Supervisory Standard No.11

INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

STANDARD ON DISCLOSURES CONCERNING INVESTMENT RISKS AND PERFORMANCE FOR INSURERS AND REINSURERS

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in consultation with Members and Observers

Standard on disclosures concerning investment risks and performance for insurers and reinsurers

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1. Introduction

1. IAIS *Insurance core principles and methodology* (October 2003) ICP 26 states that supervisory authorities are to require insurers to disclose relevant information on a timely basis in order to give market participants[1] a clear view of the business activities and financial positions of the insurers, and to facilitate the understanding of the risk exposures of the insurers. Armed with this understanding, market participants will be better able to reward insurers that are transparent and operate effectively, and penalise those that are less transparent.

2. The IAIS decided to issue three standards on enhanced disclosure in order to promote meaningful disclosure by insurers that facilitates market discipline. This is the second of the three standards.[2]

3. This standard should be read together with:

- the IAIS *Insurance core principles and methodology* (October 2003) (ICPs), in particular ICP 26 - Information, disclosure and transparency towards the market - and the related criteria

[1] For the purposes of this standard, market participants include policyholders, direct insurers, shareholders, equity analysts, insurance agents and brokers, rating agencies, and the media.

[2] The *Standard on disclosures concerning technical performance and risks for non-life insurers and reinsurers* was adopted in October 2004. A *Standard on disclosures concerning technical performance and risks for life insurers* is scheduled to be released in 2006/7. A comprehensive review will be conducted on the three disclosure standards subsequently, with a view to combine them into one single standard.

- the IAIS *Standard on disclosure concerning technical risks and performance for non-life insurers and reinsurers* (October 2004)
- the IAIS *Guidance paper on public disclosure by insurers* (January 2002) that contains general guidance on public disclosure and
- the IAIS *Guidance paper on investment risk management* (October 2004).

2. Scope, application and implementation

4. The purpose of the standard is to enhance market transparency and to facilitate market discipline by setting minimum disclosure requirements on investment risks and performance for insurers and reinsurers.[3] Standard setters may also require additional public disclosure when circumstances require.

- An insurance company should disclose information that reflects the risks it is exposed to through its investment activity. Normally the exposure to investment risk is directly linked to, and depends on, the kind of business conducted. A life insurance company may very well have different investment needs and strategies than a company biased towards general lines business. Also, specialised insurers might follow different investment strategies to those of companies involved in mass business. Hence, investment risk and performance should be seen in the light of the overall risk exposure of an insurance undertaking. As this standard aims to address the risks associated with investment activity, further explanation should be given by the insurance companies where other factors are of importance to interpret the information disclosed accurately.

5. It is important that supervisors require disclosure of sufficient qualitative information to enable an overall investment risk profile to be determined. In addition, sufficient supplementary quantitative information is required so that market participants can assess the specific risk to which the company may be exposed.

6. This standard therefore requires disclosures in the following broad areas:

- investment objectives, policies and management
- risk exposure
- asset class segregation, description and profiling
- performance measurement.

7. This standard applies to all insurers (including reinsurers), with limited exemptions available to captives at the discretion of the insurance supervisor of each jurisdiction.[4] This standard should, at a minimum, apply to each insurer in an insurance group or financial

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[3] Although not all assets are regarded as investments, this standard is applicable to all assets.

[4] A supervisor can decide not to apply this standard to "captives" that are considered insurers or reinsurers in the legislation of its jurisdiction, provided there is no potential threat to the financial system, no public interest need for disclosure and no legitimately interested party is prevented from receiving information. For the purpose of this standard, "captive" shall mean an insurance or reinsurance entity created and owned by one or several industrial, commercial or financial entities, other than an insurance or reinsurance group entity, the purpose of which is to provide insurance or reinsurance cover for risks of the entity or entities to which it belongs, and only a small part, if any, of its risk exposure is related to providing insurance or reinsurance to other parties.

conglomerate.[5] Supervisors may also apply this standard on a consolidated basis to the group or conglomerate.

8. Insurance supervisors who have the authority to set public disclosure standards should set disclosure requirements that are consistent with this standard. Otherwise, insurance supervisors should encourage the relevant standard-setting body to do so.

9. It is not intended that this standard should conflict with accounting requirements. Instead, this standard may be viewed as providing additional insurance-specific disclosures that insurers should make. In situations where public disclosures are made under accounting requirements or are made to satisfy listing requirements, such disclosures may be relied upon to fulfil the requirements of this standard.

10. Supervisors should use their discretion in determining the appropriate medium and format of the disclosure in implementing this standard. The disclosure set out in this standard should be made on an annual basis. More frequent disclosure may be required.

11. The requirements set out in this standard should be read bearing in mind the concept of materiality. Supervisors should decide on the threshold for materiality in their jurisdictions based on the state of development of markets and the cost of additional disclosure.

12. The manner in which assets are valued in the financial statements is out of the scope of this standard. For reasons of comparability, this standard specifies common ways of expressing risk and performance exposures regardless of how asset values are booked in an insurer's accounts.

13. Annexes 1 and 2 to this standard provide examples of how some of the requirements for quantitative information may be satisfied. Where it assists market participants in enforcing market discipline, a different format from that given may be adopted.

3. Disclosure requirements

14. Disclosure of an insurer's investment activity, risks and performance should provide sufficiently comprehensive information that is relevant to market participants.

(a) Investment objectives, policies and management

15. An insurer should disclose qualitative information on investment objectives, policies and practices that allows market participants to form an impression of the broad risk and return behaviour of an insurer's asset portfolio.

16. Such disclosure should include information on:

- general investment strategy and objectives. This should include an explanation of the rationale for asset allocation, investment horizon and asset-liability management;
- performance management. This should include an explanation of the frequency and types of measurement used and methods adopted to monitor performance;

[5] In deciding the reporting entity, consideration should be given to the rights of various market participants including policyholders.

- types of instruments used, business rationale and risks underlying their usage (e.g. whether collaterals are used or whether derivatives are used for risk management, for balance sheet protection or otherwise);
- the approach to risk tolerance and methods used to reduce and/or mitigate investment risks, including any constraints imposed on exposures to investment risks.

17. An insurer should disclose whether or not it carries out stress tests or sensitivity analysis on its investment risk exposures, and, if so, it should disclose the process and types of assumptions used, and the manner in which the results are used as part of its investment risk management practices.

18. Where the investment management function of an insurer is outsourced in part or in whole to external parties (including outsourcing to related entities within the insurance group or financial conglomerate), the insurer should describe its outsourcing policy and how it maintains control, ownership and oversight over the outsourced portfolio.

19. An insurer should disclose information about, and changes to, its management of asset-liability matching.

20. The manner in which asset-liability matching is managed is of paramount importance to insurers. An unmatched position may increase the risk of loss but can enhance profitability.

21. Matching of assets and liabilities has two dimensions. First, an insurer needs to monitor that it continues to have assets in excess of liabilities as market variables and credit risks fluctuate. This is often referred to as the solvency dimension. Second, and of equal importance, is the ability of an insurer to have enough funds available to meet payments of policy benefits and other obligations as they fall due. This is the liquidity dimension.

22. Insurers should disclose how they tackle these two dimensions of asset-liability matching. An insurer should disclose qualitative information explaining the appropriateness of its investments in matching its liabilities. The explanation should take into account the ability to realise its investments quickly if necessary without substantial loss in value, and the sensitivities of these investments to fluctuations in key types of market variables (including interest rate, exchange rate, and equity price indices) and credit risks.

23. Where firm-wide risk management models are used, an insurer should disclose qualitative information about such models, types of the parameters used and how they are calibrated, the performance of the model over time, and model testing and validation methodologies.

24. An insurer should disclose information on and changes in the management, structure and organisation of its investment management function.

25. An insurer should disclose the manner in which the investment management function is organised within its organisation structure, mechanism used by the board of directors to oversee the function, changes to key personnel and other management infrastructure. The discussion should also demonstrate how the investment management function fits into an insurer's overall risk management framework.

26. Where investment objectives, policies and management differ significantly between parts of the insurer, separate disclosures should be provided for each of these parts.

27. Insurers may designate certain parts of their investments as those used to support specific groups of liabilities. Such segregation may arise from a statutory requirement to maintain separate funds, or merely for better asset-liability matching and risk control. Where investment objectives, policies and management differ significantly between parts of an

insurer, it may be inappropriate or impractical to make generalised disclosures that characterise all parts of an insurer. Separate disclosure about the parts therefore gives market participants a more precise view of how each part is intended to be, and is being, managed.

(b) Asset class segregation, description and profiling

28. An insurer should group assets with similar characteristics and/or risks into asset classes.

29. An insurer's asset portfolio generally consists of many types of instruments with a variety of characteristics. These instruments may be valued in different manners, have different expected returns, sensitivity to market variables, level of liquidity or constraints on disposal. To allow meaningful analysis of risks and performance, instruments exhibiting similar risk and return behaviour need to be grouped. The most common way is grouping them by type of asset classes. However, for some jurisdictions asset segregation by risk exposure might be appropriate. It is expected that those jurisdictions should disclose more information about the risk management techniques used to measure the economic sensitivity to risk exposure. Nevertheless, it is suggested that some breakdown by types of assets is made in such a case.

30. Materiality considerations should be taken into account when setting up asset classes. Disclosure at an excessive level of segregation may overwhelm market participants and incur unnecessary costs for insurers. On the other hand, over-aggregation may conceal important information.

31. An insurer should disclose information segregated by asset class.

32. For each asset class, an insurer should give sufficient information to allow market participants to understand the nature of the class. This would generally include the following:

- criteria for recognition as an asset
- criteria for classification into that asset class
- methods and assumptions used in measuring asset value
- significant terms and conditions that may affect the amount, timing and certainty of future cash flows.

(See example in Annex 1 Table 1)

33. For an asset class that involves equity securities, an insurer should show a breakdown of listed securities versus unlisted securities.

(See example in Annex 1 Table 2)

34. For an asset class that involves debt securities, an insurer should show —

- a breakdown by credit rating of the issue
- a breakdown among government, semi-government and corporate securities
- a breakdown by residual maturity.

(See example in Annex 1 Table 3.)

35. For an asset class that involves loans (except policy loans to policyholders secured by cash value of life insurance policies), the insurer should show —

- a breakdown by types of loans (e.g. residential mortgage, commercial mortgage etc.);

- a breakdown of loans according to whether they are backed by collateral[6] or are uncollateralised.

(See example in Annex 1 Table 4.)

36. For an asset class that involves properties (e.g. land and buildings), an insurer should show —

- a breakdown by properties according to whether they are held for investment or are owner occupied
- a breakdown by types of properties (e.g. residential, commercial, etc.)
- a breakdown by geographical location.

(See example in Annex 1 Table 5.)

37. For an asset class that involves receivables, an insurer should show —

- a breakdown by types of counterparties (e.g. reinsurer, cedent, agent/broker, etc.)
- a breakdown of the ageing of the receivables aggregated by time bands.[7]

(See example in Annex 1 Table 7.)

38. In regard to derivatives, an insurer should disclose —

- a breakdown of derivatives according to whether they are used for hedging purposes or not
- a breakdown of how derivatives are allocated into different asset classes
- a breakdown of exchange-traded derivatives versus over-the-counter derivatives
- the difference between the market value of derivative positions and the value shown on the balance sheet
- a breakdown of the main types of derivatives used (e.g. forward/futures, versus options, versus swaps, interest rate versus equity versus debt/credit, etc.).

(See example in Annex 1 Table 10.)

39. An insurer should disclose the amount of assets invested in, lent to, or otherwise dependent on the operations of related parties of an insurer, including the insurer's parent, subsidiaries or associates as defined by the insurance supervisor or by other legislations, or a joint venture (often referred to collectively as affiliated investments).

40. In regard to collective investment schemes, an insurer should —

- explain how collective investment schemes are classified in establishing asset classes, in particular, for schemes with mandates to invest in more than one asset class
- disclose the amount attributed to each asset class.

(See example in Annex 1 Table 9.)

[6] For the purpose of this standard, details about the collateral should be given where appropriate.

[7] It is recommended the following time bands be used: up to 3 months; more than 3 months and up to 1 year; and more than 1 year. Narrower time bands may be used where appropriate.

41. In regard to intangible assets of an insurer, the insurer should list and describe the nature of the key types of intangible assets. Other investments not specified in any other asset class should also be listed and described. (See example in Annex 1 Table 8.)

42. Each jurisdiction should decide whether an insurer should disclose both market value (or fair value) and historical cost of its assets.[8] However, it is strongly recommended to display market value (or fair value) at a minimum.

(c) Performance measurement

43. An insurer should provide information on returns on assets and, where relevant, components of such returns.

44. Investment performance is one of the key determinants of an insurer's profitability. In addition, for many life insurance policies, returns that policyholders receive may be either directly or indirectly influenced by the performance of an insurer's investments. Disclosure of investment performance is therefore essential to market participants.

45. An insurer should disclose changes in values, both over the accounting period and since an asset was acquired, and income, both received and accrued.

46. Disclosure of investment performance should be made on appropriate subsets of an insurer's assets (for example, assets belonging to the insurer's life insurance business, assets belonging to statutory or notionally segregated portfolios, assets backing a group of investment-linked contracts, assets grouped as the same asset class).

47. For investment performance disclosure related to equity securities, debt securities, properties, and loans, an insurer should disclose a breakdown of income (e.g. dividend receipts, interest income, rental income), realised gains/losses, unrealised gains/losses, impairments including changes in loan loss provisions, and investment expenses.

48. An insurer should separately disclose the impact of amortisation and impairment of intangible assets on investment performance.

(d) Risk exposure

49. An insurer should disclose sufficient information, including quantifiable, about its exposure to:

- **Currency risk**
- **Interest rate risk**
- **Credit risk**
- **Liquidity risk**
- **Concentration risk**

50. Generally, the return achieved should be interpreted together with the level of risk undertaken to achieve it and the intention of the investment policy. Disclosure of risk exposures can provide market participants with valuable insight into both the level of

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[8] For assets such as short-term receivables, no disclosure of market value (or fair value) is required when the carrying amount suffices as a reasonable approximation. Disclosure of market value (or fair value) is also not required for assets whose market value (or fair value) cannot be measured reliably, in which case insurers should explain why market value (or fair value) cannot be measured reliably. Disclosure of historical costs is required as long as insurers need to maintain historical costs for regulatory and tax reporting purposes.

variability in performance that one can expect when economic or market conditions change, and the ability of an insurer to achieve its desired investment outcome.

51. Paragraph 49 lists key risks related to investment activities. It should be noted, however, that these risks may affect both assets and liabilities. Market risk arising from interest rate movement is an example. Where an insurer's liabilities for policies issued are valued using market interest rates, both asset and liability values change as interest rates move. Furthermore, changes in interest rates may also change the amounts that an insurer has to pay for its borrowings. Therefore, disclosure of risk exposure should include exposure arising from both an insurer's assets and its liabilities.

52. To facilitate a better understanding of risk exposures, an insurer should not limit itself to stating only its exposures at the end of a reporting period. Instead, it should disclose the intra-period high, median, and low and the amount bought and sold during a reporting period as a proxy for turnover. In addition, it should have separate disclosure of risk exposures for each asset class.

53. Risk exposure measures disclosed should reflect the model used by the insurer in managing its investment risks. For most insurers whose investment portfolios are not actively traded, results of sensitivity tests should be disclosed instead. Annex 2 provides examples of how interest rate sensitivity may be defined. Such sensitivity measures may also be extended to equity price, property price or foreign currency sensitivity.

54. On the disclosure of credit risk, in addition to breakdowns on ratings and types of credit issuers described in paragraph 34, an insurer should disclose the aggregate credit risk arising from off-balance sheet exposures.

Annex 1: Sample of Asset Class Segregation

This Annex provides an example on how the quantitative aspects of this section may be complied with. Where it assists market participants in enforcing market discipline, one may adopt a different format from that given here or further disaggregate the asset classes and provide more detailed breakdowns.

Table 1

Breakdown by asset class (refer to paragraphs 32 and 39)

	Table	Market value		Historical costs	
		This year	**Last year**	**This year**	**Last year**
Equity securities	2				
Debt securities	3				
Loans	4				
Properties	5				
Cash and deposits	6				
Receivables	7				
Others	8				

Table 2

Details regarding equity securities (refer to paragraph 33)

	Market value				Historical costs			
	This year		**Last year**		**This year**		**Last year**	
	Amount	**As % of total for this class**	**Amount**	**As % of total for this class**	**Amount**	**As % of total for this class**	**Amount**	**As % of total for this class**
Breakdown by listing status								
Turnover								
Total bought								
Total sold								

Table 3 **Details regarding debt securities** (refer to paragraph 34)								
	Market value				**Historical costs**			
	This year		**Last year**		**This year**		**Last year**	
	Amount	**As % of total for this class**	**Amount**	**As % of total for this class**	**Amount**	**As % of total for this class**	**Amount**	**As % of total for this class**
Breakdown by credit rating								
AA- or better								
Worse than AA- but not worse than A-								
Worse than A- but not worse than BBB-								
Worse than BBB- but not worse than B-								
Worse than B-								
Unrated								
Breakdown by residual maturity								
Up to 1 year								
More than 1 year and up to 3 years								
More than 3 years and up to 7 years								
More than 7 years and up to 10 years								
More than 10 years								
Breakdown by type of issuer								
Government								
Semi-government[9]								
Corporate securities								

[9] Include debt securities issued by statutory bodies or municipalities.

Table 4 **Details regarding loans** (refer to paragraph 35)								
	Market value				**Historical costs**			
	This year		**Last year**		**This year**		**Last year**	
	Amount	**As % of total for this class**	**Amount**	**As % of total for this class**	**Amount**	**As % of total for this class**	**Amount**	**As % of total for this class**
Breakdown by types								
Residential mortgage								
Commercial mortgage								
Other private loans								
Other commercial loans								
Breakdown by whether collateral exists[10]								
With collateral								
Otherwise								

[10] Excludes guarantees.

Table 5 **Details regarding properties** (refer to paragraph 36)								
	Market value				**Historical costs**			
	This year		**Last year**		**This year**		**Last year**	
	Amount	**As % of total for this class**	**Amount**	**As % of total for this class**	**Amount**	**As % of total for this class**	**Amount**	**As % of total for this class**
Breakdown by type								
Residential								
Commercial								
Industrial								
Others								
Breakdown by geographical location								
Domestic								
Foreign								
Breakdown by purpose								
Investment property								
Own occupation								

Table 6 **Details regarding cash and deposits**								
	Market value				**Historical costs**			
	This year		**Last year**		**This year**		**Last year**	
	Amount	**As % of total for this class**	**Amount**	**As % of total for this class**	**Amount**	**As % of total for this class**	**Amount**	**As % of total for this class**
Breakdown by type								
Cash								
Deposits								
Cash equivalents								

Table 7 **Details regarding receivables** (refer to paragraph 37)				
	Historical costs			
	This year		**Last year**	
	Amount	**As % of total for this class**	**Amount**	**As % of total for this class**
Breakdown by ageing[11] Less than 90 days 90 days up to 1 year More than 1 year				
Breakdown by obligor From reinsurers From cedents From other insurers From agents/brokers From other counterparty				
Confirmed by counterparty				

Table 8 **Details regarding other assets** (refer to paragraph 41)				
	Historical costs			
	This year		**Last year**	
	Amount	**As % of total for this class**	**Amount**	**As % of total for this class**
Breakdown by type Intangibles Goodwill Deferred tax Other intangibles Others <describe>				

[11] Narrower time bands may be used where appropriate.

Table 9 **Details regarding collective investment schemes** (refer to paragraph 40)								
	Market value				**Historical costs**			
	This year		**Last year**		**This year**		**Last year**	
	Amount	**As % of total for that class**	**Amount**	**As % of total for that class**	**Amount**	**As % of total for that class**	**Amount**	**As % of total for that class**
In asset class								
Equity securities								
Debt securities								
Properties								
Other asset classes								

Table 10 **Details regarding derivatives** (refer to paragraph 38)								
	Market value				**Historical costs**			
	This year		**Last year**		**This year**		**Last year**	
	Amount	**As % of total for that class**	**Amount**	**As % of total for that class**	**Amount**	**As % of total for that class**	**Amount**	**As % of total for that class**
In asset class								
Equity securities								
- for hedging								
- otherwise								
Debt securities								
- for hedging								
- otherwise								
Properties								
- for hedging								
- otherwise								
Other asset classes								
Breakdown by counterparty								
Exchange-traded								
Over-the-counter								
Breakdown by type								
Forward/futures								
Swaps								
Options								
Others								

Annex 2: Measuring sensitivity to interest rate risk

Insurers should disclose the effect of interest rate changes to the insurer's assets. Where the value of an insurer's liabilities is sensitive to changes in interest rates, the insurer should also show in its disclosure of interest rate risk the net effect of interest rate changes to the insurer's assets and liabilities combined.

One way to give a perspective of asset and liability matching is to provide a measure of the relative movement in the value of free assets for a given movement in interest rates. The movement in interest rates should be expressed as a percentage point change (for example +/- 100 basis points) in the current interest rate, equivalent to a parallel shift in the yield curve.

Let Ai = the market value of total assets at interest rate i

Li = the fair value of total liabilities at interest rate i

Ai – Li = free assets at interest rate i

Therefore, the absolute movement, M, in free assets for a shift in interest rates from i to j equals | (Ai – Li) – (Aj – Lj) |.[12]

The measure of matching can then be calculated as 100M/(Ai – Li), i.e. the percentage change in the value of the free assets for a given change in interest rates.

Another possible measure to demonstrate interest rate sensitivity may be specified as follows:

Let Ki = the market value of interest rate sensitive liabilities at interest rate i

Bi = the fair value of assets backing the interest rate sensitive liabilities at interest rate i

The measure of matching interest rate shift from i to j can be calculated as 100 | (Bj – Kj) | / Bi i.e. the degree of mismatch for a given change in interest rates, expressed as a percentage of the interest rate sensitive assets.

Methods similar to that described above can be extended to disclosure about equity price risk, property price risk and currency risk.

[12] Changes in assets and liabilities may be calculated by revaluing the portfolio fully, or be approximated using the modified duration and convexity of the portfolio's cash flow stream.