U.S. DEPARTMENT OF THE TREASURY
FEDERAL INSURANCE OFFICE (FIO)
FEDERAL ADVISORY COMMITTEE ON INSURANCE (FACI)

MINUTES – March 29, 2023

The Federal Advisory Committee on Insurance (FACI) convened at 1:30 pm on 29 March 2023 in the Cash Room at the U.S. Department of the Treasury, 1500 Pennsylvania Ave. NW, Washington, D.C., and also via Zoom, with John Doyle, Chair, presiding. A quorum existed for the meeting. In accordance with the Federal Advisory Committee Act, the meeting was open to the public.

Committee Members Present:

JOHN DOYLE, Marsh McLennan, Chair
ERIC ANDERSEN, Aon
AMY BACH, United Policyholders
BIRNY BIRNBAUM, Center for Economic Justice
KERMITT BROOKS, Guardian Life Insurance Company of America
BILL CHURNEY, Verisk
MICHAEL CONWAY, Colorado Division of Insurance
ROB FALZON, Prudential
LUCY FATO, AIG
DAMON HART, Liberty Mutual
DOUG HELLER, Consumer Federation of America
EDMOND JORDAN, Louisiana House of Representatives
PETER KOCHENBURGER, University of Connecticut School of Law
CAROLYN KOUSKY, Environmental Defense Fund
TOM SANTOS, proxy for Laura Lazarczyk, Zurich North America
JOHN SEO, Fermat Capital Management
CASSADRA SOUCY, proxy for Andrew Stolfi, Oregon Division of Financial Regulation
JULIE SPORE, Transamerica
BETSY WARD, MassMutual
JOE WAYLAND, Chubb Group

Department of Treasury Staff Present:
STEVEN SEITZ, Director, FIO
STEPHANIE SCHMELZ, Deputy Director, FIO
ELIZABETH BROWN, Senior Insurance Regulatory Policy Analyst, FIO
JOHN GUDGEL, Senior Insurance Regulatory Policy Analyst, FIO
BRET HOWLETT, Senior Insurance Regulatory Policy Analyst, FIO
JEREMY PAM, Senior Insurance Regulatory Policy Analyst, FIO

Also Present:
KENNETH FRINO, AM Best
MICHAEL PORCELLI, AM Best

Opening Remarks by Secretary of the Treasury Janet Yellen

Treasury Secretary Yellen thanked FACI members for their service and, in particular, on providing advice on one of FIO's main priorities, improving the understanding of climate-related financial risks in the insurance industry. In her remarks, she noted that the Financial Stability Oversight Council (FSOC) identified climate change as an emerging threat to U.S. financial stability. She also noted that climate change poses various risks to the financial system, including physical risk. Insurers in states like California, Florida, and Louisiana are raising rates or pulling back from high-risk areas in response to rising insured losses, and insurance may be especially difficult to find in traditionally underserved communities. This protection gap may indicate that Americans are facing challenges in finding available and affordable insurance in their area, and this can have significant consequences for homeowners and the value of assets. In turn, these developments can have cascading effects on the financial system. Secretary Yellen also noted that, in October 2022, FIO issued a proposed data collection from certain property and casualty insurers on their current and historical underwriting data on homeowners' insurance. The aim is to gather consistent and granular data down to the zip code level that can help provide a nationwide understanding of the availability and affordability of insurance and it will help assess how insurance coverage is being affected by climate-related risk. This data collection builds on other steps that FIO has taken in the past 18 months to bolster its climate work, including ramping up its engagement with the insurance sector domestically and internationally, and producing an upcoming report that will focus on assessing climate-related issues or gaps in the supervision and regulation of insurers.

Welcome and Opening Remarks by FACI Chair John Doyle

Chairman Doyle opened the meeting and gave introductory remarks. He then welcomed one new FACI member: Carolyn Kousky, Associate Vice President for the Environmental Defense Fund. He provided an overview of the agenda, and then introduced FIO Director Steven Seitz.

Director Seitz Update on FIO Activities

Director Seitz thanked John Doyle for agreeing to be FACI chair. He also welcomed new member Carolyn Kousky. He then provided an update on FIO activities.

He noted that FIO continues to work closely with the White House's Office of the National Cyber Director and the Cybersecurity and Infrastructure Security Agency (CISA) to access the need for some form of federal insurance response in connection with potential catastrophic cyber incidents involving critical U.S. infrastructure. He also noted that the Administration's new national cybersecurity strategy, released earlier this month, includes an objective to explore a potential federal insurance backstop.

FIO recently became a full member of the International Forum of Terrorism Risk Reinsurance Pools (IFTRIP), consisting of member countries that support the insurance and re-insurance of terrorism risk. FIO participated in an IFTRIP meeting in London earlier this month.

FIO continues to monitor recent market developments and the potential effects on the life and retirement sector, including the increased use of offshore affiliated and non-affiliated reinsurance by U.S. life insurers. FIO has been engaging with the Bermuda Monetary Authority on its proposed targeted enhancements toward increased regulatory oversight of Bermuda life insurers. FIO is also monitoring the investment strategies in the life sector that involve greater amounts of non-traditional and alternative investment allocation.

FIO is also continuing to work with the International Association of Insurance Supervisors (IAIS) on the Insurance Capital Standard (ICS). This year, key decisions will be made by the IAIS on the structure of the global insurance standard. FIO is working closely with our state and federal partners with a focus on improving the ICS framework to include design elements to better reflect U.S. markets, business practices, and products.

The IAIS also recently published a consultation on climate risk, part of a package aimed at promoting a globally consistent supervisory approach.

Finally, it is important that the sector and FACI remain at the forefront of the policy discussions surrounding the implications of climate-related financial risk in the insurance sector. FIO continues to work on an upcoming report that will focus on assessing climate-related issues or gaps in the supervision and regulation of insurers. FIO also continues work on a proposed data call to assess the physical risk from P&C insurers' current and historic climate-related exposures. The proposed collection would give FIO access to consistent, granular, and comparable insurance data in order to identify and assess the potential for major disruptions of insurance coverage in regions of the country that are particularly vulnerable to the impacts of climate change. FIO has been meeting with stakeholders, including some FACI members, the NAIC and their leadership, as well as state insurance commissioners, on FIO's proposals.

Presentation by AM Best on Life and Retirement Market Developments and Trends

Ken Frino, Managing Director of AM Best's Life Health Group and Mike Porcelli, Senior Director of the Life and Annuity Ratings Group gave a presentation on life and retirement market developments and trends.

Ken Frino first discussed the outlook for the life and annuity segment. In December 2022 AM Best maintained a stable outlook on the life and annuity segment, explained by high levels of risk adjusted capitalization and favorable earnings in the marketplace. There have been strong liquidity profiles, new entrants picking up capacity, and robust sales in the marketplace, both on the life side and the annuity side. Offsetting these favorable trends is market volatility, as well as both the unrealized position of organizations and companies' liability profiles and the potential for increased lapses or surrenders within their portfolio. Factors that could change this outlook include widening of credit spreads, tightening of access to capital markets, spikes in interest rates, the level and scale of unrealized losses, and increases in lapses and surrender activity. Next Mr. Frino reviewed U.S. life and health rating activity, comparing "under-review" (increased from 2020), "upgrades" (increased from 2020), "downgrades" (increased from 2020), "initial ratings" (increased from 2020), and "affirmations" (decreased from 2020).

Mike Porcelli next discussed US Life/Annuity's Bond and Stock Unrealized Gains/Losses. He noted there is volatility in unrealized gains and losses that will work itself out as long as we do not run into any problematic credit conditions. Also, there is an increase in sector high-risk asset exposure likely due to the proliferation of newer companies, which tend to be private equity backed, with a tendency to take on higher asset risk. While AM Best's capital model also takes a similar approach, there is an increase creeping up in high-risk assets.

Member Heller noted on the high-risk asset slide that the increase from 62 percent in 2008 to 70 percent in 2018 is very significant, and he then asked about the implications. Mr. Porcelli replied that this could be problematic for the industry.

Member Bach asked if long-term care product lines are included in this reporting. Mr. Frino answered yes, any company, multi-line company or single company that is exposed to long-term care would be included in all these exhibits. Ms. Bach then asked for the number of policies in force in the United States today that provide some measure of long-term care. Mr. Frino answered that he did not know, but he could get that information. However, the participants are the largest players in that marketplace and would have pretty significant exposure.

John Seo asked about the high-risk asset slide, which ends in 2018, and asked if the trend continues through 2022. Mr. Porcelli answered that AM Best was close to compiling 2022 information. As part of their rating process, AM Best gets additional non-statutory information that companies self-reported - something called our supplemental ratings questionnaire or SRQ.

Member Brooks asked about concerns regarding legacy risk. Mr. Frino replied that AM Best expects that there is potential for the trend to continue with riskier old business moving off companies' balance sheets.

Member Birnbaum asked about changing product mix where, historically, insurers provided products that emphasize debt protection, and now insurance is essentially a wrapper for market type investments, and the insurance companies engage in hedging to provide those guarantees for things like fixed index annuities or index universal life. He then asked is AM Best able to track the strength of the parties providing the promises for these derivatives and is there any sense of danger for the accumulation of risk in these hedging programs? Mr. Frino replied that AM Best has seen a shift from protection to retirement style products, following a trend of an aging population looking to secure their retirement. In terms of diversification, there are certain companies that are concentrated in retirement products, be it a multi-year guarantee products or pension risk transfer products. But of AM Best rated population, the companies at the higher rating levels are still very well diversified between both life and annuity type products. However, as companies shift to more retirement and interest rate sensitivity type products, it does raise our level of concern.

Member Birnbaum asked if AM Best is in a position to judge any macro threats to financial stability based on their assessment of the accumulation of individual company risk management techniques. Mr. Porcelli answered that AM Best is not in a position to assess systemic risk, but there are certain companies that, if there were to be a failure, would signal to the entire market that there are fundamental flaws.

Presentation by Availability and Affordability of Insurance Products Subcommittee – 2023 Priorities

Subcommittee Chair Member Birnbaum opened by noting that the subcommittee will offer some responses to FIO's request for member views on the life insurance industry's role in retirement and savings markets, specifically: 1) the impact of recent legislation, Secure 2.0, and the Index-Linked Annuities Act, 2) the insurance industry role in providing lifetime income products, and 3) the evolution of and consumer protection issues in life insurance and annuity markets. The subcommittee as a whole did not have a consensus view, so it presented the views of industry members, consumer perspectives, and regulator perspective separately.

Giving the industry perspective, Member Spore stated that the life insurance industry is committed to helping provide financial security to Americans at all stages of life. However, in the US, significant gaps exist in both insurance protection and retirement savings. Many Americans lack adequate death and disability protection, and most retirees fear that their savings are inadequate. The life insurance industry aspires to close these gaps. Secure 2.0 will help close the retirement gap by enabling more Americans to access workplace retirement plans, with the greatest beneficiaries likely to be middle class and working-class Americans. The industry's capacity to meet the needs of Americans is shaped not merely by legislation but by competition and innovation in response to evolving demographics, market preferences, and economic conditions. The take-up of insurance products might be increased by policy solutions. Some policy measures that merit further exploration include requiring all but the smallest employers to offer retirement plans. Legislation has been drafted permitting certain guaranteed lifetime income products to qualify as default investment options within qualified retirement plans, promoting financial literacy through various means ranging from state education requirements to ad hoc efforts online. Also, the lack of industry-wide standards for annuity data integration is an impediment for providing insurance and annuity solutions within financial planning and portfolio management tools. The recent legislation to streamline the SEC filing for registered index-linked annuities (RILAs) is a recent success, but impediments remain. Another nascent product line is contingent deferred annuities (CDAs) which are variable annuity type guarantees attached to an external investment fund. Federal recognition of CDAs as a distinct type of annuity would encourage state approval of CDAs.

Speaking from the consumer perspective, Member Birnbaum stated that insurance is essential for individual and community economic development and well-being. The promise of retirement security has not been fully realized and fixing regulatory gaps and weaknesses can really help. In addition, better use of federal resources through tax expenditures is needed. The sale of life insurance is focused more and more on affluent consumers. Secure 2.0 does contain dozens of provisions mostly oriented towards retirement savings. While some of the provisions do target low- and middle-income savers, the vast majority of the tax benefits go to more affluent consumers. While long-term care insurance has provided billions in benefits for many consumers, many others have faced unexpected premium increases, forcing consumers to devote massive amounts of retirement income for higher premiums or accepting significantly reduced benefits in exchange for still substantial premium increases. Next, Member Birnbaum discussed standards of care which refers to the obligation of the insurers when selling life insurance of annuities. Some insurance products—like variable annuities, buffered annuities, and variable life—are considered securities so are subject to federally mandated standards of care. Other insurance products—like whole life, universal life, index universal life, and fixed index annuities—may be subject to state-based standards of care. There is a need to develop consistent and high consumer protection approaches to standards of care for all investment type life insurance and annuities. Member Birnbaum concluded by discussing illustrations, that is, documents provided by life insurers to consumers considering investment type life insurance, life insurance with a cash value component, and annuities. In practice, illustrations are the primary sales and marketing tool for life insurers. In 2015, NAIC developed guidance to address unrealistic assumptions regarding accumulation values and index universal life illustrations. State regulation permits life insurers' illustrations to project historical returns into the future. No other investment type product is permitted to project future returns based on past results. The illustrations assume a constant annual return resulting in depictions of the rewards of risky types of investments without showing the risk. In closing, the life insurance industry has the products and resources to promote retirement security for all, but gaps and weaknesses in regulatory guidance must be addressed.

From the regulator perspective, Member Conway stated that both Secure 2.0, and the Index-Linked Annuities Act are going to help increase access to tools for consumers to build out resources for retirement. This is particularly important given the kind of inflation we are currently experiencing. It is also important for us to evaluate any impact on historically underserved communities. The NAIC needs to review some of its model acts to make sure that they are in line with the requirements of the new laws. State regulators are going to want to monitor the implementation and the new products that may arise as part of the new acts. Also, it is important to ensure that there is education about the new legislation and the benefits to consumers. In Colorado we have focused on a variety of different mechanisms to make sure that insurance products are properly marketed to all communities. People need to understand the automatic enrollment components, the student loan payment matching, and no penalty for emergency expense withdrawal. Annuities and insurance products should keep pace with changes to the economic landscape, technology, and consumer needs, and this is important in evaluating and understanding who is utilizing or not utilizing annuities and insurance products for retirement.

Update on International Subcommittee Activities

Chair Doyle gave an update on the activities of the International Subcommittee. At its first 2023 meeting in March, FIO staff proposed several areas in which the views and advice of the subcommittee could be of assistance including IAIS work streams and bilateral engagements with non-US regulators. The subcommittee will make decisions as to where to focus its work. The subcommittee also heard a presentation from FIO's staff on the recent IAIS Committee meetings and its ongoing work.

Update on Climate-Related Financial Risk Subcommittee Activities and FIO's Climate-Related Work

Bret Howlett provided an overview of the meeting of the FACI Subcommittee on climate-related financial risk held virtually on March 3, 2023. During this meeting, the FIO team discussed FIO's proposed data collection and engaged with subcommittee members on various topics related to the proposal, including the questions posed in the Federal Register notice. FIO has also had individual follow-up meetings with several members of FACI. Next, Mr. Howlett gave a status update on the proposed data collection. FIO received 35 separate comments in response to its request for comment. FIO received comments on a range of topics including data elements, analysis of affordability, collection of data at ZIP code level, selection of insurance lines, analysis of availability, nationwide collection, selection of reporting period, burden estimate, and annual collection.

Elizabeth Brown discussed the drafting of the FIO climate report focusing on insurance supervision and regulation. FIO expects the report will cover prudential regulation and supervision, macro prudential regulation and supervision, market conduct regulation, and climate-related disclosure initiatives. FIO plans to issue the report in the coming months. Ms. Brown noted that the NAIC has taken steps to increase their work on considering climate-related financial risk. A consistent theme that FIO has heard is the lack of granular and decision-useful climate data, particularly for the insurance sector. FIO is also looking at the NAIC's climate risk disclosure survey and its use by state insurance regulators. Ms. Brown next noted that FIO actively participates in and plays a leadership role on the Financial Stability Oversight Council's staff-level Climate-Related Financial Risk Committee (CFRC) and its working groups. FIO is actively engaged with the IAIS's climate work, including the Climate Risk Steering Group and the new Protection Gap Taskforce, which will initially focus on natural catastrophe protection gaps. FIO continues to participate in the EU-U.S. Insurance Dialogue Project and its climate-related workstreams. FIO is also continuing to participate in the Sustainable Insurance Forum (SIF).

Member Bach asked if FIO has a general timeline of when it will initiate the data call. Director Seitz answered that it is critical for FIO to get engagement from FACI, the NAIC, and the states, and that it is a FIO priority.

Member Kochenburger asked if the EU-U.S. Insurance Dialogue Project meeting in Seattle was open to all interested parties. Director Seitz said that the meeting will be open to the public.

Update on Comments to FIO's Catastrophic Cyber RFI

Jeremy Pam provided an update on comments to FIO's request for information (RFI) on a potential federal insurance response to catastrophic cyber incidents. He first noted that, earlier this month, the National Cybersecurity strategy was released. The strategy has five pillars, and Pillar 3 is to shape market forces to drive security and resilience. Strategic Objective 3.6 under Pillar 3 is to explore a federal cyber insurance backstop. FIO, in coordination with CISA, published the RFI in the Federal Register on September 29, 2023. FIO received 55 comments from a wide range of commenters, based on which FIO identified six initial themes. First, there was broad support for developing some type of federal insurance response while a few commenters expressed the view that adopting a federal insurance response now would be premature, citing the still developing cyber insurance market. Second, there was general agreement that any federal insurance response should address cyber hygiene. Third, commenters proposed a range of ideas for the structure of a potential federal insurance response. Fourth, there were different views regarding the adoption of key structural elements from TRIA/TRIP. Fifth, commenters suggested numerous structural elements not featured in TRIA. Sixth, there was support for considering cross-border scenarios while assessing catastrophic cyber insurance. In closing, Mr. Pam noted that FIO, in coordination with CISA and ONCD, is now conducting post-RFI engagements with various commenters and other public/private sector stakeholders, including international counterparts, to further inform the analysis.

New Business/Update on Old Business

Member Heller asked about the status of the FIO Auto Report. Director Seitz responded that the Auto Report remains a top FIO priority on which we're actively working on and hoping to move forward on as quickly as we can.

Chairman Doyle confirmed that FACI members had no additional new business, then adjourned the meeting.

MEETING ADJOURNED AT 3:17 PM.

I hereby certify these minutes of the March 29, 2023, Federal Advisory Committee on Insurance public meeting are true and correct to the best of my knowledge.

John Doyle, Chair