input for the BCRs)
- **ICS Reporting to Supervisor** starts in 2017
- Through to the 3rd quarter of 2018, the ICS will be further tested and revised.



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Backstop Capital Requirements (BCRs)

The FSB's request

“As a foundation for higher loss absorbency (HLA) requirements for G-SIIs, the IAIS should as a first step develop straightforward, backstop capital requirements to apply to all group activities, including non-insurance subsidiaries, to be finalised by the time of the G20 Summit in 2014.”

- BCRs need to cover all activities of the group:
 - Traditional insurance business
 - Non-traditional, non-insurance business (NTNI)



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BCRs principles agreed by IAIS

- **Substantive principles**
 - Major risk categories should be reflected
 - Comparability of outcomes across jurisdictions
 - Resilience to stress

- **Construction principles**
 - Simple design and presentation
 - Internal consistency
 - Optimise transparency / use of public data

Proposed BCR formula

- The determination of capital required for the BCR is currently envisaged as six factors applied to six exposures reflecting the main categories of activity, namely
 - Traditional Life insurance
 - Traditional Non-Life insurance
 - Assets
 - Asset-Liability Matching
 - Non-Traditional (NT) insurance and
 - Non-Insurance (NI)

- The BCR mandate requires consideration of all these items and the approach also addresses the BCR principle requiring that major risk categories should be reflected. Insurance is typically a long term liability driven business and this drives the need for managing the assets to reflect their relationship to the liabilities.

Proposed BCR formula – details (1)

- The BCR required capital is currently envisaged as:

$$BCR = \alpha \times [\beta_1 Tr. Life + \beta_2 Tr. NL + \beta_3 Assets + \beta_4 ALM + \beta_5 NT] + \gamma \times NI$$

- For each of the insurance activities, the amount is computed as the product of a factor and a risk weighted exposure
- These risk weighted exposures are calculated as weighted sums of more granular factors with their associated exposures

BCR formula – details (2)

- α and γ are scalars to adjust the overall BCR level and potentially target a specified confidence level. These factors allow the BCR required capital, overall, to be calibrated to a desired level.
- β_1 , β_2 , β_3 , β_4 and β_5 are fixed risk weight factors reflecting relative riskiness between activities.
- Traditional Life** is the risk weighted amount of traditional life insurance liabilities measured by their current estimate liabilities or other relevant measures
- Traditional Non-life** is the risk weighted amount of traditional non-life insurance liabilities measured by their current estimate liabilities or other relevant measures

BCR formula – details (3)

- **Assets** is the risk weighted amount of assets. At a minimum inclusion of Assets is necessary to address NI and possibly NT. The need to address off-balance sheet exposures is also noted
- **ALM** is the indicator of asset-liability mismatch
- **Non traditional (NT)** reflects the risk weighted amount of non-traditional insurance activities measured by their current estimates and/or other relevant measures
- **Non insurance (NI)** reflects the charges provided by sectorial rules. For example, Basel requirements

The link between the BCR and valuation approaches included in field testing

- A major challenge to achieving the principle of global comparability of the BCR is overcoming differences in valuation approaches
- The primary valuation basis for the Traditional Life and Traditional Non-Life exposures will be **Current Estimates of liabilities**
- The primary valuation basis for assets will reflect their '**fair values**'

NT and NI activities

- An important aspect of the BCR is its reflection of NT and NI activities. For NI activities sectorial rules will be used
- For example, regarding banking activities, it needs to be determined which of the Basel III Leverage Ratio or the fully risk-based Basel Accord is most appropriate for the BCR
- Issues of this type will be addressed during field testing

BCR Balance Sheet

- The key data items, primarily taken from an adjusted balance sheet will be used as inputs to the BCR computations. In practice, there are some important issues to be addressed in obtaining appropriate and useable data
- These issues are primarily being addressed by the Field Testing Task Force (FTTF) in its 2014 field testing exercise. Adequate resolution of these issues is a necessary prerequisite to the success of the BCR

Proposed Implementation

- The IAIS proposes that the implementation of the BCR should include these matters:
 - During the first few years of implementation, reporting of outcomes to supervisors, on a confidential basis, with use of that information by the IAIS for review
 - The decision on possible application of the BCR to IAIGs will be made by the IAIS during 2014
 - A target amount of BCR capital in excess of the MCR, but (significantly) lower than PCR would be appropriate. The approach to calibration will be refined based on information collected in field testing and from other data sources

BCRs and HLA – the link to ComFrame field testing

- BCRs and HLA initiatives for G-SIIs and they will be subject to field testing to assess their potential impact
- Applicability of BCRs - ready to apply to G-SIIs from end 2014 (HLA from 2019)
- Future application of BCRs to the wider IAIG population still uncertain – testing will provide further input to discussion
- The valuation approach tested under ComFrame will be used to determine capital resources for BCRs and HLA and serve as an input to BCRs calculation where required
- Testing of BCRs and HLA needs to be coordinated with the broader ComFrame field testing

IAIS global capital standards - summary

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

Open issues

- Should the policy measures be harmonised between G-SIIs and IAIGs?
- How does the BCRs relate to other capital requirements? Is it a minimum capital requirement?
- How do the BCRs and ICS interact – do we need them both?
- Should the ICS be regarded as basic, global risk sensitive front-stop capital measure, acting like as a floor to local front-stop rules, or something more comprehensive?

Conclusions

- Unique opportunity to shape the **global** insurance regime
- Field testing will provide both firms and supervisors with an opportunity to contribute to this process – get familiar with these initiatives
- ComFrame currently under consultation – comments due by 16 December 2013
 - Comments requested on all aspects of ComFrame (including Module 2 E5 – Capital adequacy Assessment)
 - Comments on capital adequacy assessment in context of ICS
- Resolution and application of FSB Key Attributes

Questions



Appendices

Module 1 – Scope of ComFrame

Module 1
Scope of ComFrame

Module 2
The IAIG

Module 3
The Supervisors

Identification of IAIGs and its process [E1,2]

- Qualify as IAIG if it meets both criteria:
 - (a) international activity criterion
 - Premia are written in three or more jurisdictions, and
 - At least 10% of gross premia written outside home jurisdiction
 - (b) size criterion (based on a rolling 3-year average)
 - Total assets are at least USD50bn, or
 - Gross written premium are at least USD 10bn
- Supervisory college is the mechanism
 - Group-wide supervisor leads the process, any involved supervisor may prompt the process.
- Constrained discretion to involved supervisors

Module 1 – Scope of ComFrame

Module 1
Scope of ComFrame

Module 2
The IAIG

Module 3
The Supervisors

Scope of supervision [E3]

- Defining the perimeter of supervision (ICP 23)
- Can not narrow the scope due to lack of legal authority and/or supervisory power

Group-wide supervisor [E4]

- In principle, group-wide supervisor is where:
 - Head of the IAIG is based
 - insurance operations where it is actually controlled
 - largest proportion of balance sheet is located
 - the main business activities are undertaken

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Module 2 – The IAIG

Module 1
Scope of ComFrame

Module 2
The IAIG

Module 3
The Supervisors

Qualitative requirement [E1-3]

- Structure: group structure sufficiently transparent to not hinder supervision
 - IAIG provides IAIG Profile
 - Identify and manage risks raised by structure
- Governance: have sound and prudent management and oversight of its overall business
 - Roles and responsibility of IAIG's Governing Body
 - Internal control (from group-wide perspective)
- ERM: addresses all relevant and material risks
 - Risk management policy and ORSA
 - Strategy, intra-group transaction

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Module 2 – The IAIG

Module 1
Scope of ComFrame

Module 2
The IAIG

Module 3
The Supervisors

Quantitative requirement [E4-5]

- Investments and liabilities: develop policy re investment, underwriting, claims management, valuation, ALM, etc.
- Valuation: is still under development
 - Discussions underway about using the valuation component of IAIGs' economic capital models
 - Market based valuation option considered for field testing
- Capital adequacy assessment: to be replaced by Insurance Capital Standard (ICS) – **however important get feedback on Module 2 E5, as this would be considered for the development of the ICS**

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Module 3 – The Supervisors

Module 1
Scope of ComFrame

Module 2
The IAIG

Module 3
The Supervisors

Supervisory process and cooperation [E1,2]

- A key difference between the ICPs and ComFrame is that every IAIG must have a supervisory college.
- There is flexibility in the structure of supervisory colleges so that they fit the context of the particular IAIG
- Defines responsibilities of group-wide supervisor which has a central role and the roles of other involved supervisors
- Involved supervisors cooperate, coordinate and participate in group-wide supervisory activities

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Module 3 – The Supervisors

Module 1
Scope of ComFrame

Module 2
The IAIG

Module 3
The Supervisors

Crisis management and resolution measures [E3]

- Involved supervisors develop and maintain crisis management plans, which includes
 - setting out process for information sharing
 - taking into account PPS
- Resolution measures are still under development as we continue to assess the relevance of the FSB's Key Attributes beyond their application to GSIFIs. Therefore, this section is indicative of the measures that will be proposed but not yet intended to be definitive.

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Field Testing Task Force: Scope of Work

- The Field Testing Task Force (FTTF)'s **overall objective** is to:
 - **perform impact studies** to test whether ComFrame promotes effective group-wide supervision of IAIGs and whether the elements lead to practical benefits without undue burden
 - **perform impact studies** on BCRs, HLA and ICS
 - **assess the results** of such field testing to determine any evidence-based changes that are necessary to the draft ComFrame, design and calibration of BCRs, HLA and ICS.
- Field testing will be conducted using the conduit of group-wide supervisor

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Field testing – plans overview

- Field testing activities will run from 2013 up to 2018
- First initiative was launched in October 2013, (Module 1 testing) this includes:
 - the identification of the potential IAIG population (including testing of suitability of identification criteria)
 - scope of the group, and
 - identification of the group-wide supervisor (GWS)
- **Quantitative testing** - 2nd quarter of each year up to 2018:
 - 2014 valuation approaches and BCRs testing started
 - 2015 HLA testing for G-SiIs and ICS testing start
- **Qualitative field testing** - two rounds of testing in 2014 and in 2016
- **Supervisory process field testing** - two rounds of testing in 2014 and in 2016 - timing aligned with qualitative testing.
- **Crisis Management and Resolution field testing** – two rounds of testing in 2015 and 2016 (integrated with supervisory process and qualitative testing)



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Field Testing: Key points

- All testing to be on a best efforts basis
- Not assessing individual IAIGS – trying to determine the overall impact of and effectiveness of ComFrame
- No publication of individual IAIG results
- Trying to find methods of testing that mitigates impact on firm and IAIS resources
- Field testing all aspects of ComFrame – not just quantitative impact assessments
- Qualitative requirements will be subject to field testing
- Supervisory process also subject to field testing
- Comprehensive field testing for a comprehensive framework



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Quantitative Testing proposed timeline

- **2014** - only testing different approaches for the balance sheet and BCRs
 - **Objective of first exercise** – considering comparability and sensitivity of balance sheets over time
 - **Proposed approach** - leveraging off what IAIGs are currently doing to streamline options without compromising comparability
- **2015** – first ICS test and testing of HLA, BCRs implementation
- **2016** – second ICS test
- **2017** – ICS reporting to supervisors (all IAIGs)
- **2018** – ICS reporting to supervisors + public disclosure
- **2019** – ICS full implementation and HLA implementation

Field Testing begun – Module 1

- Module 1 field testing launched with survey of all IAIS Members
- Responses due by 16 December
- Outcomes sought:
 - understand gaps between current practices and requirements of ComFrame
 - Better understanding of population of IAIGs
 - Powers at the holding company level and indirect authority over holding companies