To: Federal Advisory Committee on Insurance (FACI)

From: FACI Subcommittee on FIO's international work

Re: Recommendations re. FIO's international work

Date: Monday, September 23rd, 2019

The Subcommittee on FIO's international work consists of FACI members from AIG, Aon, Athene, AXA XL, Liberty Mutual, the Oregon Division of Financial Regulation, and Prudential. Below are the Subcommittee's recommendations for FIO's international work.

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

Summary of ICS recommendations

Our ICS-related recommendations to FIO focus on:

- The importance of **continued strong collaboration** across the members of Team USA in its negotiations at the IAIS.

- Establishing a **viable pathway to international acceptance of Aggregation**. This effort should be the key priority for Team USA and should encompass: outreach and education on the NAIC's development of its Aggregation construct, well-specified IAIS public communications about the way forward, detailed work-plans and timelines, and realistic and achievable criteria for assessing Comparability.

- Developing a **coherent design and candid framing of the so-called "Monitoring Period"** – which, in addition to concrete work-plans on Comparability, should also specify mechanisms for further work, messaging on the inappropriateness of use of ICS results by third parties (such as rating agencies), and impact testing of the potential negative externalities of the ICS on product availability and pro-cyclicality.

ICS engagement strategy

- The upcoming IAIS Annual Meeting in November is a critical juncture in the ICS process. To ensure a successful outcome, **we urge continued strong collaboration** between FIO and its NAIC and Federal Reserve negotiating partners within "Team USA" – with the ultimate goal of securing an agreement at the IAIS that lays a credible pathway for international acceptance of the US "Aggregation" approach to insurance group regulatory capital.

- We also see FIO playing a vital role in **helping to support the NAIC's education, outreach, and advocacy with IAIS members on the "Aggregation" approach** – by helping to explain the process, substance, and value proposition of the Aggregation approach being designed by the NAIC:

- This outreach should be pro-active, opportunistic, and could take several forms – for example, as part of formal IAIS meetings, informal bilateral discussions with IAIS Executive Committee peers (and their staff), public speaking opportunities, or written Treasury reports or statements.

- Importantly, as part of its outreach, FIO should highlight the Federal Reserve's recently published proposal as an example of an implementable "Aggregation" construct.

- However, by the same token, FIO should also emphasize that the NAIC, unlike the Federal Reserve, currently has standard-setting authority for internationally-active US insurers – and that, in turn, **it is the NAIC's "Aggregation" approach which should be the operative basis of Comparability discussions** at the IAIS.

- We also believe that, contingent on the outcome of the IAIS meeting, FIO and its "Team USA" partners should **consider issuing a joint public statement** to both re-assert and clarify the US position on:

    - The pathway forward for Aggregation, including a status update on development and tangible elements of future work on ICS comparability (e.g., principles, criteria, workplans, involved parties, and timelines).

    - The structure and design of ICS 2.0 (including a candid assessment of likely remaining technical issues).

    - The intended approach to the 5-year Monitoring Period, including an explanation of why the ICS is not, at this stage, appropriate for any meaningful analytical usage (whether by supervisors or by third party analysts, such as credit rating agencies).

Comparability assessment of US "Aggregation": advocacy objectives and process

- We urge FIO, along with its "Team USA" partners at the IAIS Executive Committee, **to prioritize, as its key focal point within ICS negotiations: advocacy for the US Aggregation** approach being developed by NAIC.

- The critical objective is **to design and implement a viable pathway for international acceptance of the NAIC's Aggregation approach**, which we expect will result in a determination that Aggregation achieves comparable supervisory outcomes as ICS 2.0.

- As elements of this advocacy, we propose that FIO, along with "Team USA", should highlight:

    - The significant work achieved by the NAIC's Group Capital Calculation Working Group since its inception in February 2016, which has conducted multiple consultations, open hearings, and quantitative field testing.

- The value proposition of an Aggregation style approach in:
    - reflecting the primacy of entity-level jurisdictional requirements in how the industry manages capital; and
    - providing greater insight into the legitimate similarities and differences across various local regimes…which is an issue that has long vexed supervisors and analysts, and therefore merits further study and attention via the Aggregation work.
- The importance of jurisdictional flexibility as a key tenet of prudential oversight and tailoring of insurance regulations to local markets and circumstances.
- The unproven and untested nature of the ICS 2.0, including design issues, concerns about the validity of "best efforts" valuations, and the potential for pro-cyclicality across changing market environments.

- We also recommend that FIO and "Team USA" should **urge the IAIS to issue a clear and well-specified communication (at or before its November meeting)** that lays out, in tangible and granular detail, the work-plan and approaches underlying Comparability assessments
    - A clear and tangible communication will be vital in signaling to the broader stakeholder community that there is a well-defined and realistic IAIS commitment to addressing Comparability.
    - Such a communication should provide more detail about how the IAIS plans to approach the next formative 12-18 months in the process, including timelines, objectives, and accountable IAIS working groups.
    - As a matter of transparency, this communication should provide considerably more detail than either the so-called Kuala Lumpur Agreement or the recent IAIS statement at its Global Seminar in Buenos Aires.

Comparability assessment of US "Aggregation": standards and substance

- As part of the Kuala Lumpur Agreement, the IAIS stated that it "aims to be in a position by the end of the monitoring period to assess whether the aggregation method provides comparable, i.e. substantially the same (in the sense of the ultimate goal), outcomes to the ICS. If so, it will be considered an outcome-equivalent approach for implementation of ICS as a prescribed capital requirement (PCR)."

- Somewhat conversely, the IAIS has provided that the "ultimate goal . . . is a single ICS that includes a common methodology by which one ICS achieves comparable, i.e. substantially the same, outcomes across jurisdictions."

- Of course, the aggregation method's methodology differs significantly from that of the ICS. And the very concept of a comparability determination regarding an alternate capital assessment regime presumes that a "single ICS" is not an end in itself. As a result, **we recommend that the following framework be utilized for determining the comparability of any jurisdiction's group capital assessment regime** applicable to internationally active insurance groups (or IAIGs) **and incorporated into the IAIS communication referred to above**:

    - The primary criterion for assessing the comparability of a group capital assessment regime should be **whether it provides a comparable level of policyholder protection and contributes to global financial stability**. Consequently, a comparability determination should not be based on whether the regime achieves equivalent quantitative outcomes to the ICS. Rather, the proper focus of a comparability determination should be whether the group capital assessment regime, in conjunction with other available supervisory measures, ensures substantially the same supervisory outcomes as part of coordinated solvency oversight.

    - A comparable group capital assessment regime **should include a worldwide group capital calculation capturing risk at the level of the entire group**, including the worldwide parent undertaking of the insurance or reinsurance group, which may affect the group's insurance or reinsurance operations and activities.

    - A comparable group capital assessment regime **should recognize and value all material liabilities and capital resources in a consistent, objective and reliable manner**.

    - The group wide supervisor **should have the authority to impose preventive, corrective, or otherwise responsive measures** on the basis of the group capital assessment, including requiring, where authorized, capital measures, as a result of the group capital assessment.

    - A comparable group capital assessment **must not undermine existing jurisdictional capital requirements**.

ICS Monitoring Period

- We recommend that FIO push for a candid framing and coherent design of the so-called "Monitoring Period" – ideally, with a formal IAIS statement issued at the IAIS Annual Meeting that comprises the following messages:

    - The IAIS plans to execute on a credible, well-specified process for assessing Comparability of "Aggregation" and other alternative approaches.

    - Implementation of ICS 2.0 for IAIGs remains the authority of the respective group-wide supervisors, and as such, the form and timing of final ICS 2.0 implementation are unknown at the beginning of the monitoring period. Local regulators will make the final decision on the form and timing of ICS implementation in their jurisdiction.

- ICS 2.0 is a work in progress and may be subject to substantial changes before final implementation. The 5-year period starting in 2020 is not, therefore, simply a "phase in" of ICS 2.0 for adoption as a prescribed capital standard in 2025, but rather an opportunity to assess the validity of the standard and address issues with the standard before implementation. Of note, the appropriate recognition of long-term guarantee business in ICS 2.0 remains a key area of ongoing development.

- Both the form and timing of the final ICS 2.0 implementation are subject to the results of a public consultation process and market impact studies to be conducted during the monitoring period and focused on impacts on financial stability, the macro-economy and consumers.

- In the context of these uncertainties and concerns, any ICS 2.0 results reported by companies during the Monitoring Period will not be indicative of capital positions and could well misrepresent a company's financial strength.

Recommendations to FIO re. **Holistic framework for Systemic Risk Assessment**:

We applaud FIO's efforts in helping to spearhead the development of the IAIS "holistic" framework for systemic risk, which creates a pathway for an activities-based approach to serve as the primary basis of identifying, monitoring, and addressing potential systemic risk within insurance. In light of the positive overall direction of this effort, we recommend a continued focus on the following five substantive themes:

- First -- Promoting a true cross-sectoral activities-based approach, which places insurance within the proper context of financial services more broadly. We believe this cross-sectoral view will:

    - Serve as a more effective mechanism for identifying and addressing potential systemic vulnerabilities.

    - Dis-incentivize insurers from pursuing banking-like activities that were at the heart of the problems faced by several insurers during the financial crisis.

    - Demonstrate the very limited potential for core, well-managed insurance activities to pose systemic issues.

- Second -- Ensuring that macro-prudential surveillance does not become a monolithic, over-engineered data mining exercise:

    - We want to caution against an over-reliance on a purely data-driven approach to surveillance, which could distract from meaningful qualitative analysis and dialogue around emerging risks.

- Third – Ensuring that the IAIS approach does not overtly single out or discriminate against US insurance products, particularly well-established products such as annuities that play an important role in US retirement planning.

- Fourth – Deferring to local supervisors as the primary and accountable authorities for systemic risk oversight:

    - Jurisdictional supervisors (i) are closer to developments and risk factors in local financial markets, and (ii) can more readily collaborate with their financial services supervisory peers to ensure a cross-sectoral approach.

    - The IAIS should, in turn, assist with high-level coordination across the respective local supervisors and serve as a convening body for cross-jurisdictional dialogue on emerging risks.

- Finally – the ABA should be implemented based on a principle of proportionality, based on an insurer's exposure to potential systemically-risky activities:

    - Proportionality should focus on activities that should be in scope, not on a defined list of covered companies.

    - The in-scope activities should have a demonstrable linkage to financial risk factors, and should not cover uncorrelated risks such as cyber and catastrophe – risks which, while meaningful to insurance ERM, are not pertinent to illiquidity-driven market disruptions and macro-prudential financial surveillance.

    - Implementation, in turn, should not require the build-out of cumbersome, enterprise-wide approaches, but rather target the particular activities of potential concern – and the corresponding risk mitigants.

Recommendations to FIO re. **Market Access**:

- Regarding market access issues, we recommend that FACI identify and study situations in which jurisdiction-specific solvency measures are exported through "upstream" application, FDI limitations, post-mandatory tender offer sell-down requirements, LOB restrictions and affiliate or third country reinsurance cession restrictions, among other market access issues.

- We also note that other, not-specifically-insurance-related measures either are intended to or have the impact of restricting market access or otherwise treating foreign companies differently. Among these are unreasonable data transfer restrictions and data center location requirements.

- We propose that this study should then inform the specific jurisdictions that FIO, in coordination with Treasury International and the USTR, should prioritize in its engagement on market access issues.