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The dilemma of setting a global capital standard in insurance

Speech by IVASS Board Member

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On 9 October 2013 the IAIS announced its plan to develop a risk-based global insurance capital standard. We are now nearly at the end of a long journey that will lead to set this standard, the so-called ICS. The IAIS recently issued a final consultation paper on the ICS as PCR, i.e. as capital requirement according to the IAIS standards. The result of the consultation will feed into the finalization of the ICS, whose adoption is planned for December 2024.

In the light of the many challenges encountered in these 10 years of work, as well as of the strong scepticism that still accompanies the project, one could wonder whether we are moving in the right direction and even whether it is worthwhile to try and set a global capital standard.

The challenges to find an agreeable design and calibration of the standard are apparent, and understandably related to the different national supervisory approaches, legal backgrounds and market features. Scepticism mainly stems from the foreseeable difficulties to reach a sufficiently consistent implementation of the standard across different jurisdictions, also considering its minimum harmonization approach. In this perspective, the risk that the global standard could contribute to hide actual differences would become real. In other words, we could end up considering comparable what is actually different. In this case, the standard could even be an obstacle to effective supervision.

As an insurance supervisor, I think that despite the risks, challenges and scepticism, setting a global capital standard in insurance remains an essential and worthwhile objective.

It is apparent that having a consistent metric to measure risks and capital would finally allow more effective prudential supervision of international groups. Clearly, this would facilitate supervisory cooperation. Macro-prudential considerations would be more effective, as a common metric to measure risks would allow for easier detection and management of systemic risk concentrations. A consistent approach towards capital requirements would also be a precondition to reach a consistent level of protection to policyholders and to ensure a level playing field for insurers.

At the same time, we should obviously be aware that setting the standard would be only the first step in achieving all these objectives. The next key step would require actual consistency in its implementation.

In general, it is safe to predict that consistency of the standard will not be sufficient when first implemented. The discretion left to national jurisdictions in transposing the standard as well as to national supervisors in interpreting many aspects of the standard will remain significant. In this regard, Europeans can easily draw the lessons from the first implementation of Solvency II, which - despite its maximum harmonization approach - still presents areas lacking genuine consistency.

In particular, the criteria to assess the comparability of the US Aggregation Method with the ICS will be outcome-based and, above all, mainly focussed on the comparability of the situations that trigger supervisory interventions. Even assuming that this type of comparability is achieved, it will not be sufficient to ensure a true level playing field between insurers in different conditions. Just to give an example: two companies might show the same ratio between capital requirements and available capital, but with a different amount in the numerator and in the denominator. This could trigger equivalent supervisory interventions, but would not result in a level playing field.

In this context, I believe that it will be key to be stringent in recognizing relevant misalignments at national level, be aware of the consequences of these misalignments and be as transparent as possible in explaining them. At the same time, the IAIS and all parties involved, starting from the first implementation, should continue to follow a path towards progressively enhancing global convergence - which I dare to predict will be long and difficult.

Following this path, it will be crucial for the IAIS to work on its implementation assessment with quality and accuracy. Based on the assessment, the IAIS should then be able to provide application guidance and, if necessary, review the standard to limit excessive misalignments and promote convergence. In the meantime, it will be necessary to rely on sufficiently detailed and comprehensive disclosure of the solvency calculation, in order to avoid the obfuscation of differences and to allow the proper interpretation of solvency indicators by supervisors, insurers, consumers and all other users. The role of national supervisors will be essential in this respect.

All in all, it is true that a genuine global capital standard is still a long way ahead, but we are marching in the right direction and it is worthwhile to keep momentum. Over time, the challenges will be outweighed by the benefits.