Session 72PD: IAIS Capital Standards Update

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2017 Valuation Actuary Symposium

Session 72: IAIS Capital Standards Update

Industry Observations

David Sherwood, ASIP

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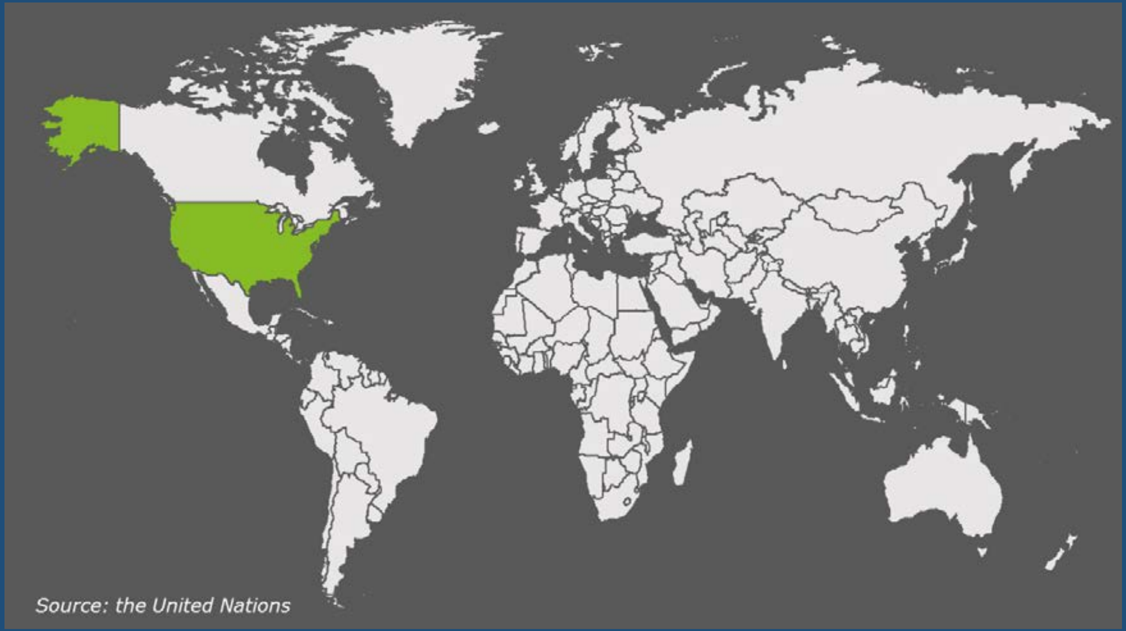
Industry Observations

Participation:

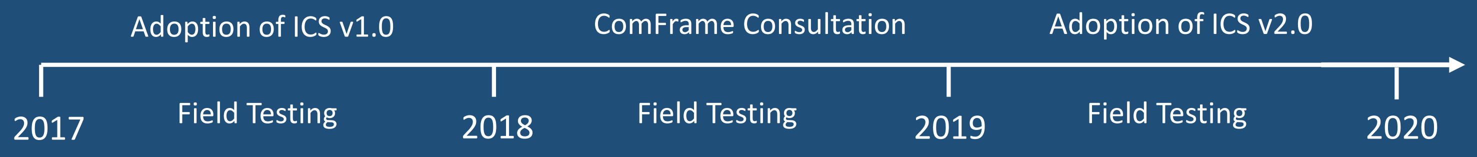
- Global
- United States



Industry Observations

Field testing:

- Only one part of ComFrame
- Key themes
- Adoption of ICS Version 1.0
- What is next - ICS Version 2.0



Abbreviated Timeline: (Source IAIS)

Industry Observations

Unanswered questions:

- Field testing helps explore differing approaches – only so much can be achieved in any one year
- Focus has been technical content not implementation
- Many other areas remain unknown
- Benefits of participation

Industry Observations

Moving from project to process

Current field testing allows for discretion

Some considerations for reliable ICS production:

- Governance
- Process and controls
- Systems and data

Industry Observations

Wider considerations:

- Linkage to other regulatory aspects e.g. ORSA
- Other emerging group capital calculations / standards
- Impact on business strategy

Questions?

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2017 Valuation Actuary Symposium

DEVELOPMENT OF THE INSURANCE CAPITAL STANDARD (ICS)

Josh Windsor - NAIC

August 28 - 29, 2017

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Presenters (in order)

Josh Windsor (NAIC)

John Dieck (Pacific Life) & Russ Davis (Aflac)

David Sherwood (Deloitte)

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Why Do We Care About The ICS – What Is In It For Us?

- Initially ICS will affect IAIGs and GSIIs
  - Including subsidiaries and branches of Non-US multinationals
  - May affect DOI participation in supervisory colleges conducted by other supervisors
  - Preparation for a Crisis management group (CMG) to deliver coordination in a crisis event
- ABA may cast a wider net
- Once the ICS is established
  - Market expectations for ICS related info to be published
  - The ICS may have to be examined (and audited)
  - There may be a trickle-down effect to non IAIGs through for example rating agencies

ICS Progress – Version 1.0

- For the first time provides stakeholders a simulation tool to allow "What if" games to be played.
- Still focusses on the three areas of valuation, capital requirements and capital resources
- The ICS will be the ratio of capital resources/ capital requirements
- There are still two major views on valuation: MAV and GAAP with Adjustments (known as GAAP plus). These will most likely carry through to version 2.0.
- MAV now has three options to be tested in 2017 called the (1) blended (2) HQA and (3) OAG
- Each still uses the IAIS base discounting curve; the differences lie in the additional spread

Principal MAV Valuation Features (three options)

- Blended: Divided in two; one has special (favorable) treatment for portfolios that meet very restrictive criteria (basically such assets and liabilities have to be very closely matched)
  - The other general part is for other liabilities, and its provisions include a reference portfolio based on a representative portfolio that reflects the assets typically held by all IAIGs in that particular currency. Only 80% of the spread above the risk free rate (jargon: application ratio) is allowed to be used in the computation.

- HQA: Originally inspired by the accounting approaches to recognition of assets and liabilities. The FASB especially has used the term High Quality Assets in their discussions. The application ratio is 100% but the guardrail for the 2017 Field Testing is a maximum of AA spread

- OAG does not divorce the valuation of liabilities from the assets. It employs the discounting mechanisms inherent in the entity's own portfolios (based on a partition by ALM management) subject to various guardrails such as a maximum of BBB spread.

Principal GAAP Plus Features

- Also contains more than one approach. A basic approach which relies on the (jurisdictional) GAAP methodology for the determination of discount rate and makes certain adjustments to (jurisdictional) GAAP when current assumptions are used for valuation of life insurance liabilities
- A second approach is in line with the HQA approach under MAV
- A reconciliation spreadsheet aims to understand as best as is possible the differences between MAV and GAAP Plus to understand if and how the differences between the two basic approaches can be converged.

Main Items To Look Out For In Capital Requirements

- Calibrated (as best as possible) to 99.5% VaR
- Risk sensitive so stress based
- Largest ticket items:
  - Interest Rate Risk. The basic methodology uses the Dynamic Nelson Siegel method chosen in 2017 in preference to a principal component analysis used in 2016 or the simplified Cox Ingersoll Rand method employed in 2015. There are 5 different stresses applied (up, down and twists). The results are combined with the gain or loss under mean reversion scenario using the square root approach.
  - Longevity Risk. As a compromise the level, trend and volatility stresses were combined into one level stress of 17.5%
- The methodology for the morbidity/disability stresses is new and it is hoped that companies will contribute data for the calibration of this risk
- Margins over current estimates (MOCE)

Capital Resources: Many Open Issues But A Few Particularly Stand Out

- Structural subordination (particularly as regards senior debt)
- Financial instruments issued by mutual IAIGs (e.g. surplus notes)
- Non-paid up capital resources
- Discretionary repurchases of Tier 1 unlimited financial instruments
- NAIC Designations

Emerging Issues

- Internal Models
- Other Methods
- Infrastructure as an asset class
- Taxation
- SRATF
- TFBI

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