

IAIS Consultations

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Q-Nr.	Reference Question
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Executive Summary

Q-1	General Comments
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1

Introduction

Q-2	General Comments
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Q-3	1	<p>The IAIS is participating in a global initiative, along with other standard setters, central banks and financial sector supervisors, and under the purview of the Financial Stability Board (FSB) and G20, to identify global systemically important financial institutions (G-SIFIs). The focus of IAIS analysis is in relation to potential Global Systemically Important Insurers (G-SIIs). To this end, the IAIS has developed a public consultation document "Global Systemically Important Insurers (G-SIIs): Proposed Assessment Methodology" , explaining the proposed assessment methodology to identify any insurers whose distress or disorderly failure, would cause significant disruption to the global financial system and economic activity. Any such insurers should be regarded as systemically important on a global basis.</p> <p>Comment: We, the Financial Regulatory Reform Task Force of the American Academy of Actuaries appreciate the work of the International Association of Insurance Supervisors (IAIS) to develop policy measures for G-SIIs. We concur with the stated goals and are in general agreement with the objectives and methods of implementing the policy measures. We offer these comments as suggestions to improve upon the work already completed. Generally, we are concerned with some of the examples given as non-traditional, non-insurance (NTNI) activities in the proposed assessment methodology for G-SIIs. The proposed policy measures for G-SIIs are differentiated for traditional insurance activities and NTNI activities. It is essential that NTNI activities be thoroughly vetted and agreed upon by the IAIS. To date, that has not occurred. Unless there are compelling reasons to the contrary, we recommend that activities that fall under the jurisdiction of a functional insurance regulator should not be considered NTNI activities. For instance, certain insurance coverages in the US, such as mortgage insurance and financial guarantee insurance, are required to use single purpose entities regulated by a functional insurance regulator. As such they are already subject to self-support and their own capital requirements. Additionally, risk-mitigating activities that take place within an insurance legal entity are already regulated by a functional insurance regulator. There should be no bifurcation of activities occurring within a regulated insurance entity into traditional and non-traditional activities.</p>
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Q-4	2	The IAIS has now also developed a proposed framework of policy measures for G-SIIs. The proposed framework is based upon the general framework published by the FSB with adjustments. As with the assessment methodology, these adjustments reflect the factors that make insurers, and the reasons why they might be systemically important, different to other financial institutions.
Q-5	3	At the Summit meeting in Seoul, November 2010, the G20 leaders endorsed the FSB's framework for reducing the moral hazard posed by systemically important financial institutions. The framework recommends several policies which should combine to: <ul style="list-style-type: none"> • Improve the authorities' ability to resolve SIFIs in an orderly manner without destabilising the financial system and exposing the taxpayer to the risk of loss, • Require higher loss absorbency for SIFIs to reflect the greater risks that these institutions pose to the global financial system, • Apply more intensive and co-ordinated supervision of SIFIs, • Strengthen core financial infrastructures, and • Provide other supplementary prudential and other requirements as determined by the national authorities.
Q-6	4	As discussed in the IAIS' report, Insurance and Financial Stability , the two most important factors for assessing the systemic importance of insurers are non-traditional insurance and non-insurance activities and interconnectedness. Non-traditional and non-insurance (NTNI) activities are important because, among other matters, the longer timeframe over which insurance liabilities can normally be managed may not be present, and interconnectedness is important because there can be strong connections between the insurance and banking sectors that can amplify the impact of stress events. Therefore, the policy measures need to address these causes of systemic importance. Comment: We reiterate our concern that the definition of NTNI activities has not been vetted. Wherever it is used in identifying G-SIIs and in applying policy measures, its rationale for being identified as non-traditional should be confirmed.
Q-7	5	The purpose of this consultation document is to seek views from supervisors, industry and the public on the proposed policy measures framework for G-SIIs.

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Overview

Q-8		General Comments
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2.1

The supervisory challenges in relation to G-SIIs

Q-9	6	G-SIIs are a risk to financial stability because their scope, the nature of their business and their position in the financial system is such that, if they fail, they may cause disruption to the rest of the financial system and the real economy.
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Q-10	7	G-SIIs are different to Global Systemically Important Banks (G-SIBs), in part because the traditional insurance business model is not inherently systemically important. Insurers vary widely from banks in their structures and activities and consequently in the nature and degree of risks they pose to the global financial system. The activities or variations on the traditional insurance business model that would make an insurer a G-SII can vary greatly from one insurer to another. This requires a policy response designed to address the specific nature and source of systemic importance and the different drivers of possible negative externalities.
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2.2

Objectives of G-SII policy measures

Q-11	8	<p>The proposed G-SII policy measures should reduce moral hazard and the negative externalities stemming from the potential disorderly failure posed by a G-SII. These policy measures should:</p> <ul style="list-style-type: none"> • Reduce the probability and impact of distress or failure of G-SIIs and thus reduce the expected systemic impacts which disorderly failure may cause. • Incentivise G-SIIs to become less systemically important, and give non-G-SIIs strong disincentives from becoming G-SIIs, and • Be linked to the drivers of the G-SII status of each individual insurer. <p>Comment: We recommend that any disincentives applied to G-SIIs be limited to those NTNI activities that give rise to systemic risks. Traditional insurance activities should not be disincentivized.</p>
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Q-12	9	<p>G-SIIs may be regarded as a safe haven by policyholders and institutional investors, either because of a perceived implicit state guarantee or maybe more so because the policy measures are understood to bring an additional level of security. Within the financial market place, this might have substantial distortional consequences. For example, the G-SII designation of insurers could result in giving G-SIIs access to lower funding costs. The financial strength rating assessment by credit rating agencies and the bespoke ratings assigned by investment banks and repo dealers today do not assume any implicit state guarantee for insurers. During implementation of the policy measures for G-SIIs, potential unintended consequences should be considered and avoided where possible.</p>
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The G-SII policy measures

Q-13	General Comments
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3.1

Overview

Q-15	10	<p>The IAIS proposes a framework of policy measures for G-SIIs in line with the FSB recommendations.</p> <ul style="list-style-type: none"> • Enhanced supervision: Enhanced supervision applies immediately to all G-SIIs to ensure that they rapidly achieve the higher standards of risk management their G-SII status demands. The Insurance Core Principles (ICPs), the common framework for supervision of internationally active insurance groups (ComFrame), and the FSB’s “Supervisory Intensity and Effectiveness” (SIE) recommendations would form the basis of the IAIS’s approach to enhanced supervision while special emphasis would be placed on group-wide supervision and liquidity planning, as described below. The authorities should also analyse activities that cause systemic importance of G-SIIs and take necessary measures to reduce that systemic importance. This includes development and implementation of a Systemic Risk Reduction Plan (SRRP) which could include measures such as separation of NTNI activities from traditional insurance business and/or restriction or prohibition of systemically important NTNI activities). • Increased resolvability: The FSB’s “Key Attributes for Effective Resolution Regimes” (Key Attributes) would be the basis for improved resolvability and would help reduce the impact of a G-SII failing. Under the Key Attributes, all G-SIIs will be required to produce recovery and resolution plans (RRPs) with their supervisor. The G-SII authorities will also be required to establish a crisis management group (CMG), conduct resolvability assessments and have cooperation agreements with other involved supervisors. • Higher loss absorption (HLA) capacity: This will entail the supervisor requiring the G-SII to hold more regulatory capital or to increase loss absorption capacity by other means. Higher capital will be targeted at those NTNI activities the G-SII undertakes which generate systemic risk if, and to the extent to which, the G-SII has demonstrated effective separation of NTNI activities from traditional insurance activities. It is noted that some national supervisory frameworks are expected to provide for capital surcharges that account for the systemic risk profile of an insurance group and these additional capital requirements would be taken into consideration in assessing whether the G-SII has an appropriate level of HLA capacity.
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Q-16	11	<p>When applying policy measures authorities should keep the following points in mind:</p> <ul style="list-style-type: none"> • Measures should be proportionate and should avoid unintended adverse consequences, where practicable; • Measures should be directed at the source of systemic importance and linked to the assessment methodology; and • Measures will often require strong cooperation among authorities, including authorities with responsibility for non-insurance entities within the insurance group.
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3.2

Enhanced supervision

Q-17	General Comments
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3.2.1

General description

Q-18	12	<p>Enhanced supervision of G-SIIs will generally mean, in line with the SIE recommendations, specifically tailored regulation, greater supervisory resources and bolder use of existing supervisory tools compared to the supervision of non-systemically important insurers. The enhanced supervision of G-SIIs should include a direct approach to consolidated group-wide supervision and should especially focus on the unique risk profile and possible risk concentrations of G-SIIs in order to lessen the probability and impact of failure. In doing so, involved supervisors should take into account the reasons for the systemic importance of the G-SII suggested by the results of G-SII assessment methodology.</p>
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Q-19	13	<p>The desired outcomes of enhanced supervision are:</p> <ul style="list-style-type: none"> • The supervisor determines a set of measures to reduce the risks posed by the G-SII and establishes timelines and indicators to adequately monitor the effectiveness of the measures. • There is a group-wide supervisory framework that applies to the group as a whole with a particular focus on its systemic risks and the need for cooperation among supervisors, including supervisors with responsibility for non-insurance entities within the insurance group. Obstacles that could hinder effective group-wide supervision are identified and removed. For G-SIIs, the supervisor has direct powers over holding companies to ensure that a direct approach to consolidated group-wide supervision can be applied. • The supervisor has clear visibility of internal control systems and risk management and solvency assessment procedures within the insurance group. This includes requiring the G-SII to have the ability to aggregate and identify risk exposures and concentrations quickly and accurately at the group-wide level, across business lines and legal entities, and to other firms. • The G-SII has internal controls and limits that are appropriate, investments and reinsurance arrangements that are appropriately diversified, increased disclosure and additional stress testing. • Enhanced supervisory co-ordination is achieved via supervisory colleges (cross-sector and cross-jurisdictions).
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Q-20	14	<p>The IAIS approach to enhanced supervision builds on:</p> <ul style="list-style-type: none"> • The IAIS ICPs, which are applicable to all insurers and will be the foundation for the G-SII policy measures. • The IAIS ComFrame, which will aim to foster global convergence of regulatory and supervisory measures and approaches for Internationally Active Insurance Groups (IAIGs), whether or not they are identified as G-SIIs, although ComFrame is not expected to directly focus on addressing systemic risk. • Special attention should be paid to group-wide supervision since G-SIIs are most likely to take the form of a group and NTNI activities are often carried out by separate entities within a group. • The FSB's recommendations for "Intensity and Effectiveness of SIFI Supervision", (SIE recommendations), especially in relation to: <ul style="list-style-type: none"> – Unambiguous mandates, independence and appropriate resources
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Mandates geared toward active early intervention can facilitate a culture where supervisors have the will to act early. The mandate should convey the point that the supervisory authority's risk view of a firm will always reflect a higher degree of conservatism and will therefore often be a source of conflict when viewed against the respective risk appetites of senior management, board and shareholders.

Reinforcing the operational independence and resources of supervisory agencies is critical to ensuring supervisory effectiveness and credibility in general. Supervisor independence is of particular importance as the mandates of agencies is broadened to include authority to take countercyclical actions such as imposing more conservative underwriting standards in boom times, or raising capital requirements, which may run contrary to public perceptions of risk and be politically unpopular.

– Full suite of supervisory powers

Since the crisis, the need for tools such as increased liquidity requirements, large exposure limits, imposing dividend cuts, requiring additional capital etc. have come to the forefront. Given that a full suite of powers is critical to a supervisor executing their role, the inventory of required tools should be updated. Supervisors need to ensure that the stress testing undertaken is comprehensive and commensurate with the risks and complexities of these institutions.

– Improved standards and methods

Increased focus on outcomes of governance and business processes and greater use of horizontal reviews are desirable. Supervisors need to evaluate whether their approach to and methods of supervision remain effective or have, for example, moved too far toward focusing on adequacy of capital and control systems, and away from detailed assessments of sources of profits and financial data.

Supervisory interactions with Boards and senior management should be stepped up, in terms of frequency, level of seniority, and assessment of their effectiveness. Consideration should be given to developing expanded guidance to supervisors on how to assess a board with the goal of being better armed with tools and techniques which enable better determination of board effectiveness. Supervisors should adopt proactive approaches to deal with succession planning and performance expectations for key positions within G-SIIs (e.g. CEOs, CROs, Internal Auditors), elements that should no longer be regarded as only internal matters for institutions.

– Stricter assessment regime

Supervisors should consider how their supervisory frameworks set internal control expectations (including risk management frameworks) for G-SIIs, and they should be confident that the assessment criteria for the control environment at G-SIIs set a "higher bar" for these firms to achieve in the areas of internal controls given the potential systemic impact that they pose. Supervisors should further explore ways to formally assess risk culture, particularly at G-SIIs. Establishing a strong risk culture at financial institutions is an essential element of good governance.

– Group-wide and consolidated supervision

Group-wide supervisory work can be impaired when supervisors do not have the legal right or ability to review the group entities including non-regulated entities (including parents and/or affiliates), yet those entities have the potential to pose risks to the regulated entity. Consolidated supervisory blind spots can be created when there are entities within the regulated firm that the consolidated supervisor does not have access to or influence over. In some cases this is caused by business lines that have a primary supervisor that is different from the primary supervisor of the consolidated entity. Competing mandates and approaches of these supervisors can fragment the overall supervisory effort.

– Risk aggregation

Supervisors should study their data needs and data processing capabilities in the context of the higher requirements for G-SII supervision. Where there are deficiencies in any or all of i) the type of data collected, ii) the authority's ability to process the data in a timely and fulsome way, or iii) their ability to collect ad-hoc data in a timely manner, these should be addressed as soon as possible.

Supervisors need to consider putting in place additional data management and analysis processes for the information available from a range of sources, such as that collected by trade repositories and other centralised sources of financial data, so that key players in markets and market anomalies are identified.

Comment: These appear to be desirable approaches of an enhanced supervisory framework. The policy measures should be principle-based with stated objectives to ensure consistent implementation by different jurisdictions. We also suggest that some of the items here may not be appropriate, or appropriate in all circumstances. For instance, some enhanced regulatory powers may be appropriate as part of an escalation process for G-SIIs rather than in all cases. Also, the framework describes a higher level of involvement by the supervisor in company operations. While heightened supervision of G-SIIs is appropriate, it should not change the fundamental roles and responsibilities of regulators and company management, respectively.

3.2.2

Enhanced liquidity planning and management

Q-21

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The supervisor should require the G-SII to have adequate arrangements in place to manage liquidity risk for the whole group, primarily in relation to NTNI activities and key channels of interconnectedness and secondarily also for the remainder of the group. These arrangements should include written strategies and policies for liquidity risk management during normal and stressed conditions subject to clearly documented governance requirements. Adjustments for expected behaviour of market participants and customers during stressed conditions (especially in relation to acceleration of liabilities) should be considered. Liquidity risk management policies should include all relevant issues. Relevant issues may include: the basis for managing liquidity (for example, regional or central); the degree of concentrations, potentially affecting liquidity risk, that are acceptable to the firm; a policy for managing the liability side of liquidity risk and potential effects of downgrades on rating triggers; the role of marketable, or otherwise realisable, assets; ways of managing both the firm's aggregate foreign currency liquidity needs and its needs in each individual currency; ways of managing market access; the use of derivatives to minimise liquidity risk (including potential for collateral calls and margin calls); and, if NTNI activities exist, the management of intra-day liquidity.

Comment: Liquidity plans should be required of G-SIIs for those activities that give rise to systemic risks. Liquidity plans should take into account restrictions on transfers between entities, whether separated to comply with SRRPs or with local jurisdictions. Risks stemming from traditional insurance activities should be outside the scope of this requirement.

3.2.3

Structural measures and the Systemic Risk Reduction Plan (SRRP)

Q-22

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The authorities should analyse activities that cause systemic importance of G-SIIs and take necessary measures to reduce that systemic importance. The authorities should select the most effective policy measures to achieve this goal. The authorities should oversee the development of a SRRP by each G-SII (in addition to the recovery and resolution plans (RRPs)) to reduce that systemic importance and monitor implementation of the plan. Where feasible and appropriate, the SRRP may include effective separation (so as to achieve self-sufficiency) of systemically important NTNI activities from traditional insurance business (in combination with targeted HLA) and/or restrictions or prohibitions of specified systemically important activities or any other measures.

Comment: We concur that it is desirable to separate or otherwise mitigate NTNI activities that give rise to systemic risks from those that do not and should be self-sufficient.

3.2.4

Separation of non-traditional and non-insurance (NTNI) activities

Q-23

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Separation of NTNI activities is an ex-ante policy measure aiming for greater transparency, self-sufficiency and resolvability of G-SIIs by targeting the structure of G-SIIs. The desired outcomes of implementing this measure are:

- Traditional insurance business is more strongly shielded from NTNI business and vice versa. The qualities and resilience of traditional insurance business can be largely preserved, even in G-SIIs with less traditional operations.
- The resolvability of G-SIIs is structurally improved ex-ante, unlike RRP which are conceived ex-ante but executed ex-post. The resolvability of traditional insurance business can be largely preserved, even in G-SIIs with less traditional operations, and the resolvability of NTNI business is addressed. (see 3.3 Effective Resolution)
- (In combination with targeted HLA) the expected impact of the distress or failure of the NTNI entities is reduced to non-systemic level.

Q-24	18	<p>The aforementioned outcomes are supported by the following combination of specific measures:</p> <ul style="list-style-type: none"> • NTNI business is conducted in separate legal entities that are structurally and financially self-sufficient <p>– Structural self-sufficiency means that it should be possible to ring-fence (and liquidate) self-sufficient legal entities without impacting the remaining legal entities of a group. As well as legal entity separation, it requires that problematic NTNI intra-group transactions such as guarantees (especially any unlimited guarantees, upward and peer guarantees and intra-group transactions aimed at capital gearing) as well as cross-default clauses are prohibited or at a minimum adequately monitored and restricted.</p> <p>– Financial self-sufficiency requires economically adequate capitalisation of legal entities that account for their systemic importance and hence of the G-SII; avoiding certain structures designed to allow for undercapitalisation and subsidies of selected legal entities.</p> <ul style="list-style-type: none"> • Subsidies in the form of capital and/or funding to the benefit of NTNI entities should not be allowed • Self-sufficiency in terms of structure and financial condition is to be monitored and verified by the authorities during the process of implementation of the SRRP.
Q-25	19	<p>Company structures exist in such a variety of forms that it is impossible to capture the structural measures in a set of all-encompassing rules. The structure of G-SIIs becomes more transparent and hence tractable with their businesses separated according to the business segments proposed in Insurance and Financial Stability. This allows supervisors to target their supervisory actions and measures more effectively and efficiently to the nature and risks of the respective business segments. In terms of tractability and transparency, the organisational structure of G-SIIs would be simpler to understand if different types of activities and businesses were compartmentalised. The financial statements would also be simpler to understand if segment reporting is aligned accordingly.</p>
Q-26	20	<p>The authorities should avoid the creation by the G-SII of non-regulated entities through the separation of NTNI activities. Any entities used to separate NTNI activities should be effectively regulated under direct consolidated group-wide supervision including coordination with other involved supervisors, as discussed above.</p>

3.2.5

Restrictions and prohibitions

Q-27	21	<p>The supervisor could choose to apply restrictions and prohibitions with the following goals in mind:</p> <ul style="list-style-type: none"> • to reduce the probability and impact of failure resulting from systemically important activities within G-SIIs; • to eliminate or limit systemically important activities based on the nature of the activity; and • to discourage such activities and thereby encourage G-SIIs to reduce or eliminate their systemically important activities and discourage other insurers from undertaking potentially systemically important activities. <p>Comment: Some jurisdictions require local insurance entities to be separate from the group and self-supporting, in the same manner contemplated herein for NTNI activities. To the extent that such a requirement exists, systemic risk is reduced, and there should not be an HLA requirement.</p>
Q-28	22	<p>Restrictions and prohibitions are most effectively applied to NTNI and interconnectedness activities and could be applied on a stand-alone basis or in combination with other policy measures. Restrictions and prohibitions could be targeted to specific legal entities within the G-SII or they could be tailored to specific systemic NTNI activities or those activities that make a company more interconnected.</p>

Q-29	23	<p>Restrictions and prohibitions cover a broad range of options that include both direct prohibitions, limitations and restrictions on activities as well as measures that provide strong disincentives and/or internalise the costs for engaging in systemically important activities. These include:</p> <ul style="list-style-type: none"> • Direct prohibition or limitation of the systemically important activity; • Requirements for prior approval of transactions that fund or support systemically important activities; • Requirements for spreading or dispersing risks relating to systemically important activities. • Limiting or restricting diversification benefits between traditional insurance business and other businesses. This measure improves the overall capital position and hence provides HLA capacity. In practical terms, it could either be applied at ultimate parent level or at the NTNI sub-holding or entity level
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Q-30	24	<p>Given the premise that insurers are not likely to inherently generate systemic risk other than through NTNI and interconnectedness, prohibitions or strict limitations of an activity can be applied to G-SIIs where the goal is to eliminate the activity or severely curtail the risky activity. When a systemically important activity is conducted by a non-insurance entity within a group and joint banking and insurance make it more desirable to contain the risk rather than remove the activity, restriction may play a lesser role when compared with structural measures (e.g. segregation or separation) and HLA capacity.</p>
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Effective Resolution

Q-31	General Comments	
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Q-32	25	<p>The desired outcomes of effective resolution are:</p> <ul style="list-style-type: none"> • to ensure the resolution of G-SIIs can take place without severe systemic disruption and without exposing taxpayers to loss, • to protect vital economic functions through mechanisms which make it possible for shareholders and unsecured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation, • to ensure that policyholder protection arrangements remain as effective as possible, • to avoid unnecessary destruction of value and ensure that non-viable G-SIIs can exit the market in an orderly way, and • to identify and remove impediments to smooth resolution.
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3.3.1

Resolution regimes and tools for G-SIIs

Q-33	26	<p>In 2011, the FSB published an international standard for resolution – “Key Attributes of Effective Resolution Regimes for Financial Institutions” (Key Attributes) . This standard sets out a range of specific requirements for institutions that should apply at a minimum to all G-SIFIs including G-SIIs. They include (i) the establishment of Crisis Management Groups (CMGs); (ii) the elaboration of recovery and resolution plans (RRPs); (iii) the conduct of resolvability assessments; and (iv) the adoption of institution-specific cross-border cooperation agreements.</p> <p>Comment: We are concerned that the time and effort involved in preparing and continually updating an RRP is not worth the benefit for a well managed, well capitalized G-SII. In a time of crisis a plan is unlikely to be applicable to the circumstances giving rise to the crisis. The development of an RRP might instead be included as part of an escalation process.</p>
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Q-34	27	<p>To carry out an effective resolution, authorities need to have at their disposal a broad range of tools that enable them to intervene safely and quickly to protect policyholders and avoid destabilisation of financial markets. At present, many IAIS jurisdictions have a fourfold power in connection with the trigger points of a recovery system to require a solvency plan if the “prescribed capital requirement” (PCR) is breached, a financing plan if the “minimum capital requirement” (MCR) is breached, a recovery plan if the asset/liability ratio is breached and a liquidation plan if both the asset/liability ratio and the MCR are breached. These powers should be considered for RRP of G-SIIs when they are in good health. The FSB Key Attributes should serve as a point of reference for the reform of national resolution regimes, setting out the responsibilities, instruments and powers that all</p>
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national resolution regimes should have to enable authorities to resolve failing G-SIIs in an orderly manner and without exposing the taxpayer to the risk of loss.

Comment: It is not practical to elaborate on an RRP for a G-SII in good health. Rather, the focus should be on the establishment of clear communication plans and agreed-upon roles of involved regulators and constituencies in the case of a crisis. Such a plan would also need to provide for suitable protections from arbitrary actions (i.e., reasonable due process protections in a crisis situation).

Q-35	28	It needs to be further examined whether a mainly traditional insurance group with a large derivatives portfolio may experience a disorderly run-off and, if so, whether there needs to be adjustments to the methodology or policy measures as a result.
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Q-36	29	Authorities will consider and take all necessary actions to ensure effective resolution including removing obstacles to the separability of non-traditional and non-insurance (NTNI) activities from traditional insurance activities during a stressed event. The resolvability assessment will include assessing whether, and the extent to which, effective ex ante separation of activities is in place. (See 3.2.3 Structural measures and the SRRP).
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Q-37	30	The FSB Key Attributes provide guidance to assist authorities in implementing the requirements for G-SIFIs. The IAIS concurs that these requirements are also relevant for G-SIIs, although insurance specificities need to be taken into account in implementing them. The FSB is currently developing an assessment methodology which should be used for assessments by the IMF and World Bank of national resolution regimes for financial institutions. The IAIS considers that the methodology should contain insurance-specific elements and hence is working closely with the FSB to ensure that the methodology addresses insurance specificities. Where necessary, the IAIS will explore with its members the need to develop further guidance for inclusion in the assessment methodology. Insurance specificities which need to be taken into account, include:
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- Plans and steps for separating NTNI activities from traditional insurance activities,
- The possible use of portfolio transfers and run off arrangements as part of the resolution of entities conducting traditional insurance activities, and
- The existence of policyholder protection and guarantee schemes (or similar arrangements) in many jurisdictions.

Comment: As noted, there exists policyholder protection and guarantee schemes in many jurisdictions. These will include their own definition of what policies are covered and what are NTNI. Deference should be given to effective schemes in order to ensure their ongoing viability.

Q-38	31	The IAIS will also consider whether to develop a template for assessing resolvability of G-SIIs. This template could assist authorities in identifying structural measures that would better prepare G-SIIs for resolution if the G-SII needs to be resolved. The issues discussed under the previous section 3.2.3.1 on separation should also be considered in this context.
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3.4

Higher Loss Absorption (HLA) capacity

Q-39	General Comments
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3.4.1

General description and purpose

Q-40	32	All G-SIIs should have higher loss absorption (HLA) capacity to reflect the greater risks that G-SIFIs pose to the global financial system. The desired outcomes of HLA capacity, all of which work to reduce the probability or failure of distress and thus expected impact, include: <ul style="list-style-type: none">• The G-SII is more resilient to low probability but high impact events.• Supervisors intervene earlier than they would for non-G-SIIs giving them more time to address emerging risks to the soundness of the G-SII.• Any implicit or explicit funding subsidy linked to G-SII status is offset.
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Q-41	33	HLA can be applied as an instrument at the group level or as a targeted instrument at the legal entity level if, and to the extent to which, the G-SII has demonstrated effective separation of NTNI activities from traditional insurance activities. Comment: Any HLA should be targeted to the NTNI activities that give rise to systemic risk. Traditional insurance activities should not be subject to HLA requirements. Further, the HLA requirement should take into account risk mitigation activities that would reduce the systemic risk, perhaps to levels that would drop the entity from a G-SII designation.
Q-42	34	The application of HLA to G-SIIs is complicated by the fact that there is no global solvency standard for insurers. By requiring group-wide HLA, it might further aggravate differences between jurisdictions which might result in further regulatory arbitrage possibilities. Furthermore, the international differences in accounting and regulatory requirements would need to be considered when deciding the basis for any calculations, with IFRS, US GAAP or Japan GAAP with bridges to IFRS as the basis.
Q-43	35	Mandating a higher loss absorption capacity for a G-SII will help to reduce its probability of failure. This is important given the greater risks that the failure of G-SIIs poses to the global financial system. The IAIS proposes that the following cascading approach to achieve HLA capacity should apply. This is in line with the principle for HLA is to be targeted, where possible, at activities that have the potential to generate or aggravate systemic risk. <ul style="list-style-type: none"> • Step 1 – if, and to the extent to which, the G-SII has demonstrated effective separation (so as to achieve self-sufficiency) of NTNI activities from traditional insurance activities, targeted HLA will be applied to the separate entities conducting NTNI activities. • Step 2 – whether or not NTNI activities have been separated, an overall assessment of the HLA needed at the group level is required. In the case where Step 1 has been applied, this should take into account the HLA in the separate entities and the fact that separation exists, but only where that HLA was not created by multiple-gearing through down streaming capital within the G-SII. The group-wide supervisor determines (in consultation with involved supervisors) whether the HLA capacity held at the NTNI entities is sufficient or needs to be further increased at the group level. • As an alternative to Step 2, there is on-going discussion within the IAIS on whether there is a need for group-wide HLA if targeted HLA, and other measures (such as restrictions and prohibitions), are effective in reducing the level of systemic importance to an acceptable level.
Q-44	36	The HLA assessment will take into account any capital charges imposed to mitigate the systemic risk of an insurer that are in place under national legislation.
Q-45	37	The structural measures required to achieve self-sufficiency are discussed in the previous section 3.2.3.1 on separation.

3.4.2

Methodology for applying group HLA capacity

Q-46	38	There is currently no global solvency standard for insurance groups upon which to build HLA capacity requirements to apply consistently across jurisdictions. Nevertheless, the IAIS has decided in November 2011 that the capital component of the solvency assessment in ComFrame should have, among other items, a partly harmonised set of standards and parameters that sets out a narrow range of target criteria and time horizons for measurement purposes.
Q-47	39	Currently, ICPs 17.3, 17.4 and 17.5 describe the concept of solvency control levels which could be used as the basis for applying HLA capacity. These ICPs specify a “prescribed capital requirement” (PCR), above which level the supervisor does not intervene on capital adequacy grounds. The PCR should be set such that, in adversity, an insurer’s obligations to policyholders will continue to be met as they fall due, that is, at a level such that the insurer is able to absorb the losses from adverse events that may occur over a defined period while technical provisions remain covered. HLA capacity would essentially be setting a higher PCR that accounts for the fact that the failure or distress of a G-SII is associated with negative externalities towards the global financial system and the

economy, not just the policyholders and other direct stakeholders of the G-SII.
Comment: Above some level of HLA, other policy measures may be unnecessary.

Q-48	40	HLA capacity could be applied to the current national/regional solvency regime, as an HLA uplift to the closest conceptual equivalent to the PCR that is required under each country's regulation. This approach should fit with most solvency regimes provided there is an equivalent of a PCR. Because it would be an add-on to the existing baseline solvency requirements in each jurisdiction, the large part of the overall solvency requirement should still be risk sensitive (to the extent that the existing regime is risk sensitive). This approach would also not impede the convergence of solvency standards over time.
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Step 1 – Targeted HLA capacity

Q-49	41	If, and to the extent to which, the G-SII has demonstrated effective separation (so as to achieve self-sufficiency in terms of structure and financial condition) of NTNI activities from traditional insurance activities, targeted HLA will be applied to the separate entities conducting NTNI activities. Thus it sits where it is most needed in situations of stress. Targeted HLA capacity establishes an additional capital buffer and also makes it more expensive to carry out systemic activities. It is specifically aimed at the systemic NTNI business of insurers and is a disincentive as G-SIIs would require more capital.
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Q-50	42	Targeted HLA could directly affect the activities that pose systemic risk within the insurance business and also provides incentives to undertake any activities that pose systemic risk to a lesser extent.
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Q-51	43	For any banking or bank-like activities, whether carried out in a bank subsidiary or a non-insurance financial entity, the targeted HLA capacity could be set according to Basel III rules (eg HLA of at least 1% of risk-weighted assets). Where Basel III can be used, it should be carefully designed to avoid regulatory arbitrage by applying the same rule to the same activity. Moreover, the same standards should apply to the same business in different jurisdictions to ensure a level playing field.
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Q-52	44	For other NTNI activities, the supervisor would need to determine suitable rules based on the nature of the activities and the principles in the ICPs and other relevant regulatory frameworks. The IAIS will provide guidance for supervisors as part of the proposed concrete policy measures on HLA, by the end of 2013.
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Step 2 – Group-wide HLA capacity

Q-53	45	Under Step 2, an overall assessment of the HLA needed at the group level is required. In the case where Step 1 has been applied, this should take into account the HLA in the separate entities and the fact that separation exists, but only where that HLA was not created by multiple-gearing through down streaming capital within the G-SII. Possible add-ons should also be considered. Ideally, the level of group-wide HLA capacity should reduce the expected impact of a G-SII failing to an agreed benchmark. One way to set the appropriate level of group-wide HLA capacity would be so that the probability of failure is reduced to the point that the expected impact of a G-SII failing equals the expected impact of other similar insurance groups that are not G-SIIs failing. This approach is not considered feasible in the short term, as there is not sufficient data available to make a proper assessment.
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Application of the HLA uplift

Q-54	46	Deciding a basis to calculate the HLA uplift is complicated by different solvency regimes and accounting requirements across jurisdictions. Two options on which the HLA uplift could be based are to use a capital measure or a balance sheet measure:
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i) Capital measure based on existing local solvency regimes

The capital measure could be the nearest equivalent solvency standard to the PCR and the HLA uplift would be a percentage of the PCR (possibly in the range of 10% to 30%).

Advantages:

- Simple to handle.
- Consistent with the concept of PCR which is the baseline of HLA uplift.

Disadvantages:

- As the baseline of group-wide HLA capacity is different, distortions could occur, depending on what business is being taken into account under local regimes and whether the major part of the business lies in jurisdictions with higher or lower regulatory capital requirements.
- Aggregation of local regimes may not create a sufficient capital measure or, conversely, may provide an excessive capital measure.
- Most local regimes will have little or no regard for specific treatment of NTNI activities.

ii) Total balance sheet (including off-balance sheet positions)

The balance sheet measure could be based on the total balance sheet (excluding capital but including off balance sheet items) and the HLA uplift would be a percentage of that amount (possibly in the range of 0.5% to 1.5%). It should be considered whether and how to deduct insurance assets and insurance liabilities in an appropriate manner in order to dis-incentivise reductions in insurance technical reserves and related assets.

Advantages:

- More global approach
- Improves comparability between G-SIIs provided IFRS, US GAAP or Japan GAAP with bridges to IFRS are used as a basis
- Independent from the levels of regulatory capital, and hence may provide more consistency between jurisdictions than the previous approach.

Disadvantages:

- Not as precise as a fully-fledged economic capital regime.
- Not risk-sensitive, and could be inconsistent with an insurer's risk management framework.
- Accounting differences across jurisdictions in the calculation of insurance liabilities mean this approach could also yield considerable inconsistency of HLA uplift.
- This approach penalises insurers with healthier balance sheets within jurisdictions, including those insurers that maintain more conservative technical provisions.
- It is technically difficult to define off-balance sheet items.

3.4.3

Acceptable instruments

Q-55	47	<p>Currently, there is no common global definition of capital in the insurance sector. The ICP 17.11.34 provides an example of broad categorisation of capital as follows.</p> <p>a. Highest quality capital: permanent capital that is fully available to cover losses of the insurer at all times on a going-concern and a wind-up basis;</p> <p>b. Medium quality capital: capital that lacks some of the characteristics of highest quality capital, but which provides a degree of loss absorption during on-going operations and is subordinated to the rights (and reasonable expectations) of policyholders;</p> <p>c. Lowest quality capital: capital that provides loss absorption in insolvency/ winding-up only.</p>
Q-56	48	<p>The FSB report , endorsed at the G20 Seoul Summit in November 2010, states that G-SIFIs should have greater loss absorption capacity whereby a higher share of their balance sheets is funded by capital and/or by other instruments which increase the resilience of the institution as a going concern.</p>
Q-57	49	<p>In line with the FSB recommendation, given the going-concern objective of the HLA capacity requirement, the HLA capacity should be met by the highest quality capital as defined in the above-mentioned ICP 17.11.34. Instruments comprising the highest quality capital – that is permanent capital that is fully available to cover losses of the insurer at all times on a going-concern basis – are the appropriate instruments to meet a HLA capacity requirement for the time being.</p>

Q-58	50	The supervisor should judge whether an instrument which exists in its jurisdiction constitutes the highest quality of capital or not. It should also be noted that the IAIS has decided that a common definition of capital resources is to be established by 2013.
Q-59	51	Attention should be paid to the fact that the additional capital should sit in the place where it is most needed (e.g. in separate NTNI businesses). Otherwise, particularly if sitting in non-regulated entities (e.g. holding companies), issues relating to supervisory powers as well as transfer impediments might arise.

3.4.4

Refining the HLA capacity requirement

Q-60	52	The IAIS will elaborate the above-mentioned HLA capacity measure and develop a concrete proposal by the end of 2013 taking into account that a sufficient transitional period of the introduction of this measure has been proposed as implementation is scheduled to begin from 2019 (see section 4). Comment: We look forward to this proposal and to the opportunity to offer helpful commentary.
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Implementation

Q-61	General Comments
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4.1

Implementation timeframe

Q-62	53	The starting point for the implementation of G-SII policy measures is the public determination by the FSB and national supervisory authorities that a particular insurer is found to be a G-SII. For each G-SII, the group-wide supervisor would contact the G-SII to commence the process of implementing required policy measures. The key dates and timeframes are expected to be:	
		Key Implementation Dates and Timeframes	Action required (or intermediate activity)
		April 2013	First G-SIIs designated (with annual designations thereafter expected each November)
		From 2013	Implementation of enhanced supervision and effective resolution commences
		End 2013	IAIS to elaborate proposed HLA capacity measures
		Within 12 months of designation	Crisis Management Groups (CMGs) to be established
		Within 18 months of designation	Other resolution measures to be completed
		Within 18 months of designation	Systemic Risk Reduction Plan (SRRP) to be completed
		Within 36 months of designation	Implementation of SRRP to be assessed
		November 2014 to 2016	G-SIIs designated annually (with HLA not applicable until 2019)
		November 2017	G-SIIs designated based on 2016 data (with HLA applicable from 2019)
		January 2019	HLA capacity requirements apply based on assessment of implementation of the structural measures

Q-63	54	Discussions with the G-SII would focus first on the particular drivers of G-SII status. The authority would immediately begin to implement measures with regards to enhanced supervision (including development of the SRRP) and effective resolution. The SRRP and resolution measures should be completed within 18 months after G-SII designation. The implementation of the SRRP should be assessed by the authorities 3 years after G-SII designation. Implementation of the SRRP is a prerequisite for application of the targeted HLA capacity requirements.
Q-64	55	Regarding the proposed policy measures on HLA, the IAIS will elaborate and develop a concrete plan by the end of 2013.
Q-65	56	The HLA capacity requirements will apply from 2019 for those G-SIIs designated in 2017 and will be based on the status of implementation of the SRRP in 2017. The list of designated G-SIIs will be updated every year. After the first designation in 2017, a newly designated G-SII will be allowed to have the same period to meet the HLA capacity requirement.
Q-66	57	The IAIS expects national authorities to prepare a framework in which insurers will be able to provide high quality data for the indicators. To ensure the transparency of the methodology (for the benefit of market participants and to promote market discipline) and the efficient identification of G-SIIs, the IAIS expects all participating insurers to disclose relevant data when the G-SII policy is implemented and the IAIS will provide reporting guidance.
Q-67	58	Implementation of G-SII policy measures should be monitored by an IAIS peer review process in order to ensure international consistency.