INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

16 December 2013

Subject: Copy of BCR Consultation Tool

1 Purpose

The purpose of this document is to provide a copy of the BCR Consultation tool in a format that can be shared among multiple staff members of an organisation. This should facilitate the process of gathering comments.

SPECIFICATIONS OF THE BCR CONSULTATION TOOL

IAIS Consultations

Your information:

Note: Please check if your information is correct because it will be submitted exactly as you enter it in this form. Particularly for organisations representing more than one jurisdiction, please consider carefully how to enter your jurisdiction.

Organisation	North American Chief Risk Officer Council	Mandatory
Jurisdiction	North America	Mandatory
Role	IAIS Observer	Mandatory
Name of Person responsible for comments		Mandatory
E-mail address	secretariat@crocouncil.org	Mandatory
Phone		Mandatory

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IAIS Consultations

Note: You need to click on **"Next"** or you use the **"Jump to Section…"** drop down box on the right top to save your entries. You can go back to the previous page to change or review the last set of questions by clicking on **"Previous"**

Q-Nr	Reference question	Jump to Section <drop down menu of Sections and questions>
2. Executive Summary		
Q1	2. General comments on Executive Summary	
The CRO Council appreciates this opportunity to provide insight that will support the efforts of the IAIS in developing an international framework for group-wide capital standards. We believe the combination of stated goals, which include full comparability across multiple accounting and regulatory regimes, sensitivity to individual company risk, and transparency, will be difficult to obtain within the stated timeframe due to the complexity of the global insurance industry. Recognizing this difficulty, we encourage the IAIS to acknowledge potential limitations while taking a simple and practical approach. We caution that any attempt to measure the market impacts of risk drivers on asset and liability values needs to recognize the risks of spurious volatility and cyclicality that may emerge if the framework undesirably incents companies with long-term portfolios to take action based on short-term market volatility. Additionally, we ask the IAIS to clarify the long-term purpose of the BCR in relation to existing and proposed regulatory measures as early as possible. These ideas are expanded upon in the sections that follow.		
Q2	2.1 Comments on Overview	
Q3	2.2 Comments on Approach	
See response to Q12 and Q32.		
Q4	2.3 Comments on Generic Example	
Q5	2.4 Comments on Key risks addressed	
Q6	2.5 Comments on Other considerations	
Q7	2.6 Comments on Conclusion and next steps	
See response to Q26.		

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Q-Nr	Reference question	Jump to Section <drop down menu of Sections and questions>
3. Context		

Q8	3. General Comments on Context
Q9	3.1 Comments on Background
Q10	3.2 Comments on The BCR Mandate
The BCR should allow for high level comparisons of companies, but should otherwise allow flexibility of management decision making. To this end and to mitigate any unintended incentives created by the simplified factor approach, the BCR should serve as a minimum capital floor, rather than a target capital level. Structuring the BCR as a floor would provide an international minimum standard for all subject companies. In addition, companies would continue to hold capital in excess of the BCR as they would still have target capital levels set by their national regimes and rating agencies.	
Q11	3.3 Comments on Scope of application
Q12	3.4 Comments on Principles
A factor-based approach can produce a very good diagnostic high level indicator of capital adequacy, but full comparability across multiple accounting and regulatory regimes, sensitivity to individual company risk, and transparent simplicity is not attainable. Insurance companies have a wide range of assets available for investment with a wide range of risks. Insurance risks are diverse among products and carriers as well. Some products include inherent risk mitigants such as market value adjustments, pass-through crediting strategies, policyholder dividends and discretionary payments, which should be adjusted for appropriately. These considerations should be accounted for in the factor-based approach, but, ultimately the nuances and product mixes specific to various companies and the various levels of risk they create cannot be fully captured by a set of simple factors. As a result, the IAIS should remain cognizant of the proper uses and limitations of such a BCR and develop it in as practical a manner as possible. For the same reasons, to the extent adjustments must be made to companies' existing balance sheets, we encourage the IAIS to be simple and practical in their approach. Given the differences in business mixes and accounting regimes, full comparability among companies, and jurisdictions, will be difficult to achieve. We suggest therefore that the IAIS consider both the costs and benefits of any particular adjustment, and that adjustments only be required if they have a material impact. To identify areas where consistency may be achieved, we suggest that the IAIS maintain an awareness of proposals from the FASB and IASB. Leveraging portions of one or both of these approaches may be an efficient way for the IAIS to help satisfy goals of optimizing transparency and use of public data. However, in doing so, the IAIS should take care not to compromise stability or other key principles of the BCR metric.	
Q13	3.5 Comments on Role of a "basic" BCR
Q14	3.6 Comments on Qualifying capital resources
Q15	3.7 Comments on Non-insurance activities

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4.0 Comparability of valuations	
Q16	4. General comments on Comparability of valuations
Q17	4.1 Comments on Valuation of liabilities – current estimates

The Public Consultation contemplates an adjusted balance sheet approach to valuation, on a "market-based" basis. Although it is not yet clear how this market-based approach will be structured, we have fundamental concerns with the use of a market-based approach to valuation, particularly with respect to long duration liabilities.

The adjusted balance sheet approach proposed by the IAIS may create unnecessary volatility and stress on insurer balance sheets, particularly for life insurers and others writing long duration liabilities. Many insurance companies have long-term liabilities and long-term assets to match these liabilities. A pure current market value view of assets is fundamentally inconsistent with the non-marketable nature of the offsetting liabilities, producing dangerously pro-cyclical and potentially false panic producing outcomes in periods of temporary asset market disruption. As such, insurers could be forced to engage in pro-cyclical selling of assets in a stressed market even though our liability profile enables us to hold assets and be a source of stability in the markets.

For the same reasons, a market-based valuation approach will from time-to-time create misleading regulatory indicators. Significant changes in value when measuring long term insurance liabilities and the related assets are only meaningful to regulators if they signify an inability on the part of the insurer to meet its obligations to policyholders and others. Near term changes in valuations due to volatility in market interest rates or asset values can obscure for the regulators a view of the insurer's ability to meet its long term liabilities.

Because of this volatility, use of a market-based approach has the potential to dramatically alter the types of insurance, particularly long-duration products, available to consumers. Long-duration products are the core of the U.S. insurance market and fill a great societal need. Traditional life insurance offers lifetime protection against untimely death to policyholders and their beneficiaries. Longevity annuities and pensions provide retirement income in a time where people are living longer and society is more stressed than ever to find ways to support the retired population. If a market-based approach is ultimately considered, it is critical that it be crafted in a way that will not undermine the viability of long-duration products. For example, the market-consistent valuation embedded in the Solvency II directive proved difficult to reconcile with stability objectives as the financial crisis emerged, and this has been cited as one cause underlying the delays and confusion surrounding implementation in Europe. In order to facilitate the availability of long-duration products, the BCR must be a stable capital measure.

In addition to creating a void in the insurance marketplace, reduced viability of long-duration insurance products likely would have broader implications. As noted above, insurers invest heavily in long-duration assets to effectively match their long-duration liabilities. The insurance industry is an important investor for long-term corporate debt and equity, municipal bonds, and other long-dated securities, such as commercial mortgage loans as well as long-term infrastructure projects. As described above, a market-based valuation could put pressure on insurer balance sheets, and generate misleading balance sheet volatility, in stressed environments. If insurers choose not to offer long-duration products in order to mitigate this pressure and volatility, not only will consumers lose the ability to protect themselves, but long-term investments will dry up as well, which will raise the cost of capital for corporations, municipalities and entrepreneurs. In times of financial distress, this can further reduce a stable source of

capital supplied by insurance companies to finance the economy. We ask that the IAIS seriously consider the potential impact to consumers and long term funding costs of any measures that cause unnecessary balance sheet volatility that may limit companies' ability to sell long-duration products.	
Q18	4.2 Comments on Valuation of assets

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Q-Nr	Reference question	Jump to Section <drop down menu of Sections and questions>
5. Factor-based approach		
Q19	5. General Comments on Factor-based approach	
See response to Q32.		
Q20	5.1 Comments on Context	
Q21	5.2 Comments on Major risks	
Q22	5.3 Comments on Factor-based approach calculation	
Q23	5.4 Comments on level of granularity	
Field testing should be conducted with a goal of developing a simple yet effective approach. Given that a factor-based approach will be used, field testing should identify the least number of factors needed for a meaningful calculation. There is no advantage to predetermining an arbitrary number of factors at 10 or fewer.		
Q24	5.5 Comments on Generic example	
Q25	5.6 Comments on Field testing process	
Q26	5.7 Comments on Next steps	
It will be important that the BCR be monitored as experience emerges and the ICS is developed. As a capital floor, any shortcomings that are uncovered may be addressed along the way without potentially severe consequences to the risk management practices of organizations or the market's view of their health.		

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<tr><td colspan="3">6. General Questions:
A second consultation in mid-2014 will specifically invite comments on a range of questions regarding the BCR and its relationship with other existing and proposed regulatory measures affecting G-SIIs and Internationally Active Insurance Groups (IAGs). You may comment below if you wish to provide input on any of these general questions in advance of the second consultation:</td></tr>
<tr><td>Q27</td><td colspan="2">1. Is the purpose of the BCR clear enough?</td></tr>
<tr><td colspan="3">Additional clarity is required regarding the intended application of the BCR and its interaction with other proposed capital measures.</td></tr>
<tr><td>Q28</td><td colspan="2">2. At what level should the BCR be calibrated compared to existing national benchmarks?</td></tr>
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<tr><td>Q29</td><td colspan="2">3. Is the BCR expected to be a temporary measure, until the risk-based group-wide global insurance capital standards (ICS) is in place, or will it continue to apply?</td></tr>
<tr><td colspan="3">Given the deliberately simplistic approach to the BCR, it would be inappropriate to use the same approach to develop the ICS without serious consideration of other approaches and methodologies or an expansion of granularity. Ultimately, once the ICS is developed, the form and function of the BCR may need to be reconsidered.</td></tr>
<tr><td>Q30</td><td colspan="2">4. Should a backstop capital measure be introduced to complement the proposed ICS, in addition to or instead of the BCR? If so what should the purpose of such a backstop capital measure be, compared to the BCR?</td></tr>
<tr><td colspan="3">See response to Q29.</td></tr>
<tr><td>Q31</td><td colspan="2">5. Will the proposed approach to valuation of assets and liabilities provide sufficient global comparability?</td></tr>
<tr><td colspan="3">Global comparability will be difficult to accomplish and subject to rapidly declining incremental benefit versus the effort involved. We suggest applying an “80/20 rule” with a focus on key adjustments that provide comparability across major risk categories.</td></tr>
<tr><td>Q32</td><td colspan="2">6. Can a reasonable balance of risk sensitivity and simplicity be achieved using a factor based approach?</td></tr>
<tr><td colspan="3">With the simple factor-based approach contemplated for the BCR, it will be a serious challenge for the IAIS to balance the need for simplicity with the risk of unintentionally incentivizing risk taking behavior. Further, with only limited time for testing, and given the BCR is not being constructed from a previously existing and successful factor-based regime, there is increased uncertainty surrounding the initial reliability of the BCR and its ability to fully capture all of the important differences between companies.</td></tr>
<tr><td>Q33</td><td colspan="2">7. How should the BCR be integrated into national or regional frameworks which are in the process of being implemented or modified?</td></tr>
<tr><td colspan="3">BCR development should be done in a context that recognizes ongoing work by national and regional regulators to build their own robust capital and risk management frameworks. Acknowledging this can help minimize redundant or conflicting frameworks.</td></tr>
<tr><td>Q34</td><td colspan="2">8. How should supervisors enforce the BCR in a consistent manner across jurisdictions?</td></tr>
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