INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

Public

Resolution of Main Issues from the Comments on *Basic Capital Requirements (BCR) for Global Systemically Important Insurers (G-SIIs)*

Consultation Period: 20 December 2013 to 3 February 2014

18 March 2014

Introduction

On 16 December 2013, the IAIS issued a public consultation document on its proposal for Basic Capital Requirements (BCR) for Global Systemically Important Insurers (G-SIIs). The consultation closed on 3 February 2014 and the feedback received was published on the IAIS website.

This document highlights the major issues raised by respondents and provides IAIS comments in response to these issues. The IAIS will consider all the feedback obtained during this consultation when conducting work on BCR development and field testing. The BCR field testing process commences on 21 March 2014 and a second public consultation on the BCR will be conducted after the field testing.

Main issues raised in consultation responses	**Comments in response and proposed resolution of issues raised**
Role and Objective of BCR	
BCR should focus on gone-concern instead of going-concern	The IAIS Paper on 'Global Systemically Important Insurers: Policy Measures' published on 18 July 2013 states: *'HLA capacity requirements should be met by permanent capital that is fully available to cover losses of the insurer at all times on a going-concern basis.'* This is consistent with the FSB report endorsed at the G20 Seoul Summit in November 2010 which indicates that the greater loss absorption capacity of G-SIFIs should increase their resilience as a going concern. Given the BCR's role as a foundation for HLA, it is appropriate for the BCR to be calibrated on a going-concern basis.
BCR should be a minimum (given its simplicity, using it as a target level of capital is inappropriate)	The IAIS will consider this feedback during its analysing of the results of field testing and in the context of the Principles established in the Consultation Document to guide the development of the BCR.

Intended applicability of BCR beyond G-SIIs to include all IAIGs is uncertain and needs further clarification	The IAIS recognises this issue and will address it during 2014. Currently the primary role of the BCR as a foundation for HLA, the latter of which will apply only to G-SIIs, is clear. Hence, the primary focus of BCR development work this year will be on its applicability G-SIIs. As part of its assessment of whether the BCR should apply to all IAIGs, the IAIS will take feedback from this consultation into account.
Principles and Approach to BCR Development	
BCR should not be volatile or encourage pro-cyclical behaviour	The IAIS agrees that BCR should not be volatile or incentivise pro-cyclical behaviour. However, IAIS has observed that there exists a range of opinion of the meaning of 'pro-cyclicality", and will consider the need to elaborate further on this issue during the 2nd BCR Consultation.
BCR appears overly geared towards simplicity and should have greater emphasis on risk sensitivity	As indicated in the Consultation Document, there is a natural tension between the objectives of simplicity, comparability and risk-sensitivity in the development of regulatory capital frameworks. An over emphasis on any one of these objectives may compromise the others. The IAIS will consider this feedback during its analysis of the results of field testing and in the context of the Principles established in the Consultation Document to guide the development of the BCR.
BCR should leverage on the work already done for factors in existing frameworks (e.g. Solvency II, US NAIC RBC Formulas, Canadian regulatory framework)	The IAIS expects to consider work already done in the development of factor based approaches to determining capital required for BCR purposes. It is noted, however, that there is no global framework for determining capital requirements in place (for BCR or other purpose), and consequently the perspective the BCR will take should not be expected to mirror that of any particular jurisdiction.
Field testing should focus on BCR only in the interest of resources and time	The 2014 field testing was developed in the broader context of supporting the ongoing development of the IAIS's Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame). This first iteration of ComFrame Quantitative Field Testing focuses on the reporting of the group balance sheet under different valuation bases. The main objectives of this exercise are to provide the necessary inputs for the field testing of the Basic Capital Requirements (BCR) and test the comparability and risk sensitivity of the values of the balance sheet items in preparation for the development of the Insurance Capital Standard (ICS).

	Then IAIS does not consider it appropriate to defer the longer development of ComFrame or defer preparation for the development of the ICS.
Factor-based approach	
More than 10 factors will be needed	The IAIS will consider this feedback during its analysis of the results of field testing and in the context of the Principles established in the Consultation Document to guide the development of the BCR.
Diversification, reinsurance, hedging, ALM and risk-mitigating / loss absorbing features in products should be recognised in BCR. Some respondents suggested that other risks that are not being considered in the BCR (e.g. operational, liquidity or currency risks) should be considered.	As indicated above, the benefits of additional risk sensitivity through using additional factors to reflect ALM, and other risk mitigation measures will need to be balanced against the criteria of simplicity and comparability. The BCR is intended to reflect major risks, however other less major risks may be excluded, at the cost of some risk sensitivity, for the sake of simplicity. A more sophisticated and risk-sensitive framework is anticipated to be achieved via ICS development. It is also noted, in the context of the BCR having some responsiveness to risk and risk mitigation, that it is desirable to reduce the risk of the BCR encouraging perverse outcomes (such as, having required capital for BCR purposes ignore significant risk mitigation activities). The IAIS acknowledges the possibility that the BCR may use more than 10 factors. This will be considered during the analysis of the results of field testing.
Interaction with other capital requirements	
BCR should not increase or conflict with existing group capital requirements on insurers	IAIS will assess the interaction with local jurisdictional requirements during field testing. The IAIS does not rule out the possibility of the BCR, in at least some cases, being higher than jurisdictional requirements. However, this statement needs to be interpreted in the context of the base to which any additional capital requirements may be applied. A key aspect of the BCR is the need for global comparability. This is being addressed, with regard to insurance liabilities, by focusing on best estimate liabilities.
Intended interaction between BCR and other standards or policy measures (HLA, ICS) lacks clarity.	The role of the BCR as a foundation for HLA has been detailed in the IAIS document 'Global Systemically Important Insurers: Policy Measures', dated 18 July 2013. Its continued existence and interaction with the ICS will be assessed and clarified following further development work on the ICS.

Segmentation	
Preference for more granular segmentation of business lines	The IAIS will consider this feedback during its analysis of the results of field testing and in the context of the Principles established in the Consultation Document to guide the development of the BCR.
Catastrophe risk should be distinguished	The IAIS has considered this feedback and has incorporated it into the field testing data call.
Accounting and Valuation Approach	
Market-based approach is not appropriate for long-term nature of business	The IAIS is aware that, in some circumstances, the use of 'market- based approaches' may lead to outcomes which may not be considered to be ideal by all stakeholders interested in the reporting provided. The BCR Consultation Document states: *'For the purpose of developing the BCR, the IAIS proposes to use asset valuations based on generally accepted accounting principles in each relevant jurisdiction, subject to various adjustments that will be determined via the field testing process. The appropriateness of this proposal will be investigated further through field testing to be carried out by the IAIS in 2014. This testing will focus on the total balance sheet approach and on understanding the impact of stresses on that balance sheet.*
Use of current estimates of insurance liabilities	There was widespread support for the BCR approach to insurance liabilities being based on current estimates (best estimates) of insurance liabilities.
Confusion over 'off balance sheet exposures' and criteria for immateriality	The IAIS will consider this feedback, and provide further clarification in its specifications and guidance for 2014 field testing. It will also consider results from the analysis of the data provided in field testing in the context of the Principles established in the Consultation Document to guide the development of the BCR.
IAIS should define principles or guidance for determining discount rates / yield curves	The IAIS has determined that, for the purposes of the 2014 field testing, that it is appropriate to specify yield curves to be used for the purposes of discounting. This reflects the core objective of obtaining results that are comparable, both within and between jurisdictions over a number of insurance groups. The main objective of providing IAIS

	specified discount curves is comparability. As such, the approach chosen for the first quantitative exercise does not pre-empt the future development of alternative comparable approaches to discounting the current estimate that may better reflect the long term nature of insurance liabilities and that could be eventually used as part of the IAIS standard. That applies to both, the mechanics of the curve as well as any factors used in the calculation for the purposes of the field test.
Non-Life Technical Provisions should be undiscounted	The IAIS will consider this feedback during its analysis of the results of field testing and in the context of the Principles established in the Consultation Document to guide the development of the BCR. The IAIS acknowledges that for short term liabilities (Non-Life in particular), in the current low interest rate environment (which is not guaranteed to continue indefinitely), that the question of whether or not liabilities are discounted to reflect changes in the future value of both assets and liabilities, may not in all cases be of primary importance in the context of financial projections. However, the IAIS also notes that not all non-life insurance liabilities are short term in nature. Indeed some may be very long term (and variable and/or inherently uncertain) including, for example, liabilities associated with asbestos claims and hazards.
NTNI (non-Traditional and Non-Insurance activities)	
"NTNI" needs to be better defined	In terms of its field testing, the IAIS will consider this feedback. During its analysis of the results of field testing, and in the context of the Principles established in the Consultation Document to guide the development of the BCR, the IAIS will also consider the impact of variations in the specifications of NT and/or NI activities.
NTNI activities should not be double-charged by NTNI factors and other factors	The IAIS does not intend to 'double charge' for NTNI activities, however it may be appropriate for the BCR to specify capital requirements based on a combination of factors
Sectoral rules should only be applied to NI activities within that same sector and not be extended beyond those sectors	The IAIS will consider this feedback during its analysis of the results of field testing and in the context of the Principles established in the Consultation Document to guide the development of the BCR. However , it is also noted that the mandate for the BCR, as stated in the BCR Consultation Document, is:

	'As a foundation for HLA requirements for G-SIIs, the IAIS will as a first step develop straightforward, backstop capital requirements to apply to all group activities, including non-insurance subsidiaries, to be finalised by the end of 2014.' The requirement to included non-insurance subsidiaries (and hence activities) is noted. The quantitative field test has been designed to collect the Basel Committee leverage ratio data points for non-traditional (NT) business.
Capital Resources	
BCR should not have tiering of capital	The IAIS will consider this feedback during its analysis of the results of field testing and in the context of the Principles established in the Consultation Document to guide the development of the BCR. It is noted that the HLA, for which the BCR is to provide a basis, is to be considered on a going-concern basis. It is also noted that the HLA is intended to only recognise then highest quality capital.
Qualification of capital resources should be principles-based rather than rules-based	There is a core requirement that the BCR be comparable across jurisdictions. This is a natural consequence of it being a global standard. The IAIS acknowledges that there may be practical issues in the specifics of the implementation of principles and agreed objectives. Comparability of outcomes is a core objective for the BCR, so a principles based approach may not provide sufficient clarity and direction for outcomes, after implementation, to be comparable.
Supervisory discretion on transferability/ fungibility of capital reduces comparability and should be minimised	The BCR is an input to a capital adequacy assessment at a group level. Thus it is not focused on the components of group, be they in the same or different jurisdictions. Consequently the issue regarding the fungibility of capital, with or without supervisory input or approval, while acknowledged in the context of the development of the BCR, is not considered to be a primary concern. Transferability and fungibility of capital should also be considered in a supervisory capital adequacy assessment. In general, supervisory discretion should be minimised to avoid loss of comparability.