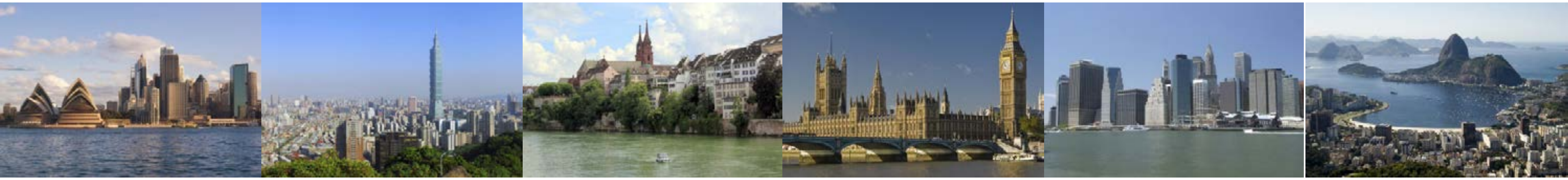
PUBLIC

NTNI Consultation Document
IAIS Responses to Comments



About this slide deck

1. Comments from both Members and Stakeholders are provided
2. Due to the large number of responses, Stakeholder comments are presented on a thematic basis.
3. Comments sent on a confidential basis are not included

Please note, a full list with all (non-confidential) comments grouped by question is also available on this website!

Q1 Members comments

Question 1. Is the terminology non-traditional confusing? If so, what might be better term than NTNI? Additionally, what might be a better term than traditional for products and activities that are not NTNI?

Members comments:

CIRC: We are happy with the two terms. But we suggest further define NI and provide a analytical framework for NI.

NAIC: Yes, the terminology is confusing as it suggests a focus on products and activities that are less common or only more recently undertaken by insurance companies. An alternative that captures the purpose of the IAIS work on NTNI might be Potentially Systemic Activities and Product features or "P-SAP". The term has the additional benefit of making it clear that activities and product features in this category require additional analysis - a second step to evaluate the extent of actual systemic risk to the global financial system.

Q1 Stakeholders comments

Stakeholders comments:

- The vast majority of responses (17/18) favours the introduction of a revised terminology, as it is recognised that the current term does not appropriately capture the systemic features of "NTNI".
- The range of suggestions includes: Potentially Systemically Risky Activities, Potentially Systemically Risky Insurance Products, Systemically Risky Activities, Potentially Systemically Relevant Activities, Systemic Risk Contributing Activities, Potentially Systemically Relevant Exposures. In summary, there appears to be some consensus on reference to the potential systemic nature of these activities.
- A small portion of respondents also agrees that the term is not appropriate, but considers that changing it is not a priority and that the term has been well-integrated in IAIS terminology.
- No respondents have indicated that they deem the current term appropriate.

Q1 IAIS response

IAIS Response:

“The IAIS has decided to replace the NTNI label with a more granular and nuanced assessment of product features, which maintains the consideration that subject to their characteristics or features, certain insurance products may have a greater potential to pose systemic risk”. Consequently, “the first two NTNI Principles in the 2013 IAIS G-SIIs Policy Measures document will no longer be used, having been superseded by the more detailed assessment set out in this document”.

Apart from these Non-traditional insurance products, insurers can also engage in activities that may more appropriately be categorised as “shadow banking” than insurance and thus may be captured by the term Non-insurance. Investment and funding or other capital market activities that result in maturity or liquidity transformation, leverage or imperfect transfer of credit risk, such as repo and securities lending, should be considered potentially systemic non-insurance activities.

Q2 Members comments

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

Members comments:

NAIC: A key issue is that the CD does not clearly explain how the identified market and liquidity risk features are transmitted and pose systemic risk to the global financial system.

Q2 Stakeholders comments

Stakeholders comments:

- Wide range of responses.
- Some respondents believe the set is too narrow, and some suggestions are made to include combinations of features and transmission channels.
- A fair share of respondents suggests that more recognition should be provided to risk mitigation tools and methods, including the use of derivatives.
- Some respondents mention that the framework does not allow for the assessment of “hybrid products”
- Some respondents suggest that product benefit should be assessed in terms of social and economic needs that they address.
- One respondent brings up the suggestion to start by confirming that most insurance products do not contribute to systemic risk.

Q2 IAIS response

IAIS Response:

The IAIS has carried out a contractual features-based assessment of macroeconomic exposure identifying product type, contractual guarantees[1] and extent to which an insurer can invest in order to (contractually) match cash-flows of liabilities with the accompanying varieties to be analysed (see the table in par. 4.5). The combinations of these features considered should cover the vast majority of insurance products sold across jurisdictions.

“Beyond the contractual features, there may be additional influences that are relevant to the discussion of systemic risk but go beyond certain product features and/or require consideration of qualitative aspects. These effects could exacerbate or mitigate the systemic effects and are taking into account as part of Phase III of the assessment methodology”.

The IAIS is committed to a continuing development of alternative metrics and reviewing the current indicators accordingly, in order to refine the measurement of macroeconomic exposure.

As regards the substantial liquidity risk, “the revised framework sets out a combination of quantifiable factors and areas for supervisory judgement in determining the extent to which product features could increase the risk of a run”.

[1] Note that guarantee in this context focusses on explicit minimum benefit guarantees (i.e. those made in the contract) and does not, for instance, include implicit assumptions made in product pricing.

IAIS

Q3 Members comments

Question 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?

Members comments:

NAIC: Yes, these are the key channels for consideration. However the analysis needs to make clear how these channels translate micro prudential risks into macro prudential issues.

Q3 Stakeholders comments

Stakeholders comments:

- The analysis is too micro-focused. There seems to be a general conflation of probability of default (micro risk) and loss given default (macro/systemic risk), which was also phrased as "system to firm" and "firm to system" risk. There should be more emphasis on how the vulnerabilities spread shocks.
- Other comments point out the need for a more thorough transmission channel analysis (which could help with the above). One piece of this that is brought up a lot, is how NTNI creates interconnections with the rest of the system. This, however, means that the issue should be captured in the Interconnectedness category in the G-SII Assessment Methodology, not in NTNI. Some proposed changing NTNI to "asset liquidation".
- More emphasis should be placed on firms' risk management practices (liquidity planning, management action, asset mix, size, substitutability, trading) and supervisory frameworks.
    - Also more emphasis should be placed on risk mitigation, such as collateralization (quality of assets posted, frequency of margin calls, etc.) and central clearing
- Other mechanisms may also be appropriate, such as margin calls from agreements with downgrade clauses that might exacerbate liquidity problems.

Q3 IAIS response

IAIS Response:

The IAIS has considered "three channels for systemic risk transmission: (i) the exposure channel; (ii) asset liquidation channel; and (iii) the critical function or service channel[2]. The IAIS has evaluated these channels and concluded that the two most relevant systemic risk channels for the analysis of insurance product features in this context are:

- Exposure Channel: A shock to the insurer may spread more easily to other financial institutions or markets where there are direct and indirect exposures of creditors, counterparties, investors or other market participants.
- Asset Liquidation Channel: An insurer could be forced to liquidate assets quickly and on a scale that, exacerbates market movements and contributes to asset price volatility. Such asset sales could impact asset prices and thereby disrupt trading or funding in key markets, potentially triggering losses for other firms with similar holdings".

To enhance the clarity of the framework, the indicators belonging to the previous NTNI category as part of the G-SIIs Assessment Methodology have been aligned with the relevant transmission channels and are hence included in the Asset Liquidation category and the Macroeconomic Exposure sub-category respectively, still maintaining the same weight.

[2]The IAIS has not finally concluded on the concept of critical functions in insurance.

Q4 Members comments

Question 4. Are these the appropriate two steps that should be used to assess whether a benefit feature could expose 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?

Members comments:

NAIC: The proposed two-step process is first identifying whether there are material benefit guarantees which potentially expose the insurer to significant market risk, followed by an assessment of whether those market risks can be mitigated. The analysis of these steps should be conjunctive. However, additional clarity is needed regarding the second step of the analysis. The consultation document proposes determining the ability to cash-flow match based on whether there is an absence of contractual limitations from doing so. For life insurance products, the existence or absence of such limitations may not be a sufficient determinant for "NTNI' classification. For these products, additional analysis, guidelines or mechanisms to verify that effective mitigation strategies are actually occurring may be needed.

Q4 Members comments (2)

Members comments (cont’d):

OSFI:

- With respect to "market risk", the IAIS should be clear that "market" risk is "financial market risk" - i.e. it is not the risks of pricing changes to the value of goods and services. The IAIS should also be clear as to whether or not commodities are considered part of the financial markets for the NTNI analysis.
- The steps the IAIS is proposing are appropriate except the IAIS has not defined what it means by "is the insurer contractually able to invest in assets that match the cash flows of the guaranteed payments" (see Figure 2). The matching of assets to cash flows could vary depending on jurisdictions due to the availability of deep and liquid markets. It could be the case where an insurer, for example, sells the same product in North America and in Asia, but yet has substantially different assets backing the cash flows of the products. Depending on the assets backing the cash flows, would this change whether the product is defined as NTNI? If so this would be contrary to finding a common definition for different jurisdictions.
- In addition, the IAIS refers to unpredictability of cash flows, does the IAIS have definitions for what is "predictable" and "unpredictable" cash flows?

Q4 Stakeholders comments

Stakeholders comments:

- As in question 3, several firms request an additional step that takes individual firms' risk mitigation practices, risk management strategies, liquidity and solvency positions into account
- It was raised that we do not define contractual ability to match satisfactorily, which could result in differential treatment for markets in which markets are not sufficiently deep.
- There is substantial disagreement with the decision to ignore the effects of derivatives as the concerns raised are taken into account by the G20 reforms
  - It was raised that there should be a distinction between static and dynamic hedging programs
- Several stakeholders point out the successive nature of the two questions (i.e. presence of a guarantee is a necessary condition before assessing ability to match)
- It was also emphasized that it isn't clear how the proposed vulnerabilities create systemic risk
- Short-term Trade Credit should be exempted from NTNI to maintain consistency with the Field Testing
- Many stakeholders note that market risk is not systemic. One noted that market risk, absent liquidity risk, is not systemic.
- The market risk framework is too simplistic and doesn't take into account the strategies used to mitigate the risks in complex new products

Q4 Stakeholders comments (2)

Stakeholders comments (cont'd):

- The impact of products being classified as non-traditional may undermine the availability and affordability of designated products and diminish the role of insurers in financial stability
- Duration gaps do not present systemic risk as the problems materialize over the long-term
- There is some concern over how the cash-flow matching standard is applied across jurisdictions.
- Lump-sum payouts should be included as a benefit type
- Market risk can be substantial for the assets the insurer invests in and therefore create a different risk
- As in question 3, several stakeholders raise the need to assess how the shock would be transmitted to the system
- The IAIS should allow more room for supervisory judgment

Q5 Members comments

Question 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?

Members comments:

OSFI: - Product features - There can be ambiguity between what is a feature directly in an insurance contract and features that are included/required by legislation/regulation. The IAIS may want to consider a way to characterise products that have features either embedded directly or some form of legislation that may limit the exposure of certain features. Examples in Canada would be participating policies (need to set up a PAR account according to the Canadian Insurance Companies Act), or cancellation conditions for fire policies. Some of these legislative features involve supervisory judgement, where the regulator would review the company procedure for compliance with act and regulations/guidelines. While there are others that involve supervisory judgement in limited or extraordinary circumstances. For example, a feature that enables a supervisor to mandate delayed payments to policyholders - while it can be effective for stopping a run, it is not a power ordinarily used.

Q5 Stakeholders comments

Stakeholders comments:

- Lack of granularity and some suggestions for the inclusion of other relevant dimensions are provided. For instance, it is proposed that the relationship between guarantees and market risk should be explored further.
- Respondents observed the exclusion of products with non-guaranteed elements that do not have profit participation.
- Some suggestions to take into account individual supervisor discretion
- Some respondents note that an exclusive focus on cashflow matching in the market risk assessment is too simplistic.

Q4 and Q5 IAIS response

IAIS Response:

Under the current product feature approach, the IAIS has further specified the two steps of the assessment of the degree to which a benefit feature could expose the insurer to macroeconomic stress. The first step is to identify whether a material benefit guarantee applies, thereby transferring a risk from the policyholder to the insurer. The second step is to determine whether the insurer is able to invest the assets backing the guarantee in a manner that aligns the asset and liability exposures or, put differently, that matches the benefit cash-flows of the applicable guarantee. The IAIS considers that the suggested list of the "*Nature of the benefit*" assesses a comprehensive range of features and would cover any type of insurance contract. Some explanation to the contractual limitations on cash flow matching (Step 2) has been produced (cf. table in par. 4.12). In particular, limitations to cash-flow matching are based on specific contract clauses that directly or indirectly limit the insurer's ability to replicate benefit guarantees in the way they invest the backing assets. Any market risks assumed by the insurer which are not directly related to such contractual limitations on the product are not taken into account by this approach. The IAIS recognises that this assessment focusses on the liability side only, ignoring risks stemming from the way assets are actually managed by the insurer in practice. Such considerations would require an approach that spans both sides of the balance sheet, and will be developed as part of the on-going work of the IAIS in this area.

There are other ways to capture the macroeconomic risk using a total balance sheet approach. The IAIS is currently working on such an approach.

Q6 and Q8 - Members comments

Question 6. Do the proposed time period appropriately capture liquidity risk?

Question 8. Do the proposed economic penalty thresholds appropriately capture the monetary disincentives to surrender?

Members comments:

Q6:

FSC BVI: Possibly consider time periods of: less than a month, 1 to 6 months, more than 6 months

CIRC: Agree with proposed time periods but suggest IAIS provide 1) surrender value payment periods and the value of surrender penalties IAIS observed in major insurance markets; 2) how the current buckets are set and supported by these data.

NAIC: The break points appear reasonable.

Q8:

CIRC: We suggest IAIS consider products with different level of surrender penalties by policy year, for example products with high penalties in initial years and low penalties I later years, and vice versa. We also suggest IAIS advise how to classify these products to the current proposed buckets.

NAIC: The 20% threshold, which is also used in the G-SII Assessment Methodology, appears to be a reasonable starting threshold for further discussion and testing.

Q6 Stakeholders comments

Stakeholders comments:

- The time periods appear high
- Three months could be too short a period of time for a H rating given that events that lead to a loss of liquidity could be systemic and persist for an extended period. We consider six months to be more appropriate
- More information/analysis needed to explain rationale of choice made
- May need to reflect different situation across countries
- More appropriate to consider insurer’s ability to manage liquidity holistically
- Move from 3 to one month. One month allows sufficient time for appropriate dis(investment) actions to mitigate increased liquidity demands
- The period of time required will depend heavily on each insurer’s ability to manage liquidity risk.
- The focus on contractual requirements does not take into account the possibility of regulatory measures (e.g. power to impose a temporary stay on surrenders)
- Any such classification is arbitrary but the proposed segmentation is not unreasonable
- Clear distinction needs to be drawn between whether the systemic risk concern 1) relates to losses incurred by insurers in case surrenders paid out are more than the value of assets backing liabilities (microprudential issue) or 2) whether it relates to impact of liquidation of assets on the asset markets
- Recognising that different products may have different settlement periods, it would be appropriate to adopt a weighted average approach, considering the aggregate potential policyholder exposure by maximum potential settlement period.

Q8 Stakeholders comments

Stakeholders comments:

- If the reference value is the best estimate of the contract obligations, a penalty of more than 20% is rather high (excessive).
- The full range of monetary disincentives are only captured together with the ancillary factors.
- Any such classification is arbitrary but we agree that the low bans should be restricted to no penalty.
- Policies with no surrender value are in the high category by default.
- Inconsistent with the fair treatment of customers as it would introduce an unreasonable barrier to exit.
- It is unlikely that counterparties' decisions to surrender policies will significantly differ between when there is no penalty or when there is a very minor penalty. Therefore, we suggest having two thresholds by removing the low rating.
- Concerned that the proposed economic penalty thresholds could lead to unintended consequences
- It is unclear what penalty of less than 20% means. To what number will the percentage be applied?
- To the extent they do not capture the personal tax consequences to the policyholder, the economic penalty thresholds fail to adequately capture the monetary disincentive to surrender.

Q6 and Q8 IAIS response

IAIS Response:

It is accepted that the choice of time periods for the delay in access and economic penalties used is a matter of judgment and perfect precision is not possible. Hence, the IAIS decided to keep them as proposed in the Consultation Document.

For that reason, the G-SII Methodology also applies a gradated approach to the assessment of liability liquidity risk indicator. In addition, other factors are taken into account in the wider assessment of liability liquidity risk (cf. Phase III in the G-SII Methodology).

It is acknowledged that those simplifying “product characteristics” do not fully capture the heterogeneity of markets and products and the potentially different behaviours of policyholders. Therefore, it is acknowledged that supervisory judgement also plays a role in the analysis of substantial liquidity risk.

Q7 Members comments

Question 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)

Members comments:

FSC BVI: In relation to the medium rating, consideration should be given to a penalty of 10% instead of a penalty of less than 20%.

Q7 Stakeholders comments

Stakeholders comments:

- Overemphasis on exit penalties and failure to consider other factors that are equally important
- A narrow focus on readily quantifiable and generally applicable penalties that are not policy- or policyholder dependent would produce an incomplete picture of surrender risk.
- The combination of a) contractual terms allowing for a very short settlement periods, b) surrender value guarantees, and c) a high proportion of institutional investors as policyholders, has proved in the past to cause issues to insurance companies facing mass lapse events. This is the main factor the IAIS should focus on.
- The operational differences between banks and insurers should also be recognised ("ATMs")
- Policyholder protection scheme should also be considered
- Also consider the opportunity cost for policyholders surrendering
- Policyholders consider the loss of guaranteed rate caused by the surrender as an economic penalty.
- We agree that contractual penalties and tax requirements are the most obvious quantifiable factors. One could add accrued guaranteed benefits to the list of ancillary factors.
- We believe that guarantees are valuable to policyholders and will be even more valuable when market are down.
- For longer term policies the cost of replacement should be considered.

Q7 IAIS response

IAIS Response:

Although economic penalties encompass all monetary penalties including tax penalties, Phase II only takes into account contractual penalties imposed by firms. In practice, there may be other economic penalties to surrendering policies, including loss of tax benefits, for instance through the tax treatment of policies and surrenders. Those factors will be assessed in Phase III of the G-SIIs Methodology.

Q9 Members comments

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

Members comments:

NAIC: These factors appear to be relevant. However, it is not transparent why certain factors are allocated to the "narrow set of factors", while others are allocated to the "wider set of factors". Clarification is needed to explain how these factors, which reduce risk for the firm also serve to reduce systemic risk to the global financial system.

Q9 Stakeholders comments

Stakeholders comments:

- Guarantees and loss of guarantees should be included as a separate key element of the framework, and not as part of ancillary factors
- It is not clear how surrender values relative to the market value of assets would be evaluated
- Supervisory judgment of the group supervisor should be applied to assess the wider set of factors.
- The question of whether the policy purpose is protection or savings is a key issue and should be asked upfront.
- Some supervisors are able to reduce the value of guarantees associated with in-force business
- Any assessment of the impact on the asset markets of transmission through the asset liquidation channel will vary depending on the markets, and the nature of the stress that gives rise to a mass surrender event.
- We do not see the relevance of surrender value relative to market value. Since the policyholder does not have access to the supporting assets in any case, there is no opportunity to earn a premium. Moreover, the relationship changes with market conditions, leading to the perverse result that a product could be NT one year and T the other.
- The wider set of factors includes a reference to tax. This seems to suggest that the CD deems tax penalties an ancillary factor. However, footnote 12 suggests that the economic penalties comprise taxes.

Q9 Stakeholders comments (2)

Stakeholders comments cont'd:

- A lot of these factors extend beyond insurance product features and should not be taken into account. They are externalities that do not necessarily impact on the NTNI classification. These wider factors are more likely to restrict the potential calls for surrender, so act to lessen the need for fire sales of assets during significant crises. In addition, as these influence policyholder decisions, the insurer can do nothing to influence them.
- We suggest that these considerations can be built into the assessment process in one of the following two ways. 1) the IAIS identifies products which may not have considerable liquidity risk based on the ancillary factors and excludes those from the G-SII data collection. 2) The IAIS provides clear guidance on which factors need to be considered when providing data for the liability liquidity indicator.
- We suggest that a regulatory regime that emphasises liquidity stress testing be weighted favourably when compared to products with similar features in a jurisdiction that lacks such compliance with stress testing requirements.

Q9 IAIS response

IAIS Response:

As the objective of the analysis is no longer to provide a binary classification between Traditional and Non-Traditional insurance products and activities, the IAIS has opted for covering both wider and narrow set of factors under the heading of "potential mitigating and exacerbating factors" on substantial liquidity risk. This is a range of further factors that cannot directly be translated into a monetary economic penalty, but that nevertheless provide incentives or disincentives for surrendering policies. For this reasons they will be assessed in Phase III of the Methodology (Discovery Phase). No distinction is made regarding the relevance of those factors. For G-SII Assessment purposes, these factors are have been combined together with the former "Other relevant but non-determinative factors" (Section 4 of the CD) to be considered in Phase III (Discovery Phase) to serve the purpose of having a more accurate understanding of the Liability Liquidity indicator. They aim to provide additional insights for the assessment of the systemic relevance.

Q10 Members comments

Question 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?

Members comments:

FSC BVI: "Any other combination" should be expanded to indicate whether this is considered to be MM for medium risk, given that LL an HH exist within the table:
CIRC: We suggest to use more determinative quantitative factors, and less ancillary factors to avoid subjective judgement. Moreover, we view that only to use surrender value payment period and surrender penalties may not be sufficient to assess the liquidity risk. For example, two companies sell same products with low surrender penalties and short surrender value payment period, one of the companies has sufficiently allowed for potential surrenders and has properly done risk managements, the liquidity risk of this company should be lower than the other one.
NAIC: Other considerations relevant to the insurers' exposure to liquidity risk could include the size of the portfolio assessed as having significant liquidity risk relative to the insurers total portfolio, and the availability of unallocated or excess liquidity assets.

Q10 Stakeholders comments

Stakeholders comments (to the extent not covered in previous questions):

- Regarding the liquidity features we want to emphasise that liquidity risk can also arise in (re)insurance business due to forced commutation, clean cut arrangements or downgrade clauses
- Further factors to be taken into account depend o the products in each jurisdiction, but will include management and supervisory action, and the cost of switching
- The existence of mortality guarantees, e.g. in guaranteed annuity rates, is also relevant and should be considered.
- The nature of a product's target customer could, in some cases, be a relevant consideration

Q10 IAIS response

IAIS Response:
It is acknowledged that the two simplifying ‘product characteristics’ (delay in access and economic penalties) do not fully capture the heterogeneity of markets and products and the potentially different behaviours of policyholders. Therefore, it is acknowledged that supervisory judgment also plays a role in the analysis of substantial liquidity risk.

Q11 and Q12

Question 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 wider set of ancillary factors?

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

Q11 and 12 Members comments

Q11

NAIC: Many insurance and annuity products contain both protection and savings components. In order to promote greater consistency across jurisdictions, one option would be to assess products along two-dimensions: a) richness of benefits, and b) surrender penalties. Using these categories, insurance savings products would be those with limited protection value (i.e., cheap/easy to replace coverage) and limited penalty on surrender (i.e., low fees and tax liability). On the other hand, insurance protection products would be those that offer rich benefits (i.e., difficult to replicate/replace coverage) and punitive surrender fees and taxes (e.g., total penalties exceeding 20% of the contract value).

Q12

CIRC: Based on the current approach, almost all insurance products in China Mainland market will be rated MM (Delay in access = M and Economic Penalty = M), so need judgments based on ancillary factors. It will be very difficult to implement and non-comparable to other countries.

Q11 Stakeholders comments

Stakeholders comments:

- Products that combine protection and savings components are fairly common in some markets. In principle, one can draw a distinction between term life insurance, which is a protection product and some unit linked participation products, which have a protection element, but whose purpose is mainly savings. There is no substitute for analysing the purpose of each product and a crude limit would not be effective.
- Where the contract includes protection such that cannot be separated from the rest of the contract, the contract is very unlikely to be perceived a s pure deposit.
- In the majority of jurisdictions, savings products require a protection component to be considered insurance products and for an insurance company to sell them.
- In general, products with no explicit account value should be considered protection. For products with and explicit account value a test could be developed based on the ratio of net amount at risk to face amount.
- Judgment could be based on the method of premium payment (single premium or level premium).
- As for products with both protection and savings components, the portion of savings components tends to be larger for products with single premium compared to those with level premiums. Therefore, it is possible to consider single premium products with both protection and savings components as savings type products and level premium products as protection type products
- The distinction can be drawn by determining whether the product has any surrender value payable to the policyholder upon policy withdrawal or any maturity value.

Q11 and Q12 IAIS response

IAIS Response:

Policies offering protection to policyholders serve a different economic purpose than products used as a vehicle for saving, which makes them less likely to be seen as deposits. They therefore do not have the same incentives for surrender. In particular, the two quantifiable factors for assessing substantial liquidity risk (i.e., economic penalty and time restraint) do not take into account the purpose of the policy, meaning that the substantial liquidity risk may be overestimated for products that are primarily for protection. Based on this consideration, the NTNI consultation document states that those particularities (overriding ancillary factors) may override the findings based on a simple economic penalty/time restraint categorisation. However, as the objective of the analysis is no longer to provide a binary classification between Traditional and Non-Traditional insurance products and activities, the IAIS has opted for covering the narrow set of ancillary factors including purpose of the policy together with the wider set of ancillary factors under the heading of "potential mitigating and exacerbating factors" on substantial liquidity risk.

The IAIS acknowledges that policies offering protection to policyholders serve a different economic purpose than products used as a vehicle for saving and therefore policyholders do not have the same incentive to surrender. Considering that there are technical difficulties to identify quantifiable and consistently applicable criteria to distinguish the two types of products, the purpose of the policy and any forgone benefits needs to be carefully taken into account in a holistic assessment of substantial liquidity risk through Phase III of the G-SII Assessment Methodology.

Q13 Members comments

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

Member comments:

No specific comments

Q13 Stakeholders comments

Stakeholders comments:

- distribution channels from the perspective of assessing the extent of encouraging vs. discouraging policy surrenders
- the bottom paragraph 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" should be in the narrow set of factors or at least in the wider set
- liquidity risk can also arise in (re)insurance business due to forced commutation, clean cut arrangements or downgrade clauses
- whether the policies are group or individual policies.
- insurer's enterprise (and product) risk management including mitigation, transfer and diversification (Global Federation of Insurance Associations.
- The laws and regulations in the domiciliary jurisdiction where relevant.
- the legal right that many policyholders have to claims payment by the guaranty funds
- the orderly wind-down of insurers in some jurisdictions where relevant (policyholders are more likely to keep their policies in-force which reduces any potential liquidity exposure)
- governmental support (e.g. government reinsurance mechanisms and collateral requirements, designed to mitigate or eliminate market or liquidity risk). Some products may be quasi-governmental in nature, such that the insurer acts only as a servicer for a government social program, with the government absorbing any market or liquidity risk.

Q13 Stakeholders comments (2)

Stakeholders comments (cont'd):

- Asset Concentration toward a specific asset class or counterparty, Net exposure to risky asset classes such as alternative asset classes or derivatives, Exposure to illiquid markets such as property or unlisted investments, Market volatility of specific asset classes, Available liquid or readily convertible assets; Elements of the overall portfolio ring-fenced for specific policyholders, Collateral held (for example against derivative positions), Size of the portfolio being reviewed to assess liquidity risk compared to the overall portfolio.
- insurers do not manage their liquidity at the product level but rather via liquidity pools.
- Available liquidity resources should become an explicit determinative factor, at minimum in jurisdictions that have defined regulatory liquidity requirements, such as China and Switzerland or the regulatory requirement for Asset Adequacy Testing in the US. Adequacy of liquidity sources versus requirements: products with sufficient liquidity to cover requirements would not subject the respective insurer to significant liquidity risk and are therefore not systemically risky. Moreover, no products, for which the individual insurers holds sufficient liquidity, are NTNI. This would also make the framework more adequate in terms of measuring potential transmission channels for systemic risk.

Q14 Members comments

Question 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?

Members comments:

NAIC: Some of the factors enumerated in section 4.1 should be determinative for NTNI identification
- Use of Derivatives:
- Potential Duration Gaps: This speaks to the ability to cash flow match which has previously been stated to be a determinative factor.
- Contractual Ability to Adjust Premiums: The ability to adjust premium can mitigate market risk and should be considered
- Extent to which the insurer is invested in liquid assets: This is relevant consideration but may be more appropriate for the G-SII assessment.

Q14 Stakeholders comments

Stakeholders comments:

- No. National supervisors should assess and weight the factors, and comparability should be tested in the recalibration of the BCR and the HLA.
- Include among ancillary factors (§ 3.2.1.3) only the last 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."
- With the exception of the above, the listed factors should not be taken into account as determinative in general. They are not definitely measurable and highly dependent on interpretation. In cases where these factors might influence the NTNI classification, the respective national supervisors should decide on the application of these factors. They know their market's products best and are able to assess the dimension to which the factors apply to them.
- some reservations about the factor labelled "lack of suitable assets for fixed benefit policies"; the interpretation of the word "suitable" is open to subjective reading. The inclusion of these ancillary factors in no way diminishes the need for supervisors to co-operate to ensure consistent application of the definition of NTNI.
- 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.

Q14 Stakeholders comments (2)

Stakeholders comments (cont'd):

- The use of derivatives should not be considered determinative - while it may be an indication of NTNI activity, this cannot be objectively assessed across jurisdictions and firms which have differing hedging capabilities.
- The guidance is subject to wide variations in interpretation. If ancillary factors are to be considered, their application needs to be better define
- "liquidity of assets" vastly affects liquidity risk, and therefore should be added as an ancillary factor. If "other relevant but non-determinative factors" were to be used in the Phase III analysis of the G-SII assessment process, their influence on systemic risk should be considered according to the principle of substance over form.
- The lack of suitable assets for fixed benefit policies should not be included in the factors for Phase III.
- Ability to amend premium terms when guarantees are in the money.
- The IAIS should consider derivative use as non-determinative in the NTNI classification. The IAIS seems to assume that derivative positions must be rolled over, exposing an insurer to market risk in stressed market conditions, e.g. if derivatives that need rolling over would become unavailable. In many cases, derivatives do not need rolling over as the maturity of the derivative matches the expiration of the risk so that the hedge remains in place in all market conditions. Moreover, exchange-traded and collateralized derivatives do not expose an insurer to substantial counterparty risk.

Q14 Stakeholders comments (3)

Stakeholders comments (cont'd):

- In order to promote the consistent application of the NTNI concept across jurisdictions, we believe that the quantitative framework should be enhanced to include as many of these factors as possible in the objective assessment of activities. We do not agree that "substantial market risk" is a reliable indicator of systemic risk. We therefore do not agree with "derivative usage could be an indication of NTNI activity." Derivatives, when used for hedging and risk management optimise an insurer's risk profile. Derivatives generally allow risks to be more efficiently transferred within the financial markets, rather than creating new risks.
- If a product can be made non-systemic via an appropriate risk mitigation strategy or other factor, then the existence and deployment of such a strategy or other factor should be taken into account, and should be considered to be determinative, as doing so creates an incentive to reduce systemic risk. If, instead, these strategies and other factors are not taken into account, or if they are not treated as determinative despite a decisive impact, there may be a disincentive to reduce systemic risk. A flexible, principle-based approach is best suited to the challenge of assessment, weighting, and consistent application. Because of differences among jurisdictions, local regulators will require a significant level of discretion.

Q13 and Q14 IAIS response

IAIS Response to Question 13 and 14:

Following the consultation, the IAIS has decided not to provide any binary classification of NTNI products. Consequently, the former "Other relevant but non-determinative factors" (Section 4 of the CD) have been combined with the ancillary factors as referred to in the Substantial Liquidity Risk assessment (par. 3.2.1.3 of the CD). All of the factors are now considered as "Potential mitigating and exacerbating factors", distinguishing between those affecting Macroeconomic Exposure and Substantial Liquidity Risk. Under this label the IAIS has collected all the factors that are relevant to the discussion on systemic risk, but that cannot:

- be directly imputable to the contract features;
- be objectively assessed and measured;
- directly be translated into a monetary economic penalty but that nevertheless provide incentives or disincentives for surrender in policies.

While these factors are not currently used in calculating the indicators for the purposes of Phase II of the revised G-SIIs assessment methodology, they are relevant for consideration as part of Phase III (the Discovery Phase) in the process for the Identification of G-SIIs.

In addition to the factors already mentioned in the CD, the following are now included:

- supervisory interventions (stays or lower surrender values);
- maximum contractual stays;
- degree to which liabilities of firms are cash flowed matched in practice;
- derivatives to hedge guaranteed returns for variable products;
- derivatives collateral requirements.

Question 15

Question 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?

Q15 Stakeholders comments

Stakeholders comments:

- General statement; despite the disclaimer (Annex 1 does not pre-judge whether listed products and activities should be classified as traditional or non-traditional. This list contains some products, product features and activities that will – following the assessment - not be classified as NTNI), some stakeholders state that they do not understand why "certain types of Property and Casualty/Liability Insurance" are listed in the Annex as meriting further consideration. Stakeholders have perceived listed products being tested again the conceptual framework as having (although a minimum) chance to fall into the NTNI category. This has generated lots of reactions oriented to have a deeper understanding for the rational of including such products in the analytical review (e.g. categorization of insurance products is quite broad, vague and therefore does not really help the sector understand which products are regarded as systemic by the IAIS , suggestion of removals from the list of Certain types of Property and Casualty/Liability Insurance and unit-linked products without guarantees
- P&C and Health have a more limited scope (i.e. "certain"), but there is not the same restriction for life products and hence all product types should be limited to "certain" to avoid scoping in more than the systemically risky activities
- The assessment of the NTNI classification should be based on product features and the level of risk they entail. It should not be taken from a set list of products

Q15 Stakeholders comments (2)

Stakeholders comments (cont'd):

- 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
- Universal life is missing from the list, and perhaps some consideration should be given to product packaging, secondary benefits and riders
- Could potentially include salary replacement policies that provide a fixed benefit each month as a replacement for an individual's salary
- Individual insurers may be active in various markets with similar products and should not be faced with situations where similar products are treated in a materially different manner within the G-SII framework.

Q15 IAIS response

IAIS Response:
Considering that: (i) the framework at issue is only focused on insurance product features and related activities that may raise the potential for an insurer to pose systemic risk upon failure; and (ii) the IAIS decided to discontinue the NTNI product label and to focus on substantial liquidity risk and macroeconomic exposure and their related systemic risk transmission channels, the IAIS believes that it is no longer necessary to proceed with the publication of a list of products as proposed in the CD.
It is worth noting that the list of product features, and by extension products considered for the purposes of Phase II Minimum Guarantees on Variable Product indicator calculation, remains unchanged from the 2013 methodology.

Q16 Members comments

Question 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.

Members comments:

NAIC: The Principles and the revised NTNI framework should be better aligned. In addition, the consequences of the framework should be carefully considered to ensure that they do not dis-incentivize appropriate use of derivatives or other prudent risk management practices that serve not only to reduce risk to the insurance firm, but also (via the transmission channels) reduce risk to the financial system. Moreover, the NTNI framework should not discourage product offerings that are socially desirable, for instance, products that facilitate retirement savings and provide retirees confidence that they can participate in the markets, yet enjoy the security of principal and/or income protection. The use of derivatives, in a controlled environment, ought to not be discouraged. Consistent application of the NTNI concept could be enhanced if:

- Further clarification is provided on the salient determination points such as cash flow matching (currently step 2 in the market risk assessment) and the application of ancillary factors.
- A mechanism is established whereby products/product features flagged by different jurisdictions could be submitted for review to the IAIS on an on-going basis.

Q16 Stakeholders comments

Stakeholders comments:

- It is premature to revisit the Principles
- In revising the principles to look only at the systemic risk or loss given default
- Need for common understanding and distinction between impact, POD, systemic risk for a consistent application. Need to look at the residual risk not captured by micro-prudential regulation
- NTNI should focus on products not desirable or not properly managed
- Need for consideration of risk mitigation tools
- Principles should not be prescriptive to allow supervisors for discretion in their application at local level to take local specificities into account
- Principle 1 should be revisited as not all product that fit the principle contribute to systemic risk
- Principle 1 should be revisited to capture part of the explanation "When credit guarantee or coverage is short-term in nature then the exposure to systemic events is limited."
- Principle 2 should be revised to focus on potential systemically relevant exposures
- Principle 2 should be revisited as the transmission channels remain unclear on market risk, especially why derivatives causes systemic risk
- Principle 3 should be revisited – no explicit suggestion on how
- The IAIS should adopt principles that align NTNI with interconnectedness and asset liquidation and assess risks on a loss-given-default basis.

Q16 IAIS response

IAIS Response:

With this paper the IAIS discontinues the term NTNI and provides further clarification on the notion of Non-traditional insurance products, by introducing a more granular and nuanced assessment of the product features that influence the systemic potential of an insurer.

As a consequence, the first two NTNI principles in the 2013 IAIS G-SIIs Policy Measures document will no longer be used, having been superseded by the more detailed assessment set out in the "Systemic Risk from Insurance Product Features" document. Unlike the former NTNI principles, this revised framework is not intended to be a criterion for binary classification of products or activities conducted by insurers, but rather introduces a more granular and nuanced assessment of the product features that influence the systemic potential of an insurer as follows:

Policies or products that have features that expose the insurer to substantial macroeconomic risk (including credit guarantees) or substantial liquidity risk through the exposure and asset liquidation transmission channels contribute to higher systemic potential of insurers.

In this context:

Substantial macroeconomic risk relates to exposures where an insurer's financial position is highly correlated with the broader economy.

Substantial liquidity risk relates to exposure to the risk of a policyholder run.