ICS – market risk charges – Executive Summary

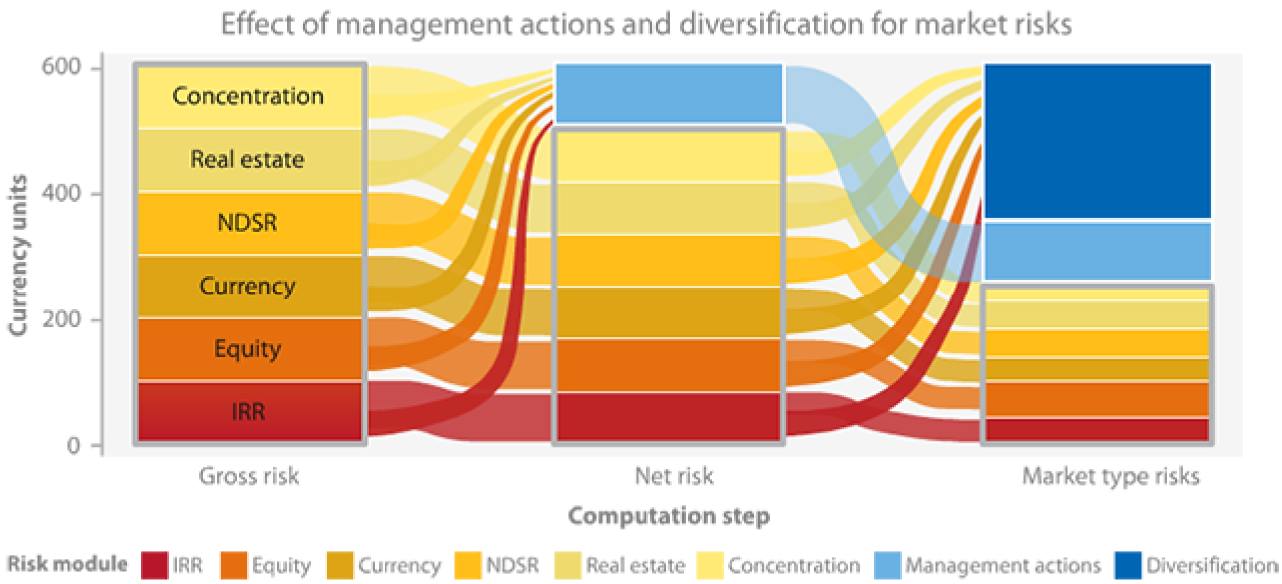
The Insurance Capital Standard (ICS) is a consolidated group-wide capital standard that applies to internationally active insurance groups (IAIGs). During the monitoring period from 2020 to 2024, IAIGs are expected to confidentially report to supervisors their ICS solvency ratios, which are calculated by dividing qualifying capital resources by the standard method ICS capital requirement. Market risk charges are components of the standard method ICS capital requirement.

General methodology and scope

The standard method ICS market risk charges cover six risks: interest rate risk (IRR), equity risk, real estate risk, currency risk, non-default spread risk (NDSR) and asset concentration risk. Except for asset concentration risk, the risk charges are calculated using a stress approach where prescribed stress factors are applied on balance sheet items, and the resulting decrease in capital resources is taken as the risk charge. For asset concentration risk, a factor-based approach is applied by multiplying prescribed factors by specific exposure measures.

The market risk charges are calculated as follows:

- Step 1: Calculate the risk charge for each risk, taking into account direct impacts of the prescribed stress scenarios on the value of assets and liabilities and indirect impacts arising from potential changes in policyholder behaviour. In the chart below, this is the "Gross risk", before allowing for management actions and diversification.
- Step 2: Calculate the risk charge to reflect management actions that meet specified criteria, eg actions that are evidenced by current business practice and strategy. This is shown as "Net risk" in the chart below, after allowing for management actions but before diversification. The difference between steps 1 and 2 is the effect of management actions.
- Step 3: Aggregate the risk charges using a prescribed correlation matrix to derive the total market risk charges, shown as "Market type risks" in the chart below, after allowing for management actions and diversification. The difference between steps 2 and 3 is the effect of diversification.



Components of market risk charges

The table below describes components of the market risk charges:

Risk component	Description
IRR	IRR is calculated for each currency using prescribed formulae that reflect the impact of five stress scenarios on interest rate-sensitive assets and liabilities (except those that qualify as capital resources). The scenarios are mean-reversion, level up, level down, twist up-to-down and twist down-to-up.
Equity risk	Equity risk is calculated as a change in net asset value exposure (both direct and indirect exposures) by applying stress factors to the level and volatility of fair value of equities. For the level of fair value, the stress factor is 35% for listed equities in developed markets and 48% in emerging markets, and ranges from 4% to 35% for hybrid debt and preference shares. The stress factor for other assets is 49%. For implied volatilities, the stress factors extend up to 42 percentage points in implied volatility, depending on the maturity of the instrument. The level risk charges are aggregated using a correlation matrix and summed with the volatility risk charges. There is no credit risk charge.
Real estate risk	Real estate risk is calculated as the change in net asset value by applying a 25% stress factor to the level of real estate prices of both assets and liabilities with such exposures.
Currency risk	Currency risk is calculated as the higher of aggregated losses in two stress scenarios that reflect an IAIG's net open position (both direct and indirect exposures to that currency) against its reporting currency. Stress factors of up to 75% are applied to the net open position for each currency. For each scenario, losses by currency are aggregated using a 50% correlation factor.
NDSR	NDSR is calculated as the higher of upward and downward stress on spreads of spread-sensitive assets and liabilities (except those that qualify as capital resources). The stress factors range from +/– 50 bp to +/–100 bp. Downward stresses are subject to a 50% relative limit.
Asset concentration risk	For real estate, asset concentration risk is calculated as 25% of net property exposure (both direct and indirect exposures) exceeding 3% of an IAIG's total net investment assets. For other assets, this risk is calculated using a prescribed formula based on exposures to connected counterparties and the associated credit and equity risk charges for those counterparties.

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