30 January 2015

Mr. Yoshihiro Kawai
Secretary General
International Association of Insurance Supervisors
c/o Bank for International Settlements
CH4002, Basel, Switzerland

Re: Comments by the APEC Business Advisory Council on the IAIS consultation document on the Risk-Based Global Insurance Capital Standard (ICS)

Dear Mr. Kawai,

As the private sector dialogue partner of the Asia-Pacific Economic Cooperation (APEC) Forum, the APEC Business Advisory Council (ABAC) is charged with providing private sector perspectives to policy makers and stakeholders from the Asia-Pacific region, and to facilitate APEC initiatives. In forming its views on financial issues, ABAC draws on insights from a broad range of industry, public sector, multilateral and academic experts, particularly through the platform of the Asia-Pacific Financial Forum (APFF), which ABAC initiated in 2012 and APEC Finance Ministers adopted in 2013 as one of their official policy initiatives managed by ABAC.

Among the key priorities that APFF has identified in its most recent report to APEC finance ministers[1] is the development of the Asia-Pacific region's insurance and pension fund industries, in view of the substantial need to expand the long-term investor base for the growth of infrastructure investment and capital markets and for meeting the needs of aging societies.[2] Regulation plays a critical role in this process; thus we have adopted APFF's recommendation to undertake dialogues on regulation and accounting issues and how these impact the long-term business of insurers and longevity solutions.

In this context, we welcome the opportunity to provide comments on the IAIS consultation document dated December 17, 2014 on the Risk-Based Global Insurance Capital Standard (ICS). In submitting these comments, we do not intend to respond to all the technical questions, but rather to provide high-level recommendations from our vantage point as representatives of the region's business community. In particular, we wish to highlight specific requirements that may affect the ability of insurers to play the role that our policy makers are hoping they can play in the development of our region, in particular:

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[1] The 2014 APFF Interim Report to the APEC Finance Ministers synthesized the results of discussions undertaken by more than 270 senior representatives and experts from 137 major private and public institutions and proposed 12 action plans, which are clustered around two major issues: promoting capital market depth and liquidity and long-term investments, and expanding financial access of enterprises and individuals to financial services. The report was officially endorsed by APEC Finance Ministers at their annual meeting on October 22 in Beijing. It can be obtained through the following links:
Executive Summary https://www.abaconline.org/v4/download.php?ContentID=22611923
Full report https://www.abaconline.org/v4/download.php?ContentID=22611921
(See E. Insurance and Retirement Income on page 56-62).

[2] As a part of the above mentioned project, ABAC developed a list of high level accounting, regulatory, market and operational issues and recommendations on promoting long-term investments in the Asia-Pacific, as a basis for discussions with policymakers and regulators. See Annex H: Constrains on Promoting Long-Term Investment in the Asia-Pacific https://www.abaconline.org/v4/download.php?ContentID=22611898.

- to effectively provide long-term funding;
- to support financial stability, economic and infrastructure development and;
- to serve the needs of our aging societies.

While we generally support enhanced harmonization, we see the need for a flexible approach that can accommodate a wide variety of insurance contracts and insurance company business models across the diverse Asia-Pacific region, with its variety of consumer preferences, roles of insurers in society and development stage of financial markets. In order to facilitate implementation in the region, international standards should avoid a "one-size-fits-all" approach and respect the diversity of Asia-Pacific markets.

We believe that some items in the proposed IAIS consultation paper may cause significant challenges and disadvantages for the APEC region if the proposals are adopted as currently drafted. The following are some areas that, in our view, require further improvements to avoid unintended consequences, to promote long-term business and investments, as well as longevity solutions in the Asia Pacific.

A. Principles for the development of the ICS (*Question 1: ICS Principles*).

We believe that the ICS principles should be enhanced to incorporate the following key elements:

- **Bank-centric regulations should be avoided, and the ICS should take into account the specific nature of the insurance sector**. Insurers play an important role as long-term investors and in the social security system. Applications of regulatory requirements that are not appropriate to the insurance industry may negatively impact insurers' stabilizing role in financial systems. This element may be either a stand-alone principle, or added to Principle 4, which deals with all material risks across sectors.
- **A short-term oriented economic regime should be avoided for long-term business, and the ICS should take into account the long-term nature of insurance**. An economic-based regime should have a long-term vision. Otherwise, unintended consequences may occur on long-term products and investments. Short-term oriented economic regimes may incentivize insurers to transfer risks to consumers, shift away from long-term protection business and investments, and discourage them from investing in assets other than fixed income. This element may be either a stand-alone principle, or added to Principle 7, which deals with pro-cyclicality.
- **"One-size-fits-all" models should be avoided, and the ICS should properly reflect the diversity in different jurisdictions**. Adoption of regulatory requirements based on a "one-size-fits-all" model that do not sufficiently take into account variations of insurance products and insurers' roles, needs and consumer behavior and development stage across markets may produce unexpected negative consequences for insurance markets. This element may be either a stand-alone principle, or added to Principle 5, which deals with comparability.

B. Bank centric regulations (*Question 3: Risks across the sectors, 9.2.3. Market risk, 9.2.4. Asset concentration risk*)

- **The ICS should capture all material risks across sectors; however, insurance regulations should take into account the specific nature of the insurance business.** Regulations which are targeted for bank deposits and other financial products with short-term liquidity needs should not be applied to the insurance business. Bank-oriented regulations may negatively impact insurers' role of providing long-term investments and stabilizing the financial system.
- **The ICS should avoid bank-centric capital weighted rules, and consider the characteristics of long-term assets supporting long-term liabilities as well as the effect of asset diversification**. High risk charges for long-term investments, including infrastructure projects and equities, may discourage insurers to undertake such investments.

- Capital constraints on traditional long-term products may drive companies to shift to short-term investment products. **Capital charges should be looked into, for the companies to have incentives to promote long-term products, taking into account the interaction between long-term assets and liabilities**.
- **The regulatory framework should holistically promote the role of insurers to support macroeconomic goals, sustainable development, social security and long-term insurance protection, and pay due care to the issue of pro-cyclicality** (as identified by Principle 7). Bank-oriented regulations with an undue over-emphasis on systemic risk and interconnectedness may dis-incentivize insurers to play their proper role in stabilizing the financial system and market, rather than mitigate systemic risks. In designing regulatory requirements, it is important to pay due care to emerging market economies and their need to grow and develop for a long-term. A reference to specific jurisdictions, such as OECD countries, may have unintended consequences in other jurisdictions.
- **Regulations should be designed in a way to promote and incentivize insurers' roles to stabilize the financial system and market and its ability to manage risk efficiently**. Bank-oriented regulations may affect negatively the availability of equity and long-term debt instruments and efficient risk management tools, such as hedging instruments.

C. Short-term oriented economic regime
(*Question 11: Market-adjusted approach and treatment of long-term business*)

- **An economic based regime should have a long-term vision. Short-term oriented economic valuation may produce significant volatility for long-term business, which may not be relevant to the insurers' capacity to meet long-term obligations.** It should avoid replacing the existing regulatory regimes simply with a regime based on economic based regulations.
- Short-term oriented regimes tend to capture the risk assessment with a snapshot and consider long-term business and investments as excessive risk taking. While economic information may be a useful indicator in determining a future long-term direction when used appropriately, t**he long-term nature of the insurance business model and the illiquid nature of liabilities should be properly taken into account when designing the regulatory regime.** Insurers should be allowed to take time in adjusting their positions.
- **The ICS should avoid the introduction of a regulatory regime which would require immediate regulatory actions in response to short-term market fluctuations**. If such a regime is used for regulatory interventions, insurers that need not be concerned with solvency positions for the foreseeable future may be forced to take remedial actions, including exit from long-term business and investments, in response to short-term fluctuations in financial markets.
- Paragraph 46 includes the sentence "The market-adjusted approach would be transparent and verifiable to supervisors." This language should be deleted, since it is misleading and does not reflect the situations in most jurisdictions, notably those in emerging markets. The market-adjusted approach would produce a snapshot of the current status, assuming the assumptions remain the same for the entire time horizon, which may not be true for long-term products. Short term fluctuations based on the current market may not reflect the long-term nature of the business and would not provide useful information to assess capital adequacy for the foreseeable future or in the long run. Complexity of the model with potentially unreliable assumptions for long-term business may result in practical burdens and lack of understandability, which may reduce transparency and verifiability to supervisors.
- **The ICS should be designed to promote sound long-term operations of internationally active insurance groups (IAIGs) without over-emphasizing short-term volatility (as stated in paragraph 38), reduce unnecessary complexities, and improve understandability**.

- **Measures should be taken to mitigate the impact of regulations on long-term protection business and the assets supporting such contracts**, in order to address unintended consequences. For example, a short-term oriented economic solvency regime may incentivize insurers to transfer risks to customers, shift away from long-term protection business and investments and discourage them from investing in assets other than fixed income assets. The ICS should appropriately accommodate both short-term and long-term business models in a balanced way.

(Question 13: Yield curve/discount rate)

- The methodology for determining the yield curve under the market-adjusted approach may result in volatility for insurers selling certain long-term products which may produce unintended consequences for insurers' ability to support long-term investment, sustainable economic growth and market stability. **Appropriate measures should be taken to minimize pro-cyclicality and disincentives for insurers to provide long-term business and long-term investments. In setting those measures, the different business models, role of insurers and development stage should be taken into account**.
- **The choice of the discount rate should be reflective of the business model of the insurer.** A discount rate largely based on the current risk-free rate may not reflect the asset liability interaction of the insurers, and may bring volatility that may not represent the underlying economics.
- **Measures should be taken to avoid short-term fluctuations in the medium to long-term. The rate may not be observable. Importantly, moreover, significant volatility may occur where there is an observable but no deep and liquid market**. One solution may be grading from market consistent rate to long-term average rate.

D. "One-size-fits all" models

(*Question 2: Comparability*)

- **International standards should be principles-based and aim to achieve comparable outcomes by taking into account the region's diversity**. While we generally support the harmonization across the region, we believe that adoption of "one-size-fits-all" regulatory models would not accommodate the diversity that exists in the region and may produce unexpected negative consequences for insurance, capital markets and social security systems.
- **Due to the difference in business models and existing regulatory frameworks, the application of prescriptive international standards may not ensure overall comparability or a level playing field in the region**. The IAIS may consider an approach that starts from the regulatory framework in each jurisdiction, evolved and tested on its characteristics and harmonizes those regimes from a unified point of view.

(Question 14: GAAP with adjustment approach)

- **As the valuation for local capital requirements for a legal entity is typically based on a local GAAP, group capital adequacy based on another method may not demonstrate group-wide available capital in practice, and may not ensure comparability between IAIGs and non-IAIGs in the same jurisdiction**, which is of higher priority for policyholders. The use of a local GAAP as a starting point may be a solution
- **A model based on one jurisdiction may not meet the regulatory objectives in other jurisdictions**. The IAIS may consider the use of different valuation approaches for different purposes. Also, the use of valuations in the existing regulatory regime in each economy may be an option.

We appreciate this opportunity that has been given us by IAIS to provide our views on the ICS consultation paper. Given the potentially significant adverse impact that some of the proposed regulatory changes could have on the insurance industry's role in the development of long-term investment and in funding of retirement security in the APEC region, we hope that the IAIS will take into careful consideration the concerns and recommendations in this letter.

We hope the IAIS will take the necessary time to develop high quality standards rather than compromise on quality to meet an ambitious deadline. Furthermore, the next few years will see numerous regulatory changes implemented or developed in EU, US and many other economies in the Asia Pacific. The IAIS may benefit from experience of those anticipated changes. In this regard, the IAIS may reconsider the 2016 deadline in favor of a more deliberate and thoughtful process which will accommodate for various jurisdictional developments. ABAC will be pleased to collaborate with experts in the APFF's Insurance and Retirement Income Work Stream in further developing ideas on ways to accommodate the various points of principle raised in the letter.

As a body representing the Asia-Pacific business community, we place high value on financial stability and recognize the important contribution of insurance regulators and IAIS in maintaining fair, safe and stable insurance markets. We therefore welcome continued dialogue and opportunities for future collaboration with IAIS to promote stability in our region and the global economy, while facilitating the further development of the insurance industry's tremendous potential to contribute to sustained, balanced and inclusive growth in the Asia-Pacific region and the world.

Sincerely yours,

Doris Magsaysay-Ho
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