



# IAIS

INTERNATIONAL ASSOCIATION OF  
INSURANCE SUPERVISORS

# ICS Consultation Document – Responses to Comments

Global Seminar and Stakeholders Meeting  
Macau, 19 June 2015



# IAIS Consultation Document Responses – points to note

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- In excess of 1500 pages of comments received – much to review at same time as preparing for field testing exercise in 2 month timeframe
- Technical responses initially reviewed to inform the development of field testing – no intention to reach definitive conclusions
- **‘It is important to note that if a design option is not included in field testing for 2015 that does not definitively close it off from future consideration and vice versa.’**
- The summary of these technical responses is not included in this document
- This document focuses on responses to the questions asked in the consultation
- Report only focuses on select few questions covering more strategic matters
- For these slides, themes are derived primarily from stakeholder responses – member comments are not specifically included in the development of the themes

# ICS Principles

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- **Question 1.** Are these principles appropriate as the foundation for a global consolidated insurance capital standard? Are any enhancements or modifications needed to the ICS Principles?
- The following slides summarise the key themes of responses on each of the 10 principles and provide suggested responses to be published after this meeting

# ICS Principle 1 themes

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**ICS Principle 1 – The ICS is a consolidated group-wide standard with a globally comparable risk-based measure of capital adequacy for IAIGs and G-SIIs.**

The standard incorporates consistent valuation principles for assets and liabilities, a definition of qualifying capital resources and a risk-based capital requirement. The amount of capital required to be held and the definition of capital resources are based on the characteristics of risks held by the IAIG irrespective of the location of its headquarters.

- Many respondents indicated they supported Principle 1 as written (Alternative views are set out below)

Theme from Responses	Resolution
The IAIS needs to clarify meaning of comparability as used in Principle 1	See Question 2 regarding comparability

# ICS Principle 1 themes

With respect to Principle 1 - it is not necessary to adopt a different accounting valuation approach in order to develop a global risk-based measure  
Note: From US stakeholders only

The IAIS is not developing a new accounting standard. This response reflects a difference of expectation about the use of accounting based data in supervisory reporting. Some supervisors view supervisory reporting as a separate and distinct view of the solvency of an insurance group compared to an accounting view which has a different purpose (one accounting purpose is to apportion income and expenses to a particular period).

Jurisdictions who take the view that supervisory reporting is distinct from general purpose financial reporting are more likely to support a supervisory valuation methodology such as market-adjusted valuation.

The two views are accommodated by the existence of both the market –adjusted valuation approach (for those who believe supervisory reporting is not necessarily tied to general purpose financial reporting) and the GAAP with adjustments approach (for those who believe supervisory reporting should be more closely linked to general purpose financial reporting). No decision can be made on this matter until the two valuation approaches are explored further in field testing in 2015 and beyond.

# ICS Principle 2 themes

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**ICS Principle 2 - The main objectives of the ICS are protection of policyholders and to contribute to financial stability.**

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 global financial stability.

# ICS Principle 2 Themes

Theme from Responses	Resolution
<p>Many industry stakeholders do not support the prominence of the financial stability purpose in Principle 2.</p> <ul style="list-style-type: none"> <li>Some say there should be no mention of financial stability</li> <li>Some say it should be a second order consideration</li> </ul> <p>With respect to these responses there was a significant regional bias with most of these responses coming from US stakeholders but not exclusively.</p>	<p>No change to Principle 2. The wording of principle 2 reflects the IAIS mission in Article 2 of the IAIS By-Laws.</p> <p>The mission of the Association is to:</p> <p>(a) 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</p> <p>(b) contribute to global financial stability.</p> <p>To be clear the IAIS is developing the ICS as a going-concern measure of capital adequacy in line with Principle 2. This can be seen through the inclusion of Tier 1 (going concern) and Tier 2 (gone concern) capital resources. However, it is not pursuing a zero-failure level of capital adequacy if such a thing exists. This is why calibration levels of 99.5% VAR and 90% Tail-VAR were proposed in the ICS Consultation document. This does still indicate the risk of failure of a group that meets such a level of capital adequacy.</p>

# ICS Principle 3 Theme

## ICS Principle 3 – ICS is the foundation for HLA for G-SIIs.

Initially, the BCR is the foundation for HLA for G-SIIs.

Theme from Responses	Resolution
<p>Some stakeholder views stated that this principle is premature before more is known about the ICS.</p> <p>There is also concern that the principle blurs the distinctions between G-SIIs and IAIGs.</p> <p>These views are principally from trade associations indicating these views have wide support in the insurance industry.</p>	<p>The BCR was always intended to be an interim comparable measure until the more risk-sensitive ICS could be developed. The ICS should be also developed with the purpose of serving as a basis for HLA in mind. Principle revised as follows:</p> <p><b>‘One of the purposes of the ICS is the foundation for HLA for G-SIIs.</b></p> <p>Design and calibration of HLA will be reassessed before the ICS becomes the foundation for HLA.</p>



# ICS Principle 4 Themes

**ICS Principle 4 – The ICS reflects all material risks to which an IAIG is exposed.**

The ICS reflects all material risks of IAIGs' portfolios of activities taking into account assets, liabilities, non-insurance risks and off-balance sheet activities.

To the extent that risks are not quantified in the ICS they are addressed in ComFrame.

<b>Theme from Responses</b>	<b>Resolution</b>
There was mostly support for this Principle however a number of comments were made about specific aspects	The ICS is a group-wide capital standard and should therefore focus on all material risks to which the IAIG is exposed.

# ICS Principle 4 Themes

Theme from Responses	Resolution
<p>There needs to be recognition of an IAIG's mitigation of risks including asset-liability management, diversification benefits, hedging, reinsurance and risk sharing with policyholders</p>	<p>Recognition of mitigation of risks is an important point. It may be better to address this by adding explanatory text to Principle 6 regarding promotion of sound risk management. So it would read:</p> <p><b>ICS Principle 6 – The ICS promotes sound risk management by IAIGs and G-SIIs</b>            This includes an explicit recognition of appropriate and effective risk mitigation techniques.</p>
<p>The need to recognise IAIG's important role as long-term investors and in the social security system. Regulatory requirements should not negatively impact insurers' stabilizing role in financial system</p>	<p>This point is dealt with in Principle 7, "minimising inappropriate procyclical behaviour by supervisors and IAIGs."</p>

# ICS Principle 5 Theme

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**ICS Principle 5 – 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.**

Applying a common means to measure capital adequacy on a group-wide consolidated basis can contribute to a level playing field and reduce the possibility of capital arbitrage.

<b>Theme from Responses</b>	<b>Resolution</b>
The need for a common understanding of comparability is the major issue for this principle.	Addressed in Question 2

# ICS Principle 6 Themes

**ICS Principle 6 – The ICS promotes sound risk management by IAIGs and G-SIIs.**

<b>Themes from Responses</b>	<b>Resolution</b>
Concerns were expressed about this principle in the context of a standard method rather than use of internal models which are more tailored to individual IAIGs	The principle is meant to be independent of the methods chosen and is also meant to inform the methods chosen. Therefore, no change suggested.
Additional explanatory language suggested to recognise an IAIG's prudent mitigation of material risks including asset-liability management, diversification benefits, hedging, reinsurance and risk sharing with policyholders	See proposed resolution for Principle 4 – explanatory text to be included

# ICS Principle 7 Theme

**ICS Principle 7 – The ICS promotes prudentially sound behaviour while minimising inappropriate procyclical behaviour by supervisors and IAIGs.**

The ICS does not encourage IAIGs to take actions in a stress event that exacerbate the impact of that event.

Examples of procyclical behaviour are building up high sales of products that expose the IAIG to significant risks in a downturn or fire sales of assets during a crisis.

<b>Theme from Responses</b>	<b>Resolution</b>
While there was general support for this Principle it was suggested by some industry respondents that the explanatory text should be expanded to incorporate a message that the underlying valuation basis and the required capital ratio of the ICS should not overemphasize the effects of short term market fluctuations on long term assets or liabilities	There is a theme going through a number of the comments about the interaction between the valuation basis, capital resources, capital requirements and concerns about the effect on long-term business. This is just one example.  The ICS will have to strike the balance between reflecting changes in market conditions, where appropriate, and avoiding reflecting changes that do not threaten the solvency of the IAIG.

# ICS Principle 8 Themes

**ICS Principle 8 – The ICS strikes an appropriate balance between risk sensitivity and simplicity.**

Underlying granularity and complexity are sufficient to reflect the wide variety of risks held by IAIGs. However, additional complexity that results in limited incremental benefit in risk sensitivity is avoided.

<b>Themes from Responses</b>	<b>Resolution</b>
A number of respondents (both industry and regulators) noted that it is essential to distinguish between true risk sensitivity and spurious volatility.	See response to Principle 7. The issue will be explored further in field testing.
While conceptually supporting the principle, a number of industry respondents expressed concern about the potential over emphasis on simplicity and some drew an inference to the development of a standard method not being sufficiently risk sensitive for their circumstances.	No change suggested – this is an issue that can only be dealt with through the actual development of the ICS.

# ICS Principle 9 Themes

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## **ICS Principle 9 – The ICS is transparent, particularly with regard to the disclosure of final results.**

<b>Themes from Responses</b>	<b>Resolution</b>
<p>Overall responses on this principle were mixed. However, it must be noted that individual IAIGs that responded expressed concern about the lack of detail about the nature of the disclosure expected and the meaning of ‘final results’. Concerns are particularly expressed about the confidentiality of proprietary information. There seemed to also be a few concerns about disclosure of numbers may create confusion without adequate context.</p>	<p>Given the concerns raised and the early stage of ICS development the IAIS cannot give a definitive response to this issue. The IAIS will determine the degree and extent of public disclosure once the ICS is finalised.</p> <p>Comments did also mention the transparency of the process of developing the ICS – that is a matter addressed by the IAIS procedures.</p>
<p>Concerns were expressed about the need for disclosure prior to the ICS being fully field tested and adopted.</p>	<p>No specific change is needed but clarification to the milestones in the ICS project may be helpful and will be separately communicated.</p>

# ICS Principle 10 Themes

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**ICS Principle 10 – The capital requirement in the ICS is based on appropriate target criteria which underlie the calibration.**

The level at which regulatory capital requirements are set reflects the level of solvency protection deemed appropriate by the IAIS.

<b>Themes from Responses</b>	<b>Resolution</b>
Some respondents noted that principle 10 should put the level of protection in the context of the balancing that is required to also consider the cost of insurance and accessibility to insurance products.	The calibration should be viewed in the broader context of the ladder of intervention. The development of the ICS will enable the IAIS to take into account stakeholder views about the level of solvency protection.



# Comparability

**Question 2.** What does comparability mean for the ICS from your perspective?

<b>Themes from Responses</b>	<b>Resolution</b>
<p>Comparability should be outcomes-based – two kinds of outcomes mentioned</p> <ul style="list-style-type: none"><li>• outcome of policyholder protection</li><li>• outcome of supervisory assessment</li></ul>	<p>After the consultation document was released the IAIS determined the ultimate goal for the ICS which describes comparability.</p> <p>The ultimate goal of a single ICS will include a common methodology by which one ICS achieves comparable, i.e. substantially the same, outcomes across jurisdictions. Ongoing work is intended to lead to improved convergence over time on the key elements of the ICS towards the ultimate goal. Not prejudging the substance, the key elements include valuation, capital resources and capital requirements.</p>
<p>Local regimes that are consistent with the ICS framework on an outcomes-based analysis should be recognised as a suitable implementation of the ICS framework</p>	
<p>Comparability should not mean quantitative results are identical</p>	

# Comparability

**Question 2.** What does comparability mean for the ICS from your perspective?

<b>Themes from Responses</b>	<b>Resolution</b>
It is unclear whether a single capital ratio or a single risk factor for a similarly labelled product can result in true comparability across national boundaries or different products	ICS intended to be a risk-based standard It focuses on risks rather than product labels. The approach taken for 2015 Field Testing is to consider each risk category and determine an approach to measuring that risk which is suitable on an individual basis.

# Comparability

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**Question 2.** What does comparability mean for the ICS from your perspective?

<b>Themes from Responses</b>	<b>Resolution</b>
The IAIS must clearly articulate both the quantitative and qualitative output it expects to obtain from the overall ComFrame assessment process, as well as identify the specific output it would like to achieve from the ICS development process	The ComFrame assessment process is contained in Module 3 of ComFrame. It will be updated to take into account the development of the ICS.

# Measuring risks across sectors

**Question 3.** Should the IAIS consider integrating the measurement of some or all risks across different sectors?

Themes from Responses	Resolution
There was overwhelming support for using separate sectoral requirements	2015 Field Testing approach focuses on the impact of risks on insurance business under the example of the standard method while requesting volunteers to report their respective sectoral requirements for non-insurance business.
One alternative proposed was that non-insurance subsidiaries should be deducted from the group leaving the ICS to only apply to insurance activities.	This approach of aggregating capital requirements across sectors while considering capital resources on a consolidated level is considered to be an appropriate and simple way to consider risks across the sectors.

# Variations to the standard method

**Question 157.** Should any variation to the standard method be allowed? If so, should IAIG-specific variations to the standard method be allowed? If yes, for which risks should IAIG specific parameters be allowed?

**Question 158.** If variations from the standard method are allowed, what disclosure should be made of the variations? Should there be a standardised disclosure no matter what variations are allowed so that stakeholders can assess the impact of the variations?

<b>Themes from Responses</b>	<b>Resolution</b>
There was a large amount of support for variation to the standard method, but this is interpreted in many different ways and requires significant clarification.	The focus of 2015 Field Testing is to test an example of a standard method under the MAV. There is a need to further develop the standard method which will be followed by further consideration about variations to the standard method. The next ICS CD could ask questions about where variations are needed.

# Use of internal models

**Question 159.** Should the IAIS permit the use of partial internal models for calculating elements of the ICS capital requirement? If so, for which elements of the ICS capital requirement should partial models be allowed? What are the advantages and disadvantages?

**Question 160.** Should the IAIS permit the use of a full internal model for calculating the ICS capital requirement? What are the advantages and disadvantages?

Themes from Responses	Resolution
<p>Q159 – Most of the responses received support the use of partial models usually subject to supervisory approval. Some responses support the use of partial models for catastrophe risk restrictively.</p>	<p>It is proposed that for catastrophe risk the use of a partial internal model is already allowed in 2015 Field Testing to measure that risk even within the standard method.</p>
<p>Q160 – Responses were more split than for Q159 (use of partial models). When the use of full models was supported it was often done subject to supervisory approval.</p>	<p>The additional use of internal models is an issue that should be further investigated after further development of the standard method. The use of models should be considered as a development in moving from ICS Version 1.0 to ICS Version 2.0.</p>

# Use of internal models

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**Question 161.** In what ways would the inclusion of internal models impact the ability of the ICS to be comparable across jurisdictions?

<b>Themes from Responses</b>	<b>Resolution</b>
There were a range of responses. Some stated that the use of internal models will reduce the comparability while others stated that it will increase the level of comparability of outcomes (by reflecting more accurately the risk profile of the IAIGs).	There is a diversity of views among stakeholders about the use of internal models. This is an issue that needs to be kept on the table but can be further considered as the ICS develops. The use of models should be considered as a development in moving from ICS Version 1.0 to ICS Version 2.0.

# Use of internal models

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**Question 162.** What additional safeguards and supervisory standards will the IAIS need to develop to support and complement the use of internal models (partial or full)? Please explain.

<b>Themes from Responses</b>	<b>Resolution</b>
Supervisory approval was often mentioned as a supervisory standard to be developed, sometimes in conjunction with specified requirements for the internal models.	To be considered in further development of the ICS



# Use of internal models

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**Question 163.** Should the development of internal models for the ICS be assessed against the standard method? What role should the example standard method play in this context?

<b>Themes from Responses</b>	<b>Resolution</b>
There were a range of contrasting responses: <ul style="list-style-type: none"><li>• some propose to use the standard method to help assess the internal model during the assessment or field testing period</li><li>• others to use it as a floor for the model</li><li>• others believe that the standard method should play no role.</li></ul>	To be considered in further development of the ICS

# Use of internal models

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**Question 164.** Please give details and explain any experience with model approval processes.

<b>Themes from Responses</b>	<b>Resolution</b>
Some responses refer to existing frameworks implemented or in the process of being implemented.	To be considered in further development of the ICS