INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

Public

ICS Consultation Document – Responses to Comments on Look-Through & Life Insurance Risks (Sections 9.2.1.2 – 9.2.2.4)

9 March 2016

About this slide deck

1. This is the next tranche of resolutions of ICS Consultation Document (ICS CD) responses and comments received from IAIS Members and Stakeholders.
2. Member comments are grouped, noting that:
   i. Members who provided confidential responses are not explicitly identified, but the total number of responses received is reported; and
   ii. it is the policy of some Members to not comment on public consultations.
3. Stakeholder comments are presented on a thematic basis.

Glossary of Member Acronyms

AMF	Autorité des Marchés Financiers, Quebec, Canada
BaFin	Federal Financial Supervisory Authority, Germany
BMA	Bermuda Monetary Authority
CIRC	China Insurance Regulatory Commission
EIOPA	European Insurance and Occupational Pensions Authority
Hong Kong	Office of the Commissioner of Insurance
MAS	Monetary Authority of Singapore
NAIC	National Association of Insurance Commissioners, United States
OSFI	Office of the Superintendent of Financial Institutions, Canada
Russia	Central Bank of the Russian Federation

9.2.1 Look through

Question 59. Should a look-through approach be applied on the basis of Option 1 or Option 2?

AMF, BaFin, EIOPA, MAS and five other Members support Option 1, which looks at the underlying current exposure.

OSFI supports Option 2, which looks at the maximum risk exposure of the fund.

Stakeholders views varied. Most stakeholders support Option 1. However, there was also support for Option 2, as well as a few stakeholders commenting that a look-through approach should not be applied, but rather a standard factor should be developed.

IAIS Response: The IAIS intends to maintain Option 1 for 2016 field testing. In addition, data will be collected on the exposure amount to which the look-through approach applies.

9.2.1 Look through

Question 60. Is the proposed grouping above appropriate? How can the grouping be refined?

AMF, BaFin, EIOPA, MAS, OSFI and six other Members support the proposed grouping, which is by portfolios of products or policies where the exposure to insurance risk is homogeneous within the class.

Most stakeholders support the proposed grouping of policies for life risks. Suggestions for refinement included grouping policies together with similar characteristics, risk exposures and durations. One stakeholder suggested that the appropriate level of grouping should be determined based on the risk being analyzed. One stakeholder commented that in principle, the scenarios should be applied consistently within a single jurisdiction, regardless of the homogeneous risk group.

IAIS Response: The IAIS intends to maintain the proposed grouping for 2016 field testing.

9.2.2.2 Mortality and longevity risks

Question 61. Is it appropriate and practical to use a stress approach to calculate the mortality and longevity risks for some products/portfolios within the ICS? If yes, which products/portfolios? If not, why not (see also Question 62)?

AMF, BaFin, CIRC, EIOPA, MAS, OSFI and six other Members support the use of a stress approach.

Most stakeholders support the use of a stress approach, in particular for products with a duration greater than one year. A few stakeholders commented that only internal models will provide a truly risk sensitive approach.

IAIS Response: A stress approach will be maintained for mortality and longevity risks for 2016 field testing.

9.2.2.2 Mortality and longevity risks

Question 62. Is it appropriate and practical to use a factor approach to calculate the mortality and longevity risks for some products/portfolios within the ICS? If yes, which products/portfolios? Of not, why not?

BaFin, EIOPA, MAS, OSFI and six other Members do not support the use of a factor approach.

AMF suggested that factors could be used when the results are similar to a stress approach.

CIRC commented that factors are appropriate for premium risk and reserve/outstanding claims risk.

OSFI commented that factors are appropriate for short-term products or where mortality/longevity risk is minimal.

Most stakeholders do not support the use of a factor approach. Some Stakeholders expressed support for a factor approach for those products with durations less than one year or non-participating products.

IAIS Response: A stress approach will be maintained for mortality and longevity risks for 2016 field testing.

9.2.2.2 Mortality and longevity risks

Question 63. Where risk mitigation tools are used, which ones are more practically measured separately from the liabilities and which ones are more practically measured in combination with the liabilities?

AMF, OSFI and two other Members support measuring risk mitigation tools separately from the liabilities, while BaFin, EIOPA, and four other Members support measuring risk mitigation tools in combination with the liabilities.

MAS commented that it would depend on the type of liability.

Stakeholders commented that the following should be measured separately from the liabilities: credit for participating insurance, adjustments to cost of insurance rates, reinsurance, derivatives and securitizations.

Stakeholders commented that the following should be measured in combination with the liabilities: reinsurance, mortality swaps, hedges, and management actions that changes cash flows to policyholders such as credited interest rates, fees, mortality changes and dividends payable.

IAIS Response: Instructions for the use of risk mitigation techniques were provided in the Technical Specifications for 2015 field testing. The IAIS continues to consider which risk mitigation techniques should be measured separately from the liabilities and which should be measured in combination with the liabilities.

9.2.2.2 Mortality and longevity risks

Question 64. How should participating policies be allowed for in the mortality and longevity risk charge calculations?

EIOPA and three other Members suggest using the difference between the risk charges calculated with and without a reduction of benefits due to management actions.

MAS suggests applying a shock to the guaranteed benefits only.

AMF suggests considering any historical evidence of reducing participating dividends.

OSFI suggests considering the ability and willingness of the insurer to pass through dividends, where ability is measured as the present value of future dividends and willingness can be reflected through a haircut to the present value of dividends available to absorb adverse movements in mortality and longevity (e.g. 50% haircut).

9.2.2.2 Mortality and longevity risks

Question 64. How should participating policies be allowed for in the mortality and longevity risk charge calculations?

Several stakeholders highlighted the need to take into account the impact of management actions for participating policies. The effectiveness, legal enforceability and willingness of management should be considered.

A few stakeholders suggest using a stress calculation approach.

Other suggestions include considering historical evidence of reducing participating dividends, a separate calculation for participating policies, and only including non-discretionary benefits in the calculation.

IAIS Response: The IAIS intends to maintain the current stress approach for 2016 field testing, including allowance for management actions that reduce liabilities for future bonuses and other discretionary benefits of participating policies.

9.2.2.2 Mortality and longevity risks

Question 65. Which sub-risk components (see paragraph 194) should be included within the mortality and longevity risks calculation?

BaFin, EIOPA, OSFI and six other Members support the inclusion of all three sub-components: level, trend and volatility.

AMF supports the inclusion of level, trend and volatility risk for mortality risk, but only level and trend risk for longevity risk.

MAS commented that it may not be necessary to include volatility risk, but supports the inclusion of level and trend risk.

Most stakeholders support the inclusion of level and trend sub-components, but not volatility as it is considered immaterial. Most other stakeholders support the inclusion of a level sub-component only while one stakeholder does not think level should be included. A few stakeholders support a volatility sub-component for mortality risk only.

IAIS Response: The IAIS may test a shock to trend in 2016 field testing, in addition to a shock to level. For reasons of proportionality, volatility will not be shocked.

9.2.2.2 Mortality and longevity risks

Question 66. For each risk component that should be included, which approach may be most appropriate for its measure and why?

BaFin, EIOPA, MAS and five other Members support a simple stress approach, as outlined in the consultation document.

Most stakeholders support a stress simple approach, as outlined in the consultation document.

IAIS Response: A simple stress approach will be maintained for level risk for 2016 field testing. If trend is included, a simple stress approach will also be used.

9.2.2.2 Mortality and longevity risks

Question 67. Should the IAIS explore other groupings or should it not further explore one or both of the geographic or stress bucket groupings in favour of determining a specific level of stress for each jurisdiction as these implement the ICS at the then specified target criterion?

EIOPA and four other Members do not support geographical differentiation.

BaFin, Hong Kong, MAS and one other Member support geographical differentiation if there is data to support different stresses.

CIRC commented that China should be a separate bucket, while OSFI suggested separating the UK from Europe.

Stakeholders responses varied. Some stakeholders support the proposed geographical split, while a few do not believe there should be a geographical split. Stakeholders from jurisdictions with higher stresses questioned the level of the stresses.

IAIS Response: The IAIS continues to consider the use of geographic differentiation for mortality and longevity risk.

9.2.2.2 Mortality and longevity risks

Question 68. Are there jurisdictions where an IAIG does business for which it may not be clear in which geographic grouping it should be included? If yes, what are the jurisdictions an in which geographic group should they be included?

EIOPA and three other Members commented that there is no need for geographical groupings.

Few stakeholders responded to this question. Some stakeholders commented that the groupings are clear, while one stakeholder commented that the groupings were unclear. There was a suggestion to define specific criteria to determine which jurisdictions would be considered ‘other developed’ and ‘emerging’ markets. Another suggestion was to eliminate ‘Other developed’ and include three new groupings: Hong Kong, Other Asia Pacific and All Other.

IAIS Response: The IAIS continues to consider the use of geographic differentiation for mortality and longevity risk.

9.2.2.2 Mortality and longevity risks

Question 69. How could stress buckets/groupings be used and how should these be defined?

EIOPA and three other Members commented that there is no need for geographical groupings and that the same stress should be applied to all jurisdictions.

Stakeholders responses varied. Some responded that any grouping should be clearly justified and based on historical data. One stakeholder suggested that grouping should be used to segment stresses in order to improve risk sensitivity. One stakeholder questioned the need for groupings.

IAIS Response: The IAIS continues to consider the use of geographic differentiation for mortality and longevity risk.

9.2.2.2 Mortality and longevity risks

Question 70. If GAAP with adjustments were used as an alternative valuation approach for the ICS, detail those adjustments, if any, that would be required to produce a comparable mortality/longevity risk charge to that produced using the Market-Adjusted valuation approach under the mortality/longevity risk charge described in this section.

BaFin, EIOPA and four other Members support the same approach to risk measurement regardless of the valuation basis.

NAIC and one other Member commented that it is difficult to answer since GAAP with adjustments is still under development.

Few stakeholders responded to this question. One stakeholder commented that it is difficult to answer since GAAP with adjustments is still under development. Two stakeholders responded that a GAAP with adjustments approach is not feasible.

IAIS Response: As the GAAP with adjustments approach is further developed, interactions with and implications for the mortality/longevity risk charge will be considered.

9.2.2.3 Morbidity/disability risk

Question 71. With respect to the list of examples of major types of morbidity/disability in paragraph 211, the expectation is that the "Other" category should be small. Are there material omissions in the preceding list of examples?

BaFin, EIOPA, OSFI and five other Members responded that the list is comprehensive.

Most stakeholders responded that the list is comprehensive or asked for more clarity on the specific risks. A few stakeholders responded that the list was not comprehensive enough. The following changes were suggested:

- New categories: dental, dread disease, hospital indemnity, infirmity, accidental death and dismemberment, travel insurance
- Expand critical illness to include payment upon diagnosis
- Differentiate disability between short-term and long-term
- Differentiate between individual and group coverage
- Do not limit accident to "at work"
- Exclude health insurance – it is not a risk, but rather a benefit
- Exclude non-life risk events from the scope
- Do not separate morbidity and disability from non-life business

IAIS Response: The IAIS is considering a redesign of the treatment of health risks (including morbidity/disability) for 2016 field testing compared to the design in 2015 field testing. The new design aims to address some of the suggestions from Stakeholders.

9.2.2.3 Morbidity/disability risk

Question 72. Are there any material or benefit payment approaches (or implications of them) that that should be included but are not mentioned above?

EIOPA and five other Members responded that the list of comprehensive.

OSFI commented that waiver of premium and credit payments should be considered.

Most stakeholders responded that the list of comprehensive.

One stakeholder noted that LTC is neither a single benefit payment nor an income stream, but rather a series of indemnity payments.

One stakeholder responded that waiver of premium should be considered.

IAIS Response: The IAIS is considering a redesign of the treatment of health risks (including morbidity/disability) compared to the design in 2015 field testing. Other approaches to benefit payments could be considered implicitly within the calibration.

9.2.2.3 Morbidity/disability risk

Question 73. Regarding the over/under payment risk, is this likely to be significant? More generally, are there good reasons for excluding consideration of the over/under payment risk in the design of risk charges for morbidity/disability risk?

EIOPA and four other Members support the consideration of over/under payment risk.

BaFin, MAS, OSFI and one other Member do not support the consideration of over/under payment risk since it is not significant.

Most stakeholders do not support the consideration of over/under payment risk since it is not significant. A few stakeholders commented that it should be considered in operational risk.

IAIS Response: The IAIS does not intend to explicitly consider over/under payment risk. However, it could be considered implicitly within the calibration.

9.2.2.3 Morbidity/disability risk

Question 74. Should a distinction be made between “similar to life” products and “not similar to life” products? Or should a stress scenario as designed above be applied consistently across all the portfolio of policies of IAIGs?

CIRC, EIOPA, MAS, OSFI and six other Members support distinguishing between “similar to life” products and “not similar to life” products.

AMF and BaFin do not support distinguishing between “similar to life” products and “not similar to life” products.

Stakeholders were almost evenly split on this question; however, more stakeholders do not support distinguishing between “similar to life” products and “not similar to life” products.

IAIS Response: For 2016 field testing, the IAIS is considering alternative designs that may or may not remove the distinction between “similar to life” products and “not similar to life”.

9.2.2.3 Morbidity/disability risk

Question 75. With regard to the stress scenario, is the example provided above fit for purpose? If not, why? If "no", what should be refined, e.g. the differentiation of the stress factors by type of biometric risk; by geographical area; by point in time in the future (please indicate in order of priority)?

Two Members responded that the example is fit for purpose.

EIOPA and four other Members responded that the example partially fits the purpose.

BaFin, MAS and OSFI suggest refinements to the example.

Approximately half of stakeholders responded that the example is fit for purpose, while half of stakeholders responded that refinements are needed. Suggested refinements include: geographical differentiation and refinement of the correlation between incidence and termination rates.

One stakeholder responded that more clarity is needed on what is meant by “relative increase of the medical expenses costs”. Another stakeholder commented that the confidence level of the scenario is unclear.

IAIS Response: The IAIS is considering a redesign of the treatment of health risks (including morbidity/disability) compared to the design in 2015 field testing. This example would no longer be relevant under the new design.

9.2.2.3 Morbidity/disability risk

Question 76. Is the combination structure presented above (simultaneous occurrence of stresses) appropriate? If not, why and what is the alternative?

BaFin, CIRC, EIOPA and four other Members commented that the structure is appropriate for incidence and recovery rates, but expenses should be dealt with separately.

AMF and one other Member support the combination structure.

Stakeholders responses varied. A few stakeholders support the combination structure, while a few do not. Some stakeholders commented that the combination structure is too simple or it may lead to an overestimation.

One Stakeholder commented that each risk should be separately evaluated and a combined risk charge recognizing diversification should be developed.

One stakeholder commented that simultaneous occurrence of stresses is not appropriate as the drivers of each sub-risk are not the same.

IAIS Response: The IAIS is considering a redesign of the treatment of health risks (including morbidity/disability) compared to the design in 2015 field testing. The presented structure would no longer be relevant under the new design.

9.2.2.3 Morbidity/disability risk

Question 77. If GAAP with adjustments were used as an alternative valuation approach for the ICS, detail those adjustments, if any, that would be required to produce a comparable morbidity/disability risk charge to those produced using the market-adjusted valuation approach under the morbidity/disability risk charge described in this section.

BaFin, EIOPA and four other Members support the same approach to risk measurement regardless of the valuation basis.

Few stakeholders responded to this question. One stakeholder commented that it is difficult to answer since GAAP with adjustments is still under development. Two stakeholders responded that a GAAP with adjustments approach is not feasible.

IAIS Response: As the GAAP with adjustments approach is further developed, interactions with and implications for the morbidity/disability risk charge will be considered.

9.2.2.4 Lapse (contractual option) risk

Question 78. Does the proposed scope capture the key risks relating to lapses? If not, please provide comments on any other key risks that should be considered.

EIOPA, MAS and five other Members responded that the scope captures the key risks relating to lapses.

A few stakeholders responded that the scope captures the key risks relating to lapses.

Stakeholders sought clarifications on how various policyholders' options should be accounted for including: renewal, paid-up options, partial withdrawals, additional premium payments, utilization benefits.

One stakeholder suggested the inclusion of early duration lapses (due to agent/producer behavior) and mortality anti-selection.

One stakeholder noted that the U.S. did not experience any mass lapse events during the 2008-09 financial crisis.

IAIS Response: The IAIS will retain the scope as published in the consultation document; however, further clarifications will be provided based on stakeholder comments.

9.2.2.4 Lapse (contractual option) risk

Question 79. Is the proposed grouping by geographical region appropriate for lapse risk? If not, what should be the appropriate geographical grouping?

EIOPA and four other Members do not support geographical differentiation or commented that it is unnecessary.

BaFin supports geographical differentiation only if there is data to support different stresses.

MAS and one other Member commented that the proposed grouping is appropriate.

CIRC commented that China should be a separate bucket, while OSFI suggested separating the UK from Europe.

CIRC and one other Member commented that differentiation by product type should be considered.

9.2.2.4 Lapse (contractual option) risk

Question 79. Is the proposed grouping by geographical region appropriate for lapse risk? If not, what should be the appropriate geographical grouping?

Most stakeholders do not support geographical grouping for lapse risk and suggested differentiating lapse risk by product type.

A few stakeholders support a more granular geographic grouping. One suggestion was to eliminate 'Other developed' and include three new groupings: Hong Kong, Other Asia Pacific and All Other.

Two stakeholders responded that the proposed grouping is appropriate, while two stakeholders support geographical differentiation only if there is data to support different stresses.

IAIS Response: The IAIS continues to consider the use of geographic differentiation for lapse risk.

9.2.2.4 Lapse (contractual option) risk

Question 80. Should the mass lapse risk charge depend on the type of products? If yes, how should the mass lapse risk charge be considered by product?

BaFin, EIOPA, MAS and six other Members support a mass lapse risk charge that varies by product.

OSFI suggested grouping products between lapse supported and lapse sensitive at the portfolio level.

Most stakeholders support a mass lapse risk charge that varies by product.

A few stakeholders commented that it is a crisis of confidence in the insurer/industry that could cause mass lapse, not the type of product.

There were suggestions to consider a mass lapse risk charge that varies by: savings vs protection; individual vs group, lapse sensitivity of the product; liquidity features of the product; high level portfolio grouping.

IAIS Response: For 2016 field testing, the IAIS intends to continue differentiating products between retail versus non-retail, but does not intend to continue differentiating policies between those with a positive or negative surrender strain.

9.2.2.4 Lapse (contractual option) risk

Question 81. Is the above methodology appropriate? If not, please provide comments on how the methodology can be refined.

EIOPA, MAS and five other Members responded that the methodology is appropriate.

EIOPA and four other Members also commented that mass lapse should not be limited to a period of 12 months.

AMF and OSFI support grouping policies into lapse supported and lapse sensitive policies.

Most stakeholders responded that the methodology is appropriate. A few stakeholders responded that the methodology is not appropriate, while some commented that mass lapse should be addressed as a separate risk event.

IAIS Response: For 2016 field testing, the IAIS intends to explore different designs and calibrations of the mass lapse charge.

9.2.2.4 Lapse (contractual option) risk

Question 82. Is lapse risk also relevant for Non-life business, and if so, to what extent would the methodology described for measuring lapse risk for life business be appropriate for non-life business?

BaFin, MAS, NAIC and one other Member responded that lapse risk is not relevant for non-life business.

EIOPA and four other Members responded that lapse risk is relevant for non-life business.

OSFI commented that lapse risk for non-life business can be included in premium risk.

Most stakeholders responded that lapse risk is not relevant for non-life business or is immaterial due to the short-term nature. Some stakeholders also commented that lapse risk for non-life business can be included in premium risk.

A few stakeholders commented that lapse risk is relevant, but immaterial for non-life business.

IAIS Response: The lapse risk module applies only to life business. For non-life business, the lapse risk is implicitly accounted for in the non-life risk charges.

9.2.2.4 Lapse (contractual option) risk

Question 83. If GAAP with adjustments were used as an alternative valuation approach for the ICS, detail those adjustments, if any that would be required to produce comparable lapse risk charge to those produced using the market-adjusted valuation approach under the lapse risk charge described in this section.

BaFin, EIOPA and four other Members support the same approach to risk measurement regardless of the valuation basis.

NAIC and one other Member commented that it is difficult to answer since GAAP with adjustments is still under development.

Few stakeholders responded to this question. Two stakeholders commented that it is difficult to answer since GAAP with adjustments is still under development. Two stakeholders responded that a GAAP with adjustments approach is not feasible.

IAIS Response: As the GAAP with adjustments approach is further developed, interactions with and implications for the lapse risk charge will be considered.

9.2.2.5 Expense risk

Question 84. Is the above methodology appropriate? If not, please provide comments on how the methodology can be refined.

BaFin, EIOPA, MAS, OSFI and five other Members responded that the methodology is appropriate.

Most stakeholders responded that the methodology is appropriate for life business.

Most stakeholders also responded that the proposed methodology is not reflective of non-life risk and there exists the possibility of double counting expense risk within premium risk and claim reserve/revision risk.

IAIS Response: The expense risk module applies only to life business. For non-life business, the expense risk is implicitly accounted for in the non-life risk charges.

9.2.2.5 Expense risk

Question 85. If GAAP with adjustments were used as an alternative valuation approach for the ICS, detail those adjustments, if any, that would be required to produce a comparable expense risk charge to those produced using the market-adjusted valuation approach under the expense risk charge described in this section.

BaFin, EIOPA and four other Members support the same approach to risk measurement regardless of the valuation basis.

Few stakeholders responded to this question. Two stakeholders commented that it is difficult to answer since GAAP with adjustments is still under development. One stakeholder responded that a GAAP with adjustments approach is not feasible.

IAIS Response: As the GAAP with adjustments approach is further developed, interactions with and implications for the expense risk charge will be considered.