Insurance comprehensive systemic risk framework

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Global framework for the supervision of insurance groups and systemic risks

The supervision of cross-border insurance groups is now facilitated by the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), adopted by the IAIS last year. ComFrame is a comprehensive framework for effective group-wide supervision of Internationally Active Insurance Groups (IAIGs), to help supervisors address group-wide risks and avoid supervisory gaps. ComFrame will provide supervisors with a common language for the supervision of IAIGs. By coordinating supervisory activities and exchange of information about IAIGs, the practical implementation of ComFrame should result in more efficient supervisory processes, for the benefit of both supervisors and IAIGs.

ComFrame builds on, and expands upon, the high-level standards and guidance set out in the Insurance Core Principles (ICPs), which generally apply to the supervision of all insurers and insurance groups.

As part of ComFrame, the IAIS is developing the Insurance Capital Standard (ICS), which aims to provide a globally comparable risk-based measure of capital adequacy of IAIGs. In November 2019, the IAIS agreed on ICS Version 2.0 to be used during a five-year monitoring period for confidential reporting to group-wide supervisors (GWSs) and discussion in supervisory colleges. The purpose of the five-year monitoring period is to monitor the performance of the ICS over a period of time, and not the capital adequacy of IAIGs. Earlier this year, GWSs identified IAIGs based on the international activity and size criteria as provided in ComFrame. GWSs committed to publicly disclose the identification of IAIGs at the earliest possible opportunity, noting that in some cases this disclosure may require legislative changes or regulatory action.

The IAIS is currently focused on supporting Members' efforts in the implementation of ComFrame. In future years, the IAIS will shift its focus to the robust assessment of the timely and globally-consistent implementation of ComFrame.

In delivering its commitment to contribute to global financial stability, last year the IAIS also adopted the Holistic Framework for the assessment and mitigation of systemic risk in the insurance sector. This framework recognises that systemic risk can arise both from sector-wide trends with regard to specific activities and exposures, as well as from a concentration of these activities and exposures in individual insurers. The Holistic Framework consists of: 1) an enhanced set of supervisory policy measures and powers of intervention for macroprudential purposes, incorporated into the ICPs and ComFrame; 2) an annual IAIS global monitoring exercise and collective discussion on the assessment of the potential build-up of systemic risk and appropriate supervisory responses; and 3) a robust assessment of the globally consistent implementation of the enhanced supervisory measures.

ComFrame and the Holistic Framework help provide the tools insurance supervisors need to assess and respond to the impact of COVID-19 on the global insurance sector, including on IAIGs. ComFrame provides a globally consistent framework for both assessing (through, for instance, supervisory review and stress testing) and coordinating (through supervisory colleges) a cross-border supervisory response at the level of the insurance group.

The Holistic Framework will be employed by the IAIS to undertake a targeted assessment of the impact of COVID-19 at the global level and to facilitate a collective discussion among insurance supervisors from around the globe on a coordinated supervisory response. ●

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ICS 2.0: a big opportunity for European insurers

The Insurance Capital Standard (ICS) has been developed since 2014 by the International Association of Insurance Supervisors (IAIS) with the purpose of creating a common language for supervisory discussions of group solvency of internationally active insurance groups (IAIGs) to enhance global convergence among group capital standards. A major milestone in the development of the ICS was achieved on 13 November 2019 with the agreement of the so-called ICS version 2.0. Indeed, since then, the ICS has entered a 'monitoring period' and, for the next five years, it will be used for confidential reporting to the group-wide supervisor, for discussion in supervisory colleges, and for further analysis by the IAIS.

The agreed ICS fulfilled all the major objectives specified by European supervisors and insurers. This success results from the continuous and intense engagement of all European supervisory authorities and numerous European IAIGs, for more than 5 years. Key elements of Solvency II, such as the market-adjusted valuation of the prudential balance ▶

sheet, are already fully acknowledged within the reference ICS. In addition, internal models have been allowed as additional reporting methodologies for them to be further discussed. Solvency II will be a practical implementation of the ICS in most of its areas, which prevents parallel layers of regulation in the future or any degradation of the strong and successful European prudential framework currently in place.

The United States is currently developing an Aggregation Method (AM) to a group capital calculation that is not part of ICS Version 2.0. The IAIS aims to be in a position by the end of the monitoring period to assess whether the AM provides comparable outcomes to the ICS. If so, it will be considered an outcome-equivalent approach for implementation of ICS as a prescribed capital requirement. The IAIS has already agreed that the comparability assessment will take into account the prudence of the AM in relation to the ICS, recognising that the latter will be a minimum standard. Therefore, the AM will have to be more prudent than the ICS throughout all economic and financial market conditions over the usual business cycle.

The purpose of the monitoring period is to monitor the performance of the ICS over a significant period. The active participation of IAIGs in the monitoring period is of the utmost importance to provide effective feedback on the ICS (covering both the reference ICS and additional reporting - on internal models for instance). EIOPA therefore strongly encourages European IAIGs to participate in the monitoring period, including the use of internal models, to ensure their specificities will be as well taken into account as possible in the next steps of the ICS development.

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Carpe Diem and give thought to the future

On April 2, 2019, U.S. Federal Reserve Board Vice Chair Randall Quarles outlined his vision of how best to build on post 2008 reforms to strengthen the financial system and address the so-called "too-big-to-fail" issue. Cautioning that "the causes of financial crises rarely announce themselves ahead of time", he called for a focus on emerging risks through the broader perspectives and range of views of "search parties" organized with the intention of sharing and discussing concerns to determine if and how they should be addressed in advance.[1]

Today we live the situation Vice Chairman Quarles urged us to be prepared to meet and we call on our standard setters to seize this unannounced opportunity to integrate learnings from the impact of COVID-19 into standards under development.

This will ensure that global standards, necessarily developed on the basis of historical evidence and theoretical constructs, reflect real-time issues and offer more effective models of how to manage solvency and systemic risk in the insurance sector. One example is the IAIS Holistic Framework due to be implemented this year.

Its sector-wide monitoring exercise (SME) would be a strong foundation for the creation of the kind of search party Vice Chair Quarles describes.

Most importantly, the IAIS intention to hold regular public/private discussions of current trends and potential concerns arising from the SME, would encourage early identification and correction of emerging threats to the financial system and broader economy. We applaud the IAIS for taking this step.

Another example is the IAIS global Insurance Capital Standard (ICS) that enters its five-year monitoring phase this year.

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What better opportunity than the current situation for the IAIS to understand the impact of the ICS, particularly its market-adjusted valuation approach, on insurers' ability to manage through short-term volatility in capital markets and the potential unintended consequences it could have on availability of product and markets worldwide?

There are likely to be many detailed and valuable insights afforded by the sector's experience of this evolving and uncertain situation that we continue to live through and learn from.

Once the air begins to clear, we urge the IAIS to engage with industry to leverage the great potential for the current unprecedented and unfortunate situation to provide insights and understandings that could improve standards that will impact the industry for many years to come.

1. April 2, 2019 remarks to European Bank Executive Committee Forum, "The Future of Banking: The Human Factor", Brussels, Belgium

Andrew Mais

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The Aggregation Method: an outcome-equivalent approach to implementing the ICS

As a founding member of the International Association of Insurance Supervisors (IAIS), and by virtue of the size and diversity of the U.S.'s highly competitive insurance market, the NAIC and U.S. state regulators actively participate in and have been a critical and leading voice in international standard setting activities. As we work with our international counterparts, it is important that the elements of an effective international insurance supervisory framework are adaptable to the U.S. insurance market in particular and respect jurisdictional imperatives in general.

Last November, the IAIS reached agreement on a way forward on the Insurance Capital Standard (ICS), which is to be used during a five-year monitoring period. At the same time, the IAIS agreed on a definition of comparable outcomes and an overarching approach and timeline for the development of criteria to assess whether the Aggregation Method (AM), being developed by the U.S. and other interested jurisdictions, provides comparable outcomes to the ICS.

While U.S. state insurance regulators will not be implementing the ICS, we remain committed to an approach to group capital analysis which can and should be viewed as comparable to the outcomes achieved by the ICS, namely the AM. The AM builds on existing proven capital regimes to provide a measure of group capital adequacy. The starting point is existing legal entity regulatory capital requirements and scaling to a common level.

Nevertheless, we remain interested in ICS Version 2.0 as part of IAIS activities and join other jurisdictions in wishing to avoid a "one-size-fits-all" approach to group capital adequacy. During the monitoring period, other approaches within the ICS construct are being actively considered, such as a GAAP Plus approach to valuation and an internal model approach to capital requirements. The impact of such approaches on providing comparability will need to be considered as part of the process.

The AM embodies principles underlying the ICS - indifference to corporate structure, minimization of procyclical behavior, promotion of sound risk management and transparency – while being grounded in existing legal entity requirements. We have long questioned whether the "market adjusted valuation" (MAV) approach in the ICS Reference Method is consistent with these principles. The environment created by COVID-19 will provide a test of whether MAV provides the appropriate risk management incentives during periods of market volatility. In our view, the AM is not only comparable, but superior to the current ICS as it provides more transparency into the capital structure and local risks within a group and uses less volatile accounting methods.

Committed to an approach to group capital analysis which can and should be viewed as comparable to the outcomes achieved by the ICS, namely the AM.

The IAIS began collecting data on the AM in 2018 and will continue to do so through the ICS Monitoring Period. The next milestone for the AM will be the IAIS' assessment regarding comparable outcomes. If comparable, the AM will be considered an "outcome-equivalent" approach for implementation of the ICS.

The IAIS has made clear that the AM will not be precluded at the outset from being comparable nor given a free pass. The question is not whether aggregation can produce comparable outcomes but what form a comparable AM will take. As this work continues forward, we are committed to working with our colleagues at the IAIS and in other jurisdictions in reaching this determination.