7.3 Risk mitigation

Q66 Section 7.3 Should the effect of the renewal be recognised for any other risk mitigation arrangements? If “yes”, please also provide specific examples of such arrangements that should qualify.

Organisation	Jurisdiction	Confidential	Answer	Answer Comments
China Banking and Insurance Regulatory Commission (CBIRC)	China	No	Yes	
European Insurance and Occupational Pensions Authority (EIOPA)	EIOPA	No	No	see Q67.
General Insurance Association of Japan	Japan	No	No	
Financial Supervisory Service (FSS) & Financial Services Commission (FSC)	Korea (Republic of)	No	No	
American Council of Life Insurers	Office of General Counsel	No	Yes	Rolling hedges: The impact of risk-mitigation processes that are subject to renewal is capped at 80% of the difference between full recognition and proportional recognition (based on the renewal period), allowing for hedge transaction costs. This approach does not appropriately differentiate between

				different types of risk mitigation processes. For example, the proportional recognition is applied to 3-month equity futures that are widely used in dynamic hedging programs, even though these types of instruments are highly liquid even under stressed market environments. The ability to renew these types of instruments is not in question, and the application of the renewal adjustment may in fact disincentivize appropriate risk management practices. Disallowance could have the unintended consequence of incentivizing companies to use more long-dated hedges where the renewal adjustments are not applicable, even though a static hedging strategy is most likely to be a less effective risk mitigation strategy than a dynamic hedging strategy using shorter dated hedging instruments.
Legal & General	UK	No	Yes	Reinsurance of life and non-life risks should also be included
Property Casualty Insurers Association of America (PCI)	USA	No	Yes	We believe this question to be best addressed by field test volunteers who have the ability to do so with the benefit of actual data for support and context. The absence of a response by PCI should not be taken one way or the other with respect to the subject of the question.PCI´s yes or no response was simply required in order to open the text box and file comments.
National Association of Insurance Commissioners (NAIC)	USA, NAIC	No	Yes	Yes, provided appropriate criteria are met and the cost is reflected on the balance sheet, then it is appropriate to recognize the renewal of any financial instruments used to

				hedge certain market risks associated with life insurance liabilities. As a basis for these criteria, we would recommend those for a "Clearly Defined Hedging Strategy" (CDHS) under U.S. Principles Based Reserving. For a CDHS, a company must be able to identify: i. The specific risks being hedged (e.g., delta, rho, vega, etc.); ii. The hedge objectives; iii. The risks not being hedged (e.g., variation from expected mortality, withdrawal, and other utilization or decrement rates assumed in the hedging strategy, etc.); iv. The financial instruments that will be used to hedge the risks; v. The hedge trading rules including the permitted tolerances from hedging objectives; vi. The metric(s) for measuring hedging effectiveness; vii. The criteria that will be used to measure effectiveness; viii. The frequency of measuring hedging effectiveness; ix. The conditions under which hedging will not take place; x. The person or persons responsible for implementing the hedging strategy.

Q67 Section 7.3 Should any changes be made to the criteria for recognition? Please explain. If “yes”, please also provide:
• Suggestions for how the criteria could be amended; and
• Specific examples of risk mitigation arrangements that would qualify if these changes were made.

Organisation	Jurisdiction	Confidential	Answer	Answer Comments
Canadian Institute of Actuaries	Canada	No	Yes	The 20 percent haircut to renewal of hedge positions is arbitrary and does not reflect the underlying liquidity risk of these hedges in developed markets. For example, it can be shown that S&P 500 equity futures are highly liquid even in stressed financial markets, including the 2008 financial crisis. The current approach of applying a 20 percent haircut, therefore, fails to distinguish between renewal/liquidity risks for different types of risk mitigation strategies, and ultimately disincentivizes sound risk mitigation strategies such as dynamic hedging.
China Banking and Insurance Regulatory Commission (CBIRC)	China	No	No	
European Insurance and Occupational Pensions Authority (EIOPA)	EIOPA	No	Yes	The relaxation of requirements for risk-mitigation renewal for Currency risk or Equity risk instruments may not be appropiate. The fact that the current proposal includes a burden for the IAIG of demonstrating that there are no additional risks (eg liquidity of the instruments), shows that there are concerns with such frequent renewal and introduces an element of subjectivity. EIOPA would prefer to keep the three months requirement.

Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)	Germany - BAFIN	No	Yes	Monthly or weekly renewals could be taken into account for rolling financial hedging programs, which are often applied in practice for hedging currency risks.
Dai-ichi Life Holdings, Inc.	Japan	No	No	We highly appreciate that the minimum maturity term has been relaxed from 3 months to 1 month as a requirement for equity and currency risk reduction measures.
General Insurance Association of Japan	Japan	No	No	
The Life Insurance Association of Japan	Japan	No	No	• As a requirement for equity and currency risk mitigation arrangements, the LIAJ welcomes the improvement on the mitigation of minimum maturities which is eased from three months to one month.
Financial Supervisory Service (FSS) & Financial Services Commission (FSC)	Korea (Republic of)	No	No	
American Council of Life Insurers	Office of General Counsel	No	Yes	The impact of risk-mitigation processes that are subject to renewal is capped at 80% of the difference between full recognition and proportional recognition (based on the renewal period), allowing for hedge transaction costs. This approach does not appropriately differentiate between different types of risk mitigation processes. For example, the proportional recognition is applied to 3-month equity futures that are widely used in dynamic hedging programs, even though these types of instruments are highly liquid even under stressed market environments. The ability to renew these types of instruments is not in question, and the application of the renewal adjustment may in

				fact disincentivize appropriate risk management practices. Disallowance could have the unintended consequence of incentivizing companies to use more long-dated hedges where the renewal adjustments are not applicable, even though a static hedging strategy is most likely to be a less effective risk mitigation strategy than a dynamic hedging strategy using shorter dated hedging instruments.
Legal & General	UK	No	No	We are broadly comfortable with the criteria set out.
National Association of Mutual Insurance Companies	United States	No	Yes	The ICS is not yet fit for purpose. Significant additional work is needed to achieve an appropriate global capital standard and it may be completely unachievable. Mitigation risk and all other risks and their factors should be determined by the local jurisdictional supervisor. NAMIC disagrees with the mandate of a standard method, the 99.5% VaR calibration level and the IAIS dictating the factors to be used in the formula. Jurisdictional flexibility is the appropriate way to capture these risks with mutual recognition and shared understanding of the jurisdictional approach at supervisory colleges.
MetLife, Inc	USA	No	Yes	We welcome the improvement introduced in 2017 in response to industry comments resulting in recognition of renewal risk mitigation that is more reasonable and appropriate than in 2016. However, the formula for calculating the credit for hedges (due to be renewed over the next 12 months) remains overly complicated and the recognition of the renewal of the hedges remains capped at 80% of the full value attributed to the renewal element. We recommend simplifying the formula, and replacing the unjustified 80% cap with full recognition and recognition of hedging renewal costs subject to any hedge inefficiencies based on past performance.

Property Casualty Insurers Association of America (PCI)	USA	No	Yes	PCI´s yes or no response was simply required in order to open the text box and file comments. We believe this question to be best addressed by field test volunteers who have the ability to do so with the benefit of actual data for support and context. The absence of a response by PCI should not be taken one way or the other with respect to the subject of the question.
National Association of Insurance Commissioners (NAIC)	USA, NAIC	No	Yes	Yes. See response to Q66 for examples of some criteria. Also, changes should be made to the MAV reference method so that expenses associated with renewal are included on the Balance Sheet.

Q68 Section 7.3 Should there be any change to the calibration and application of the limitation of value? If “yes”, please also provide suggestions on how else the future costs and uncertainty could be adequately captured in the ICS.

Organisation	Jurisdiction	Confidential	Answer	Answer Comments
China Banking and Insurance Regulatory Commission (CBIRC)	China	No	No	
General Insurance Association of Japan	Japan	No	No	
Financial Supervisory Service (FSS) & Financial Services Commission (FSC)	Korea (Republic of)	No	Yes	

Legal & General	UK	No	No	We are comfortable with the limitation of value
National Association of Mutual Insurance Companies	United States	No	Yes	The ICS is not yet fit for purpose. Significant additional work is needed to achieve an appropriate global capital standard and it may be completely unachievable. Mitigation risk and all other risks and their factors should be determined by the local jurisdictional supervisor. NAMIC disagrees with the mandate of a standard method, the 99.5% VaR calibration level and the IAIS dictating the factors to be used in the formula. Jurisdictional flexibility is the appropriate way to capture these risks with mutual recognition and shared understanding of the jurisdictional approach at supervisory colleges.
Prudential Financial, Inc.	United States of America	No	Yes	Currency hedges - For the risk mitigation arrangements meeting the IAIS renewal criteria, the hedge should be recognized fully at 100% instead of imposing the 80% limit. + Currency derivatives used to hedge would be fully effective in mitigating the impact of currency stresses regardless of their maturities. The short-term maturities may expose the insurers to “cross currency basis risk” upon renewal of these derivatives; however, Prudential Financial does not believe that this is what the currency stresses intend to measure. + The currency markets for short-term FX forwards for major currency pairs such as JPY-USD and Euro-USD are deep and liquid, and we do not expect to incur meaningful costs as the short-term FX forward positions are renewed and rolled forward. Therefore, the limitation in recognizing the value of the renewal of the risk mitigation arrangements appears particularly punitive for these currency pairs.

Property Casualty Insurers Association of America (PCI)	USA	No	Yes	PCI´s yes or no response was simply required in order to open the text box and file comments. We believe this question to be best addressed by field test volunteers who have the ability to do so with the benefit of actual data for support and context. The absence of a response by PCI should not be taken one way or the other with respect to the subject of the question.

Q69 Section 7.3 How should the associated expenses and other aspects of the reinsurance contracts be accounted for within the ICS?

Organisation	Jurisdiction	Confidential	Answer	Answer Comments
International Actuarial Association	International	No	The Insurance Regulation Committee of the IAA points out that the business plan of property/casualty insurers includes a strategy for the use of reinsurance to manage their net risk. To the extent that the current portfolio of in-force ceded reinsurance contracts is in line with that overall strategy, with no material one-off arrangements, it is customary for the business plan of the coming year to assume continuation of the current portfolio of ceded reinsurance contracts. If one-off arrangements do currently exist, then the impact of those arrangements would likely be removed when projecting the budget for the coming year. There can be dozens of individual ceded reinsurance contracts	

			within the in-force portfolio of reinsurance arrangements for a large property/casualty insurer (and potentially more than that if facultative arrangements are considered). The insurer's budget for the new year is unlikely to separately estimate the impact of each such contract (including the cost to renew such contract). We do not see a need to separately estimate such renewal costs for the ICS to the extent that the current reinsurance program is expected to continue. The cost of such renewals is embedded in the business plan for the company, net of reinsurance financial results. In summary, the use of net of reinsurance data implicitly includes the cost of such contracts and there should be no need to break out the cost of renewing such contracts in ICS projections.	
General Insurance Association of Japan	Japan	No	The associated expenses of reinsurance contracts which affect the net assets of an insurer when risks manifest should be taken into account. More specifically, reinstatement premiums apply. The impact of reinstatement premiums is especially important with regard to catastrophe risk. It is relevant that paragraph 628 of the Technical Specifications reflects its impact on catastrophe risk charges.	

Legal & General	UK	No	These should be treated in the same way as the premium i.e. if allowing for a reinsurance renewal in the calculation then expenses associated should also be allowed for.	
RAA	United States and many other jurisdicitons	No	We agree with the objective of the ICS to match reinsurance contracts, including costs, with the underlying contracts that are included in the current estimate. The complexities discussed in the consultation could be more simply addressed by adoption of an unearned premium approach for valuing premium liabilities, which would allow for a consistent recognition of these expenses.	
American Academy of Actuaries	United States of America	No	The business plans of property/casualty insurers generally include strategies for the use of reinsurance to manage their net risk. To the extent that the current portfolio of in-force ceded reinsurance contracts is in line with that overall strategy, with no material one-off arrangements, it is customary for the business plan of the coming year to assume continuation of the current portfolio of ceded reinsurance contracts. If one-off arrangements do currently exist, then the impact of those arrangements would likely need to be removed when projecting the budget for the coming year. There can be dozens of individual ceded reinsurance contracts within the in-force portfolio of	

			reinsurance arrangements for a large property/casualty insurer (and potentially more than that if facultative arrangements are considered). The insurer's budget for the new year is unlikely to separately estimate the impact of each such contract (including the cost to renew such contract). We do not see a need to separately estimate such renewal costs for the ICS to the extent that the current reinsurance program is expected to continue. The cost of such renewals is embedded in the business plan for net of reinsurance financial results.	
Property Casualty Insurers Association of America (PCI)	USA	No	The underlying issue is that reinsurance may be purchased before (or after) a policy is recognized on the ICS balance sheet. An 'unearned premium' approach for valuing premium liabilities would allow for a more consistent recognition of these expenses	
National Association of Insurance Commissioners (NAIC)	USA, NAIC	No	The underlying issue is that reinsurance may be purchased before (or after) a policy is recognized on the ICS balance sheet. An 'unearned premium' approach for valuing premium liabilities would allow for a more consistent recognition of these expenses.	

Q70 Section 7.3 With regard to non-life premium and natural catastrophe risk, are there any changes that should be made to the criteria used for the recognition of renewal of risk mitigation arrangements?

Organisation	Jurisdiction	Confidential	Answer	Answer Comments
China Banking and Insurance Regulatory Commission (CBIRC)	China	No	No	
International Actuarial Association	International	No	No	The Insurance Regulation Committee of the IAA expects that documentation requirements will be consistent with current practice for documentation of an insurers current reinsurance strategy. We do not see a need for extensive documentation to justify an assumption that the current reinsurance program will be renewed at a cost embedded in net data.
General Insurance Association of Japan	Japan	No	No	
Financial Supervisory Service (FSS) & Financial Services Commission (FSC)	Korea (Republic of)	No	No	
Legal & General	UK	No	No	We are comfortable with these.
National Association of Mutual Insurance Companies	United States	No	Yes	The ICS is not yet fit for purpose. Significant additional work is needed to achieve an appropriate global capital standard and it may be completely unachievable. Mitigation risk and all other risks and their factors should be determined by the local

				jurisdictional supervisor. NAMIC disagrees with the mandate of a standard method, the 99.5% VaR calibration level and the IAIS dictating the factors to be used in the formula. Jurisdictional flexibility is the appropriate way to capture these risks with mutual recognition and shared understanding of the jurisdictional approach at supervisory colleges.
RAA	United States and many other jurisdicitons	No	Yes	See response to Q69. The criteria would be simpler and more effective by adopting an unearned premium approach, which would record the premium liabilities, both gross and ceded, at an amount equal to the unearned premium reserves.
American Academy of Actuaries	United States of America	No	No	This response assumes that documentation requirements will be consistent with current practice for documentation of an insurer's current reinsurance strategy. We do not see a need for extensive documentation to justify an assumption that the current reinsurance program will be renewed at a cost embedded in net data.
Property Casualty Insurers Association of America (PCI)	USA	No	Yes	Yes, to better align the recognition of the expenses with the earning of the related premiums. A simple way of doing this would be setting the premium liabilities (both on a gross and ceded basis) equal to the unearned premium reserves.
National Association of Insurance Commissioners (NAIC)	USA, NAIC	No	Yes	Yes. This issue could be solved by better aligning the recognition of the expenses with the earning of the related premiums. A simple way of doing this would be setting the premium liabilities (both gross and ceded) equal to the unearned premium reserves.

Q71 Section 7.3 Should dynamic hedging arrangements be included in the scope of recognised market risk mitigation techniques for ICS Version 2.0? If “yes”, please also comment on:
• The approaches currently used in local jurisdictions or internally within insurance groups to assess the risk mitigation properties of dynamic hedging programmes for the purposes of regulatory or economic capital.
• How these could be incorporated into the ICS as an other method for calculating the ICS capital requirement; and
• The criteria required to be met to allow the use of these other methods.

Organisation	Jurisdiction	Confidential	Answer	Answer Comments
Canadian Institute of Actuaries	Canada	No	Yes	While detailed modelling of dynamic hedging would likely be outside the scope of a standard formula approach, practical alternatives for reflecting a prudent recognition of dynamic hedging should be considered. This could include, for example, applying a hedge effectiveness factor as approved by the local regulator, where the factor is based on an analysis of a company’s historical hedge performance effectiveness.
CLHIA	Canada	No	Yes	Conceptually, dynamic hedging should be recognized as mitigation for market risk. While we agree that full blown modeling of dynamic hedging cannot be addressed within a Standard Approach, this should not be used as an excuse for not reflecting any recognition for dynamic hedging in ICS 2.0. Other practical approaches to dynamic hedging could be considered for ICS including defining qualitative criteria to demonstrate a clearly defined hedging strategy and then applying a hedge effectiveness factor to the equity risk, where the hedge effectiveness factor could be based on actual hedge experience, local regulator

				input etc. Ideally hedging programs recognized in company's ORSA should be allowed.
Office of the Superintendent of Financial Institutions (OSFI)	Canada - OSFI	No	No	OSFI's view is that it would not be prudent to recognize dynamic hedging in a standardized approach, because assessing the availability of existing hedges, as well as an insurer's ability and intent to renew existing hedges will entail, for example, large additional supervisory responsibilities that are more closely associated with a model approval regime. If the ICS were to include dynamic hedging arrangements in ICS Version 2.0, the basic methodology for incorporating dynamic hedging should be to model real-world (not risk-neutral) stock and bond prices stochastically over the solvency time horizon, along with the insurer's actions under its dynamic hedging program. The capital requirement could then be determined by applying the solvency confidence measure to the insurer's losses over all of the modelled scenarios. The stock and bond price models could be the same as those used to develop the standardized ICS capital requirements. Additionally: • any and all criteria that are applied to the approval for use of internal models should be met in order to approve an insurer using its own model of its dynamic hedging program • the hedging program model should fully take into account real-world concerns such as basis risk, transaction costs and lags between trades; • the supervisor should consider the operations and controls around the hedging program (for example to obtain comfort that it will be followed in all circumstances), and oversee

				validation and backtesting to determine how well the hedging program has performed compared to modelled results.
China Banking and Insurance Regulatory Commission (CBIRC)	China	No	Yes	
European Insurance and Occupational Pensions Authority (EIOPA)	EIOPA	No	No	see Q72
Insurance Europe	Europe	No	Yes	Insurance Europe welcomes the IAIS' consideration of dynamic hedging arrangements within the scope of recognised market risk mitigation techniques, as hedging is an appropriate risk mitigation technique. As dynamic hedging cannot be addressed in the standard formula, this points to the need for recognition through internal model approaches.
Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)	Germany - BAFIN	No	No	Please see our response to Q72.
Global Federation of Insurance Associations	Global	No	Yes	GFIA welcomes the IAIS' consideration of dynamic hedging arrangements within the scope of recognised market risk mitigation techniques, as hedging is an appropriate risk mitigation technique. As dynamic hedging cannot be addressed in the Standard Method, this points to the need for recognition through internal model approaches.
International Actuarial Association	International	No	Yes	The Insurance Regulation Committee of the IAA recommends that this is a topic that will need further consideration and

				refinement. Being able to distinguish between (and encourage) dynamic hedging that mitiigates risk from derivative programs that aim to take on risk, as typically occurs outside of insurance activity, is needed for effective insurance oversight. There are appropriate analytics and processes that are needed to assess the actual effectiveness of dynamic hedging programs. They include : 1. the use of rolling hedges based on deep and liquid markets versus specialized long dated options that may not be able to be replicated in a future, unknown environment. 2. Governance procedures such as: a. Documented back testing of hedge effectiveness b. Specified risk tolerances and documentation of their enforcement c. Documentation of hedge objectives, allowable instruments, etc. . This topic of Dynamic Hedging is also being worked on currently to be included as a separate chapter in the IAA Risk Book which we will be glad to discuss when it is finished.
Dai-ichi Life Holdings, Inc.	Japan	No	Yes	Although we recognize that there will be discussion regarding dynamic hedging, current method in ICS which don't permit risk mitigation by dynamic hedging doesn't reflect the risk management behavior by insurance companies. And we are worried about that this method may lead lose of insurance companies' incentive to enhance risk management. The all effects of risk mitigation by dynamic hedging should be reflected into the risk amount in ICS. In the US, SAP reflects dynamic hedging. In details, we use stochastic method to evaluate reserve and required capital for valuable annuity. The effect of risk mitigation is obtained by

				calculating weighted average the result with rebalancing and the result of without rebalancing, considering the effectiveness of hedging.
General Insurance Association of Japan	Japan	No	Yes	< The approach currently used > There are cases where insurers set a target interest rate hedge ratio (interest sensitivity of asset/interest sensitivity of liability) to mitigate interest rate risks and continuously rebalance their investment so that the ratio falls within a certain range. In such cases, we reflect this interest rate hedge strategy by reflecting the rebalancing of hedge ratio to 1 year continuous interest rate change in Monte-Carlo simulation of the internal model. < How the approach could be incorporated into the ICS > While we would like to reflect the effect of interest rate risk mitigation, it is difficult to incorporate such practices within the standard method. Therefore, ICS should allow the effect of interest rate hedging by reflecting the risk mitigation effect in risk factors if implementing this interest rate hedging strategy. < The approach currently used > There are cases where insurers apply dynamic hedging by using derivatives trading such as futures and swaps to hedge minimum guarantees of variable insurance products. In the case of optional risks, the main exposure before hedging is delta risk (risk of drop in stock prices in case of equity investment) and the main exposure will be converted to gamma risk (risk of suffering losses due to increased volatility) after hedging. Therefore, such insurers mitigate delta risks while measuring and calculating gamma risks using internal models. At the same time, they also measure vega risks. < How the approach could be incorporated into the ICS > The ICS could allow offsetting Delta risks when hedged risks and the means are closely connected. As for gamma and vega risks, which cannot be mitigated by dynamic hedging, internal

				models and application of factors taking into account the period in force of the option liabilities may be considered. < The criteria required to be met to allow the use > When the rules on dynamic hedging policies are properly set (related risks, the method of hedging, allowance of error, etc.) and documented, delta risks are converted to gamma and vega risks, so risk mitigation measures should be taken into account. As mentioned above, risks are converted into different risks as a result of hedging, which should not be overlooked.
The Life Insurance Association of Japan	Japan	No	Yes	• The US-SAP includes dynamic hedging arrangements. Specifically, the stochastic approach is used in the valuation of minimum guaranteed liabilities for variable annuities and the calculation of required capital. In addition, the effect of risk mitigation techniques is calculated based on a weighted average of results that reflect rebalancing and that do not consider rebalancing. • The effect of risk mitigation techniques for dynamic hedging arrangements should be fully reflected in the ICS risk amount.
Financial Supervisory Service (FSS) & Financial Services Commission (FSC)	Korea (Republic of)	No	No	
American Council of Life Insurers	Office of General Counsel	No	Yes	The IAIS needs to include appropriate credit for dynamic hedging programs. It is inconsistent and inappropriate for the ICS to include equity volatility risk but to refuse credit for the tools that insurers use to more broadly mitigate and manage equity risk. It is also inadvisable for prudential supervisors not to provide

				appropriate incentives for insurers to manage risk. Indeed, insurers that prudently and actively seek to hedge the market risks on insurance products that provide important financial protection to policyholders would incur both the cost of hedging as well as counterparty credit requirements, without a commensurate recognition of a valid hedge in ICS capital. This would create a disincentive to hedge, and insufficiently hedged risks could undermine policyholder protection objectives that are at the heart of the ICS. Accordingly, the ICS should provide credit for dynamic hedging. Governance and guardrails can be provided through documentation, back-testing, and a margin for prudence. Documentation can include the proportion of risk or risks being hedged (and not being hedged), hedge objectives, hedging instruments, hedge trading rules including tolerances, and hedge effectiveness metrics and frequency. Regular back-testing, along with a margin for prudence, can ensure that the assumed hedge credit is consistent with supervisory objectives. We recognize that dynamic hedging risk mitigation is a complex subject, and recommend that the IAIS engage with industry dynamic hedging practitioners and experts to develop the appropriate recognition of dynamic hedging in ICS 2.0.
Aegon NV	The Netherlands	No	Yes	It is inconsistent for the ICS to include equity volatility stresses but to exclude recognition of the tools that insurers use to manage the risk of such stresses. It is also inadvisable for prudential supervisors not to provide appropriate incentives for insurers to manage risk. Indeed, insurers that prudently and actively seek to hedge the market risks on insurance products that provide important financial protection to policyholders

				would incur both the cost of hedging as well as counterparty credit requirements, without a commensurate recognition of a valid hedge in ICS capital. This would create a disincentive to hedge, and insufficiently hedged risks could undermine policyholder protection objectives that are at the heart of the ICS. Accordingly, the ICS should provide credit for dynamic hedging. Governance and guardrails can be provided through documentation, back-testing, and a margin for prudence. Documentation can include the proportion of risk or risks being hedged (and not being hedged), hedge objectives, hedging instruments, hedge trading rules including tolerances, and hedge effectiveness metrics and frequency. Regular back-testing, along with a margin for prudence, can ensure that the assumed hedge credit is consistent with supervisory objectives.
Legal & General	UK	No	Yes	We believe that it makes sense for dynamic hedging arrangements to be taken into account where these are sufficiently well controlled and can be deployed with confidence in the market conditions prevailing post-stress. It is also important that the cost associated with any rebalancing is taken into account. Solvency II (our local capital basis) Standard Formula allowance for dynamic hedging beyond what is in place at the valuation date is limited to recognition of any automatic processes to renew hedges, which we believe is broadly sensible. The impact of dynamic hedging could be included within the impact of the market stress gross of such actions, by overlaying the impact of the hedging as an extension of the scenario assessment.

Association of British Insurers	United Kingdom	No	Yes	The ABI welcomes the IAIS' consideration of dynamic hedging arrangements within the scope of recognised market risk mitigation techniques, as hedging is an appropriate risk mitigation technique. As dynamic hedging cannot be addressed in the standard formula, this points to the need for recognition through internal model approaches.
AIG	United States	No	Yes	We believe dynamic hedging arrangements should be included in the scope of recognized market risk mitigation techniques since it serves an important function as a risk mitigating tool. Additionally, dynamic hedging is cost-effective and flexible as it can be employed on a stand-alone basis or in conjunction with other market risk mitigation techniques and reinsurance. Dynamic hedging also fosters prudent risk management practices and, as outlined in ICP 15.6.3, the recognition of dynamic hedging as a market risk mitigation technique should "include the pre-approval of an insurer's derivative investment plan e.g. a dynamic hedging program. That pre-approval procedure could require that the insurer describe its controls over the derivative investment process and the testing of the process before it is used in a live environment.
Prudential Financial, Inc.	United States of America	No	Yes	Prudential Financial believes that dynamic hedging should be included and fully reflected in the scope of recognized market risk mitigation techniques. It is a well-established practice and an integral part of insurers' risk management processes around products such as variable annuities with guarantees. More specifically, short-dated hedges (e.g., 3 month) are subject to an arbitrary haircut, even though the ability to renew these instruments is not in question as they are highly liquidity, even under market stresses. The lack of full recognition of these

				instruments fails to sufficiently reflect insurers' proper risk management practices. Indeed, it incentivizes companies to opt for more long-dated hedges where the renewal adjustments are not applicable, even though dynamic hedging using short-dated hedging instruments is likely to be more effective than a more static hedging strategy backed by long-dated instruments. For U.S statutory reporting purpose, we consider our dynamic hedging program qualified to be Clearly Defined Hedging Strategy ("CDHS"), i.e. strategies undertaken by a company to manage risks through the future purchase or sale of hedging instruments and the opening and closing of hedging position. As such, the impact of the dynamic hedging program, including future renewals, is reflected through an implicit modelling approach and reported through a "net impact of hedging assumption". In order to qualify as a CDHS, the strategy must meet the prescribed requirements and shall, at a minimum, identify the specific risks being hedged, the hedge objective, the risk not being hedged, the financial instruments that will be used for hedging, the hedge trading rules, metrics/criteria/frequency for measuring hedge effectiveness, the conditions under which hedging will not take place; and the person(s) responsible for implementing the hedging strategy. We believe the ICS could leverage the CDHS qualification criteria and methodology to provide credit for dynamic hedging and incentivize insurers' proper risk management practice for the underlying risks. Dynamic hedging is a complex subject. We believe the IAIS needs to broadly engage with industry practitioners and experts to develop an appropriate approach for recognizing dynamic hedging in the ICS

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Property Casualty Insurers Association of America (PCI)	USA	No	Yes	PCI´s yes or no response was simply required in order to open the text box and file comments. We believe this question to be best addressed by field test volunteers who have the ability to do so with the benefit of actual data for support and context. The absence of a response by PCI should not be taken one way or the other with respect to the subject of the question.

Q72 Section 7.3 Are there any further comments on risk mitigation that the IAIS should consider in the development ahead of ICS Version 2.0? If “yes”, please explain with sufficient detail and rationale.

Organisation	Jurisdiction	Confidential	Answer	Answer Comments
China Banking and Insurance Regulatory Commission (CBIRC)	China	No	No	
European Insurance and Occupational Pensions Authority (EIOPA)	EIOPA	No	Yes	EIOPA wants to emphasize that dynamic hedging arrangements should not be recognised for their risk mitigating properties. As stated in the consultation document, this would otherwise conflict with the standard method that relies on instantaneous shocks and should therefore, by construction, not allow any mitigating effects of any subsequent hedging adjustments.

Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)	Germany - BAFIN	No	Yes	We want to emphasize that dynamic hedging arrangements should not be recognised for their risk mitigating properties. As stated in the consultation document, this would otherwise conflict with the standard method that relies on instantaneous shocks and should therefore, by construction, not allow any mitigating effects of any subsequent hedging adjustments.
Global Federation of Insurance Associations	Global	No	Yes	Where clearly defined hedging strategies exist, artificial constraints relating to non-renewal of hedges should not be applied. While the current approach would provide some conservatism in the capital requirement calculation, it is inconsistent with ICS principle 6 of promoting “sound risk management” and including “an explicit recognition of appropriate and effective risk mitigation techniques”. GFIA also notes that applying an arbitrary haircut creates inappropriate risk management incentives. For example, it creates incentives to use hedges that are of longer term – these would be less liquid, more expensive and can create more counterparty risk relative to using exchange-traded derivatives that are of shorter tenor. Applying haircuts does not recognise the full economic benefit of the hedges in place and creates poor risk-management incentives. A distinction should be made between developing futures markets where there may be a cost associated with renewing the hedging instruments, and a developed futures market with high liquidity and minimal trading cost.

				Therefore, GFIA takes the view that the current restrictions, particularly the 20% haircut, do not appropriately reflect the risks typically associated with hedging programmes. Market hedges and on-going market hedging programs are core to risk management, and therefore any restriction must appropriately reflect the risks associated with these programmes and promote sound risk management.
Dai-ichi Life Holdings, Inc.	Japan	No	No	
General Insurance Association of Japan	Japan	No	No	
The Life Insurance Association of Japan	Japan	No	No	
Financial Supervisory Service (FSS) & Financial Services Commission (FSC)	Korea (Republic of)	No	No	
Legal & General	UK	No	No	Our comments have been sufficiently well captured by our responses to other questions in this section.
Association of British Insurers	United Kingdom	No	Yes	Where clearly defined hedging strategies exist, artificial constraints relating to non-renewal of hedges should not be applied. While the current approach would provide some conservatism in the capital requirement calculation, it is inconsistent with ICS principle 6 of promoting “sound risk management” and including “an explicit recognition of appropriate and effective risk mitigation techniques”.

				The ABI also notes that applying an arbitrary haircut creates inappropriate risk management incentives. For example, it creates incentives to use hedges that are of longer term – these would be less liquid, more expensive and can create more counterparty risk relative to using exchange-traded derivatives that are of shorter tenor. Applying haircuts does not recognise the full economic benefit of the hedges in place and creates poor risk-management incentives. A distinction should be made between developing futures markets where there may be a cost associated with renewing the hedging instruments, and a developed futures market with high liquidity and minimal trading cost. Therefore, the ABI believes the current restrictions, particularly the 20% haircut, do not appropriately reflect the risks typically associated with hedging programmes. Market hedges and on-going market hedging programs are core to risk management, and therefore any restriction must appropriately reflect the risks associated with these programmes and promote sound risk management.
National Association of Mutual Insurance Companies	United States	No	Yes	The ICS is not yet fit for purpose. Significant additional work is needed to achieve an appropriate global capital standard and it may be completely unachievable. Mitigation risk and all other risks and their factors should be determined by the local jurisdictional supervisor. NAMIC disagrees with the mandate of a standard method, the 99.5% VaR calibration level and the IAIS dictating the factors to be used in the formula. Jurisdictional flexibility is the appropriate way to capture these

				risks with mutual recognition and shared understanding of the jurisdictional approach at supervisory colleges.
Property Casualty Insurers Association of America (PCI)	USA	No	Yes	PCI´s yes or no response was simply required in order to open the text box and file comments. We believe this question to be best addressed by field test volunteers who have the ability to do so with the benefit of actual data for support and context. The absence of a response by PCI should not be taken one way or the other with respect to the subject of the question.

End of Section 7.3