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

MINUTES – September 29, 2022

The Federal Advisory Committee on Insurance (FACI) convened at 1:00 pm on 29 September 2022 in the Cash Room at the U.S. Department of the Treasury, 1500 Pennsylvania Ave. NW, Washington, D.C., and also via Zoom, with Dan Glaser, 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:

DAN GLASER, Marsh McLennan, Chairman
JESSICA ALTMAN, Pennsylvania Department of Insurance
ERIC ANDERSEN, Aon
AMY BACH, United Policyholders
BIRNY BIRNBAUM, Center for Economic Justice
MARTIN BOGUE, Proxy for Lucy Fato, AIG
QUINCY BRANCH, Branch Benefits Consultants
BILL CHURNEY, Verisk
BETH DWYER, Rhode Island Insurance Division
ROB FALZON, Prudential
LAURA HAINES, Proxy for Kermitt Brooks, Guardian Life Insurance Company of America
DAMON HART, Liberty Mutual
DOUG HELLER, Consumer Federation of America
EDMOND JORDAN, Louisiana House of Representatives
PETER KOCHENBURGER, University of Connecticut School of Law
LAURA LAZARCZYK, Zurich North America
ANDREW MACFARLANE, Proxy for Sean McGovern, AXA XL
JOHN SEO, Fermat Capital Management
JULIE SPORE, Transamerica
ANDREW STOLFI, Oregon Department of Insurance
BETSY WARD, MassMutual
JOE WAYLAND, Chubb Group

Department of Treasury Staff Present:
STEVEN SEITZ, Director, FIO
STEPHANIE SCHMELZ, Deputy Director, FIO
JIGAR GANDHI, Senior Insurance Regulatory Policy Analyst, FIO

Also Present:
MATTHEW GENDRON, Rhode Island Insurance Division
NEAL HIGGINS, Deputy National Cyber Director, Office of the National Cyber Director (ONCD)
DANIEL KANIEWSKI, Marsh McLennan
POOJA RAHMAN, Chief Risk Officer, Protective Life Corporation
AARON SARFATTI, Chief Risk Officer and Chief Strategy Officer, Equitable Holdings
BILL SCHWEGLER, Transamerica
JAMES SONNE, MassMutual

Welcome and Opening Remarks

Chairman Glaser opened the meeting and welcomed four new FACI members: Damon Hart, EVP, Secretary and Chief Legal Officer of Liberty Mutual; Laura Lazarczyk, Chief Legal Officer and Corporate Secretary of Zurich North America; John Seo, the co-founder and Managing Director of Fermat Capital Management; and Joe Wayland, EVP and General Counsel of Chubb Group. Chairman Glaser also welcomed two new conditional members: Bill Churney, President of Extreme Event Solutions for Verisk; and Edmond Jordan, State Representative from Louisiana.

Director Seitz Update on FIO Activities

Director Seitz noted that, earlier this month, he testified with Commissioner Birrane of Maryland at the Senate Banking Committee Hearing on current issues in insurance.

With respect to FIO's work concerning climate and climate-related financial risk, FIO has been meeting with stakeholders, including some FACI members, on best practices and challenges regarding climate-related financial risk. In July, FIO reached out to state insurance regulators to better understand whether and to what extent they have consistent, comparable, and granular data, and FIO is continuing to evaluate next steps in this area. FIO plans to continue to work with FACI on climate issues.

On cyber-related risk, FIO is examining insurers' cyber resilience and the development of the cyber insurance market. FIO is also working with DHS's Cyber Security and Infrastructure Security Agency (CISA) to jointly assess the need for a Federal backstop for cyber insurance for catastrophic cyber incidents involving critical U.S. infrastructure. Today's Federal Register contains a notice published by FIO seeking public comments on this topic. FIO is also closely working with the Office of the National Cyber Director (ONCD) at the White House.

FIO has been monitoring the increased involvement of alternative asset managers and private equity firms in the life insurance sector. FIO has identified four areas of focus to consider the potential risks and regulatory issues in this area: (1) Liquidity Risk, (2) Credit Risk and Capital Adequacy, (3) Questions Around Offshore Reinsurance Vehicles, and (4) Issues Related to Potential Conflicts of Interest.

Director Seitz discussed the two covered agreements with the EU and the UK. The NAIC, in consultation with FIO, developed and adopted amendments to its Credit for Reinsurance Model Law and Regulation, with the intention for the states to implement by September 2022, insurance measures addressing the reinsurance collateral provisions of the Covered Agreements. All 50 states, as well as D.C., Puerto Rico, the U.S. Virgin Islands, Guam, Northern Mariana, and American Samoa have adopted revisions based on the model amendments. At the end of this month, FIO will submit its annual preemption report to Congress which will state that FIO does not plan to take any steps pursuant to its federal preemption authority.

Presentation on the Insurance Policy Advisory Committee (IPAC) Report on the Potential Impact of the ICS on the U.S. Life Insurance Industry, Policyholders, and Markets

Ms. Rahman and Mr. Sarfatti presented the following results of a two-year Insurance Policy Advisory Committee (IPAC) study on the potential impact of the Insurance Capital Standard (ICS) on U.S. insurers, policyholders and markets with a focus on long duration life insurance and retirement products. They made three broad observations. First, the ICS fails to reflect several relevant asset classes and is overly reactive to credit spread movements. This could introduce excessive conservatism and significant volatility into required capital and excess capital indicators, potentially leading to false solvency signals for regulators and markets. Second, the treatment of par-life in the ICS discounting methodology is misaligned with the actual risk-mitigating profile of that business, causing overstatement of risk charges in low interest rate environments.

Third, the ICS does not recognize dynamic hedging programs or the use of long-term alternative assets in liability management. Based on these observations, the ICS, in its present form, does not appropriately reflect the product and risk-mitigation features of long-duration life and retirement products sold in the U.S. nor does it reflect how investment choices available in U.S. capital markets support such long-duration products. As currently constructed, the ICS would not be appropriate as a Prescribed Capital Rule (PCR) for U.S. internationally active insurance groups.

IPAC, based on these observations and conclusions, made two recommendations. First, to be "appropriately designed" for the business practices, products, markets and supervisory regime in the U.S., at a minimum, the proposed revisions described in the IPAC report and Appendix needs to be satisfactorily addressed and incorporated. IPAC also proposed that these changes be considered in the determination of comparability with the ICS in the forthcoming Aggregation Method comparability assessment.

In follow-up Q&A, Mr. Birnbaum asked if the analysis would change or cause different implications if index products were considered. Ms. Rahman responded that any work regarding indexed products would need to be data-backed and that no index products have been modeled.

Mr. Seo noted, from an investment manager's point of view, that there is a lot about the ICS framework and the fundamental approach that is alarming. The first is the market orientation of the framework. The life insurance industry is a very important counter-cyclical element on the U.S. financial system and, as applied in this framework, is post-cyclical. Ms. Rahman noted that the IAIS comes up with a new set of yield curves every year, and then builds a representative portfolio within the ICS construct of what people would be investing in based on these curves.

Mr. Kochenburger noted that the report has only been out a couple months, and that the IAIS is still working through the methodology and assessment. How has this this report been received by IAIS and EU technical experts? Ms. Rahman answered that there have been discussions between the U.S. representatives at the IAIS and among IPAC representatives into some of the study analysis, and they are asking questions about the report's methodology and findings.

Ms. Spore noted that in recent years, several jurisdictions have implemented ICS-like frameworks. Since long duration products are sold in many jurisdictions, are there solutions to the concerns raised that might be borrowed from other regulatory frameworks? Ms. Rahman answered that in a perfect world market-based constructs provide some value. The hope is to improve the ICS, even if it is never going to be adopted by the U.S. market.

Mr. Bogue noted that the recommendations seemed to hit on two points. First, that the ICS approach could be improved to address short falls. Second, that the IAIS is building a shared understanding for an aggregation method acceptance, but that the market in the U.S. is going in a different direction. Ms. Rahman responded that the purpose of this study was to explore if the ICS in its current form works.

FIO Affordability and Availability of Auto Insurance Study - Questions and Feedback

Mr. Heller noted that, while Availability Subcommittee has provided thoughts and feedback, he was under the impression that FIO was going to be able to complete an affordability report rather quickly, building off the original report that was issued in 2017 using 2016 data. There is a need for data on auto insurance affordability and this is a critical issue for economic security because auto insurance is one of the only products in America that consumers are required to buy.

Director Seitz answered that the auto report is a top priority for FIO. There have been some issues with the data statistical agent used to update the study, but FIO's staff has been able to work through those issues and plans to move forward with the work quickly. Mr. Heller noted that over the last year there has been a dynamic discussion around auto insurance affordability, availability, and particularly the disproportionate harms felt by communities of color. This adds a level of urgency and importance to FIO's work since there is a recognition that there is a need throughout the country to better understand the impact of auto insurance prices on communities.

Marsh McLennan Presentation, Innovative Risk Transfer Solutions: Reducing Disaster Risks and Building Resilience for Wildfires

Mr. Kaniewski presented a case study on the California Wildfire Fund. Wildfires have cause severe impacts in California over the past several years. Due to inverse condemnation laws in the state, the investor-owned utilities (IOUs) are held strictly liable. As claims skyrocketed, the IOUs found themselves unable to cover the costs, leaving the state to compensate victims. Marsh is the insurance brokerage for the State's largest utilities.

Marsh partnered with The Nature Conservancy of California, to undertake a research project to quantify the benefits of a nature-based approach to reducing wildfire risk by using the town of Paradise, California as a case study. The results found that building codes, coupled with the use of wildfire-risk reduction buffers, can have measurable financial and wildfire risk reduction benefits for communities, and minimize ecological impacts. Further, the research demonstrated the economic value of a community-level focus on catastrophe resilience and the potential for Community-Based Catastrophe Insurance (CBCI) to capture the financial benefits for residents through reduced insurance premiums and increased supply of risk capital.

Mr. Kaniewski explained the potential benefits of CBCI, a five-part framework for implementation, and the spectrum of CBCI solutions. Mr. Kaniewski then outlined another planned CBCI case study project in New York City. The project's goal is to increase the financial resilience of low- and moderate-income households in New York City to flood risk through the use of inclusive insurance. These communities are increasingly vulnerable and, in many instances, under or uninsured.

United Policyholders Presentation, Hot Topic: Wildfire Risk and Insurance Markets

Ms. Bach recapped testimony given before to the U.S. House of Representatives. In many counties throughout California, there are now no choices – no options for insuring homes other than limited and expensive protection through the California Fair Plan.

Because increased wildfire risk is driving insurer non-renewals and price increases, insurers are reacting to climate change predictions and data by dropping long time customers and raising premiums sharply. Reinsurers are reacting by raising their rates and limiting the amount of catastrophic risk they are willing to reinsure.

United Policyholders is working to promote wildfire risk reduction through the Wildfire Risk Reduction and Asset Protection (WRAP) initiative. One of the most critical things needed is for insurance companies to reward risk reduction through policy renewals and discounted rates for those who have invested time and money into risk reduction, and whose neighbors are doing the same. WRAP is a regular convening of public and private stakeholders, firefighting pros, community-based risk reduction advocates, public officials and agencies, fire scientists and insurance sector reps working together to: 1) reduce wildfire risk and restore home insurance availability and affordability in California and other regions, 2) increase financial and technical assistance options for property owners to make risk reduction improvements, build community engagement, and 3) secure insurance incentives and rewards for property owners that proactively reduce wildfire risk.

During follow-up Q&A, Mr. Jordan asked whether there has been consideration of "risk transfer" equating to "cost transfer?" Mr. Kaniewski answered that premium reduction is certainly one of the goals. Insurers want to make sure that insurance is available and affordable. The theory is that by reducing the risk profile and investing in hazard mitigation, then that should be recognized in insurance risk transfer solution premiums, whatever the risk transfer mechanism might be.

Mr. Jordan noted that only about 30 percent of the people that have lived in a 100-year flood plain have flood insurance. Yet, just in the last few months, FEMA has announced that National Flood Insurance Program (NFIP) rates for those people are going to double. Mr. Kaniewski replied that looking back at-Risk Rating 2.0, the program referenced for NFIP, FEMA believed that the only way to succeed, especially in those areas that are most vulnerable to disasters and are economically vulnerable, is to pair the program with risk reduction measures. That was the genesis of the Building Resilient Infrastructure and Communities (BRIC) program.

Mr. Stolfi noted that the Oregon legislature passed a law to address wildfire risk which called for the creation of a state fire risk map – an educational tool for consumers who do not have access to the risk maps and scores that insurers are using. The law will also trigger defensible space requirements, home hardening and building code requirements, which are great measures, but are going to take decades to introduced throughout the communities. There is real opportunity for insurers to play a role and to help ensure that those requirements are put into place. Insurers can also provide incentives for mitigation efforts not only in ratings, but also in underwriting as well.

Presentation on the White House's Office of the National Cyber Director

Mr. Higgins gave an overview of the Office of the National Cyber Director (ONCD). ONCD is one of the newest elements to the Executive Office of the President created in law by Congress in January 2021.

Mr. Higgins noted that ONCD has four main objectives. First, to champion federal coherence on cybersecurity matters making sure ONCD is addressing such matters in a coherent fashion across the federal government. Second, to improve public-private collaboration. Third, to align resources to aspirations. Fourth, to increase present and future resilience, assuring that the federal focus is not just on responding to cyber incidents, but also preventing them from occurring. To accomplish these objectives, ONCD has divided it work into four business areas. The first is the Federal Cybersecurity Team responsible for the protection of the federal enterprise including implementation of new standards for securing federal systems. The second is the Strategy and Budget Team responsible for drafting the national cybersecurity strategy and having the authority to review agency budgets and how those agencies are spending money to maintain cybersecurity in the sectors they oversee. The third business area, the Technology and Ecosystem Team, is responsible for cyber workforce training and education, and also technology security issues, including supply chain issues such as open-source software. The last business area is the National Cybersecurity Team tasked with protecting all federal, state, local, and critical infrastructure networks, working with sector risk management agencies and new federal boards.

Mr. Higgins then turned to the administration's cyber priorities. First, strengthening federal government cybersecurity and leading by example. Second, strengthening critical infrastructure of cybersecurity through incident reporting. ONCD is supporting state and local governments and their efforts to increase cybersecurity, including a billion dollars in grants. ONCD is focusing on cyber education, workforce, and training issues and is also developing a national cyber workforce strategy, partnering with the private sector, including through the joint cyber defense collaborative run by CISA.

Mr. Higgins turned next to cyber insurance priorities. First is driving stronger cyber underwriting scrutiny and cyber hygiene for policyholders. ONCD recognizes that cyber insurance plays an important role in any firm's cyber risk management strategy and, subsequently, plays a critical role in their overall cybersecurity. Second is promoting resilience and economic recovery after catastrophic cyber losses. Third is developing public-private partnerships for the collection and sharing of data. The insurance community has access to important information about cyber threats, vulnerabilities, and controls and the government also has information of value to the industry. Thus, the insurance community can be a strategic security partner and likewise, the government can be an important partner to the industry.

During follow-up Q&A, Mr. Kochenburger asked about ONCD's perceptions of the cyber insurance market. Mr. Higgins answered that there is a sense of caution and some retraction because of the unknowns and the potential exposures.

Chairman Glaser noted that the interest in individual cyber is still strong and capacity is adequate. The pressure on the insurance industry and the concern for many insurers is not with individual risk or even ransomware types of risks, it is more the systemic cyber hurricane potential, the accumulated risk. So, there is plenty of capacity for vertical, while there is a challenge with horizontal.

Mr. Heller asked how much of a gap there is because of exclusions? What is the interaction of cyber with terrorism and the Terrorism Risk Insurance Program (TRIP), and is there any movement of the risk over to TRIP? Mr. Higgins noted it is difficult to quantify the risk of a nation-state attack or what the losses such an attack would incur. It is also difficult to assess the risk of a major infrastructure collapse such as a cloud service provider or an internet backbone provider experiences an outage incurring losses. There have been incidents where infrastructure failure has led to an exclusion or to a denial of a claim.

Chairman Glaser asked Director Seitz if he had a perspective on TRIP? Director Seitz noted that TRIP is one area being evaluated by FIO. The next presentation by FIO Deputy Director Schmelz will look at the additional work FIO is doing to increased data collection in TRIP, and the interplay with cyber insurance.

Mr. Bogue stated that the data sharing piece is interesting. Given the sensitive nature of these events it is very hard to get information on what is happening from clients. Mr. Higgins agreed and added that identifying the legitimate barriers to information sharing – removing or mitigating barriers -- is a high priority. Finding ways to share information that promotes the collective defense must be a priority.

Ms. Bach asked if there would some minimum coverage standards for cyber policies to try to keep whatever risk can be kept in the private market? Mr. Higgins was not able to determine minimum standards across policies and agreed that there is great variation across policies and coverage.

Chairman Glaser noted that what has happened when new risks emerge is that eventually a separate program is established. Right now, there are lots of policies which have "silent cyber." The industry has gone through these periods with emerging risks in the past, and it is happening in real time now.

Presentation: FIO's RFI on Potential Federal Insurance Response to Catastrophic Cyber Incidents

Deputy Director Schmelz provided an overview of FIO's cyber work, and then indicated that FIO is now working on a joint project with CISA in response to a GAO Report, *Cyber Insurance: Action Needed to Assess Potential Federal Response to Catastrophic Attacks* (June 2022). The GAO report concluded that a full evaluation of whether there should be a federal insurance response in connection with catastrophic cyber risks would be best addressed jointly by FIO and CISA. FIO and CISA accepted the GAO Report recommendation. In connection with this work, FIO is seeking public comment on questions relating to cyber insurance and catastrophic cyber incidents, with a Federal Register Notice (FRN) published on September 29, 2022. Deputy Director Schmelz outlined the FRN questions. FACI members had no questions concerning this presentation.

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

MEETING ADJOURNED AT 3:48 PM.

I hereby certify these minutes of the September 29, 2022, Federal Advisory Committee on Insurance public meeting are true and correct to the best of my knowledge.

Daniel Glaser

Dan Glaser, Chair