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

MINUTES – 23 SEPTEMBER 2019

The Federal Advisory Committee on Insurance (FACI) convened at 1:30 pm on 23 September 2019 in the Media Room at the U.S. Department of the Treasury, 1500 Pennsylvania Ave. NW, Washington, D.C., with Dan Glaser, Chair, presiding.

In accordance with the Federal Advisory Committee Act, the meeting was open to the public.

Committee Members Present

DAN GLASER, Chief Executive Officer, Marsh & McLennan
ERIC ANDERSEN, Co-President, Aon
NANCY ATKINS, Commissioner, Kentucky Department of Insurance
AMY BACH, Executive Director, United Policyholders
BIRNY BIRNBAUM, Executive Director, Center for Economic Justice*
QUINCY BRANCH, Chief Executive Officer, Branch Benefits Consultants
GREG CRABB, President & CEO, Amerisure*
JILLIAN FROMENT, Director, Ohio Department of Insurance
GEORGE KEISER, Representative, North Dakota House of Representatives
JIM KELLEHER, Executive Vice President and Chief Legal Officer, Liberty Mutual
TOM LEONARDI, Executive Vice President and Vice Chair AIG Life Holdings, Inc., AIG
SEAN MCGOVERN, General Counsel, AXA XL
ANDREW STOLFI, Administrator, Oregon Division of Financial Regulation*
KENT SULLIVAN, Commissioner, Texas Department of Insurance (by proxy, LUKE BELLSNYDER)
BILL WHEELER, President, Athene

*Present via teleconference

Also Present

BIMAL PATEL, Assistant Secretary, Financial Institutions, Treasury
TYLER WILLIAMS, Deputy Assistant Secretary, Financial Institutions Policy, Treasury
STEVEN SEITZ, Director, Federal Insurance Office (FIO)
LINDSEY BALDWIN, Senior Policy Analyst, FIO (Designated Federal Officer)

Welcome and Introduction

Chairman Glaser welcomed three new committee members: Jillian Froment, Director, Ohio Department of Insurance; Nancy Atkins, Commissioner, Kentucky Department of Insurance, and Tom Leonardi, Executive Vice President and Vice Chair of AIG Life Holdings, AIG.

Chairman Glaser welcomed Treasury representatives Tyler Williams, Deputy Assistant Secretary, Financial Institutions, Policy and Steven Seitz, Director, Federal Insurance Office (FIO).

Chairman Glaser summarized the activities of the last public meeting. The meeting was held via teleconference and each of the three subcommittees (on the Availability of Insurance Products, FIO's International Work, and Addressing the Protection Gap Through Public-Private Partnerships and Other Mechanisms) developed an initial work plan. Following that meeting, each of the subcommittees held phone calls.

Chairman Glaser outlined the meeting agenda. First, Director Seitz would provide a summary of FIO's activities. Next, each subcommittee's co-chairs would provide an update and the FACI would discuss each subcommittee's work. Finally, if any of the subcommittees presented preliminary advice and recommendations to FACI, the full committee would discuss those preliminary recommendations in detail and decide which recommendations (if any) to present to FIO.

Update on Federal Insurance Office Activities

Director Seitz summarized his September 2019 testimony given before the Senate Committee on Banking, Housing, and Urban Affairs, which related to developments in global insurance regulatory and supervisory forums. He said that in his testimony, he emphasized the importance of the federal government's participation in international forums to ensure that international standards do not inappropriately affect U.S. insurance companies or the U.S. market. He also highlighted the equal importance of FIO's continued coordination with the rest of Team USA: state regulators, the NAIC, and the Federal Reserve. At the testimony, Director Seitz reaffirmed Treasury's commitment to supporting the insurance capital standard's (ICS) overall objective of working to create a common language for supervisory discussion but reiterated Treasury's concerns about certain aspects of ICS development.

The first concern regarded Treasury's work to improve the design of the ICS so that it more appropriately reflects the business model of insurers. He said Treasury has identified has identified as an issue the ICS's market valuation approach and the negative effects it could have on the ability of insurance companies to provide long-term savings products, which are important to insurers and policyholders in the United States. Director Seitz added that the ICS needs to appropriately consider long-term savings products that are critical to Americans entering retirement.

Second, Director Seitz said that Treasury believes it is important for the IAIS to create a defined structure and process for further work and revisions on the ICS during the five-year monitoring

period (2020 to 2024). He added that any ICS version 2.0 will most likely need further development and revision. Therefore, the IAIS needs to develop a process that ensures appropriate confidentiality for insurers during the five-year monitoring period, while allowing the IAIS, its members, and other important stakeholders to continue evaluating, revising, and improving the ICS. Director Seitz stated that Team USA must remain closely and actively engaged during this period, and advocate for U.S. interests so that U.S. insurers remain competitive overseas, and international standards do not have inappropriate effects at home.

Third, Director Seitz said it is important that the IAIS strengthen its efforts to develop a final ICS that is implementable in the United States. He said Treasury is focused on working with its Team USA colleagues and the broader membership of the IAIS to develop the criteria and process by which the U.S. approach to group capital may be deemed outcome equivalent.

He said FIO will continue to advocate that the IAIS increase its focus on enhancing compatibility of the ICS with the U.S. system.

Director Seitz concluded his discussion of this topic by saying that getting the ICS right at the IAIS is more important than meeting a fixed schedule that mandates completion of the project at a specific point in time.

Director Seitz then discussed the expected adoption of the holistic framework at the upcoming IAIS meetings in Abu Dhabi in November 2020. He said that implementation by IAIS members is expected in 2020. Director Seitz said that Treasury supports shifting the focus of systemic risk analysis away from individual insurance entities and toward the activities of insurers and other market participants. Treasury also supports the efforts of the IAIS to improve the standards for liquidity management and planning.

Director Seitz provided an update on the EU-U.S. Covered Agreement. He said that the U.S. states, through the NAIC, have amended the Credit for Reinsurance Model Regulation as a basis for the states to conform their laws to the commitments made in the EU-U.S. Covered Agreement. He said that FIO has been monitoring this process and engaging with state regulatory colleagues to have each state conform its laws to the U.S.-EU Covered Agreement. He added that in the coming months, FIO will be asking both the NAIC and NCOIL to assist in this by providing FIO with real-time status information on the state law and regulation amendment process. Director Seitz said this information will assist FIO in meeting the U.S. obligation to encourage the states to act expeditiously, and also allow FIO to prioritize its federal steps and enable FIO to keep the EU up to date on developments in the United States.

Director Seitz discussed recent FIO reports delivered to Congress. In early September 2019, Treasury and the Federal Reserve issued a joint report to Congress summarizing FIO's work at international standard-setting bodies. This report included discussions about the efforts of Team USA with respect to the ICS and the holistic framework. In June 2019, Treasury published a study of Small Insurer Competitiveness in the Terrorism Risk Insurance Marketplace. This study found that small insurers are significant participants in the U.S. market for terrorism risk insurance, although their market share has slightly decreased over the last decade.

Director Seitz said that FIO continues to be mindful of the upcoming expiration of the Terrorism Risk Insurance Program on December 31, 2020, and the Advisory Committee on Risk-Sharing Mechanisms met in August 2020 to discuss the development of advice and recommendations related to this Program. He added that the Advisory Committee on Risk-Sharing Mechanisms would be holding a public meeting on September 30, 2019.

Director Seitz discussed the August 2019 publication of the National Mitigation Investment Strategy by FEMA. The mitigation strategy included input from a variety of national stakeholders, and recommended actions that stakeholders can take related to disaster resilience.

Director Seitz said that the Mitigation Strategy provides an opportunity for nationwide coordination around mitigation investment and disaster resilience. FIO was involved in drafting of the mitigation strategy and will be involved with implementation efforts going forward. These implementation efforts will involve a variety of partners, including federal agencies, state, territorial, tribal and local governments, and private, and non-profit sector entities such as businesses, foundations, universities, and other non-governmental organizations.

Director Seitz confirmed that FIO would be releasing its annual report at the end of September 2019. This report provides a financial overview of the insurance sector and highlights insurance issues as well as FIO's work in 2018, and the first half of 2019. He added that FIO would highlight the topic of InsurTech in the report, following meetings with over three dozen stakeholders to hear viewpoints on issues related to InsurTech. Based on this outreach, Director Seitz said that the report will provide a market overview, assess current innovations and the impact they are having on the insurance sector, and discuss regulatory topics related to the current regulatory structure, including sandboxes, data use and privacy, and RegTech. Director Seitz added that FIO will continue to monitor developments and evaluate whether to put forth InsurTech recommendations in its 2020 annual report, or in other forms as appropriate.

Director Seitz discussed work of the federal government's Long Term Care Interagency Task Force, which held a public meeting on July 25, 2019 as part of its stakeholder outreach. The Task Force also invited the public to submit written comments by October 30th, 2019. Director Seitz said that the Task Force would review these comments along with data, research and published materials from public and private sources, and expects to issue a written report with its findings and recommendations in late 2019 or early 2020.

The Committee had no questions or comments for Director Seitz.

Update from Subcommittee on Addressing the Protection Gap Through Public-Private Partnerships and Other Mechanisms

Chairman Glaser reminded members that the subcommittee is chaired by Sean McGovern of AXA XL and Chairman Glaser. At the June 2019 public meeting, this subcommittee decided to focus on topics related to the P&C sector, and specifically to examine protection gap topics related to natural disasters.

Chairman Glaser said that since that time, the subcommittee has held two conference calls to define the protection gap, design a set of strategies to mitigate the protection gap, and compile a set of recommendations on ways to address the protection gap through coordinated, public, private partnerships. The subcommittee distributed a draft PowerPoint presentation to members of the Committee to provide more detail on these topics.

Mr. McGovern said that the subcommittee approached the work on this subject from a level-setting perspective, seeking to understand the issue of the protection gap, to size the challenge, and then develop recommendations together with thoughts on some of the challenges in implementing those recommendations. He added that the conversation about resilience and mitigation was also timely in the context of the UN Climate Summit, which was occurring simultaneously. He added that the issue requires action at every level, including the individual level, where behavioral issues and transparency affect the protection gap. At the government level, there is a need for coherent policy framework, at the national, state, and local levels. The government can also help provide better data to both the insurance industry and individuals, which could help size and increase understanding of risks. Mr. McGovern added that the insurance industry has a role to continue to innovate, provide meaningful capacity, incentivize the right behavior and mitigation work with the federal government, and work on private market solutions.

Mr. McGovern said that the subcommittee defined the protection gap as the gap between the insured and actual economic losses caused by large scale catastrophic events. The subcommittee focused primarily on the P&C space, and in particular issues relating to flood, earthquake, wind, and wildfires. Research publications (by the industry and others) show significant insured losses at both the global and domestic level, but much more significant economic losses. Mr. McGovern noted there is an opportunity to try to close this gap.

Mr. McGovern first addressed the importance of understanding the cause of the protection gap before trying to address it, to identify where risk could be avoided or mitigated. After this was done, the subcommittee looked at mitigation solutions to understand its challenges and how to change consumer behavior. Finally the subcommittee looked at areas with a clear possibility for the insurance industry to take on risk that currently sits with the federal government.

Mr. McGovern said that the subcommittee concluded that a significant cause of the protection gap relates to consumer behavior, resulting from a lack of consumer understanding about exposure, a lack of consumer education, and a lack of consumer understanding. However, the protection gap is also driven by economic factors and matters of affordability.

Mr. McGovern said the subcommittee concluded that the insurance industry needs to improve both consumer education and policymaker education, which allows informed decisions to be reached at both at the individual level and the government level. He added there is a need to provide data to consumers so they can understand their exposures.

In its focus on flood, earthquake, wildfire and wind risks, the subcommittee received a presentation on the National Mitigation Investment Strategy, which has the goal of creating a combined mitigation strategy that involves the federal government, industry, and individuals.

Mr. McGovern summarized the goals identified by the subcommittee (many of which align with the investment strategy). First, there is an obligation to educate and ensure that people understand the relevance of mitigation in their communities. There is a need to build grassroots support for community action. There is also a need to publicize what works well to expand implementation. There is also a need to educate policymakers to help them foster implementation.

Information sharing and access to risk information is very important for consumers and the industry. Having granular and up-to-date data allows the insurance industry to assess better risk and deploy capital.

Mr. McGovern added there is a need to streamline mitigation funding down to a local level. There is also a role for the government and industry to create financial incentives. While the government can create tax benefits and subsidies, the industry can apply the fundamentals of insurance to ensure that people properly manage risk, and drive down overall exposure and cost.

The fourth goal related to standard setting, enforcing building codes, and enforcing zoning and critical infrastructure. Mr. McGovern said that these fundamentals of building and zoning must be clear and enforced or the problem will continue to worsen.

The final goal related to effective use of traditional solutions, which requires the industry to continue to drive take-up of insurance products and be innovative in creating solutions that will be used at the individual level. So this is where the industry needs to continue to play its part to drive take up in insurance products and try and be an innovative as possible with solutions that can be absorbed and used both at the individual level and community level (e.g., microinsurance or parametric products). The industry should also adapt to technology in product design and transparency.

Mr. McGovern then summarized the subcommittee's discussion of challenges related to implementing these goals. First, although there is a need to increase risk-based pricing to encourage the right behavior and recognize higher risk areas, doing so will exacerbate take-up and affordability issues. He also noted challenges in improving data accessibility for the industry, as well as improving and enforcing building codes. The subcommittee also identified the need for an increased focus on mitigation for all hazards (as opposed to the current focus on extreme tail risks), because people are more often impacted by smaller events. Proposals around mandatory insurance and mandatory offerings also creates challenges. Mr. McGovern noted that many of these challenges involve influence the right kind of consumer behavior.

Mr. McGovern discussed programs that currently transfer insurance risk to the federal government. The GAO recently counted as many as 148 such federal programs, and the subcommittee believes there is an opportunity to provide additional private market capital to

these risks. Mr. McGovern acknowledged the opportunity to learn lessons from successful programs and understand how private market capacity has been deployed (whether through reinsurance-type solutions or deployment of bonds).

Chairman Glaser welcomed Assistant Secretary Bimal Patel to the meeting before inviting the Committee to provide comments on the subcommittee's presentation.

Ms. Bach complimented the work done by the subcommittee so far, and encouraged the subcommittee to incorporate lessons learned/best practices from the state level related to mitigation funding. She highlighted the Florida's property assessed clean energy (PACE) programs, California's Brace and Bolt program, innovations by the Institute for Home and Business Safety related to fortification against wind and water, and state efforts related to wildfire.

Ms. Bach identified challenges for individuals not understanding what they can do to reduce risk, how they can pay for mitigation, and who they can hire to perform the work. She highlighted the importance of individuals feeling like they have made an investment that paid off (whether because their insurance premium went down or they were able to keep their insurance).

Ms. Bach acknowledged that there is not an expectation that insurance will cover everything but stressed the importance of restoring financial integrity to basic insurance coverage. The industry should not only help people understand their exposure, it should restore consumer confidence that insurance will provide the money they need. Ms. Bach acknowledged the difficulty in the industry relaying this message, but highlighted the decline in take-up rate of flood insurance on Long Island following Superstorm Sandy. She said that local officials she spoke with said that people didn't get paid because they didn't reach their deductibles (or heard others complaining) and there was a loss of confidence in the program. She added that media strategy will also be important, as many media stories now tend to focus on individuals who are disappointed or frustrated by their insurance.

Mr. Kelleher asked if the subcommittee would be looking at the constraints that seem to be holding back the development of a private flood insurance market, given that only one percent of people outside flood zones purchase insurance even though 50 percent of losses occur in those areas. Mr. McGovern responded that the subcommittee would take Mr. Kelleher's comment under advisement, although added the subcommittee is approaching its work incrementally and wants to examine systemic issues rather than trying to immediately fix certain perils.

Mr. Glaser noted that the private insurance market is heavily involved with providing flood insurance to the commercial market, whereas homeowners and small commercial insurance is essentially built around the NFIP program. He highlighted a July 2019 regulatory change which encouraged mortgage servicers to consider private insurance products in the same way that they would consider an NFIP policy (thereby removing the requirement for a homeowner to have an NFIP policy), which will likely result in growth of the private market. He added that the subcommittee believes it is unacceptable for the number one peril in the United States to be

underinsured/uninsured when modeling has improved and policyholder surplus levels are near all-time highs.

Mr. Keiser said it is imperative that the Committee understand the variables within the NFIP in order to address the problem. As an example, he said that in North Dakota (and many other states), many homes have basements, but he believes flood insurance doesn't cover basement flooding from groundwater.

Mr. Keiser said that the use of "3P" is becoming more attractive to states to deal with natural disasters, because they don't have the capacity for bonding and taxation is high. 3P is seen as an easy route, however in terms of transparency it is unclear how much more expensive a 3P is versus bonding. Mr. McGovern replied that although this is a relevant question, the subcommittee is more focused on the type of mitigation planning as opposed to the source of funding, so this might be difficult for it to address.

Mr. McGovern asked Director Seitz three questions. First, whether FIO could use its convening power to help the subcommittee learn about the NFIP's experiences and success with building reinsurance capacity. Second, whether a connection should be made between FIO and the work of the Insurance Development Fund (IDF) related to the protection gap in emerging market economies. Third, what thoughts FIO has about the best way to engage the industry in the work of the Mitigation Strategy. Director Seitz replied that the Mitigation Strategy has set up a series of task forces to proceed with implementation, and FIO is participating in these task forces. He said that FIO's convening power could be helpful with respect to the Mitigation Strategy as well as de-risking programs, noting that approximately 18 months ago, prior to adoption of the Mitigation Strategy, FIO held a roundtable with FEMA and NOAA, and it was a good opportunity for the insurance sector to look at issues from FEMA's perspective. Finally, Director Seitz said that FIO has been approached in the past about participating in the IDF, and the IDF is now working in partnership with the IAIS. He added that the IDF is looking at the work of the NAIC and the sates, and considering how IAIS can contribute.

Mr. Andersen suggested that the IDF is focusing on using the tools that exist in the U.S. model but trying to apply it in places where there are no models, private market, or expertise. He said this raises an interesting problem, as the U.S. is struggling with this issue even though it has these tools.

Mr. Andersen suggested that the subcommittee should discuss the need to frame insurance products in a more understandable way, noting that many of the member comments made during the meeting came up in terms of understanding the products being purchased and risk-based pricing. Ms. Bach suggested a public information campaign that would be federally supported and coordinated with the states. She added that entities with statutory mandates seem to be the source of innovation for mitigation efforts (e.g., the FAIR Plan) and it might be beneficial to start by helping residual markets (which arguably have the worst risks and could innovate on mitigation support, financial systems, and implementation).

Update from the Subcommittee on FIO's International Work

Mr. Leonardi, co-chair of the subcommittee on FIO's international work, said that the subcommittee developed recommendations in three areas. First and most significant was the Insurance Capital Standard (ICS) currently under development at the IAIS. Second was the evolving IAIS approach to the Holistic Framework (systemic risk assessment within the insurance sector). The Holistic Framework will increasingly deploy an activities-based approach (ABA) rather than the current entities-based approach (EBA) which has taken the form of the G-SII designation framework. Third was market access issues for U.S. insurance groups operating globally. Mr. Leonardi noted that most of the subcommittee's proposed recommendations at this meeting would focus on the ICS and IAIS-related issues given upcoming milestones related to the ICS (specifically, the IAIS annual meeting taking place in Abu Dhabi in November). The proposed recommendations were also submitted to the Committee in writing.

Mr. Leonardi said that the recommendations on ICS focused first on the importance of continued strong collaboration across the members of Team USA: FIO, the NAIC, state commissioners, and the Federal Reserve, as relates to the negotiations at the IAIS.

Second, the subcommittee recommended establishing a viable pathway to international acceptance of aggregation. This effort should be the key priority for Team USA and should encompass two key elements: 1) outreach and education on the NAIC's development of its aggregation construct, and 2) a well-specified IAIS public communications about the way forward, including detailed work plans and timelines, and realistic and achievable criteria for assessing comparability. Mr. Leonardi added that, contingent on the outcome of the IAIS meeting, FIO and its Team USA partners should consider issuing a public statement to both reassert and clarify the U.S. position on the way forward.

Third, the subcommittee recommended developing a coherent design and candid framing of the monitoring period, which in addition to concrete work plans on comparability and achieving IAIS acceptance of the aggregation approach, should also specify that ICS 2.0 is a work in progress and may be subject to substantial changes before final implementation. Mr. Leonardi added that the five-year monitoring period (beginning in 2020) should not simply be a phase-in for ICS 2.0 to become 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 takes effect (of note, the appropriate recognition of a long-term guarantee business remains a key area of ongoing development). The subcommittee also recommended that both the form and timing of the ICS 2.0 implementation should be 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. Mr. Leonardi also stated that in the context of these uncertainties and concerns, any ICS 2.0 reported by companies during the monitoring period should not be indicative of capital positions, and could well misrepresent a company's financial strength.

Mr. Leonardi provided additional context for these recommendations, because the forward pathway on ICS in the United States depends in large part on the pathway for acceptance of aggregation. As core elements of its advocacy for aggregation, the subcommittee proposed that FIO and Team USA should highlight the following:

- The significant work achieved by the NAIC's Group Capital Calculation Working Group since its inception several years ago. The working group has conducted multiple consultations, open hearings, and quantitative field testing.
- The Federal Reserve's recently published proposal as an example of an implementable aggregation construct.
- The NAIC, unlike the Federal Reserve, currently has standard-setting authority for internationally active U.S. insurers. As a result, the NAIC's aggregation approach should be operative basis of comparability at the IAIS.
- The prudential benefits of the aggregation-style approach in reflecting the primacy of entity-level jurisdictional requirements in how the industry manages capital.
- The value proposition of an aggregation-style approach in providing greater insight into 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.

In terms of the standards and substance for the comparability assessment of U.S. aggregation, the subcommittee recommended that the following framework be utilized for determining the comparability of any jurisdiction's group capital assessment regime applicable to internationally active insurance groups (IAIGs):

- The primary criteria 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.
- 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 also 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 assessment of capital regime should also recognize and value all material liabilities and capital resources in a consistent, objective and reliable manner.

- The group-wide supervisor should also 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 group capital assessment must not undermine existing jurisdictional capital requirements.

Mr. Leonardi then summarized the subcommittee's proposed recommendations relating to the holistic framework for assessing potential systemic risk. He said that the subcommittee applauded FIO's efforts in helping to spearhead the development of the IAIS holistic framework for systemic risk, which creates a pathway for an ABA to serve as the primary basis of identifying, monitoring, and addressing potential systemic risk within insurance. The subcommittee recommended a continued focus on the following five substantive themes:

- Promoting a true cross-sectoral ABA, which places insurance within the proper context of financial services more broadly.
- Ensuring that macro-prudential surveillance does not become a monolithic, over-engineered data mining exercise. The subcommittee wished to caution against an overreliance on a purely data-driven approach to surveillance, which could distract from meaningful qualitative analysis and dialogue around emerging risks.
- Ensuring that the IAIS approach does not overtly single out or discriminate against U.S. insurance products, particularly well-established products such as annuities that play an important role in U.S. retirement planning.
- Deferring to local supervisors as the primary and accountable authorities for systemic risk oversight. Jurisdictional supervisors are closer to developments and risk factors in local financial markets, and can more readily collaborate with their financial services supervisory peers to ensure a cross-sectoral approach.
- Implementing the ABA based on a principle of proportionality, by focusing 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. 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 in the enterprise risk management perspective, are not pertinent to illiquidity-driven market disruptions and macro-prudential financial surveillance.

Mr. Leonardi said that the subcommittee recommended that, regarding market access issues, FACI should identify and study situations in which jurisdiction-specific solvency measures are exported through upstream applications, foreign direct investment limitations, post-mandatory tender offer sell-down requirements, limitation of benefit restrictions, and affiliate reinsurance cession restrictions. The subcommittee also noted that there are other, non-insurance specific measures that are intended (or have the impact) to restrict market access or otherwise treat foreign companies differently. Among these measures are unreasonable data transfer restrictions and data center location requirements. The subcommittee proposed that this study should

determine which jurisdictions that FIO (in coordination with Treasury and the USTR) should prioritize in its engagement on market access.

Chairman Glaser confirmed that the subcommittee was providing FACI with recommendations in three categories: the ICS, the Holistic Framework for systemic risk assessment, and market access. Mr. Leonardi noted that the market access recommendations were less defined, being less time-sensitive than the other two topics.

Mr. Kelleher commented that it seems imperative for Team USA to receive a clear statement from the IAIS at Abu Dhabi indicating that the insurance group capital standard assessment and the aggregate approach are deemed appropriate to ICS. He added that with respect to the Holistic Framework, the complementary roles of local supervisors should be clearly defined, because he thinks it is important that the IAIS does not take on the role of a global systemic risk supervisor. He added that mission creep should be avoided, and activities should be delineated as in or out of scope to avoid the risk of sweeping activities within the exercise that have no place in the process.

Mr. Birnbaum asked what the EU's objections are to the U.S. aggregation method. Mr. Leonardi responded that, based on his conversations with members of the EU, EIOPA, and the IAIS Executive Committee, the objections have been related to the perception that the NAIC really isn't working on an aggregation system or construct, rather than the substance of the method. However, the NAIC has been working on this system for approximately three years, primarily through the Group Capital Calculation Working Group. Due to the importance of having an outward marketing strategy, the NAIC converted the (G) Committee meeting into an open hearing (at the March 2019 meetings in Orlando) to facilitate robust discussion on the impacts of aggregation, ICS, and the implications to industry. This was also done at the August 2019 NAIC summer meeting in New York. Mr. Leonardi added that AIG was involved in both ICS field testing as well as field testing of the aggregation method. Director Seitz added that there are other technical issues that European colleagues find concerning. For example, one system uses a consolidated group focuses with a market evaluation approach while another uses a legal entity-state based system, and there are also issues related to capital resources (e.g., the way debt is issued, contractually subordinated, or structurally subordinated). As a result, working through these technical issues is important as is education.

Mr. Birnbaum noted that Mr. Leonardi referenced comparability in terms of whether group capital provides the same solvency oversight and financial stability effectiveness, rather than in terms of capital equivalence. He asked how could this standard be assessed proactively (i.e., absent a catastrophic financial event). Mr. Leonardi responded that he had spoken on this issue extensively as a state commissioner and (G) Chair as well as on the IAIS Executive Committee, and has noted that at times the capital standard is sometimes a solution looking for a problem. He suggested that if there had been a robust supervisory college at AIG in 2006 and 2007 (rather than an extensive amount of capital), it is quite possible that this would have prevented the concentrations of risk that were occurring in the securities lending and financial products divisions. He said that a supervisor's ability to use "all of the tools in the toolbox" is far more important than simply having a capital standard.

Mr. Birnbaum agreed that capital is not the solution to everything, but asked for clarification as to how this factor relates to the demand for a comparability standard that uses something other than equivalent outcomes. Mr. Leonardi replied that the NAIC has taken a very strong position that the capital construct doesn't work for the U.S. system, Secretary Mnuchin made this point in his speech at the NAIC International Forum in May 2019, and Governor Quarles (chair of the FSB) has also clearly stated it does not work for the U.S. system. Mr. Leonardi also noted that 43 senators (from both parties) endorsed Governor Quarles's letter. Mr. Leonardi said that these statements support the fact that a version of comparability should allow for the recognition that different jurisdictions have different products, different legal systems, and therefore one size does not fit all.

Mr. Birnbaum asked Mr. Leonardi to outline the principal differences in capital and the reserve requirements for annuities and investment type life insurance between the EU and the U.S. systems that are prompting concern about products in the U.S. Mr. Leonardi replied that when he served on the IAIS Executive Committee, variable annuities were viewed as non-traditional non-insurance, and made up 40 percent of an entity's systemic risk score (more than an entity's size or global reach). Mr. Leonardi stated that that variable annuities have been sold in the United States only by insurance companies for over 50 years, and it was therefore a misnomer to call them non-traditional non-insurance. In addition, the United States has a robust private sector solution for retirement security, and U.S. policymakers are trying to determine how to broaden private market solutions to avoid burdening the public sector's finances in supporting retirement. Mr. Leonardi said many European countries take a different approach to retirement, and therefore don't have a need for these products and don't sell these products. He said the market consistent valuation aspect of creating volatility for these long-term products can last 40 to 60 years. In asset liability management, an entity is trying to match its long-term assets to its long-term liabilities, so if the entity has to mark to market every quarter (particularly in times of stress), it creates tremendous volatility. Many companies therefore decide they can't afford the volatility, and therefore do not offer these retirement products. This creates a public policy problem because the public sector can't unilaterally handle retirement security but the private sector is pulling back.

Mr. Birnbaum replied that he finds implausible the argument that the EU has designed a regulatory system that discourages annuities and long-term investment type life insurance because its members have robust public pension systems and therefore they don't need these products. He added that these type of products have been sold in Europe for a long time, and it seems that the reason that the Europeans developed a solvency framework around those products is because those products have the potential for creating a financial stability risk. He suggested that there is a need for much closer scrutiny of the capital and reserve programs in the U.S. for these product, because that they do have the potential to pose financial stability risk. Mr. Leonardi disagreed with the concept that variable annuities are as widespread in Europe as they are in the United States, stating that he has not seen data supporting this.

Director Seitz responded to Mr. Birnbaum by noting that Team USA is actively engaged in the technical aspects of the ICS development, and is looking at a number of issues, such as how the current discount rate is used, the long-term forward rate, and how liabilities are bucketed in the

three bucket approaches. He said that these discounting factors are driving punitive effects to long-term life insurance players, and Team USA is working to address this.

Mr. Birnbaum asked which data transfer provisions are unreasonable in terms of market access. Mr. Leonardi said that countries have various views on the privacy of data. Most insurer operations involve data stored in the cloud, so if a jurisdiction requires data to be in a localized data center in their country, that data can get locked down. This creates a problem for multinational companies operating in many countries. Putting a data center in every country creates additional expenses and creates unfair competition compared to local insurers. In addition, having numerous different data centers is less secure than having one concentrated data center. Mr. Leonardi added that the customer experience may also diminished because they are not able to access the cloud.

Mr. Keiser moved that the recommendations developed by the subcommittee would be formally be presented to FIO by FACI. Mr. Kelleher seconded the motion. All members present supported the motion.

Update from the Subcommittee on the Availability of Insurance Products

Chairman Glaser confirmed that Mr. Keiser replaced Ms. Bach as Co-Chair of the Subcommittee on the Availability of Insurance Products.

Mr. Keiser reported that the subcommittee had received an update from FIO staff on the Interagency Task Force created by the 2017 Treasury report, *A Financial System that Creates Economic Opportunities: Asset Management and Insurance.* The task force is led by Treasury's Economic Policy office and includes representatives from the Department of Health, Human Services, Office of Management and Budget, Department of Labor, the Centers for Medicare and Medicaid Services, and the Internal Revenue Service. The task force was created to discuss the state of the long-term care insurance industry and how the industry can be restored.

The task force held a public session with stakeholders (including NAIC and state regulatory representatives) and invited members of the public to comment on their business by 5:00 p.m. on August 30th. Mr. Keiser added that the NAIC has identified ten federal policy changes that Congress could consider to increase private long-term financing consumer options. The NAIC would be coming forward with its recommendations in time for the OSSA meeting in December 2019. Mr. Keiser said the subcommittee decided to withhold its discussion on long-term care until it can view the work products resulting from these activities.

Mr. Keiser provided an update about the subcommittee's state-related discussions on long-term care. He said that states vary in the way they manage long-term care. Some states, like North Dakota, have equalized billing (which enables an individual to pay the same amount through Medicaid or private payment). Most states have non-equalized billing, where private payments subsidize Medicaid payments. This can create a problem for states, because as the cost of private payment increases, more individuals must rely on Medicaid.

Mr. Keiser also emphasized the importance of the federal medical assistance percentage (FMAP) score for Medicaid, which is assigned to each state (based on the state's financial condition) and determines the proportion of Medicaid payments that will be made by the state versus federal government. As an example, Mr. Keiser noted that North Dakota's current FMAP is 49/51, so for every dollar spent on Medicaid, 49 cents comes from North Dakota and 51 cents comes from the federal government. He added that this has resulted in rapidly-growing Human Services budgets in each state.

Mr. Keiser discussed recent developments by the NAIC wherein both health and life insurance groups were combined to support state guaranty funds for insolvencies related to long-term care. However, he said the fund would operate different from a traditional guaranty fund, wherein if a line of insurance experienced an insolvency, other companies in the line absorbed the insolvency and any individuals who lost coverage were picked up and had their premium subsidized by the fund in some manner. In this agreement, insurers would be permitted to offset their guarantee fund payments through a credit on their premium taxes (which ultimately impacts a state's general funds).

Mr. Keiser also discussed the Deficit Reduction Act (Partnership Act) which was intended to facilitate portability of long-term care plans when a policyholder moves to another state. However, plan rates are extremely different across states, and it is difficult to make a policy truly portable when it hasn't been adequately funded for a different level of risk in another state. He said North Dakota created legislation modeled after the Indiana legislation which has been passed twice and signed by the governor of North Dakota, but CMS will not grant the state a waiver. Mr. Keiser expressed his hope that the Committee can delve into problems associated with the Partnership Act. Mr. Keiser also suggested that the underlying problem with long-term care insurance is that participation needs to increase among younger individuals.

Mr. Keiser expressed his hope that the subcommittee would be able to examine these issues going forward along with the outcomes of the work being performed by the long-term care task force and the NAIC.

Ms. Bach commented that she received a call from a reporter saying that a policyholder had reported a 100 percent increase in her long-term care premium (from $300 to $600), which the insurer was due to increased aggregated policyholder costs. She suggested that the difficulty in pricing the product seems to be at the core of the matter.

Mr. Wheeler asked Mr. Keiser if the task force's study would diagnose why the private long-term care market has disappeared. He suggested it is important to understand why the market went away before it is possible to encourage its return. Mr. Wheeler proposed the following reasons for the disappearance of the private market: the policies were written in a different time and we are now in an environment with extraordinarily low interest rates. Following the financial crisis, risk managers began to recognize a significant interest rate risk in selling traditional long-term care policies. These low interest rates have led to extraordinary premium increases. He said that this issue can be solved if more state insurance departments allow price increases, rather than having some states that agree and others that always refuse. Mr. Wheeler

also questioned whether high interest rates would return and if interest rates could become even worst. He added that long-term care products need to be redesigned and changed for the private market to be revived.

Mr. Keiser agreed that legacy plans are in trouble and may not be salvageable long-term, but the guaranty fund system will hopefully manage them over time. He added that 15 years ago, about 112 entities sold long term care insurance, but today only 11-12 entities sell these policies. The market has somewhat corrected by selling modified products that work through annuities or other combinations of life insurance.

Mr. Birnbaum suggested that the long-term care market has gone away because products were underpriced significantly when they were introduced in the 80s and the 90s, and insurers sold these products on a cash flow basis. He added that the Center for Economic Justice (CEJ) suspects there was some fraud involved, but insurers also created a problem by moving more favorable/profitable customers to new blocks. He said that one of the key issues facing regulators is how much responsibility a shareholder of an insurance company has for the company's pricing mistakes, versus the responsibility of the consumer who was promised the stable premiums over the life of the product. He also added that the CEJ's view is that the traditional long term care product is defective and there shouldn't be any public resources to support it.

Mr. Birnbaum suggested that products offered in the current marketplace are not "really" long-term care products because they are limited in duration and strongly limited in benefits. They are structured this way because that is the only way to provide an affordable price point. He suggested that the standalone long-term care market is a niche market that doesn't warrant tax incentives because it is targeted to more affluent consumers. Mr. Birnbaum said that CEJ rather supports promoting more combination products which provide consumers with value in a number of ways (including long-term care service benefits) and using federal dollars for other purposes such as strengthening social programs, including Medicaid.

Mr. Leonardi provided his perspective as a former state regulator. He said that insurers underestimated the inflation of medical costs, increased life expectancy, and decreased lapse ratios; then did not request rate increases until several decades later when they began asking for significant increases. He also replied that he believes standalone long-term care products are targeted to the middle class, rather than to the affluent (because high net worth individuals don't generally have long term care insurance). Furthermore, purchasing long-term care insurance does not make sense for individuals without assets to protect. As a result, the middle class are those who are risk, rather than the affluent. Mr. Birnbaum replied that the data (reported to the interagency task force) suggests that tax benefits for long-term care insurance are largely going to more affluent consumers rather than to the middle class.

Mr. Birnbaum discussed big data analytics as a possible topic for the subcommittee to assess as part of its InsurTech workstream. Specifically, Mr. Birnbaum suggested an evaluation of the disparate impact as unfair discrimination in insurance. He proceeded to provide background on the topic. Mr. Birnbaum said that in most states, intentional discrimination (against prohibited

classes, race, religion, national origin) is prohibited regardless of any statistical or actuary relationship between the class characteristics and the expected claims and expenses. In some states, unfair discrimination also includes other prohibited characteristics. For example, some states prohibit the use of consumer credit information, one or two prohibit use of gender, and one state (Texas) does not permit consideration of an individual's status as an elected official or state legislator. He said that the historical perspective was that regulatory oversight over all phases of insurance pricing (starting with data collection to underwriting through rates) would prevent discrimination on the basis of direct use of prohibited characteristics. However, Mr. Birnbaum provided an example of a challenge by fair housing groups in the 1990s against using age and home value as underwriting guidelines, which alleged that use of these factors disproportionately impacted minority communities (which were characterized in large part by older and lower value homes). Accordingly, the use of age and value of the house had the effect of discriminating on the basis of race. Mr. Birnbaum said that as a result of these fair housing challenges, insurers changed their practices to examine structural home characteristics that were more directly tied to claims, such as age of electrical systems and condition of roofs.

Mr. Birnbaum said that challenges to insurance practices were brought as federal complaints under the Fair Housing Act before the Department of Housing and Urban Development (HUD), and courts opined that the Fair Housing Act covers fair access to homeowners' insurance in additional to mortgage lending discrimination. Mr. Birnbaum added that courts have also recognized disparate impact as a form of unfair discrimination under the Fair Housing Act (and other statutes such as equal employment opportunity laws. He said that the issue of disparate impact in insurance and other financial services has long been contentious and industry has brought numerous legal challenges to disparate impact claims (he noted that the Supreme Court affirmed disparate impact as a recognizable claim under the Fair Housing Act in 2015).

Mr. Birnbaum said that HUD developed a methodology and procedure for organizations wishing to bring a disparate impact claim and for accused organizations to defend their practices. This methodology required parties bringing the claim to make a prima facie case that the housing-related practice in question had a disparate impact on the protected class. He added that the

party bringing the complaint also had to provide statistical evidence of the disparate effect of the practice. The organization being challenged could defend itself by either proving the allegation wrong or arguing that the practice had a vital business purpose for which no alternatives occur or exist.

Mr. Birnbaum said that last month, HUD proposed a rule intended to better implement the Supreme Court's decision and current disparate impact procedures, but said fair housing advocates believe the rule, if adopted, will effectively eliminate disparate impact claims. He noted that Treasury's July 2018 Executive Order Report states that new models and data may unintentionally run the risk of producing results that arguably risk violating fair housing laws if they result in a disparate impact on protected class. He added that FIO's 2018 Annual Report highlighted HUD's expressed intention to continue analyzing disparate impact liability under the Fair Housing Act to homeowners' insurance practices that have an unjustified discriminatory effect. Treasury also recommended that Treasury recommended that HUD reconsider the

application to such insurance practices of its 2013 rule and consider whether application of the rule is consistent with the McCarran-Ferguson Act of 1945 and relevant state laws.

Mr. Birnbaum said that at the state level, disparate impact and insurance become issues with the growing adoption of big data analytics by insurers, due to the greater potential for proxy discrimination against protected classes resulting from the use of new data sources and complex algorithms. Mr. Birnbaum said that state insurance regulators have argued that they have authority to stop proxy discrimination. He noted that this concept was raised in a recent draft paper by the NAIC Casualty Actuarial Task Force, which provided guidance to state regulators on the review of complex models for private passenger, auto, and homeowners' pricing. Mr. Birnbaum said the draft paper contemplates a regulator rejecting proposed risk classifications if the company cannot provide a reasonable explanation of the relationship between the new data source and the proposed risk classification.

Mr. Birnbaum proposed that it is unclear whether regulators actually have the authority to enforce disparate impact as unfair discrimination. He said that the Texas Supreme Court ruled in the mid-2000s that disparate impact was not a recognized form of unfair discrimination under Texas law.

Mr. Birnbaum said the subcommittee discussed the possibility of examining the application of disparate impact as unfair discrimination in insurance, by to reviewing Treasury's statements/reports and HUD's proposed regulation. He suggested that this information could be useful to both state and federal regulators.

Mr. Birnbaum said the subcommittee also discussed emerging state digital rights/data privacy legislation and emerging efforts to provide guardrails for artificial intelligence.

Mr. Birnbaum discussed California's consumer data privacy law, and noted that other states have considered similar laws. Mr. Birnbaum said that the California law, which applies to all industries and is not specific to insurance, intentionally limits some use of personal consumer data and requires more affirmative consent for others. The law also contains disclosure in accountability provisions. He added that there are some concerns that current or innovative industry practices may be compromised because the general law that doesn't account for unique industry characteristics.

Mr. Birnbaum said there are also emerging efforts to provide legislative or regulatory guardrails to artificial intelligence. The NAIC recently convened a working group to develop such principles and is referencing AI principles developed by the Organisation for Economic Cooperation and Development. He added that the U.S. House of Representatives' Financial Service Committee has developed a new subcommittee examining AI issues.

Accordingly, Mr. Birnbaum said that the subcommittee discussed a potential workstream to review the work-to-date on consumer digital rights at the state and federal levels, as well as AI principles, and develop recommendations that recognize the specific needs of the insurance industry and insurance consumers.

Director Seitz confirmed that FIO has highlighted the topic of disparate impact in its reports, and added that digital rights and data privacy emerged as a clear theme in FIO's outreach on InsurTech over the past 6 months. He said that FIO would be working to level-set in its upcoming annual report on the topics of data privacy and AI.

Mr. Keiser said that the issue of data privacy is moving quickly and he hopes the federal government will establish basic standards, because a state-by-state approach will be problematic for insurance companies (and other industries). He said there is an urgency to the issue, and suggested the subcommittee should be spending a lot of time and effort to develop general standards that should be employed by all states.

Committee Presentation of Advice and Recommendations to FIO

Chairman Glaser re-confirmed that recommendations made by the international subcommittee were endorsed by the full FACI and were formally given to FIO.

Director Seitz thanked the international subcommittee for its concrete tangible suggestions as FIO works to operationalize activities going forward.

New Business and Closing Remarks

No new business was presented.

Chairman Glaser announced that the next FACI meeting would be held at the U.S. Treasury building on December 5, 2019.

At 3:39 pm, Chairman Glaser concluded the meeting.

I hereby certify these minutes of the September 23, 2019 Federal Advisory Committee on Insurance public meeting are true and correct to the best of my knowledge.

Dan Glaser
Chair