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The Insurance Capital Standard (ICS) Moves Forward

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The International Association of Insurance Supervisors (IAIS) has moved one step closer to the release of its capital standards for Internationally Active Insurance Groups (IAIGs). While these standards are meant to apply on a group basis and not to individual legal entities, there is often a trickle-down effect so all practitioners need to be aware of what is transpiring.

The IAIS is the international standard setting body responsible for developing principles, standards and other supporting material for the supervision of the insurance sector and assisting in their implementation. The IAIS is a member of the Financial Stability Board (FSB). The IAIS is routinely called upon by the G20 leaders and other international standard setting bodies for input on insurance issues as well as on issues related to the regulation and supervision of the global financial sector.

To refresh, IAIS supervisory materials are structured in three layers:

- At the bottom, the insurance core principles (ICPs) which are intended for regulation of all licensed insurers in all jurisdictions.
- Atop that, ComFrame provides additional requirements that are meant to apply to all IAIGs. The ICS will be the capital component of ComFrame.
- Atop of that, additional requirements apply to the regulation of all Global Systemically Important Insurers (G-SIIs). This additional capital requirement—in addition to a Basic Capital Requirement (BCR), eventually meant to be the ICS—is called the High Loss Absorbency (HLA).

A few years ago, the IAIS announced a temporary version of the ICS called the Basic Capital Requirement (BCR). It is more formula-driven and will be replaced by the under-development and focus of this article, the ICS.

The ICS is meant to apply to all IAIGs. It is estimated there will be about 50 75 IAIGs, although there are currently no plans to make the complete number or the list of IAIGs public. The ICS is being developed with significant field testing; over 30 IAIGs from around the globe participated in the latest field test.

FEATURES

Based on the IAIS's 250-question consultation document, actuaries (and his/her peers) who prepare the ICS will have to deal with the following concepts:

- Selecting a Market Adjusted Values (MAV) Balance Sheet or an Adjusted Generally Accepted Accounting Principles Balance Sheet (GAAP+) as starting values
- Understanding GAAP+: Begin with reported values under local GAAP; replace all assumptions with current, entity-specific assumptions; hold present value of cash flows (using a gross premium) as liability (for life companies)
- Getting comfortable with three definitions of contract boundaries—one for US GAAP, one for IFRS and one for ICS
- Developing a Margin Over Current Estimate (MOCE), either sufficient to run off the block or sufficient to transfer to third party, as an additional liability
- Utilizing a discount rate (many options remain)
- Not incorporating Asset Liability Matching (ALM) into the mix
- Targeting 99.5 percent VAR under a one-year time horizon as the calibrated capital requirement
- Preparing to deal with tiered capital in a fashion similar to bank leverage ratio rules
- Looking over the shoulder of an actuary who has performed Solvency II as many of the requirements and procedures are similar
- Dealing with multiple correlation matrixes, including correlation between risks and between geographic regions
- Wrestling with future tax rates for the global entity
- Deciding whether to create a health module or leave the health risks within the life or non-life rubrics
- Performing stress tests addressing shocks to (for life companies):
  - Mortality
  - Morbidity
  - Longevity
  - Lapse
  - Expense

- Applying risk-factors to an exposure (for non-life companies) for:
  - Non-life premium
  - Non-life claim liability
  - Latent liability
- Considering these risks (for both life and non-life companies):
  - Operational
  - Market (interest rate, equity, real estate, currency)
  - Credit (default)
- Applying to become Head of Insurance Group
- Tearing up as you realize available capital will be tiered as the banks do
- Identifying scope such that significant non-insurance entities are within ICS perimeter
- Modeling the expected effects of natural and man-made catastrophes such as typhoons, earthquakes, pandemic, and terrorism
- Collecting and submitting data on a wide range of topics, such as exposure information by line of business by jurisdiction, in order to allow supervisors to ultimately develop factors for the ICS that are based on actual observed results
- Enhancing your segmenting skills, such as property-like or liability-like for non-life companies and six geographic regions (Europe, U.S./Canada, emerging markets) for diversification purposes

The ultimate goal of this calculation will be the development of a ratio. It is of the form actual to required, or more explicitly Qualifying Capital Resources in the numerator and the ICS capital requirement in the denominator.

Of course, these concepts are from where we stand at the end of 2016; the ICS will certainly evolve before its finalization.

KEY CONCEPTS STILL TO BE ADDRESSED

At a January ICS stakeholders meeting, participants identified many areas they felt needed significant attention. Some of these are:

- The interplay between the ICP's and ComFrame needs to be clarified. The IAIS will have several public consultations on this during 2017.
- The potential redundancy between the MOCE and available capital needs to be resolved.
- The benefits and use of ALM needs to be better reflected as well as other, if not all, aspects of the company's business model.
- Can internal models be used more?
- Discount rates. For the MAV, the ICS is not using the risk-free rate. Investigation during 2017 will look at a) a blend of prescribed rates/curves, b) a rate based on own assets with guard rails, and c) an AA curve minus a spread. It has been noted by FASB followers that the typical life company's portfolio is more reflective of a single rather than double A security.
- There should be linkage between assets and liabilities discount rates; the liability discount rate should reflect how the company invests.
- Many markets consider that surplus notes and senior debt are surplus that is available to fund policyholder claims in time of stress. Is this appropriately reflected in the tiering?
- Artificial volatility needs to be eliminated. Artificial volatility can be introduced by a reference portfolio. Volatility can be inflamed by using a subjective, unsubstantiated spread haircut.
- The investment portfolio already reflects the nature of the liabilities. Assets are selected based on the maturity and liquidity of the products.

TIMETABLE AHEAD

The IAIS has scheduled the release ICS version 1.0 for 2017. Field testing will again occur in 2017. The IAIS has scheduled the release v2.0 in 2019. This will be part of ComFrame as the capital requirement component of this supervisory material (which is targeted to IAIGs). All three IAIS global capital standards are focused on being consolidated group wide assessments.

The IAIS cannot require or mandate that any of its standards be enacted in any jurisdiction. The IAIS expects its members (there are about 200 of them, including the 50 United States) to implement IAIS standards to the best of their abilities and as appropriate in their jurisdictions.

The U.S. has announced its own efforts to develop capital requirements for insurance groups. Both the Federal Reserve Board (who generally deliberates in private) and the National Association of Insurance Commissioners (who deliberates issues in public) are developing their own approaches for development of group capital. ■

The author thanks Ralph Blanchard and Josh Windsor for their insights.

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