

FINAL_ACLI response to the IAIS Insurance Capital Standard consultation (Version 1.0)

Question & Section of the Consultation Document	Yes / No	Proposed Answer
4. VALUATION		
4.1 Market-adjusted valuation 4.1.1. MAV general approach.		
<p>Q5. <i>Do the adjustments to GAAP specified in the 2016 Field Testing Technical Specifications for the construction of the MAV balance sheet succeed in providing a largely comparable picture of the financial situation of IAIGs and a consistent basis for the calculation of the ICS? Please explain. (Section 4.1.1)</i></p>	<p><input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p>	<p>Paragraph 74 c) of the ICS CD requires that the adjusted value of debt instruments issued by the IAIG not reflect the credit standing of the IAIG, or in other words, not be marked to market. Current 2016 Field Testing specifications require debt instruments to be valued at IAIS liability discount curves. This results in a less efficient capital structure, raising cost of capital and increasing product pricing for consumers.</p> <ul style="list-style-type: none"> • Materially higher debt valuation due to the low discount rate used; • Significant penalty for any debt in the capital structure, including subordinated debt; • Counterproductive to stability as it punishes longer term and higher loss-absorbing instruments more; and • For some long term subordinated debt, the capital deduction may be over 50% of principal.
4.1.3 Contract boundaries		
<p>Q 7. <i>Should MAV include a more economic approach to contract boundaries (eg renewal rate and stability of premiums) rather than focusing on contractual or legal aspects? If “yes”, why would this provide a better assessment of the solvency position of IAIGs? (Section 4.1.3)</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>While ACLI recognizes that conservatism in a prudential context is appropriate, we have consistently argued against the application of a strict legal definition of contract boundaries to select products, including short-term renewable products, for balance sheets that are designed to be economic in nature, like the ICS balance sheet.</p> <p>The ICS MAV approach is an economic approach based on realistic, best estimate assumptions and observable data. The GAAP plus adjustments approach will similarly lead to a valuation of liabilities on a best estimates basis. Applying a strict legal/accounting definition of contract boundaries is inconsistent with this economic approach.</p>
<p>Q 12. <i>Would other components of the ICS, be affected by such change? If “yes”, please specify those components and provide an explanation. (Section 4.1.3)</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>We recognize that a change in approach to contract boundaries will impact other elements of the balance sheet and propose we undertake to look into and comment on impact on calibration of risk charges, MOCE, capital resources, and how the “extension” of the boundary might be impacted by confidence level/time horizon.</p>
4.1.4 Discounting		

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4.1.4.3 IAIS' response to stakeholder comments and Field Testing results (approach to discounting)		
<p>Q17. <i>The proposed LTFR is based on a macroeconomic approach using OECD information. Is this methodology appropriate? Please explain. (Section 4.1.4.3)</i></p>	<p><input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p>	<p>While we conceptually agree with the two-component approach, The LTFR should take into consideration of both long-term forecasts and realized historical data. Long-term forecasts should be based on a broader set of surveys rather than relying on the OECD study as a sole source.</p> <p>The use of the asset earned rate (or something close) for RDR in discounting future liability cash flows would potentially circumvent the need for a LTFR or minimize its relevance.</p>
4.1.4.4 Policy issues regarding the design of the adjustment		
<p>Q20. <i>Which approach to portfolio selection, as a basis for the calculation of the credit spread adjustment, is more appropriate for the MAV approach, taking into account the need to ensure a balance between complexity, comparability and basis risk? Please explain. (Section 4.1.4.4)</i></p>		<p>At this early stage of development, we propose that the IAIS continue to test different base yield curve adjustments options, but narrow the options under consideration to two approaches: [i] a firm-specific approach (Option 2) with appropriate guardrails to avoid excessive risk-taking and [ii] either Option 1 (single reference portfolio) as it's currently defined, or a hybrid approach to Options 1 and 2. We believe both Option 1 and Option 2 require further refinement: more specifics are needed on the reference portfolio for Option 1 and guardrails for Option 2 need to be developed.</p> <p>Option 2, with the appropriate guardrails, recognizes each insurer's unique portfolio while affording regulators some control by implementing guardrails to eliminate any improper risk-taking. We recommend the following principles for a firm-specific approach:</p> <ul style="list-style-type: none"> • An own portfolio approach should recognize additional asset classes beyond corporate bonds, including equities. • Guardrails such as limiting the spread for below investment grade bonds or equities, could apply. Other guardrails may include limits on the recognition of certain assets in the discount rate, as well as transparency to regulators into the company's investment portfolio and ALM practices, can apply. <p>A benefit of a firm specific approach is that it recognizes that insurance companies mitigate interest rate and liquidity risk by employing sophisticated Asset Liability Management (ALM) techniques where asset portfolios are tailored to the company-specific liability profiles. Mandating a reference portfolio for all insurance groups will likely result in an inaccurate measurement of risk for many companies as it would not properly allow for the risk-reducing benefits of ALM or, worse, may conceal poor ALM practices.</p>

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		<p>However, we agree with the IAIS that the potential for improper risk-taking with respect to an own-portfolio approach should be addressed. We note that this should be considered holistically in ComFrame, and not considered the sole responsibility of the ICS through an arbitrary prescribed standard discount rate. Examples of ways that this risk is currently addressed in the ICS and ComFrame include:</p> <ul style="list-style-type: none"> • Within the ICS, there are capital charges for market risk, credit risk, and asset concentration which will directly apply capital requirements based on the asset risk and ALM mismatch risk that an insurer is exposed to. • There are other elements of ComFrame, including those directly related to ERM and ALM, which enable regulators to evaluate a company’s investment behaviour, risks and risk management. • Furthermore, guardrails, including limits on the recognition of certain assets in the discount rate, as well as transparency to regulators into the company’s investment portfolio and ALM practices, can apply. <p>In addition, the ICS should reflect an appropriate long term spread adjustment aligned with the spread adjustment that is applied in the observable and grading portions of the curve.</p> <ul style="list-style-type: none"> • A reference portfolio based approach - Option 1- may also be appropriate with certain adjustments, which is why we believe the ICS should test both approaches. We recommend the following adjustments to Option 1: An appropriately tailored representative portfolio approach would utilize a peer group of companies to set the representative spread adjustment, with limits on the asset allocation based on the IAIG’s own portfolio. We believe that this would produce a comparable spread adjustment to an own portfolio approach described above. • Constructing the reference portfolio based on assets held by comparable market participants (e.g., Life vs. P&C) only, instead of all IAIGs in the respective currency • Using more granular asset classes (e.g., publics/privates/structured securities) in addition to credit quality to construct spread adjustments • Applying tenor-specific spread adjustments rather than a single adjustment across all tenors • Recognizing additional “spread” based on equity premiums for equity / real estate / alternatives investments

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		<ul style="list-style-type: none"> • Deducting expected default losses and investment expenses (instead of “Risk-correction” for credit risk) as the “spread adjustment”
<p>Q23. <i>Should insurance liabilities be segregated into buckets for the purpose of applying the credit spread adjustment? (Section 4.1.4.4)</i></p>	<p><input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p>	
<p>Q23.4. <i>If “no” to Q23, as an alternative to a criterion for predictability of insurance liabilities, could partial risk transfer to policyholders (eg market value adjusted products) be a criterion for determining the credit spread adjustment? (Section 4.1.4.4)</i></p>		<p>ACLI does not support the development of different discount rates through the segregation of liabilities into buckets due to concerns about decreased comparability across jurisdictions and the likely implementation complexity. We believe for global companies the rigorous evaluation of all products required to assign a bucket – particularly those outside the primary jurisdictions of the IAIG – would consume significant resources (both initially and ongoing) for only a modest impact on results even if done consistently and properly. Moreover, the subjective interpretations of the bucket parameters are certain to result in inconsistent bucket assignments for common liabilities across IAIGs. However, if the IAIS should feel compelled to take a bucketing approach, we recommend the IAIS adopt a more achievable goal as part of a step-wise approach toward a bucketing solution. Namely, for all but the most mature markets, we encourage the IAIS to require IAIGs only to segment the liabilities into buckets, while still discounting at a single curve, rather than requiring the generation of many different sets of discount rates. This approach allows the IAIS and IAIGs both to:</p> <ul style="list-style-type: none"> • assess the complexity of the bucketing approaches alone, and • measure the impact of bucketing for the preponderance of IAIGs – but without the additional challenge of requiring discount rate creation in markets immaterial for most IAIGs. <p>Additionally, and without prejudice to the above concerns about the proposed bucketing options, we note that the “reference portfolio” and our proposed “firm-specific asset allocation” approaches (see comments on Table 5 below) are fully compatible with bucketing:</p> <ul style="list-style-type: none"> • A pure reference portfolio approach would require a separate reference portfolio for each bucket. • Proposed “firm-specific asset allocation” would require a simple adjustment to the caps on asset allocations for different liability types (e.g., the share of illiquid liabilities would influence the cap on allocations to less liquid assets).
<p>4.1.4.5 Options for adjustments to base yield curves – 2016 Field Testing</p>		

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<p>Q31. Which of the proposed options strikes a better balance between the different policy issues under consideration by the IAIS? Please explain. (Section 4.1.4.5)</p>		<p>[Repeat of answer to Question Q. 20]</p>
<p>4.2 GAAP with adjustments</p>		
<p>4.2.5 2016 Field Testing</p>		
<p>Q33. The AOCI adjustment is proposed to only apply to unrealised gains and losses related to debt securities backing long-term liabilities where it is more likely than not that the unrealised gains and losses would not be realised. Is this an appropriate way to segregate non-economic volatility from the fair value measurement of investments in debt securities? If “no”, what alternative would you propose, and why. (Section 4.2.5)</p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>We support the use of an AOCI adjustment, although we believe the approach can be improved. Specifically, the AOCI on qualifying hedges on debt securities should be included in the AOCI adjustment calculation. The current process identifies the AOCI on the debt securities, but does not consider the AOCI on foreign currency swaps or interest rate swaps hedging the debt security.</p>
<p>Q34. Are there any refinements that should be made to identify assets backing long-term liabilities for purposes of the AOCI adjustment? For example, would a bucketing approach similar to that proposed for assets under MAV discounting option 3 (based on liquidity characteristics of the liabilities) be an appropriate way to identify assets backing long-term liabilities? Please explain. (Section 4.2.5)</p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>Yes, there are refinements that should be made. This proposal could identify the AOCI on assets backing long-term liabilities; however, reductions to this AOCI balance would need to be taken into consideration for instruments where the unrealized is more likely than not expected to be realized. This would include callable bonds and RMBS expected to be prepaid. In addition, an adjustment for the AOCI from qualifying hedges on the assets backing long-term liabilities would be necessary.</p> <p>Non-fixed income investment elements of AOCI should also be excluded as these contribute non-economic noise in the measurement of available capital. Regarding AOCI on equity securities – equity securities typically make up a small percentage of a U.S. life insurer’s portfolio and are generally used to back liabilities that extend beyond the investible horizon. Insurers transition to a fixed income investment as the liability becomes investible and given the long term nature of the liability are unlikely to be in a position where the equity investments need to be abruptly liquidated.</p>

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<p>Q35. <i>Is the “more likely than not” criterion to exclude certain unrealised gain/losses an appropriate element of the AOCI adjustment calculation? Please explain. (Section 4.2.5)</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>ACLI believes the “more likely than not” criterion is appropriate with the following reservations /amendments to the proposed approach: In determining the amount of AOCI that is included in the GAAP Plus AOCI Adjustment there is a requirement to exclude those assets that are backing non-life insurance liabilities. We believe that any reference to product type should be removed and the determination of whether an AOCI amount should be included should be based entirely on whether it is more likely than not that the unrealized gain/loss would be realized. Assets are purchased so that the overall entity’s asset portfolio matches the overall entity’s cash flow needs. Introducing a generalization based on product type incorporates unrealized gains/losses that are not likely to be realized. A methodology that relied solely on the likelihood of the realization of an unrealized gain/loss would provide a more accurate view of what is expected to be realized.</p> <p>In addition, the criteria presumes that insurers know in advance which assets they will need to dispose of in the future, which could result in different interpretations of which assets should be included or excluded. Accounting guidance (e.g. STAT, GAAP, etc.) requires insurers to regularly assess assets for impairment which captures potential liquidity concerns for securities and credit downgrades, bankruptcy or other adverse financial conditions of the respective issuers and may offer more appropriate criterion.</p>

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<p>Q36. <i>Are there specific asset classes that should be included in the “more likely than not” category? If “yes”, please explain. (Section 4.2.5)</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>We propose the following more appropriate ways to segregate certain assets where unrealised gain/loss is more likely than not to be realized:</p> <ul style="list-style-type: none"> • Callable bonds: For callable bonds, there should be more specific criteria to determine the amount of AOCI to exclude. For example, we could treat gains as unlikely to be realized due to call when the following criteria are met: 1) the call price is less than the current market price and 2) the call date is within the next 3 years. The time frame is limited due to the market volatility over a time period of greater than 3 years. In addition, the amount of AOCI expected to be realized should be the difference in the call price and amortized cost basis. The difference between current market price and call price is not expected to be realized. • RMBS expected to be prepaid: Using similar criteria to callable bonds, the reduction to the AOCI adjustment on RMBS expected to be prepaid could be determined to be issuances with a weighted average life of less than 3 years and a market price greater than 100. The securities that are pre-payable are those structures that are backed by consumer loans where the borrower is given the ability to fully prepay without penalty to the borrower. These types of pre-payable loans are predominately with RMBS as well as ABS Student Loans/Consumer Loans/Auto Loans. • Below Investment Grade Securities: We do not believe any reduction to the AOCI adjustment is necessary for below investment grade securities. It is general practice to record impairments on such securities through the financial statements while the investments are still being held.
<p>Q39. <i>It has been suggested by some Volunteer IAIGs that the default risk spread could be highly volatile in certain periods of stress. Are there methods to evaluate this volatility over historically relevant periods, and is appropriate data available to do so? Please explain. (Section 4.2.5)</i></p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>ACLI does not believe the default risk spread would be volatile.</p>
<p>5 CAPITAL RESOURCES</p>		
<p>5.3 Open issues for consultation 5.3.4 Structural vs contractual subordination (treatment of senior debt)</p>		

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<p>Q73. <i>Is structural subordination sufficient to guarantee that policyholders will be paid first in a winding up? Please explain. (Section 5.3.4)</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>In the U.S., proceeds from debt issuances of holding companies, to the extent they are contributed into regulated operating insurance entities, are available to absorb losses and are subordinate to policyholder obligations. In the U.S. insurance regulatory system, policyholder protection takes priority over protecting holders of related debt instruments and other investors from financial loss. The focus of solvency regulation in the U.S. is on the individual insurance legal entity within a holding company system, with transactions between an insurance legal entity and its affiliates with the insurance entities subject to state insurance statutes and regulation. In determining whether a transaction, for example, an extraordinary dividend, should be approved, the domiciliary regulator considers the financial impact to the insurer. The insurance regulator has broad authority in evaluating the insurer's overall financial condition, (including actions of the non-regulated holding companies). There is precedent in U.S. law that affirms the U.S. regulatory view that available capital resources are based upon structural subordination for the inclusion of certain debt instruments as these laws were upheld in the U.S. legal system during insolvency and receivership proceedings in the early 1990s where policyholders were ultimately protected from harmful actions of the parent holding company.</p> <p>Capital raised via a holding company is typically infused by the holding company (who is the direct or indirect parent of the regulated insurance entity) into its wholly owned regulated insurance company subsidiary in the form of a capital contribution. This structure insulates the policyholders from the debt related obligations maintained by the holding company. Under these arrangements and corporate structures, the annual dividends from the regulated insurance company (which are subject to regulatory restrictions) are used to service the holding company debt. Simply put, if the policyholder obligations are not being met, extraordinary dividends to the holding company will not be approved by the domiciliary supervisor.</p>
<p>Q74. <i>Does structural subordination produce the same outcomes as legal or contractual subordination? Please explain. (Section 5.3.4)</i></p>	<p><input type="checkbox"/> Yes <input checked="" type="checkbox"/> NO</p>	
<p>5.3.5 Mutual IAIGs</p>		
<p>Q75. <i>Is a requirement for supervisory approval prior to redemption of a financial instrument at contractual maturity</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>The regulatory regime that governs the issuance and redemption of surplus notes is of paramount importance when considering whether surplus notes should be considered Tier 1 assets. Although the terms of most surplus notes have a maturity date, U.S. insurance laws give regulators the power to override this contractual term. The regulatory approval (or lack of</p>

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<p><i>sufficient for that instrument to be considered perpetual? Please explain. (Section 5.3.5)</i></p>		<p>approval) at maturity effectively makes surplus notes perpetual when needed most, i.e., when the insurance company is under financial stress. The regulator of the insurance company, when determining whether to permit the redemption of a surplus note, is typically required by law to evaluate the current financial strength of the issuing insurer. If the insurer is not in a good financial position, the regulator will not approve the redemption of the principal amount of the surplus note, leaving the funds in the hands of the insurer, effectively making the note perpetual until the financial position of the insurer improves. This integral feature of surplus notes is required by law in the United States.</p>
<p>Q76. <i>Is a requirement for supervisory approval of distributions prior to contractual maturity (eg interest payments, dividends) sufficient for the instrument to be considered non-cumulative? Please explain.</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>As mentioned in response to question 75, the regulatory regime that governs the issuance of surplus notes must be taken into consideration when evaluating surplus notes. It is not sufficient simply to examine the contractual terms of the notes. In the United States, the most important factor in this regard is the regulator’s obligation to disapprove payments of principal and interest in a time of financial stress for the insurance company. When a payment is not approved, insurance laws and regulations also specify how that payment will be treated while it remains outstanding. Typically, when a payment is disapproved, interest will stop accumulating on the unpaid amount. Although the regulator retains the discretion to later allow the payment, approval can be withheld for as long as the regulator deems it necessary to preserve the insurer’s financial strength. In this sense, the regulator effectively has the power to render distributions non-cumulative.</p>
<p>Q77. <i>Do existing financial instruments issued by mutual IAIGs (for example, but not limited to surplus notes, Kikin, and other forms of subordinated financial instruments) absorb losses on a going concern basis? Please identify which instrument and explain.</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>Surplus notes that are issued by mutual IAIGs in the United States can absorb losses on a going concern basis. If the issuing insurance company is in good financial condition, the insurer would make applicable interest and principal payments when due and as permitted by the applicable financial regulator. However, as discussed above, in times where the issuing insurance company is under financial stress, the financial regulator will disallow payments of interest and principal on the surplus notes. When payments are disallowed, the surplus notes and other obligations of the company will not go into default, there is no requirement for a receivership proceeding, and the company can continue to operate in a normal fashion, i.e., the issuing insurance company can still be solvent when the financial regulator determines that no distributions should be allowed. If the insurance company’s financial condition improves, the financial regulator may permit distributions to be made, but while distributions are not permitted, the insurance company can continue to operate as a going concern.</p> <p>There are examples of this type of scenario in the marketplace today.</p>

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<p>Q78. <i>Should the Tier 1 criteria (unlimited or limited) be changed in some way to better classify the instruments of mutual IAIGs? Please explain.</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>Certain of the Tier 1 criteria (limited and unlimited) should be changed in order to better classify financial instruments issued by mutual IAIGs, e.g., surplus notes, as follows:</p> <ul style="list-style-type: none"> <input type="checkbox"/> The instrument is perpetual (i.e. it does not have a maturity date). <ul style="list-style-type: none"> <input type="checkbox"/> This criteria should be revised to reflect that surplus notes are perpetual when the issuing insurance company is undergoing financial stress. E.g., “The instrument is perpetual (i.e., it does not have a maturity date or the issuer or its regulator has the power to prevent acceleration when the issuer is undergoing financial stress without triggering a default of the insurer or group)”. <input type="checkbox"/> There are no circumstances under which a distribution is obligatory (non-payment is, therefore, not an event of default). <ul style="list-style-type: none"> <input type="checkbox"/> This criteria should also reflect that if a regulator disallows distributions to be made to holders of surplus notes, the surplus note would not be in default. <input type="checkbox"/> The paid-in amount is recognized as equity capital (i.e. not recognized as a liability) where a determination that liabilities exceed assets constitutes a test of insolvency. <ul style="list-style-type: none"> <input type="checkbox"/> This criteria should be revised to make clear who is required to recognize the paid in amount as equity capital. For example, “The paid-in amount is recognized as equity capital (i.e. not recognized as a liability) by the applicable financial supervisor . . .” <input type="checkbox"/> The Volunteer IAIG has full discretion at all times to forego or cancel distributions (i.e., dividends and coupon payments are non-cumulative). The IAIG’s obligation to pay missed distributions is forever extinguished and non-payment is not an event of default. <ul style="list-style-type: none"> <input type="checkbox"/> This criteria should be revised to reflect the regulator’s full discretion to cancel distributions.
<p>Q79. <i>What would prevent mutual IAIGs from issuing other financial instruments that meet the qualifying criteria for Tier 1 capital resources as set out in the 2016 Field Testing specifications?</i></p>		<p>In the United States, the primary capital resource that is currently classified by the IAIS as Tier 1 that is available to IAIGs but not mutual IAIGs is share capital. Mutual IAIGs are owned by their policy holders and not shareholders. They are not publicly owned and are legally prohibited from issuing shares. Accordingly, mutual IAIGs are in a unique position of being unable to issue the Tier 1 capital resources as currently defined by the IAIS.</p> <p>Changing from a mutual to a non-mutual IAIG would be an exceedingly complex transaction that fundamentally alters the rights of its policyholders. A transaction of this kind is an expensive and difficult undertaking that requires prior regulatory approval and the payment of</p>

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		<p>compensation to policyholders for the loss of their ownership rights. It is a transaction that transforms the organization’s character, potentially to the detriment of policyholders, and is not purely a capital raising mechanism. We do not believe the IAIS should create incentives within its capital requirements for companies to favor non-mutual organizational structures over the mutual form.</p> <p>The financial regulators that oversee insurance companies recognize surplus notes as capital of the issuing insurance company. This is primarily due to the deep subordination of surplus notes, the potential for distributions to be disallowed but not create a default, i.e., continue as a going concern, and the requirement for distributions to be approved in advance.</p>
5.4 General Comments		
<p>Q90. <i>Are there any further comments on capital resources that the IAIS should consider in the development of ICS Version 1.0? If “yes”, please explain with sufficient detail and rationale. (Section 5.4)</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>ACLI believes that existing instruments should be grandfathered. They were issued to meet a different set of regulatory standards during a higher interest rate environment.</p> <p>Current field test guidance requires a capital deduction for encumbered assets in excess of liabilities. The deduction is in addition to existing capital requirements on pledged assets and related secured liabilities. A capital requirement, not a capital deduction, is the appropriate treatment for excess collateral. The current approach is overly conservative, does not reflect the true economics of the balance sheet, and implies loss is certain, and it may discourage insurers from maintaining sources of secured liquidity, reducing flexibility in a crisis. We recommend the IAIS develop guidance for the “deduction from capital for total secured (encumbered) assets”. We recommend that the guidance contemplate that an excess of restricted assets over related liabilities can exist but should not be treated as a deduction from capital, when such amounts are in excess of the permitted recovery by the third party against such pledged assets and the IAIG has the legal right to such amounts.</p>
6. ICS CAPITAL REQUIREMENT: THE STANDARD METHOD		
6.3 Risk Mitigation		
6.3.4 Open Issues for consultation		
6.3.4.1 Allowance for the effect of risk mitigation techniques in the ICS capital requirement only on the basis of assets and liabilities existing at the reference date of the ICS calculation		
<p>Q91. <i>Is the principle of allowing for the effect of risk mitigation techniques in the ICS capital requirement only on the basis of</i></p>	<p><input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p>	<p>ACLI urges the IAIS to subject financial risk mitigation techniques to the same general principles and requirements as other non-financial risk mitigation techniques. We understand that an estimate of the underlying, pre-hedged, economic risk is a meaningful</p>

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<p><i>assets and liabilities existing at the reference date of the ICS calculation appropriate? Please explain. (Section 6.3.4.1)</i></p>		<p>data point for the IAIS to have. However, as currently proposed, the data the IAIS would be gathering will be neither comparable nor meaningful, given that (for example) companies with long term hedging programs, rolling hedge programs with one year hedges, and three month hedges will be providing very different results.</p> <p>Furthermore, the assumption that these deeply liquid plain vanilla instruments would be wholly unavailable is unreasonable and excessive. We strongly suggest, therefore, that for this particular aspect of modeling the IAIS permit volunteers to incorporate their dynamic hedge programs, relying on precedent under existing rules (see ACLI response to Q92), and introduce a sensitivity test with no hedging (whether rolling or long term) to indicate the amount of liability risk sitting on the balance sheet. Companies could then indicate the results on the basis of assuming no renewals for instruments under 12 months as a supplement (either supplemental worksheet or in the questionnaire).</p> <p>Allowing reflection of risk mitigation in the data submission—while providing results without renewal of risk mitigation separately—will preserve the meaningfulness of the data submissions and resulting ICS calculations</p>
<p>Q92. <i>Should dynamic hedging arrangements be included in the scope of recognised risk mitigation techniques for ICS Version 2.0? Please explain. (Section 6.3.4.1)</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>ACLI urges that dynamic hedging arrangements be recognized in ICS Version 1.0.</p> <p>Where the risk mitigation techniques are in force for a period shorter than 12 months and the IAIG intends to renew and replace at the time of expiry with a similar arrangement, the risk mitigation technique should be fully taken into account in the calculation of the ICS capital requirement. This should also apply to dynamic hedging approaches, as the ICS already provides for volatility risk to be accounted for. To ensure proper reflection of risks, these allowances are subject to certain requirements being met, including:</p> <ul style="list-style-type: none"> • The risk mitigation arrangement (e.g., hedging strategy) is clearly defined and documented; • Such arrangements provide an effective transfer of risk to a third party; • There are no material basis or operational risks compared to the risk mitigation effect; • There is sufficient degree of liquidity in the market for such instruments under different market conditions. • Where applicable, credit risk and other risks and costs arising from the use of such techniques should be reflected in the ICS capital requirement. <p>Examples of financial derivatives used for purposes of financial risk mitigation (i.e., hedging) that should be fully allowed for in the calculation of the ICS capital requirement in Version 1.0 include:</p> <ul style="list-style-type: none"> • Equity futures, forwards and options; • Bond futures and bond options;

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		<ul style="list-style-type: none"> • Swaps and swaptions; • Currency futures, forwards, options and swaps; • Variance swaps; and • Credit default swaps. <p>Additionally, in order for dynamic hedging to properly be reflected in the ICS, the stressed should be applied over the year horizon, rather than as instantaneous shocks. For example, the current interest rate stress requires an immediate reevaluation of assets and liabilities using a stressed yield curve. We would suggest that there should be a transition to the new yield curve over the year (e.g., quarterly yield curves) so that the insurer's hedging program can be rebalanced and reflected in the results.</p>
<p>6.5 Management Actions 6.5.3 Open issues for consultation 6.5.3.1 Further extension of management actions</p>		
<p>Q101. <i>Are there examples of other instances for which an extension of management actions to allow for the recognition of premium adjustments may be appropriate? Please explain. (Section 6.5.3.1)</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>ACLI believes that rate actions such as COI increases should be allowed. We understand that rate actions might precipitate other policyholder actions such as increased lapses and possibly reputational risk. Such policyholder behavior sensitivity could be captured by reasonable dynamic lapse assumptions.</p>
<p>6.6 Mortality and Longevity risk 6.6.2 2016 Field Testing</p>		
<p>Q104. <i>Should the trend component be explicitly considered within Mortality risk? Please explain. Section 6.6.2</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>Yes, the trend component is a key risk for mortality and should be considered. However, the overall level and trend risks included in the consultation document and field testing specifications are far too high and need to be recalibrated. There are two key risks for large insurers with credible experience: a mortality catastrophe, which is captured as a separate risk, and unexpected changes in the trend of mortality. Mortality risk is more appropriately captured through a stress on the trend component directly as opposed to a stress on base mortality.</p>
<p>Q105. <i>Are the stress levels for Mortality risk appropriate? Please explain. If "no", please provide supporting evidence and rationale</i></p>	<p><input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p>	<p>The current proposed mortality stress remains unrealistic and the calibration greatly exceeds the notional 99.5 VAR or 1 in 200 concept, especially for companies that have significant,</p>

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Question & Section of the Consultation Document	Yes / No	Proposed Answer
<i>for a different stress level. (Section 6.6.2)</i>		<p>credible homogeneous claims data. Additionally, if a trend stress is added, then they should be considered independent stresses with zero correlation.</p> <p>The primary driver of base risk is mis-estimation risk. Limited Fluctuation Credibility Theory, which is widely accepted and used throughout the US insurance industry, can be used to show that only 3,100 claims (approximately) are required in order for the estimate to be within 5% of the true mean at a 99.5% confidence level. Companies with significant, credible, homogeneous claims data will have this quantity of experience data.</p>
<p>Q106. <i>Should the trend component be explicitly considered within Longevity risk? Please explain.</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>Yes, the trend component is a key risk for longevity business and should be considered. The key risk for large insurers with credible experience is unexpected changes in the trend of mortality. Longevity risk is more appropriately captured through a stress on the trend component directly without a simultaneous stress on base mortality rates.</p>
<p>Q107. <i>Are the stress levels for Longevity risk appropriate? Please explain. If “no”, please provide supporting evidence and rationale for a different stress level.</i></p>	<p><input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p>	<p>No. The longevity level stress of an additional 15% is too high for insurance companies that have significant amounts of longevity business and credible historical data on which to base their assumptions.</p> <p>Additionally, it is inappropriate to hold the trend stress level for all ages. As people age, longevity improvements are limited because changes in longevity drivers show decreasing returns. The stress should reflect this reality and be decreased for older ages.</p> <p>Further, the level and trend risks should be considered independent stresses. They are currently simply added together in the current proposal and, as a result, considered 100% correlated. The industry view is that these are uncorrelated.</p>
<p>6.7 Morbidity/Disability Risk 6.7.3 Open issues for consultation 6.7.3.2 Single approach to Morbidity/Disability for ICS Version 1.0</p>		
<p>Q120. <i>Is Option 1 (Health risk) or Option 2 (Morbidity/Disability risk) the most appropriate to adopt within ICS Version 1.0? Please explain. (Section 6.7.3.2)</i></p>		<p>An approach to morbidity/disability risk to adopt with ICS Version 1.0 and any future reiterations must be consistent with the following principles:</p> <ul style="list-style-type: none"> The design and calibration of the approach must reflect the appropriate risk profile of a wide range of diverse health products, business segments and companies that

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		<p>exist in the global insurance market, rather than a one-size-fit all approach based on one type of health product.</p> <ul style="list-style-type: none"> The design and calibration should be derived from, and reflect, historical data and real world experience rather than hypothetical scenarios. <p>Option 1 and Option 2 could meet the above principles but need additional refinements to their current designs and calibrations. For a given IAIG, one option may be more appropriate than the other for practical reasons, which should be considered in future refinements in their designs and calibrations.</p>
<p>6.13 Credit risk 6.13.3 Open issues for consultation 6.13.3.1 Reliance on the use of external credit ratings</p>		
<p>Q198. <i>Do you support the approach used for 2016 Field Testing with respect to allowing the use of external credit ratings for ICS Credit risk purposes? Why or why not? (Section 6.13.3.1)</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>ACLI supports the use of external credit ratings for credit risk purposes and recommends that the current list of approved agencies be expanded to include Morningstar Credit Ratings, LLC, a rating agency approved by both the National Association of Insurance Commissioners and the United States Securities and Exchange Commission.</p>
<p>Q200. <i>Should the IAIS allow the use of ratings and/or designations that are not issued by credit rating agencies, for example, ratings and/or designations that are issued by a supervisory-owned process (eg, the NAIC Securities Valuation Office)? Please explain. (Section 6.13.3.1)</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>ACLI strongly urges the IAIS to continue permitting the use of NAIC ratings and expanding the list of acceptable bond rating agencies to permit the use of all acceptable rating agencies approved by the SEC as nationally recognized statistical rating organizations. ,</p>
<p>6.13.3.2 Granularity of commercial and residential mortgage factors</p>		
<p>Q202. <i>Is the approach adopted for 2016 Field Testing for commercial and residential mortgage Credit risk charges</i></p>	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p>	<p>ACLI fully supports the approach adopted for 2016 Field Testing for commercial and residential mortgages.</p>

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<p><i>appropriate for the ICS standard method? Please explain. If “no”, please provide specific proposals for how it should be changed as well as supporting rationale and evidence. (Section 6.13.3.2)</i></p>		
<p>6.15 Aggregation/Diversification</p>		
<p>Q214. <i>Are the correlation factors being used for Life risks appropriate for the ICS standard method? If “no”, please provide rationale and alternative suggestions supported by evidence. (Section 6.15.3.2)</i></p>	<p><input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p>	<p>Longevity level and trend risks should be considered independent risk factors that have zero correlation. This is standard industry practice for internal models. Likewise, if a mortality trend stress is added, it should be considered independent of the mortality level stress.</p>
<p>Q215. <i>Are the correlation factors being used for Market risks appropriate for the ICS standard method? If “no”, please provide rationale and alternative suggestions supported by evidence. (Section 6.15.3.2)</i></p>	<p><input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p>	<p>Life risks and market risks should be considered independent variables and have zero correlation between them. The current ICS proposal assumes 25% correlation. There is no evidence that changes to mortality levels or longevity trend/level impacts equity markets, interest rates or credit spreads/defaults.</p> <p>There may be rationale that a mortality shock (pandemic) impacts market risks, but this is a one-sided correlation (i.e. poor markets do not cause pandemics). The current correlation between catastrophe and market risks is 25% and this seems reasonable. But other Life risks such as mortality, longevity and lapse should be considered uncorrelated with market and credits risks.</p>