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Private & confidential
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Submitted electronically via email to:
Mr John Maroney (john.maroney@bis.org)

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Dear Mr Kawai

Submission to IAIS consultation on G-SII's

We welcome the opportunity to respond to this consultation on proposed policy measures for global systemically important insurers.

Systemic risk for insurers:

We support the IAIS view that there are essentially two separate but interlinked elements when examining systemic risk for the insurance sector – the continuity of critical economic functions and the resolvability of an insurance group in an orderly manner. The latter has particular resonance for all supervisory jurisdictions given systemic importance is often a local issue (i.e. economic detriment may occur because of the risk of undue concentration in one specific jurisdiction) and, in the absence of a uniform global policyholder compensation scheme, becomes an issue for each local supervisory authority and their efforts to protect policyholders. Other important considerations such as minimising the recourse to government funds in the event of failure, associated impacts on the local economy and political considerations are also relevant and understandable factors requiring examination.

Resolution and continuity:

Similarly - and as highlighted by your paper - resolution and continuity are often implemented locally in the insurance sector, given the legal entity focus of the typical insurance group operating model, where subsidiaries rather than branches are created, requiring solo capital and funding considerations. In addition, resolution laws generally differ between jurisdictions and can have implications for an insurance group's recovery and resolution planning. The need to understand 'local' regulatory powers is important to recognise before 'resolvability' can be properly assessed. Considerable uncertainty can exist for an insurance group regarding cross-border operations, given unilateral actions that could be taken by local supervisors in the event of crisis situations - especially where the need to protect local policyholders becomes an overriding imperative for the immediate regulatory authority concerned.

Global solvency structures:

We support measures to build more integrated and effective approaches to solvency structures at a global level. The possibility of creating a globally accepted common framework (ComFrame) for the supervision of internationally active insurance groups (IAIGs) should be central to these considerations. We acknowledge the IAIS view that such a framework can support cross-border cooperation and implementation concerning systemic risk analysis and be facilitated by effective group supervision. We therefore support the continued efforts of the IAIS in seeking to produce a common framework and would encourage greater convergence towards agreeing a common view of policyholder protection levels. We consider this particularly relevant in the context of systemic risk given at present there is no globally consistent framework to apply group-wide supervision requirements, particularly concerning quality of capital measures and actual capital requirements. We note however that the development of ComFrame is still likely to be many years away. Our view has consistently been that many of the elements discussed in this paper (and more generally concerning the topic of systemic risk and how such risks should be addressed), are fundamentally concerned with the provision of good risk management disciplines - applicable for all insurers. We provide further views on such issues for your consideration later in our submission.

Reducing systemic risk:

At a more immediate and practical level, we note the intention of the FSB to require a Systemic Risk Reduction Plan (SRRP) and higher loss absorption (HLA) capacity for systemically important financial institutions (SIFIs). The application of HLA measures proposed by the IAIS, such as the separation of entities conducting non-traditional, non-insurance (NTNI) activities is likely to require further consideration. The paper suggests separation or other measures may be required to address structural inefficiencies within insurance groups which could give rise to increased capital requirements. Additional analyses of these issues are likely to be beneficial, though we acknowledge from the paper that it does not infer that HLA's will be automatically applied (if at all) to NTNI activities which we welcome. We are also encouraged that the IAIS recognises that, in general, traditional insurance is less likely to pose systemic risks, and that the predominant focus of the IAIS is to be concentrated on NTNI activities and the level and degree of interconnectedness. Of course there may be some exceptions, for example monopoly suppliers of key insurance cover or key insurance services.

Given this focus, the need for ComFrame is evident given it remains unclear whether supervisory colleges are effectively focussing on the key risks pertinent to insurance groups. For example, in some jurisdictions, there are still no formal group-wide supervisory requirements. Where this is the case, supervisory colleges have to currently negotiate a variety of different jurisdictional requirements concerning capital, investments valuation, governance and solvency rules which are not necessarily consistent. Application of HLA requirements and other associated systemic risk measures in such an environment may give rise to unintended consequences and inconsistencies arising across supervisory jurisdictions – especially where capital requirements are markedly different.

Basing the IAIS approach on the existing ICP framework is to be supported, but at this stage, there is considerable difficulty with this approach in that the capital adequacy standard, for example, does not specify actual capital levels. This is particularly pertinent given PCR levels are not defined, meaning that existing capital requirements across jurisdictions are not consistent. We also consider that applying HLA requirements against a total balance sheet position may result in a blunt measure being used, and potentially not take into account mitigating actions that have been established (such as the SRRP, RRPs and improvements to enterprise-wide risk management frameworks) which may materially alter the net risk position that still may reside with any NTNI activity.

Additional policy options:

For these reasons, and also as any HLA framework is not intended to be operational before 2019 and ComFrame is still many years away, we consider that there are a number of other policy options which could be used by supervisors, in advance of these measures, to better address the overall assessment of systemic relevance of potential G-SII's and other insurers. Such considerations do not appear to have been considered in this consultation paper; so we now provide an outline for further discussion:

Continuity of insurance services:

We acknowledge that supervisors consider insurers as providing two important economic functions: the supply of critical insurance products and acting as an enabler of risk transfer within the broader financial services sector. The continuity of such provision is therefore of key concern and it is understandable that supervisors, as articulated in the paper, have essentially two over-arching objectives in relation to systemic risk and the insurance sector generally: ensuring the ongoing functioning of the broader financial services sector at a macro level (in which the insurance industry plays a significant role) and protection of policyholders. In light of these important considerations, and as many insurers operate at a local level, it may be appropriate to consider how such objectives are actually applied more generally given very few insurance groups (if any) may be considered as a G-SII. Economic dislocation may arise from a broad spectrum of situations, not solely from the failure of an insurer that operates globally. For example, consider:

- An insurance group of sufficient global scale and importance that failure could cause considerable economic consequences;
- An insurance group whose failure at the domestic level (such as within one region or country) could pose considerable economic consequences but unlikely to cause global disruption. HIH is a good example;

- An insurer whose failure could cause considerable economic difficulties for a particular State (such as in the U.S.) or Member State (such as in the EU) but not extend on a national/regional scale; and
- An insurer whose importance within a particular City or localised area could cause considerable economic consequences for that particular market.

Such considerations are important, as they are linked to the issue of resolvability within the particular markets that insurers operate. Greater examination of such issues would be beneficial, especially regarding recovery and resolution plans (RRPs) - and the scale of economic impact that the failure of an insurer could cause in a particular market. Such analysis, for example, could be provided via the Own Risk and Solvency Assessment (ORSA). It would allow supervisors to assess the result of such situations, providing flexibility in the supervisory response proportionate to the local market conditions enabling more targeted and appropriate supervisory action.

Enhanced supervisory tools

In supporting the continuity of insurance services objective, we also support the view that a wide range of tools should be available for supervisors to take proactive action upon the trigger of each level of intervention. Similarly, we consider it appropriate for each jurisdiction to have adequate and appropriate restructuring tools in its legislation available to insurance firms, to facilitate an effective response to regulatory intervention. Further consideration of these restructuring tools is likely to be beneficial. Likewise, consistent resolution requirements across supervisory jurisdictions (such as portfolio transfer requirements and run-off schemes) would assist convergence between jurisdictions. We consider the IAIS would play a lead role in facilitating such consistency at a global level. Such commonality, to the extent possible, would be extremely useful for the insurance sector in dealing with resolution issues across national borders.

Establishing a better ladder of intervention:

ComFrame will need to set criteria for the assessment of the quality and suitability of capital resources, taking into consideration the insurers' ability to absorb losses on both a going-concern and wind-up basis. The present ICP does not have a common view as to how this could be achieved. Within this context, an opportunity exists now to establish a new regulatory control level based on whether the insurer or insurance group concerned presents any systemic risk to the local market. Such an intervention level could take the form of additional capital and/or enhanced risk management requirements via the insurer's ORSA. We believe achieving greater consistency of these measures is appropriate.

Own Risk and Solvency Assessments (ORSA):

The ORSA is a new policy tool required by the IAIS. Many jurisdictions are either in the process, or are still to determine how they will effectively implement this new requirement into their existing framework. Such analysis requires, inter alia, insurers to incorporate detailed market analysis, the focus of which could incorporate risks posed to the wider economic environment. In certain jurisdictions, such as the UK, the FSA already requires a forward assessment of the financial condition of an insurer under a range of scenarios via the Individual Capital Adequacy Standards (ICAS). A widening of the risk analysis performed in the ICAS and ORSA frameworks should assist insurers in performing recovery and resolution analysis. In turn, supervisors will likely need to consider how they could leverage this information from the ORSA in developing the SRRP framework requirements. For example, UK and European insurance groups seeking internal model approval will be required to demonstrate they have a comprehensive understanding of their business and contractual arrangements, adequacy of reserves, structures, capital and intra and extra group relationships. The extension of such analysis requiring insurers to have mechanisms in place to restore the group should there be solvency and/or going concern issues, or at least to consider such scenarios within their ORSA or internal model analysis, such as the insurer's ability to reassess reserves or technical provisions, and to deconstruct the group in an orderly manner, could be included in ORSA requirements and for ComFrame. Insurers could be encouraged, or required, to construct more hypothetical sets of assumptions, via stress and scenario tests, for how exposures may change in light of unexpected shocks and analyse the impact on the business model. Such analysis could also incorporate financial transactions such as intercompany cross-guarantees or internal reinsurance arrangements.

Strategy, risk appetite, and capital considerations:

Principally, risk appetite defines the level of risk a firm accepts. This is set from executive and board level and is intertwined with the company's strategy. A poorly defined risk appetite (or risk tolerance) and lack of goal clarity for the insurer can cause considerable financial distress. One of the lessons from the financial crisis has been that supervisors, and a number of insurance groups, were not cognisant of the inherent underlying risks, particularly those risks which may have systemic relevance. A key issue is the consistent cascade of risk appetite across the group which needs to be well understood, with clear monitoring of limits on a solo and aggregate basis to provide understanding of the diversification and fungibility impacts arising. Similarly, in regards to capital management/allocation, supervisors need to understand how capital is allocated based on local regime requirements and the varying economic bases used. Such allocation should be consistent with the risk appetites and risk limits within the group's capital model and confidence levels used.

How risk appetite is effectively used and monitored is less clearly understood by supervisors, as this has not traditionally formed a key component of the supervisory toolkit in most supervisory jurisdictions; in particular, how the risk appetite of an insurer fits with the strategic direction of the company and related impact on pricing, sufficiency of reserves and capital adequacy. Formalising links between strategy and risk appetite, and establishing formal reporting mechanisms is a practical policy option available for the ORSA and ComFrame. Extending such arrangements, such as to instances of acquisitions and mergers, may also assist supervisors better assess the systemic relevance of firms, as well as enabling insurers to articulate impacts to the business model of such changes.

Greater use of reverse stress testing:

The use of reverse stress testing, or test-to-destruction analyses, which identify scenarios that are most likely to cause an insurer to fail, could also more explicitly form part of the ORSA and ComFrame requirements. The benefit of requiring such analysis is that it can provide management, and supervisors, with the necessary information to assess the adequacy of the management actions proposed in order to avoid business failure. This leads to an element of specific focus - that of resolvability and associated planning.

Requiring an analysis of the concentration of business written:

HIH, the Australian insurance group that ultimately collapsed in 2001, is a useful example, where the impact of its collapse was indeed detrimental to the local insurance market in Australia (HIH was the dominant provider of indemnity coverage for the building industry), but the consequences of its collapse was not detrimental on a global scale. The failure of HIH starkly demonstrated the impact that a concentration of business underwritten in a particular market or segment can cause on the local economic system. The dominance of HIH's professional indemnity business was allowed unchecked such that it amassed a disproportionate market share. The analysis of whether the sudden withdrawal of such cover could give rise to any wider economic impact on the local market had not been fully appreciated. The introduction of measures to assess and determine market share criteria could be one option available to insurance supervisors, and included within a firm's ORSA within ComFrame.

A market concentration analysis of life and/or non-life insurance products would also allow firms to undertake discussions with their supervisors in advance of any stress environment allowing for constructive dialogue to occur regarding a firm's strategic objectives and marketing plans. Such analysis could also be extended to the risks posed to the insurer from its own products (such as variable annuities and subsequent impact on liquidity and cash-flow positions), securities lending and reinsurance and other significant counter-party dependencies, including significant intra-group transactions.

Enhanced corporate governance requirements:

The financial crisis revealed some shortcomings in the ability of many Boards to ensure that firms provide adequately against the risks that are being taken and to ensure sufficient liquidity and solvency is retained. Board composition, role and effectiveness are a critical component of any insurer's financial condition and therefore play a crucial role in prudential regulation. The crisis highlighted that poor decision making at either Board or senior management levels contributed to the financial malaise. Strengthening board competence requirements including various risk and audit subcommittees and applying increased assurance measures are likely to considerably strengthen the robustness of oversight functions within most firms. Requiring key approved persons within firms to demonstrate such analysis, particularly in regards to complex financial transactions, could provide an additional layer of expertise and assurance to assist insurers avoid some of the crisis experiences. Such analysis is also likely to be very relevant in any HLA considerations.

Formalising a Chief Risk Officer (CRO) role:

The role and structure of risk management has received considerable attention post-crisis. A consideration going forward to enhance firm commitment to better risk management outcomes and culture - subject to proportionality principles - could be to create in advance within ComFrame and other supervisory frameworks a function holder responsible for the firm's risk management. This would be similar to the role and nature of the Actuarial Function Holder within many jurisdictions. Requiring a distinct function or 'line of defence' which holds an aggregate view of risk across the insurer, independent of the business and reporting to the Board, could be considered.