

Member and Observer Comments on IAIS Draft Paper
Draft Guidance paper on capital requirements
GNAIE August 30, 2007

Name	Paragraph reference	Comment ¹	Resolution
GNAIE	Key Feature 6	<p>GNAIE's most material concern is the lack of explicit acknowledgement that the solvency regime should take into account risk diversification and risk mitigation when determining regulatory capital requirements.</p> <p>In the box with Key Feature 6, we suggest adding: "The regime should also be explicit as to how risks are reflected in regulatory capital requirements AS WELL AS HOW RISK DIVERSIFICATION AND MITIGATION ARE TAKEN INTO ACCOUNT."</p>	
GNAIE	2	<p>The wording implies that technical provisions serve as a shock absorber against losses in the sentence "...both insurers and supervisors recognize that (<u>in addition to its technical provisions</u>) an insurer's capital functions as a shock absorber against <u>unforeseen</u> losses."</p> <p>We suggested deleting the words in parentheses. This is just editorial since in paragraph 7 it is stated that technical provisions represent the "expected amount..."</p>	
GNAIE	3	<p>In the sentence that reads: "...requires suitable forms of capital that enable the insurer to absorb significant unforeseen losses." add: "...requires suitable AMOUNTS AND forms of capital..."</p>	
GNAIE	8/9	<p>The comment on capital resources is confusing, mixing the LHS (paragraph 8, focus on assets) and RHS of balance sheet (paragraph 9, focus on capital instruments). Essentially the paper is trying to say that insurers should have "right" capital instruments and should invest those in "right" assets, i.e. the focus is both on quality of capital and on a broader issue of quality of the balance sheet (paragraph 8).</p>	
GNAIE	13	<p>The last words: "...which will require a market consistent valuation for both assets and liabilities" should be deleted or the term "market consistent" should be defined. The thrust of the argument remains valid even without this statement. Paragraph 19 (on total balance sheet requirements) is silent on any "market-consistent notion" while still acknowledging the need for "appropriate recognition" of interdependence between assets, liabilities and capital as well as "consistent measurement". We feel it is a more principle-based and therefore preferable to paragraph 13.</p> <p>Since there is a separate paper on valuation, perhaps the details of valuation should be deferred to that paper.</p>	
GNAIE	21	<p>In the last sentence, add: "...and the impact on the effective operation of the insurance industry of unduly onerous levels AND COSTS of regulatory capital requirements."</p>	

¹ Please provide comments of a more critical nature on scope and content, together with alternate drafting suggestions

GNAIE	24	Change first sentence: "A range of different intervention actions will be taken by a supervisor..." to "A range of different intervention actions MAY be taken by a supervisor..."	
GNAIE	25	In the last sentence: "The MCR may also provide a lower bound for the PCR..." delete the remaining part which says: "especially in cases where the PCR is determined on the basis of an insurer's internal model..." since it unnecessarily singles out internal models in this particular context. Add language making clear that the MCR, like the PCR should reflect diversification and risk mitigation	
GNAIE	27	In the next to last bullet remove the word "independent" in front of "review", as "independent" would then need to be defined In the last bullet add: "measures that strengthen...risk management framework AND OVERALL GOVERNANCE" We suggest adding a reference here to regular reporting of the solvency position to the regulator.	
GNAIE	30	Delete because redundant, since it is covered in 4.1	
GNAIE	31	Expand the statement regarding the need to take into account insurer's ability to increase its capital resources ("...seeking capital from the financial markets") to also say: " <u>or to mitigate its capital requirements through other measures such as reinsurance, hedging and similar tools available.</u> " Capital management tools should be considered on a holistic basis, inclusive of capital raising and capital relief alternatives Consideration also be added for assessing the costs of raising that capital, as well as the estimated costs of financial distress associated with the forced sale of illiquid assets.	
GNAIE	32	The example is too specific. Streamline by saying "including, for example, a response to market corrections or other events".	
GNAIE	33	Add two extra bullets under "considerations in establishing solvency control levels": a. quality of Risk Management and overall governance b. transparency and comprehensiveness of disclosure that enable markets to exercise sufficient scrutiny of (and impose discipline on) insurer's actions Remove the peer comparisons as a consideration, i.e. "overall level of capitalization in the insurance industry in the jurisdiction..." - It holds a company hostage to the action of its competitors / peers that may be driven by their specific motives, e.g. accumulating capital for acquisitions or other company-specific reasons In the last bullet point, add again (as per page 3): "...arising from unduly onerous AMOUNTS AND levels of regulatory capital requirements Title under 4.3: I would put in brackets (ORSA) - to define the acronym	
GNAIE	34/35	"Economic capital" is not defined and is used both at the end of paragraph 34 and paragraph 35. "I would change the ending of paragraph 34 to say: "...financial resources relative to its OWN ASSESSMENT AND QUANTIFICATION OF RISKS (TYPICALLY REFERRED TO AS	

		"ECONOMIC CAPITAL") and the regulatory capital requirements set by the solvency regime."	
GNAIE	36	The last sentence: "An insurer should be able to withstand such stresses without triggering supervisory consequences..." This is too strict, as supervisory consequences may be triggered the moment capital approaches PCR, let alone MCR. It essentially would require a large capital cushion over the PCR level. It should be changed to read: "An insurer should be able to withstand such stresses WHILE FULFILLING ITS OBLIGATIONS TO POLICYHOLDERS AND OTHER CREDITORS".	
GNAIE	41	The statement starting with: "The same applies to a transfer of a portfolio..." is out of place and should be deleted.	
GNAIE	43	This paragraph can be misinterpreted to mean that internal models can only be used to set capital at a level that is higher than the factor based PCR. IAIS should make clear that is not the intention. The last sentence "...and objective" is hard to define. The IAIS should develop criteria or delete the term.	
GNAIE	Footnote 15	In footnote 15, if the IAIS is going to recommend the use of internal models, there should have some commitment from supervisors to make efforts to get resources to deal with internal models approvals. The capacity for a supervisory regime to allow the use of internal models should NOT be dependent on the resources of the supervisor, as all regimes that did not have such resources should permit an independent, commercial third party certification/review/audit of the internal model to be arranged by the insurer (at insurer's expense). Insurers should not be the poor cousins in the internal models world	
GNAIE		Paragraph 44, last sentence: "...that the insurer's internal model was appropriately calibrated...", I would change to: "...that the insurer's internal model REMAINS appropriately calibrated..."	
GNAIE	48	The paragraph discusses the issue of being able to address SOME risks through controls and limits, not just technical provisions and capital, but in a somewhat cumbersome way. We suggest adding at the end of the first sentence: "...whether in technical provision, regulatory capital requirements OR OTHER CONTROLS." (delete: "or both".)	
GNAIE	51	Add a paragraph 51B that mentions the need to consider risk diversification.	
GNAIE	54	The sentence starting with "A judicial opinion in one year..." is not necessary, since the point was made in the first sentence.	