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

MINUTES – September 26, 2023

The Federal Advisory Committee on Insurance (FACI) convened at 1:30 pm on September 26, 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
IAN ADAMCZYK, Proxy for Rob Falzon, Prudential
ERIC ANDERSEN, Aon
AMY BACH, United Policyholders
BIRNY BIRNBAUM, Center for Economic Justice
MARTIN BOGUE, Proxy for Lucy Fato, AIG
KERMITT BROOKS, Guardian Life Insurance Company
JILL BROWN, Proxy for Betsy Ward, MassMutual
MICHAEL CONWAY, Colorado Division of Insurance
DAMON HART, Liberty Mutual
DOUG HELLER, Consumer Federation of America
MICHAEL HUMPHREYS, Pennsylvania Department of Insurance
EDMOND JORDAN, Louisiana House of Representatives
PETER KOCHENBURGER, University of Connecticut School of Law
CAROLYN KOUSKY, Environmental Defense Fund
LAURA LAZARCZYK, Zurich North America
KEVIN O'DONNELL, RenaissanceRe
JOHN SEO, Fermat Capital Management
JULIE SPORE, Transamerica
ANDREW STOLFI, Oregon Division of Financial Regulation
JOSEPH WAYLAND, Chubb Group

Department of Treasury Staff Present:

STEVEN SEITZ, Director, Federal Insurance Office (FIO)
ELIZABETH BROWN, Senior Insurance Regulatory Policy Analyst, FIO
JOHN GUDGEL, Designated Federal Officer, Senior Insurance Regulatory Policy Analyst, FIO

Also Present:

SCOTT ROBINSON, Moody's
BOB GAROFALO, Moody's
RICH BABEL, Oliver Wyman
ETIENNE SCARBOROUGH, Oliver Wyman
KEVIN STINE, National Institute of Standards and Technology (NIST)

Welcome and Opening Remarks by FACI Chair John Doyle

Chairman Doyle opened the meeting and provided an overview of the agenda. Then he introduced FIO Director Steven Seitz.

Director Seitz Update on FIO Activities

Director Seitz noted that FIO issued a Federal Register Notice in August requesting expressions of interest in joining FACI and encouraged anyone who wanted to be considered to submit their expression of interest by September 30, 2023.

Director Seitz said that FIO continues to monitor market developments in the life and retirement sector. Over the last several years, this sector has attracted the interest of large, alternative asset managers, including private equity firms. FIO is closely following the increased use of offshore-affiliated and non-affiliated reinsurance by U.S. life insurers, as well as work in this area by the National Association of Insurance Commissioners' (NAIC) and the Bermuda Monetary Authority (BMA).

FIO's climate-related work is also a top priority. In June 2023, FIO issued a report assessing climate-related issues and gaps in the supervision and regulation of insurers, as requested by President Biden's 2021 Executive Order on Climate-Related Financial Risk. FIO has also proposed a data collection of underwriting data on homeowners insurance from certain property and casualty insurers that would provide non-public, consistent, granular, and comparable homeowners insurance data on a nationwide level.

The NAIC has begun scoping its own potential data call, based on issues of affordability and availability of insurance coverage in their property markets. FIO is pleased to see that the NAIC and state regulators have recognized the importance of granular insurance data to help understand and address climate-related risk and will continue to engage with the NAIC and states to attempt to mitigate burdens to the extent possible, while staying cognizant of our distinct roles and authorities.

FIO will continue to work closely with the White House's Office of the National Cyber Director and Department of Homeland Security's Cybersecurity and Infrastructure Security Agency to jointly assess the need for a federal insurance response in connection with potential catastrophic cyber incidents involving critical U.S. infrastructure. In the coming months, FIO will undertake further analysis and engagement on the topic of insurance for catastrophic cyber incidents, including the ways this issue may converge with or diverge from the Terrorism Risk Insurance Program and terrorism risk insurance more broadly.

FIO continues to assist the Secretary in its management of the Terrorism Risk Insurance Program. FIO has recently increased its status in the International Forum of Terrorism Risk Insurance Pools to a full member, and FIO now acts as Vice Chair of the organization.

FIO continues to work with the International Association of Insurance Supervisors (IAIS) on the Insurance Capital Standard (ICS) and will be closely engaged in the comparability assessment of the aggregation method to the ICS, which the IAIS will be launching shortly. FIO is also prioritizing its engagement with the Insurance Regulatory and Development Authority of India (IRDAI) under the signed memorandum of understanding between FIO and IRDAI. FIO and IRDAI intend to establish a regular, ongoing dialogue, including a public sector and private sector meeting that will be held in India in 2024.

Presentation by Moody's on the U.S. Life Insurance Sector

Scott Robinson, Associate Managing Director of the U.S. Life, Health, and Specialty Group, and Bob Garofalo, Vice President of the U.S. Life, Health, and Specialty Group and Senior Credit Officer, gave an overview of the U.S. life insurance sector.

Scott Robinson started with a summary of key themes in the U.S. life sector. Moody's currently has a stable outlook of the sector due to rising interest rates, good investment portfolios, solid balance sheets, and the pandemic becoming endemic. Mr. Robinson noted four key credit themes in the sector, namely increasing M&As and divestitures, a move toward more private-type and structured investments, higher interest rates, and improved capital and risk management. He explained that private capital has accelerated the convergence of asset management and the insurance sector. There has also been a shift toward more private investments with Moody's focused on collateralized loan obligations, private credit, and real estate. Additionally, Moody's expects an uptick in U.S. spec-grade defaults, peaking in the first quarter of next year at about 5.6 percent, not far above historical averages. With respect to interest rates, Mr. Robinson said that although gradually rising rates are positive, a spike could be negative, so Moody's is looking into life insurers' liquidity. With respect to inflation, although it is expected to recede, it remains a risk. Moody's has not seen anything out-of-the-ordinary regarding surrenders but is monitoring the topic carefully. There has also been a significant movement of capital, continuing a long trend of moving toward captives, but capital remains solid overall.

Then Bob Garofalo spoke about cross-border life reinsurance. Around 80 percent of offshore reinsurance is going to Bermuda because the BMA has invested significant resources to build and maintain its regime, specifically with its asset liability management and economic capital, Solvency II equivalency, and qualified and reciprocal jurisdiction with the NAIC. Because of Bermuda's good historical record with regulating sidecar structures, much of that business is moving offshore too. The offshore movement is primarily due to capital and investments. There is a large influx of private capital into the life insurance sector, and life insurers are trying to leverage their asset management expertise to improve risk management. Given the extended low interest rate environment, companies believe they could have better efficiency managing the risks of their business offshore. Moreover, certain jurisdictions offer more flexibility in investment strategies with less restrictions compared to the United States.

Then, Mr. Garofalo spoke to the risks of moving offshore, the most significant being counterparty risk. He also spoke to the key themes that Moody's will be monitoring with respect to offshore transactions, namely how enterprise risk management is changing, how counterparty risk affects companies, how groups' capitalization has changed, how investments will perform under stress, how the sector is ripe for consolidation, and how the regulatory environment has strengthened. Overall, Moody's sees the movement offshore as a net negative for the U.S. life insurance sector because of less transparency for investors and less regulation compared to the United States.

Member Birnbaum asked how an insurer can achieve a higher return on equity by reinsuring in Bermuda versus the United States. Mr. Garofalo responded that U.S. companies can achieve higher returns on capital by investing in certain products offshore. Mr. Robinson responded that companies might move offshore because of strict reserve requirements or because the company is holding less reserves for a particular product offshore.

Member Kochenburger asked what Moody's was referring to by non-economic liability, reserve, and drive commensurate with liability. Mr. Garofalo responded that they were referring to redundancies in the statutory reserve, which are some of the reserves that are potentially being unlocked in a structure. Member Kochenburger ensured that by liability, Moody's was not referring to litigation risk, and Mr. Garofalo confirmed.

Member Birnbaum commented that one of the charts showed that the industry aggregate or industry risk-based capital (RBC) was fairly stable over time and asked whether the dispersion of individual company RBCs around the median and the mean has changed. Mr. Robinson responded that he would have to look into the issue but that those companies are pretty high from an RBC perspective and Moody's has not seen the dispersion change dramatically. He said that the point of the slide is that RBC can be unreliable if a riskier business has been moved to an entity that is not included in the RBC. Member Birnbaum asked whether Moody's assumes the regulator has transparency into the companies where some of the risk has been transferred. Mr. Garofalo responded affirmatively but said that Moody's still wants to conduct their own analysis so that they understand the capital.

Presentation by FIO about its Report, *Insurance Supervision and Regulation of Climate-Related Risks*

Elizabeth Brown said that the report's key finding is that climate-related risks, including transition, physical, and litigation risks, present new and increasingly significant challenges for the insurance industry. More work is needed by state and federal regulators and policymakers, as well as by the private sector, and the climate science and research communities, to better understand the nature of climate-related risks for the insurance industry, their implications for insurance regulation and supervision, and for the stability of the financial system, including for real estate and banking. Ms. Brown explained that the report provides FIO's assessment of the U.S. climate-related supervision and regulation of insurance in three main areas: prudential, macroprudential, and market conduct. The report also discusses disclosure initiatives and provides an overview of additional FIO priorities concerning climate-related risks. Finally, it outlines FIO's next steps.

In terms of prudential regulation, FIO recommends that every state adopt climate-related risk monitoring guidance appropriate for their markets. The NAIC and state insurance regulators should also prioritize the creation of new and effective climate-related risk tools and processes for use by state insurance regulators through, for example, the development of scenario analysis and the increased use of the NAIC's Catastrophe Modeling Center for Excellence. Additionally, FIO recommends that state insurance regulators and federal authorities continue encouraging insurers to capture more granular, consistent, comparable, and reliable data on climate-related risks and continue identifying relevant data to fill data gaps.

In terms of macroprudential regulation, FIO recommends that the NAIC incorporate climate-related risks in future macro-risk assessments and that the state insurance regulators and the NAIC monitor trends that could indicate wider issues in the insurance market, including hardening of the reinsurance market, growth in residual and surplus line markets, and potential climate-related risks for state guarantee funds.

In terms of market conduct regulation, FIO recommends that the NAIC, state insurance regulators, the insurance industry, FIO, and other partners work together to increase consumer education and outreach regarding climate-related risks, including pre-disaster mitigation efforts. Public-private partnerships with the insurance industry can aid this educational effort.

In terms of climate-related disclosures, FIO recommends focusing on promoting transparency and helping stakeholders compare how insurers are addressing the climate-related risks that they face. FIO recommends that the NAIC and state insurance regulators support efforts to improve climate-related disclosures by the insurance industry and that all state insurance regulators adopt the NAIC Climate Risk Disclosure Survey. FIO also recommends that the NAIC continue monitoring responses to its Climate Risk Disclosure Survey and publish an annual quantitative report summarizing the survey results and addressing how well the survey is fulfilling its six purposes.

FIO plans to advance progress on the recommendations in the report by monitoring climate-related work of state insurance regulators and how their work addresses the identified issues and gaps. FIO will issue periodic updates detailing the progress made by state insurance regulators and the NAIC. Finally, FIO is engaging with the NAIC, state insurance regulators, and other domestic and international stakeholders on these issues.

Member Birnbaum asked several questions around a specific scenario that insurers should be required to test. Ms. Brown responded that the report did not specify a particular scenario; however, it suggests that the NAIC and the states consider a pilot scenario project. Director Seitz noted that the report describes how the NAIC is looking into this area through their Catastrophe Modeling Center of Excellence, and it is an area that the NAIC should continue to prioritize; the report did not address specific climate scenarios.

Then Member Birnbaum asked if FIO's position is that the main obstacles for greater investments in risk mitigation and ensuring policyholder partnerships for loss mitigation is consumer education. Ms. Brown responded that the report only focused on the aspects specifically targeted towards insurance supervision and regulation, education being one of them. There are other recommendations from the report that could have been addressed, but FIO chose to highlight education. Member Birnbaum asked how enhanced consumer education could address the obstacles to risk mitigation if the source of funds for consumers is the main problem. Ms. Brown responded that the report focused on the actions of insurance regulators and supervisors and that there are many other programs in the federal and state governments that address funding for mitigation and resilience.

Member Heller asked if FIO has considered the need for more accountability or investigation into the practices of insurers dealing with adjusters' estimates. Ms. Brown responded that FIO did not necessarily find that to be a unique area related to climate-related risk. Member Heller commented that it connects with climate issues because part of the way insurers have been confronting their exposure is by increasing deductibles; adjusters might be pressured to bring adjusted claims below the newly high deductibles. Member Heller hopes that FIO considers this issue in the future.

Member Hart commented that with respect to FIO's data call, he would welcome coordination with the NAIC from an efficiency and consistency basis. Then, he asked if there are updates on the status of the negotiation. Director Seitz responded that FIO appreciates the need to coordinate and collaborate very closely with the NAIC and that FIO has spoken with them on numerous occasions, and FIO is aware of the distinct roles and authorities of each.

Presentation by Oliver Wyman on a Case Study in Analyzing Homeowners Insurance Availability and Affordability Following a Catastrophe

Rich Babel and Etienne Scarborough presented on an Oliver Wyman report that analyzes the availability and affordability of homeowners insurance in Colorado.

Member Conway explained that the study originated because of the Marshall fire in Colorado on December 30, 2021, and was completed to ascertain whether Colorado has a growing availability problem, especially because Colorado lacked a FAIR plan at the time.

Mr. Scarborough shared that the study had four analytical topics: whether premiums and exposure were increasing, whether rate filing differed in Colorado compared to other states, whether there were significant discrepancies at the carrier level, and whether the trends were widespread across the state or specific to certain areas. The study incorporated information from Oliver Wyman's own data call, publicly-available sources, and Guy Carpenter. Then, Mr. Scarborough provided more specifics about the exact data that Oliver Wyman collected and explained why the group focused on written units and average premiums. He described how maps of wildfire risk are more granular than the collected ZIP-code-level data, so they used satellite imagery to create ZIP-Code-level metrics of wildfire risk.

Then Mr. Scarborough described the report's findings. According to the carrier data collected, premiums increased significantly in Colorado over the analysis period, by 11.5 percent annually, and the pace of increase accelerated too. Premiums increased more in ZIP Codes with higher wildfire exposure; however, the difference was very mild, 14 percent to 17 percent. Even in ZIP Codes with no wildfire exposure, there was a significant unexplained portion, partly due to inflation. Additionally, smaller carriers have been shrinking on average, getting picked up by larger carriers in the industry.

Then Mr. Scarborough spoke about ways to improve a future analysis. He said it would be helpful to look at perils other than wildfires and to compare insurance trends with housing development trends. Member Conway emphasized that some of the data can be explained by hail exposure, which was excluded from the study.

Member Heller commented that Colorado insurers that continue to insure high-risk places are sending a land-use message to consumers that it is okay to live in those areas. He appreciated the presenters' comment that some of the data could possibly be explained by an increase in insurers covering wildfire-prone areas. If insurers suddenly want to leave those areas, they should be reminded that they were previously signaling that those places were okay to live by their underwriting.

Presentation by the National Institute of Standards and Technology (NIST) on the Cybersecurity Framework 2.0

Kevin Stine, Chief of the Applied Cybersecurity Division at NIST, presented an overview of the recently-released NIST Cybersecurity Framework 2.0.

Mr. Stine explained that the Cybersecurity Framework is a risk-based, outcome-focused tool that is intended to help organizations better understand, manage, reduce, and communicate cybersecurity risk in the context of their missions and business objectives. Version 1.0 was issued in 2014, version 1.1 was issued in 2018, and NIST is working on the 2.0 update now. NIST has seen significant uptake of the framework from various sectors, including all layers of government and internationally. For every version, including the current update, NIST has incorporated widespread feedback from stakeholders.

Between versions 1.1 and 2.0, the Framework will continue to be voluntary, outcome-focused, based on the principles of risk management, and meant to be paired with other resources. In terms of changes, NIST wants to make it easier to put the Framework into practice, to provide more guidance outside the Framework, and to broaden the Framework's interest and applicability outside of critical infrastructure. The five functions of the Framework have been to "identify, protect, detect, respond, and recover," and version 2.0 will add both a sixth function – "govern" – which will address risk management strategy, oversight, and roles and responsibilities, as well as a new category that focuses on supply chains. Additionally, the Framework will include new implementation examples, which will lead to informative references, and they will be revised more frequently.

Member Seo commented that Fermat Capital uses NIST's Framework and has always been impressed with NIST's research and practicality. Mr. Stine thanked Member Seo and said that he would welcome more feedback from his team as well as a one-on-one discussion.

Update on Climate-Related Financial Risk Subcommittee Activities

Member Lazarczyk provided an overview of the meeting of the FACI Subcommittee on climate-related financial risk held virtually on August 17, 2023. During the meeting, Elizabeth Brown explained the key findings of the June 2023 Climate Report and summarized the report's contents. Then Becky Swanson shared feedback that had been received on the report. There was considerable subcommittee member questions and feedback.

Update on International Subcommittee Activities

Chair Doyle provided an overview of the meeting of the FACI International Subcommittee held virtually on August 31, 2023. Krishna Kundu presented on the status of the Insurance Capital Standards as a prescribed capital requirement. Alex Hart presented on FIO's engagement with the IRDAI. Andrew Shaw presented on recent IAIS macroprudential work, including updates from the June committee meetings and global insurance market report. Members showed particular interest in FIO's engagement with IRDAI, and specifically, with the implementation of supervisory materials underlying the holistic framework.

Presentation by Availability and Affordability of Insurance Products Subcommittee

Member Birnbaum provided an overview of the FACI Subcommittee on the availability and affordability of insurance products. The subcommittee reviewed the availability of life insurance products, starting with long-term trends. For example, since the 1950s, per capita possession or purchase of life insurance has dropped by 75 percent. The subcommittee is trying to gather more data on the cause of some of these changes to see how they might impact the availability and affordability of life insurance in traditionally underserved areas. The subcommittee asked some of its members to reach out to LIMRA for more information.

New Business/Update on Old Business

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

MEETING ADJOURNED AT 3:45 PM.

I hereby certify these minutes of the September 26, 2023, Federal Advisory Committee on Insurance public meeting are true and correct to the best of my knowledge.

John Doyle, Chair