

IAIS CONSULTATION ON THE INSURANCE CAPITAL STANDARD

Introduction

On 23 June 2023, the International Association of Insurance Supervisors (“IAIS”) launched its final public consultation on the global Insurance Capital Standard (“ICS”) before its intended adoption in December 2024.

The consultation document (“Consultation”) seeks to solicit feedback from stakeholders on the ICS ahead of its adoption as a group prescribed capital requirement (“PCR”) for Internationally Active Insurance Groups (“IAIGs”). The Consultation also identifies certain changes to the Level 1 and Level 2 documents for ICS version 2.0, which were issued by the IAIS in November 2019 and March 2020 and are currently being assessed through a five-year monitoring period.

Stakeholders are invited to provide feedback on the Consultation by 21 September 2023 which will then be considered when finalising the ICS. The adoption of the ICS is planned for December 2024.

What is the IAIS?

The IAIS is a voluntary membership organisation whose members include insurance-specific authorities, central banks, financial authorities (including the UK’s Prudential Regulation Authority (“PRA”) and the Financial Conduct Authority (“FCA”)), ministries of finance and international organisations from over 200 jurisdictions. The IAIS operates as an international standard-setting body responsible for developing principles, standards and other support material for the supervision of the insurance sector.

The standards adopted by the IAIS are addressed to insurance supervisors across all jurisdictions and in relation to the supervision of all insurance entities. Relevant supervisors (including the PRA and FCA in the UK) will generally implement those standards in their jurisdiction by way of applicable legislation and regulations; they do not apply directly to insurers or insurance groups until implemented in this way, save for limited reporting purposes.

What is the ICS?

The ICS is being developed by the IAIS as a risk-based, consolidated group-wide capital standard for IAIGs and is expected to be adopted as a group prescribed capital requirement at year-end 2024. The ICS will act as a measure of capital adequacy for IAIGs, constituting the minimum standard to be achieved and enhancing global convergence among group capital standards.

It is expected that supervisors represented in the IAIS will implement, or propose to implement, the ICS whilst taking into account specific market circumstances in their relevant jurisdictions.

The ICS forms the quantitative component of the supervisory requirements for IAIGs and will be integrated into the wider Common Framework for the Supervision of IAIGs (“ComFrame”).

IAIGs

IAIGs are insurance groups: (i) for which premiums are written in three or more jurisdictions and gross written premiums outside of the home jurisdiction are at least 10% of the group’s total gross written premiums; and (ii) with total assets of at least USD 50 billion or total gross written premiums of at least USD 10 billion.

The IAIS compiles and publishes a register of IAIGs publicly disclosed by supervisors, which it has indicated that it intends to update at least annually.

Consultation Document

The Consultation sets out the updated candidate ICS which incorporate policy changes made to ICS version 2.0 based on data and feedback collected during the monitoring period.

These include changes to the three components of the ICS (valuation, capital requirements and capital resources), which were informed by inputs from various stakeholder engagement efforts.

Capital resources

The Consultation notes that, based on inputs received over the initial years of the monitoring period, the proposed requirement for prior replacement of capital instruments called within the first five years of issuance conflicted with certain current market and regulatory practices, resulting in the exclusion from ICS capital resources of instruments otherwise considered prudentially sound. Certain amendments have been made to the criteria in the ICS for Tier 1 Limited and Tier 2 Paid-Up instruments (broadly, limiting the requirement for replacement in the context of tax and regulatory calls) in order to remedy those possibly unintended exclusions from ICS capital resources.

In addition, an exemption has been proposed which disapplies the requirement for prior replacement of instruments called within the first five years of issuance in respect of legacy Tier 2 Paid-Up instruments issued prior to the adoption of the ICS, provided that such call is subject to a make-whole.

The ICS criteria for Tier 1 Limited instruments also proposes a requirement for any redemption prior to five years (other than tax and regulatory call options) to be subject to a requirement for the call to be economic. This requirement has been made subject to a transitional arrangement, such that it may be disapplied for instruments issued prior to the adoption of the ICS that fulfil all other Tier 1 Limited criteria (until the instrument is redeemed).

These proposals appear to be aimed at aligning the ICS regime in this area more closely with existing market and regulatory practice (including, for example, under the UK regulatory capital regime for insurers and the EU Solvency II regime) and so in principle represent welcome developments for UK and EU IAIGs expecting to be subject to the ICS. That said, there are still certain features of the ICS regime in this area that are not fully aligned with the equivalent requirements under the UK and EU regimes. By way of specific example, the requirement for calls to be economic is not a feature of the UK or EU regimes.

To the extent that there remains divergence going forward (and following the adoption of the ICS) between the ICS and the capital resources regimes that currently apply to IAIGs, then the potential implications of this will need to be considered carefully as national implementing measures are developed, including in particular in respect of legacy instruments issued under pre-ICS regimes.

Implications for IAIGs

Participating IAIGs currently report to supervisors (the PRA for UK IAIGs) on the candidate ICS, and so will need to consider how the changes to the ICS may affect their applicable reporting and monitoring going forward, and whether or not they should respond to the Consultation.

Until the end of the monitoring period, the ICS is not a PCR and so will not be used as a basis for triggering supervisory action. The IAIS has previously made clear that ICS data should be reported confidentially to supervisors and used to provide feedback to the IAIS (which will inform the ongoing development of the ICS) rather than being disclosed for other purposes. IAIGs are not therefore expected to manage their business with regard to the ICS during the monitoring period.

Once the ICS is finalised and adopted by the IAIS as a PCR for IAIGs following the end of the monitoring period, national regulators will need to take steps to implement its requirements into their national regimes.

The PRA has stated that, in its view, effective international collaboration remains crucial to addressing global risks, and maintaining UK financial stability, the safety and soundness of internationally active firms, and reducing regulatory arbitrage. It has indicated that it intends to continue to participate actively in global standard-setting bodies such as the IAIS, with one of its specific focuses in this area being the development and monitoring of the ICS. From an EU perspective, EIOPA has stated that it is strongly committed to the ICS, which it views as a project that is of great importance for the global insurance supervisory community.

In that context, IAIGs should expect that the PRA in the UK and EIOPA in the EU may take further steps to implement the requirements of the ICS, once finalised, into the applicable regulatory regimes for insurers. It remains to be seen what shape any such regimes will take and (for UK IAIGs) how it will interact with the wider proposed reforms to the UK regulatory regime for insurers (to be known as Solvency UK) that are expected following the UK government's review of the Solvency II regime. Slaughter and May is actively monitoring developments and will continue to raise and discuss these with its IAIG clients.

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