IAIS Global Insurance Capital Standards

ICA 2014, Washington, DC
2 April 2014

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Outline

1. Who, what, when, why & how?
2. Three layer approach to standard setting
3. Insurance Core Principles (ICPs)
4. ComFrame
5. Basic Capital Requirements (BCR)
6. Global Insurance Capital Standard (ICS)
7. Questions

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1. Who, what, when, why & how?

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"IAIS considers a sound capital and supervisory framework for the insurance sector essential for supporting financial stability and protecting policyholders"
July 2013

BCR
- 2014 for G-SIIs (and IAIGs?)
- Field testing started

HLA
- 2015 for G-SIIs only
- Applies from 2019

ICS
- 2016 (consultation Dec 2014)
- Applies from 2019

" … the International Association of Insurance Supervisors to develop by the Brisbane G20 Summit a basic capital requirement (BCR) on which higher loss absorbency (HLA) for global systemically important insurers (G-SIIs) will be built."
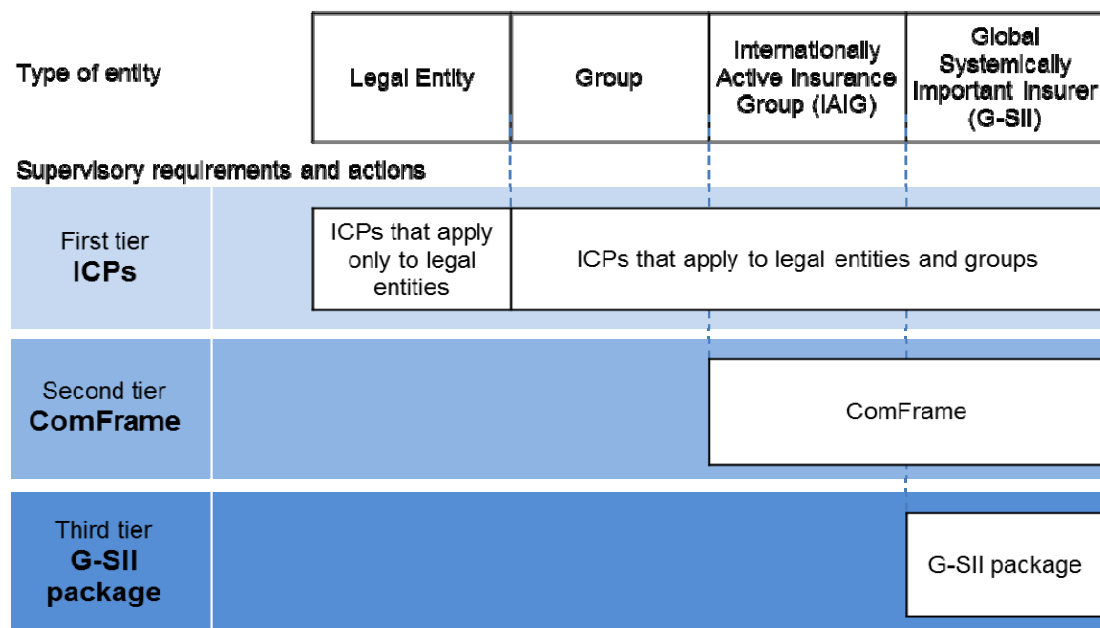*FSB Plenary meeting 31 March 2014*

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3

1. Who, what, when, why & how?

Global standards require global cooperation from all major jurisdictions – both supervisors & volunteer IAIGs!

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4

2. IAIS Three layer Approach

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

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5

3. Insurance Core Principles (ICPs)

Scope:

Insurance legal entities and insurance groups (unless otherwise specified)

Three levels:

Principles, Standards, and Guidance

Proportionality:

Tailored approach taking into account nature, scale and complexity of insurers.

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6

4. ComFrame

Objectives:

Establish a comprehensive framework for group-wide supervision

Foster global convergence of regulatory and supervisory requirements

Scope:

Internationally Active Insurance Groups (IAIGs) and Global Systemically Important Insurers (G-SIIs)

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7

5. 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.

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8

Proposed BCR formula – details (1)

- The BCR required capital is currently envisaged as:

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

- 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.

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9

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

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10

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'**.

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11

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.

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12

Discounting

- **IAIS Specified Discount Curves**
  - Main objective is **<u>comparability</u>**
  - Methodology is open for further development on the basis of Field Testing results
    - Based on liquid interest rate Swaps or Government Bonds
   - Adjustment based on relevant corporate bond index, capped

$$min\left(basic\ risk\ free_t \frac{40\%\ times\ spread_{10}}{basic\ risk\ free\ rate_{10}}, spread_{10}\right)$$

    - In the case of currency unions, different adjustment is used

    Weight_Govt * Relevant_Spread_Govt + Weight_Corp * Relevant_Spread_Corp

    - For markets where the corporate bond index approach is not considered adequate, adjustment assumed to be 50 bps

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13

Discounting

![IAIS logo]

14
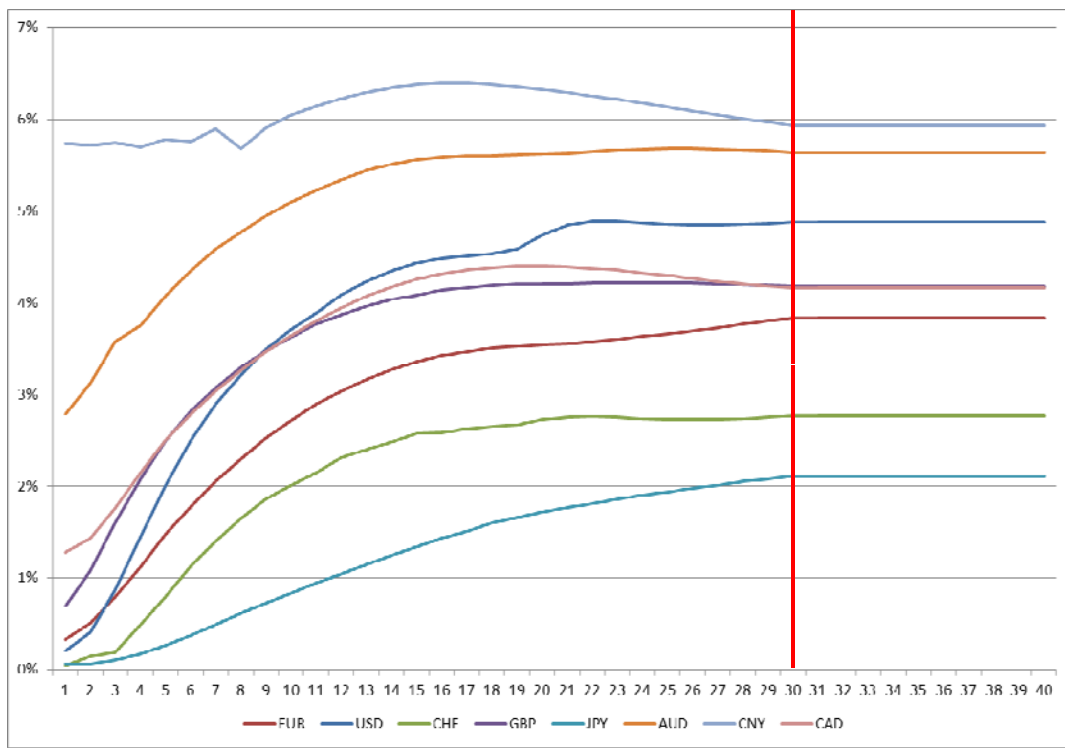
6. ICS: When is it to be developed?

Date	Activity
Early 2014	• Testing of BCR (Backstop Capital Requirements) • Testing ICS (in particular valuation)
November 2014	• BCR finalised and ready for implementation by G-SIIs
2015 - 2016	• Testing of ICS
End 2016	• Development of ICS completed by IAIS
2017 - 2018	• Testing and refinement of ICS
End 2018	• Adoption of ICS
2019	• Implementation of ICS begins

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15

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Thank you

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16

Segmentation – Life

Life insurance – traditional	Life insurance – non traditional
Protection - Life	Investment with portfolio choice and guarantee
Protection - health	Separate accounts with guarantees (including VAs)
Protection - other	of which value of guarantees
Savings without guarantees or living benefits	Guaranteed Investment Contracts (GICs)
Annuities	Synthetic GICs
Participating products	Other non-traditional
Other traditional	

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17

Segmentation – Non-Life

| Non-Life insurance – traditional	Non-Life insurance – non traditional
Motor	Mortgage Insurance
Property Damage	Commercial credit insurance including suretyship
Non-proportional property, APH and motor damage	Other non-traditional non life insurance
Catastrophe Reinsurance	
APH - Accident, protection and health	
Other liability	
Non-proportional liability	
Marine, Aviation and Transport (MAT)	
Non-proportional MAT	
Other traditional - short-tail	
Other traditional – medium tail	
Other traditional - long-tail	

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18

Contract Boundaries

- Only cash-flows related to existing contracts should be taken into consideration.
- Future premiums (and associated liabilities) should not be considered, unless the insurance company can compel the policyholder to pay the premiums, from:
  - The future date where the IAIG has a unilateral right to terminate the contract or reject the premiums;
  - The future date where the IAIG has a unilateral right to amend the premiums or the benefits payable in such a way that premiums fully reflect the risk.

- For group contracts, consider same rules at portfolio level.
- Projection horizon should cover the full lifetime of cash-flows required to settle the obligations related to existing contracts.

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19

Contract Boundaries

- Example: annually renewable policy, 3 years fixed price.

Date where insurer can unilaterally change
the premium to fully reflect the risk

+P	+P	+P	+P	+P	+P	+P	+P
-(C+E)	-(C+E)	-(C+E)	-(C+E)	-(C+E)	-(C+E)	-(C+E)	-(C+E)

N   N+1   N+2   N+3   ...   N+t
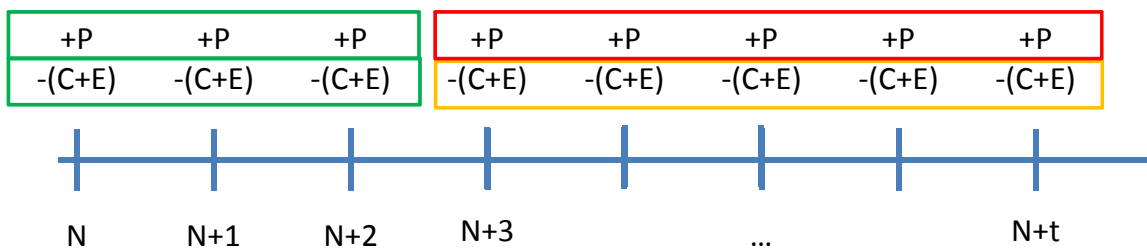
- CF to be considered: in full/partially/not consider

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20

Contract Boundaries

- Questions received from Volunteers
  - Technical Specifications deviate from economic valuation, recognition of policyholder behavior and other economic principles.
    - Objective of Market Based Valuation approach is to derive a comparable valuation of insurance liabilities for prudential purposes (different objective from economic models and/or accounting valuation). Issue needs to be seen in conjunction with treatment of capital resources.
  - Contract boundaries rules likely to be interpreted differently by different Volunteers.
    - This is only the first exercise. It is expected that convergence will be enhanced as experience in the application of these specifications is accumulated.
  - Current estimates may be negative and therefore poor risk proxies.
    - The materiality of this issue will be investigated in Field Testing.

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21