

## IAIS Consultations

*\*Please note that these comments were submitted using the International Association of Insurance Supervisors online submission form. The submission's title is Higher Loss Absorbency Requirements for G-SIIs.*

<b>Question #</b>	<b>Section</b>	<b>Reference</b>	<b>Questions</b>	<b>CIA Response</b>
1	2.1	Executive Summary Overview	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issues that should be considered, then please outline them and how they may impact the conclusions reached.	<p>The Canadian Institute of Actuaries (CIA) has reviewed the consultation document, and we are pleased to have the opportunity to provide our feedback. We understand the objective of the IAIS is to reduce the impact on the financial system from a G-SII that becomes distressed or fails, and the probability of that happening. The IAIS desires to achieve this through additional capital requirements known as Higher Loss Absorbency capacity, or HLA. We commend the IAIS's effort to develop proposals for the determination of HLA requirements for G-SIIs in a relatively short time-frame.</p> <p>We have two overarching comments on the proposals:</p> <p>(1) It is proposed that the level of HLA required capital for G-SIIs can be 10% to 15% (and possibly up to 20%) of total insurer Uplifted BCR.</p>

<i>Question #</i>	<i>Section</i>	<i>Reference</i>	<i>Questions</i>	<i>CIA Response</i>
				<p>In appendix D a 15% factor is used to illustrate the calculation. We agree with para. 30, which states “there is little evidence of traditional insurance either generating or amplifying systemic risk”, and it is rather the NT/NI operations of G-SIIs that are of concern. Therefore, we would suggest it is more appropriate to target an aggregate amount of HLA as a percentage of NT/NI Uplifted BCR (i.e., set gamma close to 1). Alternatively, it could be targeted as a significantly smaller percentage of total G-SII Uplifted BCR, to reflect that a large portion of G-SIIs’ business is in fact traditional insurance, but we believe this would unfairly attach potentially significant HLA required capital to traditional insurance businesses.</p> <p>(2) The formulas proposed include a scale factor. We understand this scale factor will be calibrated to target an aggregate amount of HLA required capital across the G-</p>

<b>Question #</b>	<b>Section</b>	<b>Reference</b>	<b>Questions</b>	<b>CIA Response</b>
				<p>SII universe. It is less clear whether the scale factor will continue to be re-calibrated on an annual or other regular basis even after an initial calibration period, possibly as a result of individual G-SIIs restructuring their portfolios and altering their risk profiles. We believe it is important that individual G-SIIs ultimately have an ability to forecast and manage their own HLA required capital, without regard to the actions of other G-SIIs. To achieve that, the scale factor would need to be stable, and not be a function of the changing risk profile of other G-SIIs.</p> <p>Section-specific comments are inserted below.</p>
2	2.2	Key HLA consultation points	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issues that should be considered,	

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3	3.1	Context Overview	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issues that should be considered, then please outline them and how they may impact the conclusions reached.	We understand that the HLA capital requirements are meant to help protect the system against systemic risks posed by the largest insurers. However, as is recognized in this consultation document, the sources of systemic risk tend to arise out of a limited subset of activities of those largest insurers. Therefore, in our opinion, the risk inherent in a particular balance sheet should be as important a consideration as the actual size of an insurer.
4	3.2	The purposes of HLA at July 2013	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issues that should be considered, then please outline them and how they may impact the conclusions reached.	
5	3.3	IAIS position on systemic risk	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your	One of the reasons for carrying high-risk activities is to meet shareholders' ROE expectations. This was evident from detailed analyses of companies' behavior leading up to the 2008 economic crisis.

<i>Question #</i>	<i>Section</i>	<i>Reference</i>	<i>Questions</i>	<i>CIA Response</i>
			disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	<p>Increasing capital requirements (in the form of HLA) may produce unintended consequences, e.g., that G-SIIs take on additional risk to meet those ROE targets or expectations.</p> <p>We believe the IAIS has appropriately assessed the importance of the time dimension in the insurance business model and regulatory actions. Accordingly, we suggest that a stable HLA would be appropriate to avoid undue volatility.</p> <p>We agree with paragraph 30: there is little evidence that traditional insurance either generates or amplifies systemic risk. We would also emphasize that NT and NI activities <u>may</u> (or may not) generate or amplify systemic risk.</p>
6	3.4	Relatively small size reported of BCR NT insurance and BCR NI required capital amounts	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may	Basic capital requirements are very simple, in particular for the NT components. We expect both the traditional and NT components to evolve to a more sophisticated approach in the global ICS. While NI is largely based on Basel III, the relative weights could change materially as the framework

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			<p>impact the conclusions reached.</p>	<p>evolves. As a result, applying excessive leverage to the relatively small NT and NI components of the BCR may be inappropriate.</p> <p>Given that traditional insurance is believed to not pose significant systemic risk, having HLA required capital on traditional business may be no more appropriate than the potential volatility associated with the requirements calculated on NT/NI activities.</p> <p>Instead of using the Trad Ins BCR as a stabilizing mechanism to reduce volatility, we suggest that the HLA could be based more heavily on NT/NI Uplifted BCR. To address the potential volatility of this proposed approach, a smoothing mechanism (e.g., a moving average over a number of reporting periods) could be applied to the HLA required capital outcomes. The unsmoothed results would still be calculated, and could be reported confidentially; if these unsmoothed results become unreasonable, the smoothing mechanism also provides some time to adjust the formulas for</p>

<b>Question #</b>	<b>Section</b>	<b>Reference</b>	<b>Questions</b>	<b>CIA Response</b>
				future periods.
7	3.5	HLA Relationship with ICS	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	We agree with the proposal to use ICS as the base for HLA, once the ICS is developed. When this change is made, we suggest that it will be imperative that all of the components of the HLA should be reviewed for continued appropriateness and confirmation that they continue to achieve the desired results.
8	3.6	Principles for development of HLA	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	Principle 4 calls for the HLA to be resilient, i.e., to remain valid in a wide variety of economic conditions. We agree with that principle. We also recognize that global markets (financial and other) have become increasingly interconnected and correlated. We therefore suggest testing of the HLA requirements should recognize this new normal of higher correlations and also recognize there can be short periods of particularly high correlation between global markets, particularly when markets are stressed.
9	3.7	HLA time frame	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then	

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			please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	
10	4.1	BCR Calibration	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	
11	4.2	Components of total BCR + HLA	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	
12	4.3	Uplifting the BCR	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your	We agree that the Uplifted BCR NI should be capped, so that insurers are not competitively disadvantaged vs. banks by holding more capital than the lowest-ranked G-SIBs for banking risks.

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			disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	
13	4.4	Transition period for Uplifts	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	We support a transition period for the Uplifts.
14	5.1	Overall Approach (Possible HLA required capital formulas)	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	
15	5.2	Bucketing	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are	If there is to be bucketing, then more buckets would be desirable to avoid large changes in HLA required capital (particularly large increases) resulting from a given insurer changing buckets over time.

<i>Question #</i>	<i>Section</i>	<i>Reference</i>	<i>Questions</i>	<i>CIA Response</i>
			additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	
16	5.3	Proposed HLA Insurance formulas	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	<p>We support the proposal to use a Combined HLA Insurance formula (third bullet of para 69).</p> <p>One of the key inputs to the overall HLA approach is the average BCR weights of G-SIIs (table D-1 uses 80/5/15). These average G-SII weights will determine the initial scale factor. This makes the HLA required capital for a specific company very sensitive to the BCR weights of the average of the G-SIIs.</p> <p>We support the use of a high gamma factor to make the HLA risk sensitive to the level of the NT and NI exposures of the company.</p> <p>We expect the scale factor will be refined throughout the initial calibration period, which may last some years. Subsequently, we expect that the scale factor would be further refined infrequently and with sufficient advance notice to G-SIIs.</p>

<b>Question #</b>	<b>Section</b>	<b>Reference</b>	<b>Questions</b>	<b>CIA Response</b>
				<p>We are concerned about more-frequent adjustments to the scale factor. More-frequent adjustment, e.g., an automatic recalibration to reflect the evolving risk profile of the G-SII universe, would make it impossible for a G-SII to proactively manage its capital ratio. Companies would be unable to anticipate changes caused by the scale factor, and thus could not appropriately forecast their capital ratio.</p> <p>From a practical perspective, it is important to understand how often the scale factor would change. Annual updates may result in abrupt and unpredictable changes in the HLA requirement. We suggest further clarity be provided on how and when the IAIS expects to set and then update the scale factor, and how and when it will communicate changes to the scale factor.</p>
17	5.4	Calibration of HLA	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are	We understand that the conclusion to target calibration of the HLA up to 20% of Uplifted BCR is based on a review of the HLA applied to the G-SIBs under Basel III.

<b>Question #</b>	<b>Section</b>	<b>Reference</b>	<b>Questions</b>	<b>CIA Response</b>
			additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	Given that traditional insurance is noted as not generating or amplifying systemic risk (paragraph 30), we suggest the calibration target be applied with relatively more weight to the NT and NI components of the Uplifted BCR, rather than evenly to the full amount of the BCR. This implies a gamma closer to 1.
18	5.5	HLA Non-Insurance required capital formulas	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	
19	5.6	Outcomes for a range of Combined HLA required capital formulas	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	
20	5.7	Coverage ratios using various	Please provide your views on the assessments made and conclusions arrived	

<b>Question #</b>	<b>Section</b>	<b>Reference</b>	<b>Questions</b>	<b>CIA Response</b>
		calibration reference points	at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	
21	5.7- Question 1		The IAIS is currently considering putting G-SIIs into one or two populated buckets when determining the HLA required capital. How many buckets should the IAIS consider selecting to manage the tension between risk sensitivity, complexity and volatility when calibrating the HLA required capital? Please provide a rationale for your response and suggest how this may be done if you consider it should be done.	We believe a larger number of buckets would be needed to prevent large changes in total company HLA required capital resulting from a G-SII changing from one bucket to another (see our comments in 5.2).  Having the beta factor, which is multiplied by some function of BCR, also being risk-sensitive effectively compounds the risk-sensitive nature of HLA, perhaps excessively so.
22	5.7 – Question 2		Should the IAIS consider selecting the size of gamma to manage the tension between risk sensitivity, complexity and volatility when calibrating the HLA required capital? Please provide a rationale for your response and suggest how this may be done if you consider it should be done.	We agree the IAIS should consider selecting the size of gamma to facilitate more uniform application of the HLA approach across jurisdictions.  We suggest a higher value of gamma be selected as the HLA should be focused on the NT and NI exposures. This serves the purpose of acting as a disincentive to

<i>Question #</i>	<i>Section</i>	<i>Reference</i>	<i>Questions</i>	<i>CIA Response</i>
				<p>significant NT or NI activities. The challenge will be to manage to the desired purpose of the HLA while also having an acceptable level of stability in the results.</p> <p>Our own analysis suggests that the HLA required capital can become quite volatile for individual G-SIIs when a higher gamma is selected. We would therefore recommend some element of a smoothing mechanism be introduced to the resulting HLA or the underlying exposure measures.</p>
23	5.7 - Question 3		Should the IAIS consider selecting the calibration levels of the factors to manage the tension between risk sensitivity, complexity and volatility when calibrating the HLA required capital? Please provide a rationale for your response and suggest how this may be done if you consider it should be done.	The underlying required capital is the best place to balance risk sensitivity and volatility; the bucket factors are not granular enough to be appropriately risk-sensitive. The calibration of the beta factors for each bucket should be kept simple, as the underlying NT and NI exposures have enough complexity and risk sensitivity.
24	5.7 - Question 4		Should the IAIS consider introducing ceilings and/or floors on results for G-SIIs to manage the tension between risk sensitivity, complexity and volatility when calibrating the HLA required capital? Please provide a	Caps and floors should be considered, especially since HLA is entirely factor-based and BCR is quite rudimentary, at least until such time as the ICS and ComFrame may come on stream and the

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			rationale for your response and suggest how this may be done if you consider it should be done.	overall framework stabilizes.
25	5.7 - Question 5		Should the IAIS consider using a combination of the above approaches to manage the tension between risk sensitivity, complexity and volatility when calibrating the HLA required capital? Please provide a rationale for your response and suggest how this may be done if you consider it should be done.	<p>This has merit, especially since HLA is entirely factor-based, until such time as the ICS and ComFrame may come on stream and the overall framework stabilizes.</p> <p>We have indicated above the approaches we feel have most merit in response to previous questions. We agree that a combination of approaches may ultimately be needed to achieve the stated objectives. The challenge for the IAIS will be to collect sufficiently detailed results on each approach considered during field testing without over-burdening the G-SIIs.</p>
26	5.7 - Question 6		Should the IAIS consider using other approaches to manage the tension between risk sensitivity, complexity and volatility when calibrating the HLA required capital? Please provide a rationale for your response and suggest how this may be done if you consider it should be done.	We suggest that the HLA required capital be calculated as a moving average over several reporting periods, to stabilize it. This could be useful given that the underlying ICS is expected to evolve over time.

<b>Question #</b>	<b>Section</b>	<b>Reference</b>	<b>Questions</b>	<b>CIA Response</b>
				Alternatively, a moving-average approach could be used as a transitional measure until the ICS methodology has stabilized.
27	6.1	BCR and HLA capital resources	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	
28	7.1	HLA interaction with G-SII designation process	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	
29	7.2	Field Testing 2015	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered,	

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30	7.3	HLA reporting process	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	
31	7.4	BCR and HLA review process	Please provide your views on the assessments made and conclusions arrived at in this sub-section. If you agree, then please indicate this. If you disagree then please explain the rationale for your disagreement. If you consider there are additional issue that should be considered, then please outline them and how they may impact the conclusions reached.	
32		General	Are there any further comments you would like to make regarding this Consultation which have not been included in your responses under specific sections above?	We understand that the designation of G-SIIs and NT/NI is subject to further changes by the IAIS. However, the HLA consultation will be completed before the completion of the revised designation of NT/NI. This process introduces uncertainties regarding the results.