Property Casualty Insurers Association of America
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PCI comments on IAIS Insurance Capital Standard Version 1.0 Public Consultation Document

October 19, 2016

Question	Response
Scope of Group	
1. Should the IAIS further define the concept of an insurance-led financial conglomerate to give greater certainty to supervisors and IAIGs as to how the head of an IAIG will be identified in a complex conglomerate structure? If "yes", is the proposed definition a helpful start and if so what further specification is needed?	<u>No</u>. ICP 23 provides an appropriate mechanism to determine the scope of an insurance group, and there is no need to change it in order to define the scope of an IAIG. The discretion of the group-wide supervisor, in coordination and cooperation with the other members of the supervisory college, to alter the scope should provide sufficient flexibility for one-off situations.
4. Are there any further comments on this section on the scope of group that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.	Paragraph 62's last sentence should be amended to read, "The IAIG must be able to establish that financial stress or bankruptcy of the non-financial businesses would have no <u>material</u> financial effect on the financial entities, holding companies or ultimate holding company of the group." In particular the ICS should be concerned about material effect on the insurance companies in the group. A materiality requirement is essential to avoid unnecessary inclusion of non-financial entities that might waste supervisory resources better spent on the entities that do pose material risk. Factors that could be considered for determining the appropriateness of excluding non-financial affiliates could include: • Existence of corporate guarantees, intercompany indebtedness and other financial links; • Relative Importance to the ultimate holding company of the overall group based on size thresholds, such as excluding

	entities that account for 10% of the non-financial revenue or assets of the overall group; • Operational interdependence, including the existence of shared resources such as IT platforms, treasury operations and office facilities; • Materiality to the application of credit rating methodologies to the overall group rating; and • Reputational risk should only be considered to the extent that the potential reputational damage would likely have a material adverse impact on (i) the ability of the insurance group to conduct its business in the ordinary course, (ii) the group's credit rating; or (iii) its access to the capital markets.
GAAP with adjustments (GAAP Plus)	
40. Do the GAAP Plus principles and guidelines constitute a sufficient basis for the specification of an ICS Valuation Approach that fulfills the ICS Principles as defined by the IAIS? Please explain.	Yes. GAAP Plus is consistent with the ICS Principles in general. In particular it promotes Principle 7 (promoting prudentially sound behavior while minimizing inappropriate pro-cyclical behavior) by reducing non-economic accounting volatility and allowing for use of audited financial statements.
43. Under GAAP Plus there are differences between jurisdictions in the approach to valuing liabilities. Should all liabilities be valued under the same approach whether that be closer to book value or market value for all jurisdictions? Please explain.	No. Valuing all liabilities under the same approach is not necessary. PCI does not oppose proceeding with both the MAV and GAAP Plus valuation approaches as long as the GAAP Plus approach is maintained. The ICS should focus on comparability of outcomes, not on uniformity of valuation approaches which will be very difficult to achieve and will be actively harmful if the wrong uniform approach is chosen.
47. Are there further comments on GAAP Plus that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.	GAAP Plus should continue to allow non-life claims liabilities to be valued on a non-discounted basis if the GAAP of the IAIG's home jurisdictions requires this method (as in the U.S.). Deterministic (non-stochastic), undiscounted reserve calculation methods have a proven track record superior to any other method, as well as being more transparent (since they reflect the unadjusted amount management expects to pay).

Margin Over Current Estimate (MOCE)	
48. With respect to the CC MOCE calculations (both prudence and cost of capital approaches), are there any particular issues with the way that GAAP Plus liabilities are calculated that would necessitate a difference in the calculation of a CC MOCE under GAAP Plus from the CC MOCE under MAV? If "yes", please explain.	Yes. For IAIGs headquartered in jurisdictions whose GAAP requires undiscounted claim liabilities, the P-MOCE should not apply to those liabilities. The amount of P-MOCE is effectively included in undiscounted liabilities, and requiring a separate calculation would be double-counting.
66. Are there any further comments on MOCE that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.	PCI opposes use of a CoC (cost-of-capital) MOCE for GAAP Plus. The concept is inconsistent with the use of undiscounted claims liabilities. There is no need for any MOCE under the GAAP Plus concept.
Reinsurance recognition	
67. Should all reinsurance contracts be identified using a consistent definition across all jurisdictions? If "yes", please propose a definition.	No. Supervisors should simply be aware that there are potential differences in reinsurance recognition between IAIGs produced by differing risk transfer definitions. For the ICS to propose a uniform definition would be extremely disruptive for the jurisdictions whose reinsurance recognition method is not chosen, and the benefit is not worth the cost.
Capital resources	
73. Is structural subordination sufficient to guarantee that policyholders will be paid first in a winding up? Please explain.	Yes. Paragraph 258 describes the U.S. insurance liquidation system when it states, "in a winding-up, the assets of a (insurance) subsidiary would be paid to that subsidiary's policyholders first, and any surplus would only be distributed to the holding company . . . after all of the subsidiary's policyholders and other creditors have been paid in full." Therefore the proceeds of senior debt distributed to a subsidiary insurer are "subordinated to policyholders and other non-subordinated creditors" (paragraph 254(a)).
74. Does structural subordination produce the same outcomes as legal or contractual subordination?	Yes. U.S. insurance supervisors have the authority to prevent dividends from a subsidiary insurer to a parent holding company where such payment would compromise policyholder protection, either in a going concern or winding-up situation. This outcome is the same as that provided by legal or contractual subordination.
75. Is a requirement for supervisory approval prior to the redemption of a financial instrument at contractual maturity sufficient for that instrument to be considered perpetual? Please explain.	Yes. U.S. insurance regulators can defer redemption or payments of principal or interest due on surplus notes indefinitely in order to properly protect policyholders.

76. Is a requirement for supervisory approval of distributions prior to contractual maturity (eg interest payments, dividends) sufficient for the distributions to be considered non-cumulative? Please explain.	Yes. The unfettered discretion given U.S. state regulators to approve or disapprove payments of surplus note principal and/or interest effectively makes surplus notes non-cumulative.
77. Do existing financial instruments issued by mutual IAIGs (for example, but not limited to surplus notes, Kikin and other forms of subordinated financial instruments) absorb losses on a going concern basis? Please identify which instrument and explain.	Yes. Surplus notes absorb losses on a going concern basis because their proceeds can be used at any time to pay claims and because regulators can disapprove payments of principal and interest for an indefinite period when necessary. Surplus notes should qualify as Tier 1 assets.
Premium and Claims Reserve Risks	
140. Non-life exposures should be reported based on the location of risks to ensure consistency across IAIGs. Regarding the reporting segment, which of the following should be used: • A more compact standardized segmentation. If "yes", please explain the rationale. • A more detailed reporting segmentation based on existing jurisdictional reporting segments. If "yes", please explain how consistent treatment across segments could be ensured.	It is more appropriate to use existing jurisdictional reporting segments. Risks differ materially between jurisdictions for many different reasons, and using a standardized segmentation will be less risk-sensitive.
141. Should projected net earned premiums be used as the exposure base for Premium risk? If "no", please specify what other measure should be used and why.	No. Net written premium is more appropriate. This provides a measurement of risks that are actually covered, rather than risks that are estimated to be covered.
142. Should net current claims estimates be used as the exposure base for Claims Reserve risk? If "no", please specify what other measure should be used and why.	No. If "net current claims estimates" are discounted, undiscounted net current claims estimates should be used.
151. Are there any further comments on Premium and Claims Reserve risks that the IAIS should consider in the development of ICS Version 1.0? If "yes", please explain with sufficient detail and rationale.	Yes. The factors for non-life Premium and Claims Reserve risks appear to be too high. With the revision we propose in our answer to Q.141, the factors would be even higher. We are aware that substantial calibration will be necessary to target the ICS capital requirement at any specific level, but these factors appear to be too high for even a 99.5% VaR level.

Catastrophe Risk	
152. Is the new specification of "latent liability risk" appropriate? Please explain.	No. While mass torts are a risk, there is no theoretically sound way to impose a charge. The mass tort scenario risks significant double-counting, and the risk cannot be modeled in the same way as catastrophe risk.
155. In addition to the perils covered in 2016 Field Testing (listed above), are there other material Catastrophe perils to which IAIGs may be materially exposed for which a scenario should be defined in the IAIS standard method? If "yes", please provide a list, including a definition of the peril and any other specific details to support the suggestion(s).	No.
157. Should the IAIS allow the use of catastrophe models for the ICS Version 1.0? Please explain.	Yes. Catastrophe models are by far the best tools for estimating exposure to perils such as windstorm and earthquake for which historical data alone is insufficient.
158. If the IAIS allows the use of catastrophe models in ICS Version 1.0, should there be requirements to ensure that the use of catastrophe models results in a fair and comparable assessment of the natural catastrophe risk? If "yes, please comment on requirements that should be included.	The IAIS should rely on the catastrophe model certification processes of the jurisdiction of each IAIG. The ICS should not require a separate model certification process – this would duplicate the substantial work done in the U.S. and in other jurisdictions that have or are developing catastrophe risk charges. IAIGs should be required, however, to use the same models and assumptions that they use in their internal risk management processes.
Credit risk	
200. Should the IAIS allow the use of ratings and/or designations that are not issued by credit rating agencies, for example, ratings and/or designations that are issued by a supervisory-owned process (eg, the NAIC Securities Valuation Office)? Please explain. (1) If "yes" to Question 200, should the IAIS consider modifying the criteria for the recognition of rating providers, taking account of the specific features of the supervisory-owned process? Please explain. (2) If "yes" to Question 200, are the criteria for credit rating agencies appropriate for alternatives to the use of credit rating agencies? Please explain.	Yes. For jurisdictions such as the U.S. where insurance supervisors have developed a rating system, use of that system's ratings/designations should be allowed.

General comments	
236. Are there any additional comments that the IAIS should consider in the development of ICS version 1.0 that have not been addressed in any of the previous questions? If "yes", please explain with sufficient detail and rationale.	1. PCI is very concerned with the Consultation Draft's statement, in paragraph 31, that "the ICS capital requirement, calculated using a risk-based method, is the amount of capital resources needed to cover loss(es) at the specified target criteria of 99.5% Value at Risk (VaR) statistical measure." While the 2014 ICS Consultation Draft asked whether 99.5% VaR was appropriate for field testing purposes, we are not aware of any place where the IAIS has asked stakeholders whether this was the appropriate final target level. And the IAIS has made no case for selection of the 99.5% level as the ultimate target. Please clarify whether paragraph 31 is stating the target level for 2016 field testing or whether the IAIS has decided this is the final target level. If the IAIS proposes to adopt this standard for ICS Version 1.0 and following, it should be exposed to stakeholders for comment before any decision is made. We also urge that the 2016 aggregate ICS required capital for all field testing volunteers be compared against their current aggregate jurisdictional required capital, and that if the aggregate ICS required capital level is significantly higher a downward adjustment be exposed for stakeholder comment and adopted. 2. PCI notes that Paragraph 15(j) states, "As the ICS is still being developed, it is too early to say to what extent existing group capital frameworks will be considered consistent with the ICS." We reiterate that existing group capital frameworks that achieve comparable results in policyholder protection to the ICS should be recognized as a suitable implementation of the ICS framework. This will avoid both significant additional implementation costs and conflicts between differing and duplicative group capital assessments.