Actuarial Association of Europe

IAIS Global Capital Standards

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21 April 2016

Agenda

- Context
  - IAIS policy initiatives for regulatory capital
  - Systemic risk
- Current positions
  - Basic Capital Requirement (BCR)
  - Higher Loss Absorbency (HLA)
  - Insurance Capital Standard (ICS)

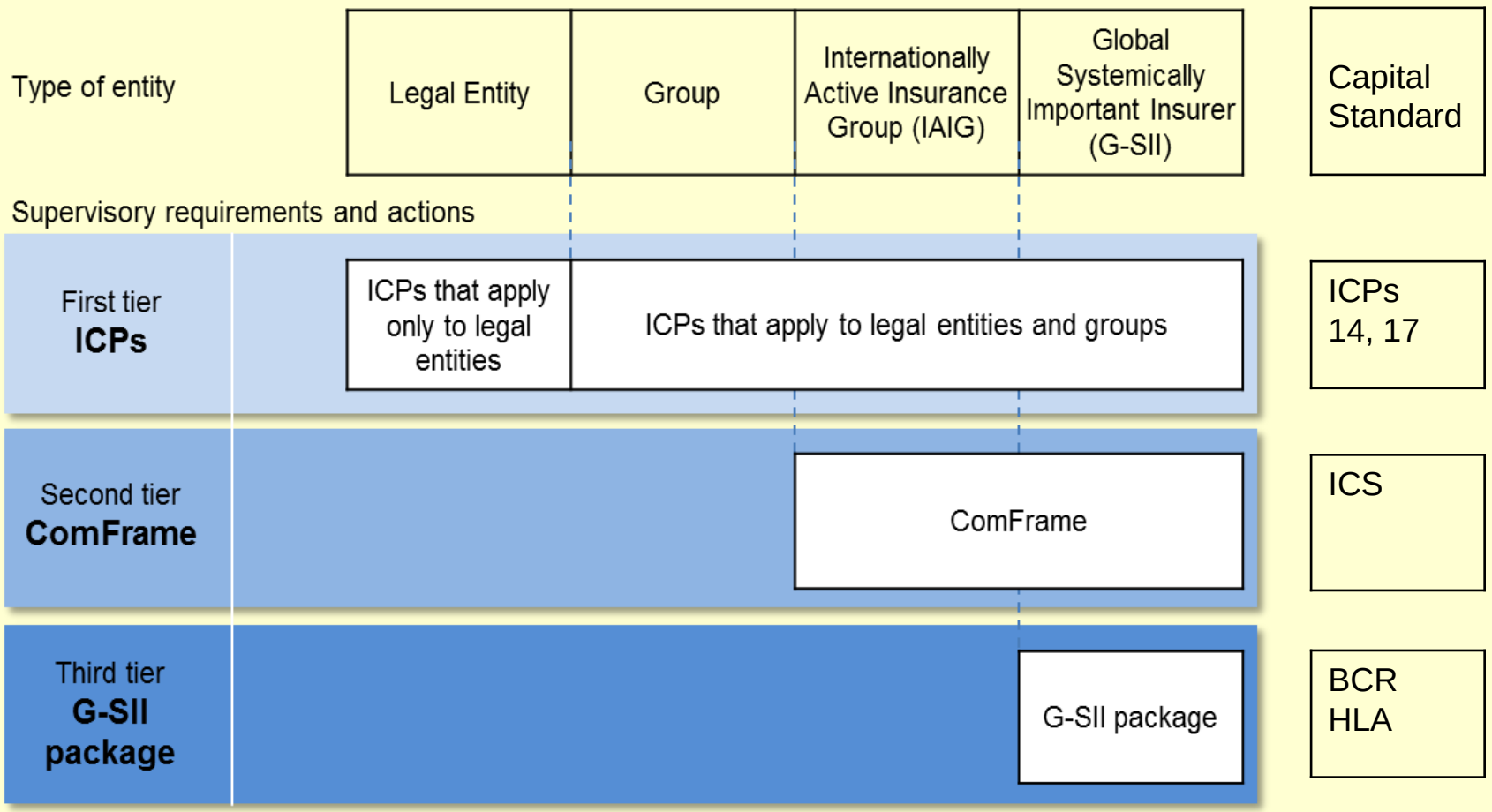
Context and timetable

IAIS - a global standard setter

- Mission
  - 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***
  - Contribute to ***global financial stability***

- IAIS membership is broad and diverse:
  - About 200 jurisdictions in nearly 140 countries
  - 97% of the world's insurance premiums

IAIS three layer approach to standard setting



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IAIS G-SII policy measures

- Identification of G-SIIs (and NTNI)
- IAIS framework for G-SII policy measures is in line with FSB recommendations, with main components:
  - Enhanced supervision
  - Effective resolution
  - Loss Absorbency (BCR) capacity
  - Higher loss absorption (HLA) capacity
  - Other supplementary prudential and regulatory requirements
- BCR and HLA are part of an integrated package

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IAIS global capital standards

- Basic Capital Requirement (BCR)
- Higher Loss Absorbency (HLA)
- Insurance Capital Standard (ICS)

	Adopt	Confid Report Annual Review	Apply	Apply to
BCR	2014 FSB G20	2015 ->	2019 ->	G-SII
HLA	2015 FSB (G20)	2016 ->	2019 ->	G-SII
ICS 1.0	2017	2017 ->	n/a	IAIG (G-SII)
ComFrame incl ICS 2.0	2019	n/a	2020 ->	IAIG (G-SII)

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IAIS capital standards

- 3 main components - that need to be consistent
  - Valuation basis
  - Qualifying capital resources
  - Measure of capital requirement = resources / requirement
- Scope
  - Take into account all risks within the group
- Principles
  - Separate sets provide guidance for each standard
  - BCR, HLA, and ICS

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Systemic risk

- The risk of disruption of financial services that is
  - Caused by impairment of all or parts of the financial system and
  - Has the potential for serious negative consequences for the real economy

FSB and IMF (2009)

- External to institutions
  - So may be imposed on an insurer
  - Systemic risk events impact multiple insurers

- Macroprudential in nature
  - Different perspective to microprudential, institution focused, regulation and supervision

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Summary of IAIS position

- Systemic risk is present in insurance
- Currently 9 designated G-SIIs (by FSB)

	G-SII Business		
	Traditional	Non-Traditional	Non-Insurance
Is Susceptible	YES	YES	YES
May Amplify	YES	YES	YES
May Generate		YES	YES

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Current position - BCR

BCR and HLA: For G-SIIs

- These need to be considered together
- Sum is minimum required regulatory capital
- BCR provides a consistent measure on which to build the HLA
  - Microprudential components
  - BCR required as no globally comparable measure available
- HLA provides additional minimum regulatory capital requirement for G-SIIs as a consequence of being designated as a G-SII
  - Macroprudential focus

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BCR: Scope

- '*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.*'
- Uplifted in 2015 compared to 2014
  - Essentially increase of 33%, with exception of Regulated banking

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BCR: Formulas

- BCR status given by

$$\text{BCR Ratio} = \frac{\text{Qualifying Capital Resources (for BCR)}}{\text{Required Capital (for BCR)}}$$

- $\text{BCR Required Capital} =$

$$\alpha \left[\sum_{i=1}^{4} a_i \, TL_i + \sum_{i=1}^{4} b_i \, TNL_i + \sum_{i=1}^{4} c_i \, NT_i + \sum_{i=1}^{3} d_i \, A_i \right]$$

$$+\alpha \sum_{i=1}^{n} NI_i \; + NI\_RegBank$$

  - α (alpha) = 1.33, scalar to adjust the overall BCR level
  - a_i, b_i c_i and d_i are factors applied to the exposures
  - TL_i, TNL_i, NT_i, and A_i represent the exposures
  - NI reflects charges provided by sectoral rules for non-insurance activities where available (Basel Accord).

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BCR: Features

- Liability valuation - Current Estimates
  - Primary proxy measure for risk exposures for insurance liabilities
  - Neither deliberately overstated nor understated
  - Ideally, but not necessarily, via expected realistic cash-flow projections
- Asset valuation
  - Based on generally accepted accounting principles (in each relevant jurisdiction), with adjustments to enhance comparability
- Quality of capital resources: ‘Core’ or ‘Additional’
  - Not more than 50% of capital resources supporting BCR may be additional capital

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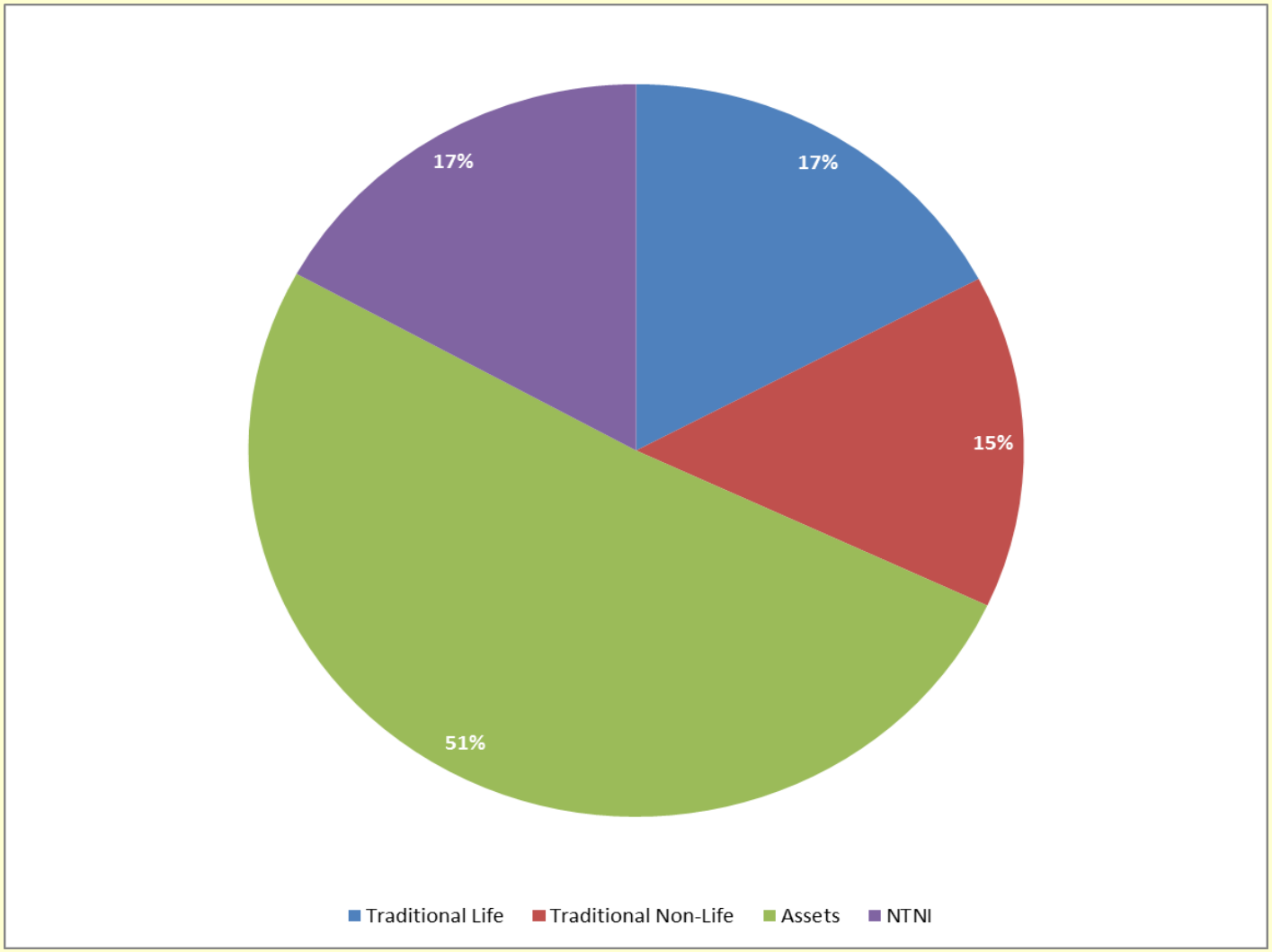
BCR: Average allocation of required capital - 2014



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Current position - HLA

HLA: Policy objectives

- HLA capacity reflects greater risks G-SIFIs pose to global financial system
  - G-SII more resilient to low probability but high impact events
  - Supervisors intervene earlier than for non G-SIIs (time to address emerging risks)
  - Internalise some of the costs to the financial system and overall economy … that occur as a result of G-SII distress or failure by making G-SIIs more resilient to low probability, high impact events
  - Any implicit or explicit funding subsidy linked to G-SII status is offset
- Existing PCRs do not fully address systemic risks

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HLA: Key design considerations

- Balances three key policy objectives
  - Risk sensitivity, robustness and simplicity
- Disincentives built into HLA formulas
  - To encourage G-SIIs to reduce potential systemic activities
- Separate Insurance and NI business aspects
  - Existing global regulatory requirements in non-insurance sectors can be reflected
- HLA initially built on the foundation of the BCR
  - When ICS developed, HLA will be reviewed as the ICS will replace the BCR as the foundation for HLA

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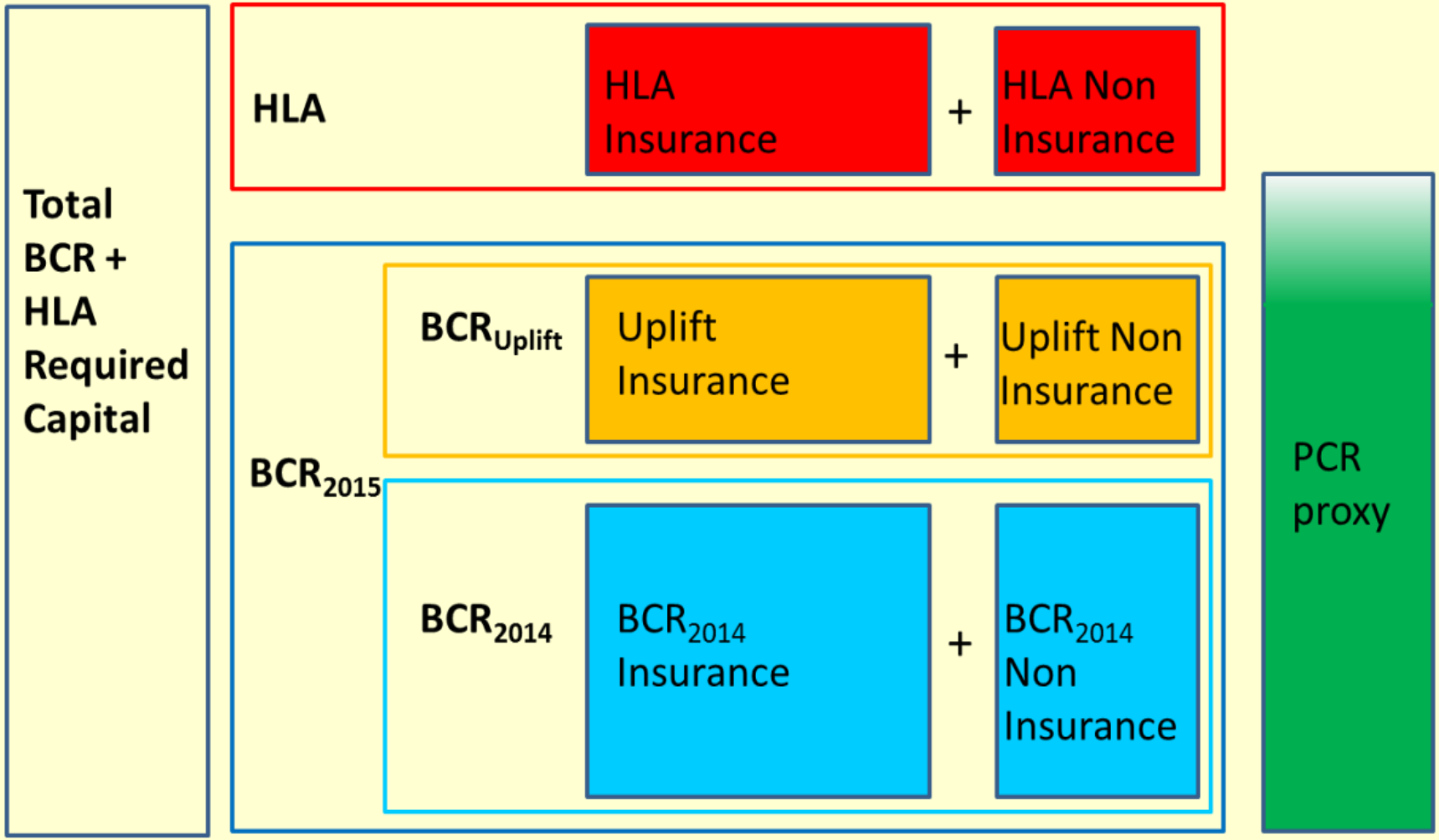
Total BCR + HLA required capital



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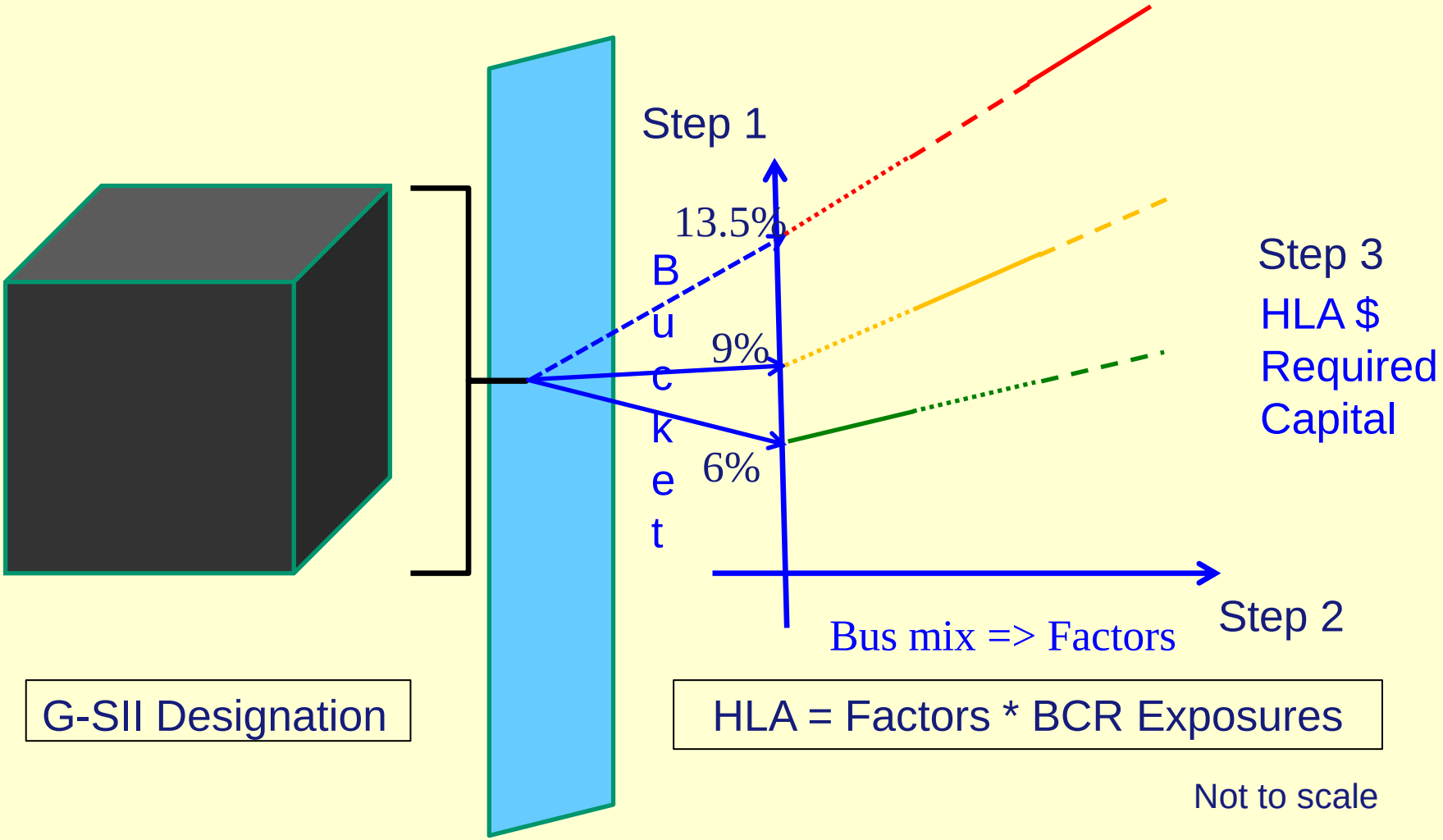
HLA: Process picture



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HLA: Required capital formula factors

BCR required capital exposure	HLA Factors		
	Low Bucket	Mid Bucket	High Bucket
Traditional Life insurance	6%	9%	13.5%
Traditional Non-Life insurance			
Assets			
Non-Traditional insurance	12%	18%	27%
Non-Insurance – Assets Under Management			
Non-Insurance – Other			
Non-Insurance – Regulated Banking	8.5%	12.5%	18.75%
Non-Insurance – Unregulated Banking	12.5%	18.75%	25%

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BCR+HLA Ratio

- BCR+HLA status given by

$$\text{BCR+HLA Ratio} = \frac{\text{Qualifying Capital Resources (for BCR+HLA)}}{\text{Required Capital (for BCR+HLA)}}$$

- Required capital - Factor-based
  - Exposures based on BCR required capital amounts
  - HLA factors reflect the assessed systemic risk of each exposure
  - Buckets reflect assessment of systemic risk of G-SII from G-SII designation process
- Qualifying capital resources
  - HLA: Of the highest quality (BCR Core capital)
  - BCR+HLA = Core capital +min(50% BCR, Additional capital)

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BCR+HLA: Average impacts on current G-SIIs

	G-SII	All Volunteer
BCR_{2014} / BCR_{2015}	75%	n/a
HLA / BCR_{2015}(*)	10%	n/a
BCR_{2015} / PCR (**)	100%	90%
(BCR_{2015}+HLA) / PCR (**)	110%	100%
BCR+HLA Ratio (**)	260%	305%

Notes

- Results averaged over 2014 and 2015 field testing
- Results rounded to 1% (*) or 5% (**)
- Non-G-SII Volunteers assumed in lowest HLA bucket only for illustrative purposes

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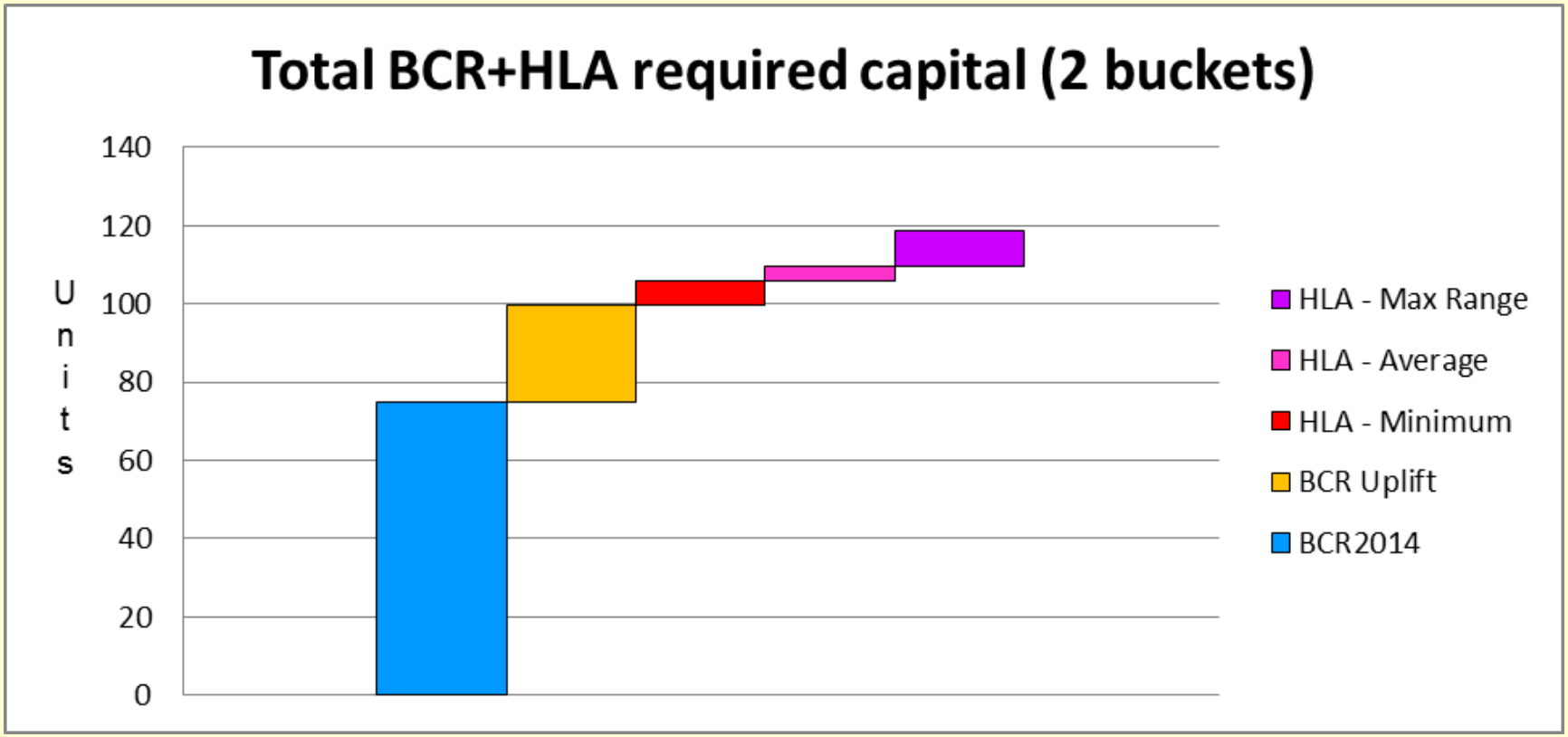
BCR+HLA: Range of hypothetical outcomes



- HLA results reflect the full range of possible values based on the HLA Factors. They do not report results for any actual G-SII

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Current position - ICS

ICS: Ultimate goal

- A single ICS that includes 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.

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ICS: Key points

- To be a group-wide, risk-based, consolidated insurance capital standard applicable to all IAIGs
- ICS will be a measure of capital adequacy part of ComFrame for IAIGs
  - Is not intended as a legal entity requirement
  - Will constitute the minimum standard to be achieved
- Expected supervisors represented in the IAIS will propose for adoption in their respective jurisdictions
- Supervisors may
  - Adopt additional arrangements that set higher standards or higher levels of minimum capital.
  - Put in place supplementary measures of capital adequacy for the IAIGs in their jurisdiction

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ICS Construction: High level

- 3 main components of ICS (as for BCR):
  - Valuation basis
  - Qualifying capital resources
  - Measure of capital requirement
- ICS to be more risk sensitive than BCR
  - General principles for recognition of risk mitigation
  - Treatment of profit sharing and adjustable products
  - Explicit recognition of diversification
- ICS to take into account all risks within the group
  - First focus on insurance activities
  - Treatment of non-insurance activities in ICS will be addressed later

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Valuation

- Overall design of ICS - total balance sheet approach

- ICS Principles – complementary goals for valuation
  - Comparability (ICS Principles 1 and 5)
  - Promote prudentially sound behaviour while minimising inappropriate procyclical behaviour (ICS Principle 7)

- Two approaches currently tested
  - MAV: Market Adjusted Valuation (refinement from the BCR valuation); and
  - GAAP+: GAAP with adjustments

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ICS: Interim versions

- Version 1.0 (for confidential reporting)
  - By mid-2017
  - Two valuation approaches
  - A standard method
- Version 2.0 (for adoption with ComFrame)
  - By 2019
  - Achieve an improved level of comparability
  - May still include two valuations but with reduced differences
  - May allow both standard and other methods including the use of internal models and variations of the standard method
- After ICS Version 2.0 is adopted implementation period while jurisdictions embed the ICS into regulatory requirements and supervisory practices

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ICS standard method: Overall approach

- A Standard Method based on MAV was tested in 2015
  - Main goal was to test the design
  - Interim calibration involving supervisory judgement
  - Includes an aggregation of risks
- Design and calibration being refined in 2016
  - Design refined based on data analysis and feedback and suggestions from volunteers
  - Calibration refined based on improved methodology and available data
  - As design is firming up, and consistent calibration methodologies are being developed, specific data are being/will be collected collected to refine the calibration

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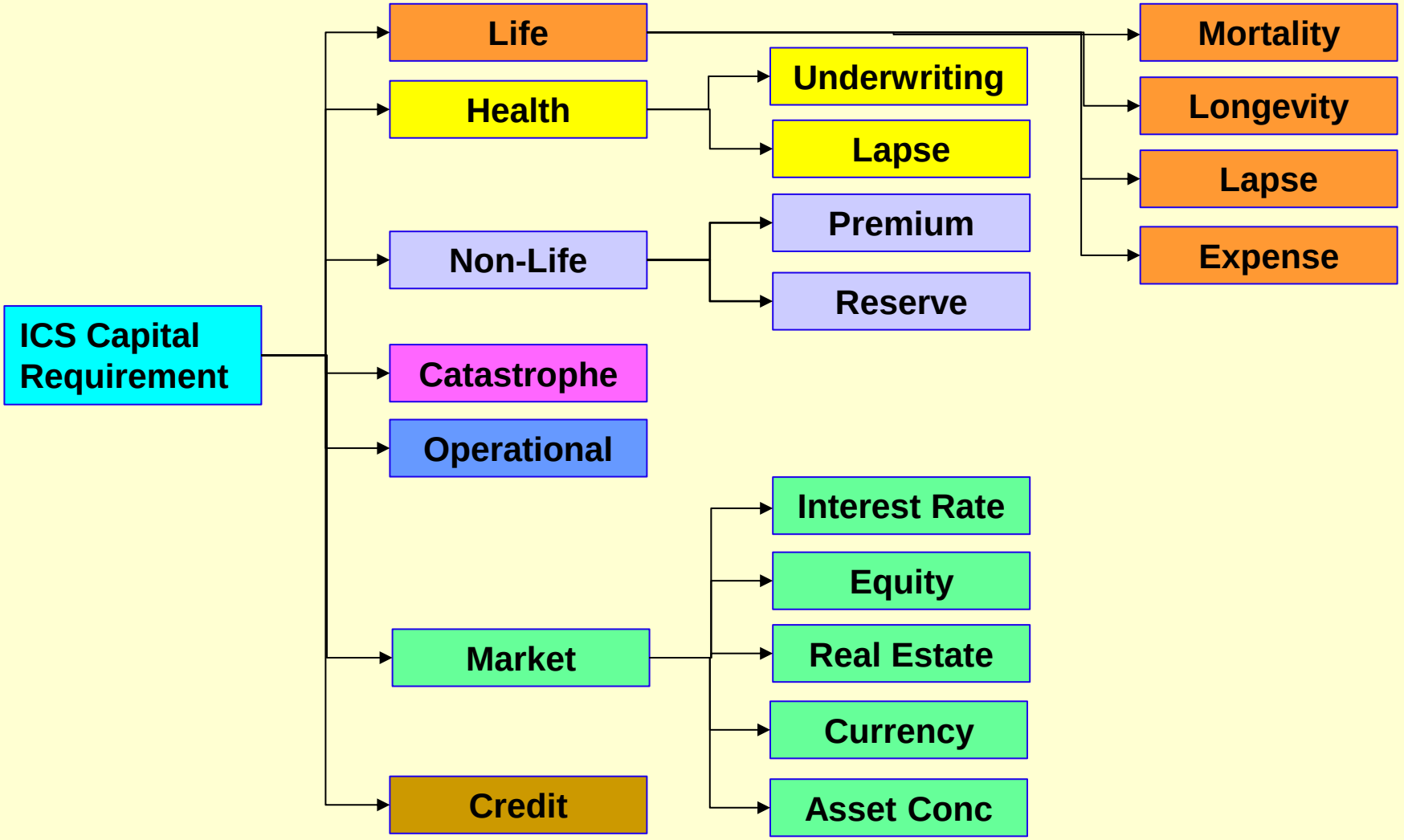
ICS standard method: Risks (MAV and GAAP+)



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ICS: Capital resources - overview

- Capital resources comprise both financial instruments and other capital elements (e.g. retained earnings, regulatory reserves, etc.)
- Qualifying capital resources are determined through an assessment of the nature, quality and suitability of all potential capital resources
- The assessment considers:
  - Subordination
  - Availability to absorb losses
  - Loss absorbing capacity
  - Permanence
  - Absence of encumbrances and mandatory servicing costs

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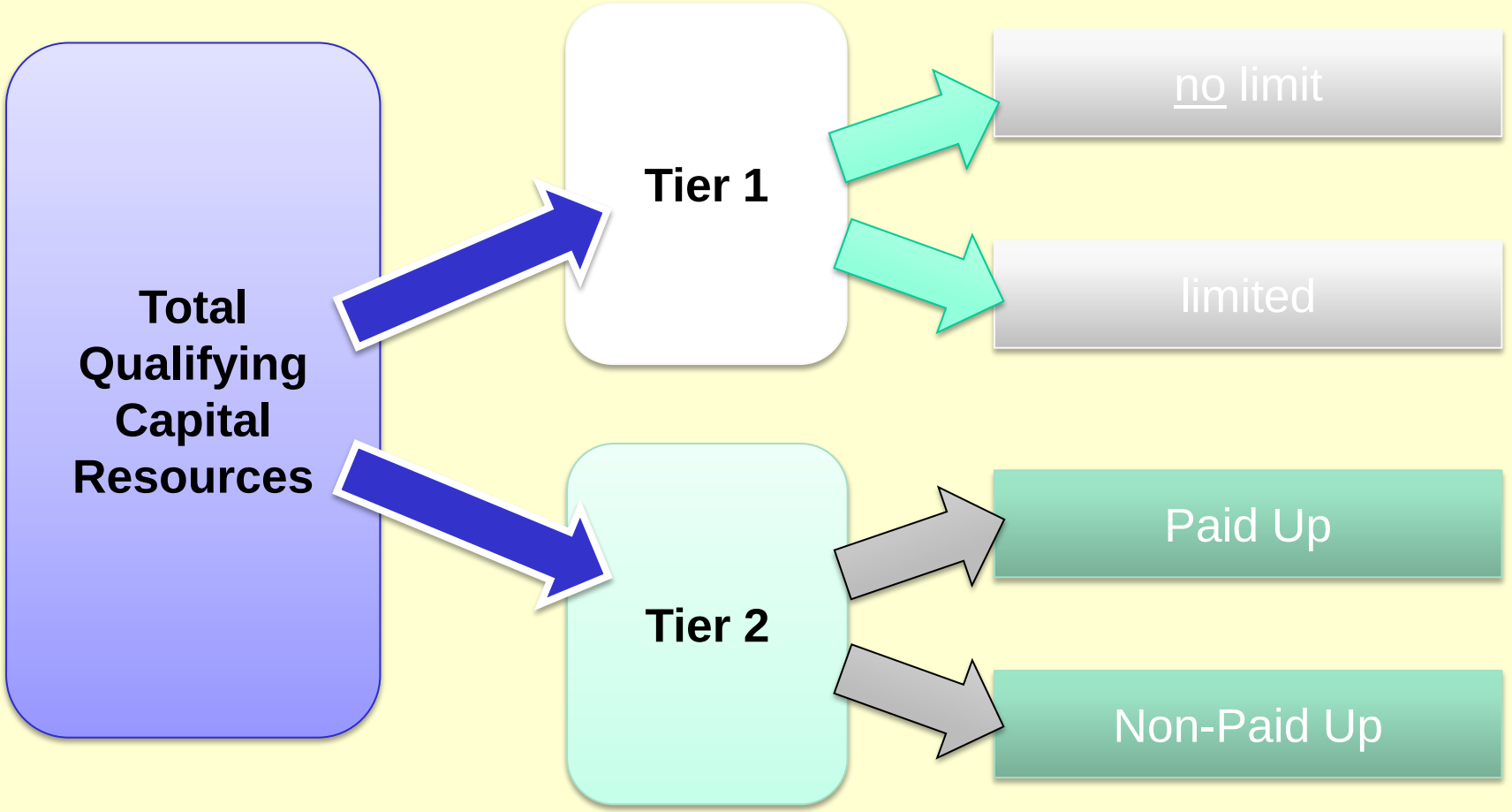
ICS: Capital resources

The tiering being considered:



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ICS: The challenge

- Developing global insurance capital standards is a complex matter, especially as time is at premium
- The goal is to develop a truly global insurance capital standard for internationally active insurers (IAIGs)
  - Striving to create something unique that works for different firms, markets and supervisors
- This does not mean 'lifting' any of the existing regulatory frameworks into the ICS (e.g. RBC, SST, S2 or APRA's), but leveraging the experience from developing those frameworks

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Thank you

IAIS Global Capital Standards:

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