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Mr Yoshihiro Kawai
Secretary General
International Association of Insurance Supervisors (IAIS)
c/o Bank for International Settlements
Centralbahnplatz 2
CH-4051 Basel
Switzerland

Re: G-SII and NTNI consultations

Dear Mr. Kawai,

The Institute of International Finance (IIF) and the Geneva Association (GA) welcome the opportunity to provide comments on the International Association for Insurance Supervisors (IAIS) consultation documents dated November 25, 2015. These concern the "Proposed Updated Assessment Methodology for Global Systemically Important Insurers" and "Non-traditional Non-insurance Activities and Products". Our response has been provided by the joint IIF/GA Systemic Risk Working Group, which is comprised of a wide variety of insurers with representation across all geographies, product lines, and organizational structures, including all insurance groups which have been identified as Global Systemically Important Insurers (G-SIIs).

We appreciate that the IAIS is giving stakeholders the opportunity to provide their views on a wide range of issues concerning systemic risk and systemic assessments. We are committed to continuing to work with the IAIS and other stakeholders in order to develop an effective systemic risk framework that is sensitive to the features of insurance, including its long-term, premiums-funded character.

General comments

Before responding to the questions of the consultation documents, we would like to make some important comments of more general relevance. We appreciate that the IAIS is proposing revisions to the G-SII methodology as well as its core component, the definition of non-traditional, non-insurance (NTNI) products and activities. As indicated in the past, we believe the framework for systemic designations should be significantly revised in order to conclusively address systemic risk in a way that is compatible with the distinctive characteristics of insurance.

On the whole, we think that the general intent of the proposed changes in both the G-SII and the NTNI methodologies proposed by these consultations is directionally appropriate. In particular, we note the following improvements in the proposals:

- In the G-SII methodology proposal, we generally support the application of absolute reference values as opposed to the current relative, sample-based reference values. The relative ranking of insurers among the sample of approximately 50 firms is not representative enough to determine the potentially systemic nature of an insurer. Taking system-wide indicators would enable the methodology to measure the contribution of insurers to systemic risk in the context of the financial system as a whole.
- The introduction of a qualitative phase to the assessment methodology provides an opportunity for the IAIS and supervisors to learn about critical elements of an insurer's business model that may be difficult to capture quantitatively at this point in time. Knowledge gained from the qualitative phases will provide the IAIS and supervisors relevant information to refine a firm's score in the quantitative assessment and provide insurers clarity on the basis for their consideration or designation as a G-SII and, thereby, how they can avoid or shed designation.[1]
- The introduction of a quantitative threshold in Phase II of the designation methodology, if transparent and provided to the firms submitting the data, can provide additional clarity to firms on the entry and exit criteria from the G-SII list. The formalization of engagement between regulators and candidate G-SIIs in Phase IV of the assessment procedure is also welcomed as a positive development.
- We believe that the proposed NTNI framework offers more transparency primarily by structuring the thought process behind the categorization of products and activities as non-traditional.

However, we believe that major flaws in both the designation methodology and the NTNI concept are unfortunately not yet being addressed by the currently proposed changes. Below we highlight the major areas where we believe further work is required.

Distinguishing between risk and systemic risk

We believe the current G-SII assessment methodology and the underlying NTNI framework does not appropriately distinguish between macroprudential and microprudential risk. Both must better distinguish between the probability of default and the loss-given default; and between a firm's own risk profile or exposure to risk on the one hand and the potential for a firm to transmit or amplify risks to the system.

Systemic risk, by nature, is macroprudential, and concerns loss-given default: the potential damage of an institution's failure on the financial system.[2] In contrast, the likelihood of an individual institution's

[1] We understand the IAIS intends, in Qualitative Phase III, to better evaluate the quantitative results of Phase II assessment in order for the heterogeneous nature of the sector to be adequately accounted for. As it stands Phase III could alter an insurer's ranking but not alter its score. We welcome a qualitative assessment, subject to criteria as described in our section "qualitative assessment in Phase III" and elsewhere in this response. In footnote 5 we address an apparent incongruity that arises when Paragraphs 39 and 40 of the Updated Methodology are read with current HLA guidance, which proposes that GSIIs will be assigned to buckets on the basis of their overall assessment score.

[2] This conclusion was reached, for example, by the BCBS in its July 2013 report on the updated assessment methodology for banks: "The Committee is of the view that global systemic importance should be measured in terms of the impact that a bank's failure can have on the global financial system and wider economy, rather than the risk that a failure could occur. This can be thought of as a **global, system-wide, loss-given-default (LGD) concept** rather than a probability of default (PD) concept."

failure in itself is a microprudential issue, which is accounted for in microprudential regulation and supervision.

The systemic risk framework should focus on system-wide and cross-sectoral risks beyond single institutions, propagating to the system through the identified transmission channels within the insurance sector, the financial system and the real economy. As of today, the IAIS has not demonstrated the link between these vulnerabilities and the transmission mechanisms of systemic risk.

In line with academic research on systemic risk, the IAIS identifies two transmission channels of systemic risk in its NTNI consultative document: inter-institutional exposures and asset liquidations. Unfortunately, it remains unclear exactly how these relate to NTNI products and activities. While the liquidity and market risks identified in the proposed non-traditional insurance (NT) methodology are indicative of the risks on an individual insurer's balance sheet, they are not necessarily indicative of the risks its activities pose to the financial system at large. As such, the analysis does not clearly articulate how vulnerabilities translate through identified transmission channels to systemic risk. Nor does the analysis distinguish between:

- origination, contagion and amplification channels, and
- macroprudential and microprudential considerations.

As with all insurance products, the presence of a vulnerability should only be addressed by systemic risk regulation if its order of magnitude warrants it and it links to a transmission channel of systemic risk.

Incentives for risk management

We strongly advocate a more prominent role and incentives for tractable components of insurance risk management in the assessment methodology. A firm's asset-liability management (ALM), diversification of assets and liabilities, hedging strategies and collateralization policies are crucial determinants of its risk profile and any potential risk it may pose to the financial system at large.

- Indicators and risks, i.e. market and liquidity risk, should be viewed net of related risk management tools. For example, derivatives should be netted with collateral, technical provisions should be net of reinsurance ceded, liability liquidity should consider the liquidity of the assets backing the liability, and the probability of surrender should be net of all considerations that influence such policyholder behavior (forgoing coverage, ability to secure replacement coverage, tax ramifications, etc.). In that way, indicators would better reflect the actual size of risks exposures to the financial system. For example, in the case of derivatives, collaterals reduce exposure to the financial system and thus reduce the impact of a potential default on the system.
- Derivatives are not adequately represented in the framework. Derivatives can be held to maturity, in turn minimizing rollover risks (the inability of a firm to roll over derivatives would present a microprudential rather than a macroprudential problem). Derivatives can also help hedge nonlinear exposures without the need for complex hedging strategies such as dynamic hedging. We therefore propose that the derivatives indicator in the G-SII assessment method would exclude derivatives held for risk management purposes and be corrected for the use of master netting agreements and the transfer of collateral.

Source: Basel Committee on Banking Supervision, "Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement," July 2013. [Emphasis added by the IIF and the GA.]

- While the NTNI framework reflects some aspects of ALM[3], this does not create incentives for good risk management for the individual insurer, as it is only used for the general designation of products as NTNI. The qualitative Phase III of the G-SII assessment method should better take applied risk management into account, like ALM, collateralization, and hedging using derivatives and other strategies.

Appropriately measuring the contribution of insurance to systemic risk in the wider financial system

The G-SII designation methodology should better reflect the systemic risk contribution of the insurance sector to the wider financial system. The introduction of absolute reference values in the methodology is a step forwards; however absolute reference values need to be implemented in the G-SII methodology in a way that will actually have an impact on the designation or (non-designation) by reflecting system-wide developments.

The introduction of absolute reference values can lead to some practical problems in the G-SII assessment methodology's quantitative assessment, as it leads to an implicit change in the indicator weights. This issue is currently not addressed by the IAIS in the G-SII methodology consultation document. For any indicator, changing reference values reflecting a sample of firms to one reflecting the entire financial system (or, where appropriate, the entire insurance sector) will increase the denominator. As the individual insurer's score for this indicator will now be divided by a larger denominator, the outcome value of the indicator will decrease in size. Since not all indicators in the G-SII assessment are being changed to absolute reference values, indicators with sample-based references will have a relatively larger impact on the total G-SII score, because their denominator is likely smaller.

This issue illustrates the importance of the IAIS making clear choices on how to implement absolute reference values in the methodology. Yet the current proposal leaves open a possibility of (some) relative scoring, even using absolute reference values.[4] We advocate that the IAIS implements absolute reference values in a way to reflect 'absolute', system-wide reference values. Only in that way can the contribution of the insurance sector to systemic risk in the financial system be measured. It is thus crucial for the IAIS to carefully assess the impact of the introduction of absolute references on the relative impacts of all the indicators, category weights, and on the total G-SII score.

While the proposed introduction of a quantitative threshold and of absolute reference values for some indicators may increase the clarity and stability of an insurer's score in the G-SII assessment methodology, the scoring method remains largely relative and the intent of introducing these elements is not clearly explained in the consultation document. When a firm's designation and bucket allocation is determined not only by its own activities, but by the ranking of those activities relative to those of other firms, de-risking of the individual firm may not lead to a decrease of its score in the assessment procedure. Therefore, the use of absolute measures should be extended to include other indicators; we would advocate for the IAIS to find appropriate reference values for these indicators (please see our answer to question 2 of the G-SII designation methodology consultation).

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[3] Cash flow matching is reflected in the NTNI framework (see NTNI consultation, table on p. 10).

[4] As the G-SII assessment consultation document states in paragraph 15, p. 9: "For indicators with absolute reference values, the absolute reference value will either *replace the sum of responses from the sample insurers* in the denominator of the indicator score calculation or *add a factor to the indicator score calculation that reflects market developments*" (emphasis added by IIF/GA). The proposal thus leaves open the possibility of (some) relative scoring in the methodology.

Asset liquidations and procyclicality

In the NTNI consultation, the IAIS identifies the 'asset liquidation' channel and the related problem of procyclicality in investment behavior as a transmission channel of systemic risk. In this regard, designing an insurance policy framework that promotes stability in the valuation of insurer's balance sheets is important. Without any stabilizing arrangements, the market-adjusted valuation used by the IAIS in the BCR and HLA could have a procyclical impact on the valuation of insurer's balance sheets, potentially incentivizing fire sales when asset prices collapse in a market shock, as it will be more difficult to 'look through' cycles.

The qualitative assessment in Phase III

We support the inclusion of a qualitative assessment phase in the G-SII assessment methodology, given the heterogeneity of the insurance sector and the difficulties in quantitatively measuring key elements of an insurer's business model, provided that the IAIS does not default to a qualitative assessment which reduces the comparability of G-SII assessments.

The qualitative assessment under Phase III should assess both the quantitative data collected and relevant ancillary factors including the manner in which risk is managed within the insurer, for example utilizing the Systemic Risk Management Plan where available, to ensure that the data is representative of potential systemic risk. The qualitative assessment should ensure that quantitative outputs for each indicator that are not indicative of systemic risk are discounted from the assessment score, especially given the link between the score and the bucketing for HLA. Any adjustments to rank or score must, however be subject to a framework that would ensure consistent, comparable and transparent treatment of all GSIIs, such as described under this section paragraph 2 below. Should the IAIS choose to include in Phase II's quantitative assessment an indicator with no link to the financial system, we recommend that the qualitative assessment ensure that an insurer's ranking and score are commensurate with the potential of its failure to impact the financial system in a systemic manner.[5]

With the information available in the consultation document, it is hard to estimate the influence and role of Phase III in the process. Too large a role for supervisory judgment could make the G-SII process subjective and result in uncertain and inconsistent designation outcomes. In general, a qualitative assessment should be set up in such a way as to ensure consistent, comparable and transparent treatment of potential G-SIIs. The BCBS criteria and instructions for supervisory judgment in the G-SIB designation methodology, tailored for insurance as appropriate, may offer a starting point for parameters to guide the Phase III process. Guidelines should include a non-exhaustive list of elements to be considered and potentially a requirement for peer review of the effort. Given the necessary focus on risk management within an insurer, the group supervisor will be best placed to perform the qualitative assessment. We advocate that insurers are fully involved in Phase III to explain the features of their firm identified in the qualitative assessment.

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[5] There is an apparent incongruity that arises when Paragraphs 39 and 40 of the Updated Methodology are read with current HLA guidance, which proposes that G-SIIs will be assigned to buckets on the basis of their overall assessment score. Paragraphs 39 and 40 together suggest that a potential G-SII's rank could be altered by considerations that take place in the qualitative Phase III but that Phase III considerations will not alter Phase II scores unless there are "substantive errors" in data analysis. It would be only logical to bring an eventual HLA charge in line with a potential G-SII's final rank (ie, corrected with Phase III's inputs).

At the moment, it is hard to understand the underlying rationale for the IAIS to choose whether indicators are part of Phase II (Quantitative Assessment), Phase III (Qualitative Assessment) or of both phases (e.g. reinsurance). It is imperative that a consistent rationale underlies the distribution of indicators across Phases II and III.

Transparency, entry and exit

The designation process should not only provide a solid assessment of a companies' potential systemic impact, but provide them with a clear "off ramp" from G-SII status. For that reason, it is important that the entire designation process be transparent towards the companies. All firms participating in the G-SII designation exercise should know their individual score to allow them to make an informed decision on how to de-risk. They should be actively involved in the entire process.

We recommend the IAIS consider inclusion of an appeal process in Phase V of the proposed updated methodology, such that insurers selected for recommendation to the FSB for G-SII designation are afforded the opportunity to appeal the grounds of their designation with the FSB independently of the IAIS. Such an appeal would presume that G-SIIs will have been able to engage with the IAIS and their group-wide supervisors in meaningful discussions of the reasons for their proposed designation. Meaningful discussions would include information on individual indicator and aggregate scores, rank and how the quantitative threshold was computed.

Implementation of the G-SII assessment methodology and NTNI concept

It seems unclear which regulatory or supervisory body (national regulators, supervisory colleges or the IAIS) will be responsible for the designation of insurance activities as non-traditional in the current NT revision process. We would appreciate if the IAIS could clarify this. In our opinion, the most appropriate body here is the group supervisor with accompanying peer review, made in consultation with the insurer.

We request further clarification from the IAIS on the process of implementing the changes in the G-SII assessment and NTNI methodologies in time for the 2016 G-SII assessment exercise. The consultations provide no guidance on the potential for future consultations or further stakeholder engagement on these critical topics.

Instructions for the data collection and related definitions

We welcome the periodic review process of the G-SII assessment methodology by the IAIS but note that whatever the changes and improvements, the quantitative and qualitative assessments must rest on unambiguous instructions and definitions. The data collection informing the 2016 G-SII designations will be the fourth. Accordingly, we request that the IAIS make a major improvement in regard of the instructions and definitions that are relevant for the data collection.

To give some specific examples:

- The scope of third party reinsurance is not fully defined yet. It is not clear whether firms are expected to report business volume originated through fronting under the reinsurance indicator or not.

- As for life insurance, the 2015 data instructions suggest assessing surrender values under normal economic conditions and stressed market conditions.[6] However, the IAIS fails to define the stressed market conditions to establish a robust comparison among the sample firms. This is of particular relevance in regard of the applicability of stays on surrenders, their ultimate duration, and hence the pay-out pattern. While the ability of authorities to suspend surrenders is codified in various markets, it is situational and fraught with rational and behavioral considerations.

Insight in the methodology

The G-SII consultation proposes a range of punctual changes – process and quantitative assessment/indicators. The consultation paper does not articulate well how these changes interrelate, if they do at all, and what the overall expected impact and improvements are.

All in all this makes it hard to fully grasp the overarching rationale behind this update. For example, it is difficult for stakeholders to give suggestions on how to improve the responsiveness, or address the normalization, of indicators without detailed knowledge of the underlying issues the IAIS is aiming to address. Estimating the ultimate and combined effect of these changes on the methodology is also difficult because the methodology is tightly interlinked with other parts of the G-SII framework, such as the bucketing approach in the Higher Loss Absorbency Capacity (HLA).

The industry can currently only make general comments and formulate theoretical considerations about many of the proposed changes. For example, while the industry supports the trend towards the use of absolute reference values, the amendment of only some indicators to absolute reference values may produce results that are more difficult to judge. These results could contradict outcomes based on an assessment approach relying solely on absolute indicators, rather than a hybrid construct.

Also, details of the determination of absolute reference values are not clear. The IAIS' G-SII assessment methodology consultation document mentions that "For indicators with absolute reference values, the absolute reference value will either replace the sum of responses from the sample insurers in the denominator of the indicator score calculation or add a factor to the indicator score calculation that reflects market developments."[7] We discuss our position on the application of absolute reference values into detail in the response to G-SII assessment consultation question 2.

The IIF and GA stand ready to provide additional views or clarifications. Should you have any questions on the issues raised in this letter, please contact the undersigned.

Andrés Portilla

Anna Maria D'Hulster

[6] See 2015 data instructions, paragraph 4.10 on 'Liquidity'.

[7] See IAIS, "Global Systemically Important Insurers: Proposed Updated Assessment Methodology – public consultation document," 25 November 2015, paragraph 15, p. 9.

Comments on the updated G-SII Assessment Methodology

Absolute reference values

***1**: Is the use of absolute reference values appropriate for the indicators for reinsurance, financial guarantees, and derivatives trading (CDS sold)?*

Yes. The use of absolute values needs to be combined with a threshold for the level of activity that would lead a company to be considered systemic. The use of absolute measures combined with a relative ranking approach, as currently used in the designation methodology, would not bring about any significant change.

***2**: Should the IAIS consider measuring other indicators by absolute reference values? If yes, identify the indicator, explain the absolute reference value that can be used and explain why the use of the absolute reference value would improve the Proposed Methodology in the future.*

Yes, we urge that absolute reference values be used for any indicator where insurers are one of many participants in the financial system. For indicators only reflecting activities of the insurance sector, values should reflect the activity in the entire insurance sector. We advocate that the G-SII regime identify the contribution of the insurance sector to systemic risk in the financial system, rather than compare the risk profiles of insurer against insurer. The introduction of absolute reference values is a step in that direction.

In contrast, relative indicators may provide a misleading picture of a firm's systemic risk score, especially when overall risk is low. Moreover, sample-based reference values create an artificial sensitivity of a firms' systemic risk scores with the actions of another firm because the denominator reflects the scores of a sample of firms.

The introduction of absolute reference values can lead to some practical problems in the G-SII assessment methodology's quantitative assessment, as it leads to an implicit change in the indicator weights. This issue is currently not addressed by the IAIS in the G-SII methodology consultation document. For any indicator, moving from reference value reflecting a sample of firms to one reflecting the entire financial system (or where appropriate the entire insurance sector) will increase the denominator. As the individual insurer's score for this indicator will now be divided by a larger denominator, the outcome of the indicator will decrease in size. When not all indicators in the G-SII assessment are being changed to absolute reference values, this implies that indicators with sample-based references will have a relatively larger impact on the total G-SII score, because their denominator is likely smaller.

This issue illustrates the importance of the IAIS making clear choices on how to implement absolute reference values in the methodology. Yet the current proposal leaves open a possibility of (some) relative scoring, even using absolute reference values.[8] We advocate that the IAIS implements absolute reference values in a way to reflect 'absolute', system-wide risk. Only in that way can the contribution of

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[8] As the G-SII assessment consultation document states in paragraph 15, p. 9: "For indicators with absolute reference values, the absolute reference value will either *replace the sum of responses from the sample insurers* in the denominator of the indicator score calculation or *add a factor to the indicator score calculation that reflects market developments*" (emphasis added by IIF/GA). The proposal thus leave open the possibility of (some) relative scoring in the methodology.

the insurance sector to systemic risk in the financial system be measured. It is thus crucial that the IAIS carefully assess the impact of the introduction of absolute references on the relative impacts of all indicators, the category weights, and on the total G-SII score. Two options could be considered in this regard.

1. Adjusting the weights of indicators to bring the impacts on the total G-SII score of those indicators based on system-wide variables in line with those based on samples.
2. Introduce absolute reference values for all indicators.

The use of absolute values needs to be combined with a threshold for the level of activity that would lead a company to be considered systemic. The use of absolute measures combined with a relative ranking approach, as currently used in the designation methodology, would not bring about any significant change. It is also important that the denominators will be broadly defined, in order to properly account for the heterogeneity of the business models of insurers.[9]

Without prejudice to our challenge of the systemic link of level 3 and intra-financial assets, absolute reference values reflecting cross-sectoral values could be applied to the following indicators:

1. Size – total assets
2. Interconnectedness – intra-financial assets
3. Interconnectedness – intra-financial liabilities
4. Interconnectedness – level 3 assets[10]
5. Interconnectedness – reinsurance[11]
6. Interconnectedness - derivatives
7. NTNI – short term funding
8. NTNI – financial guarantees

At the same time, we challenge the relevance of some other indicators used in the G-SII assessment methodology.

- Intra-financial assets and level 3 assets do not transmit systemic risk to the broader financial system and therefore should be removed from the assessment. Intra-financial assets expose insurers to systemic risk, but do not create or amplify it, and thus represent a micro-prudential issue.
- If intra-financial assets were to remain part of the G-SII assessment methodology, we would have the following recommendation. A more accurate asset/liabilities picture would emerge for the financial system if the FSB and the international sectoral standard setting bodies (IAIS, BCBS and IOSCO) would establish a ground to share information on intra-financial assets and liabilities. Firms know the counterparty on the intra-financial assets they hold, but they can only make a more or less informed guess about the intra-financial liabilities they owe to the investors. By pulling all intra-financial assets together in the financial system, the FSB and standard setting bodies could complete the intra-financial assets/liabilities picture.

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[9] For example, a broad definition of financial guarantees would be able to capture the range of different guarantees provided by insurers.

[10] We prefer to exclude level 3 assets from the G-SII methodology (see further on in our answer to Q2); however, if the IAIS were to keep level 3 assets as an indicator in the G-SII assessment methodology, we advocate absolute reference values are used.

[11] The use of an absolute reference values for reinsurance may provide a better indication as to the level of reinsurance used by the sample of insurers relative to the reinsurance market as a whole, rather than a subset thereof.

- Level 3 assets are not a suitable indicator for potential fire sale risk as assets and liabilities cannot be viewed in isolation. Level 3 assets may be backing non-liquid liabilities and therefore in such circumstances fire sale concerns do not arise. We consider that this indicator should be deleted. However, if the IAIS chose to retain the indicator, a net asset-liability liquidity view should be taken, as discussed above. Further, we consider Level 3 assets as micro-prudential issues and not relevant for systemic risk generation.
- Liability liquidity should distinguish between the theoretical possibility of surrender, and the actual expected behavior of policyholders based on product characteristics such as guarantees and surrender penalties. We advocate that the 'liability indicator' in the G-SII methodology is made consistent with the approach to liquidity risk in the NTNI proposal, which includes a set of qualitative/ancillary factors determining a product's liquidity risk.[12] This approach should also include the presence of guarantees as a disincentive to surrender.
- Using 'derivatives' as an indicator for systemic risk in the 'interconnectedness' category creates disincentives for hedging. Insurers hardly use derivatives for income-generating purposes; in some jurisdictions this is even prohibited by regulation in insurance licensed entities. However, most insurers use derivatives to hedge important risks in insurance like interest rate and duration/ALM mismatch risk. As such, derivatives are a crucial element of sound insurer risk management. Using this indicator as a measure of systemic risk in effect would penalize risk hedging.
- The underlying assumption that 'reinsurance' contributes to systemic interconnectedness does not take into account the risk mitigating benefits inherent in the use of reinsurance.

3: *What information or data could be used as an absolute reference value for the financial guarantees indicator?*

Market-wide data on financial guarantee insurance volume, provided by a rating agency or a basket of broker reports may be used.

4: *Is structured finance bonds insured an appropriate denominator or should the denominator reflect the notional value of bonds guaranteed by the broader financial sector via non insurance products?*

Since these activities are not necessarily contained in the insurance sector, the denominator should reflect the notional value of bonds guaranteed by the broader financial sector via non-insurance products. We would like to ask the IAIS to provide a clear definition of structured finance bonds.

5: *Are BIS statistics on the overall global CDS market an appropriate absolute reference value for the derivatives trading (CDS sold) indicator? If so, how should this absolute reference value be used by the IAIS? What other information or data could be used as an absolute reference value for the derivatives trading (CDS sold) indicator?*

The BIS statistics provide the only public and quantified data on traded derivatives that we are aware of. However, the BIS data should be tested against information submitted by the G-SIBs on CDS notional to

[12] IAIS, 'Non-traditional non-insurance activities and products – Public consultation document,' Basel, 25 November 2015, pp. 16-17.

ensure they are reliable. The focus of this indicator should be on the trading of derivatives as opposed to holding/buying derivatives for hedging or replication purposes.

Since the crisis, significant reforms of derivatives markets have been implemented, which have vastly contained risks previously present in these markets. This should be reflected in both derivatives indicators. We strongly advocate derivatives risk measurement should first be netted and then take into account the amount and quality of collateral, following FSB guidance, before being measured as a source of systemic risk.

As a cross-sectoral benchmark the BIS statistics would help assess the impact of individual insurers in comparison to the total CDS market. As stated above, the sole re-indexing of the firms' CDS volumes (in-sample, out-of-sample) may not yield the desired improvement. Such a re-indexing may have to be complemented with the introduction of a threshold.

6*: Are total global reinsurance premiums written an appropriate absolute reference value for the reinsurance indicator? If so, how should this absolute reference value be used by the IAIS? What other information or data could be used as an absolute reference value for the reinsurance indicator?*

As much as insurance does not present systemic risk, we would like to stress that a link between reinsurance and systemic risk has not been demonstrated at this point. This conclusion is shared by the IAIS in its report "Reinsurance and Financial Stability" dated 19 July 2012, in which the IAIS concludes "traditional reinsurance is unlikely to cause, or amplify, systemic risk".

However, given the fact that the IAIS currently has a reinsurance indicator included in its G-SII assessment methodology, it would be preferable to consider the primary insurer's exposure to reinsurance and the "share of wallet" of the reinsurer regarding the ceded risk from the primary insurer.

The IAIS should use a combination of gross written premiums and technical provisions instead of technical provisions on a stand-alone basis to measure and understand the interconnections between an insurer's third party reinsurance activities and other primary insurers and reinsurers. Only the combination of both gross written premiums and technical provisions will capture current and run-off business.

Moving indicators to Phase III

7*: To what extent are large exposures an appropriate indicator of an insurer's interconnectedness with the financial system? What is the appropriate way to measure or understand the interconnections between an insurer's large exposures and the financial system?*

Large exposures are a key focus of a company's internal risk management practices. A large exposure does not indicate the impact of the insurer's failure on the financial system, but rather could contribute to an individual insurer's probability of default. We therefore argue that this indicator be removed from the G-SII assessment methodology. It is imperative that the G-SII assessment methodology and its indicators appropriately distinguish between an insurer's exposure to (systemic) risk, and its potential to amplify or create systemic risk.

8*: To what extent, if any, are intra-group commitments an appropriate measure of a potential G-SII's systemic relevance?*

Intra-group commitments are a relevant factor in the context of resolution plans for G-SIIs, yet are no indicator of an insurer's potential to create or amplify systemic risk in the financial system.

Based on prior consultations and the evolving instructions of the data collection, the industry understands that the IAIS has been primarily interested in the identification of group/conglomerate entities outside the regulated insurance scope, benefiting from group guarantees. While the issue resonates with the industry, we believe that such an analysis is better conducted in the qualitative assessment as many considerations are coming together in this measure. The use of intra-group commitments may or may not in itself be indicative of overreliance of entities within a group and, possibly, inappropriate risk and capital management. It could also be reflective of efficient capital management. Without further analysis, the indicator does not provide the insights sought by the IAIS in its qualitative assessment.

9*: To what extent is the derivatives trading (excluding hedging and replication) in economic terms indicator an appropriate indicator of NTNI activities? What is the appropriate way to measure or understand the systemic importance of speculative derivatives trading?*

Since the crisis, significant reforms of derivatives markets have been implemented, which have vastly contained risks previously present in these markets. This should be reflected in both derivatives indicators. The IAIS should consider the current exposure to a derivative counterparty adjusted to reflect legally enforceable netting (e.g. via ISDA agreements) and collateral arrangements.

We would support a clear distinction in both the G-SII methodology and the NTNI framework in the treatment of derivatives held by insurers for risk management purposes, as opposed to those held for speculative purposes. We would like to point out that insurers overwhelmingly use derivatives for risk management. As an illustration, American insurers' portfolio of derivatives for 'income generation' purposes end 2014 was equal to 0% of their total derivatives portfolio's notional value; hedging accounted for 94%.[13] Holding derivatives for speculative purposes in insurance entities is prohibited under Solvency II. Derivatives should be treated accordingly under the IAIS' G-SII and IAIG policy measures, and those held for risk management should be excluded from G-SII scores in order not to penalize risk hedging.

10*: The weightings in Phase II of the Proposed Methodology emphasize the insurer's NTNI activities (45%) and its interconnectedness (40%). Are there any developments or trends in the global insurance market that warrant further refinements to the 2013 Methodology, potentially including changes to the category weightings? Please explain your answer.*

Please refer to our answer to question 2 for remarks on indicator weighting.

[13] See http://www.naic.org/capital_markets_archive/150807.htm.

Revisions to other indicators

11*: Will the responsiveness of the derivatives indicator in the interconnectedness category be improved by using other data such as an appropriate net fair value figure (either positive or negative)? If so, what are more appropriate data and what is the appropriate way to use such data to measure or understand the interconnectedness caused by derivatives transactions? Should the IAIS measure interconnectedness with respect to derivatives transactions in the same manner as the BCBS? Please explain your answer.*

- Members have provided a couple of options to consider as appropriate measures to capture the interconnectedness caused by derivatives transactions:
    1. *Net fair value*, as this measure would best align the measurement of interconnectedness through derivatives with the BCBS method on this category.
    2. *Net notional values*, as this indicator is less volatile than the net fair value of derivatives;
    3. The *potential future exposure (PFE)* netted per counterparty, where legally enforceable, minus placed collaterals. PFE is the peak replacement cost in “worst case” scenario, measured using a minimum 10-day holding period at a 99th percentile one-tailed confidence interval;
- Regardless of the measure chosen, it is critical to reach a sufficient level of granularity, and the derivatives indicator should be improved to focus on potentially systemic activity. The current approach will disincentivize the use of derivatives to ensure assets held by insurers better match their liabilities. In addition it makes no account of the type of derivatives assets so that a 1 week FX hedge to fix a dividend cash flow is treated the same as a CDO.
- A first stage would be to distinguish between derivatives used for replicating, hedging and trading and pure speculation. Derivatives used to better match liabilities (typically vanilla interest rate swaps and swaptions) should be stripped out. Where insurers buy options, they will be exposed to counterparties and not the other way around, as options will not be in the money for counterparties who sell them. The use of derivatives for efficient portfolio management is traditional activity and it reduces risk. The products used are such that even in the event of a counterparty default it would be easy to replace them, and with the move to central clearing this will improve still further.
- More generally options used to reduce risks should be excluded if there is a liquid market for them (e.g. vanilla FX and equity forwards, futures, calls and puts used for risk reduction)
- Risk mitigation from collateralisation and clearing, e.g. under EMIR & Dodd Frank, should also be fully acknowledged. Risk assessment and the designation process should not be done in isolation of existing risk management and regulatory frameworks specifically designed to mitigate risk.
- The IAIS should therefore focus on the derivative activity it considers falls within the scope of NTNI and exclude uses of derivatives for what are deemed traditional purposes from the assessment methodology.
- The indicator for derivatives in the G-SII methodology should be based on an absolute reference value reflecting the use of derivatives in the entire financial system, in order to appropriately reflect the proportionality between derivatives held by insurers and other actors in the system.
- More generally, we believe that qualitative information on derivative use and risk management needs to be carefully considered, and that it can be gained from firms Systemic Risk Management Plans (where firms are required to prepare them) and/or dialogue with firms as part of the assessment process.

***12**: How can the reliability and responsiveness of any indicator, including those mentioned above, be further improved, modified or revised for the Proposed Methodology?*

The following indicators can be improved.

Short term funding indicator

- The short term funding indicator should be improved to focus on potentially systemic activity related to securities lending rather than measuring all securities lending.
- It is important that the measures used in the data collection exercise for the assessment methodology focus on activity that could lead to the transmission of risk. For example, the IAIS defines short term funding (STF) as “the sum of Short term borrowing, commercial paper issued, certificate of deposits issued, collateral received from REPOs and Securities lending”. The IAIS’s initial assessment methodology (18 July 2013) states that these activities “indicate the extent to which an insurer could be involved in maturity transformation [with] a large degree of short term funding [being] a feature of financial institutions involved in maturity transformation”. Further the document suggests that larger than normal STF “could signal an insurer venturing into [maturity transformation] and assuming the liquidity risk that comes with it, including the potential for fire sales of assets”. However, while this broad ranging definition has been used as a driver for designation as a G-SII, the IAIS methodology document recognises that there are types of STF arrangements that are vanilla and carried out within traditional businesses without creating the risks described above. For example, “If the cash collateral from the repurchase agreement or securities lending transaction is reinvested in liquid, high credit quality assets, and if the security lent or put out on a REPO is liquid, then the activity is traditional. However if the reinvestment is in long-term, or low credit quality or illiquid securities then the risks are sufficient for the activities to be deemed NTNI. Moreover if low credit quality or illiquid assets are used for securities lending or in repurchase agreements, then the risks are sufficient to be deemed NTNI.”
- The IAIS should consider carefully how indicators that measure funding, and lending of securities to financial counterparties should be reflected within an overall framework designed with an objective to incentivise G-SIIs to become less systemically important, and give non-G-SIIs strong disincentives from becoming G-SIIs. It is important that incentives are aligned with the desired outcome for financial stability. If there is a perception that risks could be transmitted to financial counterparties through withdrawing from funding them, and lending them securities then the assessment methodology should not disincentivize insurers from doing so as this would appear to be counterproductive.
- It is therefore important for securities lending, within the short term funding indicators for the designation methodology, that the data collection focuses on securities lending used for maturity transformation and collateral hypothecation, and excludes vanilla securities lending, which the IAIS’s policy paper accepts is not NTNI.

Level 3 asset indicator

- We prefer to exclude level 3 (L3) assets from the G-SII assessment methodology, as these assets do not transmit systemic risk to the broader financial system and therefore should be removed from the assessment. Level 3 assets are not a suitable indicator for potential fire sale risk as assets and liabilities cannot be viewed in isolation. Level 3 assets may be backing non-liquid liabilities and therefore in such circumstances fire sale concerns do not arise. However, if the IAIS were to keep L3 assets in the methodology, we suggest the following issues would be relevant for implementation.

- The IAIS defines L3 assets as those “based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement”.
- The IAIS’s initial assessment methodology (18 July 2013) states that these activities “indicate the potential scale of fire sales of illiquid assets by an insurer in distressed financial market situations”. Further the document suggests that a high proportion of L3 assets “could point towards insurers that are more active in markets for complex assets than is normal for a traditional insurance business".
- In considering the potential for Level 3 assets to pose a risk of fire sales, it is important to consider the liquidity of the liabilities that they are matching.
- There is widespread recognition of the importance of investment in boosting demand and lifting productivity in the global economy and infrastructure investment is one source of such investment that policymakers have focused on. Consequently there is a need to ensure that the designation methodology does not inappropriately disincentivize long term investment by insurers in infrastructure. To this end, level 3 assets that are held to back illiquid liabilities should be excluded from the measure of L3 assets in the designation methodology.

Phases of the assessment process

13*: What criteria, other than those listed above, should the IAIS consider when determining whether to include an insurer in the Phase I data collection?*

We would suggest the IAIS not to change the currently used criteria. We are however interested in understanding how the IAIS intends to account for the impact of M&A activity in the sector in Phase I (in particular the impact on the cohort of approximately 50 firms) and the treatment of state-owned companies.

14*: What are the strengths and weaknesses of consistency and relative annual stability as a guiding principle for establishing the quantitative threshold in Phase II? For purposes of establishing the quantitative threshold, what other principle(s), if any, should the IAIS consider?*

Consistency is important in the application of the G-SII methodology to insurance companies. Annual stability, however, should not be a guiding principle for the G-SII regime – the methodology should most appropriately identify systemic risk in the insurance sector.

15*: For purposes of establishing the quantitative threshold in Phase II, what other approaches, if any, should the IAIS consider? What are the strengths and weaknesses of the alternative approaches, as listed above, to determining the quantitative threshold?*

In its consultation document, the IAIS mentions several approaches to establishing the quantitative threshold, including cross-sectoral analysis, using a natural cliff, cluster analysis and establishing and establishing an annual floor. We advocate the IAIS use cross-sectoral analysis to establish the quantitative threshold in Phase II. For fairness on a cross sectoral basis, comparison to G-SIBs would seem to be the most appropriate basis for determining the quantitative threshold. Other options, such as natural cliffs, average insurer scores or cluster analysis, all are relative ranking mechanisms and should be avoided on that basis.

***16**: While the majority of the Proposed Methodology will be based on quantitative outputs, what specific qualitative aspects of a potential G-SII should be considered in Phase III that are not captured in Phases I and II?*

We support the inclusion of a qualitative assessment phase in the G-SII assessment methodology, given the heterogeneity of the insurance sector and the difficulty in quantitatively measuring key elements of an insurer's business model.

- Phase III should assess the quantitative data to ensure that it is representative, e.g. it should consider the ancillary factors set out in the concurrent consultation on NTNI to determine whether any of the quantitative outputs for each indicator should be disregarded.
- We believe that certain risk management practices can mitigate systemic risk. These practices include the holding of liquid assets to offset liability liquidity and the posting of collateral to protect counterparties. It is our strong recommendation that such practices be included in Phase II; however to the extent that they are not reflected in Phase II, it is appropriate to include them in Phase III.
- We also recommend that Phase III include a robust assessment of data consistency of reported data across insurers in order to ensure a sound basis for developing a list of potential G-SIIs.
- If valuable information gained from Phase III should give rise to adjustments to the quantitative score developed in Phase II, then we argue it should be taken into account for HLA purposes – subject, however, to a framework that would ensure consistent, comparable and transparent treatment of all GSIIs, such as described under this section paragraph 2 below. Should the IAIS choose to include in Phase II's quantitative assessment an indicator with no link to the financial system, we recommend that the qualitative assessment ensure that an insurer's ranking and score are commensurate with the potential of its failure to impact the financial system in a systemic manner.

That said, based on the currently available information, it is difficult to estimate the influence and role of Phase III in the process. Too large a role for supervisory judgment will make the G-SII process subjective and result in uncertain and inconsistent designation outcomes. In general, a qualitative assessment should be set up in such a way as to ensure consistent, comparable and transparent treatment of potential G-SIIs. The BCBS criteria and instructions for supervisory judgment in the G-SIB designation methodology, tailored for insurance as appropriate, may offer a starting point for parameters to guide the Phase III process. Phase III would best be carried out by regulators with knowledge of the firm and, as noted above, clear guidelines on how it should be conducted including a non-exhaustive list of elements to be considered and potentially a requirement for peer review of the effort. We advocate that insurers are fully involved in Phase III to explain the features of their firm identified in the qualitative assessment.

***17**: What constraints should be imposed on the use of non-quantitative analysis of the potential systemic importance of insurers in the Proposed Methodology? To what extent, if at all, can qualitative analysis enhance the IAIS's understanding of the systemic importance of a potential G-SII?*

While we support the need for a qualitative assessment in the G-SII assessment methodology given the heterogeneous character of insurance, there is also a risk that it may give the process too much of a

discretionary character. This could harm the consistency of application of the methodology across different jurisdictions.

We suggest that the IAIS produce guidance on the application of the qualitative phase and include this within its program of peer reviews to ensure consistency of application. The BCBS' instructions for supervisory judgment, including criteria for judgment and for how it should be incorporated into the assessment process, could serve as a guide.[14] An example of a requirement would be to demand sufficient supervisory experience for the committee of IAIS members conducting the qualitative assessment.

Phase III would best be carried out by regulators with knowledge of the firm and, as noted above, clear guidelines on how it should be conducted including a non-exhaustive list of elements to be considered and potentially a requirement for peer review of the effort.

***18**: What other indicators, if any, could be considered by the IAIS to inform the supervisory judgment aspects of the Proposed Methodology?*

See question 16.

Reinsurance supplemental assessment

***19**: How can the additional information collected in the supplementary reinsurance-specific questions as part of the data collection be relevant to better assess the potential effects of a reinsurer's failure on other reinsurers or primary insurers? Should the IAIS set a threshold amount of third-party reinsurance activities that must be exceeded by an insurer in order to be required to complete the supplementary reinsurance-specific questions in Phase I? If so, what should be the level of the threshold?*

As is the case for traditional insurance activity, there is no evidence that traditional reinsurance is source of systemic risk. These conclusions are shared by the IAIS in their reports "Insurance and Financial Stability" (2011) and "Reinsurance and Financial Stability" dated 19 July 2012.

Thereby, the IAIS' approach to assessing reinsurance in the proposed G-SII assessment methodology is problematic. It is not clear why there is a need for additional analysis of an undertaking's reinsurance activities in Phase III, particularly since there is already a reinsurance indicator in Phase II. As we have noted in our comments above, we advocate the IAIS apply a clear distinction between aspects of insurance included in Phase II and III.

If the supplemental reinsurance were to remain a distinct assessment, we support the notion of a threshold amount to determine the scope of application. Also, the threshold should recognize the different quality of third party reinsurance offered; in particular, the threshold should disregard fronting business to the extent that the IAIS wants fronting volume reported as third party reinsurance. A threshold could be established as a combination of an absolute amount, possibly around the EUR 900 mn of gross technical provisions proposed in 2015, e.g. EUR 1bn or 2bn, in combination with a threshold assessing third party reinsurance in relation to total insurance volumes of the firm: (reinsurance >= 1 bn)

[14] Basel Committee on Banking Supervision, "Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement," July 2013, p. 9.

AND (reinsurance/total insurance >= 20%). Alternatively, market share would seem an adequate determining factor.

The assessment methodology should be open and transparent and applied consistently by supervisors across jurisdictions. Clarity is needed on how this will be applied in general in respect of Phase III assessments and particularly in the case of the Reinsurance Supplemental Assessment where this forms a component of Phase III.

In economic terms, business originated through fronting, e.g. in jurisdictions where the insurer has no subsidiaries or branches by involving a third party, is equivalent to business originated directly as the fronting party and the reinsurance contract between the parties act as a pass-through. The risk kept by the fronting party is marginal, if any at all. This would be a strong argument to not report fronting under third party reinsurance.

In case the IAIS takes the view that business volume originated through fronting is relevant and akin to third-party reinsurance then the instructions have to state that fronting must be reported and under what conditions.

20*: Are gross written premiums, technical provisions or exposures an appropriate way to measure and/or understand the interconnections between an insurer's third-party reinsurance activities and other primary insurers and reinsurers?*

The relevant measure for the impact of failure of a (re)insurer on other insurers are third-party reinsurance exposures to the given (re)insurer. The IAIS should use a combination of gross written premiums and technical provisions instead of technical provisions on a stand-alone basis to measure and understand the interconnections between an insurer's third party reinsurance activities and other primary insurers and reinsurers. Only the combination of both gross written premiums and third-party reinsurance captures current and run-off business.

21*: How could the information collected be used to evaluate the extent to which an insurer's third-party reinsurance activities disperse or concentrate risk in the global insurance market?*

We need to differentiate between probability and impact of failure here. If a reinsurer does not have proper risk management and accumulation control (and thus accepts too much concentration of risks on its balance sheet), this might lead to higher probability of failure: devastating for the reinsurer, but in itself not yet a systemic question.

To determine the systemic relevance of a reinsurer, one must analyze the aggregate exposure of the primary insurance industry to reinsurance in the event of severe but plausible stresses. In particular, for any given provider of reinsurance, one must analyze the impact of a default on the post-stress excess capital throughout the insurance industry.

22*: Are an insurer's third-party reinsurance activities interconnected with financial markets and, if so, how? What additional data measures could be useful to understand the extent to which an insurer's third-party reinsurance activities are interconnected with other parts of the financial markets (e.g. banks or asset managers)?*

An insurer’s third-party reinsurance activities are interconnected with financial markets if the reinsurer is engaged in forms of alternative risk transfer (ART). The IAIS report “Reinsurance and Financial Stability” stated that “in many cases, ART simply extends the range of traditional reinsurance (e.g. for multi-year, multi-line and multi-trigger products). As far as these extensions are concerned, ART does not facilitate credit intermediation, and it is unlikely to raise broader systemic concerns.”

Indeed, such interconnections can only lead to system-wide losses if (1) the failure of a reinsurer leads to problems regarding the ARTs issued by the same; and (2) the losses of the respective ART investors lead to further losses to be propagated through the system. To measure this, regulators should use data showing the extent to which an insurer’s third-party reinsurance activities are the top exposures of banks and asset managers to ART assets issued by a given (re)insurer.

23*: What other data points would be relevant for the IAIS to consider in the Proposed Methodology when evaluating the extent to which the potential geographic risks (i.e. the risk that a reinsurer or insurer may be overly concentrated in one area) of the global reinsurance market are dispersed or concentrated among certain reinsurers or insurers?*

If the IAIS is concerned about geographical concentration in a single reinsurer's liabilities, reinsurers can assess this much better and much more unambiguously using a simple quantitative measure. However, the reinsurance market is global in nature and a significant portion of reinsurance business is cross border. It is therefore less relevant to consider local concentrations in the context of global systemic risk. No definition of "area" i.e. country, region, jurisdiction, is fully appropriate in this global context. The focus of all analysis in the context of reinsurance should be on "global" systemic relevance.

Entry and exit, and transparency

24*: What types and forms of information exchange with prospective G-SIIs should the IAIS consider?*

We advocate that insurers should already being involved in Phase III, as this phase requires extensive interpretation of insurance features. Insurers should be able to explain their qualitative features in the process, and could add value by providing an appropriate perspective on a firm’s activities and risk profile.

The information exchange in Phase IV should include a synopsis of the IAIS’ interpretation of the data submitted for Phase I, a review of the assessment score – indicator by indicator, and a review of the results of the Phase III qualitative assessment – including the rationale for changing the assessment methodology score of the firm.

25: *Is it reasonable for Phase 2 of the Methodology to be the basis for applying HLA to G-SIIs? Please indicate any alternative methods that the IAIS should consider for this allocation process. What constraints, if any, should be applied to Phase III’s effect on the allocation of HLA?*

The current quantitative Phase II in the proposed methodology considers indicators of systemic relevance that in our view do not well define the systemic importance of insurers. In addition it does not account for the additional critical elements of the insurance business model (ALM and hedging, collateral, reinsurance agreements, asset liquidity profile, other risk management activities). Without a

robust set of appropriate quantitative indicators that measure systemic risk, Phase II may not accurately measure the potential systemic importance of insurance groups, and until the IAIS has developed appropriate indicators it should not be used for HLA purposes.

Subject to a framework that would ensure that Phase III evaluation is consistent, comparable and transparent (as described elsewhere in our response), we agree that Phase III criteria should act to ensure that an insurer's score and rank reflect the potential of its failure to impact the financial system at large. We therefore support using information gained from a transparent and comparable Phase III to adjust the quantitative score developed in Phase II and thereby be taken into account for HLA purposes.

***26**: What factors, such as stability in the G-SII list, should the IAIS consider when determining the appropriate presumption period for G-SII status?*

Entry and exit from G-SII designation should be based on a high-quality and objective assessment of potential systemic risk. Where an insurer has taken planned steps agreed with their supervisor to address aspects of their systemic designation, the completion of those steps should dictate when the insurer should be regarded as no longer meeting the requirements for designation as a G-SII. We prefer that there is no arbitrary deadline in this respect.

However, if the IAIS were to consider a 2-year presumption period, then we advocate that it follows a symmetrical approach where a 2-year delay is also applied to G-SII designation. If identified as a new candidate G-SII, the firm is notified, and maybe imposed the production of a systemic risk management plan. If reconfirmed the next year, it is designated. It would give both the group supervisor and the firm a chance to act upon the designation, at a minimum to prepare. However, if the designation is related to M&A and/or the score in the interconnectedness and NTNI categories would explode, it would make sense to designate immediately.

***27**: How and, if so, to what extent should conceptual aspects of the Proposed Methodology, including the data instructions, the data template, and the detailed formulas used for the calculation of indicator scores be made publicly available? If made publicly available, who should disseminate this information? What factors should the IAIS consider in this respect?*

We see little value in the IAIS publishing the methodology for designating G-SIIs before it is final. The scores of G-SIIs should remain confidential.

***28:** How and, if so, to what extent should the resulting score be communicated to the prospective G-SII?*

In this instance, prospective G-SII should be interpreted to include all firms participating in the G-SII exercise. The score should be communicated with the participating firm, preferably through the group wide supervisor. Such a notification should at a minimum include the G-SII's score for each of the indicators, as well as the overall score and HLA bucket applicable.

***29:** How and, if so, to what extent should the data used for the calculation of the scores and the resulting scores be made transparent to the public? If made publicly available, who should disseminate this information? What factors should the IAIS consider in this respect?*

We are against the disclosure of G-SII scores, as the public sharing of such sensitive information could be interpreted or used by third parties. A list similar to that for G-SIBs could be used once the methodology has been refined. The current G-SII methodology is not an accurate assessment of systemic risk, which could give misleading signals to the market. Publishing G-SII scores without first building a clear, well understood link to systemic risk could also create problems for supervisors and industry and has the potential to unduly undermine the stability of insurance and the critical role that these parties play to their stakeholders, the policyholders and broader system.

Comments on the NTNI Activities and Products Review

Elements of the NT analysis

1: *Based on the above characterisation of NTNI, is the terminology "nontraditional" confusing? If so, what might be a better term than NTNI? Additionally, what might be a better term than "traditional" for products and activities that are not NTNI?*

We think the characterization of insurance products as 'traditional' and 'nontraditional' is indeed confusing. A better terminology would be Potentially Systemically Relevant Activities (PSRA).

2: *Are there any other benefit or liquidity features that should be taken into account in identifying NTNI products and activities?*

Yes.

- We believe the NT framework does not reflect all the dimensions of the relationship between guarantees and market and liquidity risk. Most importantly, while the use of guarantees is indeed relevant to determine an insurer's exposure to market risk, this also holds for liquidity risk. Yet this is unaccounted for in the framework. Presence of guarantees and insurance coverage creates disincentives for policyholders to surrender contracts in stress scenarios, which reduces the requirement for insurers to sell assets and reimburse policyholders, or for policyholders to switch to less risky assets. Both factors reduce the risk of liquidity and of fire sales. This should be better reflected in the market and liquidity risk analyses.
- A significant part of "credit protection/insurance" and/or "financial guarantee" insurance meets the category of "indemnity". Claims amounts are unknown ex ante and the policies cover for a specific loss, not a guaranteed value. This does not expose the insurer to substantial market risk. We would advise the IAIS to replace "Credit Insurance / Financial Guarantee" by three categories: Credit Insurance, Surety, and Other Credit Covers including Financial Guarantee. In its current form, the list combines multiple products with significantly different characteristics.
- Since CDS are not considered insurance contracts we would suggest to leave them out of your table on page 10 of the NTNI consultation document under the header features of insurance contract. CDS are correctly captured as derivatives in the relative indicator as part of NI-activity.

3*: Do the identified transmission channels appropriately capture the ways in which the vulnerabilities could amplify shocks and create systemic risk? What, if any, other channels should be considered?*

Inter-institutional exposures and procyclical asset liquidations are commonly identified by regulators and academics around the world as transmission channels of systemic risk, and we agree with their relevance in a systemic risk framework.

However, we believe that the proposed method for identifying non-traditional insurance products blurs the distinction between transmission channels for systemic risk, and vulnerabilities. Vulnerabilities are addressed by microprudential regulation; it is important to ensure that this regulation does not overlap with systemic risk regulation. The liquidity and market risks of products identified by the proposed method as non-traditional are mainly indicative of the risk profile of the individual insurer. However, it is mostly unclear how they either increase the insurer's exposures to other financial institutions, or increase the likelihood of asset liquidations with consequences for the financial system as a whole.

Market risk

4*: Are these the appropriate two steps that should be used to assess whether a benefit feature could exposure the insurer to substantial market risk? What other steps, if any, should be considered in the analysis? Should the two steps be given equal weighting in the assessment of whether a product has substantial market risk? Should the nature of the two step analysis be disjunctive or conjunctive?*

5: *Does the list above assess a comprehensive set of benefit features? What, if any, benefit features are not assessed in this section that the IAIS should consider? Do the benefit features listed in this section help provide the IAIS with sufficient information to characterise products and activities as NTNI in a way that applies equally across jurisdictions?*

Our answer to question 4 and 5:
We believe that the market risk analysis does not capture all the relevant dimensions of the impact of market risk on insurers. First, and as stated in our answer to Question 2, we believe the NT methodology should perform its analysis on a more granular level to account for the many variations in which life products are offered. For instance, profit participation products may or may not be unitized and their guarantee may or may not be tied to the existence of a profit in the first place.

Specifically, the NT methodology does not incorporate all dimensions of the relationship between guarantees and market risk. While it is correct that guarantees lead to insurers taking on risks from their customers, guarantees also reduce incentives for policyholders to switch to less risky assets in stress scenarios, therefore reducing requirement for insurers to trade assets. This should be better reflected in the market risk analysis.

Second, in assessing product features which create market risk, the IAIS has only included the ability to match liability cash flows as a way of managing this risk. The framework ignores the use of derivatives, implying that all use of derivatives is seen to have a similar impact. Yet there may be instances where derivatives are bought at inception of contracts and held to maturity and therefore no ongoing trading is necessary, such as may be the case when buying a swap to manage asset duration to match liabilities. Such use of derivatives may be different from the use of derivatives to implement a more dynamic hedging strategy. In fact, the use of derivatives to hedge non-linear exposures can prevent the need for

an insurer to pursue complex, dynamic hedging strategies of continuously rebalancing bond and equity positions. Further, the systemic implication of use of the various types of derivatives can be different. If an insurer buys options, it is not creating counterparty risk for the seller but is exposed to counterparty risk.

We would like to stress that it remains unclear from the market and liquidity risk analyses how these vulnerabilities relate to systemic risk. While the liquidity and market risks identified in the proposed non-traditional insurance (NT) methodology are indicative of the risks on an individual insurer's balance sheet, they are not necessarily indicative of the risks posed by the insurer's activities to the financial system at large. As with all insurance products, the presence of a vulnerability should only be addressed by systemic risk regulation if its order of magnitude warrants it and it links to a transmission channel of systemic risk.

Footnote 9 on page 10 of the NTNI consultation document supports the exemption of derivatives use in the NT assessment method by stating that a firms' hedging strategy could break down if they are unable to roll over derivatives in a stressed market. While this is a possibility, such an event will create a risk only for the insurer and is a microprudential issue. The footnote also mentions that derivatives in effect substitute market risk for counterparty risk. While this is correct, this also is a microprudential risk which is managed through collateralization and counterparty limits. We strongly advocate that use of derivatives be recognized as a risk mitigant under the G-SII and NTNI assessment frameworks; that way, the frameworks would incorporate incentives for good risk management by insurers.

Lastly, regarding credit guarantees, it would be useful to incorporate in the table in paragraph 3.6 that short term trade credit (with a coverage period of less than one year) is not classified as NT, consistent with IAIS field testing instructions.

Liquidity risk

6: *Do the proposed time periods appropriately capture liquidity risk?*

The length of the periods suggested as liquidity thresholds is rather high. In our opinion, less than three months should be enough time for appropriate (dis)investment actions to mitigate increased liquidity demands. The current classification would lead to many insurance products falling in bucket Medium ('Delay in access between 3 months and 1 week'). That would limit the usefulness of this framework and lead to uncertainty, as insurance products in bucket Medium would automatically get an 'NTNI classification subject to the absence of the narrow set of factors and supervisory judgment based on a wider set of overriding factors'.

7: *Other than contractual penalties or taxing requirements, what other economic penalties should be captured? These should be readily quantifiable and generally applicable (i.e. not policy- or policyholder-dependent).*

We recognize the IAIS' interest in purely quantifiable metrics; however, the heterogeneity of the insurance sector, which the IAIS has acknowledged, does not easily lend itself to such measures. A narrow focus on only readily quantifiable and generally applicable penalties that are not policy- or policyholder-dependent would produce an incomplete picture of surrender risk.

As noted by the IAIS in 3.11, it is more likely that a complex interaction between contract features, the state of the insurer, the market environment, individual characteristics and other dynamics will determine the extent to which counterparties have an incentive to surrender. Therefore focusing on only two factors is not a good proxy for assessing the liquidity of liabilities.

In addition, penalties – including contractually defined, tax related, and other potential factors – will vary from policy to policy and would be impossible to for the industry or supervisors to measure in a consistent and timely manner. Further, one of the most important factors - the cost of forgoing insurance protection - cannot be measured.

Therefore, in addition to economic penalties, the IAIS should consider the 'economic cost disincentives' that policyholders are exposed to.

8: *Do the proposed economic penalty thresholds appropriately capture the monetary disincentives to surrender?*

We would appreciate it if the IAIS could provide more clarity on the basis for the currently proposed economic penalty thresholds. Penalties below 20% already represent very significant losses for customers on their insurance or pension. We do not consider 20% to be representative of penalties applied within the industry; a lower threshold would be more appropriate.

9: *Are the above factors relevant to insurers' exposure to liquidity risk? How might these factors be objectively assessed and weighted, given the differences across jurisdictions and firms?*

It is important that judgment of the group supervisor be applied to assess the wider set of factors.

We appreciate the IAIS acknowledging the role of the factors in section 3.2.1.3 as they are exactly the types of nuances and critical elements we refer to in our response to question 7. Such factors are critical elements in the assessment of policy surrender risk. As with other key elements, the IAIS should be taking into consideration in their measures - such as risk management practices - that there will unlikely be an objective and consistent method for assessing and weighing these factors.

10: *What other considerations might be relevant to insurers' exposure to liquidity risk? Should these be incorporated into the framework as ancillary factors? To this end, how might these factors be objectively assessed and weighted, given the differences across jurisdictions and firms?*

As a general comment, we believe that the assessment of liquidity risk in the context of insurance is disproportionate. We welcome that the IAIS has included consideration of a set of factors wider than surrender charges and delay in surrender in assessment of liquidity risk, and that the IAIS includes the option of ancillary factors in the proposed method. We deem several factors to be relevant for the method:

- While it is correct that guarantees lead to insurers taking on risks from their customers, increasing their exposure to market risk, *the presence of guarantees and insurance coverage reduce the likelihood of surrender* in stress scenarios. By doing so, there is less of a requirement for insurers to sell assets especially in weak markets, when the guarantees are likely to be in the

money for policyholders. The policyholder would have to forgo the guarantee benefit when surrendering the policy. This should be better reflected in the liquidity risk analysis.

- The *ability to lower surrender values*. In some instances, supervisors by law have the power to do so. Inclusion of this tool would provide the right incentives for regulators to amend jurisdictions' legal framework to address systemic risk. Consequently, we suggest to include the paragraph at the bottom of page 19: "In addition, some supervisors are able to reduce the value of guarantees associated with in-force business, which could reduce the pressure on the firm's solvency" in the narrow set of factors or at least in the wider set of factors on page 17.
- In many cases, insurers will also have the *contractual ability to delay surrenders*.
- *Operational differences* between banks and insurers should also be recognized. Where bank depositors can access funds immediately through ATMs or mobile or online banking, insurance policies cannot be surrendered in the same immediate way.
- Most insurers *do not manage their liquidity at the product level* but rather via liquidity pools. Recognition of available liquidity resources and analysis of the covering assets' liquidity features should become an explicit determinative factor for NTNI designation.
- Products such as unit linked products or separate accounts, where the policyholder entirely bears the investment risk, do not expose the company to liquidity risk if the investments are clearly allocated to the policyholder, no investment guarantees exist or guarantees expire fully in case of surrenders. As with all insurance products, the presence of a vulnerability should only be addressed by systemic risk regulation if its order of magnitude warrants it and it links to a transmission channel of systemic risk.

Products with protection and savings components

11: *For those products with both protection and savings components, how should the distinction most clearly be drawn between those that resemble deposits and those that do not? Which considerations should be included in the narrow and the wide sets of ancillary factors?*

In the majority of jurisdictions, savings products require a protection component to be considered insurance products and for an insurance company to sell them. If a jurisdiction permits the selling of savings products without a protection component, this product will be assessed as the rest in terms of liquidity and market risk, etc. and will fall in the appropriate category. A priori, whether a product has a protection component or not should not be a determinant of higher or lower risk.

12: *How should the IAIS think about the liquidity risk of products that combine savings and protection benefits? Does the proposed approach appropriately reflect the potential liquidity risk on such products or would there be a better way to address this?*

Where the contract includes protection such that it cannot be separated from the rest of the contract, the contract is very unlikely to be perceived as a pure deposit by policyholder. In particular, in a systemic crisis, the policyholder will cancel other financial contracts first, while keeping the insurance policy as a safe harbor. Therefore, during market wide stressed conditions, insurance contracts offering protection provide stability rather than exacerbating of these conditions.

Other relevant factors

13: *Recognising that they are not determinative, what other factors might influence insurers' exposure to market or liquidity risk?*

Please refer to our answers to questions 4, 5 and 10.

14: *Should these factors be taken into account as determinative in the NTNI classification? To this end, how might these factors be objectively assessed and weighted, given the differences across jurisdictions and firms? To what extent, if any, do these factors allow for the consistent application of the NTNI concept across jurisdictions?*

Yes, these factors should be taken into account as determinative. Factors that cannot be measured objectively should not be taken into account as determinative, but rather be included for supervisory judgment.

Conclusion

15: *Is the list of products and activities set out in Annex 1 representative of the insurance activities and products that are conducted in the listed jurisdictions? Are there other products and activities that should be added to the list, for example because they have similar features as those in Annex 1? To what extent, if any, will the analysis of the products and activities in Annex 1 allow for the consistent application of the NTNI concept across jurisdictions? Also, are there additional or alternative terms for the listed products and activities that should be added to improve the completeness and clarity of the list?*

Annex 1 of the NTNI consultation document includes 'certain types of property and casualty/liability insurance'. This categorization of insurance products is quite broad and therefore does not really help the sector understand which products are regarded as systemic by the IAIS. We would appreciate if the IAIS could provide specific examples of these products.

Annex 1 of the NTNI consultation document also includes "certain types of health insurance." This categorization of insurance products could vary greatly merely by name and jurisdictional interpretation. We would appreciate if the IAIS could provide specific jurisdictional examples of health insurance that will be subject to the IAIS's analytical review as the second step of a three step analysis. We cannot think of any health products that could be classified as NTNI based on the proposed analytical framework.

A classification of Credit Insurance/Financial Guarantee products should be carried out based on individual product features at the most granular level feasible, in order to account for significant differences between products (even of the same type) both within and between jurisdictions.

16: *In light of your response to this Consultation, to what extent, if any, should the IAIS revise the existing NTNI Principles to allow for the consistent application of the NTNI concept across jurisdictions? To what extent do the three Principles help inform the IAIS' common understanding of what products and activities should be classified as NTNI? Please explain your answer.*

Principle 1 states that 'Products that provide credit guarantees to financial products such as securities, mortgages and other traded or non-traded instruments – whether principal or interest – can be considered NTNI." We believe this principle should be reconsidered in light of the framework. There is a wide array of products that fit the above description, not all of which contribute to systemic risk or would meet the classification of NTNI as given in this consultation. We propose to add the explanation "when credit guarantee or coverage is short-term in nature then the exposure to systemic events is limited" to the principle.

Principle 2 states that 'Policies or products that expose the insurer to substantial market and liquidity risk and require more complex risk management practice by the insurer in order to hedge those risks and may require substantial, complex, and dynamic use of derivatives, can be considered NTNI."

We believe that Principle 2's focus on market and liquidity risks, and the use of derivatives to identify products that may contribute to systemic risk is inaccurate, and that the Principle would therefore require revision. At this moment, it remains mostly unclear from the NTNI framework how vulnerabilities such as market and liquidity risks link to transmission channels of systemic risk (asset liquidations and inter-institutional exposures). As we have elaborated in our answer to question 11 of the G-SII assessment methodology consultation, it is equally unclear in most instances how and why the use of derivatives would be a defining characteristic of insurance products being systemically important. Derivatives are an essential tool for risk management for insurers, and risks associated with their use are often managed through measures such as counterparty exposure limits, collateralization and central clearing.