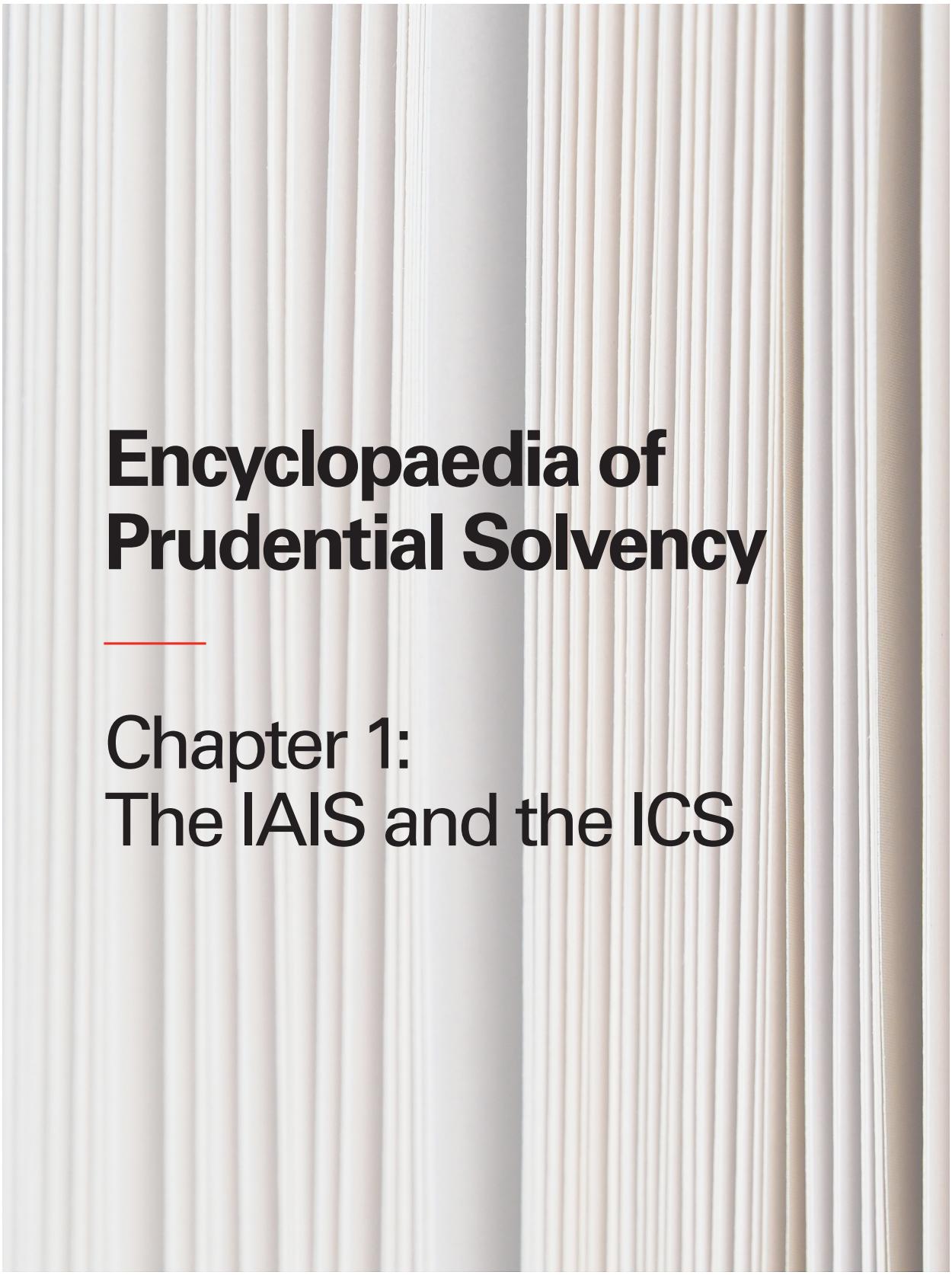
The Standard Formula

Skadden



Encyclopaedia of Prudential Solvency

Chapter 1: The IAIS and the ICS

Introduction

Established in 1994, the International Association of Insurance Supervisors (IAIS) is a voluntary membership organisation comprising insurance regulatory authorities, central banks, ministries of finance, and other insurance-related international organisations from over 200 jurisdictions, which collectively represent 97% of global insurance premiums.

The IAIS is responsible for setting international insurance regulatory standards. To this end, it adopts three tiers of regulatory standards: Insurance Core Principles (ICPs), the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), and policy measures for global systemically important insurers (G-SIIs).

The Insurance Capital Standard (ICS) is the quantitative component of ComFrame. In similar fashion to existing insurance regulatory regimes, the ICS acts as the IAIS' prescribed capital requirement (PCR), a solvency control level below which participating supervisors should intervene in the running of insurers on capital adequacy grounds.

The IAIS' adoption of the ICS in December 2024 marked the culmination of a decade of development, consultation, and monitoring to create a globally comparable capital standard applicable to insurers worldwide. By continuing to bridge insurance regulators' regulatory standards on an international scale, the ICS seeks to deliver on the IAIS' aim of creating a common framework for prudential solvency, and in this manner the ICS' adoption underpins the IAIS' growing significance in global insurance regulation.

This chapter examines the purposes and objectives of the IAIS and its tiers of regulatory standards and the technical details of the ICS. Alongside existing requirements, this chapter also considers the way forward for the implementation of the ICS in regulators' native jurisdictions.

1. Background to the IAIS' Role and the Three Tiers of Regulatory Standards

The IAIS' Role

The IAIS' primary role is to set international insurance regulatory standards. The voluntary nature of IAIS membership and its status as a standard-setting body allows it to act as an open forum for regulators and supervisors to discuss the design and implementation of common regulatory policies. Because the IAIS' standards are not legally binding, regional regulators can adapt its standards according to their markets' and regulatory frameworks' sensitivities.

The IAIS' Three Tiers of Regulatory Standards

The IAIS' standards fall into one of three tiers of regulatory standards, each of which prescribe distinct standards for insurers of different sizes and systemic importance. The IAIS' three tiers of regulatory standards are:

- **ICPs:** ICPs are high-level principles that prescribe essential regulatory components that should be present in member jurisdictions, and are globally accepted standards for insurance supervision. There are currently 25 ICPs, covering supervisory themes from public reporting and corporate governance to macroprudential supervision and supervisory cooperation and coordination. ICPs are comprised of:
  - **Principle Statements**, which are the highest level materials in the ICP hierarchy, and set out the essential elements that must be present in the IAIS' members' supervisory regimes to ensure a financially stable insurance sector.
  - **Standards**, which provide the high-level requirements that are crucial to the implementation of relevant Principle Statements.

- **Guidance Material**, which are the lowest level in the ICP hierarchy, and support Principle Statements and Standards by setting out detail on how to implement relevant Principle Statements or Standards.

- **ComFrame:** Adopted in 2019, ComFrame provides guidance, supervisory standards, and supervisory minimum requirements for the supervision of internationally active insurance groups (IAIGs). ComFrame standards build upon ICPs to set out granular qualitative and quantitative requirements applicable to the supervision of IAIGs. In keeping with its global membership, the IAIS emphasises that the achievement of the outcomes described by ComFrame is more important than applying its standards rigidly, as it is not a one-size-fits-all approach.[1]
- **Policy Measures for G-SIIs**, which were adopted in 2013 following the financial crisis of 2007/08. Policy measures for G-SIIs were preceded by an assessment methodology to identify G-SIIs and subsequently developed into standards applicable to such insurers, including enhanced group-wide supervision, to mitigate the risk of financial contagion in the insurance industry.

2. The ICS

Background to the ICS

At its December 2024 Annual General Meeting, the IAIS adopted the final version of the ICS as the PCR for IAIGs.[2] The ICS had been in development since 2013, when it was first conceived by the IAIS as a "risk-based global capital standard"[3] for IAIGs in response to the Financial Stability Board's recommendation that "a comprehensive group-wide supervisory and regulatory framework" should be created for IAIGs.

The later stages of the IAIS' adoption of the ICS in its final form were marked by its adoption of ICS 1.0 in 2017 and ICS 2.0 in 2019. ICS 1.0 was used to conduct Extended Field Testing with a volunteer group of insurance companies, and ICS 2.0 was used for confidential reporting by IAIGs to their relevant group-wide supervisors (GWSs) during a four-year monitoring period between 2020 and 2024.

The IAIS describes the PCR, in ICP 17.4, as a solvency control level at which "assets will exceed technical provisions and other liabilities with a specified degree of safety over a defined time horizon" and above which the relevant supervisor will not intervene on "capital adequacy grounds."[4] Although existing prudential solvency frameworks already set out detailed capital adequacy requirements for insurance groups, the ICS is intended to act as a minimum group-wide standard of capital adequacy for regulators and supervisors to apply to IAIGs in their home jurisdictions, and is therefore intended to bolster only those regulatory regimes falling below its standard.

The Minimum Capital Requirement is also defined in ICP 17.4 as a solvency control at which, if breached, the supervisor would invoke its strongest actions, in the absence of appropriate corrective action by the regulated insurer.

The ICS has three primary components, each of which will be examined below:

a. **Valuation:** The ICS provides a bespoke method to value insurance assets and liabilities. The ICS balance sheet is based on an IAIG's audited consolidated Generally Accepted Accounting Principles (GAAP) accounts, to which adjustments are made.

[1] Paragraph 23, ICPs and ComFrame for the Supervision of IAIGs.

[2] IAIS Press Release dated 5 December 2024, IAIS adopts Insurance Capital Standard and other enhancements to its global standards to promote a resilient insurance sector.

[3] Section 2, IAIS, Explanatory note on the Insurance Capital Standard (ICS) and Comparability Assessment.

[4] IAIS, ICP 17.4.

b. **Capital Resources:** The ICS segregates qualifying capital resources into two "tiers" based on several criteria, including their capacity and availability to absorb losses.

c. **Capital Requirements:** The ICS provides that IAIGs' capital requirements are calculated by aggregating risk charges across the major risk categories, which are calibrated to a target criteria of 99.5% value at risk over a one year time horizon. Capital requirements can be calculated either via the standard method or methods other than the standard method (Other Methods), which includes internal models.

Application of the ICS — IAIGs

IAIGs are typically identified by their relevant GWSs in collaboration with other involved supervisors, taking into account the following criteria:

- Whether the group is **"internationally active"**, which requires that the group:
  - Write premiums in three or more jurisdictions.
  - Has gross written premiums outside its home jurisdiction comprising at least 10% of its total gross written premiums.
- Whether the group is **sufficiently large** — in particular, whether (based on a three-year rolling average):
  - The group's total assets are at least $50 billion.
  - The group's total gross written premiums are at least $10 billion.

Where a GWS determines that an insurance group meets the above criteria, the group will be classified as an IAIG and will fall under the remit of the ICS. The GWS has discretion, in limited circumstance provided for in ComFrame, to determine that a group is not an IAIG even if it meets the criteria, or that group is an IAIG, even if it does not meet the criteria.

Perimeter of the ICS

The starting point of the ICS is the audited, consolidated, general-purpose GAAP or Statutory Accounts balance sheet of the insurance holding company of an insurance group or financial holding company of a financial conglomerate to which the ICS applies.[5] The balance sheet is split into two segments:

- **Insurance entities:** The first segment of the balance sheet comprises insurers (*i.e.*, insurance groups and regulated insurer entities) and insurance-related entities (which are legal entities that mainly exist to support the operations of an insurer).[6]
- **Non-insurance entities:** The second segment of the balance sheet captures items held by non-insurance entities,[7] which are entities that do not meet the definitions of insurers and insurance-related entities. Entries for non-insurance entities are reported separately from those of insurance entities.[8] Non-insurance entities (including both financial and non-financial) are incorporated into the ICS, but this will depend on the entity type and whether it has a sectoral capital requirement.[9]

(a) Valuation

The ICS provides that supervisory authorities should adopt a regulatory standard at least as stringent as Market-Adjusted Valuation (MAV) when setting out how IAIGs should value their assets and liabilities. MAV adjustments are applied to items included in insurers' and insurance-related entities' consolidated

[5] Paragraph L1-8, ICS Level 1 and Level 2 Texts (December 2024).
[6] Paragraph L2-10, ICS Level 1 and Level 2 Texts (December 2024).
[7] Paragraph L1-10, ICS Level 1 and Level 2 Texts (December 2024).
[8] Paragraph L1-11, ICS Level 1 and Level 2 Texts (December 2024).
[9] Paragraph L1-12, ICS Level 1 and Level 2 Texts (December 2024).

balance sheets, and makes adjustments for insurance liabilities and reinsurance balances, financial investments (*i.e.*, assets) and instruments (*i.e.*, liabilities), and deferred taxes[10] to minimise artificial volatility in the IAIG's solvency position that could be caused from financial market movements. The aim is to minimise such volatility while meeting the objective of the ICS of establishing a comparable risk based measure of the capital adequacy of IAIGs.

Generally, under the MAV approach, insurance liabilities, which are typically the largest item on an insurer's balance sheet, are calculated as:

> *the* ***current estimate*** *plus the* ***margin over current estimate (MOCE)****.*[11]

However, where the future cash flows associated with insurance obligations can be replicated reliably using financial instruments bearing an observable market value, then the value of the (re)insurance liabilities associated with such future cash flows can be determined via the market value of those financial instruments (rather than the calculation above).[12] Future cash flows are considered to be replicated reliably when the insurance obligation's cash flows are in every circumstance matched by the cash flows of corresponding assets.[13] Future cash flows are considered not to be replicated reliably when policyholders can exercise contractual options, the obligations depend on mortality, disability, sickness and morbidity rates, and/or the expenses associated with insurance obligations cannot be reliably replicated.[14]

Asides from the treatment of matched insurance liabilities, additional examples of MAV adjustments to items on an insurer's balance sheet and their treatments include:

- **Properties for own use and mortgages and loans**, which are adjusted to fair values. This is in accordance with fair value guidance under the IAIG's GAAP or the GAAP in the IAIG's jurisdiction.
- **Reinsurance recoverables**, which are restated consistent with how insurance liabilities are determined. Such recoverables on paid and unpaid balances are to be reported net of allowances for estimated uncollectable amounts.[15]
- **Deferred tax assets and liabilities**, which are determined for each balance sheet line item that has been adjusted to arrive at the balance sheet calculated per ICS standards. Deferred tax is calculated by multiplying the difference between the consolidated GAAP and ICS balances caused by tax adjustments by the group effective tax rate.[16] No adjustment for tax is made where a change in a line item does not result in a temporary tax difference (*e.g.*, equity line items).[17]
- **Premium receivables** falling due after the reporting date (and related contracts), which are reflected as negative cash flows in the valuation of insurance liabilities. Premium receivables falling due before the reporting date are reflected as assets.[18]
- **Loans to policyholders**, which are reported separately and are not offset against insurance liabilities.[19]
- **Other financial assets** are reported on the GAAP balance sheet at amortised cost and are restated to a fair value.[20]

[10] Paragraph L1-15, ICS Level 1 and Level 2 Texts (December 2024).
[11] Paragraph L1-16, ICS Level 1 and Level 2 Texts (December 2024).
[12] Paragraph L1-46, ICS Level 1 and Level 2 Texts (December 2024).
[13] Paragraph L2-108, ICS Level 1 and Level 2 Texts (December 2024).
[14] Paragraph L2-109, ICS Level 1 and Level 2 Texts (December 2024).
[15] Paragraph L2-16, ICS Level 1 and Level 2 Texts (December 2024).
[16] Paragraph L2-342, ICS Level 1 and Level 2 Texts (December 2024).
[17] Paragraph L2-341, ICS Level 1 and Level 2 Texts (December 2024).
[18] Paragraph L2-16, ICS Level 1 and Level 2 Texts (December 2024).
[19] Paragraph L2-16, ICS Level 1 and Level 2 Texts (December 2024).
[20] Paragraph L2-16, ICS Level 1 and Level 2 Texts (December 2024).

- **Financial liabilities**, which are valued based on a IAIG's reported GAAP without further adjustment to account for changes to such IAIG's own credit standing.[21]
- **Deferred acquisition costs and other deferred expenses**, which are adjusted to zero.[22]

The Current Estimate

The first half of the MAV equation for insurance liabilities, the current estimate, is calculated as the probability-weighted average of the present values of the future cash flows associated with insurance liabilities, discounted using an IAIS-prescribed yield curve for the relevant currency (of which there are 35) and bucket of liability.[23]

Cash Flows

The probability-weighted average of future cash flows is determined taking into account uncertainty relating to: (i) the timing, frequency, and severity of claim events; (ii) claims amounts and claims inflation; (iii) the time needed to settle claims; (iv) the amount of expenses; and (v) policyholder behaviour.[24]

Policyholder behaviour encompasses when expected cashflows reflect the contractual right of policyholders to change the amount, timing, or nature of their benefits. The likelihood that policyholders will exercise these contractual options is taken into account (considering past and expected behaviour of policyholders, whether the exercise of options would be beneficial to policyholders, and economic conditions).[25]

Yield Curves

The IAIS-prescribed yield curve used to calculate a current estimate for insurance liabilities is based on an adjusted risk-free yield curve,[26] which is provided for each major currency. There has been considerable discussion regarding the design of the IAIS yield curve as discounting is a driver of ICS results: a small change in discounting can result in significant changes to an IAIG's ICS calculation. The construction of the ICS yield curve starts with a risk-free yield curve that comprises three main segments:

- **Segment 1** is the liquid segment of the yield curve. It is based on observed market prices for government bonds or swaps in deep, liquid, and transparent financial markets.[27]
- **Segment 2** of the yield curve is based on extrapolation between the first and third segments. It starts from the Last Observed Term (LOT) for each currency, where market prices are deemed deep and liquid.
- **Segment 3** is the long-term forward rate of the yield curve. It is based on a stable long-term forward rate — which is, for each currency, the sum of an inflation target and an expected real interest rate,[28] the jurisdictions for which are allocated according to areas that share common macroeconomic characteristics[29] — plus a spread is added to represent the expected spread that might be earned from long-term reinvesting.[30] Segment 3 starts at the later of 30 years after the LOT or 60 years.[31] A spread adjustment of 2-35 basis points is added depending on the currency.[32]

[21] Paragraph L2-16, ICS Level 1 and Level 2 Texts (December 2024).
[22] Paragraph L2-16, ICS Level 1 and Level 2 Texts (December 2024).
[23] Paragraph L1-18, ICS Level 1 and Level 2 Texts (December 2024).
[24] Paragraph L1-17, ICS Level 1 and Level 2 Texts (December 2024).
[25] Paragraph L2-26, ICS Level 1 and Level 2 Texts (December 2024).
[26] Paragraph L1-31, ICS Level 1 and Level 2 Texts (December 2024).
[27] Paragraph L2-43, ICS Level 1 and Level 2 Texts (December 2024).
[28] Paragraph L1-35, ICS Level 1 and Level 2 Texts (December 2024).
[29] Paragraph L1-36, ICS Level 1 and Level 2 Texts (December 2024).
[30] Paragraph L1-33, ICS Level 1 and Level 2 Texts (December 2024).
[31] Paragraph L2-55, ICS Level 1 and Level 2 Texts (December 2024).
[32] Paragraph L2-55, ICS Level 1 and Level 2 Texts (December 2024).

The Three Buckets

Upon determining the initial risk-free yield curve, an adjustment is then applied based on the "Three-Bucket Approach" to mitigate unwanted volatility that could arise in the IAIG's ICS results due to extreme credit spread movements and to strike an appropriate balance between risk sensitivity and stability. Depending on the nature of liabilities and the assets backing them, the Three-Bucket Approach classifies liabilities into one of:

- **Top Bucket:** The adjustment for the Top Bucket is based on the average spread above the risk-free yield curve of the eligible assets backing the portfolio of liabilities meeting the Top Bucket criteria. If so, 100% of the spread adjustment is added to the risk-free rate to discount insurance liabilities.[33] In order to qualify for Top Bucket, insurance liabilities must meet all of the following criteria, without unbundling the liabilities:[34]
  - The liabilities are life insurance and disability annuities payments with no cash benefits on withdrawal, and no or limited surrender options (see next bullet).
  - The portfolio of insurance liabilities includes either no surrender option for the policyholder or only a surrender option where the surrender value does not exceed the value of the assets identified for this portfolio at the reporting date and at all future points in time.
  - The portfolio of assets used to manage the liabilities is identified and managed separately and is not used to make payments to any other business of the IAIG.[35]
  - The expected cash flows of the identified portfolio of assets replicate the expected cash flows of the portfolio of insurance liabilities in the same currency, up to the LOT of the risk-free yield curve for the relevant currency, where a mismatch does not give rise to material risks.[36]
  - The contracts underlying the liabilities do not include future premiums.
- **Middle Bucket:** Insurance liabilities in this Bucket benefit from a group-wide spread adjustment on the eligible assets backing them. The spread adjustment can be portfolio specific within a single currency, but in any case such adjustments are less than those applied to Top Bucket.[37] Middle Bucket includes insurance liabilities that meet the following criteria, among others, without unbundling the liabilities (except where specified below):[38]
  - The portfolio of assets used to manage the liabilities is identified and managed separately and is not used to cover losses from any other business of the IAIG.
  - The portfolio of liabilities includes either no surrender option or a surrender option only where the surrender value is less than or equal to the value of assets identified for the portfolio.
  - The combined market value of assets for the portfolio is greater than the current estimate of liabilities calculated using a General Bucket yield curve.[39]
  - The contracts underlying the liabilities do not include future premiums or include only future premiums that are contractually fixed or are at the discretion of the IAIG.[40]

[33] Paragraph L2-80, ICS Level 1 and Level 2 Texts (December 2024).

[34] Paragraph L2-67, ICS Level 1 and Level 2 Texts (December 2024).

[35] Paragraph L2-66, ICS Level 1 and Level 2 Texts (December 2024).

[36] Paragraph L2-66, ICS Level 1 and Level 2 Texts (December 2024).

[37] Paragraph L2-84, ICS Level 1 and Level 2 Texts (December 2024).

[38] Paragraph L2-69, ICS Level 1 and Level 2 Texts (December 2024).

[39] Paragraph L2-68, ICS Level 1 and Level 2 Texts (December 2024).

[40] Policyholder options to pay additional future premiums do not disqualify these liabilities from the Middle Bucket, but all corresponding cash flows that are not at the discretion of the IAIG are unbundled and are subject to the General Bucket. The additional premiums outside the contract boundaries and the use of discretionary benefits to purchase additional insurance are not considered future premiums Paragraph L2-68(e) ICS Level 1 and Level 2 Texts (December 2024).

- **General Bucket:** Liabilities falling within this Bucket include those which do not fall into the Top Bucket nor the Middle Bucket, except for liabilities whose cash flows can be reliably replicated, as their value is calculated according to their market value.[41]

MOCE

The second half of the MAV equation for insurance liabilities, MOCE, is a margin added to the current estimate of insurance obligations to account for the inherent uncertainty involved with calculating cash flows associated with insurance liabilities.[42] It does this by considering all the uncertainties attached to these obligations. MOCE is calculated as a percentile of probability distribution of losses in capital resources. The 85th percentile is used to compute the life component of the MOCE, and the 65th percentile is used for the non-life component.[43]

(b) Capital Resources

Capital resources that can be used by IAIGs to meet regulatory capital requirements are determined on a consolidated basis and include qualifying financial instruments and qualifying capital elements other than financial instruments.[44]

The ICS sets out two tiers of capital resources that can be used to IAIGs to meet regulatory capital requirements, and the five most significant characteristics to understanding how capital resources are tiered are their (i) loss-absorbing capacity, (ii) level of subordination, (iii) availability to absorb losses, (iv) permanence, and (v) absence of both encumbrances and mandatory servicing costs.[45]

The two tiers of capital resources are segregated according to such characteristics, among others, as follows:

- **Tier 1 capital resources** are capital resources of the highest quality, which absorb losses on a going-concern basis and on a winding-up.[46] Tier 1 capital resources are in turn split into:
  - *Tier 1 unlimited financial instruments* (Tier 1 Unlimited) are financial instruments or capital elements (other than financial instruments) for which there are no limits, that meet the following criteria, among others:
    - Fully paid-up.
    - In the form of issued capital, such that it is the first instrument to absorb losses as they occur.
    - The most subordinated claim in the event of the IAIG's winding-up, entitling the holder to a proportional share of the residual assets based on their ownership of the issued share capital.
    - Perpetual (*i.e.*, without a maturity date).
    - Free from any obligation to distribute, meaning non-payment of a distribution must not constitute an event of default.
    - Not undermined nor made ineffective by encumbrances.[47]
  - *Tier 1 limited financial instruments* are instruments for which there is a limit, and are those which meet all the criteria above for Tier 1 Unlimited except that they, among others, are:

[41] Paragraph L2-71, ICS Level 1 and Level 2 Texts (December 2024).
[42] Paragraph L1-42, ICS Level 1 and Level 2 Texts (December 2024).
[43] Paragraph L2-107, ICS Level 1 and Level 2 Texts (December 2024).
[44] Paragraph L1-48, ICS Level 1 and Level 2 Texts (December 2024).
[45] Paragraph L1-52, ICS Level 1 and Level 2 Texts (December 2024).
[46] Paragraph L1-50, ICS Level 1 and Level 2 Texts (December 2024).
[47] Paragraph L2-111, ICS Level 1 and Level 2 Texts (December 2024).

- Subordinated to policyholders and other non-subordinated creditors and holders of Tier 2 instruments (but they may rank senior to holders of Tier 1 unlimited financial instruments).
- Only callable at the option of the insurer after a minimum of five years from the date of issue, and supervisory approval has been obtained prior to the exercise of the call.
- Subject to an IAIG's full discretion to forego and cancel distributions, and such distributions are paid out of distributable items.[48]

- **Tier 2 capital resources** are capital resources of a lower quality than Tier 1 capital resources, that absorb losses only on a winding-up.[49] Tier 2 capital resources are in turn split into:
  - *Tier 2 Paid-Up instruments* (Tier 2 Paid-Up), which are financial instruments that do not constitute Tier 1 Unlimited, nor Tier 1 Limited resources, and are split into:
    - *Tier 2 non-structurally subordinated financial instruments*, which are, among other characteristics:
      - Fully paid-up.
      - Subordinated to non-subordinated creditors of the IAIG, including policyholders.
      - Has an initial maturity of five years and an effective maturity date on the earlier of the first call date or the terms and conditions of the instrument.
      - Subject to repurchase by the issuer at any time with prior supervisory approval.
    - *Tier 2 structurally subordinated instruments*, which are structurally subordinated financial instruments or other capital elements. In this context, "structural subordination" refers to debt issued by the IAIG's holding company which issues a financial instrument to external investors and downstreams the proceeds into its insurance subsidiaries.[50]

      Tier 2 structurally subordinated instruments meet the same requirements as their non-structurally subordinated counterparts, but are subject to the following "clarifications" of criteria and new criteria, among others:

      Clarifications of criteria

      - Prior supervisory approval of repurchases can be achieved via supervisory approval of dividends before they are paid by an IAIG's subsidiary to its holding company.

      New criteria

      - The insurance subsidiary to which proceeds are downstreamed is situated in a jurisdiction that proactively enforces structural subordination.[51]
  - *Tier 2 Non-Paid-Up instruments* (Tier 2 Non-Paid Up), which are commitments received by entities of an IAIG from third parties (not related to the IAIG) to provide capital upon request. Tier 2 Non-Paid Up must be, among other characteristics:
    - Callable on demand by the IAIG, must not be subject to any conditions that disincentive such a call, and must be approved by the IAIG's supervisor as meeting such requirements.
    - If called, in compliance with the requirements for Tier 1 or Tier 2 Paid-Up.
    - Legally enforceable in the relevant jurisdiction.[52]

[48] Paragraph L2-112, ICS Level 1 and Level 2 Texts (December 2024).
[49] Paragraph L1-50, ICS Level 1 and Level 2 Texts (December 2024).
[50] Paragraph L2-116, ICS Level 1 and Level 2 Texts (December 2024).
[51] Paragraph L2-117, ICS Level 1 and Level 2 Texts (December 2024).
[52] Paragraph L2-121, ICS Level 1 and Level 2 Texts (December 2024).

Tier 1 Limited and Tier 2 resources are subject to capital composition limits expressed as a percentage of an IAIG's ICS capital requirement (Tier 1 Unlimited are not subject to any such limits and can cover any percentage of an IAIG's capital requirement).[53] The limits prescribe what percentage of an IAIG's capital requirement can be met with capital resources of the corresponding category, as follows:

- For **non-mutual IAIGs**, the limits are:
  - Tier 1 Limited: 10% of the ICS capital requirement. This limit is increased to 15% provided that the instruments in excess of the 10% possess a Principle Loss Absorbency Mechanism.
  - Tier 2: 50% of the ICS capital requirement.
  - Tier 2 Non-Paid Up: No allowance (*i.e.*, 0%).[54]
- For **mutual IAIGs,** the limits are:
  - Tier 1 Limited: 30% of the ICS capital requirement.
  - Tier 1 Limited plus Tier 2: 60% of the ICS capital requirement.
  - Tier 2 Non-Paid-Up: 10% of the ICS capital requirement.[55]

(c) Capital Requirements

The capital requirements component of the ICS prescribes the amount of capital resources an IAIG must hold to absorb potential losses and ensure policyholder protection, in assessing risks, using both a stress approach and a factor-based approach.

The Standard Method

The standard method for calculating capital requirements entails combining sub-categories of risk under broad categories of major risks, including (i) insurance risk, (ii) market risk, (iii) credit risk, and (iv) operational risk. Risks are measured using either a stress approach or a factor-based approach. For natural catastrophe risk, a vendor or proprietary model may be used.[56] The ICS target criteria is a 99.5% Value at Risk, over a one-year time horizon, of adverse changes in the IAIG's qualifying capital resources.[57] The individual risk charges are combined in a way that recognises risk diversification, using correlation matrices[58].

Under the stress approach, the risk charge for each of an IAIG's individual risks is calculated as the difference between the decrease between the amount of capital resources on the IAIG's balance sheet pre-stress and post-stress, assuming the stress happens instantaneously.[59] The observed change in net asset value pre- and post-stress is used as a proxy for the corresponding change in qualifying capital resources.[60] Stresses are applied to an IAIG's balance sheets individually, such that an IAIG's individual stressed balance sheets are used to calculate the risk charge with respect to each individual stress.[61]

[53] Paragraph L1-70, ICS Level 1 and Level 2 Texts (December 2024).
[54] Paragraph L2-129, ICS Level 1 and Level 2 Texts (December 2024).
[55] Paragraph L2-127, ICS Level 1 and Level 2 Texts (December 2024).
[56] Paragraph L1-75, ICS Level 1 and Level 2 Texts (December 2024).
[57] Paragraph L1-80, ICS Level 1 and Level 2 Texts (December 2024).
[58] Paragraph L1-79, ICS Level 1 and Level 2 Texts (December 2024).
[59] Paragraph L1-76, ICS Level 1 and Level 2 Texts (December 2024).
[60] Paragraph L1-76, ICS Level 1 and Level 2 Texts (December 2024).
[61] Paragraph L1-76, ICS Level 1 and Level 2 Texts (December 2024).

The factor-based approach works by applying IAIS-prescribed risk factors to specified risk exposures.[62] Each sub-category of risk in a risk category, except for those calculated using the stress approach, is assigned a factor that reflects the capital requirement for IAIGs when faced with higher or lower stress levels. In keeping with the IAIS's intention for the ICS to be a globally comparable capital standard, risk charges are calculated with geographic and demographic divergences in mind, as detailed below.

An IAIG can potentially decrease the amount of their risk charges by undertaking effective risk mitigation. In particular, risk mitigation techniques — including recognised risk mitigation techniques, such as reinsurance, hedging of currency risk or dynamic hedging programs — may be reflected within risk charges provided that they meet all of the following requirements, among others:

- The technique results in an effective transfer of risk to a third party and is legally enforceable in all relevant jurisdictions.
- The relevant contractual arrangements clearly define the risk transfer and provide for a direct claim on the counterparty if it defaults or becomes insolvent.
- The calculation is made on the basis of assets and liabilities existing at the reporting date of the ICS calculation, and there is no double counting of mitigation effects.
- The provider(s) of risk mitigation are of an adequate credit quality (*i.e.*, are sufficiently capitalised or collateralised, or have an adequate rating) to ensure the IAIG that it will receive protection.[63]

(i) Insurance Risks

Insurance risks are calculated by aggregating risk charges for each of the sub-categories of life and non-life insurance risks. Risk diversification is taken into account when combining distinct risk charges via correlation matrices. The components of insurance risk under the ICS include:

- **Life risks**, which account for:
  - *Mortality risk*, which is unexpected changes in the level, trend or volatility of mortality rates. The mortality risk charge applies only to polices that are negatively affected by a rise in mortality rates,[64] and which is calculated as the change in net asset value after applying the prescribed stress factor to the level of mortality rates.[65] Stress factors for mortality risk vary via assigned geographical regions: for instance, EEA and Switzerland and the US and Canada are assigned stress factors of 12.5%, while Japan's stress factor is 10%.[66]
  - *Longevity risk*, which is also described as unexpected changes in the level, trend or volatility of mortality rate and whose risk charge is calculated in the same manner as mortality risk. All assigned geographical regions have a longevity risk stress factor of 17.5%.[67]
  - *Morbidity and disability risk*, is unexpected changes in the level, trend or volatility of disability, sickness and morbidity rates. The risk charge is calculated as the change in net asset value after applying the prescribed stress factors to the following four sub-risk segments: medical expenses; lump sum in case of a health event; short-term recurring payments; and long-term recurring payments.
  - *Lapse risk*, is described as unexpected changes in the level or volatility of rates of policy lapses, terminations, renewals and surrenders. The calculation of the lapse risk charge is split into the level and trend component and the mass lapse component. It is calculated as the maximum of the lapse risk

[62] Paragraph L1-77, ICS Level 1 and Level 2 Texts (December 2024).
[63] Paragraph L2-130, ICS Level 1 and Level 2 Texts (December 2024).
[64] Paragraph L1-91, ICS Level 1 and Level 2 Texts (December 2024).
[65] Paragraph L1-90, ICS Level 1 and Level 2 Texts (December 2024).
[66] Paragraph L2-145, ICS Level 1 and Level 2 Texts (December 2024).
[67] Paragraph L2-147, ICS Level 1 and Level 2 Texts (December 2024).

charge for level and trend component and the lapse risk charge for the mass lapse component. For the level and trend component, a stress factor of 40% is applied to all assigned geographical regions except Japan, where a 20% stress factor is applied.[68]

- *Expense risk*, which is described as unexpected changes in liability cash flows due to the incidence of expenses incurred. The expense risk charge is comprised of unit expense and expense inflation, is calculated as the change in net asset value after applying the prescribed stress factors to each of unit expense and expense inflation assumptions simultaneously.[69]

- **Non-life risks**, which are calculated on a factor basis (except for catastrophe). Non-life risks account for the types of risks below, for which distinct risk factors are applied depending on the relevant ICS segment (*i.e.*, line of business) and the jurisdiction in which that segment is situated:[70]
  - *Premium risk*, which is described as unexpected changes in the timing, frequency and severity of future insured events (to the extent not already captured in Morbidity/Disability risk). Premium risk charges for each ICS segment are calculated as the relevant risk factor multiplied by either net premium earned or net premium to be earned, whichever is largest.[71]
  - *Claims reserve risk* is the unexpected changes in the expected future payments for claims or events that have already occurred (whether reported to the IAIG or not) and not yet fully settled (to the extent not already captured in Morbidity/Disability risk). Claims reserve risk charges for each ICS segment are calculated as the relevant risk factor multiplied by the net current estimate.[72]
  - *Catastrophe risk*, which is described as unexpected changes in the occurrence of low frequency and high severity events. The Catastrophe risk charge covers risks associated with low frequency, high severity events occurring at any point in time in the next 12 months and takes into account all expected in-force business when the event occurs. It is calculated using a stress approach, except for natural catastrophe, which may use a model.

(ii) Market Risks

The market risk charge is calculated by aggregating risk charges for each sub-category of market risk, using a market risks correlation matrix to account for diversification effects. Market risks account for:

- **Interest rate risk**: unexpected changes in the level or volatility of interest rates.
- **Equity risk**: unexpected changes in the level or volatility of market prices of equities.
- **Real estate risk**: unexpected changes in the level or volatility of market prices of real estate or from the amount and timing of cash flows from investments in real estate.
- **Currency risk**: unexpected changes in the level or volatility of currency exchange rates.
- **Non-default spread risk**: unexpected changes in the level or volatility of spreads over the risk-free interest rate term structure, excluding the default component.
- **Asset concentration risk**: the lack of diversification in the asset portfolio.

All of the above risks are calculated using a stress based approach, except for asset concentration risk, which is calculated using a factor-based approach.

[68] Paragraph L2-159, ICS Level 1 and Level 2 Texts (December 2024).
[69] Paragraph L1-99, ICS Level 1 and Level 2 Texts (December 2024).
[70] Paragraph L2-180, ICS Level 1 and Level 2 Texts (December 2024).
[71] Paragraph L2-179, ICS Level 1 and Level 2 Texts (December 2024).
[72] Paragraph L2-180, ICS Level 1 and Level 2 Texts (December 2024).

(iii) Credit Risks

Credit risk is described as unexpected changes in actual defaults, as well as in the deterioration of an obligor's creditworthiness short of default, including migration risk and spread risk due to defaults. The credit risk charge is calculated by aggregating risk charges for each sub-category of credit risk, which are in turn calculated by applying prescribed stress factors to their specified net exposure amounts.[73] Prescribed stress factors vary principally according to exposure class, rating category, and maturity.[74] Management actions are taken into consideration in calculating this charge.[75]

The primary exposure classes include exposure to corporates (*i.e.*, debt exposure to banks and securities dealers but excluding reinsurers), infrastructure (*i.e.*, debt exposure to infrastructure projects and certain corporates in the industry), securitisation (*i.e.*, holdings of all mortgage-backed securities and any other asset-backed securities), and reinsurance (*i.e.*, all positive on balance sheet reinsurance assets and receivables).[76]

(iv) Operational Risk

Operational risk is described as operational events including inadequate or failed internal processes, people and systems, or from external events. Operational risk includes legal risk, but excludes strategic and reputational risk. The operational risk charge is calculated on a factor basis applied to items split into assigned geographical areas and along non-life and life (which is split between risk and non-risk) products. Operational risk exposures to which stress factors are applied include an IAIG's gross written premium and gross current estimate.[77]

The Other Methods

Capital requirements under the ICS may also be calculated via Other Methods, which, similar to existing insurance regulatory regimes such as Solvency II, permit IAIGs to use (i) supervisor-owned and -controlled credit assessment processes (SOCCA) and (ii) internal models to quantify their capital requirements.[78] Importantly, Other Methods can only be used to calculate an IAIG's capital requirements and the application of Other Methods is subject to the categories and sub-categories of risk specified above and the requirements associated therewith. Other Methods provide the same level of protection as the standard method, with target criteria of 99.5% VaR over a one-year time horizon.[79]

(i) SOCCA

A SOCCA process is defined by the IAIS as "an independent and objective process for assessing Credit risk, owned and controlled by a financial supervisory authority, that relies upon credit assessment methodologies deemed suitable by the supervisory authority in determining the regulatory capital requirement for Credit risk of supervised entities."[80]

A SOCCA process may only be used to calculate the Credit risk charge, and only if all of the following criteria, among others, are met:

- **Objectivity:** The SOCCA's methodology for credit assessments is rigorous, systematic and subject to validation.

[73] Paragraph L1-130, ICS Level 1 and Level 2 Texts (December 2024).
[74] Paragraph L1-131, ICS Level 1 and Level 2 Texts (December 2024).
[75] Paragraph L1-130, ICS Level 1 and Level 2 Texts (December 2024).
[76] Paragraphs L2-247 to L2-249 and L2-259, ICS Level 1 and Level 2 Texts (December 2024).
[77] Paragraph L2-331, ICS Level 1 and Level 2 Texts (December 2024).
[78] Paragraph L1-150, ICS Level 1 and Level 2 Texts (December 2024).
[79] Paragraph L1-150, ICS Level 1 and Level 2 Texts (December 2024).
[80] Paragraph L1-152, ICS Level 1 and Level 2 Texts (December 2024).

- **Independence:** The regulatory objectives of the relevant supervisor align with the SOCCA process and such is evidenced by the supervisor's approval of the credit assessment process.
- **Resources:** There are sufficient resources supporting the application of the SOCCA process to credit assessments.[81]

(ii) Internal Models

IAIGs may use internal models to quantify their capital requirements subject to strict and detailed criteria set out in the final ICS, which provides requirements on the following, among other things:

- **Internal Model Approval Process (IMAP):** Internal models must be subject to GWS approval, to be granted via an IMAP. An IMAP must have a framework for approval, including pre-application and application processes, expectations for the provision of quantitative and qualitative information by the IAIG, and an internal model review process involving off-site monitoring (which may involve on-site inspections)[82] and consideration regarding informing and information gathering via supervisory colleges.[83]
- **Post-approval monitoring and control process:** Where approval is granted, IAIGs may be subject to reporting requirements, including submitting standard periodic internal model outputs, and new or updated validation reports.[84] The GWS should, in any case, review the model regularly following approval to ensure it does not deviate from the assumptions and structures used in its approved versions.[85]
- **Model change policy:** The IAIG should have an internal policy detailing governance requirements to be adhered to when changing the internal model, which should at least set out the definition of major and minor changes, how each are assessed, and the relevant governance process for undertaking such changes.[86] Major changes to the internal model should be subject to prior supervisory approval.[87]

3. Implementation of the ICS

On 27 January 2025, the IAIS published the Roadmap 2025 — 2026 (Roadmap), its annual workplan, as part of its Strategic Plan 2025 — 2029. Importantly, the Roadmap highlighted that the "focus of the IAIS will now shift, placing a greater emphasis on supporting comprehensive and globally consistent implementation of the IAIS' supervisory material."[88] Accordingly, while the IAIS's principal focus to date has been standard-setting, the implementation of the ICS will now be top of mind.

Core objective four of the Roadmap is the assessment of comprehensive and globally consistent implementation of global standards. As part of this objective, the IAIS aims to begin developing an ICS implementation methodology throughout the course of 2025, on the basis of the IAIS' general principles and existing methodologies for assessing standards. Furthermore, in 2026, the IAIS will coordinate a baseline self-assessment of its members' progress in implementing the ICS, and aims to begin carrying out detailed jurisdictional assessments of ICS implementation in 2027.

An initial assessment of ICS implementation has already been concluded and may serve as an indication of future assessments. Before its adoption of the final version of the ICS in December 2024, the IAIS released the Report on the Aggregation Method Comparability Assessment, which set out its assessment of whether the Aggregation Method (AM) devised by the US achieves comparable outcomes to the ICS. Despite the

[81] Paragraph L2-354, ICS Level 1 and Level 2 Texts (December 2024).
[82] Section 7.3.2.1, ICS Level 1 and Level 2 Texts (December 2024).
[83] Paragraph L2-368, ICS Level 1 and Level 2 Texts (December 2024).
[84] Paragraph L2-376, ICS Level 1 and Level 2 Textss (December 2024).
[85] Paragraph L1-157, ICS Level 1 and Level 2 Texts (December 2024).
[86] Paragraphs L1-172 and L1-173, ICS Level 1 and Level 2 Texts (December 2024).
[87] Paragraph L2-425, ICS Level 1 and Level 2 Texts (December 2024).
[88] Introduction, Roadmap 2025 – 2026, IAIS.

marked differences between the AM and the ICS — including the AM's approach of aggregating capital requirement calculations at the subsidiary level and aggregating the results to produce a group-wide capital requirement — the IAIS noted that the comparability assessment "needed to be evaluated with acceptance of these differences in mind."[89] Thus, while regulatory regimes such as Solvency II, which adopt more similar approaches to the ICS, may be favoured, the IAIS has shown a willingness to accept divergent approaches, insofar as such approaches capture "*the same underlying risks as the ICS even if in some cases this is achieved differently, or to a different extent within the quantitative calculation of the group capital requirement. In particular, some risks (such as interest rate risks) are partly captured within the capital requirement and partly in the valuation of insurance liabilities in the US RBC and similar regimes.*"[90]

[89] Section 1, Report on the Aggregation Method Comparability Assessment, IAIS (14 November 2024).
[90] Section 3.3.1, Report on the Aggregation Method Comparability Assessment, IAIS (14 November 2024).

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