GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

21 December 2012

GFIA response to the IAIS consultation on proposed policy measures for G-SIIs

Executive summary

Q1	The Global Federation of Insurance Associations (GFIA) through its 32 member associations represents insurers that account for around 87% of total insurance premiums worldwide. GFIA is active on a broad range of issues affecting the international insurance industry, including developments in the systemic risk debate. GFIA welcomes the work conducted by the IAIS on systemic risk with the objective of contributing to a stable and sustainable international financial system. In particular, we appreciate the IAIS' genuine efforts to develop a specific approach for insurance, given the important differences between insurance and other sectors, and especially banking. GFIA appreciates the opportunity to comment on possible measures. However, we have found this exercise rather difficult in the absence of sufficient clarity on the envisaged methodology to identify systemically important insurers (G-SIIs) and systemically relevant activities. This is especially so given the importance of ensuring that the policy measures address the causes of systemic risk, as acknowledged by the IAIS (paragraph 4). To be effective in addressing systemic risk concerns, measures must be carefully tailored and targeted at the risk they are intending to address. However, as it is not clear which measures are intended to apply to which activities it is very difficult to provide generic comments on the measures proposed in the consultation. What is clear, however, is that each insurer has a unique risk profile and unique book of business and that blanket application of additional requirements on a group-wide basis will not effectively target areas of higher risk. GFIA is of the opinion that the IAIS should adopt a gradual approach of supervisory intervention when considering the application of measures to insurers considered as G-SIIs. As a first step, activities should be identified on the basis of their potential to generate systemic risk, due to their characteristics and scale. In a second step, identified activities would be analysed based on the extent to which their potential for systemic risk is captured by existing risk management tools and supervisory practice. If further measures are deemed necessary, they should be implemented in a graduated approach and be proportionate to the potential of the activity to generate systemic risk. Such an approach would ensure that the application of measures would target only those activities which are a source of systemic risk and would have the benefit of reducing the potential for measures to generate unintended consequences. One of the IAIS' stated objectives in designing the measures is to incentivise insurers to become less systemically important. Due to the lack of clarity as to which measures will be applied to which activities we are unclear as to how this will apply in practise especially as some measures do not seem to have any impact on indicators in the IAIS methodology. In addition, we are concerned that some of the proposed measures may lead to wrong incentives. This may result in insurers taking steps which have a negative impact on financial stability rather than reducing risk originating from the sector e.g. certain requirements may give insurers incentives to sell invested

	assets, or reduce their size and global spread. Given the possible distortive effects of the envisaged measures if applied unduly to activities which are not systemically relevant, every effort should be made to ensure that both the methodology and proposed measures are appropriate. It is for GFIA therefore of fundamental importance to continue the dialogue between the supervisory community and the industry in order to come up with an approach which addresses the systemic risk related concerns in insurance and is not detrimental to insurance companies and their policy holders. For this reason, GFIA would encourage the IAIS to consult again on its proposed measures on the basis of a finalised version of its methodology, which would clarify which activities are deemed systemically relevant, and under which circumstances. This would ensure genuine consistency between methodology and measures. GFIA would also welcome a new opportunity of having a dialogue on the methodology, as a follow-up to the June/July 2012 consultation. GFIA also believes that the envisaged timeline of the current process should be reassessed to allow for further analysis. Given the fact that some of the proposed measures could have a substantial impact on insurance companies, quality of the framework should be given precedence over speed of adoption and implementation of the framework.

Introduction

Q2	*General comments* GFIA supports the concerns expressed by a number of insurance associations under the umbrella of INIA (International Network of Insurance Associations) in response to the IAIS's June/July consultation on systemic risk that the methodology needs revisiting as it is based on indicators focused excessively on global activity and size, which are not sources of systemic risk in insurance. In addition, through the broad language used in the indicators, and the lack of consideration of mitigating factors, some insurance activities could inappropriately result in an insurer being deemed systemically relevant. For example, the indicator which refers to 'extent of liquidity of insurance liabilities' could result in life insurance portfolios with no surrender penalty being deemed systemically relevant irrespective of other dis-incentives such as tax penalties, loss of guarantee, inability of replacing the contract under the same conditions applying. GFIA is also concerned that the proposed definition of "non-traditional and non-insurance activities" (NTNIAs) was too broad to be used to define activities raising systemic risk concerns in insurance, by including activities such as life portfolios of contracts with financial guarantees including Variable Annuities (VA), trade credit insurance and those associated activities to traditional insurance products which are statutorily authorized and well supervised. In addition, it should be kept in mind that just because an activity is a NTNIA it does not automatically follow that it is of systemic importance. GFIA wishes therefore to reiterate its view that the methodology should be reviewed in order to focus specifically on activities which have the potential to raise systemic risk concerns. Without this, GFIA is concerned that it may be difficult to develop measures which "are proportionate, avoid adverse consequences and are directed at the source of systemic importance" (paragraph 11). With the current broad scope of the definition of NTNIA's there is also a risk of certain activities being considered in a differentiated manner by supervisors across jurisdictions. GFIA is of the opinion that the on-going consultation of the Financial Stability Board (FSB) on shadow banking ("Strengthening Oversight and Regulation of Shadow Banking an integrated overview of policy recommendation", November 2012") may provide useful guidance to define

	activities which may raise systemic risk concerns. Such activities would involve maturity and liquidity transformation, the creation of money-like liabilities or the inappropriate use of leverage. As regards the envisaged measures, it is fundamental that they target activities as opposed to entities. In that sense, the IAIS should not excessively mirror what the Basel Committee developed for the banking sector. Certain measures, such as a group-wide capital surcharge, would not be a useful way to address sources of systemic risk in insurance, and would have detrimental consequences, as explained in more detail below. The measures should also be designed in such a way that before applying them, a supervisor takes into account how the activities raising systemic risk concerns are managed by the insurer, whether there is appropriate regulation at local level and whether the insurers conducting the activities are sufficiently capitalised. Finally, due consideration should be given to any distortion of competition that would result from being on a list of “G-SIIs”.
Q4	Given the significant role of insurers in enabling society to manage risk more efficiently and their role as long term investors, it is important to be mindful of possible negative unintended consequences of the measures, in terms notably of more expensive premiums and reduced coverage.

The G-SII policy measures

Enhanced supervision

Q17	*General comments* We support the view that supervision has a vital role to play in addressing systemic risk concerns. It is important for supervision to be appropriate and tailored to the risk profile of an entity or activity. We also agree with the IAIS that the group wide supervisor should have a comprehensive overview of the whole group, which also brings benefits in the case of insurers considered to be G-SIIs. The group-wide supervisor shares that insight with other supervisors, which allows supervisors to have a complete picture of a group’s operations including those conducted by non-regulated and non-insurance entities. GFIA firmly believes that supervision should be risk based and therefore an assessment as to what form of enhanced supervision might be needed depends on the underlying risk or in this instance on the particular systemically important activity in question. It is also unclear what the IAIS means by ‘enhanced supervision’; given that regulation and supervisory practices in insurance are not globally consistent, what might be regarded as enhanced supervision in one jurisdiction might well be viewed as standard in another. Therefore, it is important that any additional ‘enhanced supervision’ is only applied with reference to the regulation already in place in a jurisdiction and where there is a clearly identified supervisory gap/need. On this note no enhanced supervision should apply to activities that are not systemically relevant. Supervisory powers should also remain balanced, and should not lead to a situation whereby supervisors would end up taking over the role of a company’s board and/or management while a company is still a going concern.

Q21	*Enhanced liquidity planning and management* Although insurers are significantly less exposed to liquidity risk than banks, GFIA recognises the importance of appropriate liquidity planning and management. In our opinion, most supervisory frameworks at local level and advanced management tools (such as those outlined in the CRO Forum publication on best practice in liquidity risk management, 2008) include this to a large extent. As such, additional liquidity requirements for GSII's should only be envisaged where this is not the case.
Q22	*Structural measures and Systemic Risk Reduction Plan (SRRP)* Given the lack of clarity on the activities regarded as systemically relevant, and on the sequence of measures envisaged to address these concerns, it is difficult to provide a clear view on the proposed "Systemic Risk Reduction Plan". GFIA is opposed to the SRRP if applied to a wide range of NTNIA not raising systemic risk concerns, notably activities conducted in support of insurance business. The structural separation envisaged under the SRRP should be a measure of last resort applied exclusively to unmitigated systemically risky NTNIA. Another aspect that remains unclear is whether the measures taken by a G-SII as part of its SRRP may actually result in that entity being removed from the list or being subject to more targeted measures, such as targeted HLA instead of group-wide HLA. In general, greater predictability of supervisory responses to measures undertaken by insurers is necessary. Finally, the SRRP should not lead to situations whereby supervisors undertake actions which are more appropriately carried out by an insurer's management. Given the open questions relating to the proposed SRRP, GFIA would welcome a specific dialogue on this tool on the basis of a final version of the methodology on the identification of systemic risk.
Q23	*Separation of non-traditional and non-insurance (NTNI) activities* Supervisors should carefully consider to which systemically risky activities the separation measures and constraints should be applied, keeping in mind that the application of such tools may inhibit an insurer's ability to effectively conduct business. GFIA considers that separation should only be considered as a measure of last resort in very limited circumstances for unmitigated systemically risky activities. No other activities, including those that fall under the current definition of NTNI, but do not raise particular systemic risk concerns, should be subject to separation. Structural measures have the potential to place unnecessary pressure and constraints on the insurance business model. Other measures should therefore be considered before ring fencing and structural separation of activities or entities occurs. Also, for certain activities such structural measures may show to be very difficult or impossible to implement as the purpose of an activity may necessitate that it is conducted in the insurance entity and reflected in its balance sheet for legitimate risk management reasons. Further, diversification benefits between traditional insurance business and other businesses and capital fungibility, which are at the heart of large group management, need to be considered, unless the activities involved create significant systemic risk. As mentioned above, GFIA is fundamentally concerned about the possibility of separating

	certain activities which would not raise systemic risk concerns, but based on the IAIS methodology would be regarded as NTNI. This could be the case for trade credit insurance as well as life portfolios of contracts with financial guarantees, including Variable Annuities (VA) and those associated activities to traditional insurance products which are statutorily authorized and well supervised. . Impeding risk diversification by requiring separate entities for such activities would inevitably result in a substantial drop in the supply of these products by insurers.

Effective Resolution

Q31	*General comments* GFIA believes that unlike in banking, in insurance the focus should be on recovery rather than resolution. This is due to the fact that an insurance failure is generally a much lengthier process than in banking. Also, there is a wide range of recovery mechanisms already available to insurers and supervisors (portfolio run-off, novation, whole account reinsurance, insurance business transfer and commutation plans or cross border mergers), which in our view are appropriate to meet supervisors concerns. The recent CRO Forum paper "Insurers risk management systems - providing for recovery" (CRO Forum, July 2012), provides an appropriate benchmark for how good risk management and appropriate recovery practices can avoid the need for insurers to enter into resolution. In addition continuity of policyholder cover as a last resort is provided for in many jurisdictions through policyholder protection funds and guarantee schemes. Therefore, IAIS should only suggest applying additional enhanced recovery measures in cases where existing supervisory tools at local level are considered incomplete, and for genuine systemic relevant activities.
Q 32	We fail to see the rationale for additional resolution tools for insurance as there is a limited track record of an insurance failure which resulted in severe "systemic disruption" or where "vital economic functions" were put at risk. In insurance, the business model allows for orderly resolution, based on well-established resolution tools in many jurisdictions. GFIA believes that further action by the IAIS would however be welcome in order to facilitate cases of cross-border resolution.
Q 33	*Resolution regimes and tools for G-SIIs* The FSB's "Key attributes for effective resolution regimes for Financial Institutions" have been developed with the banking model in mind and are therefore generally not directly applicable to insurance. In this regard, we support IAIS' work to adapt properly these attributes and we welcome the IAIS acknowledgement in Paragraph 30 of the need to incorporate insurance-specific elements. GFIA believes that Crisis Management Groups (CMGs) should be part of the existing supervisory colleges of G-SIIs rather than a completely separate forum.
Q38	It is important that, if a template were to be developed for assessing the resolvability of G-SIIs it would be done in such a way that it would not limit the flexibility of national authorities in managing future resolutions.

Higher Loss Absorption (HLA) capacity

Q39	*General comments* GFIA believes that the application of additional capital requirements should only be envisaged specifically for activities which are a source of systemic risk, as a measure of last resort and only where, as part of risk based supervision already being in place, a higher charge is not already targeted at the activity in question. Also, HLA requirements should be properly calibrated and be envisaged as part of a toolbox; consideration should also be given to the existence of similar supervisory and regulatory tools in place at national or regional level. GFIA strongly rejects Group-wide HLA as such a measure would not reduce the involvement of an insurer in systemically relevant activities and would result in distortions of competition. GFIA wishes to reiterate the industry's view that capital plays a very different role in insurance and in banking, and that excessive capital requirements on the insurance industry could have extensive damaging effects: • Higher capital charges may negatively affect households and commercial policyholders through higher costs and reduced capacity of insurance coverage. • At the macro-economic level, additional capital requirements would limit the role of insurers as long term investors in the economy, with a negative impact on growth.
Q42	Significant barriers exist to the effective application of HLA in insurance at a global level. As acknowledged in the consultation, it remains to be clarified how such additional loss absorbency would be applied given the regional differences in terms of accounting and solvency standards and the absence of a global capital requirement framework in insurance.
Q46	*Methodology for applying group HLA capacity* Applying group-wide HLA would not be in line with the risk based approach to supervision otherwise advocated for by the IAIS. In addition, such a measure would not be in line with the objectives established in the paragraph 11 of the consultation (i.e. be proportionate and avoid unintended adverse consequences). There is also a risk of group-wide HLA leading to distortions of competition between G-SIIs and other insurers. HLA should therefore be targeted, risk-based, and should incorporate existing national or regional solvency regimes.
Q49	*Step 1 – targeted HLA capacity* GFIA is of the opinion that targeted HLA should only be considered for specific activities which are a source of systemic risk. In addition, the application of HLA should only be considered as a last resort, as part of a gradual approach which would initially assess the appropriateness of other measures. It should also be properly calibrated and should take into account existing national or regional regimes.
Q54	*Application of the HLA uplift* The proposed HLA uplift, which is calculated based on the approach followed for G-SIBs, raises serious questions and concerns. First and foremost, an insurer's "prescribed capital requirement" (PCR) cannot be compared to a bank's capital requirement, given the very different balance sheet structures and the fact that in turn capital plays a very different role in the two sectors.

	In addition, GFIA considers the proposed uplift for insurers, with respect to the banking requirement, to be completely disproportionate to the potential for systemic risk in insurance.

Implementation

Q61	GFIA believes that this process is of paramount relevance for the insurance industry and further discussion is needed on the important outstanding issues with regard to both the proposed identification methodology and policy measures. As mentioned in the introductory remarks, we think that the industry should be given another opportunity for comments on the measures once the methodology is finished. We would also welcome a new dialogue with the IAIS on the identification methodology prior to its publication. The calendar for the application of the measures should be re-evaluated accordingly.
Q62	GFIA believes that the implementation timetable needs to be reconsidered. Some of the measures in particular (such as the envisaged resolution measures, which include a restructuring of activities) may need a longer period that the proposed 18 months.