**FACI International Subcommittee**
**Perspectives on the Request for Information (RFI) on a FIO Study of the ICS**
**February 10, 2021**

## ***Background***

On October 9, 2020 a request for information (RFI) on a Federal Insurance Office (FIO) study on the Insurance Capital Standard (ICS) was published in the Federal Register[1]. The responses received on the RFI will be considered by the FIO and inform its work on the ICS over the coming years, including its engagement on future revisions to the ICS and the economic impact assessment of the ICS to be conducted by the IAIS in 2023.

During the FACI meeting on December 3, Director Seitz requested that the International Subcommittee provide feedback on the RFI. Given the technical nature of the questions within the RFI (included on page 3 for reference) and other factors, the Subcommittee did not believe it was positioned to develop responses to the questions. As alternative means for the Subcommittee to be responsive to the Director's request, we have assessed and developed observations and thoughts around the perspectives identified within the 12 substantive responses to the RFI. A summary of themes within the respective responses developed by the team supporting the Subcommittee can be found on pages 5 – 22. The full text version of the responses submitted are available online[2].

## ***Stakeholders that submitted substantive responses***

Allstate, The American Academy of Actuaries, The American Council of Life Insurers (ACLI), The American Property Casualty Insurance Association (APCIA), The Chamber of Commerce's Center for Capital Markets Competitiveness (CCMC), The Coalition Organized for the Future of Insurance Regulation (COFIR), Liberty Mutual, The National Association of Mutual Insurance Companies (NAMIC), The North American CRO Council, Northwestern Mutual, State Farm, Transamerica

## ***Subcommittee observations and thoughts***

*The Subcommittee agrees with the following themes/points, which were largely consistent across the RFI responses:*

- *Implementation of the Market Adjusted Valuation (MAV) ICS would be detrimental for long-duration life insurance products and related long-term investment*
- *Implementation of the MAV ICS would entail significant unwarranted costs including development and maintenance of systems, processes, expertise, educating external consumers of capital measures (i.e., regulators, investors, and other stakeholders), etc.*
- *It is important to consider an insurer's capital position over time, rather than emphasizing a point in time valuation, and in conjunction with other tools*
- *The MAV ICS is being developed as a world-wide group capital regime and, to the extent it is implemented in a foreign jurisdiction, foreign supervisors should not apply it to operations of a U.S.*

[1] https://www.federalregister.gov/documents/2020/10/09/2020-22384/federal-insurance-office-study-on-the-insurance-capital-standard
[2] https://www.regulations.gov/docketBrowser?rpp=25&so=DESC&sb=commentDueDate&po=0&dct=PS&D=TREAS-DO-2020-0019

*insurer they do not regulate (i.e., they should not apply the framework extraterritorially at the worldwide parent level of the U.S. insurance group) – securing the IAIS' recognition of the Aggregation Method (AM) as comparable is important for avoiding such application*

- *The FIO study should be analytical and focus on the performance of the AM relative to the MAV ICS*
    - *The study should explore the themes identified across the RFI responses and demonstrate how they would be treated/evolve under the AM and MAV ICS individually and relative to one another – e.g., effects for long-duration business and investment, procyclicality, implementation costs, consumer protection, etc.*
    - *The study should assess the performance of the AM relative to the MAV ICS over time – covering periods or scenarios sufficient to capture economic cycles and catastrophic financial events*
    - *Recognizing the respective mandates are different, the FIO study should complement rather than duplicate the study being undertaken by the Federal Reserve Board's Insurance Policy Advisory Committee (IPAC)*
    - *The scope of the study should be established up front and existing data sources should be leveraged when possible rather than pursuing new/additional industry data calls; to the extent additional data is pursued, the requests should be tailored to addressing predefined research objectives and elements thereof that cannot be addressed through existing data sources*
    - *The study should consider the potential competitive implications that could arise under the various ways the MAV ICS could be implemented; for example:*
        - *In the domestic context, this should include both an assessment of the potential impact of application to insurers that are identified as Internationally Active Insurance Groups (IAIGs) but not the peers they compete with and an assessment of the potential impacts that could arise from broad implementation across the U.S. market*
        - *From an international perspective, this should include an assessment of the potential impact of the foreign supervisor applying the framework extraterritorially at the worldwide parent level*
    - *The study should include an assessment of select topics/issues – such as the design and calibration of certain stresses within the ICS – that would benefit from deeper attention (as proposed within the response from the North American CRO Council)*
- *The Monitoring Period should be extended due to the impact COVID-19 had in 2020*

***<u>Questions included in the RFI</u>***

1. If the ICS were adopted in the United States, how would this affect the insurance market in the United States, including consumers and insurers? How would the adoption of the ICS affect the competitiveness of U.S.-domiciled IAIGs, foreign insurance groups with significant operations in the United States, and U.S. insurers that have current or planned operations abroad?
2. Please provide information on whether the ICS could create regulatory capital arbitrage opportunities or have procyclical effects, leading to increased volatility in U.S. insurance markets.
3. How should the FIO Study consider the potential effects of implementing the AM in U.S. insurance markets as compared to implementing the ICS? In addition, should the FIO Study consider the potential impact upon U.S. insurance markets if credit rating agencies were to accept the ICS as a global standard?
4. What information should be considered in evaluating the impact of ICS implementation on the various business lines and the cost and availability of different product types in the U.S. insurance market?
5. If the ICS were implemented in foreign jurisdictions where U.S. insurers operate, what effects could the ICS have on the ability of U.S. insurers to compete with local insurers and other international insurers in these overseas markets? How should FIO evaluate issues related to global competitiveness of U.S. insurers and potential adoption of the ICS by foreign jurisdictions?
6. Please provide your views on the following issues, as relevant to the FIO Study.
    a. *Data for FIO Study:* The ICS has been developed with data provided by volunteer insurance groups. To what extent should FIO use data provided to FIO by individual insurers to conduct the FIO Study? In addition to data from specific insurers, are there any other relevant data sources that should be used to evaluate the ICS? If so, what other sources of quantitative and qualitative data would be available, including any data that could be representative of U.S. insurance practices and product types.
    b. *Market Effects from MAV:* The reference ICS is based on a market-adjusted valuation methodology. What information should be considered in assessing MAV versus other valuation approaches and their potential effects on the insurance market in the United States, including consumers and insurers? In particular, how should the FIO Study consider how MAV affects the following areas?
        i. Changes to U.S. insurer investment behavior and ability to match asset-liability cash flows;
        ii. Implications for product offerings and shifts in product mix for both life insurers and property & casualty insurers; and
        iii. Potential effects on insurers' role as a significant source of long-term investment and liquidity in the economy.
    c. *Capital Requirement:* The ICS capital requirement is based on a standardized framework, whereby the calculation of ICS required capital, including the risks and stresses, is defined. How should the FIO Study consider the following?
        i. The extent to which jurisdiction-specific risks should be taken into account; and
        ii. The use of internal ratings for assessing credit risk exposures.
    d. *Available Capital:* The reference ICS measures available capital according to IAIS-established criteria and composition limits. The IAIS is also considering transitional arrangements during the monitoring

period in order to ensure a smooth transition of the ICS as a PCR. How should the FIO Study consider the following?

  i. Application of transitional arrangements during the monitoring period; and

  ii. ii. Implications for the fungibility of capital under the ICS.

e. *Jurisdictional Flexibility:* The reference ICS recognizes a limited number of areas for national discretion, such as senior debt as qualifying capital. Should the FIO Study evaluate any further application of jurisdictional flexibility for ICS implementation?

7. Please provide any views regarding the following additional issues, as they relate to the FIO Study.

    a. What data and input from market participants should be taken into consideration?

    b. Describe any data or data services that independent third parties could provide for purposes of the FIO Study.

    c. For the purposes of the FIO Study, would a ''point in time'' analysis be appropriate or would another time frame be more relevant for determining the implications?

8. How should the FIO Study inform FIO's engagement on the IAIS economic impact assessment of the ICS?

9. How has the COVD–19 pandemic informed your views on the issues discussed in this Notice?

10. Please provide any other comments on the issues discussed in this Notice.

***Allstate***

- Supports FIO completing its study before the IAIS economic impact assessment to serve as a roadmap for engagement with the IAIS and to inform the design of the IAIS' exercise
- Believe the study should be directly connected to the high-level principles and criteria to be used in the AM comparability assessment; study results should demonstrate the AM meets the principles and criteria
- If implemented in the U.S., the MAV-based ICS:
  - Would negatively impact the insurance industry, especially long-duration products
  - Increase the cost of capital needed to support long-term product, making them both more expensive and less readily available in the marketplace
  - Lead to procyclicality in periods of higher market volatility and/or stress
- The study should analyze the potential adverse effects of ICS implementation relative to AM implementation; proposed elements to capture in the study included:
  - Assessment of impacts over the business cycle and both periods of economic growth and contraction – the study should be informed but not limited by historical scenarios
  - Consider income statement and balance sheet and impacts (e.g., to net investment income, investment portfolio mix, types of capital issued, compliance and other operating expenses)
  - Potential impacts to asset-liability duration matching during the business cycle
  - Impact to role insurers play as a source of long-term investment and liquidity in the market
  - Potential impacts from a market share perspective
- Data required will depend on types of analyses that FIO intends to perform; proposes using hypothetical values (representative of the product terms) for analyses that are more general in nature
- Recommend accounting for and complementing the work of the Insurance Policy Advisory Committee (IPAC) at the Board of Governors of the Federal Reserve System

***American Academy of Actuaries***

- As currently constructed, the ICS could have a detrimental impact on the provision of long-duration life insurance products due to its volatility and capital requirements
- Noted that it is too early to determine competitive implications, which will depend upon how it is implemented but believes it could give rise to a range of incentives/disincentives for internationally active U.S. firms and domestic only firms
- Consistent implementation across jurisdictions could reduce capital arbitrage
- Procyclicality is a concern but could be offset by the effect market based regimes have on forcing market realities to be addressed (e.g., low rates)
- Noted the AM would automatically adjust to changes in views of risks and products within various jurisdictions, while the process for updating the ICS for such changes is not clear

- Believe the study would benefit from a consideration of relative operational, solvency regulation, risk management, and product consequences
- Believe it would not be advisable for study to consider credit rating issues
- Believe the study should focus on identifying incentives and disincentives the ICS creates by comparing valuation and capital requirements for products under various regimes and over time / different market conditions (e.g., sensitivities); note that the study should also consider implications for hedging economic risk
- With respect to data for the study:
  - Noted that the data would need to be of a credible volume for an evaluation of required capital
  - Suggested U.S. capital requirement data may be available via the NAIC database
  - Investment risk information may be available from publicly available data
  - The number of IAIGs is not sufficient for creation of credible volumes of data
- To assess the market effects from MAV:
  - For life insurers, MAV will create an incentive for insurers to align their asset mix with the reference portfolio that determines liability discounting, which could lead to herding behavior, but valuation based on own assets could create inappropriate incentives (increase asset risk)
  - Impacts to ALM for P&C products is less of an issue as interest rate risk charges are generally of secondary importance when compared to the insurance risk charges
  - Effects on product mix could be assessed by evaluating the level and volatility of liability valuations and required capital for various products
  - Calibration levels of the respective regimes and insurer operating ranges for capital adequacy should be kept in mind when performing the analysis
  - Effects to the role insurers play as long term investors could be assessed by evaluating the level and volatility of liability valuations and required capital for the types of long term products these investments support
- The study should consider whether the inherent bluntness of the ICS creates disincentives for insurers to assume certain types of risk that are common in the U.S. (but less so in other markets)
- Since the U.S. does not plan to adopt the ICS, there would seem to be little point in considering transitional arrangements in the study
- Implications regarding fungibility of capital are tied to the purpose of a group capital metric; while a consolidated group capital standard generally does not inherently reflect fungibility, it would not have impact to it as the fungibility of capital is a function of a variety of other metrics
- Since the U.S. does not plan to implement the ICS, there would seem to be little point in assessing the application of jurisdictional flexibility
- The study should inform FIO's views on how the IAIS' impact assessment might be conducted

- Consumer protection should be another important facet of the study – e.g., MAV incentivizes close ALM and addressing low interest rates, which have consumer protection benefits that should be acknowledged

***American Council of Life Insurers (ACLI)***

- The ICS's "market-adjusted" accounting basis requires improvement and currently produces volatility that:
    - Provides strong disincentives for and driver insurers away from providing long-duration products and related long-term investment
    - Would reduce coverage options available to consumers
    - Create an increased burden for governments to support retirement needs
    - Create significant and costly disruptions to insurer capital management, risk management, and reporting processes
- Support the development of a comparability framework that ultimately leads to the AM being recognized as an outcome equivalent approach to the ICS
- Believe the AM achieves the IAIS' objectives of protection of policyholders, contributing to financial stability, and promoting greater confidence in cross-border analysis of capital adequacy
- Noted that competitive impact in the U.S. would be a function of how ICS was implemented (group level, group & legal entity, all or a subset of insurers, etc.) but regardless of the approach, the AM would be less disruptive
- Identified the sensitivity to short-term market movements, which have no bearing on the ability of life insurers to meet their long-term obligations, and potential for procyclicality as key concerns – notes potential to promote asset fire sales and failure to consider market environment for required capital purposes (stress on stress)
- ACLI believes that FIO's study could explore various dimensions of the AM vs. ICS:
    - Compare the properties and behavior of each across different market scenarios – benign and stressed markets – using a hypothetical insurer
    - Explore the usefulness of each measure when used to address practical "real world" situations or scenarios
    - Investigate how they would encourage or discourage various products and activities
    - Assess how each aligns with internal approaches of U.S. insurance groups and what changes might be required
    - Evaluate the costs and resource burden of implementing and routinely producing each
    - Consider the impact on U.S. state regulators and state regulation
    - Consider the impact to product pricing and availability – particularly for long-term business – and any implications for protection gaps – notes it would be ideal to differentiate between the impacts of the frameworks versus the low rate environment
    - Consider the potential for false positives and negatives

  - Impacts to investment decisions – e.g., herding in certain assets, disruptions to current ALM, etc.
- Believe the IAIS economic impact study and FIO study can and should be used to secure improvements to the ICS and outcome equivalence of the AM
- Believe the FIO study can help ensure that the IAIS' economic impact assessment is transparent, objective and does not lead to a reflexive endorsement of the ICS as it currently stands
- Suggest using the study as a means to discourage credit rating agencies from embracing it given the potential for false positives/negatives
- Sees the potential for a foreign jurisdiction to adopt and apply the ICS to a U.S. group as a vital reason why the AM must be recognized as outcome-equivalent to the ICS
- Local implementation abroad would have adverse impacts to long-term insurance products within the market and impact those that offer such business
- Believes the study should leverage, to the greatest extent possible, existing data and build on work that is already being done - ICS monitoring period submissions, work of the Federal Reserve's Insurance Policy Advisory Committee; suggested use of a hypothetical but representative U.S. insurer as an attractive alternative
- Proposed exploring if jurisdictions that adopted ICS like regimes have experienced adverse impacts to product offerings and/or the role of insurers as investors
- Noted that, to the extent company data is requested/used, confidentiality must be considered and that the design of the study should be finalized so the requests are targeted in scope
- Proposed investigating the following elements of the ICS specifically:
  - Redundancy of risk charges on investments via required capital and the application ratio
  - Disincentives MAV and the non-default spread risk charge provide for investing in less liquid long duration assets
  - Other areas that are highly punitive for the U.S. market – examples referred to include calibration of mass lapse, disregarding internal and supervisory ratings, etc.
- Believe that the study does not necessarily need to focus on transitional arrangements or jurisdictional flexibility since the U.S. will not adopt the ICS
- The ICS would not alter the reality that capital is not fungible across the group but by assuming it is, the results could promote an unwarranted sense of confidence
- Expressed view that the Monitoring Period should be extended by a year given COVID related impacts to ability to engage
- Encouraged FIO to remain engaged on the ICS and related issues, specifically:
  - Advocate for further technical improvements to the ICS to better reflect long-duration insurance business
  - Support the AM and the process that is underway to assess its outcome-equivalence
  - Advocate for inclusion of the AM within the planned IAIS impact assessment
  - Advocate for the impact assessment to be conducted independently to give it greater credibility

  - Support reconsideration of the monitoring period timeline in light of the pandemic-driven disruptions

***American Property Casualty Insurance Association (APCIA)***

- Believes FIO will find that the adverse impacts associated with the ICS are most accentuated for long-term life insurance and retirement products; notes that the main issues for non-life business relate primarily to implementation matters
- Believes implementation of the ICS would be enormously disruptive to RBC system and impose inordinate costs on U.S. insurers, their customers, and regulators
  - Would create a disconnect between group and entity level results that would risk sending mixed signals to regulators
  - Increased regulatory costs would ultimately be passed to consumers with little or no corresponding enhancement of policyholder protection
  - Would create an unlevel playing field between IAIGs and non-IAIGs
- Noted that the AM would provide greater regulatory benefits for several reasons:
  - Provides an incremental and pragmatic approach for group level analysis
  - Better tailored to jurisdictional risks
  - Aligned with other supervisory tools
  - More transparent and easily understood
- Outlined assumption that underpinned its response – ICS would be implemented at the state and federal level in its current form, it would only apply to IAIGs, there would be no changes to entity level requirements or tools
- Proposed that FIO focus its work on the incompatibility between the ICS and U.S. regulatory system and resulting impacts the disconnect would have on the U.S. market; identified several issues that could be of particular focus:
  - The challenges misalignment would create for insurers and supervisors (e.g., how to responds to mixed signaling of risks)
  - Market-based valuation basis as a foundation for the ICS including focus on non-life related aspects (discounting, recognition of first year profits at inception, etc.)
  - Restrictions on consideration of a group's own assets and ALM risk management measures that are in place
  - Use of ICS as a supervisory trigger absent consideration of insights from other supervisory tools
  - Treatment of supervisory credit ratings such as the NAIC's SVO ratings
  - Overall calibration levels
- Other points made regarding the design of the ICS included:
  - For non-life groups the net effect of the ICS' valuation methodology is less prudent than U.S. SAP and precludes back-testing (which diminishes reliability)

  - Assumes temporary market movements are effectively realized, producing spurious volatility that incentivizes procyclical behavior
  - The ICS inherently, and unrealistically, assumes that capital in legal entities is fungible across the group and jurisdictions and further ignores the frictional costs associated with moving capital (e.g., tax implications)
  - Lack of transparency could mask intra-group vulnerabilities
- Believes the impact on insurers' role as a significant source of long-term investment and liquidity should be minimal because it is exceedingly unlikely that states would change legal entity rules to conform to the ICS
- Believes jurisdictions that adopt the ICS would "true up" their legal entity requirements to a similar method and calibration as the ICS:
  - The playing field may remain level in the foreign jurisdiction but the effects of the ICS may make the market less attractive to U.S.-based groups
  - Effect on U.S. insurers would depend upon whether the AM is recognized by those jurisdictions (to preclude the potential for them requesting results under the ICS)
  - Assume U.S. groups would not be required to implement the ICS on either a global group-wide basis or a sub-group basis but notes if it were, there would be a significant anti-competitive effect – it would be inefficient and unnecessarily expensive to impose two separate group capital requirements on the same group
  - Notes that firms may have to hold more capital overseas
- Suggested that FIO's analysis can be informed by the effect of implementing Solvency II in the EU including:
  - Similar studies by EIOPA and the U.K. FSA
  - Perspectives provided by firms subject to Solvency II regarding the impact on business operations, profitability, and product selection/features
  - How the market impacts have affected EU insurers' solvency ratios and how supervisors have reacted (including throughout COVID-19)
- Believe it is very unlikely credit rating agencies would adopt the ICS – they have their own models
- Regarding data and other aspects of the study:
  - FIO should use publicly available data to the extent possible
  - Beyond publicly available data, FIO should rely on prior field test submissions (noted that FIO has access to this already) rather than requiring companies to submit new data
  - Proposed conducting a survey to obtain insights from field test participants regarding their experience with the ICS and expectations for impacts if it were adopted in the U.S.
  - Noted a "point in time" analysis would not present a compelling case and could consider how market-value accounting contributed to volatility in the financial sector during the financial crisis
  - Encouraged FIO and Federal Reserve to coordinate and collaborate on their studies as much as possible to avoid redundancies

  - Pursue a deeper understanding of how the criteria and limits for capital resources differ between the GCC and ICS
  - Should recognize that internal models would not likely not be an option for insurers if implemented in the U.S. (at least for the foreseeable future)
  - Encouraged FIO not to look at transition rules as they would simply defer the realization of the adverse impacts rather than resolve the underlying issues creating them

***Chamber of Commerce's Center for Capital Markets Competitiveness (CCMC)***

- Believe a robust economic assessment will substantiate concerns the Chamber has regarding how an inappropriately calibrated ICS could limit insurance product availability, inhibit investments by insurers and create unnecessary compliance costs
- Believes the changes to the timing and scope of the IAIS economic impact assessment and to the length of the monitoring period are needed to ensure the IAIS has adequate time to address any unintended consequences identified and compensate for the reduced level of engagement
- Believes additional costs would arise from a framework that varies from existing jurisdictional solvency regimes and the resulting impacts to risk management practices, product pricing and availability and other aspects could be detrimental to consumers and financial markets
- Believe it would be helpful if FIO completed the study soon so its observations, recommendations, and conclusions can outline and emphasize key criteria that should be used in the IAIS' assessment
- The study should consider alternative approaches to group capital and, specifically, the merits of the AM, how it could serve as an effective tool for accomplishing the supervisory objective the IAIS has for the ICS, how it can achieve comparability to the ICS and regulatory and business challenges that will result from a delayed determination that the AM is comparable
- Voiced concern about what ICS adoption in foreign jurisdictions would mean for U.S. firms that operate globally and the overall health of financial markets; suggested FIO could consider assessing potential operational challenges foreign implementation could give rise to and related implications
- Encouraged the Treasury Department, Federal Reserve and NAIC to coordinate to produce complementary research and analysis of the ICS and the AM – with specific reference to the FIO study serving as a complement to work underway by the Federal Reserve's IPAC
- Expects FIO to make use of existing data sets for the study and mitigate costs associated with establishing new data sets where possible
- Provided a summary of feedback the Chamber will provide on the IAIS' consultation on the definition and principles that will guide its comparability assessment work

***Coalition Organized for the Future of Insurance Regulation (COFIR)***

- Emphasized how integral the state-based system of insurance regulation has been in protecting American consumers
- Commended FIO for its work to advance the goal of having the AM recognized as outcome-equivalent to the ICS
- Asked that FIO remain steadfast in promoting and protecting state-based insurance regulation before the IAIS and reject any method that would reduce availability of insurance for U.S. consumers

- Believes the consolidated, bank-like approach to insurance capital that is being pushed by the IAIS has the potential to:
    - Significantly alter the business model for many U.S.-based IAIGs
    - Disproportionately and negatively impact U.S. based insurers and U.S. policyholders – citing the impact the ICS' capital requirements and the market adjusted valuation approach would have on long-duration products
- Suggested that the FIO study:
    - Compare the characteristics and behavior of the AM to that of the ICS across various scenarios (e.g., pandemic related market stresses), including an assessment of the effectiveness and usefulness of the respective approaches
    - Focus on the potential harmful impacts of the ICS on the availability and affordability of insurance-related products, particularly long-duration retirement products
    - Determine whether the ICS would discourage insurers from offering *any* [emphasis added] type of products to U.S. customers
    - Determine whether the costs associated with implementing the ICS would fall disproportionately on U.S. insurers relative to their global peers
- Noted that the potential adoption of the ICS by non-U.S. regulators underscores the importance of recognizing the AM as outcome-equivalent to the ICS – essential for avoiding unwarranted costs and significant operational challenges of having to report results under the AM and ICS and competitive disadvantages it would create

***Liberty Mutual***

- Voiced concern with framing of the study given that U.S. insurance regulators have determined the ICS is unfit for the U.S.
- Suggested FIO's future work should focus on ensuring the AM and GCC are determined to be comparable
- Believes the comparability work of the IAIS should seek consistent and effective outcomes among approaches in use or under development rather that prescribe an approach that would pre-empt local authority – states authority of local jurisdictions must be preserved
- Notes that the ICS has yet to be proven effective and could create risks/adverse impacts; believes implementation of the ICS in the U.S. would:
    - Have an adverse impact to the affordability and availability of certain insurance products in the U.S. and hamper investment
    - Result in costs (e.g., developing/maintaining systems) that would adversely impact insurers
    - Increase required capital for insurers and raise the aggregate cost of capital to the industry (raises concern over how loss absorbing subordinated and senior debt are treated under the ICS)
- Believes recognition of the AM as comparable will obviate any concern regarding application of the ICS to all or part of a U.S.-headquartered IAIG but goes on to note that costs of subgroup level implementation could have an adverse impact

- Suggest FIO future work include efforts aimed at ensuring that if the ICS is implemented in other parts of the world, that it is not done in a manner that adversely impacts U.S. insurers or consumers
- Is not aware of credible data sources FIO could leverage for the study

***National Association of Mutual Insurance Companies (NAMIC)***

- Comments focus on delivering the perspective of mutual companies that write P&C business
- Encourage FIO to remain steadfast in defending the U.S. system and ensuring that its approach to group capital will be deemed comparable as failure to do so would have significant detrimental impacts to insurance markets domestically
- Identified a range of challenges implementation would create:
    - Additional costs for insurance groups to implement and likely higher capital requirements
    - Complexity and compliance burden related to the need to manage to two separate sets of accounting and capital standards – especially in light of the differences between U.S.' entity level approach versus the ICS' consolidated approach
    - Challenges related to rate regulation, which can limit the P&C sector's ability to raise capital
    - The potential for further international pressure with respect to group level tools
    - The potential for rating agencies and other stakeholders utilizing an inappropriate standard which would lead to a disproportionate and unnecessary broadening of the potential impacts beyond IAIGs
- Highlighted the time tested nature of the U.S. system of insurance regulation, which has many different components that are not found in other countries, such as regulatory intervention mechanisms and guaranty fund systems which protect consumers and provide market stability
- A primary issue for NAMIC is that the ICS is a consolidated requirement that does not allow an aggregated approach, which significantly complicates any comparability assessment
- Highlighted concerns about application of standards to IAIGs that would not apply to large domestic insurers or may trickle down and become requirements for a broader universe of insurer
- Noted that the ICS inordinately injects interest-rate sensitivity into non-life balance sheets, resulting in increased volatility – particularly in times of stress – procyclicality and volatility that present an inaccurate picture of an insurer's financial condition
- Highlighted strengths of a jurisdictionally focused bottom up rather than top down approach to solvency and group capital, which help enable state regulators to detect problems within an insurer before its capital levels would signal a problem - the following points were made in conjunction with this theme and put forward as elements that need to be considered in any comparability exercise:
    - An entity level focus provides a more comprehensive view of the group and is better positioned to ensure the group is adequately capitalized
    - Appropriately recognizes the role of supervisory tools beyond capital requirements – e.g., financial reporting and use of statutory accounting, examinations, ORSAs and risk reports, the role of supervisory approvals, restrictions on investments and asset admission, market conduct regulations, rate structures and regulations, etc.

  - The presence of the state guaranty fund system as another element that should be considered
  - Believes outcomes based approach to the comparability assessment, with flexibility in the process is very important to U.S. insurers and regulators
- Believe the study to should consider the potential impact to the U.S. insurance markets if credit rating agencies were to accept the ICS as a global standard
- Noted that implementation of the ICS in foreign jurisdictions where U.S. insurers operate would put them at a competitive disadvantage – pointed to great flexibility their competitors would have regarding use of rates to raise capital
- Does not believe any additional data is needed for the study and notes the following:
  - FIO has access to data as a member of the IAIS
  - FIO should work with the NAIC and Federal Reserve to leverage data they are collecting for the GCC and the BBA
  - FIO should lean heavily on the NAIC and work with them to summarize all the qualitative regulations included in the U.S. regulatory structure, particularly on NAIC accreditation models
  - FIO should work to gain an understanding of the guaranty fund system to learn about how the individual guaranty funds operate and how they are capitalized
- Stressed the importance of clearly stating that the MAV approach does not work well for P&C companies – particularly the requirement and methodology for discounting short-duration liability cash flows, which adds complexity and fails to accurately address risks
- Believes implementation would increase enterprise risks, increase the cost of insurance coverage, reduce the availability of insurance coverage and – more broadly – generate negative economic impacts for consumers and the global economy
- Noted the need to exercise caution with any proposal that could impact the ability of the industry to act as a stabilizer for the economy in times of stress and serve as a driver of economic growth
- Believes that the ICS will never be adopted consistently by all jurisdictions and further, that the goal of having a comparable approach will be achieved; suggests the focus be on developing a group capital calculation that works for groups within a jurisdiction
- Believes internal models should only be allowed if the IAIS adopted a more open and flexible approach that included the use of an aggregation approach – sees the two issues as very similar and believes they must be addressed fairly and equitably
- From an implementation perspective, a slow and deliberate transitional arrangement would be needed in light of the various costs and time needed to develop processes, systems, expertise, etc.
- Raised concerns regarding the underlying intentions of the IAIS in developing a standard that requires regarding supervisory authority to require movement of capital (regulatory fungibility) between legal entities
- With respect to jurisdictional flexibility noted that they support the recognition of surplus notes as Tier 1 capital for all insurers – not just mutual insurers

- With respect to data, noted that quantitative result must be considered in conjunction with the other group supervision prudential tools as viewing quantitative measurements in a vacuum can lead to gaps in regulatory analysis hindering regulatory goals
- A point-in-time analysis would not be appropriate if the comparative analysis is based on a standard that includes an incompatible valuation methodology
- FIO should continue its engagement with Team USA and the study should inform and define the agenda for Team USA's work at the IAIS on the economic impact assessment
- Raised concerns with the quantitative approach outlined in the current consultation on comparability and echoed calls in an October 2020 Congressional letter to Treasury that encouraged an extension of the Monitoring Period and acceleration of the IAIS economic impact assessment

***North American CRO Council***

- Support FIO's ongoing engagement at the IAIS and continued collaboration with the NAIC and Federal Reserve to promote an international standard-setting process that reflects and respects the well-established enterprise risk management practices, regulatory capital regime, and supervisory oversight of the US insurance sector
- Believes the ultimate objective of the ICS process should be to build trust across group-wide supervisors in their respective approaches to enterprise-wide oversight, rather than to apply the same uniform and mechanistic rules to groups that operate globally
- Believe that FIO's top priority should be to support a meaningful and viable process for assessing the AM as providing comparable outcomes to the ICS
- The study should support recognition of the AM as comparable by demonstrating, in an evidence-based and objective manner, the shortcomings and potential unintended consequences ICS implementation would have in the U.S.
- Urged that FIO rely as much as feasible on existing or ongoing research, analysis, and data collection efforts including prior field test data (subject to confidentiality protections), the forthcoming study by the Federal Reserves IPAC and prior stylized analysis developed by a group of global CROs, and public data
- In addition to encouraging FIO to leverage existing data as much as feasible, advised that they should first define the intended contents of the study and then determine the appropriate data required to fulfill those research objectives
- Believes there is value in FIO applying hypothetical or stylized examples, which could be more tractable and less resource-intensive than trying to use real-world data
- Substantively, the FIO study should highlight the significant conceptual and technical shortcomings of the ICS that the IAIS has yet to address and are particularly impactful for long-duration liabilities
    - Believe the IPAC work will illuminate the technical flaws underlying the MAV approach and therefore encourages FIO to coordinate its work with the IPAC study
    - The FIO study should primarily focus any original research and analysis on issues and concerns that have not been addressed fully in other contexts including

  - The ICS treatment of credit risk, including the use of internal ratings and supervisory credit assessments, and inappropriateness of non-default spread risk (NDSR) charges which asymmetrically affect U.S. insurance groups relative to global peers
  - The role of senior debt and other capital instruments in serving as reliable sources of loss absorbing capital – particularly in periods of stress
  - Excess conservatism in risk calibrations (e.g., mass lapse; market risks)
  - A comprehensive assessment of the significant costs ICS implementation would entail
  - And any other areas that FIO identifies that are germane to US insurers but that have not yet been studied in an analytically rigorous manner

- Believe ICS implementation would impose multiple adverse impacts on the cost of insurance coverage for consumers, as well as on well-established risk management and ALM practices and could undermine the availability of long-duration business
- Also expect implementation to give rise to substantial implementation costs absent offering any prudential utility
- Recognized the importance of reflecting trends in market conditions but noted that the ICS does not sufficiently recognize ALM conventions and asset performance; synthetic constraints incorporated in its design would promote sub-optimal ALM to the detriment of policyholders
- Noted that a framework that prevents or penalizes insurers from investing in long-term real assets could increase the likelihood of insurer insolvency over the long-term, reduce the availability of long-duration life insurance products and create herding behavior that undermines financial stability
- Noted that for P&C business, implementation would require substantial costs for a construct that provides minimal informational value for short-duration business – despite the various mechanics required under the ICS, the resulting balance sheet would be broadly similar to GAAP
- Implementation costs would be multi-faceted and impact the industry, regulators and other stakeholders of the sector
- Voiced concern that deploying an unproven and unprecedented standard like ICS could subvert objectives of narrowing existing protection gaps and providing affordable insurance coverage for underinsured communities
- Given the local nature of insurance markets, does not believe that the uniform application of a single global standard like ICS would promote or achieve a "level playing field" across insurers and would create challenges (e.g., aligning with state guarantee associations)
- Other issues/concerns highlighted include:
  - Noted local jurisdictional rules serve as the primary anchor and focal point for solvency and capital management
  - ALM is primarily managed at an entity rather than global consolidated perspective
  - The potential confusion and complexity a dual regulatory system would create – e.g., the ICS' assumption of capital fungibility, legal implications in light of state level rate regulation, etc.
  - Potential for an unlevel playing field if applied to a subset of the market

  - Potential to by incentivizing certain activities that do not align with an insurance group's internal view of economic risk
- Sensitivity to market movements could trigger procyclical behavior including asset fire sales in periods of stress and drive risks concentrations (e.g., herding into certain assets); lack of consideration of current market environment could result in stress on stress situations that also create procyclical effects
- Suggested that the study compare the attributes of AM relative to the ICS across market cycles and consider how well each aligns with insurers' current practices in managing capital and the information value for supervisors including the potential for false positives/negatives – stressed the importance that the comparison be comprehensive rather than limited to looking at the resulting capital ratios alone
- With respect to rating agencies, believes they should not rely on the ICS given its various short-comings; noted that application to a subset of the investable insurance universe would also pose a challenge for them to embrace the ICS
- Believe the study:
  - Should apply scenario-based analysis that includes assessment of all aspects of the ICS (e.g., valuation, MOCE, capital requirements) under both stress and benign market conditions
  - Could look to the costs that EU insurance groups faced in implementing Solvency II
  - Include a simple survey across US insurance groups to gauge the prospective implementation costs
  - Consider consumer protection aspects (e.g., availability of coverage)
  - Consider potential impacts to IAIGs and domestic only insurers
  - Could look to demonstrate the stability of U.S. statutory reporting across a business cycle, as well as its embedded conservatism – e.g., conservatism in reserving, annual cash flow testing, the asset valuation reserve, the interest maintenance reserve, etc.
  - Should elucidate the numerous sources of difference across jurisdictions and markets, which is one of the core challenges in the effort to develop a uniform global standard
- The potential application of the ICS by a non-U.S. supervisor as an additional group standard underscores the significance of the need to secure AM comparability
- If limited to application within a foreign market (i.e., not pushed back to the worldwide parent level of a U.S. group), there could be negative impacts for the market and its consumers, but would not necessarily be adverse impacts to competition provided the regime is applied fairly across the market
- Noted that the comparability assessment should not treat the ICS as an ideal benchmark that the AM should seek to replicate; rather the AM should be evaluated based on its prudential utility in addressing solvency
- Notes sound insurer ALM and risk management does not necessarily entail nor necessitate the strict degree of cash flow matching that the ICS incentivizes
- Notes that the volatility and pro-cyclicality introduced by the ICS could undermine the role U.S. insurers play in providing long-term investment and liquidity to the economy

- Advised that jurisdictional flexibility is important, as strict limits and hardwired parameters could inhibit new product design, market development, and investment classes
- With respect to FIO engagement on the IAIS economic impact assessment, encouraged FIO:
  - To seek to ensure that it is a meaningful exercise of sufficient breadth and scope to assess the potential for unintended consequences to the industry, consumers, and other stakeholders
  - That the design of the study and analysis of the results be objective, rather than treated as a pro forma step toward finalization of the framework; proposed the following elements
    - It should assess the performance of the AM and ICS under a range of market conditions
    - It should explore the externalities of the AM and ICS could give rise to
    - It should assess the potential for the AM and ICS to create tension or conflict between jurisdictional regulatory requirements and tools (entity and group level) for insurers and supervisors
- Believe strong consideration should be given to elongating the Monitoring Period by one year, given these COVID-related disruptions
- Encouraged the IAIS to more expansively consider/explore how the ICS performed in 2020 (consider impacts to required capital as well) and account for the role of Central Bank actions when assessing the results

***Northwestern Mutual***

- The ICS remains inappropriate for the US insurance marketplace, and an aggregation method remains a preferable approach to assessing insurance group capital strength
- Highlighted concerns regarding the impact the ICS would have if applied to a participating permanent life insurance business – would compromise policyholder value without meaningfully limiting solvency risk – as well as to other long-term products and the related effect on consumers and capacity for insurers to provide long-term investment capital to the financial markets
- Expects these conclusions would be supported by reviewing evidence from other jurisdictions where market-consistent valuation methodologies have been adopted and applied to long-term life insurance products
  - By its nature as a market adjusted framework, the ICS will be more volatile and present the potential for significant procyclical effects than U.S. approaches
  - Noted their internal analysis has demonstrated that the ICS is likely to exaggerate solvency impact of short term movements and thus is not a good fit for long-term products
  - Highlighted how NAIC statutory accounting, including mechanisms like asset adequacy testing, the Asset Valuation and Interest Maintenance Reserves, was designed to serve as a stable approach for long-term nature of life insurance obligations
- With respect to the study:
  - Urged FIO to consider the implications of the ICS to the U.S. insurance marketplace as a whole given that adoption for IAIGs could create pressure to apply the ICS more broadly and/or to modify US insurance statutory valuation and capital requirements

  - Suggested that it consider a broad range of economic and market environments representative of the last number of decades through modeling designed to represent characteristic products in a simplified manner
  - In addition to the aspects noted in question 6.b., encouraged devoting substantial attention to the ICS MAV three bucket methodology and how it would apply to significant U.S. products
  - For participating policies, assess the ability of the ICS reflects the significant extent to which risks can be shared with owners of participating policies through discretionary dividends, where strict cash flow matching is not required to maintain strong ALM and could hurt the ability to provide policyholders long-term value
  - Could explore if the ICS is a necessary and/or appropriate tool for preventing capital arbitrage (believe a difference between group and entity level approaches could promote arbitrage)
  - Could focus on gathering data that would provide a basis for more reasonable assumptions based on product-specific US jurisdictional experience – pointed to the conservative calibration of mass lapse risk as an example
- Noted that the study could also explore the potential effects of implementing the AM vs. the ICS from multiple perspectives, including:
  - Consequences for consumers
  - Implications for insurers and supervisors – e.g., managing conflict between ICS messaging and U.S. approaches, the impact of additional costs, capital management, etc.
  - Transparency and the potential for conflicts by assuming capital is fungible – e.g., implications for the guaranty system structure
- Noted that the study may identify areas where the AM could be improved or enhanced – e.g., how it achieves an appropriate degree of comparability
- Believe that given that rating agencies have internal capital strength metrics, consideration of how they may react should be a second-tier consideration
- With respect to data and modeling:
  - Support modeling various product lines under various economic conditions for both ICS and under U.S. stat with points of significant variation further explored
  - Noted the need to collect sufficiently representative data from firms (confidentially) and other sources
  - Believe the study could build upon and integrate the work of other authorities and organizations rather than replicating it
- Highlighted the importance of jurisdictional flexibility, noting that it should allow for recognition of senior debt and other sources of risk absorbing capital

***State Farm***

- Noted appreciation for the aspirational goal of gaining international regulatory efficiency for IAIGs
- Believes the ICS' underlying philosophies of capital interdependence and fungibility are fundamentally flawed, and wholly inconsistent with U.S. legal and regulatory requirements and practices

- Notes that an aggregated view could be used to support an evaluation of risk but using it in the context of a requirement would potentially violate fundamental principles of contract law
- Believes failure to recognize legal entity boundaries would lead to prolonged litigation and uncertainty
- Believes the IAIS' view of fungibility could result in rate actions aimed at supplementing other entities within the group that would conflict with Congressional intent
- Noted that the ICS would need to be adopted by all states which presents additional complexities

- Commented that Federal adoption would create confusion vis-à-vis state and federal regulators regarding roles and responsibilities that may go beyond solvency
- Capital uncertainty resulting from implementation would increase upward pressure on insurance premiums and could limit insurance product offerings
- Believe the ICS actually enhances opportunities for regulatory arbitrage – its presumption of capital fungibility doubles down on some of the same risk factors that contributed to the financial crisis of 2008 – i.e., leverage high performing assets in one part of the group to support activities elsewhere
- Believe FIO should study how the ICS compares to the current U.S. solvency regime with the addition of the AM evaluation tool and include a focus on the significant legal and regulatory challenges that would be introduced by the ICS approach of treating capital as fungible across legal entities
- With respect to credit rating agencies – believes an approach that conflicts with the applicable state-based system would create misalignment with the way insurers are run and regulated, therefore making the ratings irrelevant at best and misinforming to the users who depend on them at worst
- With respect to the study:
  - Data sources - referenced 31 U.S.C. §313(e)(4), which mandates use of existing, available (including from state insurance regulators) information before seeking more in accordance with the Paperwork Reduction Act, 44 U.S.C. §3501 et seq.
  - Should be designed to demonstrate and offer a vigorous defense of the state-based U.S. system of insurance solvency regulation and recognize state-based differences as a feature (e.g., tailored to risks) rather than an inconsistency that warrants harmonization
  - Should focus on IAIGs and insurance holding companies with cross-border operations
- Believes it is important to make a distinction between internationally active life insurance companies and the P&C industry and note that traditional P&C insurance operations did not pose a threat to U.S. financial stability during the 2008 financial crisis and thus do not warrant the type of disruption to our business model generated by an ICS

***<u>Transamerica</u>***

- U.S. adoption would likely have significant effects on the insurance market, including products offered (few products with long term guarantees), investments, competition, taxes for policyholders and insurers pay
- The manner of implementation would inform the impacts experienced – e.g., group level only, entity level only, both entity and group level, broadly or to a subset of the industry, etc.

- Broad U.S. implementation could be a possible benefit to U.S. insurers operating abroad as they would be subject to a more homogeneous set of standards across their global operations
- All else equal, implementation of a global standard would reduce the opportunities for cross-border regulatory arbitrage.
- Noted that procyclicality is a concern as carriers may overreact to short-term market movements in a number of manners
- Also noted the potential for book value based capital approaches could ignore realities of the market
- Expect implementing an aggregation approach to be less disruptive than the ICS (require fewer resources) but believes that because most risk management is done on an economic basis there is might be potential for long term benefits to aligning regulatory capital to risk management
- Do not believe the study should consider rating agency issues as Transamerica is not aware of evidence that they have pressured companies into producing figures they would not otherwise produce
- Suggest that the study should focus broadly on identifying incentives and disincentives inherent in the ICS relative to current U.S. standards
    - Proposed comparing valuation and capital requirements on specific products under various regimes as an approach to this work
    - Particular attention should be paid to whether economic volatility creates an incentive to hedge economic risks to create stability
- The impact of implementation in a foreign market would depend on the manner it was implemented – e.g., group level only, entity level only, both entity and group level, etc.; some approaches could result in reporting and management burdens, could impact product offerings without effecting competition, subgroup application could offer diversification benefits
- Suggest calculating insurance liabilities and capital requirements for hypothetical but representative product lines and investment strategies at different points in time, or sensitivities, to facilitate a comparison and identification of incentives and disincentives
- To assess the market effects from MAV:
    - Effects on investment behavior could be assessed by evaluating if/how the industry product mix changes
    - MAV will create an incentive for insurers to align their asset mix with the reference portfolio that determines liability discounting, which could lead to herding behavior, but valuation based on own assets could create inappropriate incentives (increase asset risk)
    - Effects on product mix could be assessed by evaluating the level and volatility of liability valuations and required capital for various products
    - Calibration levels of the respective regimes and insurer operating ranges for capital adequacy should be kept in mind when performing the analysis
    - Effects to the role insurers play as long term investors could be assessed by evaluating the level and volatility of liability valuations and required capital for the types of long term products these investments support

- The study should consider whether the inherent bluntness of the ICS creates disincentives for insurers to assume certain types of risk that are common in the U.S. (but less so in other markets)
- Since the U.S. does not plan to adopt the ICS, there would seem to be little point in considering transitional arrangements in the study
- Implications regarding fungibility of capital are tied to the purpose of a group capital metric; while a consolidated group capital standard generally does not inherently reflect fungibility, it would not have impact to it as the fungibility of capital is a function of a variety of other metrics
- Since the U.S. does not plan to implement the ICS, there would seem to be little point in assessing the application of jurisdictional flexibility
- The study should inform FIO's views on how the IAIS' impact assessment might be conducted
- Consumer protection should be another important facet of the study – e.g., MAV incentivizes close ALM and addressing low interest rates, which have consumer protection benefits that should be acknowledged