September 20, 2023

Dr. Victoria Saporta
Chair, Executive Committee
Mr. Jonathan Dixon
Secretary General
International Association of Insurance Supervisors (IAIS)
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: Insurance Capital Standard as a Prescribed Capital Requirement Public Consultation Document and Consultation on ICP 14 (Valuation) and ICP 17 (Capital Adequacy)

Dear Dr. Saporta and Mr. Dixon:

The Institute of International Finance (IIF) and its insurance members appreciate the opportunity to respond to the IAIS's consultation on the candidate Insurance Capital Standard (ICS) as a Prescribed Capital Requirement (PCR) (the ICS Consultation) and the related Consultations on ICP 14 (Valuation) and ICP 17 (Capital Adequacy) (the ICP Consultations) (collectively, the Prudential Capital Consultations). The IIF has several key observations on the Prudential Capital Consultations, which we hope you will find helpful.

The lengthy and resource-intensive process of developing the ICS and the related ICPs has been valuable in terms of extensive dialogue among IAIS supervisors on the fundamental components of a framework for insurance prudential capital that assesses the capital adequacy and capital resources of an insurance group and regulatory frameworks in general. Supervisory discussions and information sharing have resulted in the adoption of new local capital frameworks and/or group capital standards in several jurisdictions. The engagement has also promoted the understanding of different jurisdictional approaches to insurance prudential capital frameworks and has allowed for the evolution of a 'common language' that describes key elements that should be reflected in a prudential capital framework and that can serve as the basis for cross-jurisdictional dialogue (e.g. through the Supervisory College process).

Focusing specifically on the ICS, it is important to acknowledge that a single global capital standard based on a uniform methodology is aspirational and not necessary to promote sound group supervision, given both the international and jurisdictional progress in enhancing prudential oversight. Individual jurisdictions have and will continue to develop their own approaches to capital, for both groups and solo insurers, that meet the needs of their markets. For these reasons, we believe a more principles-based approach must be taken towards the ICS, which we further detail below. We appreciate the IAIS's inclusion of stakeholders in a number of these discussions, as well as through the consultative process.

Our comments on the Prudential Capital Consultations focus first on some overarching considerations that we believe should be reflected in a principles-based approach to developing the key components of a framework for prudential capital. We then discuss some specific issues that relate to the ICS Consultation.

Overarching Comments

The Insurance Core Principles (ICPs) are the appropriate vehicle for adopting the needed flexible, principles-based approach to assessing the adequacy of insurance prudential capital and capital resources and identifying the key elements of an insurance prudential capital framework. We applaud the IAIS's flexible and non-prescriptive principles-based approach to assessing capital adequacy and resources that is reflected in ICP 14 and ICP 17. The ICPs should be the vehicle for providing high-level principles that reflect the key elements to be considered for regulatory frameworks to assess the quality and quantity of capital resources available to meet those levels, in light of the goals of policyholder protection and financial stability. The candidate ICS or any successor version of the ICS should serve solely as a theoretical example of a prudential capital framework that is closely aligned to the high-level principles of ICPs 14 and 17.

Identifying the ICPs as the vehicle for providing the key elements of an insurance prudential capital framework reflects the reality that a true single global insurance capital standard is both unwarranted and unlikely to come to fruition at this point in time, given that it is recognized that the ICS will be implemented through a range of jurisdictional approaches that reflect market and jurisdictional specificities. As noted above, the work on the ICS has led to several jurisdictions developing or enhancing local frameworks. Given the multiplicity of jurisdictional approaches, the detailed and prescriptive candidate ICS cannot function as a minimum standard. However, in its policy development and testing, the candidate ICS has provided a useful benchmark to promote cross-jurisdictional understanding and a level of comfort in various jurisdictional approaches. Looking ahead, the candidate ICS might serve as a theoretical example of a prudential capital framework that is closely aligned to ICPs 14 and 17.

The same high-level principles should be applied to all insurers and insurance groups, and dual reporting standards and requirements should be avoided. Applying the same high-level principles across companies, insurance groups, and jurisdictions is in keeping with the important and fundamental principle of 'same activity, same risk, same treatment,' which minimizes the risk of inefficiencies in risk management and competitive distortions. In contrast, applying different prescriptive standards and rules could create different constraints on an insurer's and a group's ability to conduct the same activity. Applying consistent, high-level principles also avoids undue complexity that may make it difficult for the insurer's board, senior management, supervisors and stakeholders to fully understand the risk profile of a particular company or group (or the sector as a whole) or to make rational decisions in light of the company's or group's risk profile and risk appetite.

The application of the same high-level principles across an insurance group should not lead to dual standards or reporting requirements at the group and legal entity levels. The adoption of a principles-based approach should obviate the need for dual standards or any reporting based on the ICS, as the ICS would serve only as a theoretical example of one possible framework for assessing prudential capital adequacy and resources, rather than as a 'one size fits all' prescriptive framework.

We encourage the IAIS to address IIF members' concerns with respect to the governance of the ICS.

The IAIS has an important role to play in setting high-level supervisory standards for the insurance sector that can be implemented in individual IAIS member jurisdictions. Notably, in most IAIS member jurisdictions, the authority and mandate to develop capital and other prudential standards do not reside with the supervisory authorities. Rather, decisions are taken through political and legislative processes in order to better ensure a framework design and calibration that is fit for purpose in the jurisdiction, taking into consideration the broader context of the local economy and markets. The decisions that result from these political and legislative processes are then implemented through regulatory and supervisory actions that are often subject to public review and opportunity to comment.

The intention of the IAIS to allow the IAIS Executive Committee to revise Level 2 text on a relatively frequent basis (see Section 2.1 of the ICS Consultation) is inconsistent with the IAIS's role as a high-level supervisory standard setter. The expanded ability to revise the Level 2 text could have the effect of modifying the overarching principles and concepts of the ICS set out in Level 1 text. The exercise of this authority would likely exacerbate the difficulties of implementing an increasingly stringent and granular standard that may not be fit for purpose in many jurisdictions.

The IAIS should explicitly acknowledge that the ICS will be implemented through a range of approaches. The design and calibration of the ICS should not be prescriptive and should reflect the reality that the ICS will be implemented through a range of jurisdictional approaches. In the publication of any final standard, it is important for the IAIS to acknowledge that the ICS will be implemented differently across insurance markets, including through the local adoption of the aggregation method given the IAIS's commitment to assess the AM as an alternative implementation of the ICS. While this is mentioned in Section 11.4 of the ICS Consultation in the context of the impact assessment, it needs to be expressed in Section 2 of the document, which discusses the development and implementation of the ICS.

Multiple jurisdictions have developed or are developing their own appropriate approaches to insurance capital frameworks, including for group supervision. Part of the nature of the development of any prudential standard is that the standard reflects the wider economic, market, legal and political context of the jurisdiction in which it is being developed and implemented; that is, the development of a prudential standard is not simply a technical exercise. It is important for the IAIS to acknowledge this concept in the final ICS. To not recognize this reality and to not provide for flexible jurisdictional ICS implementation could lead to a less than fully accurate characterization of the ICS, with adverse impacts when, for example, jurisdictions are subject to Financial Sector Assessment Program (FSAP) reviews. The failure to recognize local market specificities and the wider context in which a capital framework functions could also render the ICS unimplementable in some jurisdictions. Therefore, the IAIS should adopt a flexible and pragmatic approach to ICS implementation, based on an assessment of the degree of alignment with the foundational concepts of the ICPs, rather than an assessment of conformance to the detailed design and calibration of the candidate ICS (or any successor). A principles-based approach would avoid the negative economic impacts of adopting a highly detailed and prescriptive standard that is not fit for purpose. The introduction of prescriptive standardized rules that are not fit for purpose could give rise to financial market disruptions that may create financial stability concerns.

The use of internal models is embedded in ICP 17 and should therefore adhere to the principles of ICP 17. The use of properly vetted internal models for determining capital requirements and capital resources is already embedded in ICP 17. Internal models have been adopted in a number of jurisdictional supervisory frameworks for group supervision. Indeed, we note that a number of major insurance jurisdictions have permitted (or required, when the standard method is found to be inappropriate) internal models on this basis and many IAIGs utilize internal models.[1] Moreover, jurisdictions that recognize internal models apply a 'use test' under which the insurer needs to demonstrate that the model is used in practice for risk management purposes.

The ICS Consultation includes several prescriptive supervisory overlays to the use of internal models that do not meet the principles of ICP 17. For example, dual reporting requirements (i.e. reporting both internal model-based capital requirements and requirements under the standard method) do not provide decision-useful information to supervisors or insurers, as standard methods are potentially misaligned with bespoke internal models that are tailored to the risk profile of an insurer.

Insurers should not be subject to dual reporting requirements based on the ICS. We strongly encourage the IAIS to refrain from imposing any reporting requirements based on the ICS and its implementation or impact. Dual reporting arrangements likely would replicate jurisdictional requirements and would impose a significant burden on both insurers and their supervisors without a proportionate benefit. Rather, they would give rise to significant adverse effects and inefficiencies in capital management, as discussed above. Rather, IAIS supervisors should seek to understand how various jurisdictions may choose to implement the ICS, with a view towards developing a more comprehensive understanding of the capital adequacy and risk management of insurers that have significant operations in their jurisdiction but for which they are not the group supervisor.

Specific Comments on the ICS Consultation

The ICS should be a theoretical example of an insurance capital framework and, thus, granular calibration of the ICS is not required. However, if a technical ICS were retained, greater transparency into the ICS calibration is critical. As noted above, the ICPs are the appropriate vehicle for adopting the needed flexible, principles-based approach to assessing capital adequacy and capital resources. However, if a technical ICS were retained, we encourage the IAIS to provide greater transparency into the calibration of the ICS and to seek comment on key aspects of the calibration prior to finalizing the ICS. There has been insufficient detail provided on the calibration of several risk factors, including the interest rate risk charge and the changes in the calibration for two-country specific life risks in China and Japan. The ICS was calibrated in a 'low for long' interest rate environment that has radically changed in nearly all of the markets in which insurers conduct their activities.

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[1] Internal models should reflect a coherent and aligned approach to determining both prudential capital requirements and internal capital needs for risk management purposes. Failure to do so can result in serious inefficiencies in risk management and poor decision making. For example, the value of a given transaction could be assessed very differently under a prescriptive, 'one-size-fits-all' regulatory approach that is poorly aligned with a company's internal approach, which has been more precisely calibrated and subject to validation and supervisory review. The use of internal models can also help address serious financial stability implications from herding or procyclical behavior that would otherwise accentuate the impact of financial market stresses.

Greater transparency is needed with respect to the expected economic impact assessment of the candidate ICS. We applaud the IAIS for conducting an economic impact assessment of the candidate ICS in 2023 and 2024. However, we encourage the IAIS to provide more transparency into the economic impact assessment methodology and to discuss with stakeholders how that assessment will be reflected in the final standard. Specifically, more clarity on how the ICS impacts different insurance markets, the products offered in those markets and the risk-based pricing of those products, would be helpful. Moreover, as part of that assessment, it should be noted that continued jurisdictional flexibility to implement the ICS, including through the adoption of alternative frameworks as an implementation of the ICS, can mitigate the expected deleterious economic impacts that the ICS would otherwise have on those markets.

In addition to the four impacts that are to be evaluated under Section 11 of the ICS Consultation, we would add a fifth impact on different insurance markets and risk-based product offerings. The IAIS should measure the impact of the candidate ICS on different markets and products in order to determine whether the ICS is producing the correct 'signals' or incentives for the protection of policyholders and fair, safe and stable insurance markets, consistent with the IAIS mandate.

The impacts of the ICS on insurance markets, including local market competition effects and product offerings, have a direct bearing on policyholder protection. We encourage the IAIS to consider explicitly the impact of the ICS on the availability of insurance cover, particularly coverage that is essential to the conduct of everyday life (e.g., auto insurance) or the conduct of business (e.g., liability coverage). This may be implicit in the evaluation of the impacts that the implementation of the ICS may have on insurance products mentioned in Section 11 of the ICS Consultation, but we encourage the IAIS to make these considerations more explicit in the final version of the ICS.

We strongly encourage the IAIS to take a holistic view of the impacts of the ICS. The analysis of the impacts of the ICS on insurance markets and products should consider not only insurance regulatory and supervisory changes and refinements, but also economic and political developments, central bank policies, geopolitical dynamics and climate policies. Absent a pragmatic approach to implementation, the ICS could give rise to adverse economic impacts in various markets and jurisdictions and could exacerbate existing protection gaps or even create new gaps in insurance availability and coverage.

We appreciate the opportunity to offer our perspectives on the ICS and ICP consultations. If you would like to follow up on any of the points raised in this letter, please contact Mary Frances Monroe, mmonroe@iif.com.

Respectfully submitted,

MF Monroe