GIAJ Comments on the IAIS ICS Version 1.0 for Extended Field Testing

1. General comments
・ The GIAJ wishes to express thanks for the opportunity to comment on ICS Version 1.0 for Extended Field Testing As the IAIS's attention turns to ICS Version 2.0, we sincerely hope that it will continue to fully take into account the comments of the Volunteer Groups.
・ Utmost care should be taken to avoid regulation that produces unintended consequences. It is essential to look at the broader picture when analyzing the impact of regulation. Such analysis should go beyond insurance regulation and include aspects such as interaction with the market and real economy, and the impact on broader economic activities.
・ While the consultations preceding ICS Version 1.0 advanced discussions on technical aspects such as the valuation and measurement of liabilities and risks, we think that these issues should essentially have been addressed in conjunction with how the ICS was to be utilized (i.e. how it would be positioned within the supervisory framework and its relationship to any corrective measures taken by regulators, etc.). Our position on how to extrapolate and add spread on yield curves in order to discount insurance liability could change depending on how ICS Version 2.0 is utilized by supervisors and whether or not the final results of ICS Version 2.0 are disclosed.
2. Conditions for implementing the ICS
・ The ICS should be implemented in countries/jurisdictions as a solvency regulation that allows for supervisory intervention only after it achieves convergence toward a single economic value-based approach including for non-IAIGs in respective countries/jurisdictions, thereby ensuring true comparability and fairness. The rationale for our opinion is as follows:
(1) If the ICS were to be implemented in countries/jurisdictions as a solvency regulation which allows for supervisory intervention while maintaining variations in its standard method to calculate capital and risks, it would deviate from the ICS goal to create a global, consistent capital standard to address the lack of comparability among existing jurisdictional group capital standards.
(2) While the ICS is a consolidated group-wide standard, the group ICS ratio is composed of local entity figures and the possibility remains where each country may implement the ICS to apply to each entity. In such a case, IAIGs/G-SIIs need to consider how to maintain and improve individual local entity contributions to the group ICS ratio. Such considerations could place the local entity of IAIGs/G-SIIs at a competitive disadvantage against non-IAIGs in the country/jurisdiction. Therefore, the rules to be applied to IAIGs/G-SIIs and others on both a consolidated and single entity-basis should be consistent.
(3) Unlike G-SIIs policy measures intended to address systemic risks, the ICS as a capital standard can be relevant to non-IAIGs as well.
(4) An economic value-based measure is extremely sensitive to the interest rate level and is therefore volatile. This is observed in the Financial Sector Assessment Program findings on Japan published in July 2017 and in practical experience of Solvency II.
・ However, we understand that it is highly unlikely that ICS Version 2.0 will achieve significant convergence at its adoption in 2019, and as such supervisors being required to implement ICS Version 2.0.

・ The hurdles in implementing ICS Version 2.0, such as the introduction of new legislation and/or regulations, and the burden on insurers to prepare for implementation, will differ considerably among countries/jurisdictions.
・ It is therefore necessary to have sufficient transitional measures in place in order to address the gap in current regulations in respective countries/jurisdictions.
・ In order to establish an effective regulatory regime and be ready for implementation in 2016, starting in 2005, numerous field tests were conducted to attain convergence of the Solvency II project. It turned out that insurers had 11 years to prepare.
・ As for the ICS, work has been proceeding ever since the first field test was conducted in 2014. It should be recognized that, especially for those countries/jurisdictions and insurers who have to go through numerous field tests to deal with an economic value-based regime for the first time, a period of preparation comparable to that required for the Solvency II project may be necessary.
3. Utilization and disclosure of ICS Version 2.0
・ When considering utilization of ICS Version 2.0, the following points should be duly taken into account.
(1) Utilization of ICS Version 2.0 by supervisors
・ The conditions we mentioned in “2” above should be taken into account when supervisors utilize ICS Version 2.0. Initially, we propose using ICS Version 2.0 as a “soft” standard such as a “monitoring measure” to accumulate global experience of ICS implementation until there is a consensus among IAIS members, insurers and market participants that the ICS has achieved sufficient credibility in terms of fairness and comparability. The ICS should continue to be fine-tuned through close communication between regulators and insurers.
・ With respect to valuation approaches under the ICS, we understand that both the GAAP+ and MAV approaches are to coexist for the time being. This means that there will be at least two “patterns” of final ICS results. If all such results are used as the basis of supervisory intervention, there will be contradicting cases where an insurer satisfies the prudential threshold of “pattern A”, but fails to satisfy “pattern B”. Furthermore, supervisory measures based on “pattern B” could adversely impact “pattern A”. (For example, a corrective measure imposed on an insurer failing to attain the prudential threshold based on GAAP+ could adversely impact results based on MAV.) Therefore, we strongly believe that it is impossible to use the ICS ratio as the basis of “hard” supervisory intervention measures unless a single ICS is accomplished. Imposing competing rules on insurers goes against ICP Principle 6 by ruining their sound risk management and product strategies. For the time being, the ICS should be stated on the ORSA report and used as “a tool to facilitate communication” among supervisory college members and insurers.
(2) Disclosure of ICS Version 2.0
・ As mentioned above, if the final results of ICS Version 2.0 which maintain competing measures are disclosed, such disclosure will lead to confusion among market participants. It will put insurers under unintended pressure and adversely affect their sound risk management and product strategies.
・ Taking into account the experience of Solvency II, insurers required considerable time to develop and run a robust system to calculate reliable figures for field testing.

The decision to disclose the final results of the ICS should therefore be made with utmost care and caution.
・ If in fact the final results of the ICS are to be disclosed, then disclosure should be limited to figures such as the ICS median ratio. The names and figures of individual insurers should be kept confidential as was the case with 2016 G-SIIs identification process.
4. Other issues
(1) Valuation of insurance liabilities
・ Specifications for MAV should be consistent with IFRS 17 except for those items that need to be different from the solvency regulation perspective. For example, the advantages and disadvantages of separation from IFRS 17 with respect to items such as criteria to recognize insurance contracts, contract boundaries, the simplified approach on non-life insurance premium reserves, and the relevant cash flow should be carefully considered. On the other hand, the differences necessary from the solvency regulation perspective, such as reflections of future management actions and the deduction of residual margins should be maintained.
・ It is difficult to decide under GAAP+ what kind of incremental modifications should be made and how. For some jurisdictions, significant modifications will be required even though such modification will most likely be very different from MAV calculations. Whatever adjustments are made, they will not only fail to achieve comparability between jurisdictions but also inhibit it. If GAAP+ continues to be explored, the GAAPs that are suitable for GAAP+ (i.e., GAAPs that fulfill ICS Principles and are able to approximate MAV outcomes), should be newly identified and GAAP+ should be developed only for those GAAPs.
・ If GAAP disclosure is based on IFRS, then GAAP+ for such a GAAP should start from IFRS and add necessary adjustments. Such adjustments will improve consistency between jurisdictions and, along with the above-mentioned refinement of MAV, should accomplish convergence between MAV and GAAP+.
(2) Internal models
・ We support the use of internal models as the standard method for natural catastrophe risks. We agree that the examples identified in paragraph 385 of ICS Version 1.0 to address supervisory concerns are generally appropriate provided that information requirements on IAIGs are not overly burdensome. We also agree with making necessary adjustments with respect to the use of models. However, the criteria and conditions of such adjustments should be subject to discussion.
・ With respect to internal models beyond the scope of the standard method, we have the concerns described in a) - c) below. A robust prior approval process to dispel these concerns will be necessary to enable the use of internal models.
・ Therefore, we believe that the standard method should be used at the initial stage of ICS Version 2.0 to ensure comparability across all IAIGs. Internal models should be utilized when there is a clear view that the concerns described below will be resolved and comparability ensured.
a) Lack of comparability across insurers
There are concerns that internal models may lack comparability because of the difference in the structure of the models as well as the scenarios and parameters used by insurers.

Insurers need to decide and exercise the relevant level of governance when using internal models. However, if requirements under the supervisory approval process significantly exceed the way insurers utilize internal models, such requirements could pose a significant burden on insurers. An inappropriate approval process may also have the adverse effects described in b). Due consideration is necessary to establish rules and processes to approve internal models so that the approval process does not inhibit the sophistication of insurers' ERM and risk management. With regard to our view on the ideal process of internal model approval, please also refer to the GIAJ comment on 2016 ICS CD Q158 copied below.
b) Inhibition of model sophistication
Any excessive burden to apply and obtain approval to change the existing approved model with respect to the ICS capital requirement may inhibit sophistication of internal models by insurers.
c) The relationship between group and entity regulations
When foreign establishments obtain approval to use internal models from a local supervisor to calculate local capital requirements, views on the internal model of the group-wide supervisor and those of the local supervisor may need to be adjusted.
*GIAJ Comment on 2016 ICS CD Q158 However, with the validation of models, standards that are stricter than necessary should be avoided. The IAIS should examine the introduction of validation and review processes which are effective and efficient. For example, to begin with supervisors could compare insurers' models and then focus on matters of concern found in the first step. Additionally, models widely used by insurers could be subject to IAIS approval or, after validation and review by jurisdictional supervisors, be introduced as one of the options in a standard method of risk calculation for ICS. It should be noted that the General Insurance Rating Organization of Japan, of which almost all Japanese general insurers are members, develop risk models of natural disaster types that are common in Japan. Because these models are utilized in the assessment of natural disaster risk under Japanese solvency regulations, they should be introduced as one of the above options to calculate the risk amount of each peril, though how correlation among perils can be reflected is still to be examined.