Seeing Beyond Risk

Canadian Institute of Actuaries / Institut canadien des actuaires

Voir au-delà du risque

February 3, 2014

International Association of Insurance Supervisors
c/o Bank for International Settlements
CH-4002 Basel
Switzerland

Re: Proposal for Basic Capital Requirements (BCR) for Global Systemically Important Insurers (G-SIIs)

The Canadian Institute of Actuaries (CIA) is the national organization of the actuarial profession in Canada. The CIA establishes the Rules of Professional Conduct, guiding principles, and monitoring and discipline processes for qualified actuaries. All members must adhere to the profession's Standards of Practice. The CIA follows its Guiding Principles, including Principle 1, which holds the duty of the profession to the public above the needs of the profession and its members. The CIA also assists the Actuarial Standards Board in developing standards of practice applicable to actuaries working in Canada.

2. Executive Summary

2.1 Overview

We understand the desire to develop a framework for Basic Capital Requirements (BCR) that balances simplicity, comparability, and risk-sensitivity to major risks faced by insurers. However, we do note that the Global Systemically Important Insurers (G-SIIs) are large, complex, and sophisticated insurers, with varying reporting requirements. We are concerned that a factor-based approach which is simplistic would not adequately reflect the individual characteristics of these companies. We also feel that more definition is needed around BCR before we can make a more detailed assessment.

We understand the need to develop a tool rapidly but caution the International Association of Insurance Supervisors (IAIS) about building further tools from it. As you get to further steps, we would encourage you to consider characteristics of the Canadian regulatory capital framework. The framework in Canada worked well under recent adverse economic conditions, and reflects both the unique asset profiles of insurers and the risks inherent in their liabilities. We would be pleased to assist the IAIS in this approach.

We share your concerns regarding the possibility of gaming the system in the intermediate years. This underlines the importance of quickly implementing risk-sensitive measures.

Paragraph 8 mentions non-insurance subsidiaries, but it should also make a comment about links with parent companies.

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2.2 Approach

We agree with the exclusion of operational and liquidity risks, as these are difficult to meaningfully include within the basic capital requirements.

2.3 Generic Example

As the balance sheet is reshaped to a common framework, the capital factors should incorporate tax recoveries. The rules around the computation of tax offsets need to be clearly defined.

2.4 Key Risks Addressed

Many of the risks faced by insurers are unique within the financial services sector. Their asset portfolios have more exposure to bonds, stocks, equities and investments in subsidiaries; as well, the time horizon for credit risks tends to extend for a longer period. On the liability side, insurers must manage risks such as mortality, morbidity, policyholder persistency, and financial guarantees, to name but a few. Consequently, we support capital factors that reflect the risks faced by insurers on both sides of the balance sheet. We also note that property and casualty insurance companies have a risk profile distinct from life insurers, primarily focused on the risks of mis-pricing and under-reserving.

The document implies that asset liability matching may not be adequately addressed due to time constraints. We encourage the IAIS to include this element in the BCR framework, as it is too important within the insurance industry to be deferred.

We agree that field testing is an important exercise in order to calibrate the factors. We strongly recommend the inclusion of reinsurance Internationally Active Insurance Groups (IAIGs) in the field testing, to reflect risks such as catastrophe risk. We would also recommend the inclusion of major Canadian companies.

If the BCR is to be developed by the end of 2014, then having details that cover the various types of products worldwide would likely not be possible. In that event, we suggest using the current local valuation requirements, with a preference for best estimates. Any factors related to this should be simple, such as a percent of amount at risk, or a percent of reserves.

2.5 Other Considerations

Ideally, the factors should not simply be additive. As discussed above, they need to accurately capture the risks associated with both assets and liabilities, as well as the interaction between the two. To that end, we feel that ten or so factors may not be sufficient to construct a sufficiently risk-sensitive factor framework.

3 Context

3.1 Background

We agree that the interconnectedness with other financial companies should be included in the BCR.

3.2 The BCR Mandate

It states that the BCR will have a goal of maintaining the company as a “going concern”. A definition of “going concern” is required in this instance. As well, it should be clear whether an insurer that falls below the BCR could still be considered a going concern, subject to further and deeper analysis. It is our belief that the BCR is to be a component in an early warning system only.

3.4 Principles

We agree that the avoidance of arbitrage should be an ultimate goal of this exercise.

4 Comparability of Valuations

4.1 Valuation of Liabilities – Current Estimates

We agree that the use of best estimates is the most appropriate approach. However, we acknowledge that different countries have different approaches, and consistency will be difficult to attain. We support the development of additional guidance to limit the range of practice in this area, which will likely arise through the efforts of the International Actuarial Association (IAA).

We also note that best estimate results can be affected by the discount rate used in the calculation. Applying the same discount factor to different companies could consequently lead to different results. We would encourage the development of guidance in this area as well. We would also encourage the use of discounting for all insurance company best estimates, including those for property and casualty insurers.

Any deferred acquisition costs (DAC) should be netted against liabilities before the calculations are performed.

4.2 Valuation of Assets

We note that financial assets are addressed, but reinsurance recoverables are not. We suggest that reinsurance recoverables be put on the same discounted best estimate basis as the liabilities.

5 Factor-based Approach

5.1 Context

We suggest that a credit be available to reflect diversification benefits, which could be initially achieved through calibration of the formula. We also suggest that a calibration approach could be used to reflect more complicated risks such as asset-liability matching risk, operational risk, and others.

5.2 Major risks

The risk factors should reflect pass-through features, such as those seen with participating policies. It is important that the factors recognize any features where risk is passed on to the policyholder. Taking this into consideration, along with all the other indicated risk characteristics, again leads us to suggest that ten factors may not be adequate.

Respectfully submitted,

Jacques Lafrance
CIA President