IAIS
INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

Public

HLA Consultation Responses

5 October 2015

Introduction

This document is based on comments received in response to a public consultation on several options of draft Higher Loss Absorbency (HLA) requirements conducted from June through August 2015. All of the non-confidential comments received are available separately on the IAIS website.

All comments received were considered in the development of the HLA and, consistent with IAIS policy, the comments received as well as this summary of comments and responses are now being presented. Due to the volume of comments received the IAIS is publishing its responses on a thematic basis whereby comments are grouped into themes, each of which has a response.

In reading this document, please note that:

- Comments and responses are grouped into themes, beginning with several general themes and followed by overarching themes based on the key points of HLA design.
- Member and stakeholder comments are considered together and distinguished only where appropriate.

General comments

Theme 1	Resolution
(1) Key elements are still under development (i.e. review of G-SII designation process and review of the definitions of NT and NI): • Difficult to assess the potential impact of the proposed policy measures • IAIS should delay finalizing HLA until these elements are developed Request for open architecture for HLA design to be flexible	The approach in the HLA Document to assign different factors to different types of activities is an open and flexible architecture. The bucketing approach is also open and flexible as the G-SII designation methodology evolves. The design and calibration of the BCR will be monitored and reviewed by the IAIS and, if appropriate, refined. This review and refinement process will be informed by field testing, which is scheduled to continue through to 2018. The review and refinement process will include (but not be limited to) consideration of: • Impact of outcomes from review of NTNI methodology • Impact of outcomes from review of G-SII designation methodology, including the determination of buckets used for HLA required capital purposes For further detail on the BCR and HLA review process see section 7.2 of the HLA document.

General comments

Theme 2	Resolution
(2) The proposed HLA in the Consultation Document is not risk sensitive: • Based on BCR, which is not risk sensitive • 2 populated buckets is not sufficiently risk sensitive	The HLA will be adequately risk sensitive. Data shows sufficient differentiation of the HLA applied to different G-SIIs based on the extent of their systemic activities. The impact on hypothetical examples of G-SIIs is shown in Annex F of the HLA Document and demonstrates adequate risk sensitivity.

Overarching themes

BCR Uplift

Themes 3-5	Resolution
(3) Procyclicality: • BCR Uplift amplified weakness of BCR's risk insensitivity leading to procyclicality • BCR is extremely volatile and could encourage pro-cyclical behaviour	Over two reporting years BCR appears to have been quite stable. Changes in value of capital resources reflects market conditions. Changes in value of BCR reflects the changing risk profile of G-SIIs. BCR is an adequate basis for HLA. The average BCR/PCR ratio for G-SIIs has been stable in the data over two years. The 33% uplift is appropriate to increase the BCR to a PCR level on average. Moreover, having a transition period for the Uplifts permits review and possible refinement of the full uplift factors to reflect future data and experience.
(4) The BCR uplift is inappropriate: • Based on speculation about the future ICS calibration • Further amplifies the weakness of BCR's risk-insensitivity	
(5) With the exception of one Member, Members who responded support the BCR Uplift	

Overarching themes

Transition of BCR uplift and HLA calculation during the transition

Themes 6-8	Resolution
(6) It is not clear how the transition would operate. Clarity was sought about the way the transition would apply and how the HLA would be calculated during the transition period	The BCR_{Uplift}, for both Insurance and NI, will be phased in over a three year transition period (2016, 2017 and 2018) in three equal steps (that is, with the BCR alpha factor set at 111%, 122% and 133% respectively). This transition is expected to be completed during the HLA private reporting period, prior to the implementation of the HLA, which is scheduled for 2019. Having a transition period for the Uplifts permits review and possible refinement of the full uplift factors to reflect future data and experience. During the transition period the calculation of the HLA insurance component and the HLA NI component will be calculated based on the full amounts computed for BCR insurance Uplift and BCR NI Uplift, rather than the reduced amounts computed for transition purposes. See section 3.4 of the HLA paper
(7) Some Members believe the transition is not necessary while other Members express support	
(8) Generally there is industry support for the transition but some do not understand how a transition is relevant for a measure not yet in place.	

Overarching themes

Application of the BCR uplift for NI components

Theme 9	Resolution
(9) There should not be a BCR uplift nor HLA on assets under management since there is not a specific global asset management regulation.	It is noted that the FSB, in cooperation with IOSCO and other standard-setting bodies where relevant, have commenced work to develop within the SIFI policy framework the incremental policy measures needed to address the systemic risks posed by Non-Bank Non-Insurance (NBNI) SIFIs. In the interim, until outcomes from this work are available, the IAIS will continue to base its approach on that given in the BCR Document for the BCR_{2014} (the standard indicator method for addressing operational risk of asset management activities in Basel II) with the BCR_{uplift}. If more appropriate globally comparable regulatory capital requirements are implemented, the IAIS will review them and consider their application to the BCR and HLA.

Overarching themes

Application of the BCR uplift for NI components (continued)

Theme 10	Resolution
(10) There should be no BCR uplift on NI subject to banking requirements	The BCR_{2015} is calibrated to an average PCR level to reduce the expected gap between BCR_{2015} and the future ICS. In the banking sector, the equivalent measure is the higher of 8% of RWA or the 3% leverage ratio. Therefore, in the BCR_{2015} the maximum of these two requirements will replace the 3% leverage ratio in the BCR_{2014} for NI regulated banking business. For regulated banks the component BCR_{Uplift} for the regulated banking sector, $NI\text{-}RB_{BCR\ Uplift}$, is determined by reference to the banking sector requirements and the requirement that it may not be negative. $NI\text{-}RB_{BCR\ 2015}$ is taken to be the maximum of the BCR_{2014} component (3% of the Leverage Ratio) and the Basel III Risk Weighted Assets (RWA) requirements (of 8%). $NI\text{-}RB_{BCR\ Uplift}$ is then the increase over the $NI\text{-}RB_{BCR\ 2014}$ (the 3% Leverage ratio). This is expressed as follows: $NI\text{-}RB_{BCR\ 2015}$ = Max [3% Leverage ratio, 8% RWA] $NI\text{-}RB_{BCR\ Uplift}$ = $NI\text{-}RB_{BCR\ 2015}$ – $NI\text{-}RB_{BCR\ 2014}$

Overarching themes

Bucketing

Themes 11-13	Resolution
(11) Bucketing generally supported. There are varying views on 1 or 2 populated buckets with bucketing up to the number of G-SIIs (continuous approach) also given some support	The HLA design uses bucketing to reflect the risk sensitivity as measured by the G-SII assessment methodology. The use of buckets based on how systemic a G-SII is allows the application of higher factors to those G-SIIs that are more systemic.
(12) The use of G-SII designation scores to determine buckets as a measure of systemic risk does not seem appropriate due to the relative nature of the G-SII designation scores	
(13) There was some support for an empty bucket as a disincentive	

Overarching themes

Bucketing (continued)

Theme 14	Resolution
(14) There is a lack of transparency of G-SII designation scores.	It is anticipated that the revised G-SII Assessment Methodology would permit annual publication of the bucket allocations for all G-SIIs.

Overarching themes

Calibration level

Themes 15-17	Resolution
(15) There was a strong theme from stakeholder comments that the calibration level is too high	The average calibration for HLA across the population of G-SIIs is reduced by approximately one quarter compared to that proposed in the HLA consultation document for a number of reasons, including: • The need to ensure an appropriate minimum level of HLA for G-SIIs • The need for an appropriate relativity between traditional insurance business, non-traditional insurance business and non-insurance business • The need for an appropriate relativity between traditional insurance business and regulated banking business • Not having a higher calibration level than G-SIBs in the lowest bucket.
(16) There were a number of comments that the calibration should not be inconsistent with the calibration of HLA for G-SIBs	
(17) Members who commented were more supportive of the proposed calibration level	

Overarching themes

Gamma – or the relativity of the factors on Traditional and NTNI business

Themes 18-19	Resolution
(18) There were questions about how the gamma would translate into practical factors and calculation of HLA	The IAIS has determined that the HLA factor applied to the BCR_{2015} required capital for Non-Traditional insurance should be two times that applied in the case of Traditional insurance and assets as this relativity is regarded as achieving the most appropriate balance between risk sensitivity, complexity and dispersion. This is analogous to the gamma 50% option. NT and NI activities of G-SIIs are regarded as those most likely to cause or amplify systemic risk events. Accordingly, it is appropriate for such activities to be given greater weight in the HLA formula. However, as indicated previously, other activities conducted by G-SIIs, as reflected in the G-SII methodology indicators, may also cause or amplify systemic risk.
(19) There were a range of views exhibited by both stakeholders and Members about the appropriate level of gamma ranging from zero to 1. There were more industry stakeholders which indicated they support a gamma closer to 1 than closer to 0	

Overarching themes

HLA applicable to regulated banking activities

Theme 20-21	Resolution
(20) HLA should not be charged on banking activities unless banking activity itself is considered G-SIB.	The HLA on regulated banking activities is a 12.5% factor on the second populated bucket which is equivalent to the 1% of RWA increase in required capital for the lowest bucket of G-SIBs. In line with the relativity of the buckets, the factor for the first populated bucket is approximately 50% lower, i.e. 8.5%.
(21) There was support for alignment between the HLA required for regulated banking activities of a G-SII with the HLA applied to those activities by the BCBS. This was often described as support for the ceiling on HLA on those activities as proposed in the consultation paper	

Overarching themes

HLA applicable to unregulated banking activities (continued)

Theme 22	Resolution
(22) There was no material disagreement with the approach of treating unregulated banking activities in the same way as non-traditional activities in the HLA formula. There was actually very little comment about this.	The IAIS has determined that the HLA factor applied to the BCR required capital for Non-Insurance unregulated banking should be linked to the HLA factors applied for regulated banking, but that it should take the regulated banking factors from the next highest bucket. That is, for the Low bucket the regulated banking factor from the Mid bucket is used, and the factor for the Mid bucket is taken from the High bucket for regulated banking.

Overarching themes

HLA applicable to NI other activities including AUM

Theme 23	Resolution
(23) There should not be HLA on asset management activities until IOSCO and FSB have developed their approach for NBNI SIFIs	The IAIS has determined that the HLA factor applied to the BCR_{2015} required capital for NI-AUM should be the same as that applied NT. It is noted that the FSB, in cooperation with IOSCO and other standard-setting bodies where relevant, have commenced work to develop within the SIFI policy framework the incremental policy measures needed to address the systemic risks posed by Non-Bank Non-Insurance (NBNI) SIFIs. In the interim, until outcomes from this work are available, the IAIS will continue to base its approach on that given in the BCR Document for the BCR_{2014} (the standard indicator method for addressing operational risk of asset management activities in Basel II) with the BCR_{uplift}. If more appropriate globally comparable regulatory capital requirements are implemented, the IAIS will review them and consider their application to the BCR and HLA.

Overarching themes

Capital resources

Theme 24	Resolution
(24) Capital resources: • Support for inclusion of Margins Over Current Estimates (MOCE) in capital resources • Call for grandfathering and transitional measures • There should be no classification into core and additional capital	The IAIS has determined that, for the purposes of the development of the HLA, the definitions of Core and Additional Capital used for BCR purposes will apply to the HLA. That is, the quality of capital resources required to support the BCR_{Uplift} will be the same as for the BCR_{2014}. In particular, qualifying Additional Capital cannot exceed 50% of BCR_{2015} required capital. The HLA is to be met by the highest quality capital - Core Capital as defined for BCR purposes. For those G-SIIs that reach the limit in terms of use of Additional Capital to meet BCR required capital, there is an incentive to raise Core Capital as opposed to Additional Capital since doing so will have a positive impact on the BCR capital ratio. Margins Over Current Estimates (MOCE)/Reserves included in GAAP equity or otherwise allocated to equity are included in the definition of core capital for the BCR and HLA. The IAIS will also consider how, prior to HLA implementation, a transition of existing financial instruments may be most appropriately addressed.