



IAIS

INTERNATIONAL ASSOCIATION OF
INSURANCE SUPERVISORS

Public

ICS Consultation Document – Responses to Comments on Operational Risk (Section 9.2.6)

9 March 2016



About this slide deck

1. This is the next tranche of resolutions of ICS Consultation Document (ICS CD) responses and comments received from IAIS Members and Stakeholders.
2. Member comments are grouped, noting that:
 - i. Members who provided confidential responses are not explicitly identified, but the total number of responses received is reported; and
 - ii. it is the policy of some Members to not comment on public consultations.
3. Stakeholder comments are presented on a thematic basis.
4. Note that a single response to all questions is provided in the last slide.

Glossary of Member Acronyms/ Shortened Names

AMF	Autorité des Marchés Financiers, Quebec, Canada
BaFin	Federal Financial Supervisory Authority, Germany
BMA	Bermuda Monetary Authority
CIRC	China Insurance Regulatory Commission
EIOPA	European Insurance and Occupational Pensions Authority
Hong Kong	Office of the Commissioner of Insurance
MAS	Monetary Authority of Singapore
NAIC	National Association of Insurance Commissioners, United States
OSFI	Office of the Superintendent of Financial Institutions, Canada
Russia	Central Bank of the Russian Federation

13.4.4 Operational Risk

Question 148. Which of the options¹ presented above should be pursued? Why should this method be pursued? How can the drawbacks to that method be addressed within the standard method?

BaFin, EIOPA, NAIC, and five other Members prefer option b) for the ICS standard method.

Comments supporting this included:

- Consistency with ICS principles
- The approach directly targets some known drivers of operational risk
- Flexibility and a level of granularity appropriate to operational risk

AMF, MAS and OSFI prefer option c). These all suggest following the approach being developed in Canada, which combines options a) and b) to allow flexibility recognizing the limited experience, data, and methods currently available.

¹ For reference, the following is taken from the Consultation Document (paragraph 345):

a) The other risk charges in the example standard method for the ICS capital requirement – for example, the sum of the other charges after any diversification credit

b) The business of the IAIG – for example, exposure measures for non-life and life business, such as premiums or liabilities or account balance. Additional factors could be developed to be applied to exposure measures such as growth in premium

c) A combination of both (a) and (b).

13.4.4 Operational Risk

Question 148. Which of the options¹ presented above should be pursued? Why should this method be pursued? How can the drawbacks to that method be addressed within the standard method?

A number of stakeholders proposed that no Operational Risk charge be included in the ICS standard method.

Of the stakeholders who responded, the majority prefer option b), with four giving no preference, one preferring option a) and one preferring option c).

13.4.4 Operational Risk

Question 149. Are there any alternative methods to capture operational risk that should be explored other than the three methods described in paragraph 345 above? If so, please provide details and rationale.

BaFin, EIOPA, OSFI and four other Members indicated that there were no alternative methods to capture operational risk for the ICS standard method. Several noted that this response was 'at this time'. Many reiterated support for option b).

BMA, NAIC and one other Member suggested alternative approaches for consideration. These included a scoring approach, something similar to the Basel Level 1 approach, and use of internal models (respectively).

13.4.4 Operational Risk

Question 149. Are there any alternative methods to capture operational risk that should be explored other than the three methods described in paragraph 345 above? If so, please provide details and rationale.

Of the stakeholders who responded, three indicated that there were no alternative methods to capture operational risk for the ICS standard method.

The majority of stakeholders who responded put forward alternatives, at varying levels of detail. Some themes included:

- Removing the operational risk charge from the capital formula, often citing difficulty with data and modelling
- Using jurisdictional regulators assessment of risk management frameworks, in several instance supporting a 'scoring ' approach
- Use of internal models
- Not 'rewarding' companies for good controls and risk management practices, in several instances noting the importance of governance processes

13.4.4 Operational Risk

Question 150. What risk charges as outlined in this Consultation Document should be included when determining the exposure measure for the IAIG that is used in the operational risk charge [if option a) is pursued]? Why is this appropriate?

BaFin, EIOPA and five other Members indicated that they do not support option a) and some put forward other considerations and commentary.

Of the members who addressed option a) OSFI and one other Member indicated that all risk charges should be used, while MAS and NAIC indicated that a subset be used. Some suggestions included omitting Asset Concentration charges and calculating the operational risk charge before diversification. None suggested additional risk charges to be used.

Of the stakeholders who responded to this question, two suggested there be no operational risk charge, two support using all risk charges, and two support using a subset of the risk charges.

13.4.4 Operational Risk

Question 151. Should the operational risk charge include an additional component for growth [in premium, if option b) is pursued]? Why or why not?

AMF, BaFin, EIOPA, MAS, NAIC, OSFI, Russia and five other Members support an additional component for premium growth.

CIRC proposed the IAIS only issue principle guidance and have jurisdictional supervisors make an assessment reflecting internal controls and risk management practices.

Several themes emerged from comments, including:

- Several members noted that an important consideration in assessing ‘growth’ is whether it is considered to be in the normal course of business or not and suggested the use of thresholds. Some points noted include mergers and product and/or geographic sources.
- Growth may be positive or negative
- Source(s) of the growth be considered and then perhaps some granularity would be appropriate
- Too rapid expansion is an identified source of risk for insurers.

13.4.4 Operational Risk

Question 151. Should the operational risk charge include an additional component for growth [in premium, if option b) is pursued]? Why or why not?

Of the stakeholders who responded to this question, almost all support an additional component for premium growth, while three stakeholders did not.

Several themes emerged from the comments, including:

- Focus should be on ‘unexpected’ growth and so the use of thresholds should be considered.
- The sources of growth should be considered, including geographical sources
- To need to avoid spurious ‘growth’ due to movement in exchange rates
- Whether growth as a risk driver would be better considered via Pillar 2.

13.4.4 Operational Risk

Question 152. What are the views on the granularity and exposure measures proposed above for option (b)?

BaFin, EIOPA, MAS, NAIC and six other Members support the current level of granularity for the ICS standard method. Several commented “as a starting point”.

OSFI suggested some further granularity should be considered.

Of the stakeholders who responded to this question, one supports less granularity, one supports the current level and two support increased granularity. Several others provided commentary but no view.

One stakeholder suggested using expenses rather than premiums as a basis.

Response to questions 148 to 152

IAIS Response: The IAIS currently intends to move forward in field testing for the ICS standard method with all three options but option b) will be retained as the default option.

Further consideration will be given to some matters, including:

- Level of calibration
- Further refinements, including the appropriateness of exposure drivers, other possible exposure drivers and levels of granularity using data collected in field testing.