To: Federal Advisory Committee on Insurance (FACI)

From: FACI Subcommittee on FIO's international work

Re: Recommendations re. FIO's international work

Date: Thursday, December 5th, 2019

Recommendations below are supported by the following members of the Subcommittee on FIO's international work: AIG, Aon, Athene, Liberty Mutual, and Oregon Division of Financial Regulation. Center for Economic Justice supports the ICS recommendations, but not the extensive commentary.

Recommendations to FIO re. **Insurance Capital Standard (ICS)**:

Background: "Team USA" delivers IAIS outcome consistent with FACI recommendations

The outcome of the recent International Association of Insurance Supervisors (IAIS) annual conference in Abu Dhabi aligns well with the recommendations that FACI provided to FIO at its September meeting. Collaboration across "Team USA" has been instrumental to delivering an IAIS outcome on ICS version 2.0 for the Monitoring Period and Comparability Assessment that, consistent with prior FACI recommendations, both:

i. Establishes a **viable pathway to international acceptance of Aggregation**, including well-specified IAIS public communications about the way forward, detailed work-plans and timelines, and realistic and achievable criteria for assessing Comparability.

ii. Provides a **coherent design and candid framing of the Monitoring Period,** including mechanisms for further policy work, messaging to discourage the disclosure of ICS results (as well as to deter their use by third parties), and impact testing of the potential negative externalities of the ICS on product availability and pro-cyclicality.

To build on this outcome and maintain momentum as we enter the Monitoring Period, the FACI sets forth the following recommendations for FIO's continued engagement at the IAIS.

ICS Recommendations

The outcome from Abu Dhabi demonstrably enhances the stature of Aggregation within the ICS process, while laying a solid foundation for further substantive work to demonstrate Comparability with ICS. In forging ahead on the next critical steps, we recommend that FIO:

- *Help to drive forward the work needed to ensure timely execution on the milestones laid out in Abu Dhabi.* Put simply, having secured a constructive outcome politically, we cannot afford to pause, and must work vigorously to shape the interim negotiations on Comparability during the Monitoring Period. The evolution from Comparability principles, to criteria, to an ultimate assessment will be a multi-faceted effort requiring our collective strategic, analytical, and political resources. We view the next several months (and years) as an opportunity to provide "breathing room" for the NAIC to finalize GCC, to promote education and outreach on Aggregation across interested regulators globally, and to build out a thoughtful consensus on Comparability.

- *Continue its successful engagement model*, comprising both:

  - *active and coordinated collaboration across Team USA*, with the goal of negotiating the more granular and technical elements necessary to fulfilling the IAIS commitment to a viable approach to Comparability. Beyond its efforts at the IAIS negotiating table, the FIO can add further value by supporting bilateral outreach to non-US policymakers on the merits and substance of the NAIC's group capital calculation (GCC);

  - *frequent and transparent stakeholder engagement*, with a view to soliciting feedback on the technical and political milestones that lie ahead on the pathway to Comparability. Notably, we see value in regular touchpoints with stakeholders to inform the development of the planned IAIS consultation on Comparability for publication next July.

- *Execute substantively on the outcome from Abu Dhabi*, which we believe should include:

  - *the integration of Aggregation into all relevant aspects of the ICS work plan during the Monitoring Period*. For example, the proposed ICS economic impact study should also include Aggregation, which will help to demonstrate its relative stability and alignment with insurer ALM practices, relative to the volatility and pro-cyclicality inherent in a market-based construct such as the ICS. Inclusion in the study would also be a tangible marker of the rightful stature of Aggregation within the ICS process;

  - *a methodical, objective, and evidence-based clarification of the potential ambiguities inherent in the published IAIS Comparability definition and principles*. It is understandable that the initial published version of the Comparability principles are broadly defined and lack granular detail. However, as we work towards the planned July 2020 consultation on the Comparability assessment criteria, it will be important for FIO and Team USA to work towards agreed interpretations with their non-US counterparts at the IAIS. In particular, FIO can play a valuable role in supporting and promoting the NAIC's published Interpretive Guidance, which provide useful context and clarification around the IAIS Comparability principles. Of course, the fact that this guidance was published separately by the NAIC, and not as part of a formal IAIS document, could indicate a need, in the coming months, to elicit further agreement across IAIS members on what the Comparability principles mean in practice. For example, while the Comparability assessment will largely reflect qualitative elements, we think there is a need for a deeper clarification of what the more quantitative elements might entail. We also believe that a more defined understanding of the expectations around supervisory intervention will be helpful, particularly as the NAIC completes its work on the GCC. Finally, we think that the Comparability assessment needs to be holistic in nature, and place the role of group regulatory capital within the broader context of US state-lead group wide supervision, including, for example, liquidity stress testing, the ORSA, and state guaranty funds;

- *continued technical enhancements to the ICS, particularly with a view to aligning the ICS design more closely with US business models and capital management practices.* We believe it is important that the ICS reflect US modalities for underwriting, risk and capital management, and ALM – not only to reduce the flaws in ICS, but also to ensure that Comparability is assessed relative to an ICS that is not fundamentally biased against the US insurance model and US market needs. We note that Team USA made notable strides in the design of ICS 2.0, including the recognition of senior debt within available capital, as well as the use of NAIC designations for credit risk. We recommend that FIO should work to both preserve these enhancements, and also fix outstanding flaws, such as elimination of the spread risk charge and promotion of a liability discounting approach that is more closely aligned with ALM; and

- *reinforcement of the IAIS messaging that ICS ratio reporting (i) is non-mandatory and provisional in nature, (ii) must remain strictly confidential and should not be disclosed by individual insurers (even on a voluntary basis), and (iii) should not be used by third parties for assessing insurer financial strength during the Monitoring Period*.

FACI discussion re. **IAIS Strategic Plan 2020-2024**:

Having now concluded important milestones on both ICS and the Holistic Framework, the IAIS is seeking to increasingly pivot from the post-crisis reform agenda, to a forward-looking emphasis on emerging issues, as laid out in its Strategic Plan published last June.

The IAIS Strategic plan identifies key themes for the 2020-2024 period:

- Technological Innovation
- Cyber Resilience
- Climate Risk
- Conduct and Culture
- Financial Inclusion and Sustainable Economic Development

Although the Subcommittee does not, at this stage, have specific recommendations for FIO on the Strategic Plan, we think it useful for the FACI to have a more fundamental conversation about the interplay of prudential tools (which by and large have been the focal point of the IAIS post-crisis reform agenda) with the wider and forward-looking public policy objectives underlying the Strategic Plan. To help forge recommendations for future FACI meetings, the FACI should at this stage have a deeper conversation about whether certain prudential requirements (eg, capital charges, governance) are appropriately related to prudential oversight, or compromise prudential oversight to achieve non-solvency public policy objectives.